Effects of Proposed International Tax Changes on U.S. Multinationals

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Key Findings

- The Biden administration's "Made in America Tax Plan" would substantially raise taxes on the activities of U.S. multinational corporations, whether these activities are located domestically or abroad. From the perspective of U.S. multinationals, the proposal would increase their federal tax liabilities by $104 billion in 2022 and $1.2 trillion over 10 years, increases of 81 percent and 72 percent relative to their tax liabilities under current law.

- The Biden plan would increase the tax burden on the foreign operations of U.S. multinationals by more than $714 billion over the next decade.

- The proposal would increase tax rates on domestic income more than on foreign income, resulting in a net *increase* in profit shifting out of the U.S. This increased profit-shifting would reduce their U.S. tax liabilities by $75.5 billion over 10 years.

- The administration's proposed changes to the corporate income tax would reduce the incentives for offshoring, but any resulting re-shoring of tangible assets would be small in magnitude. The resulting effects on domestic investment and tax revenue would increase their U.S. tax liabilities by only $4 billion over 10 years.

- The proposal would impose a 9.4 percent average surtax on the foreign activities of U.S. multinationals above and beyond the taxes levied by foreign governments. These high taxes on U.S. ownership of foreign activities would put U.S. multinationals at a competitive disadvantage relative to foreign corporations, perhaps forcing U.S. firms to sell their foreign subsidiaries. This is unprecedented in recent U.S. economic history, making it difficult to quantify the magnitude of the response to this ownership distortion.

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Introduction

The Biden administration recently introduced its "Made in America Tax Plan," with stated goals of eliminating incentives to offshore investments and reducing profit shifting.[1] They propose raising the corporate tax rate from 21 percent to 28 percent, repealing the deduction for foreign-derived intangible income (FDII), raising the tax rate on global intangible low-taxed income (GILTI) to 21 percent, and tightening the GILTI rules. This paper assesses how these proposed changes would affect the tax liabilities of U.S. multinational enterprises (MNEs) and how profit shifting and investment by these MNEs would respond to the tax incentives from these changes.

Multinationals represent major sources of economic activity and tax revenue in the U.S. In 2016, the U.S. Treasury received $316.1 billion of corporate income tax revenues, with $201.3 billion from U.S. MNEs. Using data on the parent companies of U.S. MNEs from the Bureau of Economic Analysis for 2018, U.S. MNEs invested $721.6 billion in tangible capital and conducted $323.1 billion of research and development. They employed 28.6 million Americans, paying $2.3 trillion of labor compensation.

To assess the intent and effects of the administration's proposal, we first consider the context of international tax planning and the intended effects of the Tax Cuts and Jobs Act's (TCJA) international provisions. The international tax provisions of the TCJA and the administration's focus on a minimum tax on foreign earnings—through the unilateral 21 percent minimum tax in their proposal and through a globally coordinated minimum tax through the OECD—are intended to address longstanding issues with profit shifting.

Prior to the TCJA, U.S. MNEs were subject to a worldwide system of taxation with deferral; while all their income was supposed to be subject to tax regardless of where it was earned, income earned through their controlled foreign corporations (CFCs) would only count toward taxable income when repatriated to the parent company as dividends. This meant these firms could defer realization of the income for tax purposes by not repatriating the income from their controlled foreign corporation to the U.S. parent company. In practice, the combination of the high U.S. tax rate and the deferral option resulted in the steady erosion of the U.S. corporate tax base and the accumulation of untaxed profits in CFCs, particularly in countries with low tax rates. Deferring repatriations to avoid the repatriation tax penalty resulted in "trapped" earnings abroad, while the high U.S. corporate tax rate put U.S. MNEs that were not able to take advantage of this deferral at a competitive disadvantage, resulting in a wave of corporate inversions.[2]

The TCJA attempted to address these problematic incentives with three changes. First, it excluded dividends received from CFCs from taxable income, making the U.S. tax system territorial. This change alone would increase profit-shifting incentives for U.S. MNEs, so the TCJA also added two provisions to limit these incentives. The GILTI minimum tax required that half of foreign income in excess of 10 percent of foreign tangible assets—the qualified business asset income (QBAI) exemption—would be automatically included in U.S. taxable income, creating a 10.5 percent minimum tax on this income, with a credit for 80 percent of foreign taxes paid, resulting in an effective minimum tax between 10.5 and 13.125 percent.

