

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

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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 publicly available evidence:

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

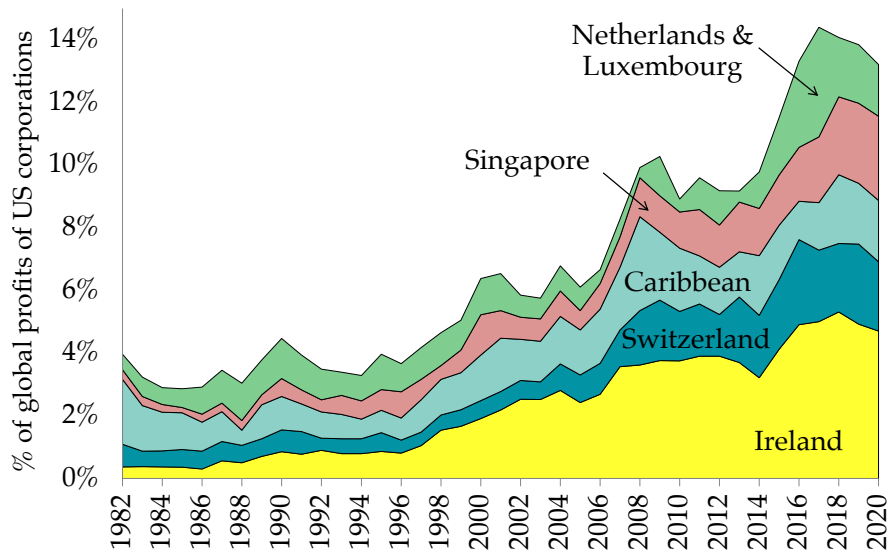
Methodological contribution: show that when confronted & corrected (eg, for double counting), **existing datasets paint a consistent picture**

# Some changes post TCJA, but not massive

## 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
- $50\% \times 30\% \approx \mathbf{15\%}$  of all profits of all US firms still booked in havens

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



# Provisions of the Tax Cuts and Jobs Act

Major changes in profit shifting incentives for 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
- ▷ 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

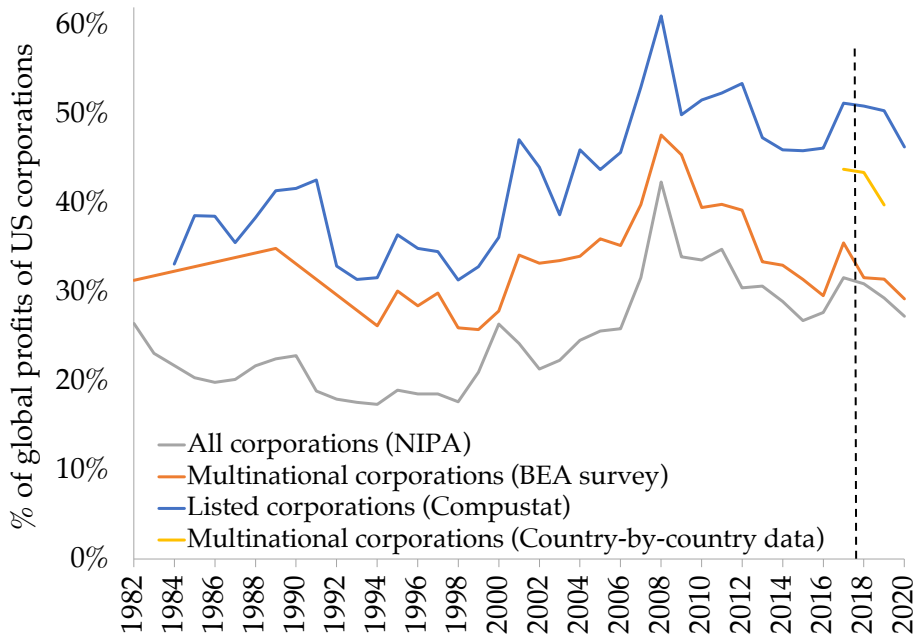
# Analysis of Location of US Firms' Profits: Profits Booked in the US vs. Abroad

