Financial Times (2.14.17)

Trump and the tax plan threatening to Split corporate America

Will the president back the radical reform that pits importers against exporters?

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Rick Woldenberg views US economic policy through an unconventional lens: a multicoloured toy microscope that retails for just $20. Copyrighted in the US but manufactured in China, My First Microscope is one of hundreds of toys sold by Learning Resources, his Chicago company, which he uses to measure the effect of Washington on his business. Alongside chief executives from Wall Street, the rust belt and Silicon Valley, Mr Woldenberg has spent years pleading for Washington to overhaul an uncompetitive tax code that charges US companies the highest rates of any developed nation. "It is a crushing load," he says adding that profits from his microscopes are taxed at above 40 per cent. After November's election Republicans said their party's control of both the White House and Congress had created the best chance to revamp the tax code in a generation. President Donald Trump has put slashing the 35 per cent corporate tax rate at the heart of his mission to boost the economy and create jobs. Expectations of success powered a post-election stock market rally.

Yet for Mr Woldenberg the hope has turned to horror. Republicans are still promising the most sweeping changes since the Reagan reforms of 1986. But the only firm proposal on the table — from the House of Representatives — threatens to devastate his 150-person business because it includes <u>a 20 per cent tax on imports</u>. "This plan is not good for me if it kills me," he says. "You know John Maynard Keynes said in the long run we're all dead. I just don't want to be dead now."'Tax revolution'US importers have serious grounds to fear being hurt. Yet there are potential winners also, because the flip side of the import levy is a tax exemption for exports leaving the US. That stark difference has triggered a corporate civil war between big importers and exporters, a conflict playing out via fierce lobbying in Congress.Tax reform is one of Mr Trump's best chances of making good on his election promise to improve the lives of financially strapped blue-collar voters. But the early skirmishes underline just how hard it will be for him to deliver his "tax revolution". They have shattered Republican unity, left lawmakers skittish about their party's plan and given the Trump administration reason to keep it at arm's length.

The broad tax blueprint does have "America first" credentials: it aims to stop US businesses fleeing overseas and seeks to eliminate advantages the current system gives to foreign companies selling into the US or competing with American rivals abroad. It would also cut the business tax rate from 35 per cent to 20 per cent. But its most potent weapon is the import duty. Coupled with a tax exemption for exports leaving the US, it was conceived

to boost the global competitiveness of American-made products and services.The problem for Mr Woldenberg is that his goods come from China — 98 per cent of the products he sells in the US are imported. US factories could not produce them with the same low costs and specialised skills, he says. So he would have no choice but to pay the import levy. He estimates it would send his tax bill soaring to 165 per cent of earnings. "To preserve cash flow I [would have to] raise my prices by a third, expect volume to go down by 40 per cent, and fire one out of five people," he says. "I don't want to do any of those things."

Walmart, Target, Best Buy, Nike, Gap and dozens of other groups that rely on imports last month began a lobbying campaign to kill the Republican plan. Dubbing it a "consumer tax", they say they would have to increase prices on foreign goods, cut jobs or lose money. Stephen Sadove, former chief executive of Saks Fifth Avenue, the luxury department store, and a coalition member, said it was fanciful to think an import tax could reverse decades of outsourcing. "This is an existential threat to the retailers," he told CNBC this month.The consumer companies are squaring off against their industrial peers.

Big exporters such as Dow Chemical, General Electric, Boeing, Caterpillar and Pfizer have formed the American Made coalition to champion the House plan. They argue that it would end the perverse practice of having lighter taxes on imports than American goods and foster job creation. Robert McGovern, a tax executive at Merck & Co, a US pharmaceuticals maker, says: "What we like most about it is that it really levels the playing field for us — for Merck and for US industry. It really puts us on the same footing as non-American companies that are importing." The clash between the marquee names of corporate America has delayed the drafting of legislation in the House.

In January Paul Ryan, the top Republican lawmaker, said he wanted tax reform introduced by August. A week later Mr Trump hinted at a longer timeline, saying: "I think before the end of the year I would like to say yes."

