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## ***TCJA boosted multinationals' investments overseas more than in U.S.***

BY MICHAEL COHN

U.S.-based multinational companies devoted more capital investment money to foreign countries after the 2017 tax overhaul than they did in the U.S., according to a new study.

The research is expected to be presented next month at the annual meeting of the American Accounting Association. The study's co-authors, Brooke Beyer of Kansas State University, Jimmy Downes of University of Nebraska - Lincoln, Mollie E. Mathis of Auburn University, and Eric Rapley of Colorado State University, compared the corporate capital spending of 1,804 public companies in the three quarters prior to the passage of the Tax Cuts and Jobs Act (from January to September 2017) to spending in the three quarters following its passage (January to September 2018). Their research found some increase among multinationals (companies with at least one subsidiary abroad) but a slight decline among domestic-only companies.

Focusing on the bill's impact on multinationals, the researchers found an increase in capital investment of about 14 percent among companies that would have faced high repatriation costs under pre-TCJA law (when they presumably had a strong incentive to keep their foreign subsidiaries' profits abroad), while investment was flat among those that would previously have faced no repatriation costs (perhaps because their foreign subsidiaries were in high-tax countries).

Companies with repatriation costs in the top quartile increased their capital expenditures from 0.86 percent of assets to 0.98 percent of assets, the researchers found. On the other hand, they also found that companies with zero repatriation costs kept their capital expenditures at 0.98 percent of assets. Clawbacks on incentive-based compensation for executives could lead to misconduct and misreporting of financial results, according to a new academic study.



*A printout of the Tax Cuts and Jobs Act, alongside a stack of income tax regulations.*

The legislation was supposed to encourage companies to do more capital investment in the U.S. Instead, much of the capital investment occurred abroad.

“Firms with high repatriation costs have a significantly greater increase in foreign property, plant, and equipment investments post-TCJA than pre-TCJA, while these same firms ... have no change in domestic PPE,” said the report. “Our results are consistent with foreign capital expenditures rather than domestic capital expenditures influencing the increase in investment post-TCJA, which is opposite of congressional intent.”

Among the companies that formerly would have faced the highest repatriation costs (the top decile) domestic PPE as a percentage of company assets increased by approximately 50 percent more after the Tax Cuts and Jobs Act (from 2017 to 2018) than it did before passage of the tax overhaul (from 2015 to 2016). In comparison, the companies’ foreign PPE increased nearly 300 percent after the Tax Cuts and Jobs Act than it did pre-TCJA.

In a further analysis that controls for an array of factors that affect PPE investment (such as sales growth, prior capital spending, and acquisition activity), the professors find the effect of the TCJA on the increase of PPE abroad to be statistically significant, while its effect on domestic PPE increase is not.

The researchers looked at two complicated provisions of the TCJA: global intangible low-taxed income, or GILTI, and foreign-derived intangible income, or FDII. They were supposed to encourage companies to repatriate their foreign profits. Their findings suggested, however, that "multinational firms were less enabled by the reduction in [repatriation costs] to increase domestic investment than they are incentivized to increase foreign investment to take advantage of [these two] tax incentives."

Why, then, were GILTI and FDII included in the new tax law? In all probability, according to the researchers, it's because they were perceived as discouraging a growing practice of U.S. multinationals that concerns policy-makers: shifting their ownership of highly profitable intangible assets, such as patents, trademarks, or other kinds of intellectual property, to subsidiaries in low-tax countries, and doing that with minimal tangible assets in those places.

While the new tax law's reduction of the top corporate tax from 35 to 21 percent might be expected to lower the incentive to shift intangible assets abroad, another feature of the law could actually increase that incentive: exempting the income of foreign subsidiaries from federal taxation. Whereas previously that income escaped federal taxation only as long as it was kept abroad, now those taxes can not only be delayed but avoided entirely for qualifying companies. GILTI and FDII were supposed to prevent that from happening by enabling the federal government to tax intangible income earned by foreign subsidiaries of U.S. multinationals.

GILTI is taxed at only about half the rate levied on domestic earnings, but, because of the way it is calculated, the provision might be expected to discourage shifts of intellectual property. Intangible income is defined by the TCJA as any income over 10 percent of subsidiaries’ tangible property in a country or jurisdiction. Therefore, the lower the value of those tangible assets, the greater would be the income subject to U.S. taxation. Conversely, the greater those assets are, the less income would be

within the reach of the IRS. In some circumstances, that could inhibit the shifting of intellectual property abroad. But it also could motivate companies to make foreign capital investments as a way of reducing GILTI. According to the new research, that is what has been happening to a far greater extent than anticipated.

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