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Corporate tax reform in the wake of the 2025 tax law: Completing the shift to a corporate cash-flow tax

William Gale, Adam Looney, and Elena Patel

JUNE 2026

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MISSION STATEMENT

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth.

We believe that today's increasingly competitive global economy demands public policy ideas commensurate with the challenges of the 21st century. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by fostering economic growth and broad participation in that growth, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments.

Our strategy calls for combining public investment, a secure social safety net, and fiscal discipline. In that framework, the Project puts forward innovative proposals from leading economic thinkers—based on credible evidence and experience, not ideology or doctrine—to introduce new and effective policy options into the national debate.

The Project is named after Alexander Hamilton, the nation's first Treasury secretary, who laid the foundation for the modern American economy. Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces. The guiding principles of the Project remain consistent with these views.

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NOTE: This policy proposal is a proposal from the author(s). As emphasized in The Hamilton Project's original strategy paper, the Project was designed in part to provide a forum for leading thinkers across the nation to put forward innovative and potentially important economic policy ideas that share the Project's broad goals of promoting economic growth, broad-based participation in growth, and economic security. The author(s) are invited to express their own ideas in policy proposal, whether or not the Project's staff or advisory council agrees with the specific proposals. This policy proposal is offered in that spirit.

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Abstract

The U.S. corporate tax is at a crossroads. Originally designed as an income tax, it has been altered in several incremental steps—most recently, with 2025's tax law—that move it partway to a tax on business cash flows. The resulting hybrid has major flaws: It distorts business decisions and creates significant tax avoidance opportunities through inconsistent treatment of different forms of investment and financing, allows numerous targeted subsidies that are inefficient and inequitable and complicate taxes, maintains incentives to shift profits out of the country, and raises too little revenue. The next phase of corporate tax reform should complete the shift to a coherent cash-flow tax. We propose to do so by extending expensing to remaining categories of investment and eliminating deductibility of interest payments, eliminating most tax expenditures, instituting a border adjustment that converts the tax base to U.S. consumption, and increasing the tax rate to 25 percent. These reforms would boost investment and growth, eliminate profit-shifting incentives, simplify taxes, and raise more revenue in a progressive manner.

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I. Introduction

The U.S. corporate tax is at a crossroads. Originally designed as an income tax, it has been altered in several incremental steps—most recently, 2025's major tax law—that move it partway to a tax on business cash flows. A true cash-flow tax has the advantage that it does not distort investment or financing choices. But the hybrid system produced by recent legislation treats different forms of investment and financing differently, distorting investment decisions and creating tax avoidance opportunities. The potential for profit shifting and the plethora of special interest loopholes only exacerbate these problems. Together, these shortcomings reduce investment and growth, create inefficiencies and inequities, and reduce tax revenue.

Rather than continuing to layer new provisions onto the existing hybrid system, the next phase of corporate tax reform should complete the shift toward a coherent cash-flow tax. It should also incorporate a coherent approach to international tax reform, and it should raise more revenue.

To achieve these goals, we propose to fully convert the corporate income tax, which burdens production, to a tax on consumption. This would involve, first, completing the shift to cash-flow tax treatment of investment by allowing expensing for those categories of investment not already covered by recent legislation and eliminating deductibility of interest payments. These changes would set the effective corporate tax rate on new investment equal to zero, versus the current system under which these rates range from positive for certain investments to negative (i.e., tax subsidies) for most categories of investment if financed with debt. Second, we propose to eliminate most business tax expenditures. Third, we propose to tax businesses based on U.S. sales, rather than on U.S. production, known as a border-adjusted cash-flow tax (BACFT). Finally, given that the reformed tax base would eliminate investment disincentives and other economic distortions from any given statutory tax rate, and given that the U.S. fiscal outlook shows a clear need for more revenue, we propose to increase the corporate tax rate to 25 percent. Taken together, these proposed reforms would eliminate tax-related incentives to shift profits or production out of the country, raise substantial revenue, and shift the burden of corporate taxes in a progressive direction.

Section II describes the problems with the current corporate tax system. Section III lays out our policy proposal. Section IV discusses the effects of the proposal. Section V addresses questions and concerns. Section VI provides concluding comments.

II. The challenge

Policymakers face a daunting but resolvable situation with regard to corporate taxation. The goal should be a tax that raises substantial revenue progressively without distorting a firm's economic choices, such as the level or type of investment and financing or the location of production, income, and expenses. The current system of corporate taxation fails on all counts.

A. Investment and financing under a corporate income tax, a cash-flow tax, and the current US corporate tax

1. Corporate income tax

The current corporate income tax treats investment and financing inconsistently, which in turn leads to overly generous treatment of some investments and misallocation of investment across types of assets and financing choices. To understand this issue, it is useful to explain how canonical taxes on income and cash flow are designed. (For details, see Auerbach [2010], Furman [2020], and Patel and McClelland [2017].)

Under an ideal income tax, businesses pay tax on their revenue less their costs of production. Because many investments are long-lived, their costs are deducted gradually over time—through the depreciation deduction—rather than in full when the investment is made. When these depreciation deductions match the asset's true economic decline in value over time (economic depreciation), the effective tax rate on new investment is positive and equal to the statutory rate. This positive tax rate raises the return a project must earn to be profitable.

2. Cash-flow tax

In contrast, under a cash-flow tax businesses pay tax on their net revenue, which is the difference between cash received and cash spent on business activities such as investment, wages, and purchases. The treatment of investment differs sharply from an income tax: Firms are allowed to expense investment costs immediately, rather than deducting costs over time. Economically, this up-front deduction is equivalent to eliminating tax on a "normal" return to the investment, and so the effective tax rate on the normal return to new investment is zero.[1] The tax instead falls only on returns above the normal level—economic rents, sometimes called "excess" or "supernormal" returns. The cash-flow tax therefore preserves investment incentives while raising revenue from highly profitable firms.

3. Current US corporate tax

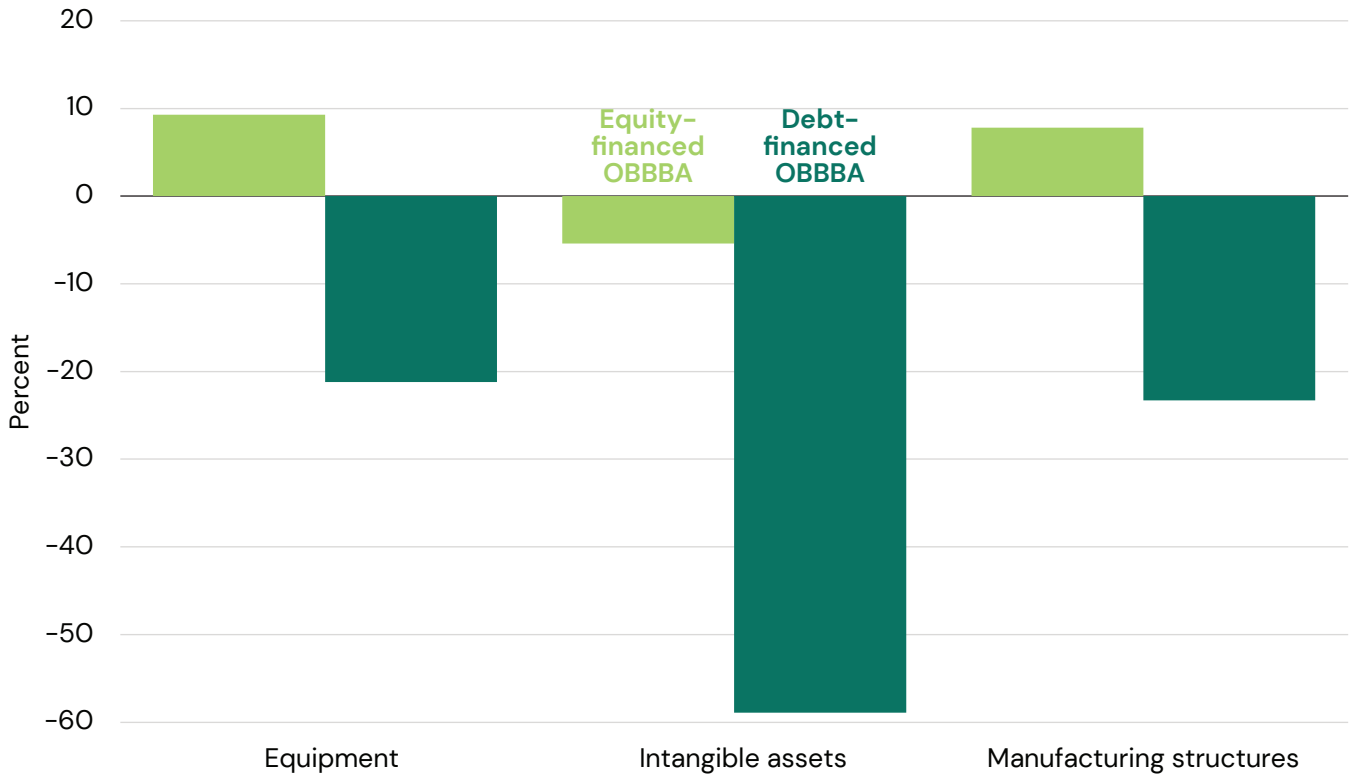
The current U.S. corporate tax is a hybrid of the two systems, and, as a result, it inherits the worst features of both. Beginning in the early 2000s, policymakers repeatedly enacted temporary bonus depreciation provisions that allowed firms to deduct investment costs more quickly than under a traditional corporate income tax; in some periods these changes allowed for full expensing on a temporary basis. These provisions generally applied to investments in short-lived, tangible assets, most notably machinery and equipment, and were repeatedly extended and modified over time (Guenther 2024). The Tax Cut and Jobs Act of 2017 (TCJA; Public Law 115-97) continued this pattern by allowing full expensing, but only on a temporary basis, with phase-outs scheduled under current law (Gale, Hoopes, and Pomerleau 2024).

In 2025, the One Big Beautiful Bill Act (OBBBA; Public Law 119-21) marked a significant shift by making full expensing for machinery and equipment permanent. It also reinstated expensing for domestic research and experimentation (R&E) expenses, reversing the TCJA's shift to delayed deductions for many internally generated intangible investments, and it introduced temporary expensing for some structures (Gale et al. 2026). However, businesses are still required to depreciate the cost of longer-lived investments, such as structures, land improvements, and certain acquired intangibles, over time. The result is that a large majority of, but not all, corporate investment is eligible for expensing.

