

Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?

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CORPTAX

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Introduction

- ▷ A body of work documents profit shifting by multinational (especially US) companies
- ▷ The Tax Cuts and Jobs Act of 2017 was the largest US tax reform since 1986, with goal of reducing profit shifting
- ▷ **Did it reduce profit shifting by US firms?**
- ▷ Important question to, e.g., assess desirability of further international tax reform

Contribution

We combine & reconcile all the existing evidence:

- ▷ Survey of US multinationals (Bureau of Econ Analysis)
- ▷ Financial accounting micro data (Compustat)
- ▷ New country-by-country reporting data (IRS)

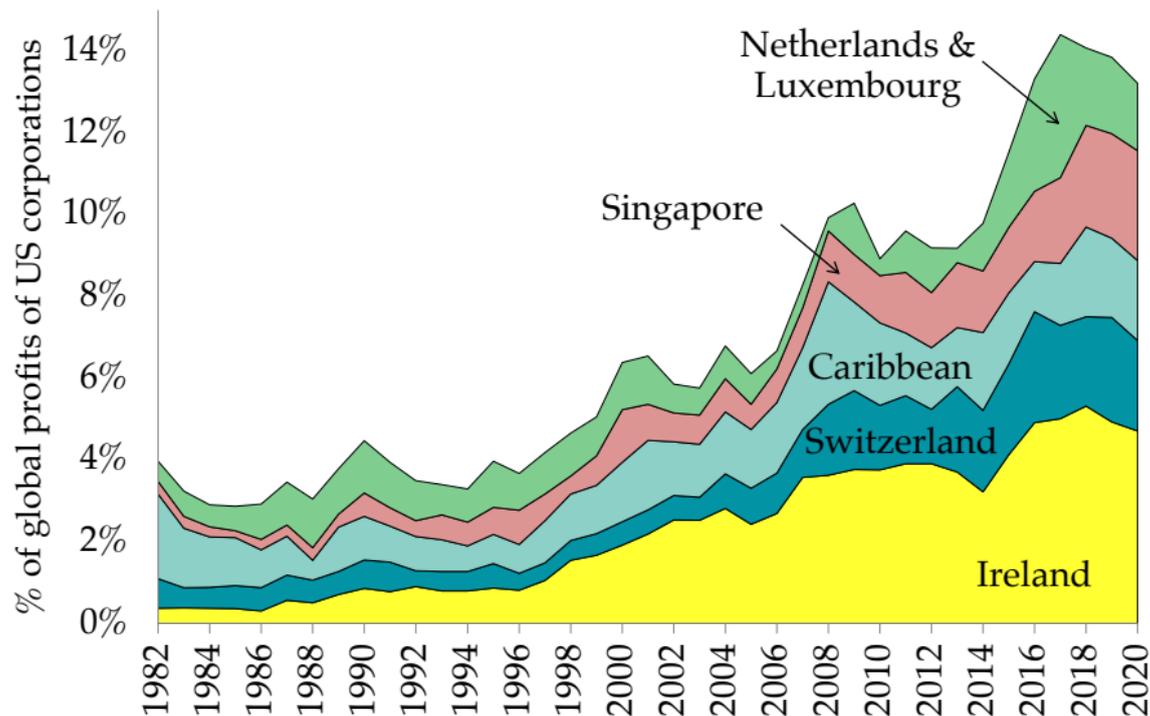
Methodological contribution: we show that when confronted & corrected (eg, for double counting), **existing datasets paint a consistent picture**

Global allocation of profits by US firms appears little changed overall

Main findings:

- ▷ US firms book slightly lower share of their profit abroad: $\approx 30\%$ in 2020 vs. $\approx 35\%$ pre-reform
 - ▷ Driven by a few big tech companies repatriating intellectual property to the US
 - ▷ Persistently high share of non-US profit booked in tax havens: $\approx 50\%$ across sources in 2015–2020
- $50\% \times 30\% \approx$ **15% of all profits of all US firms still booked in havens, a historically high level**

Profits Booked by US Firms in Tax Havens (% of Global Profits of US Firms)



Provisions of the Tax Cuts and Jobs Act

The Act dramatically changed profit shifting incentives faced by US firms

Incentives to book less income in tax havens:

- ▷ Decline in US rate from 35% to 21%
- ▷ Reduced rate on intangibles booked in the US
- ▷ Limited deductibility of certain payments
- ▷ New US tax on Global Intangible Low-Taxed Income