Start with simple descriptive trends

Then forensic exploration of listed firms micro-data

- ▷ Identify all large firms that experienced sustained decline (= lasting through end of our sample, 2020) of the foreign share of profit of at least 20 pp
- ▷ Manually check the annual 10-K of these firms to understand the origin of decline

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





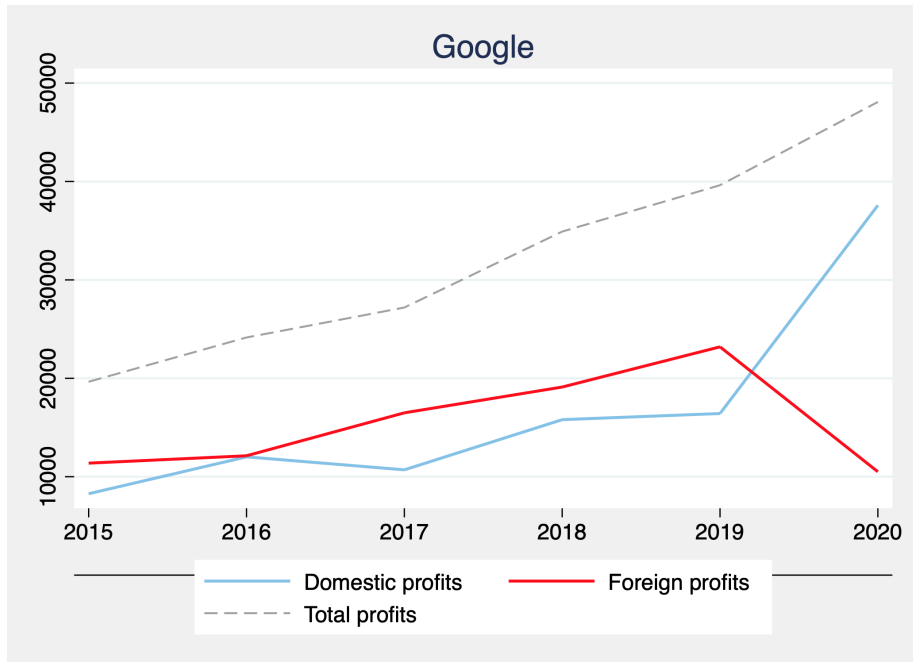
# Firm-Level Analysis

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:

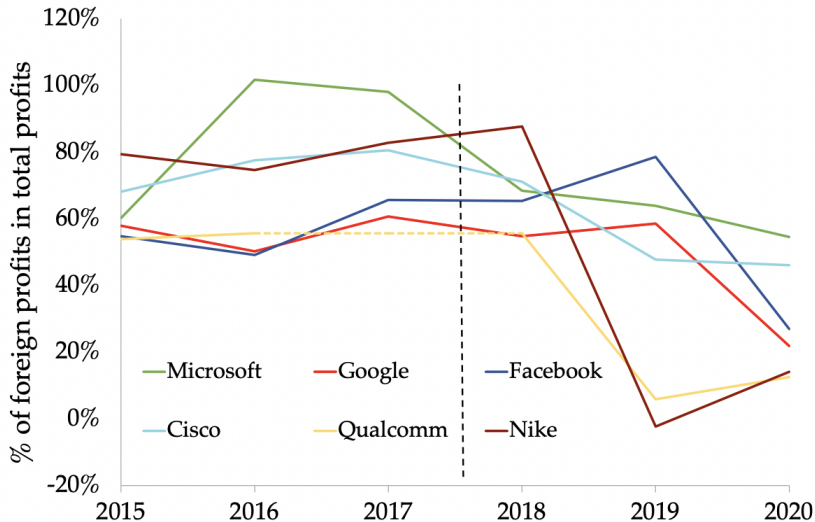
*“As of December 31, 2019, we have simplified our corporate legal entity structure and now license intellectual property from the U.S. that was previously licensed from Bermuda resulting in an increase in the portion of our income earned in the U.S.”*