However, across all of these laws business interest payments remained largely deductible, as would generally be the case under an income tax, although recent reforms have modified the extent of that deductibility. The TCJA introduced limits on interest

FIGURE 1

Marginal tax rates for debt- and equity-financed corporate investment, 2025



Source: Gravelle and Keightley 2025.

Note: Estimates account for the One Big Beautiful Bill Act (OBBBA) of 2025, and for both corporate and individual taxes.

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deductions—generally capping them at a share of earnings—thereby partially removing the tax preference for debt and moving the system closer to cash-flow treatment. OBBBA, however, relaxed these limits by reintroducing a more generous definition of earnings that had phased out under the TCJA, once again expanding the scope for interest deductibility.[2] In contrast, a cash-flow tax does not allow interest deductions at all, treating financing costs as outside the tax base.

Coupling expensing with interest deductibility leads to effective tax rates below zero for some investments and overinvestment in assets that are amenable to debt financing. That is because businesses deduct the value of the investment up front, thus effectively exempting the normal returns from tax; they also deduct the interest payments on the investment, effectively exempting the returns from tax for a second time. The Congressional Research Service (figure 1) has estimated that effective tax rates on debt-financed investment in equipment are substantially negative under current law (Gravelle and Keightley 2025). This outcome is not a feature of either a well-designed income tax or a coherent cash-flow tax; rather, it is an artifact of combining full expensing (cash-flow tax) with interest deductibility (corporate income tax).

B. Shifting income and expense abroad

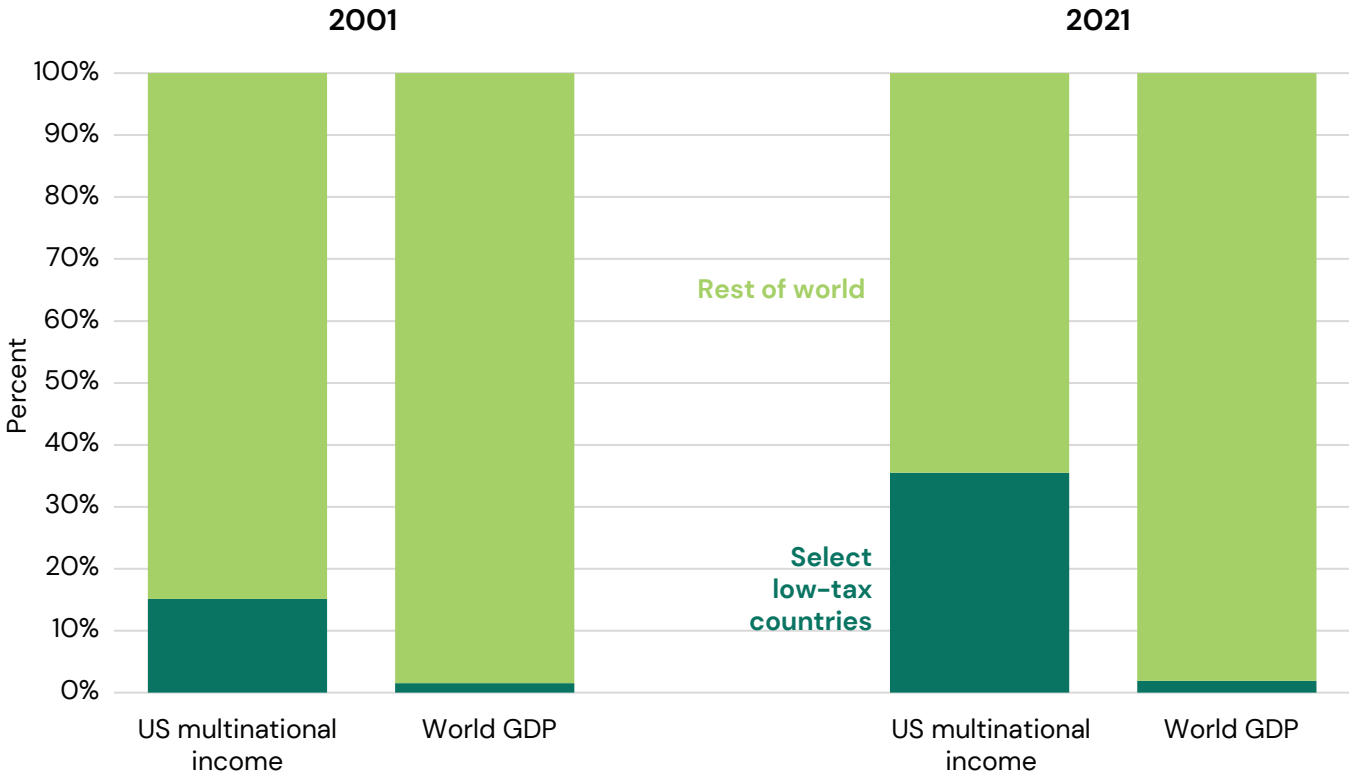
Corporate profit shifting, the practice by which multinational firms book profits in low-tax jurisdictions rather than in the country where the economic activity actually occurs, has been a central feature of the U.S. tax system for decades. Profit shifting reduces U.S. revenues and complicates the tax system significantly.

Profit shifting arises because the U.S. corporate tax is fundamentally production-based: It taxes business income based on where firms are located and where production is deemed to occur, rather than on where goods and services are consumed. This requires firms to allocate profits to particular jurisdictions. Those allocations are inherently difficult to measure and, in practice, can be influenced by the location of intangible assets, transfer pricing, and the placement of real activity. As a result, firms can reduce their tax burden by shifting profits, intangible assets, or real activity to lower-tax jurisdictions.

The incentive to shift profits creates pressure for countries to compete by lowering corporate tax rates in a global "race to the bottom." This incentive in the

FIGURE 2

Share of US multinationals' foreign affiliate income vs. share of world GDP



Source: Bureau of Economic Analysis 2005, 2024; UN Conference on Trade and Development 2026.

Note: Figure is reproduced from the 2025 Economic Report of the President (CEA 2025). Foreign affiliate income is pre-tax income net of income from equity investments, majority-owned affiliates only. Ten jurisdictions: Singapore, Luxembourg, Ireland, Switzerland, Bermuda, Cayman Islands, British Virgin Islands, Anguilla, Turks & Caicos Islands, and Montserrat.

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U.S. tax code has contributed to a long-run decline in U.S. corporate tax revenues relative to the size of the economy and is one of the most significant sources of corporate tax base erosion (Clausing 2020a, 2024). Prior to the TCJA, estimates suggested that the United States was losing about $100 billion annually in corporate tax revenue due to profit shifting (Clausing 2020a).

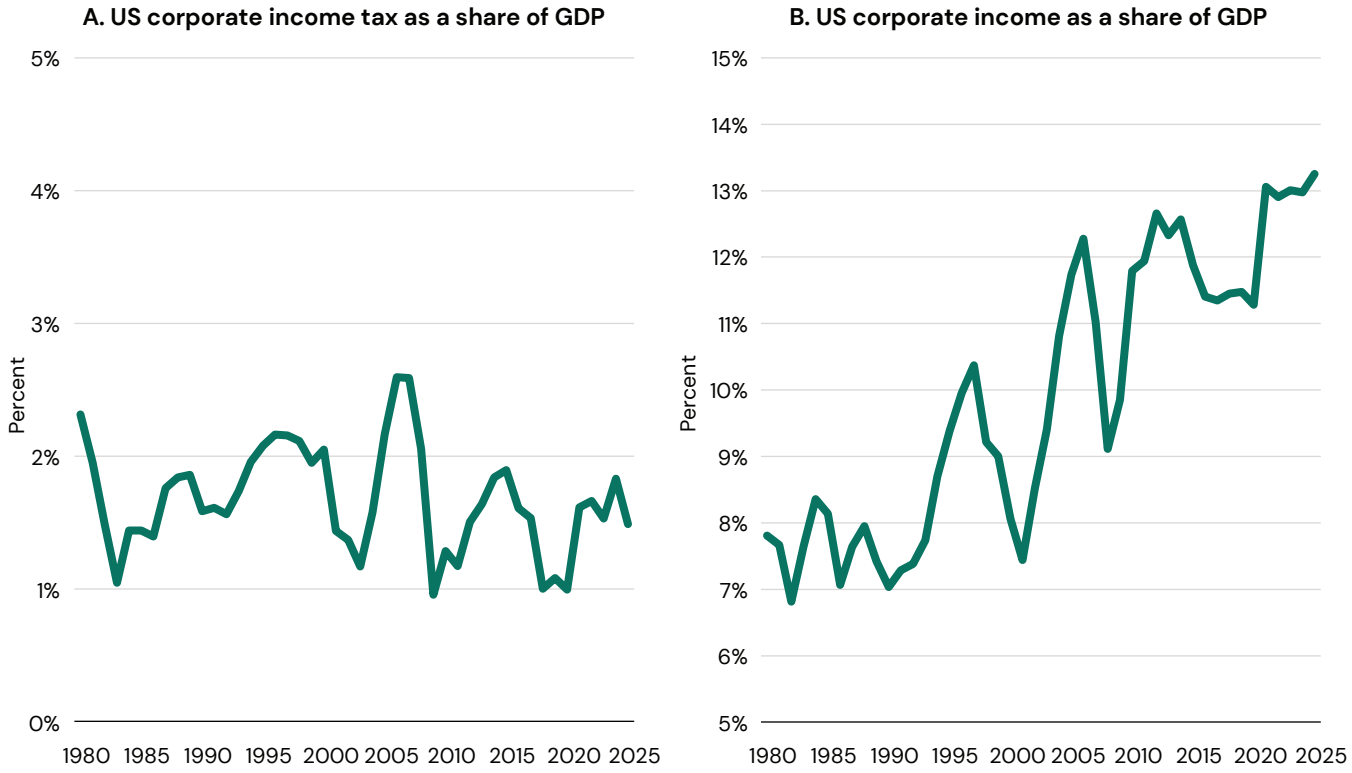
In 2017 the TCJA attempted to address profit shifting by lowering the U.S. statutory rate and introducing new international provisions, including the Global Intangible Low-Taxed Income (GILTI) minimum tax, the Foreign-Derived Intangible Income (FDII) deduction, and the Base Erosion and Anti-Abuse Tax (BEAT) (Gravelle, Keightley, and Marples 2022). However, the empirical research consensus is that the decline in profit shifting since 2017 has been relatively modest (Clausing 2024; Dharmapala 2022; Garcia-Bernando, Janský, and Zucman 2022). One reason for the limited impact is that, while the TCJA reduced some incentives to shift profits, it also created new ones: The law taxes foreign income at lower effective rates than domestic income and exempts a normal return on foreign tangible assets, which can encourage firms to locate real investment—and associated profits—abroad (Gravelle, Keightley, and Marples 2022).

