accountingTODAY FOR THE WebCPA

MAY 13, 2020

Study questions effectiveness of TCJA at stemming foreign R&D shifting

BY MICHAEL COHN

The international tax provisions of the Tax Cuts and Jobs Act will likely have less impact on the willingness of multinational companies to shift their income abroad than the money they can save by using foreign employees to do research and development, according to a new study.

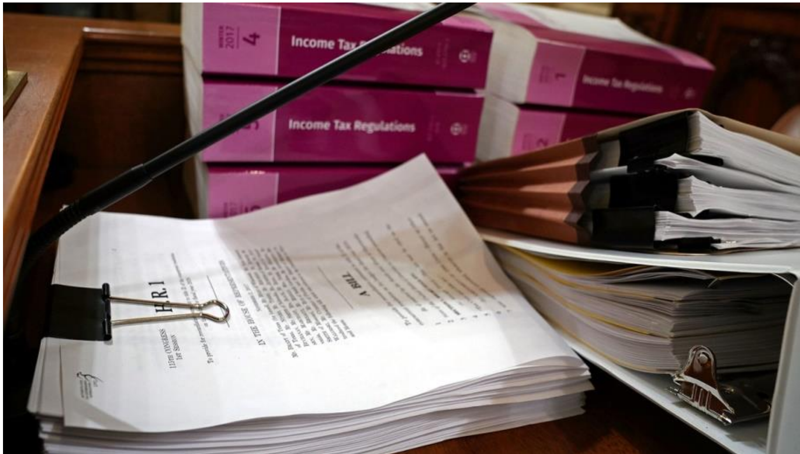
The research, which appears in the current issue of the **American Accounting Association's journal *The Accounting Review***, found that even before the TCJA was signed into law at the end of 2017, the foreign profits of U.S.-based multinationals were not helped significantly more by tax maneuvers than by the wage savings from R&D conducted abroad.

"Most income-shifting studies in accounting and economics focus on tax incentives. In contrast we distinguish between two motivations for increasing foreign profitability attributable to R&D activities," wrote the co-authors, Lisa De Simone of Stanford University, Jing Huang of Virginia Polytechnic Institute and State University, and Linda Krull of the University of Oregon. "We find that tax-motivated income-shifting [pre-TCJA] has a larger, but not significantly different, positive effect on foreign profit margins relative to wage-related income shifting."

The researchers pointed out that because of the labor-intensive nature of R&D, the incentives for multinational companies to save money from wage-related income-shifting are substantial. "Although the U.S. leads the world in technological advancement, the U.S. R&D labor supply in science and technology declined in recent years as demand rose," they wrote. "The widening gap between supply and demand increases the cost of domestic R&D labor. As firms aim to reduce costs while maintaining innovation, low-wage countries attract foreign R&D investments by offering highly skilled workers, especially in science and technology."

The study compared R&D wages in 49 countries and found wide gaps between domestic and foreign R&D labor costs, based on estimated average wages of electrical engineers in major metropolitan areas of countries. For example, companies can save as much as 91 percent by shifting R&D to India, 80 percent to the Czech Republic, and 43 percent to Spain, Italy and Israel. The findings are also based on data from 648 U.S.-based multinational corporations that registered patents

with the U.S. Patent and Trademark Office during the two decades before enactment of TCJA.



To be sure, a variety of other factors can come into play when companies make decisions to shift their R&D activities abroad. Various countries have different levels of economic growth, research activity, intellectual property-rights protection and educational opportunities. The current coronavirus pandemic also makes it difficult to travel abroad and work with colleagues in other countries. In addition, trade policy can impose restrictions and tariffs on products shipped from overseas.

The researchers avoided concluding that a desire for wage savings would either accelerate more R&D shifting or have a major role in driving it. But, based on their findings about the importance of wage savings in R&D, the researchers cast doubt on the effectiveness of the TCJA's international tax provisions such as GILTI (Global Low-Taxed Intangible Income), BEAT (Base Erosion and Anti-abuse Tax) and FDII (Foreign Derived Intangible Income). The problem, according to the researchers, is that GILTI and FDII are calculated in such a way as to allow corporate executives to simultaneously lower the tax imposed by the former and increase the deduction permitted by decreasing tangible investments in R&D in the U.S. while increasing them abroad.

Michael Cohn, editor-in-chief of AccountingToday.com, has been covering business and technology for a variety of publications since 1985.