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In this article, Rosenbloom and Barnes discuss different perspectives on the destination-based cash flow tax proposed by House Republicans.

There are, it seems, 13 ways of looking at a blackbird[1] and doubtless just as many perspectives on the destination-based cash flow tax (DBCFT), the spanking-new levy that House Republicans have advanced as a replacement for the corporate income tax. We undertake here to identify those perspectives and thereby portray the richness of this proposal. Much of the commentary to date on the DBCFT has homed in on specific features, whether favorably or unfavorably. But as the great poet mused while strolling in a Connecticut forest, examining the bird's discrete features may not do justice to its complexity.

The DBCFT is not simply another corporate income tax proposal. Let's hold it up to the light and consider it from all sides.

1. Let's begin with a general view from on high. According to its champions, the destination feature furnishes a pay-for that allows the rate of tax on corporations to be dropped from 35 to 20 percent. Revenue estimates show that the proposal would raise approximately $1 trillion over 10 years by denying a tax deduction for purchases of goods and services from suppliers outside the United States. This tax cost would largely be passed on to consumers, or at least that is the expectation (and the stock market certainly assumes that corporations would not bear the additional tax). In the previous major tax reform effort in the United States, the Tax Reform Act of 1986, increased taxes on corporations were used to fund tax cuts for individuals. This time, individuals would be funding tax cuts for corporations. Without the destination feature, the rate cut would lose boatloads of revenue, an observation that clears the mind. It may not, however, be the best means of generating public support for the DBCFT.

2. On a more technical level, there is the treatment of imports, the cost of which would not be deductible under the proposal. Apart from the obvious question of how this would affect distributors and consumers of imported goods and services, it is fair to ask how direct purchases from abroad would be handled, because consumers (and exempt organizations) do not care about deductions. Presumably some intermediary — hello, American Express! — would be required to collect the tax when a cross-border payment is made. The rules would be

[1]Wallace Stevens, *The Collected Poems of Wallace Stevens* 92 (1954).

neither simple nor readily enforceable, because current practices distinguish between foreign currency and U.S. dollar payments, but not necessarily between domestic and foreign suppliers. And our failure to enact laws that require remote sellers located within the United States to collect state sales taxes from jurisdictions where the seller does not have a physical presence does not bode well for forcing collection on sellers outside the United States.

3. We are told that exchange rates would adjust, the dollar would strengthen, and consumers would acquire more for their money under the DBCFT. There are, of course, many questions about when this strengthening would occur, how rapidly it would occur, and whether it would be uniform or nearly uniform for all foreign currencies. Some key currencies (for example, the Chinese yuan and the Indian rupee) do not float freely. There is a fair amount of skepticism out there, especially among people who deal with exchange rates daily. Any failure of exchange rates to adjust — fully and instantly — would significantly affect U.S. distributors and consumers. And, as discussed further below, any "successful" exchange rate adjustment would come with significant collateral implications.

4. The destination feature rewards exports, in the form of a tax exemption for revenues from sales to foreign purchasers. Some proponents of the DBCFT base their support on a presumed renaissance in U.S. production, to take advantage of this export incentive. A strengthening dollar, however, could not possibly be good for exports; to remain competitive in foreign markets, U.S. producers would need to cut prices dramatically. Moreover, foreign purchasers would be apt to insist that some or all of the tax benefit for exports be handed to them in the form of price reductions. Further slowing any U.S. renaissance would be the strong forces in foreign countries that preclude a major shift of production from those countries to the United States. Countries increasingly insist on local production by manufacturers that want to access local markets, particularly for purchases by governments. The effects, net-net, on exports are not so clear as supporters of the destination feature assume and assert. One final caution: The economists who designed the DBCFT are clear that the proposal, by itself, should not increase exports (or, for that matter, decrease imports).

Further, under the destination feature, significant exporters would incur regular, ongoing structural losses because their expenses, to the extent they are not for the purchase of imports, are deductible under the proposal. To make the DBCFT work, tax refunds would need to be paid to the exporters for the value of these export-induced losses. Apart from the startling prospect of the government writing large refund checks to multinational companies while consumers scramble to deal with rising prices for guacamole and gasoline, there is a question of how to administer the law. Refunds for exports would require that export transactions be segregated and related expenses identified. This would harken back to reg. section 1.861-8 and the allocation of expenses to foreign income for purposes of the foreign tax credit.

5. There is also the question of how to distinguish exports from imports, especially regarding intangible property and services. The distinction seems relatively clear for manufactured products, for which the DBCFT was surely designed. It tends to break down, however, when technology or services are at issue. Take, for instance, cloud-based computing, in which farms of computer servers are located in five or more different countries (including the United States) and data and functions are constantly shifted from server farm to server farm. Or take a U.S. attorney's advice to a foreign company contemplating a U.S. investment. What is exported? What is imported? Detailed rules would be needed to police the all-important line. And the stakes are far higher than usual because imports are not tax deductible while revenues from exports are exempt.

6. The destination feature would have especially tumultuous effects on truly global markets. Take, for example, petroleum and petroleum products. If exports are exempt and imports not deductible, what's a domestic producer to do? Would the producer sell to domestic refiners in fully taxable transactions, or would it seek out foreign markets, possibly creating a two-tiered pricing structure in which U.S. refiners — and of course, U.S. consumers —

pay full and much higher prices regardless of where the product is obtained? This could be disruptive. The market for crude oil tends to be about more than crude oil, because it is a product with a considerable economic and political reach. If exemption is provided for the oil markets, however, the demand for exemption for other global products (corn? computer chips? cars?) cannot be far behind.