In 2025 the OBBBA took some measures to adjust the international provisions of tax law, most notably by reforming GILTI. OBBBA replaced GILTI with a Net Controlled Foreign Corporations Tested Income (NCTI) tax that eliminated the GILTI exemption on foreign income below 10 percent of firms' tangible assets held abroad (Gale et al. 2026). It also replaced FDII with a broader Foreign-Derived Deduction-Eligible Income (FDDEI) regime, again removing the tangible asset exemption (Bloomberg Tax 2025). Although these changes broaden the scope of the minimum tax, they do not eliminate the underlying incentives created by differential taxation of domestic and foreign income. Firms continue to have incentives to locate profits and investment abroad.

As shown in figure 2 and figure 3, U.S. multinationals continue to report a disproportionate share of profits in low-tax jurisdictions, even as their overall profitability has increased. At the same time, corporate tax receipts have failed to rise with profits and have remained relatively flat as a share of the economy, a pattern that predates the 2017 TCJA rate

FIGURE 3

Multinational profits rise while receipts remain flat



Source: Congressional Budget Office 2026; Bureau of Economic Analysis 2026b.

Note: Figures are reproduced from the 2025 Economic Report of the President (CEA 2025).

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cut. This divergence is consistent with ongoing profit shifting and reflects a corporate tax base that is both shrinking and increasingly fragile.

In contrast to a production-based system, destination-based systems remove incentives to shift profits for the simple reason that they do not base taxes on where profits are earned. Instead, they tie tax liability to where goods and services are consumed. Sales to domestic customers are taxed regardless of where a firm produces or reports profits, while sales to foreign customers are not. Because firms cannot escape the tax by relocating production, destination-based systems are largely insulated from profit shifting and face much weaker pressure to compete through lower corporate tax rates (Auerbach 2010; Joint Economic Committee 2026; Patel and McClelland 2017).[3]

Rather than undertaking fundamental reforms to the structure of corporate taxes, U.S. policymakers have so far responded to international tax competition by reducing rates and creating a growing set of layered rules. The TCJA introduced a series of provisions designed to limit the most aggressive forms of profit shifting while preserving the underlying source-based framework. More recently, the Corporate Alternative Minimum Tax (CAMT) extended this approach by imposing minimum effective tax rates on certain income. While these measures can raise revenue and constrain certain avoidance strategies, they do not eliminate the basic vulnerability of a production-based tax to international competition. Instead, they add complexity and carve out special rules for particular types of income or firms (Patel 2024).

As long as corporate income is taxed based on where firms produce rather than where they sell, international competition is likely to translate into continued pressure on rates, ongoing profit shifting, and a further layering of complex policy responses rather than a stable and reliable source of revenue.

C. Tax expenditures

Corporate income tax expenditures are provisions—such as credits, deductions, exclusions, and preferential rates—that reduce corporate tax liability relative to a "normal" tax base. They are often described as "spending through the tax code" because they function similarly to direct government outlays by subsidizing specific activities or industries (Government Accountability Office [GAO] 2016; Griffith et al. 2021; Peter G. Peterson Foundation 2025). There are dozens

of such provisions, spanning a wide range of policy areas, from research and development to housing, energy, and international taxation.

Taken together, these provisions substantially narrow the tax base. Their fiscal cost is large, on the order of hundreds of billions of dollars per year and estimated to reach into the trillions over the next decade (U.S. Department of the Treasury 2026). Estimates indicate that corporate income tax expenditures can amount to roughly 60 percent of corporate income tax receipts (Peter G. Peterson Foundation 2026). As a result, the statutory corporate income tax rate is applied to a much smaller tax base, reducing revenue and increasing pressure to rely on a higher rate or new taxes to meet revenue goals.

A well-designed corporate tax should instead rely on a broad and neutral tax base. While a small number of corporate income tax expenditures are widely used, are relatively effective, and serve clear economic purposes—including certain clean energy and R&E credits—most are narrow, targeted incentives that largely serve special interests, are of questionable effectiveness, and often significantly complicate taxes through eligibility rules, phase-outs, and interactions with other provisions (GAO 2016; Keightley and Marples 2023; Sammartino and Toder 2020). Substantially limiting corporate income tax expenditures is therefore central to restoring a broader tax base, improving neutrality, and supporting a more-efficient and more-sustainable corporate tax.

D. Revenue

U.S. corporate tax revenues, measured relative to the size of the economy, have declined substantially over time. In the late 1940s they amounted to roughly 3 to 4 percent of GDP (Office of Management and Budget [OMB] 2026). Over time, however, this share declined markedly, and by the 1980s and 1990s it had fallen to 1.5 to 2 percent of GDP. Since then, revenues have fluctuated around that lower level, but with a further decline immediately following the passage of the TCJA, when receipts fell to about 1.0 to 1.1 percent of GDP (see figure 3a). Although revenues recovered somewhat in the early 2020s, they have remained below earlier postwar levels, with projections suggesting a long-run level near 1.2 to 1.3 percent of GDP (Congressional Budget Office [CBO] 2026). In the years after 2020, corporate tax receipts recovered somewhat, driven in large part by post-pandemic economic conditions, including strong profit growth and inflation. The surge in economic activity, high inflation, and strong corporate profits in 2021–2022 significantly boosted tax receipts, pushing them back up to around 1.6 to 1.8 percent of GDP but still below historical averages (CBO 2025; Gale, Pomerleau, and Rosenthal 2022; OMB 2026).

Overall, the pattern is one of a substantial long-run decline in the revenue raising power of the corporate tax, even as corporate profits have risen as a share of GDP, especially in recent years (figure 3b). Several structural factors explain this long-term decline: the increasing ability of multinational firms to shift profits abroad; the increasing role of the pass-through business form; the cut in statutory corporate rates in 2017; and generous tax expenditures (Clausing 2020b; Keightley and Marples 2023; McBride, Kraschel, and Li 2026). These trends underscore a central challenge for corporate tax policy: restoring a stable and adequate revenue base that better reflects the scale of corporate profits without introducing more distortions or complexity.

III. The proposal

We propose that the U.S. transition the current corporate tax to a border-adjusted cash-flow tax with a broad base. The proposal contains four components, which would work best if implemented together but could improve the tax system even if not implemented as a complete package, as discussed below. The four components are as follows:

- Convert the corporate tax base to a cash-flow tax base.
- Eliminate most targeted tax expenditures.
- Border-adjust exports and imports.
- Raise the statutory corporate tax rate to 25 percent.

Taken together, this package would increase investment, simplify the corporate tax, reduce distortions, and raise revenue in a progressive manner.

Our proposal builds on prior reforms and addresses the weaknesses created by the combination of income tax and cash-flow tax principles in the current corporate tax system. Rather than attempting to reverse the shift toward cash-flow taxation that has occurred over the past two decades, the proposal completes the transition by aligning the treatment of investment, financing, and international income. Domestically, this means completing the shift to expensing and, even more important, eliminating the deductibility of interest payments; rebuilding a broader and more neutral tax base by eliminating various tax expenditures so as to support greater revenue even in a system with stronger investment incentives; and raising the statutory rate to take advantage of the opportunity that a cash-flow tax creates to capture additional revenues without disincentivizing investment. Internationally, it means shifting the corporate tax base toward domestic consumption, thereby eliminating incentives for profit shifting and pressure to compete through ever-lower statutory rates.

The reforms proposed here apply to nonfinancial corporations. For these firms, borrowing and lending are financing activities rather than core business operations. Interest income and expense largely reflect how investment is financed and how excess cash is managed, not the production of goods and services. Additional rules would be needed for financial firms, as discussed in Section V. Questions and concerns.

A. Convert the corporate tax base to a cash-flow tax

The base for a cash-flow tax is the net cash generated by a business over time. Cash received from sales is included in the tax base, while cash spent on investment is deducted immediately. Borrowing and repayment of principal and interest do not affect taxable income. In this way, the tax base reflects the cash generated by a firm's real activities, rather than accounting conventions such as depreciation schedules for investment expenses.

The cash-flow tax is therefore designed to tax businesses in a way that minimizes the influence of taxes on real economic decisions. Rather than attempting to measure income after accounting for depreciation, financing costs, and other adjustments, a cash-flow approach focuses on net cash receipts. By reducing the need for complex accounting rules and timing adjustments, it aims to raise more revenue than the current system, without distorting investment and financing choices and with lower administrative and compliance costs than under an income-based system. The key to these effects is that the cash-flow tax sets the effective tax rate on new investment equal to zero (Furman 2020).

An easy way to understand cash-flow taxation is to note that if the corporate tax featured two changes—expensing of all investments and no interest deductions (setting aside tax expenditures)—it would be a cash-flow tax. We discuss each proposed reform in turn.

The immediate deduction of investment costs is a central feature of a cash-flow tax. The OBBBA of 2025 moved the U.S. corporate tax most of the way toward full expensing by permanently extending 100 percent bonus depreciation for machinery and equipment (or asset classes with lives less than 20 years) (Cunningham, McLaughlin, and Messner 2026). Our proposal would extend this treatment to *all* investment, including structures, land, and intangibles.

As discussed above, a major shortcoming in OBBBA's move toward a cash-flow tax is the continued deductibility of interest payments. Under a cash-flow tax, interest payments, like dividend payments, are not deductible. As a result, the tax system does not favor one method of financing new investment over another: Firms face the same tax treatment whether an investment is funded with debt or with equity. Taxes, therefore, depend only on the profitability of an investment rather than on how it is financed. Together with immediate expensing, this treatment ensures that both investment and financing decisions reflect underlying business considerations rather than tax incentives (Auerbach 2010; Patel and McClelland 2017). Our proposal would eliminate the interest deduction, with targeted modifications for intra-group and related-party transactions as described in Section V. Questions and concerns.

As discussed below, full implementation of a cash-flow tax requires additional rules to address both the transition and the ongoing implementation issues for firms with negative cash flow.

B. Eliminate most targeted tax expenditures

A cash-flow tax is most effective when paired with a broad and neutral tax base. Because investment costs are deducted immediately, and financing choices are treated neutrally, the system is designed to let market returns, rather than tax advantages, guide where and how firms invest. Targeted deductions, credits, and special regimes move the tax system away from this objective by favoring some activities or industries over others. While some such provisions may be adopted to pursue specific worthwhile policy goals, they introduce distortions and complexity that a cash-flow tax is otherwise designed to avoid.

