

A Border Tax Analysis with Alan Auerbach: Expect a Strong-Dollar Regime

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Last week on my podcast, Professor Siegel and I had the opportunity to speak to Alan Auerbach, the Director of the Robert D. Burch Center for Tax Policy and Public Finance, about his proposals for a border adjustment tax (BAT)—one of the much-discussed policy proposals being considered as part of a tax reform agenda this year.

Auerbach suggests that while the border adjustment tax is a new concept for the United States, in reality it is similar to the value-added tax (VAT) that many countries around the world have in place today.

Auerbach discusses how the BAT is often confused with tariffs, but he maintains that it is not a tariff, nor is it protectionist, just like consumption taxes are not protectionist.

How Does a BAT Work?

When applying a BAT to corporate taxes or individual taxes, it would be a tax on imports (for corporates a BAT would eliminate the deductibility of any import-oriented costs). For exporters, it would make it such that export revenue for businesses would become non-taxable.

The primary goal of this BAT is to shift the focus of taxation from where things are produced to where they are consumed. The purpose of a BAT is to encourage companies to locate production in the U.S.—which is spot on with Trump's political rhetoric.

The BAT is also meant to encourage multinational corporations to locate profits to flow through the U.S., instead of the current system, where many companies try to locate abroad to avoid U.S. taxes. There are many companies that pass through profits to foreign entities—or entities, say, in Puerto Rico, where taxes are low—in an effort to avoid U.S. corporate tax rates.

Does Lowering Corporate Taxes Help Remove the Need for a BAT?

Auerbach admits that lowering corporate tax rates is one way to address a similar issue, but it goes beyond that, because there are still ways many companies take advantage of places where there is no taxation.

On the political front, Auerbach says, that because the U.S. will be running a trade deficit over the foreseeable future, the revenue from a BAT is estimated to be \$1.2 trillion over the next 10-years—which would help offset revenue losses from lowering corporate taxes or other individual tax cuts, an appealing prospect to Republicans who worry about escalating deficits with other tax cuts.

Will the BAT Pressure Importers and Be a Boon to Exporters? It depends on the U.S. dollar reaction.

Auerbach believes there will be substantial adjustments in exchange rates to offset the costs for importers and reduce exporters' benefits. He is convinced there will be a substantial U.S. dollar appreciation in range similar to the border adjustment tax. This is one of the key areas of the debate, and there could be big consequences for investors who hold foreign assets with currency exposure—consequences directly connected to the type of tax that causes a surge in the U.S. dollar.

This discussion—if anyone believes there is a probability some variation of a BAT will come to pass—should encourage investors with assets abroad to consider implementing currency hedges.

In summary, Auerbach says it would be hard to design a system more effective in motivating companies to locate production in the United States. He believes it is simpler than the current tax system and also simpler to enforce than current systems. From that perspective, it seems to be right in President Trump's wheelhouse.

Professor Siegel, in our discussion and subsequent follow-up, expressed doubt that the BAT stands much of a chance of going through, given the disruption it may cause, but with all the political rhetoric of Trump, I come back to this being the perfect answer for him. Auerbach makes a compelling case that this tax approach is simple, not complex.

This will be one of most important issues of the tax year, with many implications for how one invests abroad, and we are grateful to the academic who has promoted the BAT for coming on our show and podcast.

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