# IMPLEMENTING THE BORDER ADJUSTMENT TAX: WINNERS & LOSERS

**Authors**
Philip R. Hirschfeld
Kenneth Lobo

**Tags**
Border Adjustment Tax
International Tax
Tax Controversy
Tax Reform
World Trade Organization

## OVERVIEW

The House plan to tax imports and exempt exports (the "border adjustment tax" or "B.A.T.")[1] is part of a tax reform package that is expected to raise more than $1 trillion to offset lower income tax rates and improve U.S. competitiveness against global rivals. It is designed to encourage U.S. companies to move manufacturing operations back to the U.S. or use U.S.-based, rather than foreign-based, manufacturers.

Sixteen major U.S. companies, including Boeing Co., General Electric Co., and Caterpillar Inc., recently urged Congress to adopt the B.A.T. with an eye toward establishing more competitive pricing for U.S. manufactured goods.[2]

However, the B.A.T. also raises concerns for certain manufacturers – retooling to a U.S. supply line is costly and can take many years to setup. Of course, the severity of the retooling problem may be looked at as a driving reason for adopting a policy of encouraging manufacturing in the U.S. Ultimately, the B.A.T. will not be a winning proposition for all American businesses, as it benefits corporations that are net exporters to other countries, rather than companies who import goods to sell to the U.S. market.

On the international stage, the potential losers and others have already raised a loud outcry against adoption of the B.A.T. The proposal likely will be challenged in the World Trade Organization ("W.T.O.") by member nations that will be harmed by the tax.

Set forth below is a description of those industries that are expected to be helped and harmed by this proposal and an examination of the potential impact on U.S. currency. Also, set forth below are likely arguments that will support a challenge in the W.T.O. and a discussion of the impact on the American consumer – who may be the biggest loser if the plan is adopted. Note that most of the arguments addressed to consumers are championed by retailers that source inventory abroad.

## EFFECT ON THE VALUE OF THE U.S. DOLLAR

There is some divergence as to whether the B.A.T. will result in an increase in the

---

1 The tax on imports is actually an indirect tax since the proposal will deny a deduction for the cost of imported goods, which will increase the taxable gain when those products are later resold. By contrast, the proposal will exempt gain from the sale of exports from tax.

2 Ginger Gibson, "CEOs of 16 U.S. Companies Urge Congress to Pass Border Tax," Reuters, February 21, 2017.

value of the U.S. dollar. Since the border tax will materially alter the terms of trade between the U.S. and the rest of the world, the border tax could be expected to lead to a sharp increase in the value of the dollar.[3]

Per economic theory, there will be a reduction in U.S. demand for imported products, and as such, U.S. consumers will transfer fewer U.S. dollars to foreign sellers, thereby reducing the global supply and raising the value of the dollar. Consequently, it would be more expensive for foreign buyers to purchase U.S. goods and cheaper for U.S. importers to purchase goods from overseas. Yet, other analysts believe that the sale of goods will have very little effect on the dollar, as the U.S. has already transitioned from an economy principally based on goods to one based on knowledge and technology.[4]

***"Technical economic observations that there will be no negative impact to American industry and the consumer have not been embraced by other commentators and have been silenced the critics of the tax."***

The dollar could rally 25% – to levels not seen since the 1980's – according to economists, including Harvard University's Martin Feldstein, who was chairman of the Council of Economic Advisors under President Ronald Reagan.[5] U.S. holders of foreign assets would see the value of those foreign assets drop. This also suggests that the dollar denominated purchase price of foreign produced products will drop. Because many foreigners borrow in U.S. dollars, some commentators have speculated that a global debt crisis may follow for those that do not hedge foreign currency exposure in their home country.[6]

Martin Feldstein, however, believes that the critics of the border tax have not taken into account that the rise in value of the U.S. dollar will serve to offset any possible price adjustments that may result from the tax. Feldstein illustrates this by looking at the impact on an imported product that now costs $100. The purchase price of this imported product will rise to $125 so that the net effect of the 20% border tax will be a price of $100. Feldstein computes this as follows: the new $125 import price is reduced by a 20% tax on that amount (or $25) so the net price equals the present $100. Feldstein then asserts that "a 25% rise in the dollar would reduce the import cost to $80 – that is, $100 divided by 1.25. The border tax would then raise the domestic selling price to the original $100, so the importer could pay 20% of that and have $80 left to cover the cost of the import."[7] Feldstein's technical economic observations that there will be no negative impact to American industry and the consumer have not been embraced by other commentators and have been silenced the critics of the tax.

