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The Border Adjustment Tax

MANUFACTURING, TAX, TAX REFORM
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Last summer, House GOP members released their blueprint on tax reform, "A Better Way, Our Vision for a Confident America." The GOP members stated within the blueprint that they would eliminate the "self-imposed export penalty and import subsidy" by moving to a destination-basis tax system. Since President Trump's inauguration, the border adjustment tax has been a hot topic, one that seemingly makes the newswire on a daily basis.

One of the biggest campaign issues that President Trump ran on was that our system of taxation did not allow U.S. companies to remain competitive due to 1) "worldwide" taxation of profits and 2) higher tax rates than our trade partners face. Both President Trump and the GOP's tax proposals suggest reductions in the corporate tax rate to as low as 15%. By reducing the corporate tax rate and including the border adjustments tax, the House GOP feels that U.S. companies will be more competitive in the global marketplace.

The border adjustment tax is almost exactly what it sounds like; you realize a benefit when you produce something in the United States and export it, but you face a penalty when you choose to import the product. If your business does not have significant import or export activity, then any border tax consequences may be minimal. However, there still could be changes to how you are taxed based on expected tax reform.

Under current tax law, when a domestic company sells a product to a customer in the United States or any foreign jurisdiction, that revenue is taxed. And similarly, taxpayers realize tax deductions for the costs to produce these revenues, regardless of where incurred. Under the border tax structure, taxpayers will be able to exclude from taxable income the sales of products beyond the U.S. borders. However, deductions would only be realized for domestic purchases; the cost for imported products would not be deductible.

One giant hurdle that this plan has to overcome is with the World Trade Organization (WTO). The WTO generally allows border adjustability on indirect taxes, but doesn’t approve of the border adjustability on direct taxes. To get the corporate tax system that we currently have to resemble more of an indirect tax system, the immediate expensing of investment in capital assets would need to be allowed. Additionally, a company would not be able to deduct the other expenses that it would normally incur in the operation of its business, i.e., wages, rents, advertising, etc. However, the current GOP border adjustment tax proposal includes a deduction for wages paid, which may cause the WTO to not permit the border adjustment that is being discussed by the GOP.

In the past two weeks, the leaders of the giant retailers and manufacturers have met with President Trump and members of Congress to discuss the impact of the border tax on their respective industries. Retailers of clothing and electronics are particularly concerned given the significant import activity within the industry. The manufacturers with a high export volume are generally in favor.

It is unclear at this time whether this tax will become law. The Schneider Downs Manufacturing Industry Group will continue to monitor any legislation and provide updates as we see them.

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