United States Congress
Joint Economic Committee
Est. 1946

ISSUE BRIEF

Border Tax Adjustment Would Curtail Profit Shifting and Provide Other Benefits, With Limited Transition Effects

March 11, 2026

Executive summary

- **America's current business tax is a "Made in America" tax, while many other countries tax consumption.** This disadvantages American producers and creates opportunities for multinationals to shift profits offshore—costing the U.S. government 16 percent of corporate income tax revenues as of 2019.
- **Border adjustment changes the U.S. business tax base from production to consumption.** It does so by denying tax deductions for import costs and excluding export revenue from taxable income. This reform does not raise tax rates or add a new tax.
- **Border adjustment is an efficient way to raise tax revenue and curtail profit shifting.** It is economically equivalent to a tariff on all imports, including services, plus a same-percentage subsidy for all exports. The export subsidy neutralizes the trade distortions that tariffs create in isolation.
- **Transition effects, including currency price changes or short-term effects on importer costs, are real but surmountable.** The U.S. dollar has appreciated 27 percent over short periods without crisis, and tariff rates reached 28 percent in the past year. A full border adjustment would entail approximately 27 percent U.S. dollar appreciation, or temporary effective tariff rates much lower than 28 percent.
- **The TCJA and the Working Families Tax Cuts Act (WFTCA) both moved in the direction of border adjustment, but they did not finish the job.** FDDEI partially shields export income from taxation. Legislation can complete the border adjustment by enacting matching tariffs and expanding FDDEI.

In 1966, the top five leading companies by market capitalization were AT&T, IBM, General Motors, Exxon Mobil, and Eastman-Kodak. Now they are Nvidia, Apple, Alphabet, Microsoft, and Amazon.[1] The former group heavily invested in physical plants and equipment, such as factories, wires, and oil wells. Identifying "where" their production took place was easy, and virtually all that production occurred in the U.S. By contrast, the latter five's value is driven by their intangible property—their knowledge, patents, and know-how. Where is this intangible property—embodied in no clear physical form—located? As business value is embodied to a greater extent in intangible assets,[2] taxation based on the location of production now turns on answering this quite philosophical question.

The difficulty of that question provides opportunities for profit-shifting based on the location of intangibles. For example, multinational corporations can strategically choose the location of promising but unproven intangible assets to obtain tax advantages. A U.S. pharmaceutical company can transfer a patent on a yet-to-be marketed drug to a foreign subsidiary based in a low tax rate country where the manufacturing will take place. The sale of the patent will generate current income to the U.S. company, but all of the future profits from the use of the patent will be earned by the foreign subsidiary. On a successful drug, those future profits can far exceed the initial value placed on the patent—and in this way, the pharmaceutical company can shift income from the U.S. to a low tax rate country.[3] How can we limit the use of these completely legal, but arguably not ideal, tax strategies?

What does not work: residence-based taxation

One response is to replace taxation based on the location of production with taxation based on the firm's residence country. For example, a company could be taxed at U.S. rates on *all* its income earned *worldwide* if it has a U.S.-based headquarters. The U.S. tried that—it does not work.[4] Prior to 2017, when the U.S. corporate tax rate was among the highest in the world, the residence-based tax system created large incentives for U.S. companies to "invert," i.e., to move their headquarters to foreign countries to avoid U.S. tax; see Figure 1. With corporate inversions reaching a fever pitch and the potential to lose the headquarters of many large multinationals, Republicans acted decisively in the 2017 *Tax Cuts and Jobs Act* (TCJA) to lower the corporate tax rate and reform international taxation, cutting these perverse incentives. In January 2024, the Tax Policy Center wrote, "[s]ince enactment of TCJA, there have been no major tax-motivated inversion transactions," affirming the reform's long-term success.[5]

---

[1] See Alan Auerbach, "Tax Reform in Theory and Practice," International Institute of Public Finance, August 20, 2017, https://www.iipf.org/Tax_Reform_in_Theory_and_Practice_IIPF_8-20-17.pdf; CompaniesMarketCap, "Largest Companies in the USA by Market Cap," accessed December 10, 2025, https://companiesmarketcap.com/usa/largest-companies-in-the-usa-by-market-cap/.

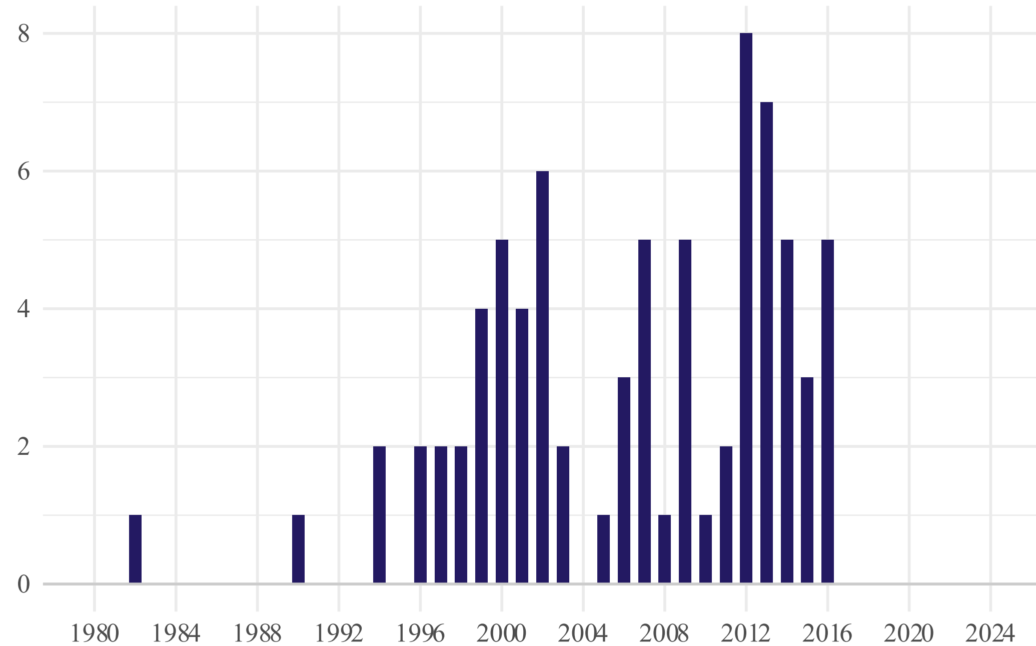
[2] See also Jonathan Haskel and Stian Westlake, *Capitalism Without Capital: The Rise of the Intangible Economy* (Princeton, NJ: Princeton University Press, 2018).