1 U.S. Department of the Treasury, "The Made in America Tax Plan," April 2021, https://www.home.treasury.gov/system/files/136/MadeInAmericaTaxPlan_Report.pdf.

2 Bloomberg, "Tracking Tax Runaways," Mar. 1, 2017, https://www.bloomberg.com/graphics/tax-inversion-tracker/.

This minimum tax was paired with the FDII provisions, which allowed a 37.5 percent deduction on domestic income in excess of 10 percent of domestic tangible assets, based on the share of this income from foreign sources. This created an effective 13.125 percent tax rate on this income. Combined with the GILTI tax rate, this was intended to substantially reduce or eliminate the incentive to shift profits abroad. These rates were set to change in 2026, with the GILTI inclusion rate rising to 62.5 percent (the GILTI deduction rate dropping to 37.5 percent) and the FDII deduction rate dropping to 21.875 percent. The result: an effective minimum tax rate on GILTI between 13.125 and 16.4 percent and an effective tax rate of 16.4 percent on FDII.

The Biden administration has criticized these provisions as imposing too lenient tax rates on supernormal profits, and not doing enough to reduce profit shifting. They have also criticized the global nature of GILTI, which allows high taxes paid in high-tax countries to offset low taxes paid in tax havens because income and the foreign tax credit are pooled across all countries; this effect is known as cross-crediting. Accordingly, in addition to raising the corporate tax rate to 28 percent and repealing the FDII deduction, their proposal would eliminate the GILTI exemption on 10 percent of tangible assets, raise the share of GILTI included to 75 percent (creating an effective 21 percent GILTI tax rate), and make GILTI apply per country to eliminate cross-crediting.

The proposal leaves ambiguous whether or how it might change the 20 percent haircut on the foreign tax credit. If their proposal would not change this provision, the actual minimum tax would fall between 21 and 26.25 percent. Because of this ambiguity, the modeling in this paper assumes that the GILTI foreign tax credit (FTC) haircut would remain unchanged.

We model the effects of the proposal on the tax liabilities of U.S. MNEs using Tax Foundation's newly developed Multinational Tax Model, which allows us to compute tax liabilities of U.S. MNEs as well as their profit shifting and investment incentives. Overall, we find that the administration's proposal would substantially increase taxes on multinationals, regardless of the location of their activities. However, it would increase taxes on domestic activity more than it would increase taxes on foreign activity, resulting in a net increase in profit shifting out of the U.S., contrary to the stated goals of the tax plan. Under most assumptions, it would decrease the forward-looking tax benefit to offshoring tangible assets, although the resulting effects on domestic investment would be relatively small. Moreover, the higher taxes on U.S. multinationals would put U.S. ownership of foreign activity at a substantial disadvantage relative to foreign ownership.

Model Overview

This section provides a summary of Tax Foundation's Multinational Tax Model.[3] The model is structured as a representative MNE that owns a set of CFCs and conducts other activity, both domestic and foreign. We use a representative CFC for each country available.

The data in the model come from the BEA data on activities of MNEs and IRS Statistics of Income (SOI) international data, all for 2014. We use 2014 because it is a benchmark year for the BEA survey—and thus has more data available—and has data available for the year from the IRS. Note that some countries' tax rates have been reduced since then, but the likely effects of this on U.S. tax revenue from multinationals is likely small.

3 For further information, Tax Foundation will provide forthcoming model documentation.

The CFC model relies on IRS data on the activities of CFCs, which provides data on assets, dividend income, profits, foreign taxes paid, subpart F income (a set of rules intended to reduce shifting incentives for passive and mobile income), dividends paid to the U.S. parent company, dividend income from related foreign affiliates, and accumulated untaxed foreign profits. These allow us to estimate the average foreign tax rate in each country, the share of income captured by subpart F, and the dividend payout rate as a share of profits after foreign taxes. The IRS data specifically identifies 41 countries, and we combine all other countries into a single "other" country category.