In a system with permanent expensing and neutral treatment of financing, most investment credits become redundant or distortionary and should be eliminated. This includes a wide range of narrowly targeted credits—such as hiring incentives, firm-specific subsidies, and other industry- or activity-specific preferences—that are not tied to clear, well-documented externalities and are often poorly targeted to marginal investment decisions. Taken together, these provisions account for tens of billions of dollars in forgone revenue annually (U.S. Department of the Treasury 1996-2027). Eliminating such preferences would broaden the tax base, reduce distortions across activities and asset types, and simplify the tax system.

Any remaining exceptions should be limited to activities that generate large, well-documented positive economic spillovers ("externalities") that are not addressed by neutral tax treatment alone. There is, for example, a strong case for continued support of R&E. Knowledge created through private R&E generates benefits that spillover to other firms and to the broader economy, and these benefits are difficult for the investing firm to fully capture. As a result, private investment in R&E remains systematically below the socially optimal level even under the cash-flow tax (Gravelle and Keightley 2026). A targeted R&E credit can help make up the difference.

A similar logic applies to clean energy investments. Environmental damages from greenhouse gas emissions are not reflected in market prices (Nordhaus 2019). In the absence of a comprehensive carbon tax, well-designed clean energy credits can serve as a second-best tool for reducing emissions. To be consistent with a broad tax base, however, such credits should be technology-neutral, clearly linked to emissions outcomes, and commensurate with the emissions benefits they generate.

Understanding these provisions as spending programs has practical implications for their design. Under a cash-flow tax, some firms—particularly those making large investments or those with significant export sales—may have little or no tax liability against which to claim credits. If credits can only offset positive tax liability, their value depends on a firm's tax position rather than on the underlying activity the credit is meant to encourage.

To ensure that support reaches intended recipients regardless of tax status, R&E and clean energy credits should be refundable or transferable. Refundability allows firms to receive the credit as a direct payment when liability is insufficient; transferability allows firms to sell unused credits to other taxpayers. Either approach treats the credit as what it functionally is: a government expenditure to support a specific activity, administered through the tax system for convenience rather than as a feature of the tax base itself.

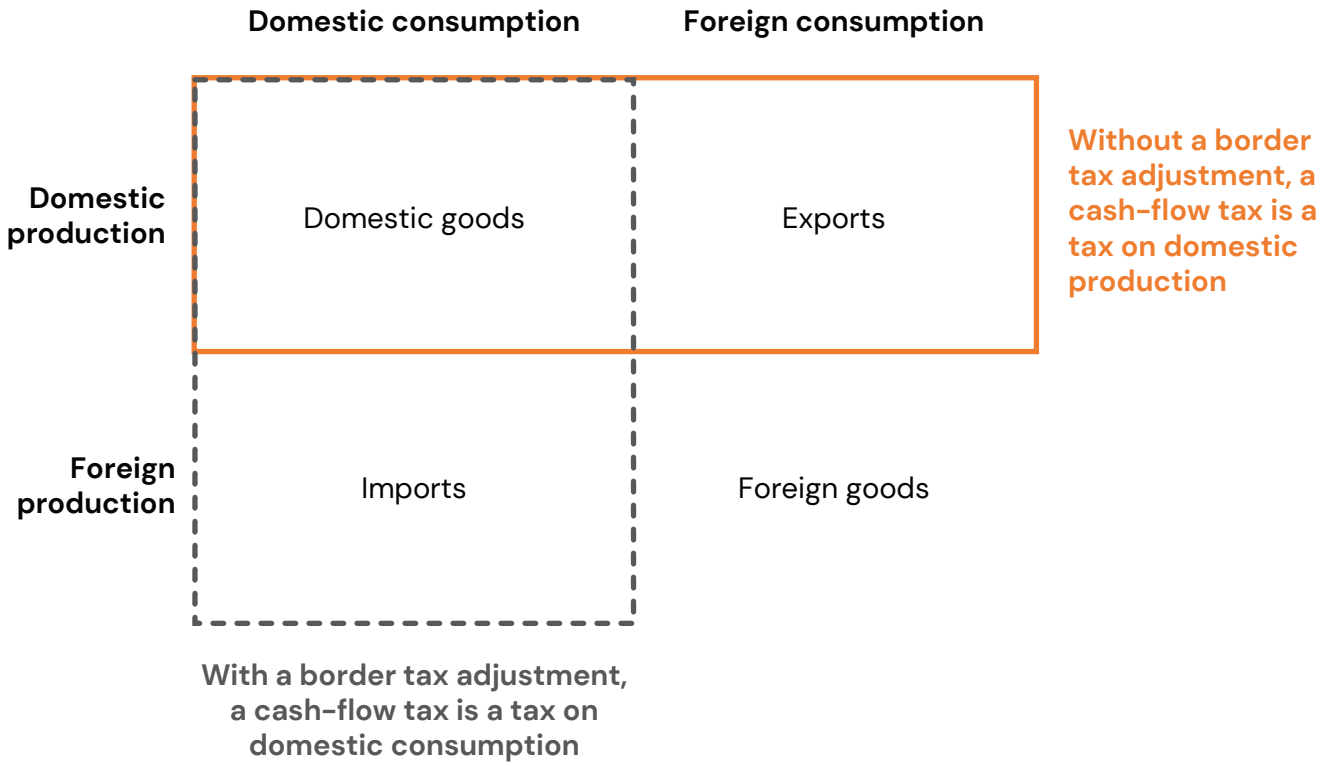
Outside of these narrow cases, most credits and sector-specific preferences weaken the tax base without addressing policy-relevant externalities (GAO 2016; Sammartino and Toder 2020). Eliminating such provisions would simplify the corporate tax, reduce distortions across activities and asset types, and restore revenue capacity in a system with stronger investment incentives. A durable cash-flow tax therefore depends not only on coherent treatment of investment and financing, but also on discipline in limiting exceptions to those grounded in compelling and persistent spillovers.

C. Border adjust the cash-flow tax

A destination-based tax is implemented through border adjustment (i.e., by exempting export sales from tax and taxing imports) so that the tax liability depends on where goods and services are consumed rather than

FIGURE 4

Border tax adjustment converts a production tax to a consumption tax



Source: Authors' analysis (Gale, Looney, and Patel 2026).

on where they are produced. This converts the cash-flow tax from a tax on production to a tax on consumption (figure 4). Under this approach, goods sold into the U.S. (imports) are taxed, while goods sold out of the U.S. (exports) are not. In practice, the tax is applied at the corporate tax rate to the value of imports, and that same tax is removed from exports (often described as an equal "subsidy"). As a result, a firm's tax burden depends on where its customers are located rather than where it produces goods and services. Sales to domestic customers are taxed regardless of where production occurs, while sales to foreign customers are not, regardless of where production occurs.

The economic rationale for border adjustment is threefold. First, it eliminates profit-shifting incentives. Under a production-based tax, firms can reduce their tax burden by relocating profits, intangible assets, or production to lower-tax jurisdictions. Under a destination-based (or consumption-based) tax, tax liability depends on where customers are located—something firms cannot easily relocate. Second, it insulates the U.S. corporate tax from the international "race to the bottom" in corporate income tax rates. Because firms cannot reduce their U.S. tax liability by shifting production or intangibles elsewhere, U.S. tax policy is less constrained by international tax competition and can be set based on domestic revenue and distributional objectives without fear of driving away investment. Third, it broadens the tax base and increases revenue capacity because the United States persistently imports (i.e., consumes) more than it exports (i.e., produces) (Auerbach 2010; Joint Economic Committee 2026; Viard 2017).

The border adjustment does not introduce a new layer of international tax policy so much as reframe existing trade instruments within a coherent tax framework. Pairing a tariff on imports with a symmetric export subsidy makes destination-based taxation a structural feature of the tax base rather than an ongoing exercise in managing avoidance through layered minimum taxes, preferential regimes, and other targeted provisions.

Symmetry is essential to this design. The border adjustment proposed here is fundamentally different from a stand-alone tariff regime, and the two should not be conflated. Tariffs imposed in isolation function as trade protection, while export subsidies in isolation operate as production subsidies. A tariff alone raises the cost of imports without offsetting the burden on exporters and distorts production and consumption

decisions. The revenue it generates comes at the cost of economic efficiency, consumer welfare, and trading-partner relations. To preserve neutrality, the tariff and export subsidy must be applied at the same rate as the corporate tax (Viard 2017). When paired at a common rate, the two instruments form a trade-neutral adjustment that shifts the tax base toward domestic consumption without distorting production or trade patterns.

As discussed in Section V. Questions and concerns, unilateral U.S. implementation of a destination-based tax would pose some challenges that would not arise if this approach were to be adopted on a multilateral basis. Nonetheless, in our view the benefits of the shift outweigh the risks.

D. Raise the statutory rate to 25 percent

In principle, the statutory corporate tax rate is and has always been a policy parameter set by lawmakers to achieve revenue and distributional objectives, given a well-defined base (Keightley and Marples 2023).

By first rebuilding a broad and internally consistent cash-flow base, our proposal restores the corporate rate to its intended role. Rather than compensating for structural weakness in the tax code or responding to global tax competition, the rate can once again be adjusted to meet revenue objectives without reintroducing distortions or instability.

Moreover, because the cash-flow base taxes only economic rents (i.e., "excess" returns above the normal rate of return on capital) a higher rate does not discourage new investment in the way that higher rates under an income tax would. The normal return is untaxed regardless of the rate, so the investment incentive is preserved even as revenue increases.

This is a central fiscal advantage of a cash-flow tax: It creates room to raise the corporate rate without the efficiency costs that rate increases impose under income-based systems. Policymakers can choose a rate consistent with different fiscal goals, whether maintaining revenue neutrality, increasing corporate tax revenues, or aligning domestic rates with multinational goals in mind. This can be done without relying on narrow preferences, minimum taxes, or complex anti-avoidance rules.

Particularly given the current U.S. fiscal outlook, we recommend that policymakers take advantage of the reduced economic distortions under a cash-flow tax to increase the tax rate.

Specifically, we recommend a rate of 25 percent. This rate reflects several considerations. First, 25 percent is still well below the pre-TCJA statutory rate of 35 percent. Second, it is roughly in line with the average statutory corporate rate across Organisation for Economic Co-operation and Development (OECD) countries, positioning the United States competitively without engaging in rate-cutting competition (OECD 2025). Third, at 25 percent the tax raises substantial new revenue. Fourth, raising the rate helps capture revenue from gains of previously made corporate investments.