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



# 6 Firms Account for Most of Macro Decline in Foreign Income Share

(b) Firms with a Large Drop in Foreign Profit

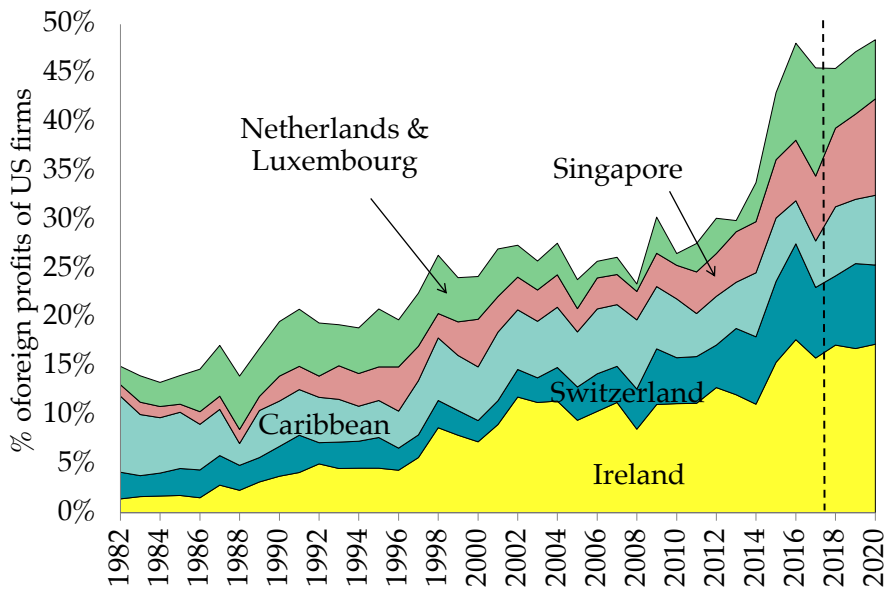


# Analyzing the Location of the Foreign Profits of US Multinationals

**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
- ▷ Does not cover Puerto Rico

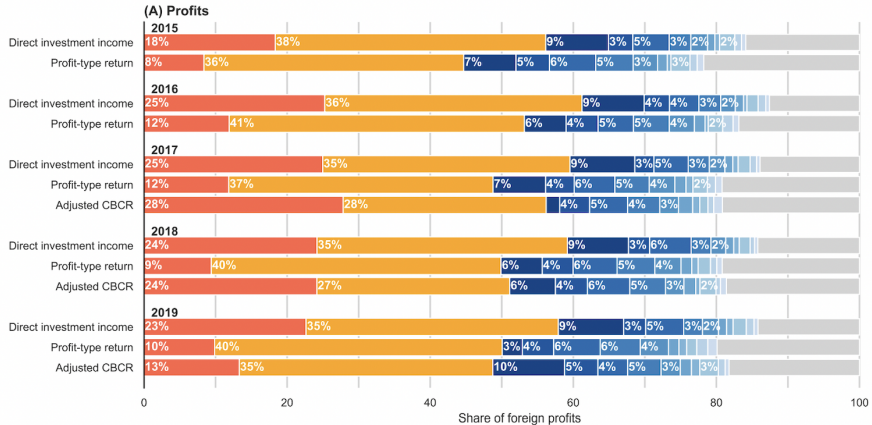
# Profits Booked in Havens by US Firms (% of Foreign Profits of US Firms)