## WINNERS AND LOSERS

Potential winners with regard to the B.A.T. will likely be (i) companies that are U.S. exporters and (ii) companies with significant input costs produced in the U.S.

---

3 Holman Jenkins, "What's Behind the Border Tax Kabuki?," *Wall Street Journal*, February 17, 2017.

4 Julian Emanuel, "The Winners and Losers of a Border Adjustment Tax," interview, Bloomberg, February 14, 2017. Stefan Kreuzkamp, "The Border Tax and Other U.S. Tax Issues," Deutsche Asset Management, February 24, 2017.

5 Martin Feldstein, "The Illusory Flaws of 'Border Adjustment,'" *Wall Street Journal*, February 26, 2017.

6 Chelsey Dulaney, "Border-Tax Plan Draws Few Bettors," *Wall Street Journal*, February 14, 2017, B10.

7 Feldstein, "The Illusory Flaws of "Border Adjustment."

As previously mentioned, the C.E.O.'s of 16 major U.S. companies recently signed a letter to Congress endorsing the B.A.T. (the "Letter"). The signatories represent:

| | | |
|---|---|---|
| Boeing | Caterpillar | Celanese Corp. |
| Celgene Corp. | CoorsTek | Dow Chemical Co. |
| General Electric | Eli Lilly and Co. | McIlhenny Company |
| Merck & Co Inc. | Raytheon Co. | S&P Global Inc. |
| Oracle Corp. | United Technologies Corp. | Pfizer Inc. |
| | Varian Medical Systems Inc. | |

While these businesses have clearly determined that they fit into one or both of the foregoing categories, the following discussion outlines the industries and sectors that are thought to be helped or harmed by the B.A.T.

## Aircraft Manufacturers

Companies that produce American-made aircraft for commercial or private use are expected to benefit from the B.A.T. An example is Boeing, which argues that its primary competitor, Airbus, similarly benefits from V.A.T. refunds for non-E.U. sales while Boeing aircraft are subject to V.A.T. in the E.U. However, if Boeing or other aircraft manufacturers import parts or subassemblies as part of their supply chains, they will be adversely effected by the border tax. This may affect the makeup of supply chains for U.S. manufacturers.[8] However, the elimination of tax on exports of aircraft should far outweigh the cost of the B.A.T. on subassemblies.

## American Consumers

A common theme echoed by many industries is that the B.A.T. will result in higher prices for the American consumer.[9]

The Americans for Affordable Products Coalition ("A.A.P.C."), a group of 150 businesses and trade coalitions, was formed to protest the B.A.T.[10] The A.A.P.C. estimates that the tax will raise the cost of everyday products like food, gas and medicine by up to 20% and threaten millions of jobs. It also indicated that this could have a harmful effect on middle-income American families and result in potentially evaporating 27% of their savings with the increased cost caused by the tax. Some notable members of A.A.P.C. are retailers like Target Corp. and Macy's, Inc., and import-focused trade associations like the National Association of Beverage Importers and the National Grocers Association.[11]

Americans for Prosperity ("A.F.P.") is a conservative political advocacy group in the U.S., which is funded by the businessmen and philanthropist brothers David H. Koch and Charles Koch. A.F.P. opposes the concept of funding lower corporate

---

8 Kirk Johnson, "Trump Talk Rattles Aerospace Industry, Up and Down Supply Chain," *New York Times*, February 23, 2017.

9 Patti Domm, "A Plan to Tax Us Imports Has Better Odds of Becoming Law than Many People Think," CNBC, December 21, 2016.

10 Chavie Lieber, "100+ Retailers Are Joining Forces to Combat the GOP Border Adjusted Tax," Racked, February 1, 2017.

11 A full list of AAPC members who stand opposed to the border adjustment tax is set forth here.

rates by increasing consumer prices. It criticized the border adjustment plan as a tax on consumers.[12]

## Automotive Industry

No matter where assembled, automobiles sold in the U.S. contain a large number of components produced abroad. One consulting firm recently prepared a report projecting the anticipated price increase that would result from the B.A.T. Ford Motor Co. would raise prices by an average of $282 per vehicle while GM would raise prices a $995 price hike. For other manufacturers, the projected increases are $1,312 for American Honda, $1,672 for Fiat Chrysler Automobiles, $2,298 for Nissan North America, and $2,651 for Toyota. Mazda Motors imports its full lineup and its projected increase is $5,156 per vehicle. The American International Automobile Dealers Association argues that impact of the B.A.T. will be to lower new car sales.[13]

## Clothing and Apparel Industry

The U.S. clothing and apparel market comprises about 28% percent of the global total. Americans buy nearly 20 billion garments a year – close to 70 pieces of clothing per person. Roughly 2% of that is made in the U.S.[14] Thus, B.A.T. is likely to adversely affect this industry severely.