This choice also reflects the fact that, under a BACFT, the statutory rate applies symmetrically to imports and exports and is therefore trade-neutral in economic terms. At the same time, the statutory rate determines the magnitude of the border adjustment applied at the border. A 25 percent rate implies adjustments of a scale that would be large relative to current U.S. tariff levels—though not comparable in economic effect—and higher rates could increase incentives for avoidance or evasion. For that reason, 25 percent should be viewed as a reasonable benchmark.

IV. Effects of the proposal

Besides raising significantly more revenue than under the current system, our suite of proposals would make the corporate tax less distortionary and simpler. They would boost investment, eliminate tax distortions across assets, eliminate incentives for profit shifting, and make the corporate tax more progressive. We discuss each—revenue effects, investment behavior, distributional effects, and simplification—in turn.

A. Revenue effects

Revenue estimates are based on a standard cash-flow tax framework that builds on Patel and McClelland (2017), calibrated to the most recent Congressional Budget Office (2026) projections of corporate tax receipts under current law. The analysis begins with the current corporate income-tax base and converts it into a "real" (R-base) cash-flow tax—one that excludes financial firms—by changing the treatment of investment, financing, and the scope of the tax base.

The estimates presented herein should be viewed as illustrative, in that they are static and do not incorporate behavioral responses, transition effects, or macroeconomic feedback. For example, they account for neither reduced profit shifting nor any new avoidance strategies that might emerge under a destination-based tax. The estimates assume no change in the U.S. trade balance and no changes in relative prices over time in response to the border adjustment. Additionally, they assume that the distribution of the corporate tax base is largely unchanged from the 2004–13 period; for example, they assume that financial flows, investment, and interest expense comprise the same share of the corporate tax base.[4]

The conversion proceeds in two stages. First, the base is limited to nonfinancial corporations, reflecting the focus of the proposal on real business activity. (As discussed below, different rules would be needed for financial corporations.) We estimate that this reduces projected 10-year tax receipts from $5.0 trillion for all corporations to $4.1 trillion for nonfinancial corporations. Second, the nonfinancial income-tax base is converted to a cash-flow base through two adjustments: Interest income and interest deductions are removed from the base, and all real investment is expensed immediately. Taken together, these adjustments increase the size of the base by roughly 10 percent relative to the nonfinancial income-tax base; removing interest income and deductions increases the base by about 13 percent, while extending full expensing reduces it by roughly 3 percent.[5]

At the current statutory rate of 21 percent, converting to a domestic cash-flow base increases revenue on the order of $400 billion over 10 years. Repealing corporate tax expenditures could raise another roughly $200 billion. Increasing the rate to 25 percent raises an additional roughly $900 billion over 10 years, taking into account the larger base.

Adding border adjustment to this cash-flow base increases revenue substantially because the United States persistently imports more than it exports. As a result, a BACFT would raise significantly more revenue at any given rate. At a 21 percent rate, the BACFT would raise approximately $7.3 trillion over the next decade, nearly double projected revenues under current law. At higher rates of 25 percent and 28 percent, revenues increase to $8.7 trillion and $9.8 trillion, respectively.

Table 1 summarizes projected 10-year corporate tax revenues under alternative base definitions and statutory rates of 21 percent, 25 percent (the proposal), and 28 percent. The estimates illustrate two key points. First, moving from the current income tax to a domestic cash-flow base modestly increases revenue capacity even without border adjustment. Second, applying border adjustment substantially expands the base, and, in turn, expands revenue capacity, creating significant fiscal room at any given rate.

Taken together, these estimates highlight the revenue potential of the proposed reform at the benchmark 25 percent rate. Under current law, nonfinancial corporate tax revenues amount to roughly 1.0 percent of GDP over the budget window. Converting to a domestic cash-flow base, repealing most corporate tax expenditures, and raising the statutory rate to 25 percent raises this to approximately 1.4 percent of GDP, thus bringing revenues for the nonfinancial corporate sector back into the range of total corporate tax revenues observed prior to the TCJA, despite the narrower (i.e., nonfinancial firm) base. Applying border adjustment increases revenues further to about 2.2 percent of GDP, roughly the revenue raised by the corporate tax in the late 1990s (OMB 2026). These results

TABLE 1

Ten-year projected corporate tax revenue under alternative bases and rates

		10-year revenue ($T)		
	Tax base	21 percent	25 percent	28 percent
Current non-financial profit tax	32.5	4.1		
Domestic cash-flow tax	35.9	4.5	5.3	6.0
Repeal expenditures		4.7	5.6	6.3
Border-adjusted cash-flow tax	55.9	7.3	8.7	9.8

Source: Authors' analysis (Gale, Looney, and Patel 2026).

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underscore that a broader BACFT can generate substantially more revenue while maintaining neutrality with respect to investment and financing decisions.

Of particular note, our estimates show that our proposed reform has the potential to more than replace the revenues currently projected from tariffs. Because the border adjustment replaces the current tariff regime with a symmetric import tax and export subsidy, these revenues would no longer be available under the proposal. As a result, revenue gains from border adjustment should be evaluated net of the repeal of existing tariff revenues, rather than relative to a no-tariff baseline.

The most recent Congressional Budget Office projections include roughly $3.0 trillion in revenue over the budget window from tariffs in place at the time that the projections were released (February 11, 2026). Subsequent policy changes have already reduced projected tariff revenues substantially. Following the February 20, 2026 Supreme Court ruling invalidating the International Emergency Economic Powers Act-based tariffs, the administration implemented a 10 percent Section 122 tariff as an interim measure. TPC models suggest that this change alone would result in a roughly 56 percent decline in projected tariff revenues (Tax Policy Center [TPC] 2026). This suggests that tariffs might raise on the order of $1.5 trillion over the next 10 years, compared to on the order of $3 trillion from the border adjustment, above and beyond the conversion to a cash flow base and at the benchmark 25 percent rate.

B. Investment behavior

A large body of empirical evidence finds that tax changes that reduce the user cost of capital or the effective tax rate on new projects increase investment (see Chodorow-Reich, Zidar, and Zwick 2024 for a review of the literature). As noted above, our proposals would reduce the effective tax rate on new investment to zero for all assets, which would likely increase aggregate investment. Even if the effect on aggregate investment is limited, however, given that expensing is already in place for most investment, the proposal would still improve investment efficiency by eliminating tax-driven distortions across asset types and financing choices. This improved allocation of capital is an important benefit in its own right, since it would raise GDP even without increasing total investment.

C. Distributional effects

The incidence of the proposed reform can be difficult to parse because the different components have different distributional effects. By shifting the tax base to domestic consumption, the border adjustment would ultimately be borne by U.S. consumers (Gravelle 2017). The removal of interest deductibility shifts burdens toward debt-reliant firms and their creditors. The higher statutory rate applied to a cash-flow base falls on economic rents (i.e., "excess" returns above the normal rate of return on capital) which are disproportionately earned by the most profitable firms and concentrated among higher-income shareholders (Patel and McClelland 2017). Because rents are a progressive base, a tax on rents is more progressive than a tax on the normal return to capital.

Taken together, the distributional effects are clearer. A cash-flow tax with a border adjustment is equivalent to a consumption tax with a deduction for wages. This means it imposes a net tax on all consumption except consumption financed by wages. There are four sources of future income: initial wealth, future wages, future normal returns to capital, and future excess returns to capital. The provision of expensing exempts the recipients of future normal returns from the tax, and the wage deduction exempts future wages. This means that the tax falls on investors who earn excess returns and on consumption financed from preexisting wealth, implying that the BACFT is quite progressive.

D. Simplification

A central advantage of completing the transition to a cash-flow tax is the substantial simplification it offers relative to the current hybrid system. By aligning the tax base with actual cash flows rather than accrual-based income, the proposal reduces compliance burdens and eliminates much of the complexity that has accumulated in the corporate tax code.

First, computing tax liability on a cash-flow basis simplifies tax calculations and reduces disputes over differences in the timing of income and deductions. Under current law, larger firms—generally those with average annual gross receipts exceeding $32 million in 2026—must use accrual accounting for tax purposes, recognizing income when earned and expenses when incurred rather than when cash changes hands (DeLuca 2025). Even when firms maintain accrual books for other reporting purposes, these timing differences complicate tax calculations and create scope for disparities. Allowing firms to compute taxes based on cash flow rather than on income would eliminate these timing issues, reduce compliance costs, and reinforce the simplicity the system is designed to achieve.

Second, the proposal eliminates the need for parallel minimum tax regimes. The Corporate Alternative Minimum Tax (CAMT) was adopted to address weaknesses in a narrow, income-based system and to limit the ability of firms to reduce taxable income through preferences and timing differences (Patel 2024). Under a broad-based cash-flow tax, the rationale for a book-based minimum tax no longer applies. Retaining the CAMT would reintroduce investment penalties and add unnecessary complexity.

Third, by shifting to a destination basis, the proposal reduces reliance on the layered international tax rules—including NCTI, FDDEI, BEAT, and related provisions—that have accumulated to address profit shifting under the current source-based system. While some international rules would remain necessary, the destination basis removes much of the underlying pressure that motivated these complex regimes (Joint Economic Committee 2026).

V. Questions and concerns

How would the proposal treat firms that have negative cash flow?

In a canonical corporate income tax, losses are the counterpart to profits and should be treated symmetrically, although in the current system they are not. In a cash-flow framework, firms report cash flow, rather than profits or losses, but firms with negative cash flow still may require special treatment. While this situation also arises under an income tax, it is particularly relevant because immediate expensing of investment increases the share of firms with negative cash flow.

While immediate refundability of the tax rate times the negative cash flow is the cleanest approach in theory, it raises practical and fiscal concerns in implementation, including exposure to fraud and substantial near-term revenue volatility. It also may raise problems related to optics or political sensibilities, because the idea of the government sending large checks to major corporations might not prove popular.

A more administrable alternative is to allow negative tax liability to be carried forward indefinitely with an interest adjustment that preserves its real value. By indexing tax carryforwards to a risk-free interest rate, such as the rate on short-term U.S. Department of the Treasury (Treasury) securities, the tax system avoids penalizing firms for the timing of investment while maintaining budgetary discipline, administrative feasibility, and political sensibility. This approach is consistent with cash-flow taxation and avoids reintroducing distortions through asymmetric treatment of profits and losses.

How would the proposal address transition issues?