# Other Sources to Study the Location of Foreign Profits

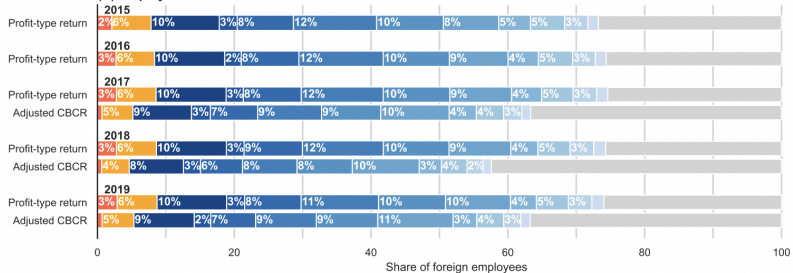
- ▷ **Direct investment equity income:** profits of affiliates more than 10%-owned, pro-rated by the ownership stake of US parent, net of foreign taxes, assigned to country with immediate link with the US
- ▷ **Country-by-Country Data:** profits allocated by “tax jurisdiction,” including Puerto Rico, gross of foreign income taxes
  - ▷ Pb: double count profit (intra-group dividends)
  - ▷ We provide correction to match true foreign and domestic profit totals

# Other Sources Confirm the Stability of Haven Profits

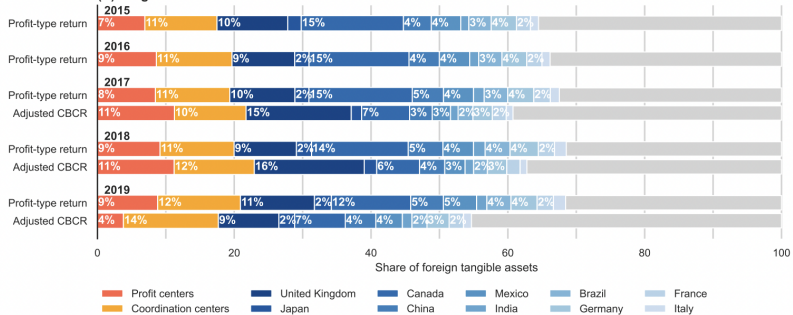


# No Change in Employee or Assets → No Change in Shifting

## (B) Employees

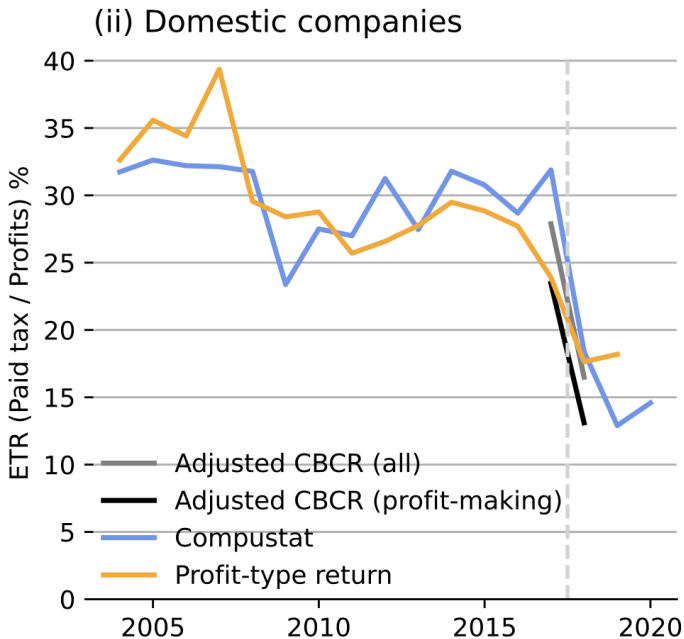


## (C) Tangible assets





# Large Decline in the Effective Tax Rate on US Domestic Profit



# Conclusion

Following the Tax Cuts and Jobs Act:

- ▷ A few large (mostly tech) companies repatriated intellectual property to the United States
- ▷ The share of profits booked by US firms in tax havens remains high: **50% of foreign profits and 15% of all profits**
- ▷ No visible changes (yet) in location of real activity