

## Trump's going to tax the US to extinction

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Trump wants to use tax as a weapon in international trade wars. That could backfire horribly for him.

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This is the transcript:

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Trump's big, beautiful budget is anything but that. In fact, we know already that it might be big, but that it's bad and ugly.

But to add to all the other problems that we know are built into this appalling economic plan for the USA, there is something that is now catching the world's attention, and that is Section 899 of this Act. This is a tax provision. It's a tax provision that is so dangerous in its ramifications for the USA that it could destroy the dollar; it could most certainly destroy the value of US government bonds; and it could completely undermine Trump's chance of delivering his economic policy. I think that's enough to mean that we have to talk about it.

899 is a catch-all provision, the meaning of which is incredibly uncertain. All that we know is that this section ensures that the US Treasury can deem certain countries, and it will have the right to decide which they are, as being unfriendly to the USA, and it will, as a consequence, impose sanctions on investors who come from those countries.

The sanction is very odd and quite unrelated to the threats that these countries supposedly impose on the USA, because the sanction will be that every year, the rate of tax that the USA will withhold from payments of dividends to people resident in those countries will increase by 5%.

Now, the rate of withholding tax in most of these cases is, right now, 0%, because that is what has been agreed under the double tax agreements between the USA and most of its friendly neighbours, who might now be deemed to be unfriendly.

So, starting from a baseline of 0% tax withholding from the USA, the threat is that after one year, 5% tax might be withheld. And if these countries don't change their tax behaviour to suit what the Trump administration wants, then after two years, they will suffer 10% tax withholding, and so on.

The consequence is that the tax rate withheld from payments of dividends and interest from the USA to these countries could reach 20%.

Now, is that going to disrupt the world's economies? Yes, it is because this is basically unprecedented in the modern world, and it's most certainly unprecedented on payments from the USA to friendly nations. So this is a tax weapon dressed up as an issue to do with trade war.

The problem is that we don't know what this means. The Act does not define what discriminatory tax measures in other countries are, although there is a hint that it does include things like digital services taxes, and maybe even VAT in the European Union, but we can't know for sure, because it doesn't say so.

All it does imply is that if the US Treasury decides that there are discriminatory measures, these tax withholding rates can be put in place.

It's rather like what Trump is doing with regard to tariffs. He threatens something, and he hopes that as a consequence, he'll win some favours. This particular provision threatens tax withholding, and he hopes he'll get tax changes as a result. But it's highly subjective. And it's open to political manipulation, and nobody in the world of tax likes that.

The fact is that this might even breach the tax treaties that many countries have already signed with the USA, where these withholding rates have already been established, usually at 0%.

It could provoke retaliatory measures against the US, of course, because if the US

imposes a withholding tax, why shouldn't other countries impose withholding taxes on payments made to the US? And there will, therefore, be uncertainty over how enforcement will take place and what protections investors will have with regard to their future income streams. All of this adds complexity to the whole world international tax system.

And the bizarre situation is that this doesn't just apply to payments of dividends and interests on corporate bonds. It would appear that it applies to payments of interest on US government bonds. And what does that mean? Well, it means that people who might hold US government bonds in places like the UK, the European Union, Canada, and Australia, all of whom are most definitely normally considered to be allies of the USA, could now find that there is tax withheld on the payment of interest on US government bonds, and that will be because these countries have digital services taxes, or maybe wealth taxes, or other measures which are deemed to be discriminatory by the USA.

What will the consequence be? Well, there will be some obvious ones. Pension funds in those countries are not going to hold US government bonds, and maybe US shares, and maybe US corporate bonds if they discover that tax is going to be withheld at source on payments made to them when, for example, many pension funds in those countries are actually tax free within the fund themselves. They will simply have no incentive to hold US investments.

Therefore, the encouragement that the current tax system supplies for these organisations to invest in the USA will disappear. And in that case, what we are going to see is something very straightforward. There is going to be an effective tax war, which is going to lead to reduced foreign demand for US investments.

But that will also have knock-on effects. First of all, it will reduce demand for the US dollar, which is, admittedly, something that Trump says he wants. He wants the value of the dollar to fall, and this will most certainly deliver that.

But there might also be significant pressure for increased interest rates in the USA. That's because people will expect an equivalent net after tax receipt of interest on US investments to that which they previously had without tax being deducted from interest. And so the upward pressure on rates in the USA will be significant, and of course, that will have a massive knock-on effect for the American population, because they will have to pay increased interest rates as a result.

And there will be a further knock-on effect. Remember, most of the world's developed countries borrow in the dollar and they will have to pay more interest as a consequence.

And the simple fact is that these measures are also likely to increase the price of imports into the USA. Ignore tariffs, a falling value of the dollar also has that effect. So there will be an inflationary effect inside the USA as well.

So, will the world still want to invest in the USA? I doubt it.

Will there be continuing demand for US Treasury bonds? Not to the same extent that there has been.

Will there be increased interest rates, maybe around the world? Yes.

Trump is taking a massive risk, in other words, and that risk is so big that the question has to be asked as to whether he will actually be able to fund the \$3 trillion increase in the US deficit that is required for him to introduce his tax cuts.

Now, I know modern monetary theory, and I understand that, of course, governments can spend money without having to borrow. But the reality is that at present, that is not the belief of the US Federal Reserve. And so they will react as if they have to. In other words, section 899 actually sabotages Trump's own budget strategy.

This makes no sense at all. This is Trump's economic nationalism going wild. Why is he doing this? And who's going to pay the price?

It won't be billionaires, because they will always be able to find a way around these things. They will, for example, shift towards investments that are focused on capital gains, and there is no withholding on those.

It could be Trump, because he may not deliver the strategy he wants.

It could be corporations because they may suffer the consequence of not being able to raise the funds that they require, but very few companies are, in practice, dependent upon shares to fund their activities in the USA now.

So, who, actually, will pay the price for this? It will be pension funds, and it will be ordinary savers, and it will be the people of the USA, and people in developing countries who will have to pay higher interest.

Section 899 is a blunt tool with some very sharp edges, and it's going to create some very uncomfortable consequences.