To apply relevant tax rules under current law, we impute information—such as tangible capital and equity income from related foreign affiliates—to each of these CFCs using BEA data on majority-owned foreign affiliates (MOFAs) of U.S. MNEs.

For the parent company, we use IRS data on corporations claiming the foreign tax credit. These tables provide detailed information on the types of income, taxes paid, and tax items for these U.S. parent companies. We use this information to identify parameters relevant to the tax calculations, such as the importance of deductions and adjustments to taxable income, as well as parameters to adjust for firm heterogeneity regarding the effectiveness of the limitation on the foreign tax credit.

These models of CFCs and their U.S. parents provide sufficient detail to model the U.S. tax rules for international activity before the TCJA, under the TCJA, and under various proposals for reforms to these international tax rules.

Effects on Profit shifting and Investment Incentives

The administration's proposal described above would have important effects on the incentives regarding the location of profits and of investment, important considerations for the effectiveness of or problems with the proposal. The administration has claimed that the TCJA created incentives for offshoring investment, and that the GILTI rate is too low and encourages profit shifting.[4]

In this section, we assess how the TCJA affected these incentives and how the administration's proposal would further change these incentives. Overall, we find that the TCJA reduced profit-shifting incentives. While the 10 percent exemptions on tangible property in the calculation of the FDII deduction and GILTI income create offshoring incentives, these incentives under the TCJA are smaller than their respective incentives under pre-TCJA law, and much smaller with expensing of investment costs. Under some assumptions, the administration's proposal would further reduce the incentives to locate tangible capital offshore.

However, contrary to the administration's claims, the proposal would *increase* profit-shifting incentives on net. Although the higher GILTI rate and changes to the structure of GILTI would raise the tax rates on profits located abroad, these effects are smaller than the increase in the tax rate on domestic income. Although these effects are heterogeneous by country, the overall impact is robust to various assumptions, and it is particularly large when accounting for the tax benefit on supernormal profits booked domestically from the FDII deduction, which the administration's proposal would eliminate.

4 U.S. Department of the Treasury, "The Made in America Tax Plan."

Profit-Shifting Incentives

The incentive to shift profits into or out of a foreign country depends critically on the average tax rate on income in that country. For CFCs owned by U.S. parents, the taxes on this income come from foreign taxes levied as well as residual U.S. taxes on CFCs. Under pre-TCJA law, current law, and the Biden administration's proposal, some of the income accruing in CFCs is automatically included in the U.S. parent company's taxable income through subpart F. Under pre-TCJA law, dividends paid to the parent company would be included in their taxable income. Under current law, dividend repatriations do not affect taxable income, but some foreign income is subject to U.S. tax through the GILTI provisions. The administration's proposed expansion of GILTI would increase the residual U.S. taxes on CFC profits.

In Table 1, we present the average tax rates on income in CFCs by foreign countries, as well as the combined foreign and residual U.S. tax rates under pre-TCJA law, under the TCJA before and after 2026, and under the administration's proposals.

The average tax rate imposed by foreign countries on income in CFCs is 12.8 percent. These tax rates are calculated from the IRS tables on CFCs, as total foreign taxes paid in each country divided by total profits reported in the country. Average tax rates estimated from this data are generally more reflective of tax burdens than statutory tax rates, as average tax rates also include differences in taxable income calculations across countries and preferential treatment for certain types of income (e.g., patent boxes).

However, average tax rates also include some measurement error due to the IRS's methodology for attributing taxes deemed paid on dividends aggregated by subsidiaries. Accounting professors Jennifer Blouin and Leslie Robinson explore the accounting problems, particularly the "double-counting" of dividends paid from one CFC to another.[5] Although this double-counting increases measured CFC income, it likely has small overall bias for our estimates despite mismeasurement in some countries. Moreover, the IRS attributes the income of disregarded entities for tax reporting purposes to the country of the CFC that owns them. For example, even though the Cayman Islands has no corporate income tax, the IRS data shows a 33.6 percent average tax rate on earnings booked in subsidiaries located in the Cayman Islands. This is likely due to ownership structures in which a Cayman Islands subsidiary owns disregarded entities in other countries; the profits and taxes paid by those disregarded entities are misattributed to the Cayman Islands by the IRS methodology.