[3] IRS transfer pricing rules require the value of transferred assets to be equal to that at which unrelated parties are observed to pay or would be willing to pay; this is called the "arm's length standard". However, many intangible assets are unique, and hence their arm's length value can be difficult to ascertain. Two other ways firms can shift the location of profits include: inflating the prices of real imports from a foreign subsidiary (this is called "transfer price manipulation") and shifting equity and borrowing so as to create interest tax deductions in higher-tax countries.

[4] The U.S. approach included foreign tax credits to mitigate double taxation.

[5] Tax Policy Center, "What are inversions, and how did TCJA affect them?" The Tax Policy Briefing Book, accessed December 2025, https://taxpolicycenter.org/briefing-book/what-are-inversions-and-how-did-tcja-affect-them.

Figure 1: Number of Corporate Inversions by Year, 1980 through 2023



Source: Michelle Clark Neely and Larry D. Sherrer;[6] Tax Policy Center[7]

Many ideas to mitigate profit shifting follow residence-based taxation principles, including recent proposals to address "round-tripping."[8] These approaches create other adverse effects and can harm U.S. competitiveness. Taxation based on corporate residence has long been tried; it is time to take up a new reform that moves away from residence-based principles.

What can work: destination-based taxation

A powerful way to curtail the major forms of profit shifting is to change the target of taxation to a factor that is easy to observe and largely immobile: a company's customers. The easiest way to do this is by taxing multinationals according to the sales they make to customers in the U.S., less all costs they incur in the U.S. In short, making their taxable income independent of the value they assign to their imports and exports. A border tax adjustment reform makes this change. By eliminating the tax advantage obtained via overstatement of imports, this reform shuts down the core machinery of most profit shifting.

Adoption of this tax reform would affect markets, leading to "transition" effects, but these would be modest and short-lived. Some of these transition effects could be seen as beneficial side effects, while others could be seen as adverse. First, given the sizable U.S. trade deficit, with imports exceeding exports by $1 trillion over the past year, the border tax adjustment would be a tax revenue-raiser. Estimates for the 2017 proposed border tax adjustment suggested it would raise over $1 trillion in the 10-year window.[9]

---

[6] Michelle Clark Neely and Larry D. Sherrer, "A Look at Corporate Inversions, Inside and Out," Federal Reserve Bank of St. Louis, The Regional Economist, February 13, 2017, https://www.stlouisfed.org/publications/regional-economist/first_quarter_2017/a-look-at-corporate-inversions-inside-and-out.
[7] Tax Policy Center, "What are inversions, and how did TCJA affect them?" The Tax Policy Briefing Book, updated January 2024, https://taxpolicycenter.org/briefing-book/what-are-inversions-and-how-did-tcja-affect-them.
[8] E.g., U.S. Senate Committee on Finance, "Wyden, Warner, Warnock, Welch Introduce Crackdown on 'Round-Tripping' International Tax Loophole," press release, June 11, 2025, https://www.finance.senate.gov/ranking-members-news/wyden-warner-warnock-welch-introduce-crackdown-on-round-tripping-international-tax-loophole.
[9] Kyle Pomerleau, "Understanding the House GOP's Border Adjustment," Tax Foundation, February 15, 2017, https://taxfoundation.org/research/all/federal/understanding-house-gop-border-adjustment/.

Potentially up to a third of this revenue increase would be due to the curtailment of profit shifting. Second, if currency prices do not adjust immediately, a border adjustment will act as a temporary import tariff and export subsidy. However, very rapid currency adjustment is predicted by economic theory. Even if currency adjustment is immediate, there will be one-time wealth effects of the policy: U.S. resident holders of foreign assets would experience a reduction in wealth, while foreign holders of U.S. assets would experience an increase in wealth. Because the export subsidy acts to neutralize the economic distortions of the broad-based tariff, a border adjustment would be more efficient than an import tariff adopted in isolation.

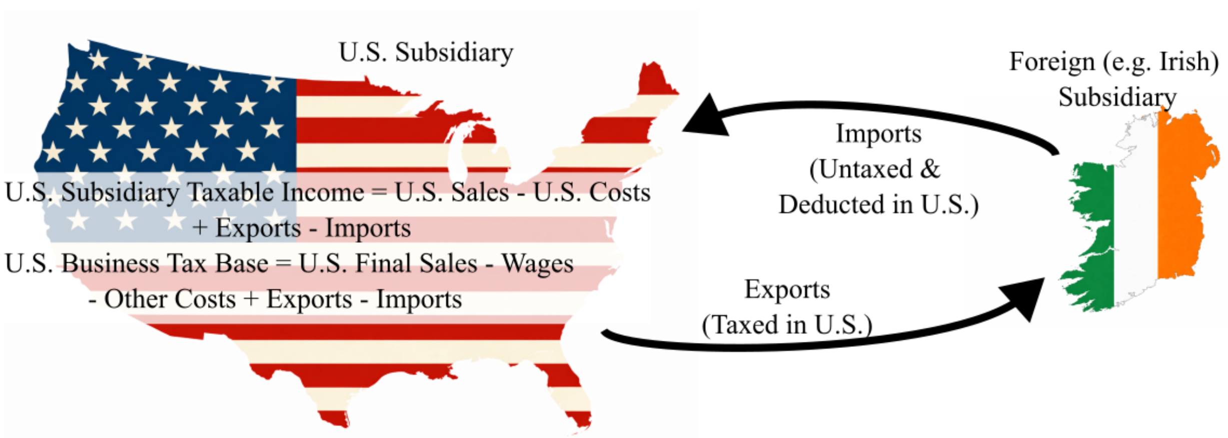
Background and details

Profit shifting today

Profit shifting of U.S. multinationals has long been a concern for the U.S. government. In general, tax administrators struggle to audit imports and exports when they are between domestic and foreign related parties (these are called "controlled" transactions). But the current tax system, as illustrated in Figure 2, relies heavily on these imports and exports to determine a multinational's U.S. taxable income. This exposes opportunities for multinationals to shift profits using imports and exports.