Incentives to book more income in tax havens:

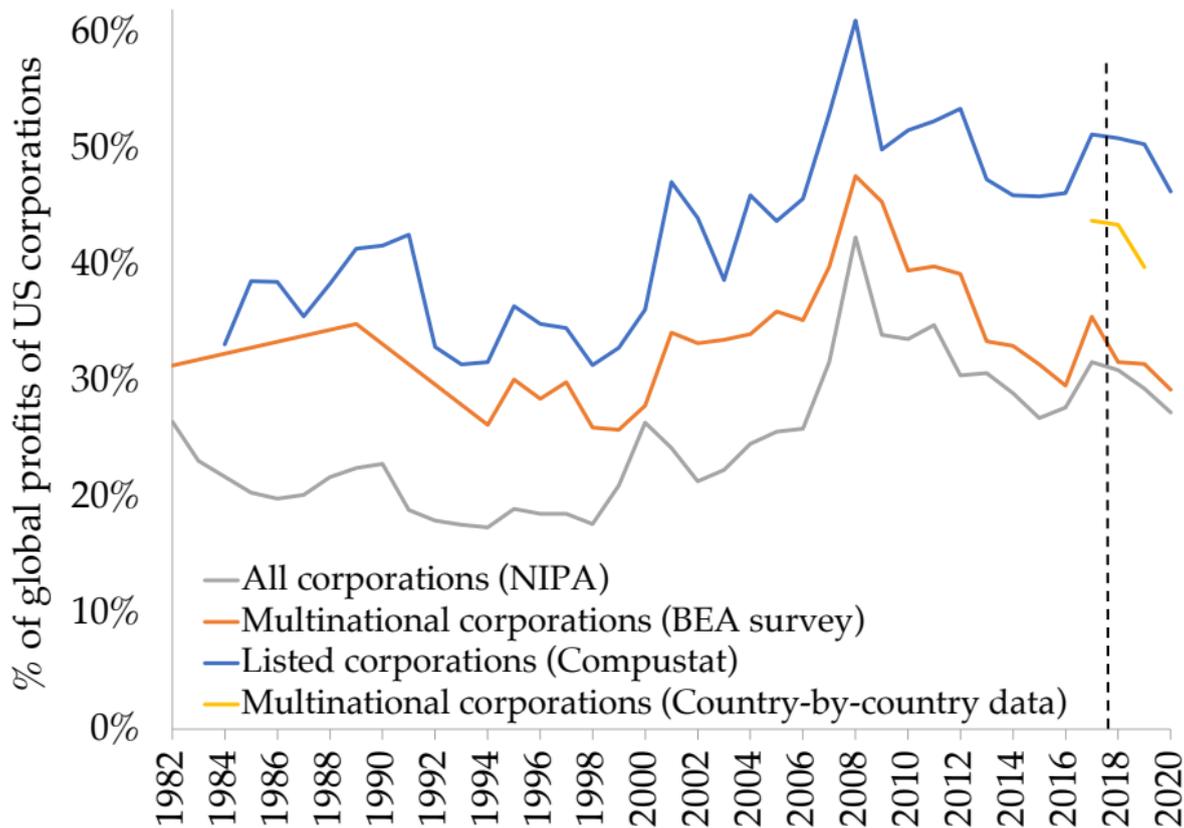
- ▷ Move from a worldwide to a territorial tax system

Analysis of Location of US Firms' Profits: Profits Booked in the US vs. Abroad

Start with simple descriptive trends

Then forensic exploration of listed firms using micro data

Foreign Profits of US Firms (% of Global Profits of US Firms)