7. Turning back to exchange rates, there would be substantial effects on worldwide investment and borrowing if the U.S. dollar strengthened to the extent some have predicted — a 25 percent increase in its value, based on a 20 percent corporate tax rate — following adoption of the DBCFT. Foreign investments by Americans, if denominated in foreign currency, would lose value, while the converse effect would apply to the U.S. dollar investments of foreigners. Every foreign mutual fund held by a U.S. individual in his IRA would decline substantially in value. Debt denominated in dollars — as much of the debt in the developing world is denominated — would become more expensive. Pressures on countries would rise. Some might begin to look like Greece.

8. One of the benefits claimed for the destination feature is the removal of incentives to play transfer pricing games. This claim reveals the U.S.-centric origins of the DBCFT proposal. Yes, U.S. companies would have no incentive to underprice exports or overpay for imports, but that hardly means that transfer pricing issues would vanish. The incentives would simply be reversed. U.S. companies would want to be overpaid for exports and to underpay for imports because related counterparties in foreign countries would in many cases be taxable and there would be a desire to reduce the tax burden abroad. Indeed, if the DBCFT passes, foreign tax authorities will assume that every U.S. multinational company is playing games with transfer pricing to achieve these tax savings.

9. So transfer pricing disputes would continue. Where would these disputes be discussed? And would the United States need to retain its transfer pricing rules, if only to come to the defense of U.S. companies? The mutual agreement procedure in U.S. tax treaties applies to taxes that are covered by the treaties. If the United States replaced the corporate income tax with the DBCFT, would treaty coverage continue? Faced with similar questions in the past regarding the Italian regional production tax (IRAP) and later the Mexican impuesto empresarial a tasa única (IETU), the United States found those VAT-like taxes not to be covered by the respective treaties. Patches were worked out, permanent for Italy and temporary for Mexico. It is, to put it mildly, unclear whether other countries would be so accommodating and continue to use the dispute resolution mechanisms in U.S. tax treaties when faced with a new U.S. tax intended to shift production and employment away from them and to the United States.

10. For that matter, what about retaliation more generally? If the United States adopted the DBCFT, other countries would likely not sit on their hands. One can imagine a range of potential retaliatory moves, including carbon copies of the DBCFT, tariffs, and exchange rate manipulation. The process would likely be contentious, and its outcome uncertain. U.S. multinational companies routinely conduct business in more than 100 foreign countries, so responding to each country's retaliatory measures would demand time and resources from the U.S. government and from each major multinational. The prospect of a trade war looms. How can that be in anyone's interest, including the exporters'?

11. Then there is the WTO. One might have thought the United States learned its export promotion lesson in the 1970s with the domestic international sales corporation and its progeny. The United States fought the good fight in the WTO for many years and ultimately lost. Income tax provisions cannot legitimately be used, consistent with WTO rules, to promote exports. There is a sharp, WTO-approved distinction between export promotion using refunds of a consumption tax like a VAT and export promotion in the direct tax world using an income tax.

The DBCFT is not a VAT, and does not appear to be any other form of consumption tax either. The proof in that pudding is that the DBCFT is not payable if a company shows a loss. A VAT is a multistage sales tax. It is due and payable on sales regardless of whether the seller is making a profit. So it would appear that the DBCFT has challenging prospects in WTO litigation. Yes, there are thoughtful U.S. commentators who have fashioned arguments for why the DBCFT should be WTO compliant. But those arguments twist around like a pretzel. Do we really need, as a country, to put our hand repeatedly on the same hot stove — and face a dozen years of WTO litigation?

12. The DBCFT would create havoc for the 44 states that impose a state-level corporate income tax. Most of the taxes piggyback on the federal definition of income and then provide adjustments. If the DBCFT is enacted, the federal definition of income would exclude income from exports — goods and services provided to consumers outside the United States, not consumers outside a particular state. Would states want to adopt that definition? Would states be inclined to enact their own (and often varying) definitions of income? These questions further complicate the transition to the DBCFT.

13. One of the claims for the DBCFT is ease of administration. Yet it does not sound as though the DBCFT would be all that easy to administer. The need to distinguish exports from imports, the policing of direct sales to consumers from outside the United States, the management of export-related refunds — all these issues pose challenges of a new and different order. The task of revamping the IRS to deal with the issues and the various restructuring possibilities that the DBCFT invites is daunting.

So there we have it: the pay-for question, imports, exports, exchange rate movements and their collateral effects, distinguishing exports from imports, global markets, transfer pricing, uncertainty about the application of treaties, potential retaliation, the WTO, state tax implications, and tax administration. As with Wallace Stevens and his blackbird, each time we look at the DBCFT, there are new features that catch the eye.

Despite the many complexities of the proposal, kudos are due to House Ways and Means Committee Chair Kevin Brady, R-Texas, and House Speaker Paul D. Ryan, R-Wis., for their zealous promotion of the DBCFT and especially the destination feature. There are positive aspects to the proposal and an undeniable elegance to its construction. Moreover, it is good and healthy for tax professionals to have something to talk about besides the boring old corporate income tax. So lead on, Republicans. Wherever we go with the destination feature, it has given us much to ponder. ■