As shown in Figure 2, under the current system, U.S. Taxable Income for a business is its U.S. Sales and Exports, minus its U.S. Costs and Imports ("Foreign Costs"). U.S. costs include intermediate input costs from taxable U.S. businesses, as well as domestic wages. Costs such as net interest deductions are included in "Other Costs". Adding up over all businesses, the intermediate input cost deductions cancel out with business-to-business sales, leaving the tax base as U.S. Final Sales (i.e. Consumer Sales) plus Exports, less Wages, Other Costs (e.g., net interest deductions), and Imports. Profit shifting opportunities arise largely because imports are untaxed and deducted in the U.S., therefore overstating imports can move profits from the U.S. to the foreign country, depicted as Ireland. There is also an incentive for firms to understate U.S. exports, because export revenue is taxed in the U.S.

Figure 2: Current System—Profit Shifting via Imports



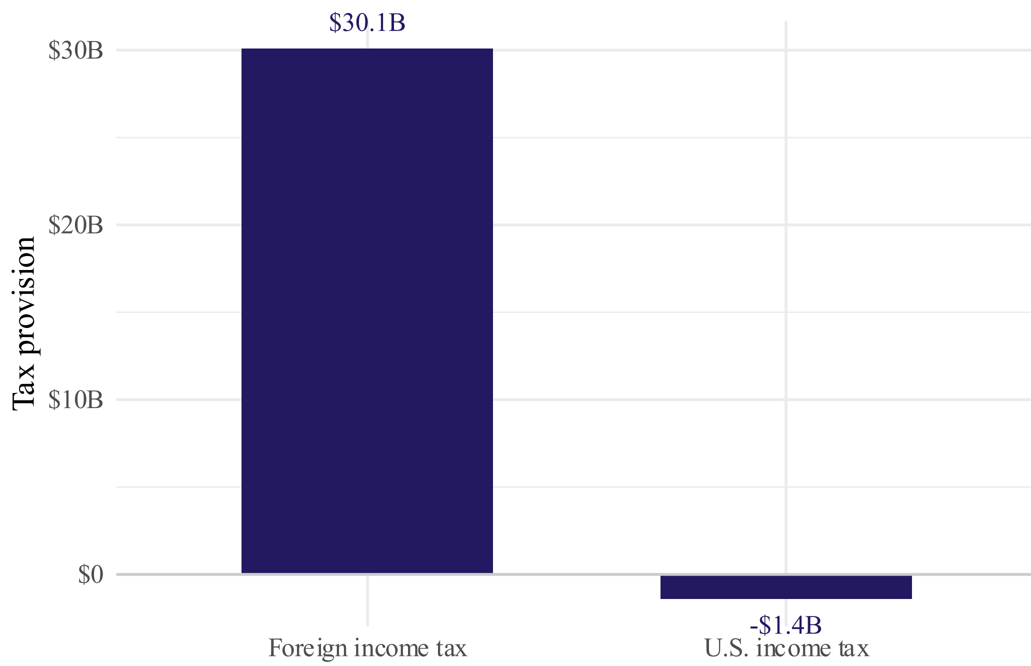
Recent estimates suggest over $160 billion of profits were shifted out of the U.S. in 2019, corresponding to a 16 percent reduction in U.S. corporate tax collections.[10] In addition to the tax base erosion, this profit shifting leads to an overstatement of the U.S. trade deficit, because the value of imports is being

[10] Ludvig S. Wier and Gabriel Zucman, "Global Profit Shifting, 1975–2019," National Bureau of Economic Research working paper 30673 (November 2022), https://www.nber.org/papers/w30673, tables A and B.

artificially inflated to move profits abroad. Some estimates suggest that tax strategies related to profit shifting could drive almost one-third of the trade deficit.[11] In other words, tax reform that meaningfully addresses profit shifting will also reduce the trade deficit.

Examples of profit shifting include high-profile inquiries into pharmaceutical and tech companies—two industries that use significant intangible assets.[12] Considering the former, drug companies have very valuable intangible capital captured by patents that are able to be transferred to foreign subsidiaries. Investigations document that some of these large drug companies book much of their income abroad, despite their income being derived mostly from U.S. sales. As a result, these companies pay little to no U.S. tax, yet significant taxes abroad; see Figure 3. In 2021, some pharmaceutical companies had annual effective tax rates of 7.6 percent.[13]

Figure 3: Total Provision for U.S. and Foreign Income Tax, Major U.S. Drug Companies, 2022 through 2024



Source: Brad W. Setser[14]

[11] Fatih Guvenen, Raymond J. Mataloni Jr., Dylan G. Rassier, and Kim J. Ruhl, "Offshore Profit Shifting and Aggregate Measurement: Balance of Payments, Foreign Investment, Productivity, and the Labor Share," National Bureau of Economic Research working paper no. 23324, revised February 2022, https://www.nber.org/papers/w23324.
[12] Patrick Temple-West, "U.S. Senate panel hammers Apple over offshore tax strategies," Reuters, May 21, 2013, https://www.reuters.com/article/business/u-s-senate-panel-hammers-apple-over-offshore-tax-strategies-idUSBRE94K0AG/; U.S. Senate Committee on Finance, "CROSS-BORDER Rx," hearing, May 11, 2023, https://www.congress.gov/118/chrg/CHRG-118shrg59577/pdf/CHRG-118shrg59577.pdf.
[13] Senate Finance Committee Democratic Staff, "American Patients, American Companies, Offshore Profits," staff memorandum, May 11, 2023, https://www.finance.senate.gov/imo/media/doc/pharma_public_release_final_51123.pdf. However, note that low effective tax rates for a corporation in a particular year could be due to many factors, including investments reducing taxable income via bonus depreciation.
[14] Firms included are AbbVie, Pfizer, Eli Lilly, Johnson & Johnson, Merck, Bristol Myers Squibb, and Amgen. Provisions for Income Tax are from firm SEC filings and may not equal actual tax paid. Brad W. Setser, "American Pharmaceutical Companies Still Aren't Paying Tax in the U.S.," Council on Foreign Relations, March 14, 2025, https://www.cfr.org/blog/american-pharmaceutical-companies-still-arent-paying-tax-us.

Border tax adjustment as a solution

A border tax adjustment would tax U.S. companies based on their U.S. activities only—their U.S. sales less domestic costs. It ignores import and export values in the calculation of taxable income (production costs association with exports remain deductible). This is illustrated in Figure 4. This extinguishes most cross-border profit-shifting opportunities.

As shown by the equations in Figure 4, with border adjustment, U.S. Taxable Income for a business is its U.S. Sales minus its U.S. Costs. Businesses no longer can deduct their imports, and they are no longer taxed on their exports. U.S. costs include intermediate input costs from taxable U.S. businesses, as well as wages and interest deductions (included in "Other Costs"). Adding up over all businesses, the intermediate input cost deductions cancel out business-to-business sales, leaving the tax base as U.S. Final Sales, less Wages and Other Costs (e.g., interest deductions). Because imports and exports are no longer involved in the calculation of U.S. taxable income, profit shifting opportunities are significantly curtailed.