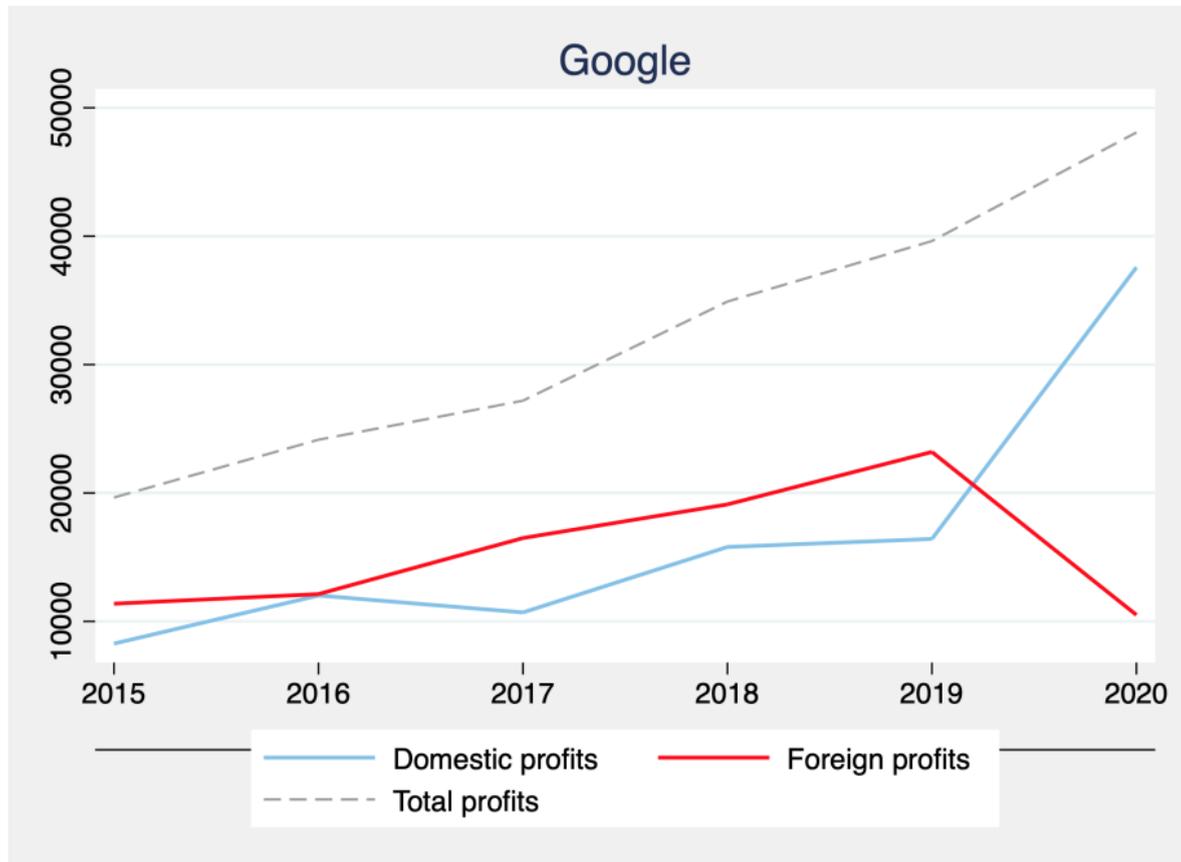
Firm-Level Analysis

For listed firms with $> \$10\text{B}$ in profit, 6 cases of large \downarrow in foreign income share linked to changes in profit shifting

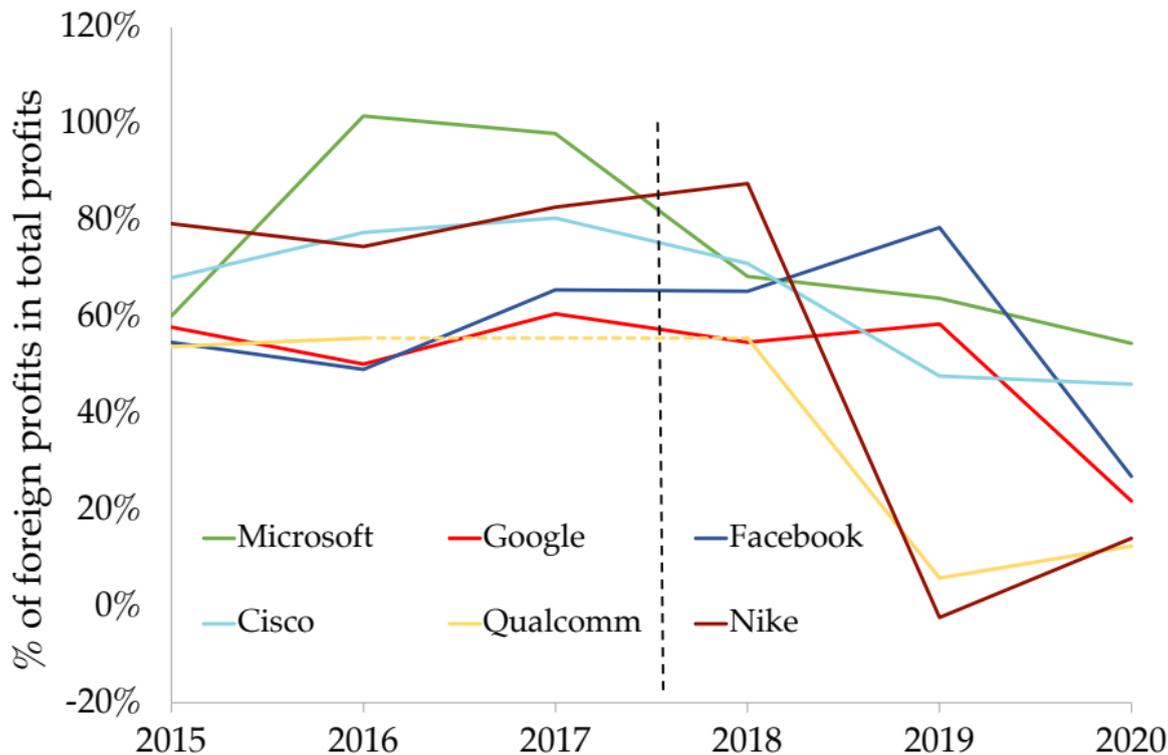
From Google Alphabet's 2020 annual 10-K:

"As of December 31, 2019, we have simplified our corporate legal entity structure and now license intellectual property from the U.S. that was previously licensed from Bermuda resulting in an increase in the portion of our income earned in the U.S."

US vs. Foreign Profits of Google (\$ million)



6 Firms Account for Most (3 out of 5pp) of Macro Decline in Foreign Income Share

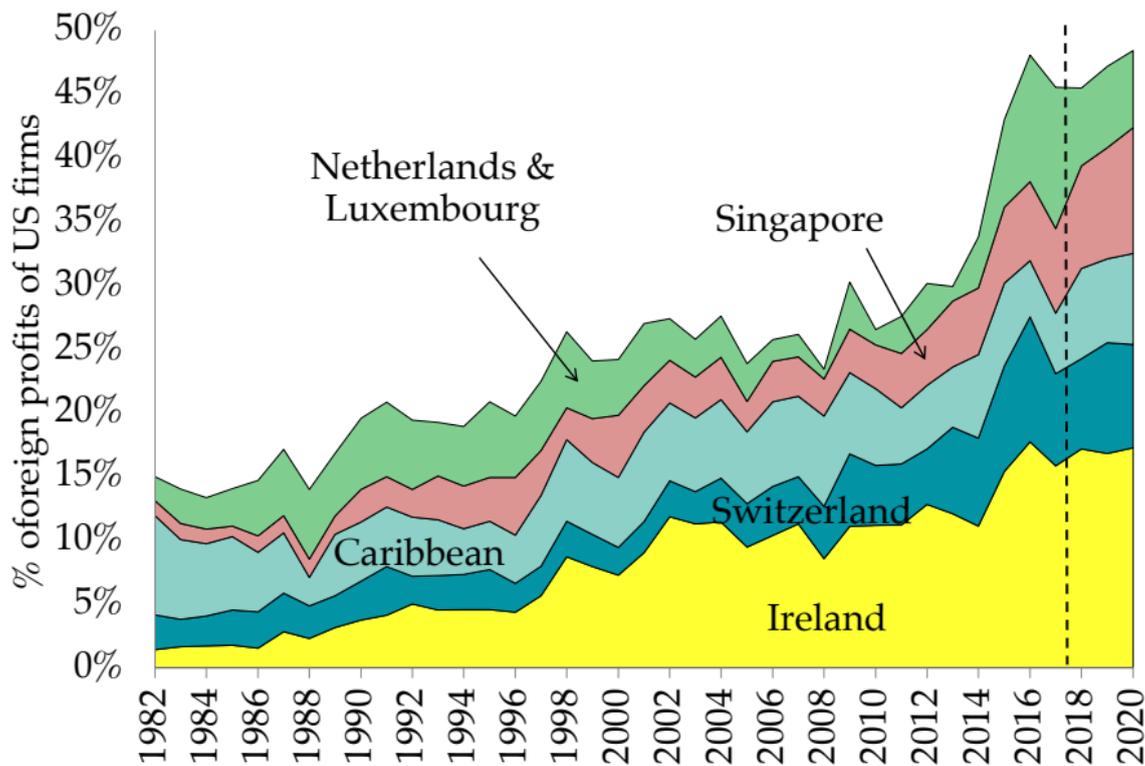


Analyzing the Location of the Foreign Profits of US Multinationals

Preferred series: “profit-type return” in the BEA survey of the foreign operations of US multinationals

