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Wages holding back repatriation of foreign profits, study finds

The drop in the corporate tax rate from 35% to 21% is unlikely to lead to a boom in repatriation of foreign profits by U.S. corporations.

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One of the main reasons the federal government enacted the Tax Cuts & Jobs Act in 2017 was to slash the corporate tax rate so more companies would bring their foreign profits back into the United States, but accounting researchers have cast doubt on whether lower taxes is getting at the heart of the problem.

Lower wages abroad among the scientists and engineers that companies rely on to conduct their research and development (R&D) is almost as big a reason for the shift abroad as high corporate taxes, the research concludes.

"Tax-motivated income-shifting has a larger, but not significantly different, positive effect on foreign profit margins relative to wage-related income shifting," according to researchers Lisa De Simone of Stanford University, Jing Huang of Virginia Polytechnic

Institute, and Linda Krull of the University of Oregon, in an upcoming issue of **The Accounting Review**, to be published by the **American Accounting Association**, later this month.

The researchers put the difference in how much tax incentives increase foreign profit margins compared to lower wages at an almost negligible 0.48% vs. 0.34%, respectively.

Focus on tax cuts

When the law was being debated, lawmakers said the corporate tax rate needed to be cut dramatically if the U.S. was going to be competitive with other countries. To achieve this goal, the law lowers the rate from 35% to 21%. It also introduced two rules. The first, the global intangible low-tax income (GILTI) rule, seeks to prevent companies from deferring their foreign profits permanently, and the second, the foreign-derived intangible income (FDII) rule, gives companies a sizable deduction as an incentive for them to repatriate their foreign profits.

But neither the lower tax rate nor the new rules do anything to address the incentive companies have to move their activity abroad to take advantage of lower researcher wage costs abroad. And those savings can be significant; as much as 91% in India, 80% in the Czech Republic, and 43% in Spain, Italy and Israel.

The wage disparity has grown particularly wide in recent years. Demand for R&D has been increasing while the supply of scientists and engineers in the U.S. has dropped, creating an expensive mismatch domestically between supply and demand.

Wage savings tend to be more important than tax issues when technologies require comparatively little capital investment and companies have subsidiaries in countries with substantial research talent. Tax incentives tend to be more important when the risk of transfer pricing is low — that is, when regulators are not likely to question the price a foreign subsidiary pays to a multinational for a technology the parent transfers to it.

The researchers also found the new rules the law created — GILTI and FDII — don't seem to be having much impact on repatriation, because corporate finance chiefs have found a way to play them off of each other. By reducing tangible investments in R&D at home while increasing them abroad, companies have been able to lower the tax imposed by GILTI while increasing the deduction permitted by FDII.

That appears to be a tactic lawmakers didn't anticipate when they passed the law, the researchers speculate.