## Companies with Locally Sourced I.P.

For politicians concerned about U.S. base erosion from royalty payments for the use of intangible property ("I.P.") owned outside the U.S., the B.A.T. may incentivize corporations to forego transfers of I.P. to foreign affiliates based in low-tax jurisdictions. Additionally, if the corporate tax rate falls to 20% or 15%, there may be little incentive left for U.S. corporations to move I.P. offshore.

## Energy Sector: Oil Drillers and Refiners

The energy sector in America comprises both drillers and refiners. Domestic drillers stand to benefit from the B.A.T. and support the proposal. However, there is a split among refiners.[15]

The U.S. is the largest producer of shale oil in the world, and while the U.S. produces about 8.6 million barrels of crude oil per day, it imports about 8 million barrels of crude oil on the same basis. Under the B.A.T., the cost of imports would no longer be deductible. Most imports come from Canada, but others come from Mexico, Colombia, Venezuela, and Saudi Arabia. Saudi crude oil is shipped to the Saudi Aramco owned plant in Texas.[16] Refiners on the east or west coasts, such as Tesoro

---

12 "Americans for Prosperity Holding Republicans Accountable," Americans for Prosperity, February 17, 2015.

13 Nick Bunkley, "Tax Threat Heightens Concern About Affordability," Automotive News, February 13, 2017.

14 Stephanie Vatz, "Why America Stopped Making Its Own Clothes," KQED News, May 23, 2013.

15 Christopher Mathews and Amy Harder, "Border Tax Divides Energy Sector," *Wall Street Journal*, February 24, 2017.

16 Domm, "A Plan to Tax Us Imports Has Better Odds of Becoming Law than Many People Think."

Corp. and PBF Energy, rely heavily on this imported crude and are opposed to the tax. Refiners with a better mix of domestic crude and the ability to export fuel products are more neutral to the idea.[17]

There is concern that gas prices may increase by up to 20% for consumers due to the increased tax on imported crude oil. Goldman Sachs Group Inc. projects that U.S. oil prices could surge to $65 a barrel from a recent $54, reflecting a sharp tightening in the supply-demand balance in the U.S. market.[18] Internal reports of the American Petroleum Institute have concluded that the proposal will raise gasoline prices by $0.20 per gallon or more in the short term.

***"Over the last decade, there has been a growing U.S. trade deficit in fresh and processed fruits and vegetables."***

This is somewhat less than a recent tax increase per gallon on gasoline sold in the State of New Jersey. Anecdotally, the price increase did not result in less congestion within the state.

Supporters of the proposal have argued that the B.A.T. will strengthen the U.S dollar, which will offset any short-term surge in gas prices. The American Fuel and Petrochemical Manufacturers ("A.F.P.M.") have also concluded that gas prices will surge. A.F.P.M. tends to represent refiners and cautions that the B.A.T. could have considerable impact on refiners, consumers, and the economy."[19]

**Food and Agriculture Sector**

California farmers supply much of the produce that is on the shelves of American supermarkets,[20] and most domestic producers – particularly U.S. corn exporters – stand to benefit from the tax. Nonetheless, foreign growers supply a substantial portion, too, especially in the winter months.

Over the last decade, there has been a growing U.S. trade deficit in fresh and processed fruits and vegetables. Although U.S. fruit and vegetable exports totaled $6.3 billion in 2015, U.S. imports of fruits and vegetables were $17.6 billion, resulting in a gap between imports and exports of $11.4 billion (excludes nuts and processed nut products). This trade deficit has generally widened over time as growth in imports has outpaced export growth. As a result, the U.S. has gone from being a net exporter of fresh and processed fruits and vegetables in the early 1970's to being a net importer of fruits and vegetables today.[21] This of course may change if consumers shy away from imported products from jams to fruits.

