

Tax Notes Quotes David Rosenbloom: The Hexagon of Tax Reform

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Tax Notes

We're now deep into 2018 World Cup qualification matches. In CONCACAF, we're in the tricky hexagon, in which the final six teams battle for three assured places in the World Cup and one playoff against a team from Asia. Readers will recall that in the previous hexagon, Mexico scraped through to qualify, and then went on to do well in the 2014 World Cup. Mexican qualification was a source of grave national concern.

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Assured of their place in Russia, the Mexicans are worried about President Trump's promise to renegotiate the North American Free Trade Agreement, which is depressing foreign direct investment. The administration wants to revamp tax and trade policy to favor domestic production and exports, and wall off the border to reduce Mexican immigration. Tax reform might or might not become another U.S. policy to encourage redomestication of manufacturing.

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The blueprint's controversial border adjustment would be the combination of a foreign income exclusion, a wage deduction from domestic income, and a 20 percent tax on income from imports, against which no expenses could be deducted. After those changes, the corporate tax might no longer be an income tax at all, raising treaty questions. It would look like a VAT, but it wouldn't be one -- the worst of both worlds from the standpoint of international agreements.

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Let's face it, the DBCFT is more fun to talk about than a VAT -- which is an endless argument about the tax exemption of cookies versus the taxability of cookie tins. "This is the greatest intellectual toy I have ever encountered in my career," said H. David Rosenbloom of Caplin & Drysdale.

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The European Union has no customs enforcement at its internal borders, which has made a mess of VAT enforcement. Rosenbloom argued in these pages that the strength of a VAT is that the government collects and refunds tax on exports (*Tax Notes*, Mar. 13, 2017, p. 1425). Whereas the idea that the government would fail to collect at the front end is a central weakness of the DBCFT. He predicted that foreign suppliers would sell directly to tax-indifferent U.S. counterparties, including individual consumers. The drafters are aware of this problem.

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But what about dollar appreciation? Oosterhuis worried that Boeing might not have pricing power. Schizer fretted that the currency adjustment would not discriminate among business sectors. Rosenbloom worried about emerging-market sovereign debt denominated in dollars. "Do we really want not just one Greece but 90 of them?" he asked. Nonetheless, the border adjustment mechanism may survive tax reform negotiations in a milder form.

For the full article, please visit *Tax Notes'* website (subscription required).

Excerpt taken from the article "The Hexagon of Tax Reform" by Lee A. Sheppard for Tax Notes.

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