Although there need not be an explicit statutory tariff, because imports are currently deducted from business costs, a tariff at the business tax rate—e.g., via a 21 percent across-the-board tariff to match the corporate rate—can exactly offset the deduction so that the net effect of imports on the combined tax and tariff burden is the same as eliminating the deduction for imports and not applying a tariff.[15] Although there need not be an explicit statutory subsidy, because export revenues are currently taxed, they can be "ignored" by providing them a refund (subsidy) at the business tax rate, e.g. 21 percent.[16] For these reasons, a border adjustment is often said to effectively be an import tariff plus an export subsidy.[17] This is also illustrated in Figure 4.

Under border adjustment, companies still wish to distort their reported financials to avoid taxes, but it is much more challenging for them to do so. Specifically, companies would like to report lower U.S. sales by, for example, disguising U.S. sales as exports, since exports are untaxed. But understating a company's U.S. sales is far more difficult than overstating a company's imports, because the U.S. tax administration has much more accurate information on what companies are doing inside the country than in other countries.[18]

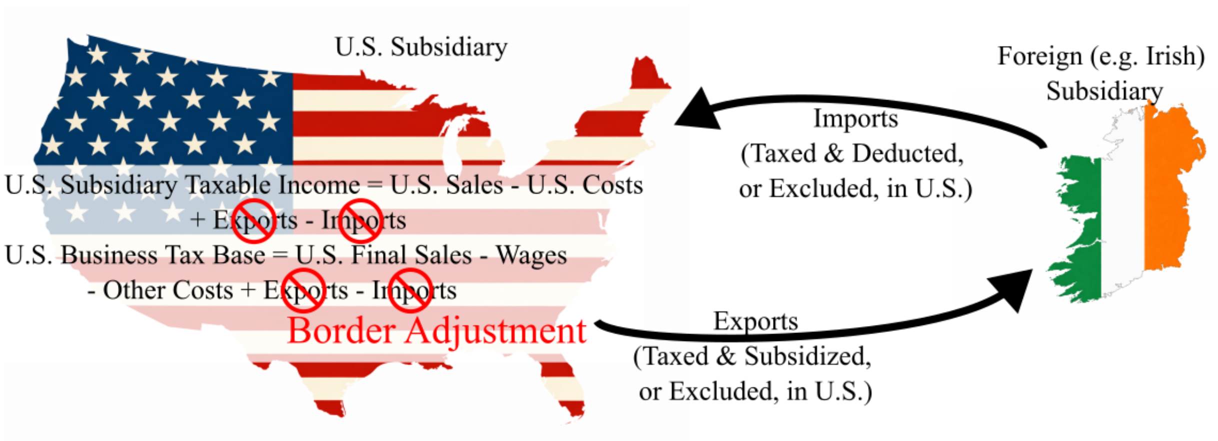
[15] Joint Committee on Taxation, "Destination-Based Taxation and Border Adjustments," JCX-20-17 (May 22, 2017), p. 36, https://www.jct.gov/getattachment/b43569f1-9f22-4dd7-bc08-16a36c8314f2/x-20-17-4993.pdf. A tax deduction for imports means after-tax income declines by only 79 cents for each dollar of imports (holding revenues and other costs unchanged). The addition of a nondeductible 21 percent tariff would cause after-tax income to decline by a further 21 cents for each dollar of imports, resulting in the combined tax and tariff burden to be unaffected by the level of imports. If a deduction is permitted for the tariff, then the tariff rate must be increased to approximately 26.6 percent (i.e., .21/.79) for this result to hold.

[16] Joint Committee on Taxation, "Destination-Based Taxation and Border Adjustments," JCX-20-17 (May 22, 2017), p. 36, https://www.jct.gov/getattachment/b43569f1-9f22-4dd7-bc08-16a36c8314f2/x-20-17-4993.pdf. Because an increase in exports of $1 (holding other revenues and costs unchanged) results in after-tax income increasing by 79 cents, a tax refund (subsidy) at a 21 percent rate that is excluded from taxable income would result in no net tax burden on exports. If the subsidy to exports is included in taxable income, then the subsidy rate must be increased to approximately 26.6 percent (i.e., .21/.79) for this result to hold.

[17] Because at present import tariffs only apply to imported goods, and border tax adjustment would require imported services to also be taxed or, equivalently, not be deductible from taxable income, changes would be required to the treatment of service imports. One approach would be to deny tax deductions for service imports. Full adoption of a destination-based tax system would also require eliminating U.S. tax on the purely foreign operations of U.S. companies, which would include for example rescinding residence-based global minimum taxes.

[18] One case where it may be easy to understate domestic sales is if the sale is to a related party, and thus the sale price is somewhat malleable—a form of "transfer price" manipulation. However, under a border adjustment, such strategies can generally only shift tax liability around subsidiaries within the company, and do not lower the company's aggregate U.S. tax liability. Key to this argument is that sale prices to final domestic consumers—which are almost always arm's length transactions, and based on market prices—cannot be effectively manipulated.

Figure 4: Border Adjusted System—No Import- or Export-Based Profit Shifting



It is useful to note that the part of border adjustment that most effectively combats the headline profit shifting concern—companies with primarily U.S. sales but that avoid most U.S. tax—is the import tariff. Thus, an import tariff alone would meaningfully reduce the opportunities for such profit shifting. The export subsidy is needed to neutralize the market distortions caused by the import tariff,[19] and it also renders irrelevant tax avoidance strategies that involve the manipulation of export prices, since exports would be effectively untaxed.