Moving from the current income-tax system to a cash-flow tax raises a distinct set of transition issues (Auerbach 2010). These arise because firms have made investments, financing, and organizational decisions under existing rules, and may have accumulated tax assets and liabilities—such as net operating losses, tax credits, and debt positions—whose value depends on the structure of the current system. A well-designed transition must avoid providing penalties or windfall gains based on firms' previous behavior, while also establishing a coherent and internally consistent cash-flow tax going forward.

A central issue for a transition concerns the treatment of net operating losses (NOLs) accumulated under the income tax. These losses were generated under rules that differ from those of a cash-flow tax, particularly with respect to cost-recovery and interest deductibility, and their value reflects the expectation formed under the prior system. Policymakers could honor existing NOLs in full, convert them using some adjustment factor, or allow their use only during a defined transition period.

Similar issues arise for unused tax credits. Under current law, firms may carry forward general business credits and foreign tax credits for up to 20 years; these balances reflect anticipated future tax reductions incorporated into past investment decisions. Again, policymakers must decide whether to honor these credits in full, adjust their value, or limit their use to a transition period. Because the proposal reframes certain credits as spending programs, one option would be to allow existing credit carryforwards to offset tax liability temporarily or to permit partial refunds at the time of transition.

A related and potentially more consequential issue concerns existing debt. Under the proposal, interest payments would no longer be deductible for nonfinancial corporations, yet much outstanding debt was issued under circumstances where interest deductibility was reflected in borrowing costs and capital structures. Eliminating deductibility immediately for all outstanding debt would raise effective tax burdens on legacy investment and could create significant cash-flow pressures for highly leveraged firms, increasing the risk of financial distress or inefficient adjustments. Transition relief—through grandfathering, phased elimination, or a combination of the two—can mitigate these effects while preserving the long-run neutrality of the cash-flow tax.

Extending expensing to structures also raises transitional and fiscal considerations. Because structures are large investments, immediate cost recovery can generate substantial deductions in early years and push otherwise profitable firms into negative cash-flow

situations, creating revenue volatility. These concerns argue for careful treatment of negative cash flows and transition rules, not for maintaining an inconsistent tax base. If expensing is the permanent treatment for investment, extending it to all asset types is a necessary step toward a neutral and internally consistent corporate tax. When assets are sold, the sale proceeds are included in taxable income, offsetting the deduction taken at the time of purchase.

As a reminder, the revenue estimates that we provide are illustrative in nature. They can be best thought of as steady-state revenue estimates that ignore transition dynamics, including how to account for the current stock of carryforward losses, unused tax credits, and outstanding debt. They also are agnostic about how the government chooses to handle negative cash-flow positions under the assumption that, over the 10-year window, negative cash-flow positions are not permanent. To the extent that transition relief is provided, or that a substantial share of firms are moved into a permanent loss position—an outcome not found in earlier work using detailed administrative tax data (Patel and McClelland 2017)—this would reduce the potential revenue raised by the proposal.

What about pass-through businesses?

In principle, the economic case for a cash-flow base applies to all businesses, regardless of organizational form. Expensing, financing neutrality, and a broad base improve investment incentives and reduce distortions whether a firm is organized as a C-corporation, S-corporation, partnership, or sole proprietorship. A coherent reform could ultimately extend cash-flow treatment uniformly to all business activity. For example, Johnson et al. (2026) discuss options to apply C-corporation tax treatment to large pass-throughs.

This proposal focuses on C-corporations for several reasons. Pass-through businesses are taxed through the individual income tax, and extending the cash-flow base to them raises a distinct set of design questions—including interactions with graduated individual tax rates, the Section 199A deduction for qualified business income, entity classification rules, and self-employment taxes—that are beyond the scope of this paper. These interactions are consequential: Applying a flat cash-flow base to businesses whose owners face different marginal rates requires careful attention to distributional and revenue effects that differ fundamentally from the C-corporation context.

It is worth noting that current law already applies many of the same investment-side provisions to pass-throughs and C-corporations alike. Permanent full expensing under the OBBBA and the interest deduction limitations under Section 163(j) apply regardless of entity type (Cunningham, McLaughlin, and Messner 2026; Internal Revenue Service [IRS] 2026). In this respect, the investment side of the cash-flow transition is already largely entity-neutral. The principal remaining gaps involve the treatment of financial flows, the scope of base-broadening, and the interaction between business-level and owner-level taxation, which are precisely the issues that require separate and careful analysis.

What about financial corporations?

The proposal adopts a "real-transactions" (R-base) cash-flow tax for nonfinancial corporations, under which only real business transactions (i.e., sales, purchases, wages, and investment) enter the tax base, while financial flows such as interest income and interest expense are excluded. For nonfinancial firms, borrowing and lending are financing choices rather than core business activities, making this treatment appropriate. Financial institutions, by contrast, generate value through intermediation itself—interest spreads, fees, and returns on financial assets—so excluding financial flows would omit their primary source of income and render the tax largely inapplicable to the sector.

Financial corporations therefore require a distinct regime. This is one area where the cash-flow tax's similarities with a value-added tax (VAT) can help design policy. Every VAT in the world must grapple with how to tax the financial sector; a number of innovative solutions have been put in place (Auerbach and Gordon 2002; Gale 2020). One option is to retain the current income-tax treatment for financial firms while applying the cash-flow tax to nonfinancial corporations. This preserves continuity in a complex sector, but risks distortions and arbitrage at the boundary between financial and nonfinancial activities. A second option is to adopt a "real-plus-financial" (R+F) base for financial firms, which includes key financial flows (e.g., interest receipts and payments, fee income, and gains/losses on financial assets) alongside real transactions. This approach taxes intermediation income directly, but increases measurement complexity and demands clear boundary and sourcing rules.

For purposes of administration, the term "financial corporations" would include depository institutions (commercial banks and thrifts), insurance companies, broker-dealers, and other firms whose primary business is financial intermediation. Investment fund managers would be treated as nonfinancial service providers (earning fees and carried interest), while the fund vehicles themselves would be treated as financial entities. Nonfinancial corporations with financial subsidiaries would apply the R base to nonfinancial operations, with the subsidiary taxed under the financial-firm rules. Boundary cases, particularly private equity and closely related structures, would require detailed definitions and anti-abuse provisions to deter reclassification or restructuring.

To reduce administrative burden without sacrificing the core objective, the R+F base could be applied more narrowly—focused on transactions between financial corporations and parties outside the corporate tax net (principally individuals and tax-exempt organizations). Intercorporate financial transactions between entities already subject to the cash-flow tax could be excluded on both sides, since their consequences largely net out within the system.

The border adjustment presents additional challenges for financial services. Unlike physical goods, financial services often lack clear import and export transactions. When a U.S. bank provides advisory services to a foreign client, or when a foreign bank extends credit to a U.S. borrower, the geographic destination of the service may be ambiguous. Moreover, much of the value generated by financial institutions takes the form of interest spreads or fee income that does not map cleanly onto border-adjusted flows. Several approaches are possible. Financial services could be excluded from the border adjustment entirely and remain subject to source-based taxation. Alternatively, customer-location rules could treat services as exported when provided to foreign customers and could treat services as imported when provided by foreign institutions to U.S. customers.

Does excluding interest create administrability or avoidance risks?

Excluding interest income from the tax base raises important administrability concerns. In practice, firms may have incentives to recharacterize operating income or other returns as interest in order to avoid tax, particularly when transactions occur with third parties and lack a clear production counterpart. Policing the boundary between genuine interest and disguised payments would require detailed rules and enforcement efforts, potentially reintroducing complexity that the cash-flow tax is designed to avoid.

In light of this, we recommend retaining pure cash-flow treatment as the conceptual benchmark while adopting targeted safeguards focused on the most salient compliance risks. Specifically, we recommend that interest received from unrelated third parties remain taxable, while interest paid and received within commonly controlled groups, or within jointly controlled ventures, be excluded or netted for tax purposes. This approach preserves financing neutrality where it matters most—by eliminating tax wedges on internal financing and joint ventures—while limiting opportunities for income recharacterization in arm's-length transactions.

Because related-party and intra-group lending is already subject to transfer pricing rules, earnings-stripping limitations, and anti-hybrid provisions, tax administrators and taxpayers are accustomed to identifying, classifying, and monitoring internal interest flows (Diosdi 2020). Extending cash-flow treatment to related-party interest would therefore build on existing institutional and informational infrastructure, even if it requires adapting those rules to a new base, rather than creating an entirely novel compliance framework. This approach preserves the core neutrality of a cash-flow tax while addressing administrability concerns in a targeted and economically grounded manner.

How will this proposal affect the exchange rate?

The theoretical case for the neutrality of a border adjustment (i.e., that a border adjustment is not an export subsidy) depends on exchange rate adjustment. If the corporate tax rate, and therefore border adjustment rate, is 25 percent, theory predicts that the dollar will appreciate by roughly 33 percent against other currencies (Driessen and Keightley 2017; Freund and Gagnon 2017).[6] This appreciation would offset the import tariff and the export subsidy simultaneously, leaving trade flows, real production decisions, and consumer prices largely unchanged. In this equilibrium, the border adjustment functions as a shift in the tax base from production to consumption, with no lasting effect on competitiveness or trade patterns.

This prediction rests on well-established theoretical foundations and is a central feature of destination-based tax design. However, the empirical evidence for rapid and complete exchange rate adjustment is limited. The closest evidence comes from Freund and Gagnon (2017), who examine VAT adoptions across 34 advanced economies and find that real exchange rates tend to appreciate by roughly the full amount of any increase in border-adjusted consumption taxes, with adjustment largely complete within two to three years. But the authors caution that these findings might not translate directly to a BACFT: VAT adjustment operates primarily through consumer prices, while a cash-flow tax would require simultaneous adjustment in both prices and wages, a more complex process. The proposed U.S. border adjustment would also require a roughly 33 percent real appreciation, far outside the range of any episode in their sample. More broadly, exchange rate models are notoriously poor at out-of-sample forecasting, and confident predictions about the speed and completeness of adjustment should be treated with caution.

If the dollar appreciates by less than the full amount implied by the border adjustment, the policy would have real effects on trade flows and relative prices. Imports would become more expensive and exports more competitive, at least temporarily, with effects distributed unevenly across sectors. These effects would resemble those of a trade policy rather than a neutral tax reform during the period of incomplete adjustment.

A reform that is clearly defined, credibly permanent, and adopted with broad legislative support is more likely to induce rapid exchange rate movement than one perceived as temporary or subject to reversal. Many of these concerns would also be substantially reduced if multiple countries adopted destination-based taxes simultaneously, since cross-border exchange rate adjustment would be unnecessary when both sides of each transaction are taxed on the same basis.

