The Boarder Adjustment Tax A Tax Policy Idea that's Maybe Just Too Good to be True

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Tax Policy

- Tax Policy Often Tries To:

- Raise additional revenue to pay for infrastructure or for an enhanced military capacity;

- Cut the burden of taxation in order to stimulate the economy;

- Encourage taxpayers to do something they otherwise might not do like invest in the US;

Tax Policy

- Get taxpayers to stop doing something such as keep profits offshore;
- Show voters that the economy is in safe hand; or
- Show voters that they are a tax cutting government.

Tax Policy

The US government currently has a policy of:

- Higher spending on the military;
- Higher spending on infrastructure;
- Reducing taxes; and
- Paying down the national debt

What is a president to do to balance the budget?

The Republican Blueprint

“<u>Way for Tax Reform</u>”

A bold blueprint for a 21st century Tax Code

built for growth

The Republican Blueprint

- The “Blueprint” is Big on ideas and Small on Details.

BUT

- When it comes to Tax Legislation the Devil is in the Detail.

Personal Tax Changes

- Remove Tax Deductions other than for Mortgage Interest and Charitable Giving;
- Cap Income Tax at 35% and reduce the number of tax bands; and
- Provide a 50% exclusion for dividend, interest and capital gain income.

Business Tax Changes

- Reduce the US corporate tax rate from 35% down to 20%, (the President wants a 15% rate)

- Capital expenditures (other than for land) would be immediately deducted in the year in which the property is placed in service.

Business Tax Changes

- **Introduce a border adjustment tax which would:**
  - Exempt export profits from US taxation; and
  - Penalize businesses who import by denying a deduction for the costs of imported goods

- **Reduced tax rate for business income from pass-through entities (partnerships or LLCs) to a maximum of 25%.**

Business Tax Changes

- Disallowance of business interest

This is likely to give small businesses serious difficulties in raising financing.

The Boarder Adjustment Tax

- This is the only substantial revenue raising measure in the Blueprint.

- Many economists estimate it could raise nearly $1.2 trillion over 10 years.

The Boarder Adjustment Tax

- It would give the US a different tax systems from most of its trading partners.

  They have reduced their corporate tax rates in favor of VAT payable at the point of consumption.

- It would eliminate the incentive for US based multinationals to shift income to low tax countries or use inversions to become foreign resident companies.

The Boarder Adjustment Tax

- Many economists believe that the tax would increase exports and discourage imports resulting in a higher value for the $ as against other currencies € £ ¥.

- In theory, this would cover the cost of the additional tax burden on importers

The Boarder Adjustment Tax

- However, business groups remain skeptical of predictions that the dollar will appreciate enough to negate their increased tax burden.

- It has been said that the border adjustment proposal…

"… has created an unusually stark disconnect between economists and the business community."

The Boarder Adjustment Tax

- For many exporters, the tax would result in loss carryovers they cannot never use.
- This will lead to unusual mergers and distortive transactions…

…created by clever tax planners.

Consider the following example:

- A Spanish corporation manufactures corkscrews in Spain and sells them in Spain and to a US distributor.
- The corkscrews for sale in Spain cost $90M to manufacture and Spanish sales are $100M = $10M profit
- For its US sales manufacturing costs are $10M with a $1M profit.
- The manufacturer pays $2.2M of Spanish income tax on its profit and $0 in US tax.

Consider the following example:

- **What if:**
- **The manufacturer moves its plant to the US and exports the corkscrews to Spain.**
  - It will avoid $2.2M of Spanish income tax.
  - It can deduct its $90M manufacturing costs for U.S. tax
  - It can exclude its $10M of profit from its Spanish export sales.
  - It Can offset its $100M manufacturing cost against its $1M profit on corkscrews sold in the US.
- **Result = $0 Spanish Tax**
- **$0 US Taxation + $99M NOL carried forward**