Border adjustment versus a Value-Added Tax

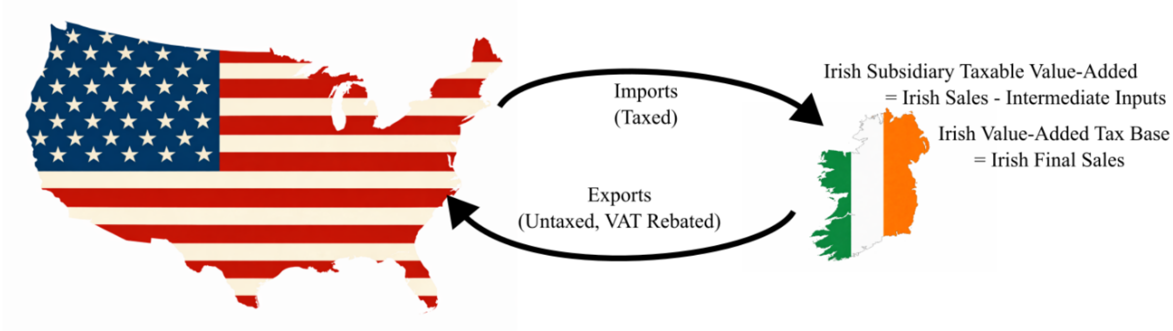
It is useful to compare the border adjustment with a Value Added Tax (VAT), such as is used by many European countries, including Ireland depicted in Figure 5. In a VAT, the taxable value-added for a given company is its sales minus its intermediate inputs; imports are taxed, and exports are exempt from taxation (that is, the VAT is refunded for exports). Thus, for this tax, imports do not provide an opportunity for profit shifting. A VAT is a destination-based tax.20 Under a VAT, the Taxable Value-Added for a business is its sales minus its intermediate inputs. Summing over all taxpayers, the Value-Added Tax Base is Final Sales. This is shown in the equations of Figure 5.

---

[19] While a broad-based tariff is likely less distortionary than particularistic tariffs on certain protected subsectors, it remains a distortionary tax. It acts to distort economic activity away from tradeable goods and services and shrinks the size of the market; see e.g. Douglas A. Irwin, *Free Trade Under Fire.* 5th ed. Princeton, NJ: Princeton University Press, 2020. An export subsidy can be used to neutralize the import tariff, by a theory in economics known as Lerner symmetry.

[20] In practice, VATs are almost always border-adjusted to some extent, although sometimes imperfectly. Technical details notwithstanding, these are destination-based taxes. European VATs are usually refunded fully for exports; see e.g. European Union, "VAT Rules and Rates," Your Europe, accessed December 2025, https://europa.eu/youreurope/business/taxation/vat/vat-rules-rates/index_en.htm. In China, the VAT is inconsistently refunded for exports, and refundability is used as a policy tool; see e.g. Julien Gourdon, Stéphanie Monjon, and Sandra Poncet, "Incomplete VAT Rebates to Exporters: How Do They Affect China's Export Performance?" CEPII working paper no. 2014-05 (February 2014), https://www.cepii.fr/PDF_PUB/wp/2014/wp2014-05.pdf. VATs are almost always fully applied to imports.

Figure 5: Value Added Tax—No Import- or Export-Based Profit Shifting



Border adjustment, like a VAT, exempts exports from taxation, and taxes imports, thereby turning the current U.S. income tax system into a destination-based tax. Due to their destination-based nature, VATs are resilient to many forms of profit shifting. As shown in Figure 4, in contrast to a VAT, wages and interest expense remain deductible from the U.S. tax base under a border adjustment. However, these forms of income remain taxed by the U.S. individual income tax system when they are received by households. They would only not be taxed via the U.S. business income tax system. Figure 6 shows how the VAT compares with the border adjustment of the business tax, highlighting the differences in treatment of wages, interest expenses, and profits. While border adjustment and a VAT are similar in terms of both being destination-based taxes, and therefore much harder to avoid than the current U.S. business income tax, a VAT would add another layer of tax to wages and interest expenses. As a result, adding VAT with an equivalent rate, adopted in isolation, would much more substantially increase the tax burden, especially on labor, than a border adjustment.

Figure 6: Value-Added Tax (VAT) versus Border Adjustment

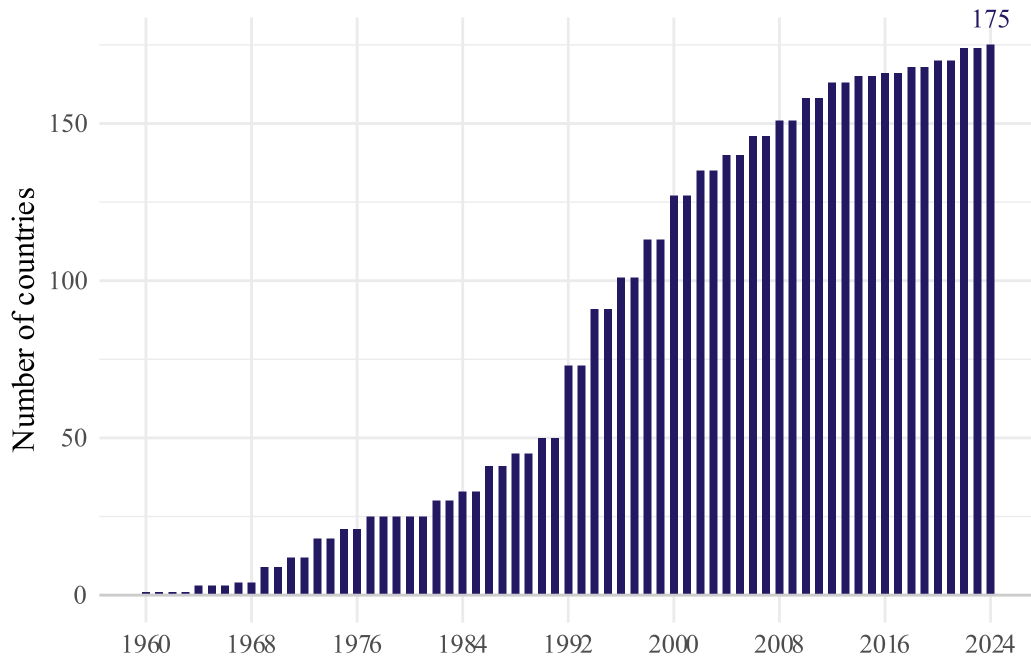
	Value-Added Tax (VAT)		**Border Adjustment of U.S. Business Tax**	
	By VAT	By other taxes	By Business Tax	By other taxes
Not taxed	Exports Domestic inputs Normal profits		Exports Domestic inputs Wages and interest* expenses	
Taxed	Imports (not deducted) Supernormal profits Wages (not deducted) and interest expenses	Wages and interest expenses	Imports (not deducted) Normal* and supernormal profits	Wages and interest* expenses

Note that in Figure 6, "wages" include all labor compensation, e.g. they are inclusive of fringe benefits. Also, as highlighted with an asterisk (*) in the figure, it is important to emphasize that under a border adjustment of the current U.S. business tax, interest expenses would remain untaxed, i.e., they would remain deductible from taxable income. They would still be taxed via the individual income tax. Moreover, due to the lack of expensing for many investments under the current U.S. business tax, in many cases normal profits would remain taxed. Adoption of a cash flow tax would remove the deductibility of interest expense from the U.S. business tax and also include full expensing for all investments. This policy brief focuses on the border adjustment reform and does not assume a cash flow tax is adopted.

