

# US Business Tax Reform

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# The Ryan/Brady Blueprint

- Taxes corporate “cash flow” – essentially capital income – at a flat 20% rate
- Denies deduction for interest; allows 100% deduction for capital expenditures
- Imposes 6%, 12.5%, and 16.5% taxes on dividends, interest, and capital gains paid to households
- Caps the tax rate on “pass-through” entities at 25%
- Adopts a territorial system for profits earned abroad
- Repeals the corporate alternative minimum tax

# The Ryan/Brady Blueprint (cont'd)

- **MOST CONTROVERSIAL**: Adjusts the cash flow tax at the border by denying a deduction for imports and exempting exports from the tax base. This is the focus of today's conference
- However, international corporate tax rates matter – a lot

# Corporate Tax Rates Compared

Statutory, marginal effective, and average actual corporate tax rates, G-8 countries

Country	Statutory corporate tax rate, 2016 (%)	Marginal effective corporate tax rate, 2014 (%)	Average actual corporate tax rate, 1998 - 2015 (%)
Canada	26.5	18.8	29.4
France	33.3	36.0	36.6
Germany	29.7	24.4	30.5
Italy	31.4	24.5	38.4
Japan	30.9	29.3	41.8
Russia	20.0	30.4	25.0
United Kingdom	20.0	23.7	29.5
<b>United States</b>	<b>40.0</b>	<b>35.3</b>	<b>31.1</b>

- US has the highest statutory corporate tax rate and the second highest marginal effective rate among the G-8 countries.
- US average actual tax rate on large corporations not much different from other G-8 countries, but other statutory rates have come down over the past decade.
- British Prime Minister Theresa May promised to lower the UK corporate tax rate to 17 percent in 2020.
- **The most important US business tax reform is to lower the tax rate.**

# The Case for Border Tax Adjustments (BTAs)

- BTAs are the linchpin for the first business tax reform since 1986
- \$1 trillion revenue over 10 years – partly paid by foreigners – to offset lower corporate tax rate
- BTAs reduce incentives for inversions, outsourcing, and transfer-pricing abuse
- Without BTAs, political arguments against territoriality would be deafening

## **BUT**

- Retailers, auto firms, oil refiners and others cite the potential cost to consumers

# BTAs: White House Chaos

- Jan 13: Trump interview with the WSJ: “Anytime I hear border adjustment, I don’t love it.....It’s too complicated”
- Jan 23: Trump promised to impose a “very major” border tax on **companies** that move operations overseas
- Jan 26:
  - Trump speech at GOP Retreat 2017 in Philadelphia: “We are working on a tax reform bill that will reduce our trade deficits, increase American exports, and will generate revenue from Mexico that will pay for the wall if we decide to go that route”
  - Press secretary Sean Spicer said the administration is considering a 20 percent tax on Mexican imports and revenue will be used to fund the wall
  - Later Spicer told NBC News that the proposal was only “one idea” that might finance the wall. He also hinted that Trump wants to eventually extend the 20 percent import tax to all countries, not just Mexico

# BTA issues

- **Compatibility with WTO rules**
- **Extent of exchange rate offset**
- **BTA tax incidence**

# BTAs: WTO perspective

## Procedural aspects of a WTO complaint

- Many countries might be persuaded not to bring a WTO complaint
- A WTO suit will take at least 4 years for panel, AB, and countermeasure decisions
- An adverse decision against US might be followed by renegotiation of WTO rules to broaden the scope for destination tax adjustments

**But: countries might apply national CVDs against US exports rather than wait for WTO relief**

# BTAs: Distinct WTO rules

- *Imported Goods*: national treatment requires equivalence between tax on imports and tax on domestic products
- *Exported Goods*: direct taxes cannot be rebated, indirect taxes can be rebated
- *Imported Services*: national treatment requirement, but not spelled out
- *Exported Services*: no rules
- Cash flow BTAs are similar to Japan's subtraction VAT
- The biggest vulnerability arises from wage deduction for domestic production but not for imports and exports

# BTAs: Exchange Rates and Prices

- Estimates on how BTAs would affect the value of the US dollar range from:
  - no exchange rate offset (in this case, the BTA is equivalent to a 20% dollar depreciation), to
  - exchange rate fully offsets the BTA (meaning a 25% dollar appreciation)
  - or someplace in between
- Many imports compete with equivalent US goods, so foreign suppliers may be forced to absorb the tax, even if there is no exchange rate offset – or lose the US market

# BTAs: Exchange Rates (cont'd)

- Auerbach/Holtz-Eakin (2016) and Feldstein (2016) claim the exchange rate will fully offset the effect of BTAs. Therefore US trade balance remains the same
- Corporations and Wall Street **DISAGREE**
- Evidence suggests that imports invoiced in dollars are not quickly re-priced to reflect exchange rate changes (Gopinath, 2015)
- Reduction in trade deficit partly depends on the extent of spare capacity in the US economy

# BTAs: Tax Incidence

- If the exchange rate offset is complete, foreigners will pay for the tax
- If the BTA has no impact on the value of the US dollar, ultimate US consumers of imported goods bear the burden – unless foreign suppliers absorb the tax

**Many questions!**

**Brave colleagues will provide  
answers!**

**Thank you!**