News:
Jyrki Katainen, the European Commission vice-president who oversees EU trade policy, indicated in a recent interview with the Financial Times that the EU had studied and was fully prepared to react to a U.S. Border Adjustment Tax (“BAT”) through EU legal mechanisms and WTO rules. WTO officials have indicated that they believe the BAT proposed by House Republicans is not compatible with WTO rules.

Views:
The proposed BAT—which would exempt all exports from income taxation, while completely eliminating deductions for imports—represents a radical change to taxation of multinational corporations (“MNCs”) operating in the U.S. The BAT would likely result in these corporations making significant changes to supply chains and trade flows as they seek to maximize the opportunities and minimize the pain of such a taxation system.

Further, the proposed BAT would likely produce macro-economic dislocations—increased consumer prices, a structural change in the relative value of the U.S. dollar vis-à-vis the currencies of U.S. trading partners, changes in trade balances—that may or may not ultimately be consistent with the goals of its authors.

The reactions above of EU and WTO representatives demonstrate something that the plan’s authors may not have fully considered—that we trade in a dynamic environment, where our trading partners can (and will) react to changes to protect their interests.

Given the potential issues with WTO compatibility, the apparent ambivalence of the Trump Administration and some Republican Senators regarding the BAT, and the warring coalitions of potential winners (exporters) and losers (importers, such as retailers)—it seems unlikely that the proposed BAT is passed as envisioned in 2017.

Notwithstanding the foregoing political hurdles, some aspects of the BAT concepts could be part of an ultimate tax reform package. The implications of a modified BAT are something that MNCs should be considering when evaluating tax and value chain planning opportunities related to tangible goods, services, and intangible assets.
Our experiences to date are that most MNCs struggle to organize their financial information and transactions in a way that is suitable to properly evaluate BAT implications. Building this framework can be valuable to evaluating the potential impact of a BAT.

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The views expressed herein are those of the author and do not necessarily reflect the opinions of the Firm.