- ▷ Covers all profits of majority-owned affiliates
- ▷ Gross of foreign income taxes
- ▷ Does not double-count profit
- ▷ Profits assigned to countries where operating income is earned from accounting perspective
- ▷ Does not cover Puerto Rico

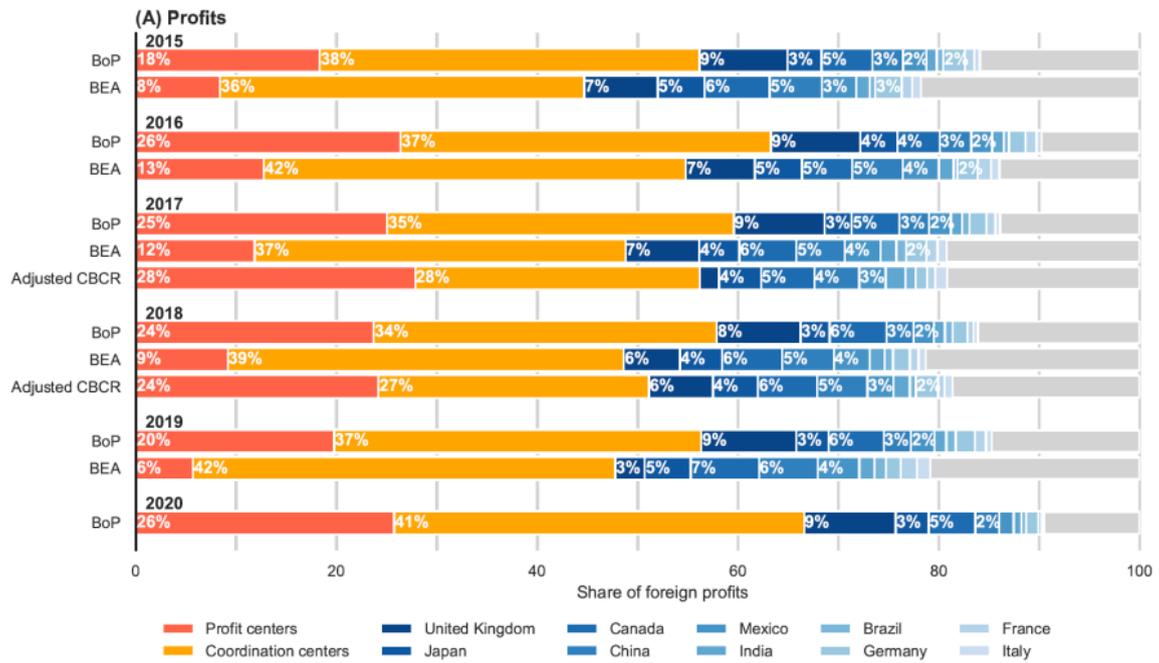
Profits Booked in Havens by US Firms (% of Foreign Profits of US Firms)



Other Sources to Study the Location of Foreign Profits

- ▷ **Direct investment equity income:** profits of affiliates more than 10⁰%-owned, pro-rated by the ownership stake of US parent, net of foreign taxes, assigned to country with immediate link with the US
- ▷ **Country-by-country reporting data:** profits allocated by “tax jurisdiction,” including Puerto Rico, gross of foreign income taxes
 - ▷ Problem: double counting of profit (intra-group dividends)
 - ▷ We provide correction to match true foreign and domestic profit totals