Mexico sold $10.4 billion of fruits and vegetables to the U.S, in 2015 making it the biggest supplier of produce from abroad. Products include tomatoes, avocados, peppers, grapes, cucumbers, melons, berries, and onions. Canada is the second biggest supplier with sales of $2.9 billion in 2015. Bananas are from tropical regions. Most of the bananas you buy are grown within 20 degrees on either side of the equator.[22]

---

17 Mathews and Harder, "Border Tax Divides Energy Sector."

18 Dulaney, "Border-Tax Plan Draws Few Bettors."

19 *Supra*, note 17.

20 Brian Palmer, "The C-Free Diet: If We Didn't Have California, What Would We Eat?," July 10, 2013.

21 Renee Johnson, *The U.S. Trade Situation for Fruit and Vegetable Products*, Congressional Research Service report (Dec. 1, 2016).

22 "Map of Banana Farms," Chiquita Bananas.

## Machinery Manufacturers

The American company Caterpillar is one of 16 signatories to the Letter supporting the B.A.T. It is expected that Caterpillar and its American competitor, John Deere, as net exporters, would stand to benefit from the B.A.T. In comparison, foreign competitors such as Komatsu and Mahindra will likely be damaged by the B.A.T. when they import machinery to the U.S. The comparison of U.S. manufacturers and their foreign competitors in this category illustrates a potential weakness of the B.A.T., as the B.A.T. may be construed as a subsidy that provides a financial benefit to U.S. residents. For example, while Caterpillar and John Deere can deduct the cost of goods sold in computing taxable income under the B.A.T., Komatsu and Mahindra are subject to a gross sales tax.

## Military Contractors

Since the U.S. is the world's leading arms exporter,[23] companies manufacturing military arms and equipment are enthusiastic proponents of the B.A.T. Note that because U.S. law prevents U.S. military technology from being produced outside the U.S., most of the inputs are sourced in U.S. Raytheon and United Technologies are signatories to the letter endorsing the B.A.T.

## Retail Industry

The retail industry is the nation's largest private-sector employer providing and supporting more than 42 million American jobs and many are undergoing significant changes brought about by the rise of online retailers. Major retailers such as Wal-Mart and Target, will be hit with increased cost as the merchandise they sell is sourced abroad, from apparel to electronics. Ninety-five percent of shoes and clothing sold in the U.S. are made elsewhere.[24]

These companies face a choice of absorbing some or all the cost of the tax or passing some or all of the cost to their customers. Neither result is favorable for the retailers. Walmart's announced position is that the added cost is likely to be passed on to the consumers in the form of higher prices when shopping at a bricks and mortar store or on the internet.

There is a view that the value of the U.S. dollar will increase as a result of the B.A.T. and that increase will soften price increases. However, officers of major brand clothing have argued it is disingenuous to argue that currency changes would even-out the impact of the B.A.T. The comment is reflective of the current almost universal view of U.S. retailers.[25]

Several major retail C.E.O.'s recently met with President Donald Trump and House Ways and Means Committee Chairman Kevin Brady (R-T.X.) at the White House to express concerns that the tax would hurt their industry.[26]

---

23 Thom Shanker, "U.S. Sold $40 Billion in Weapons in 2015, Topping Global Market," *New York Times*, December 26, 2016.

24 Alex Parker, "Border Adjustment a 'Hidden Tax' on Consumers: Wal-Mart VP," *Daily Tax Reports* 32 (2017).

25 *Id.*

26 B. Popken, Trump Meets With Retail CEOs to Discuss Taxes, Jobs, And Economy, NBC News (Feb. 15, 2017),

Although retail is generally presumed to be on the losing side of the B.A.T., there are some retailers that could benefit from the tax. Stores that operate primarily in the U.S. and sell to customers who are less price sensitive are within this category. Examples are Neiman Marcus and Saks Fifth Avenue.

**Pharmaceutical Industry**

While U.S. drug manufacturers and net exporters Eli Lilly, Merck, Celgene, and Pfizer were signatories the Letter, the pharmaceutical industry, which imported over $86 billion in products in 2015, will be largely harmed by the border tax.

This industry is comprised of companies engaged in researching, developing, manufacturing, and distributing drugs for human or veterinary purposes. The U.S. is the world's largest pharmaceutical market with $333 billion in sales in 2015 – about triple the size of the second largest market, China. Generic drugs are less expensive for the American consumer and are favored by insurance companies for reasons of cost. India contributes around 30% of the overall volume of pharma products consumed in the U.S.