In sum, the theoretical case for exchange rate neutrality is sound, but its empirical realization is uncertain. This uncertainty is a cost of the proposal that should be weighed against its substantial benefits, including the elimination of profit shifting, the removal of international rate competition, and the broadening of the revenue base.

Are there wealth effects of an exchange rate adjustment?

While the exchange rate adjustment associated with a border adjustment is expected to leave trade flows largely unchanged in the long run, it would generate potentially large one-time wealth effects through the revaluation of existing U.S. asset and liability positions (Joint Economic Committee 2026). These effects arise because an appreciation of the dollar increases the real value of dollar-denominated liabilities held by foreigners while reducing the real value, from a U.S. perspective, of foreign currency-denominated assets held abroad. The magnitude of the resulting wealth transfer depends on the net U.S. position in dollar-denominated claims, rather than on gross cross-border positions.

These balance-sheet effects are not a critique of border adjustment per se, but rather a consequence of implementing any credibly permanent exchange rate–neutral reform in an economy with large preexisting cross-border balance sheets. Using the most recent (Q4 2025) Bureau of Economic Analysis (BEA) International Investment Position (IIP) data, the United States has a very large net liability position in dollar-denominated assets under standard classification assumptions (BEA 2026a, 2026c). Total U.S. foreign liabilities equal roughly 230 percent of GDP, while U.S. foreign assets equal about 140 percent of GDP. BEA data on debt positions by currency show that the overwhelming majority of U.S. liabilities are denominated in dollars, whereas only a relatively small share of U.S. foreign assets are dollar-denominated. If we assume that non-debt liabilities, such as U.S. equities and real assets owned by foreigners, are treated as dollar claims on U.S. purchasing power, while non-debt assets abroad are treated as claims on foreign purchasing power, then the U.S. net dollar-denominated liability position is approximately 200 percent of GDP.

This exposure implies that a 25 percent border adjustment, and the associated appreciation of the dollar, could generate a one-time wealth transfer on the order of 67 percent of GDP, from U.S. residents to foreign holders of dollar-denominated claims. This effect reflects a revaluation of existing balance sheets rather than a change in ongoing trade flows or investment incentives, but its magnitude is economically meaningful and concentrated at the time of transition.

It is important to note that the cash-flow tax rate and the wealth transfer are linked: A higher tax rate implies a larger border adjustment and thus a larger one-time wealth transfer. The estimated wealth effect would be approximately 53 percent of GDP at a 21 percent tax rate and 78 percent at a 28 percent tax rate. This tradeoff is inherent in the design and means that the revenue and efficiency benefits of a higher rate come with commensurately larger transitional balance-sheet effects.

Several factors could reduce the size of this estimated effect. First, measured net dollar positions may overstate true economic exposure because multinational tax planning and offshore asset holdings can distort the apparent foreign ownership of U.S. assets; some dollar-denominated claims recorded as foreign-owned may ultimately accrue to U.S. residents (Zucman 2013). Second, if the relevant comparison is between a permanent border adjustment and the current tariff regime rather than the pre-tariff status quo, part of the exchange-rate adjustment—and the associated wealth revaluation—may already have occurred (Ostry, Lloyd, and Corsetti 2025). Third, expectations about policy permanence matter: If tariffs are perceived as temporary, their exchange-rate and balance-sheet effects are likely to be smaller than they would be under a credibly permanent shift to a destination-based system (Suwanprasert 2026).

The wealth effects would also be substantially smaller if the economic adjustment to the border adjustment occurred through domestic prices and wages rather than through the nominal exchange rate. As discussed above, the adjustment could in principle occur through either channel. To the extent that domestic prices absorb the border adjustment, existing dollar-denominated balance sheets are less affected, reducing both the magnitude of the wealth transfer and the distributional concerns associated with it.

These wealth effects represent a one-time stock adjustment rather than a persistent distortion. Whether they are acceptable depends on how they compare to the long-run benefits of the reform, including improved investment incentives, reduced profit shifting, and a more stable corporate tax base. Their potential magnitude, however, underscores the importance of explicitly accounting for transitional distributional consequences when evaluating a move to a BACFT.

How are exporters treated under the border adjustment?

A potential concern with BACFTs is that firms with persistent or large export exposure could be pushed into negative cash-flow positions because their expenses are incurred domestically while their sales occur abroad. This issue arises most clearly in reforms that implement the destination principle by excluding exports from the tax base altogether rather than with a border adjustment, such as the destination-based cash-flow tax (DBCFT) proposed in the 2016 Ryan-Brady Better Way Blueprint (Gravelle 2017).

The BACFT proposed here is economically equivalent to that approach, but it implements the destination basis through a paired tariff on imports and a symmetric subsidy for exports. While the two methods are equivalent in equilibrium, the tariff-subsidy mechanism alters the practical incidence and timing of tax liability. By providing an explicit subsidy tied to export sales, this design improves cash flow for exporting firms and reduces the likelihood that export activity alone systematically generates negative cash flow.

Export-oriented firms may nonetheless find themselves in loss positions, particularly when they combine high export shares with substantial domestic investment or wage expenses. As a result, appropriate treatment of negative cash-flow positions through carryforwards, indexing, or limited refundability remains important for preserving neutrality and avoiding distortions. Compared to a subtraction-method DBCFT (as described by the Ryan-Brady Better Way Blueprint), however, the tariff-subsidy implementation mitigates the severity and persistence of exporter losses, reducing, but not eliminating, the reliance on loss relief mechanisms.

How does the proposal interact with the global tax deal?

The interaction between a BACFT and the global minimum tax regime, commonly known as Pillar Two, is an important and unresolved question.

The Pillar Two framework. Pillar Two, developed through the OECD/G20 Inclusive Framework, establishes a 15 percent minimum effective tax rate on the profits of large multinational enterprises. The regime applies to income-based taxes and is designed to reduce incentives for profit shifting by ensuring that income is taxed at a minimum rate regardless of where it is reported. VATs fall outside its scope (Gravelle 2021). A BACFT occupies an ambiguous position between these categories. It is economically similar to a VAT with a deduction for wages, but it is collected from corporations based on their cash flows and retains features, such as entity-level taxation and loss carryforwards, that resemble an income tax.

Classification risk. If the BACFT were treated as outside the scope of Pillar Two, U.S. multinationals could face top-up taxes in foreign jurisdictions that view their U.S. tax payments as not counting toward the minimum rate. This would reduce or eliminate the benefit of the U.S. tax for treaty purposes and could result in double taxation: A U.S. firm paying 25 percent under the BACFT could still owe additional tax abroad if foreign governments do not credit the BACFT against their minimum tax obligations. On the other hand, if the BACFT were recognized as satisfying Pillar Two requirements, the destination-based structure would provide a more stable foundation for the minimum tax than the current source-based system.

The existing side-by-side agreement. The United States has negotiated a side-by-side agreement with the OECD/G20 Inclusive Framework under which certain U.S. minimum tax provisions, including NCTI and the CAMT are treated as sufficiently comparable to Pillar Two minimum tax rules for purposes of coordinated administration and safe-harbor relief (Sites et al. 2026; Young, Gardner, and Bourgeois 2026). Adopting a BACFT would fundamentally alter the U.S. tax structure in ways that are not contemplated by this agreement, likely requiring renegotiation. The optics of such a renegotiation, particularly in the context of a 2029 OECD/G20 Inclusive Framework, could be challenging, since it would represent another instance of the United States departing from multilateral tax coordination.

Implicit repeal of existing international provisions. The BACFT would substantially reduce or eliminate the rationale for several existing international tax provisions. NCTI, FDDEI, BEAT, and related rules were designed to protect a production-based income tax from profit shifting. Under a destination-based system, the profit-shifting incentive these provisions address is largely eliminated, and their continued operation would add unnecessary complexity. However, repealing these provisions, particularly NCTI, raises concerns about unraveling the broader multilateral framework (European Parliamentary Research Service 2025). Some countries view the U.S. adoption of income-based minimum taxes as a critical component of the Pillar Two architecture (Velez de Lima, Teixeira Mota, and de Landerset 2025). Withdrawing from these commitments could invite retaliatory measures or reduce other countries' willingness to enforce minimum taxes on their own multinationals.

Foreign reactions. How foreign governments respond to U.S. adoption of a BACFT would depend in part on whether they view it as a legitimate consumption tax or as an aggressive unilateral move. Countries that have adopted Pillar Two implementing legislation may view the BACFT as an attempt to circumvent the minimum tax while still collecting substantial

corporate revenue. Conversely, if the BACFT is seen as a structural improvement that reduces profit shifting, some countries might welcome it or even consider adopting similar systems.

Multilateral adoption as the strongest case. The Pillar Two concerns would be substantially mitigated if destination-based taxation were adopted multilaterally. If major economies shifted to destination-based systems simultaneously, the minimum tax framework could be reconceived around consumption rather than production, and the coordination problems associated with unilateral adoption would largely disappear (Auerbach et al. 2017). The United States moving first could create incentives for others to follow, particularly if the BACFT demonstrably reduces profit shifting and stabilizes corporate tax revenue—but the transition period would require careful diplomatic management.

These interactions do not argue against the proposal, but they underscore that its international dimensions require sustained engagement with trading partners and multilateral institutions, both before and after adoption.

Does the border adjustment comply with international trade rules?

Whether a BACFT would comply with World Trade Organization (WTO) rules remains unsettled. Under the General Agreement on Tariffs and Trade (GATT) Article III, countries may not discriminate between domestic and imported products through internal taxes (United Nations 1947). Border adjustments for indirect taxes such as VATs, however, are widely accepted because these taxes are considered to fall on consumption rather than on production.

The critical question is whether a BACFT would be viewed as an indirect tax on consumption. Proponents argue that the BACFT is economically equivalent to a subtraction-method VAT (albeit with a wage deduction) because it taxes domestic consumption, exempts exports, and therefore qualifies for border adjustment under existing rules (Auerbach 2010). Critics contend that important design features distinguish it from a conventional (credit-invoice) VAT; it is imposed at the entity level rather than on individual transactions and includes a deduction for labor costs (Lincicome 2017). These differences could lead a World Trade Organization panel to view the tax as a modified income tax, which would make border adjustment impermissible.