Other governments are moving to destination-based taxation.

Global markets, mobile means of production, and intangible capital are pushing governments the world over towards destination-based taxation. The trends are apparent when looking across the globe, and when looking at how states apportion their corporate income tax liabilities. First, consider the Value-Added Tax, or VAT. A VAT is destination-based because it is border-adjusted: a canonical VAT is charged to the value of imports, while exports are refunded their total relevant VAT liability upon leaving the country. As Figure 7 shows, VAT adoption grew to 175 countries by 2024, and 37 of the 38 OECD countries operate a VAT, with the U.S. the exception. This widespread adoption is indicative of a move toward taxation on a destination basis.

Figure 7: Number of Countries with a Value Added Tax



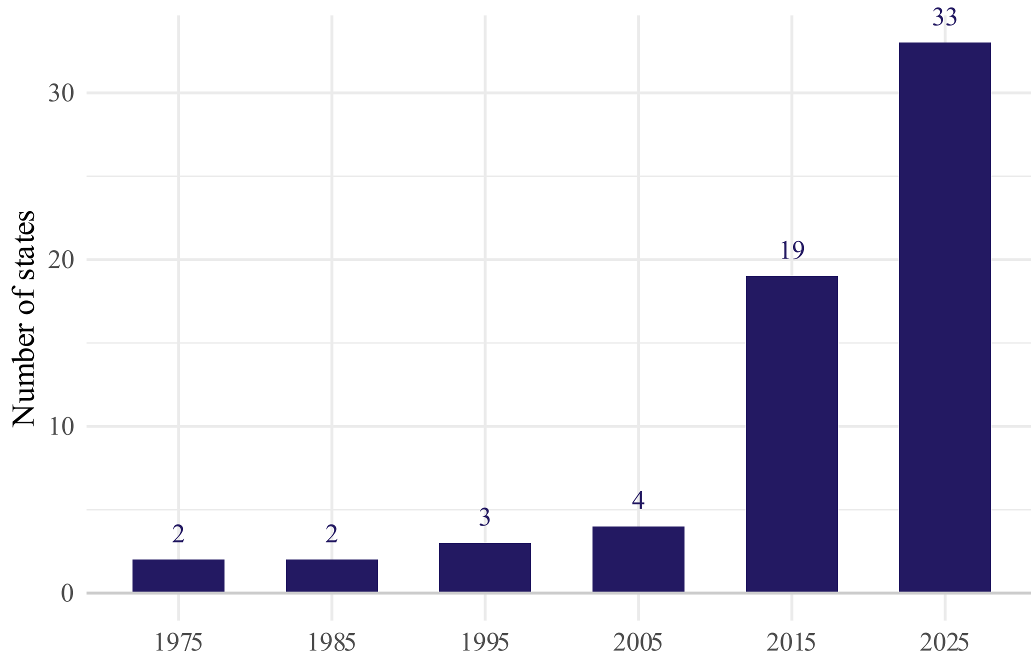
Source: Organisation for Economic Co-operation and Development[21]

Second, consider U.S. state corporate tax apportionment. There are several ways states can determine what share of a multistate business' profits are liable for their state tax. Historically, the most common approaches used the business' sales, property and employment in the state, at least to some extent. However, there has been a widespread movement towards "single sales factor" apportionment, where businesses are liable for a state's taxes on their profits in proportion to their sales in the state. This apportionment method is consistent with destination-based taxation: businesses are taxed based on where their revenues, sales, and customers are located, not where their production is located. In 1975, only two states apportioned their business tax using single sales factor, but today, this number has risen to 33; see Figure 8.[22]

[21] OECD, Consumption Tax Trends 2024: VAT/GST and Excise, Core Design Features and Trends, November 21, 2024, https://doi.org/10.1787/dcd4dd36-en. Reproduced from Figure 1.6, "Countries with VAT 1960–2024."

[22] There has also been a trend away from states using cost-of-performance sourcing to apportion the tax for service businesses to a market-based sourcing approach; see e.g. Anthony Welsch, "The Effect of Market-Based Sourcing on Labor Outcomes," Journal of Public Economics 225 (2023), https://www.sciencedirect.com/science/article/pii/S0047272723001482. This is also a move toward destination-based taxation.

Figure 8: Number of U.S. States Using Single Sales Factor Apportionment



Source: Jared Walczak[23]

A catastrophic transition? Wealth effects and importers

Many of the concerns surrounding border adjustment involve transition effects. Economic theory suggests that a border adjustment will cause the U.S. dollar to appreciate quickly, thereby neutralizing any trade effects. But if currencies adjust quickly as theory suggests, then there will be meaningful one-time wealth effects.[24] Because these are one-time changes in wealth, they are best thought of as a one-time hurdle to jump over. On the other hand, if currency prices take time to adjust, then border adjustment will act as a true tariff plus export subsidy while prices are sticky. This will distort trade for some time, potentially reducing importing retailer margins and increasing the margins of exporters. We can be confident that currency values will eventually adjust, in at most a few years, and thus trade distortions will eventually subside. Thus, trade effects, if any, can also be seen as transition effects.[25]

Much has been researched about the size and uncertainty of these transition effects.[26] Indeed, opponents of border adjustment often point to big and uncertain estimates for these transition effects as a major

[23] For these calculations, 51 U.S. jurisdictions are considered in total (50 states plus DC); Jared Walczak, Tax Foundation.
[24] For an examination of the wealth effects of dollar appreciation, see Dorian Carloni, "How Nominal Foreign Currency Depreciation Against the U.S. Dollar Affects U.S. Wealth," Congressional Budget Office working paper 2018-05 (June 2018), https://www.cbo.gov/system/files/115th-congress-2017-2018/workingpaper/53931-workingpaper.pdf.
[25] Experience with European value-added tax rate changes suggest trade effects will be minimal; see e.g. Youssef Benzarti and Alisa Tazhitdinova, "Do Value-Added Taxes Affect International Trade Flows? Evidence from 30 Years of Tax Reforms," *American Economic Journal: Economic Policy* 13, no. 4 (November 2021): 469–489, https://www.aeaweb.org/doi/10.1257/pol.20190492.
[26] Grant A. Driessen and Mark P. Keightley, "Border-Adjusted Consumption Taxes and Exchange Rate Movements: Theory and Evidence," Congressional Research Service report R44821, April 18, 2017, https://www.congress.gov/crs-product/R44821.