Adjusting borders -- Until the morning after election night, few people had paid attention to the ambitious House plan, published in June 2016. It was driven by a rising anger in both parties about the number of US companies moving factories overseas or using "inversion" deals to shift their headquarters to low-tax jurisdictions. The plan was designed to stem that tide, a major election issue, and stimulate US corporate investment, raising productivity and people's earnings.The headline proposal was the cut in business tax. However the plan would also replace income tax with a cash flow alternativeallowing companies to write off capital investment on day one rather than gradually over a period of years — a very generous provision. In addition, it would end America's unpopular practice of taxing global profits, replacing it with a system of taxing only companies' US earnings. That provides the basis for

the measures, known as "border adjustments", that exclude export revenues from the tax base while taxing imports.

"Regardless of where it is produced and regardless of who produces it, our international tax plan centres on a simple question: if it is consumed in the US it will be taxed at an equal rate." says Kevin Brady, who created the plan as chairman of the House ways and means committee. "It eliminates every tax incentive for a US company to move jobs, manufacturing or their headquarters overseas."

Border adjustments -- would provide roughly $1.1tn of revenue to help fund any rate cut, says the Tax Foundation. But the think-tank estimates the whole plan would lift federal debt by $2.4tn over a decade.Its effect on global trade, investment and supply chains would be profound, say tax experts. Michael Devereux, director of the Oxford university Centre for Business Taxation, believes the plan could be the biggest shake-up of cross-border taxation since the 1920s. Ireland, Luxembourg and the Netherlands would have particular reason to worry, he says. They are low-tax countries that have encouraged US companies to shift profits or head offices to their shores. Under the House proposal the incentive to do that disappears.

Instead, it is the US that would start operating "in a way akin to a tax haven", according to an Oxford paper Mr Devereux co-authored in January. Countries watching their tax bases drift to the US would feel the pressure to adopt the same system, triggering a race to the bottom. Alternatively, they could challenge the US at the World Trade Organisation, arguing that the import tax is discriminatory. Mr Brady says he is just bringing the US into line with 100-plus countries that already levy VAT on imports but not exports. Trade lawyers in Brussels and Geneva are said to be preparing the groundwork for a case that could be the biggest in WTO history. "For there to be a WTO violation you don't have to prove that there is both import discrimination and an export subsidy, one will do. In this case I believe there will be both," says Jim Bacchus, a former congressman and member of the WTO's top appellate body.

The first companies to wake up to the significance of the import tax were retailers, which source everything from avocados to T-shirts overseas. Koch Industries, a petrol-to-paper towels conglomerate owned by the billionaire Republican donors Charles and David Koch, warned in December that the plan would "distort" the market. David French, the top lobbyist at the National Retail Federation, says: "Some retailers have looked at the numbers and consider it a threat to their viability. We are talking about effective tax rates that easily take up 100 per cent of their profits and in some cases come close to 200 per cent or 300 per cent. These are not sustainable levels."Advocates of the House plan say the importers need not worry. Border adjustments, they argue, would not distort trade because the dollar should appreciate immediately to offset the effect, with a stronger US currency boosting the buying power of importers and making US exports more expensive overseas. Critics dismiss that as an unreliable prediction from academics.

For US exporters, the ability to export tax-free would also give them the option of dropping prices. But their support for the plan is grounded in the proposed 20 per cent corporate tax rate. Equally popular is ending the tax levied on foreign affiliates' earnings when they are repatriated, which has left an estimated $1.2tn stranded in offshore cash piles. David Lewis, vice-president of global taxes at the US drugmaker Eli Lilly, says the current system puts his company at a disadvantage to British and Swiss rivals. "They can take their earnings from outside the US and spend a full dollar in the US on investment, intellectual property, whatever it might be. Whereas if we want to take a dollar from outside the US and redeploy it in the US we're only getting 65 cents [after paying 35 per cent tax]," he says. "It's about levelling the playing field."The next step for tax legislation is the Senate, where the corporate upset has already made some Republicans nervous. David Perdue, a Georgia senator and a former chief executive at the retailer Dollar General, describes the border adjustment tax as "regressive", adding: "It hammers low-income and middle-income consumers."Politically expensiveIf tax reforms built around the import levy are to survive, Mr Trump will have to embrace them. The White House says the president will offer his "outline" for tax reform within the next three weeks. Ultimately, he will have to pick a side in the corporate civil war but so far his administration has sent out mixed signals. Peter Navarro, the head of the White House National Trade Council, told the Financial Times last month that border adjustability "offers one possible option among several" for correcting anti-US bias in the global tax system.

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