Views on this question span a wide spectrum. Some observers argue that the World Trade Organization dispute resolution system is no longer functioning effectively and that legal compliance is therefore a secondary concern in practice (Hopewell 2025). Others maintain that the border adjustment clearly violates GATT Article III and that this represents a fundamental structural obstacle, not a mere technicality (Avi-Yonah and Clausing 2017). The resulting legal uncertainty could be significant: Even if the United States ultimately prevailed in a dispute, litigation could take years and create uncertainty for firms making long-term investment decisions. Policymakers could mitigate this risk by clarifying in the statute that the tax is intended to operate as a consumption tax, restructuring it more explicitly as a VAT, or seeking advance agreement with major trading partners. Each option involves tradeoffs between legal certainty, administrative simplicity, and fidelity to the underlying cash-flow design.

Why not formulary apportionment?

Formulary apportionment—dividing a multinational's worldwide income among countries using factors such as sales, employment, and assets—is an alternative approach used within the United States for state corporate taxes and is sometimes proposed at the international level (Delpeuch et al. 2026). Both formulary apportionment and the BACFT address the difficulty of assigning income to specific jurisdictions but through fundamentally different mechanisms. Formulary apportionment retains an income tax and attempts to divide it fairly; the BACFT eliminates the need for allocation altogether by taxing consumption at destination, where geographic assignment is straightforward. The BACFT is simpler to administer, is less susceptible to manipulation through factor location, and avoids the contentious international negotiations over formula weights that formulary apportionment would require (TPC 2024).

What happens to outbound investment rules?

The destination-based structure of the BACFT substantially reduces the rationale for outbound rules such as Subpart F and NCTI, because the incentive to shift profits or locate production abroad is largely eliminated when tax liability depends on where goods are consumed rather than where income is earned (Buffie et al. 2025). However, the transition raises an open question regarding individual U.S. shareholders of controlled foreign corporations: whether they should remain subject to current-law inclusion rules, be transitioned to a simplified regime, or be addressed through individual income tax reform warrants further analysis.

VI. Conclusion

The proposals discussed here work best as a complete package. As such, they would reduce economic distortions, eliminate incentives for profit shifting, and raise substantial revenue in a progressive way.

If the cash-flow base plus border adjustment proves politically infeasible in a single legislative step, however, there is a coherent and valuable intermediate reform: completing the domestic cash-flow base without the border adjustment. This would involve extending permanent expensing to all business assets (including structures, land, inventories, and acquired intangibles) and eliminating interest deductibility for nonfinancial corporations. Together, these changes would remove the most significant domestic distortions in the current system—the bias toward debt financing, the differential treatment of asset types, and the subsidization of leveraged investment—while preserving a broad base capable of raising substantial revenue.

At a 25 percent rate, a domestic cash-flow tax without the border adjustment would raise significantly more revenue than current law. Even on its own, this reform would represent a substantial improvement. It would not address profit shifting or international rate competition, since those problems require the border adjustment, but it would produce a simpler, more-neutral, and more-productive corporate tax.

Without shifting the base to domestic consumption, however, a cash-flow tax would continue to tie liability to the location of production and reported profits. As a result, incentives for profit shifting and pressures to lower statutory rates would remain, requiring continued reliance on complex international rules and minimum tax regimes. Given the growing importance of digital activity, cross-border services, and multinational firms whose profits are increasingly detached from physical location, these pressures will continue to intensify, making the corporate tax base more difficult to sustain and increasing reliance on layered and ad hoc policy responses.

While the domestic cash-flow base alone represents a substantial improvement, the border adjustment makes the reform transformative. It eliminates profit-shifting incentives, removes international rate competition as a binding constraint on U.S. tax policy, and roughly doubles the revenue capacity of the corporate tax. These are large and durable gains that cannot be achieved through domestic base reform alone.

Endnotes

1. The "normal" return is the minimum return that investors expect in order for them to undertake an investment, given its risk and available alternatives. Firms invest when expected returns meet or exceed this level. Returns above it are often called "excess" or "supernormal" returns.
2. The TCJA limited interest deductions to 30 percent of earnings, which was initially measured using Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA), a broader measure that permits larger deductions. Starting in 2022 the limit tightened by switching to Earnings Before Interest and Taxes (EBIT), which excludes depreciation and amortization and thus reduces allowable deductions. The OBBBA reversed this change, returning to an EBITDA-based measure.
3. While destination-based systems largely eliminate traditional profit-shifting incentives, some scope for avoidance remains, such as through the misreporting of the location of final sales, especially for digital transactions, or through the structuring of related-party arrangements. These issues are typically less significant than they are under production-based systems, but do not disappear entirely (De Simone and Olbert 2025; Miller 2017).
4. As we discuss later, we do update certain elements of this distribution based on Statistics of Income (SOI; IRS 2022) corporate tables and 2025 BEA import and export values (BEA 2026f).
5. The long-term revenue loss from converting to expensing will be smaller than the 3 percent noted in the initial year. Expensing shifts deductions forward in time. It reduces the revenue in the year an investment is made but increases revenue in later years by eliminating future deductions. The estimate that extending expensing reduces the base by roughly 3 percent is based on calculations using public tax return data. Specifically, we compare the size of investment in longer-lived assets (i.e., those not already eligible for full expensing) to total investment reported on Form 4562 and relate this to the overall tax base and interest deductions using IRS Statistics of Income data (IRS 2022, SOI Tables 5.1 and 13). We use 2019 as a representative pre-pandemic year following the TCJA, avoiding distortions from the unusually high-interest rate environment and atypical investment patterns observed in later years. Because prior work assumed full expensing for all investment, this approach provides an updated estimate relative to the current-law baseline. This revenue estimate does not incorporate the transition to full expensing of intangible assets. In practice, most newly created intangibles (i.e., research and development) are already expensed under current law because their costs primarily take the form of labor and other current expenses. However, acquired intangibles are generally amortized over time; moving to immediate expensing would affect the timing of these deductions, and this effect is not reflected in the estimates.
6. Under standard destination-based cash-flow tax models, exchange rates adjust to offset the border tax so that after-tax import prices remain unchanged in relative terms. Because the tax is imposed on a tax-inclusive basis, the implied proportional appreciation of the domestic currency is $\tau / (1 - \tau)$, where τ is the tax inclusive border-adjustment rate. Thus a 25 percent border adjustment implies an appreciation of 0.25/0.75 = 33 percent.

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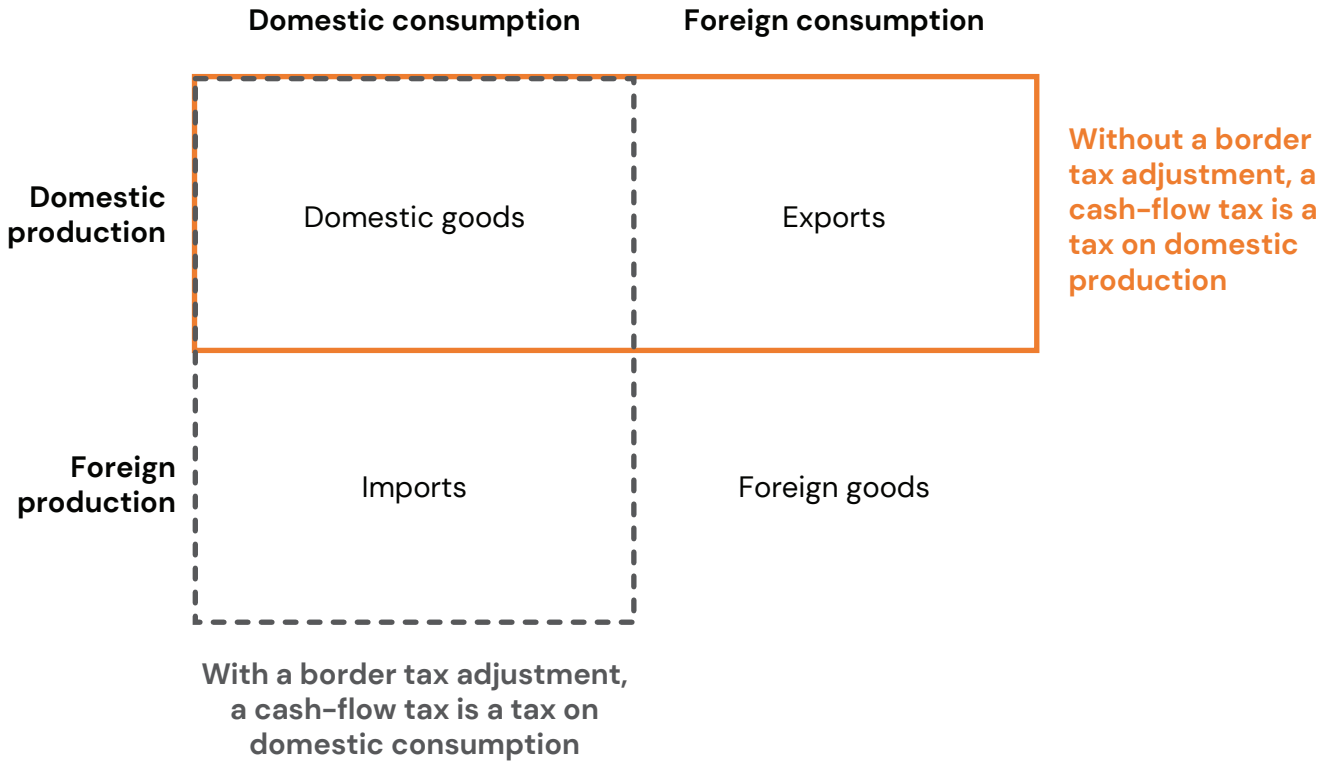
The U.S. corporate tax is at a crossroads. Originally designed as an income tax, it has been altered in several incremental steps—most recently, with 2025's tax law—that move it partway to a tax on business cash flows. The resulting hybrid has major flaws: It distorts business decisions and creates significant tax avoidance opportunities through inconsistent treatment of different forms of investment and financing, allows numerous targeted subsidies that are inefficient and inequitable and complicate taxes, maintains incentives to shift profits out of the country, and raises too little revenue. The next phase of corporate tax reform should complete the shift to a coherent cash-flow tax. We propose to do so by extending expensing to remaining categories of investment and eliminating deductibility of interest payments, eliminating most tax expenditures, instituting a border adjustment that converts the tax base to U.S. consumption, and increasing the tax rate to 25 percent. These reforms would boost investment and growth, eliminate profit-shifting incentives, simplify taxes, and raise more revenue in a progressive manner.

Border tax adjustment converts a production tax to a consumption tax



Source: Authors' analysis (Gale, Looney, and Patel 2026).

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