counterargument.[27] But will these effects be catastrophic? No, they will not be. The easiest way to rule out catastrophe is to point to recent history.[28]

First, the U.S. dollar *has* appreciated rapidly over relatively short periods of time in the same magnitude as predicted for a border adjustment without economic disruption. Indeed, for some of these appreciation episodes, few people even remember the dollar appreciated so much. Consider Figure 9, which shows the nominal broad U.S. dollar index, an index of the value of the U.S. dollar across other currencies, weighted using trade flows. A border adjustment at the corporate rate would be expected to yield an approximately 27 percent appreciation of the U.S. dollar.[29] This is comparable to the 27 percent appreciation that occurred between July 2014 and December 2016—and news articles from the time did not make a big fuss about it.[30] During the Great Financial Crisis, from July 2008 to March 2009, the dollar appreciated by 22 percent. Admittedly, that was during a crisis and a "flight to the dollar," but this flight is not widely interpreted as a cause or even a factor exacerbating the crisis, but merely a response to it. More recently, between June 2021 and September 2022, the dollar appreciated 16 percent. Rapid dollar appreciation is clearly not unusual, nor catastrophic.

---

[27] Jason J. Fichtner, Veronique de Rugy, and Adam N. Michel, "Border Adjustment Tax: What We Know (Not Much) and What We Don't (All the Rest)," Mercatus Center at George Mason University, February 23, 2017, https://www.mercatus.org/research/policy-briefs/border-adjustment-tax.
[28] Douglas Holtz-Eakin made remarks analogous to this argument in "Talking Tax Reform: A Discussion of Border Adjustability & Cash-Flow Taxes," Tax Foundation (video), YouTube, February 6, 2017, https://www.youtube.com/watch?v=FO1rlheCigk, 59:37.
[29] $0.21/(1-0.21) \approx 0.27$.
[30] Rich Miller, "U.S. Officials Not Too Worried By Dollar Surging While Central Banks Split on Policy," Bloomberg News, March 16, 2015, https://www.bloomberg.com/news/articles/2015-03-16/dollar-surge-has-u-s-officials-undaunted-as-central-banks-split; Peter Coy, "The Not-So-Almighty Dollar," Bloomberg News, March 19, 2015, https://www.bloomberg.com/news/articles/2015-03-19/fed-s-u-s-dollar-index-shows-rise-isn-t-near-1985-2000-peaks; John C. Williams, "Trick of the Light? The U.S. Economy, Global Growth, and International Risks in Perspective," speech delivered at Lee Kuan Yew School of Public Policy and U.S. Embassy Speaker Series, Singapore, March 29, 2016, Federal Reserve Bank of San Francisco, https://www.frbsf.org/news-and-media/speeches/williams-speeches/2016/03/trick-of-the-light-us-economy-global-growth-international-risks/.

Figure 9: Nominal Broad U.S. Dollar Index (DTWEXBGS)

Source: Board of Governors of the Federal Reserve System[31]

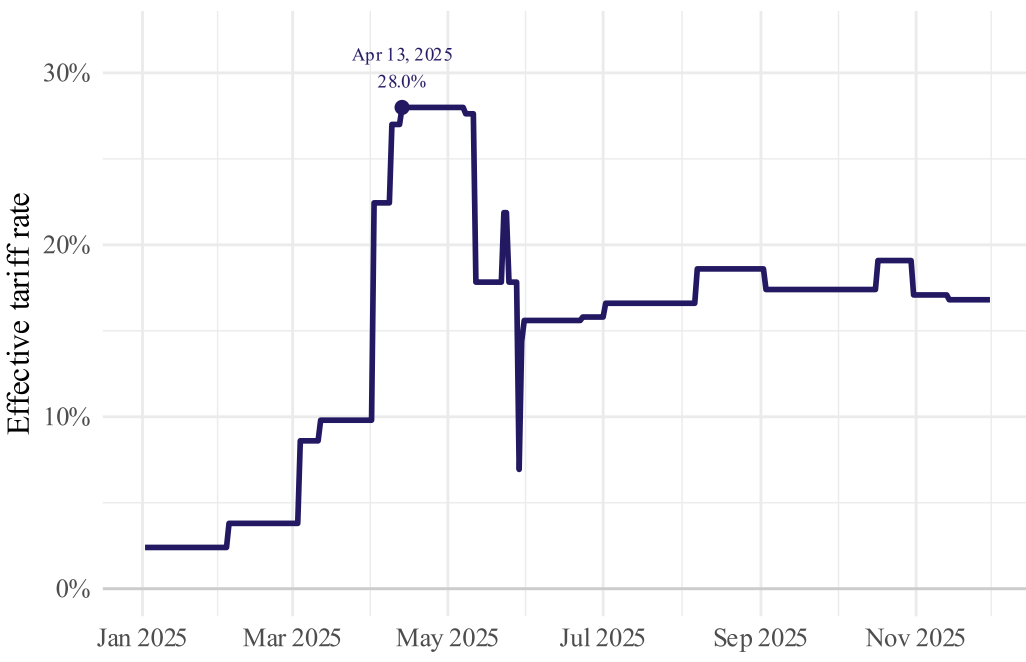
But suppose the dollar does not appreciate rapidly following the adoption of border adjustment. Then border adjustment could imply up to a 26.6 percent tariff for a short period of time, perhaps a year or two, as prices adjust—the effective tariff rate would fall as currency prices adjust, so 26.6 percent would be the peak rate.[32] In the recent past, some would argue that the effects of a short-term 26.6 percent tariff *could* be catastrophic—they would say, "we simply do not know, because there are not any cases of this occurring in recent history!" Well, this has changed in the past year.