Under pre-TCJA law, inclusions through subpart F and repatriated dividends raised this tax rate from 12.8 percent to 14.6 percent, excluding deferred U.S. tax on foreign earnings not repatriated. Replacing the dividend inclusion with GILTI raised this tax rate to 15.6 percent. Beginning in 2026, when the GILTI deduction decreases, the higher U.S. tax on these CFCs raises their tax rate by another percentage point. Under the Biden administration proposal, the average tax rate on these CFCs would rise to 22.2 percent.

5 Jennifer Blouin and Leslie A. Robinson, "Double Counting Accounting: How Much Profit of Multinational Enterprises Is Really in Tax Havens?" SSRN, Apr. 9, 2021, https://www.ssrn.com/abstract=3491451.

TABLE 1.

Combined U.S. and Foreign Average Tax Rates on Controlled Foreign Corporations

	Foreign	Pre-TCJA	TCJA, pre-2026	TCJA, post-2026	Biden
Argentina	62.4	62.0	45.2	44.8	65.0
Australia	22.6	23.4	22.5	23.0	30.0
Austria	27.6	29.5	25.5	26.2	34.1
Bahamas	7.1	11.0	9.3	9.3	9.9
Belgium	28.9	29.6	24.8	25.9	35.7
Bermuda	11.2	13.0	13.5	14.1	16.3
Brazil	37.8	38.0	29.8	30.4	43.2
British Virgin Islands	7.0	7.5	11.4	12.7	16.9
Canada	20.4	21.4	20.8	21.4	27.9
Cayman Islands	33.6	34.8	29.3	29.7	35.9
Chile	12.8	18.6	16.9	17.4	26.4
China	22.9	23.4	22.0	23.1	30.8
Colombia	35.1	35.3	31.1	31.5	38.8
Czech Republic	21.3	21.6	21.0	22.2	30.5
Denmark	19.6	20.7	20.3	21.3	28.7
France	31.7	32.3	28.5	29.0	35.8
Germany	23.2	24.0	22.4	23.4	30.6
Hong Kong	6.8	20.1	16.5	17.2	21.9
Hungary	10.3	18.1	17.5	18.7	26.0
India	45.3	45.3	33.0	33.3	48.5
Ireland	3.3	4.2	11.3	13.4	20.7
Israel	14.1	15.1	17.2	18.7	26.4
Italy	35.5	35.7	31.7	32.1	39.1
Japan	28.0	28.7	24.6	25.6	34.5
Luxembourg	6.6	8.6	11.1	12.2	16.0
Malaysia	13.0	13.6	15.5	16.6	23.9
Mexico	21.4	21.7	20.9	22.3	31.8
Netherlands	8.4	10.3	11.0	11.5	13.8
Norway	43.6	43.5	33.6	33.9	47.1
Panama	10.9	12.5	14.2	15.3	22.4
Peru	38.6	38.6	34.1	34.4	42.4
Philippines	18.2	18.6	19.2	20.5	27.9
Poland	19.8	21.0	20.4	21.5	30.6
Portugal	26.7	28.3	24.6	25.5	32.9
Singapore	5.2	6.7	11.6	13.2	19.2
South Korea	27.3	27.8	24.6	25.5	35.0
Spain	30.2	30.7	26.3	27.1	36.3
Sweden	33.5	34.5	25.8	26.7	39.4
Switzerland	8.7	11.4	14.3	15.8	21.2
Turkey	24.6	25.1	22.9	24.0	32.0
United Kingdom	10.2	11.9	13.5	14.4	20.1
Other countries	19.0	19.9	19.8	20.8	28.0
Average	**12.8**	**14.6**	**15.6**	**16.6**	**22.2**

Note: Pre-TCJA tax rates do not account for deferred U.S. tax on foreign earnings held abroad.

Source: IRS, "SOI Tax Stats – Controlled Foreign Corporations," https://www.irs.gov/statistics/soi-tax-stats-controlled-foreign-corporations; and Tax Foundation's Multinational Tax Model, April 2021.