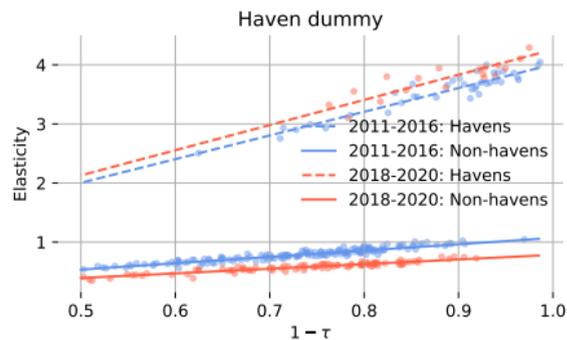
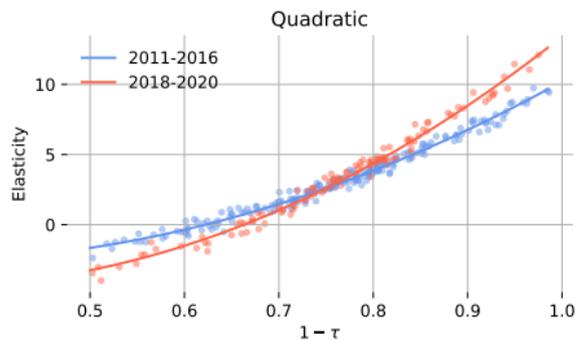
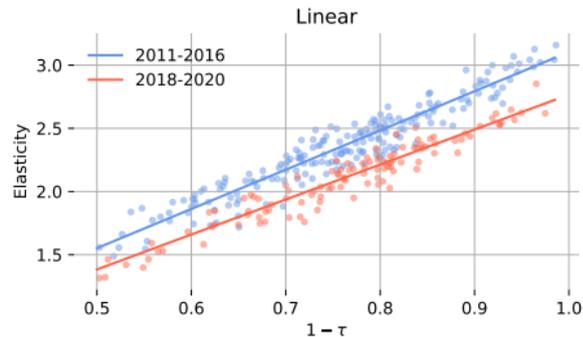
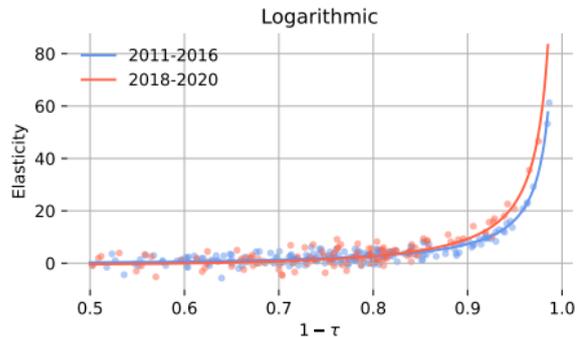
Other Sources Confirm the Stability of Haven Profits



A High Profitability Is Correlated with a Low Effective Tax Rate



Changes in Sensitivity of Profits to Tax Rates



Conclusion

Following the Tax Cuts and Jobs Act:

- ▷ A few large (mostly tech) companies repatriated intellectual property to the United States
- ▷ But they are exceptions rather than the rule
- ▷ The share of profits booked by US firms in tax havens remains persistently high: **50% of foreign profits and 15% of all profits**

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Estimating Double-Counting in the Country-by-Country Data

	Year	Compustat		CBCR		Imputation of missing profits using regression						Other datasets							
		Profits	N	Profit (inc. stateless)	Profit (exc. Stateless)	N	Profit	N	Final Profit	Double count (inc. stateless)	Double count (exc. stateless)	Double count (inc. stateless) USD billion	Double count (exc. stateless) USD billion	Orbis (N=1,221; 1,201)	Horst & Curatolo (N=1,349)	Profit-like	CFC		
Dom	2017	641	1.325	1.180	1.180	750	1.428	765	54%	54%	415	415							
	2018	748	1.345	1.488	1.488	842	1.453	856	74%	74%	632	632							
	2019	684	1.323	1.296	1.296	893	1.431	911	42%	42%	385	385							
For	2016	450	1.313			475	1.415	486							567	473	706		
	2017	551	1.325	842	638	584	1.428	596	41%	7%	246	42			669	570			
	2018	617	1.345	1.116	918	647	1.453	658	70%	39%	458	260			694	580			
	2019	560	1.323	933	768	590	1.431	602	55%	28%	331	166			671	547			
Total	2017	1.342	1.444	2.022	1.818	1.575	1.334	1.444	1.361	49%	34%	661	457	1.317	1.450				
	2018	1.493	1.468	2.604	2.406	1.641	1.489	1.468	1.514	72%	59%	1.090	891	1.418					
	2019	1.490	1.443	2.229	2.064	1.698	1.483	1.443	1.513	47%	36%	716	551	1.502					
		A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R