Figure 10, using data from the Yale Budget Lab, provides an estimate of the U.S. average tariff rate since the beginning of 2025. In late April, this rate reached 28 percent, above the 26.6 percent implied by a border adjustment with no currency or price adjustment. Since then, it has been between 15 percent and 20 percent. If we look much further back in history, during the 19th century, the tariff rate was above 26.6 percent for many years.[33] While coinciding with the recent tariff increases, there were concerns expressed that the U.S. and potentially world economy would plunge into a recession, that has not happened.[34] In fact, even the effects of the recent tariffs on prices have been more modest than forecasted.[35]

[31] Peaks and troughs highlighted by the authors. Board of Governors of the Federal Reserve System, "Nominal Broad U.S. Dollar Index (DTWEXBGS)," accessed December 18, 2025, https://fred.stlouisfed.org/series/DTWEXBGS.
[32] A 21 percent nondeductible tariff is equivalent to a 26.6 percent deductible tariff. Because current tariffs are tax deductible, the 26.6 percent rate is the appropriate comparison.
[33] See Figure 1 on The Budget Lab at Yale, "State of U.S. Tariffs: November 17, 2025," November 17, 2025, https://budgetlab.yale.edu/research/state-us-tariffs-november-17-2025.
[34] David Lawder, "IMF lifts growth outlook on more benign tariffs as revived US-China trade war looms," Reuters, October 14, 2025, https://www.reuters.com/world/china/imf-lifts-growth-outlook-more-benign-tariffs-revived-us-china-trade-war-looms-2025-10-14/; Paul Wiseman, "Despite U.S. Trade War, OECD Expects Global Economy Will Grow 3.2% This Year," The Associated Press, December 2, 2025, https://www.apnews.com/article/world-economy-tariffs-trade-inflation-oecd-36d49da64d52710d698348c89be79725.
[35] Early estimates from the Yale Budget Lab projected that the 2025 tariff package would increase the U.S. price level by roughly 2.3 percent, but their retroactive analysis showed a much smaller impact of about 1.3 percent; https://budgetlab.yale.edu/research/where-we-stand-fiscal-economic-and-distributional-effects-all-us-tariffs-enacted-2025-through-april, https://budgetlab.yale.edu/research/state-us-tariffs-october-30-2025.

As a qualification, a 26.6 percent tariff rate is a significant overestimate for the "tariff-equivalent" a border adjustment would imply in the short-run, for two reasons. First, currency rates *would* adjust to some extent from the border adjustment (both from the tariff and the export subsidy) even in the short run, reducing this effective rate; and the currency appreciation from the inclusion of the export subsidy is greater than that from a tariff alone. Second, if there were slow currency adjustment, the export subsidy would result in a net benefit to exporting firms during this period of adjustment.[36] Coincidentally, many large firms are both importers and exporters—think of large conglomerate producers or manufacturers—so the same firms that pay the short-run net import tax (i.e., the net of the tariff and the incompletely adjusted dollar appreciation) would benefit from the short-run net export subsidy (i.e., the net of the export subsidy and the incompletely adjusted dollar appreciation).[37]

Figure 10: U.S. Average Effective Tariff Rate in 2025



Source: The Budget Lab at Yale[38]

Practical implementation via FDDEI adjustments and import tariffs

> "I think what we will be converging to is something like a border adjusted business cash flow tax, because… in the Big Beautiful Bill, one of the things we did is expand the various export subsidies for multinationals, and so if you have an… export subsidy plus a tariff plus a payroll tax, then you basically have a border adjusted business cash flow tax." — Kevin Hassett, interviewed by Anna Wong
>
> "'We Lost Control' Over Inflation, Says Kevin Hassett (FULL)," *Bloomberg Podcasts*, YouTube, November 19, 2025, https://www.youtube.com/watch?v=ECFNeNqKQOM, 3:22–3:49.

---

[36] With full currency adjustment, the export subsidy would be neutralized entirely by the relative fall in foreign currency values, as exporters sell their products at unchanged local (foreign) currency prices. But if currency adjustment were slow, there would be an interval of time during which exporters receive a net export subsidy.
[37] J. Bradford Jensen, "Importers are Exporters: Tariffs Would Hurt Our Most Competitive Firms," Trade and Investment Policy Watch (Peterson Institute for International Economics), December 7, 2016, https://www.piie.com/blogs/trade-and-investment-policy-watch/2016/importers-are-exporters-tariffs-would-hurt-our-most.
[38] The Budget Lab at Yale, "State of U.S. Tariffs: November 17, 2025," November 17, 2025, https://budgetlab.yale.edu/research/state-us-tariffs-november-17-2025.

In order to implement a border adjustment, both exports and imports need to be excluded from the calculation of taxable income. Equivalently, relative to the current tax system (assuming for the moment without the additional tariffs implemented in 2025), exports need to be subsidized—their tax liabilities need to be refunded, so that on net they are untaxed—and imports need to be taxed, so that their deduction from business income is cancelled out. Border adjustment can thus be accomplished by subsidizing exports and taxing imports, keeping the remaining tax system as-is.

Under TCJA, the foreign derived intangible income (FDII) provisions could be viewed as a step toward excluding exports from taxation. FDII provided a tax deduction, which ultimately implied a lower tax rate, for exported income deemed to have been derived from intangible assets. In the Working Families Tax Cuts Act (WFTCA) of 2025, FDII has been modified, and most importantly expanded, to apply to far more kinds of foreign- and export-derived income.[39] Reflecting this major change, FDII is now called "foreign derived deduction eligible income," or FDDEI.

FDDEI also can be viewed as a step toward excluding exports from taxation, as in a border adjustment, but it is not of the magnitude necessary for the border adjustment. FDDEI provides a deduction for one-third of eligible foreign income. FDDEI partially shields foreign derived *income* from taxation, but a border adjustment must shield the entire foreign export *revenue* from taxation. In other words, FDDEI reduces the tax on export revenue *less* the cost of producing those exported goods, whereas what is needed for a full border adjustment is reducing the tax (i.e., providing a deduction for) the total of foreign export revenue. FDDEI only applies to C corporations, while a border adjustment would need to cover pass-through businesses as well. Still, FDDEI provides a useful starting point—it gives us legislative scaffolding for a larger and more complete export subsidy.

The other component of border adjustment is taxing imports, i.e. a tariff. We are broadly familiar with import tariffs, although there will need to be special considerations for imported services.

Legislators seeking to move policy in the direction of border adjustment should focus on expanding FDDEI by applying it to a broader base to further exclude exports from taxation, while enacting broad-based import tariffs to pay for the cost of the FDDEI reforms. Given the sizable U.S. trade deficit, with imports exceeding exports by $1 trillion over the past year, tariff revenue under a full border adjustment would exceed the revenue cost of the FDDEI reforms so that such reforms could be enacted in a fiscally responsible manner.

Richard DiSalvo*, Senior Economist*

[39] See explanation on Tax Foundation, "Big Beautiful Bill International Tax Changes," August 6, 2025, https://taxfoundation.org/blog/big-beautiful-bill-international-tax-changes/.