Although the TCJA raised tax rates on CFCs on average (on a current basis, excluding deferral), the effect is heterogeneous by country. For example, it raised the tax rate on Irish CFC income from 4.2 percent to 11.3 percent, but it reduced the tax rate on German CFC income from 24 percent to 22.4 percent. This reduction in the tax on German CFC income occurs because of cross-crediting; the 10.5 percent tax on GILTI income in Germany is less valuable than the 80 percent foreign tax credit for the taxes paid in Germany, as the high foreign tax credit can offset the low foreign tax credit for Irish taxes. (Germany has a higher corporate tax rate than Ireland.)

However, raising tax rates on CFCs is not sufficient to reduce profit shifting. The relevant incentive for shifting profits out of or into the U.S. is the tax shield, or benefit, from this profit shifting—the tax rate on this income if booked in the U.S. less the tax rate on it if booked in a CFC. Under pre-TCJA law, the marginal U.S. tax on these supernormal profits would be 35 percent if booked in the U.S compared to marginal U.S. and foreign taxes of 14.6 percent if booked in a CFC, offering a 20.4 percentage-point average tax shield or benefit from profit shifting. Under the TCJA, if a firm is not eligible for FDII, it would face a 21 percent tax on domestic supernormal profits, providing an average tax shield of 5.4 percentage points. On the other hand, if a firm is eligible for the FDII deduction, the marginal tax on these profits would be 13.125 percent before 2026 and 16.4 percent after, so the tax shield to shifting profits abroad would be *negative*, or reversed. On net, they would have more incentive to keep profits in the U.S.

Although the Biden administration's proposal would substantially raise taxes on CFCs, it would raise tax rates on domestic supernormal profits more, thus resulting in a net *increase* in profit shifting relative to current law. Under the Biden administration's proposal, the tax rate on supernormal profits booked domestically would be 28 percent, whereas the tax rate on CFCs would be 22.2 percent. So, profit shifting would provide a 5.8 percentage-point tax shield. Ignoring the proposed removal of FDII, the increase in profit shifting would be small. However, including the current tax shield from FDII, the Biden administration proposal would substantially increase the incentive to shift profits abroad, although the new incentive would still be substantially smaller than under pre-TCJA law.

This net increase in profit-shifting result also holds when conducting this analysis by country and aggregating the resulting shifted profits, instead of using the average results. Using a semi-elasticity of 0.8 with respect to the tax shield, this produces a net increase in profits shifted out of the U.S. of $52.8 billion in 2031.

This analysis relies on calculations of the average residual parent tax on CFCs from Tax Foundation's Multinational Tax Model. These average tax rate results capture complexities—such as the effects of subpart F, foreign tax credit limitations, and cross-crediting—omitted from calculations using statutory tax rates. Moreover, statutory tax rates may poorly reflect the actual tax burden, as they omit base differences. For example, the statutory tax rate in Ireland is 12.5 percent, but the average foreign tax rate on CFC income in Ireland is only 3.3 percent. Nevertheless, we can also calculate combined foreign and U.S. statutory taxes on CFC income under pre-TCJA law, current law, and the Biden proposal. The overall profit-shifting results are robust to using statutory tax calculations instead of average tax calculations, although the effects differ by country.

Outsourcing and Investment Incentives

A major critique of the TCJA's international provisions focuses on supposed offshoring incentives. Specifically, critics argue that shifting the location of low-return tangible capital from the U.S. to a foreign jurisdiction would raise the FDII deduction and reduce GILTI income, potentially creating a large tax benefit for offshoring tangible capital.[6] However, this argument has often been made without numerical estimates or evidence to assess its magnitude, and it disregards how this incentive compares to the offshoring incentives before the TCJA.

To assess these incentives, average tax rates and statutory tax rates are insufficient. Average tax rates are backward-looking and would thus miss the claimed tax shield from the tangible asset exemptions in GILTI and FDII, whereas statutory calculations lack the detail to capture these effects.

Instead, we model these investment and offshoring incentives using forward-looking effective average tax rates (EATRs), which include the effects of the GILTI and FDII provisions. Generally, an EATR measures the forward-looking expected average tax rate on an investment with supernormal returns.[7] This allows us to assess the discrete choice location for an investment. Table 2 presents the EATRs on tangible and intangible investment, either located in the U.S. as investment by the parent company or abroad as investment in a CFC, under our preferred parameter estimates. Because the EATR is generally used to assess a discrete investment location decision for a project with supernormal returns, we assume a 15 percent return for tangible investment and a 20 percent return for intangible investment. We also assume a 70 percent probability that the investing firm is eligible for FDII.