Directly and indirectly, the industry supports over 3.4 million jobs across the U.S. and added an estimated $790 billion to the economy in 2014.[27] No estimate is given by trade associations of the number of jobs that will be lost as a result of the B.A.T. or the reduction in sales that is projected.

**Tourism and Higher Education**

Tourism is a major industry in America. A stronger U.S. dollar means that, at the margins, fewer foreign persons may visit the U.S. as tourists.[28] A stronger dollar also means that Americans planning a vacation may find traveling abroad much less expensive. Thus, vacations outside the U.S. may increase, which would also be harmful to the U.S. tourism industry.

International students comprise a growing share of student population, especially in hard topics such as science and math.[29] For those who are not on U.S. dollar denominated scholarships, a stronger dollar increases the cost for a foreign students.

## WORLD TRADE ORGANIZATION OPPOSITION

The World Trade Organization ("W.T.O.") was formed in 1995 and is composed of 164 member nations as of July 29, 2016. The W.T.O. provides a framework for negotiating trade agreements and a forum for resolving trade disputes among members.[30]

Many commentators have suggested that the B.A.T. would violate W.T.O. rules and

---

27 U.S. Dept. of Commerce, International Trade Administration, *2016 Top Markets Report Pharmaceuticals.*

28 Jed Graham, "GOP Border-Tax Plan Would Sock U.S. Tourism – Including Trump Hotels," *Investor Business Daily*, February 15, 2017.

29 Stuart Anderson, "International Students Are Vital To U.S. Higher Education," *International Educator* Jan.-Feb. (2017).

30 See "World Trade Organization – Home page."

precipitate a challenge in the WTO by countries that export to the U.S. U.S. Congressman Kevin Brady is the Chairman of the House Ways and Means Committee and the principal advocate for the B.A.T. He is convinced the B.A.T. is compliant with W.T.O. rules. Others believe that it may violate W.T.O. rules because of the inability to include the cost of imports as part of cost of goods sold at the same time that the cost of locally made products can be included in such costs. This may be a form of subsidy that may violate the Agreement on Subsidies and Countervailing Measures.[31]

The definition of a subsidy is composed of three basic elements: (i) a financial contribution (ii) by a government or any public body within the territory of a W.T.O. member state (iii) that confers a benefit.[32] All three of these elements must be satisfied in order for a subsidy to exist. A financial contribution requires a charge on government funds. The term includes the relinquishment of government revenue or the failure to collect revenue (as would be the case with a credit or an exemption from tax generally due on domestic sales).[33]

In February, the German ambassador to the U.S. expressed concern that the B.A.T. may not be consistent with W.T.O. rules, but declined to say whether Germany might file a complaint with the W.T.O.[34]

## THE TRUMP ADMINISTRATION'S POSITION

President Trump has not yet reached a final decision on whether to support or oppose the border tax proposal.[35] However, President Trump has expressed concern about the plan calling it "too complicated" in an interview with the Wall Street Journal.[36]

## CONCLUSION

Like many controversial issues, belief in the potential adverse effects of the B.A.T. seems to depend on a company's status as a net exporter or net importer of inventory. To importers, adoption of the B.A.T. will harm major sectors of the American economy in a significant manner. They believe that the effect will be widespread and will embroil the U.S. in a controversy with its trading partners that will lead to a trade dispute that for resolution in the W.T.O. These companies argue that the ultimate consumers of their product may be the biggest losers through higher prices. Interestingly, industrial labor unions whose members are consumers seem to be quiet on the issue of the B.A.T.

---

31 Martin Kohr, "The Planned US Border Tax Would Most Likely Violate WTO Rules – Part 2," Inter Press Service, February 17, 2017.

32 See Fanny Karaman, Stanley C. Ruchelman, and Astrid Champion, "European State Aid and W.T.O. Subsidies," *Insights* 9 (2016), pp. 9, 14.

33 Article 1 of the Agreement on Subsidies and Countervailing Measures and Article 16 of G.A.T.T. 1994.

34 Nick Wadhams & Margaret Talev, "German Ambassador Warns Import Tax May Violate WTO Rules," *Daily Tax Report* 36 (2017).

35 Kaustuv Basu & Aaron Lorenzo, "Confusion Continues on Trump's Take on Border Adjustment," *Daily Tax Report* 37 (2017).

36 Dulaney, "Border-Tax Plan Draws Few Bettors."