STEPPING UP TO BAT: DON'T COUNT IT OUT

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Last week, tax policy was front and center with the Trump administration's tax outline and bullet points with guiding principles for desired tax reforms. One focus of the outline is to lower corporate tax rates toward 15%, to simplify some of the individual tax brackets and to double the standard tax deduction, all while keeping tax deductions for personal mortgage interest and charitable donations. One of the key debates involves how much new revenue the government tries to offset while bringing down higher corporate rates to make the United States more competitive for corporations and investment.

I had two tax policy experts on my podcast last week: Brian Reardon, an advisor to the American Made Coalition who also worked with President George W. Bush on his tax reform proposals in 2003, and Gordon Gray, director of fiscal policy at the American Action Forum. Gray suggested that the concept of doing your tax return on one page caught on to such a degree that Trump's team thought the whole tax code should be on one page. If only it could be that simple.

Replacing Corporate Taxes with a Cash Flow Tax: How to Remove the "Made in America Tax"

Reardon described the plan from House Speaker Paul Ryan and Rep. Kevin Brady as a comprehensive way to effectively replace the corporate income tax with a cash flow tax. This is a central feature of the border adjustment tax (BAT). The Ryan-Brady plan reduces rates, allows for immediate expensing of investments and moves to a territorial-based system. It also attempts to level the playing field between products made abroad and products in the U.S. by removing what Rep. Brady calls the "Made in America Tax." This results in a shifting locus of taxation from where things are produced to where things are consumed.

Reardon described the shift as a fairly radical change from the current regime but added that it would also take us from one of the worst incentive schemes, one that encourages companies to move production overseas, toward a regime that will give foreign companies an incentive to move their headquarters to the United States.

Reardon would like to see permanent tax cuts rather than a temporary sunsetting provision in which these tax cuts expire after 10 years. If we just get expanded deficits from the tax cuts, Reardon does not see the cuts as being able to pass on permanent basis, and then we'd receive less-positive results.

How Do We Pay for Corporate Tax Cuts?

Reardon said the 20% tax rate in the Ryan-Brady blueprint is possible because their inclusion of the BAT offsets the revenue loss. If the BAT wasn't in there, he believes the corporate tax rate would have to be lowered to only 30%. At 20%, we could be internationally competitive, but 30% is still too high. Reardon thus believes the BAT is the glue of the Ryan-Brady tax blueprint.

Gray: Trump's Principles Were Positive

In the second half of the podcast, Gray discussed why he believed the outline was a step forward in recognizing that our tax policy hinders growth in our economy and establishing the need for reform. And he was happy that the administration did not spike the BAT or rule out many things that either the House or Senate could undertake. Gray said he believes the inclusion of a territorial system requires you to do one of a few things to ensure the entire tax base does not migrate overseas:

A) **Tax Base Erosion Provisions:** Former Rep. David Camp tried pushing this concept before, and no one liked it.

B) **Minimum Tax Rate Provisions:** People also don't like this.

C) **Border Adjustment Tax Rates:** Some people don't like them, but Gray points out this tactic raises money, which is a key selling point.

Gray further points out that all our key trade partners employ a territorial tax system, so a shift toward this policy would not be an outlier in global taxation schemes.

Weighing Prospects for the BAT

Gray reminds us: we have only done tax reform a handful of times in the last 100 years of the modern tax code, and it is always very hard to get through. The probability is never good—less than 50%. But with the assumption that tax reform is happening, the BAT looks more viable the later in the reform process we get.

Discussing Equalizing Equity Financing with Debt Financing

We also talked about different proposals that may come up to equalize equity and debt financing. Gray brought up the point that the Senate has been working on shifting the locus of taxation to individual shareholders and away from the corporate tax side. WisdomTree's Jeremy Siegel has advocated that we should make dividends tax deductible to corporations in order to remove the double taxation of dividends, first at the corporate level and then the individual level. This also encourages debt financing because interest payments are tax deductible. We do not hear much discussion of this yet, but if the Senate is focused on this, it would be a useful program.

On a week where taxes were a key focal point, it was a pleasure speaking to both Brian Reardon and Gordon Gray on our program.

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