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Foreign Investment Increased After TCJA, Accounting Group Says

By **Alex M. Parker**

Law360 (July 25, 2019, 9:15 PM EDT) -- U.S. companies significantly increased spending on foreign investment after the federal tax overhaul, contradicting White House promises that the law would trigger a wave of new spending at home, according to a study recently released by the American Accounting Association.

The study released Wednesday claims that the increase may be due to the Tax Cuts and Jobs Act 's provisions on global intangible low-taxed income and foreign-derived intangible income, which critics claim provide companies with incentives to move their operations out of the U.S.

"I feel pretty confident that it's a result of tax reform, so the obvious source of change in my opinion is due to GILTI and FDII," said Mollie Mathis, an accounting professor at Auburn University and one of the study's authors.

GILTI has proven to be one of the more controversial parts of the TCJA. The provision was meant to discourage tax avoidance by moving valuable, easy-to-move properties — such as intellectual property — to countries with low tax rates. The provision defines intangible income as foreign returns of more than 10% of tangible depreciable property, and then taxes it at 10.5%, which is half the total corporate rate of 21%.

Companies can use foreign tax credits on their GILTI, but those credits are reduced by 80%. The end result is that most of the time companies will pay no GILTI tax if the foreign tax rate is above 13.125%. A separate provision, a tax incentive for FDII, grants similar income in the U.S. a discount rate at 13.125% if it is earned through overseas sales. The two provisions are meant to ensure that companies do not have tax incentives to locate their valuable intangibles abroad.

But critics **point out** that the formula may contain an incentive that could encourage companies to move their real, physical assets abroad. By increasing their tangible property overseas, companies would decrease their amount of foreign intangible income, and ultimately reduce their GILTI tax. Likewise, companies' FDII benefit is decreased with the more tangible assets they hold in the U.S.

Defenders of the law said that companies would lose other tax benefits in the U.S., such as depreciation deductions, by locating new investments offshore. And the incentive would only exist for countries with low tax rates, which may not have the infrastructure or workforce to support significant operations.

The study found that companies that paid a high amount due to the TCJA's deemed repatriation tax on pre-2017 offshore earnings increased spending as a portion of their assets by 12%, while those with low repatriation costs did not have an increase.

By compiling information about new investments in property, plant and equipment investments in filings with the U.S. Securities and Exchange Commission, the report found a greater tendency toward investment abroad.

"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," the study said.

Using regression analysis, the study also found that companies which reported a greater reliance on foreign operations before the TCJA were more likely to report an increase in overall investment after the TCJA.

"This result provides additional support for the notion that firms increased their tangible foreign property base to avoid taxes based on GILTI inclusions and FDII deductions," the study said.

Calls to the White House for comment were not immediately returned.

--Editing by Neil Cohen.

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