TABLE 2.

Effective Average Tax Rates

	Tangible EATR			Intangible EATR		
	U.S. Parent	CFC	Diff	U.S. Parent	CFC	Diff
Pre-TCJA	26.8	14.9	11.9	24.0	9.3	14.7
TCJA, pre-2026	15.5	13.7	1.8	10.6	9.0	1.6
TCJA, post-2026	15.8	14.3	1.4	12.2	11.1	1.1
Biden proposal	21.5	21.0	0.4	19.2	17.8	1.4

Note: These calculations use a 15 percent return for tangible investment and a 20 percent return for intangible investment, and they assume a 70 percent probability that the parent is eligible for FDII.

Source: Tax Foundation's Multinational Tax Model, April 2021.

The EATR is generally a weighted average of the marginal effective tax rate and the statutory tax rate, with adjustments for the additional tax or tax shield from GILTI and FDII on the return on the investment and the reduced tax or tax shield from tangible assets under current law. The foreign EATRs presented are weighted averages across countries, with the tangible EATRs weighted by tangible assets (plants, property, and equipment, or PPE) and the intangible EATRs weighted by non-tangible assets. Due to limited information on cost recovery practices in other countries, this analysis omits differences arising from different cost recovery rules between the U.S. and other countries.

6 U.S. Department of the Treasury, "The Made in America Tax Plan."

7 Michael P. Devereux and Rachel Griffith, "The Taxation of Discrete Investment Choices," The Institute for Fiscal Studies, Working Paper No. W98/16, February 1999, https://www.ifs.org.uk/wps/wp9816.pdf.

The overall EATRs on tangible assets generally exceed those on intangibles because intangible investment receives more generous capital cost recovery methods, such as expensing and the research and experimentation tax credit. Under pre-TCJA law, there was a substantial tax advantage to locating investment abroad, with a tax shield (the domestic EATR less the foreign EATR) of 11.9 percentage points for tangible assets and 14.7 percentage points for intangibles. Note that the calculations under pre-TCJA law do not account for the cost of deferring repatriation of the profits or tax liabilities if these profits might have been repatriated eventually. While including these would raise the tax EATRs on investment in CFCs, it is unlikely that they would be sufficient to offset the large tax shields from offshoring under pre-TCJA law.

The TCJA substantially reduced the tax shield to locating investment abroad, whether tangible or intangible, due to the combination of a lower statutory corporate tax rate and the FDII deduction. For domestic tangible investment, the 10 percent QBAI exemption of FDII reduces the amount of income eligible for the FDII deduction, insofar as the firm is eligible for FDII. If located in a CFC, the 10 percent QBAI exemption reduces the amount of income subject to GILTI. As identified by the administration, the 10 percent QBAI exemptions raise the forward-looking tax rates on domestic tangible investment and reduce these tax rates on foreign tangible investment. However, the resulting tax shields are small, much smaller than the tax shields under pre-TCJA law. For intangible investment, the full amount is eligible for the FDII deduction if the investing firm is eligible. After 2026, the reductions in the GILTI and FDII deduction rates raise the EATRs on domestic and foreign investment, and the tax shields to locating these assets abroad decrease slightly.

The Biden proposal would substantially raise the EATRs on both domestic and foreign investment, by almost 6 percentage points for tangible investment and almost 7 percentage points for intangible investment. On net, the proposal would decrease the tax shield to locating tangible capital abroad, with more ambiguous effects for the incentive to offshore intangible assets.

While the EATRs and their associated tax shields in Table 3 represent our preferred estimates, the estimated tax shields depend on assumptions about the rate of return and whether a firm is eligible for the FDII deduction. Because of the 10 percent QBAI exemption, if the rate of return on the investment is below 10 percent, then GILTI provides a net subsidy to foreign tangible investment, and FDII provides a net surtax to domestic tangible investment. If the return on these tangible assets exceeds 10 percent, then GILTI and FDII only apply to the return above 10 percent.

To assess how rates of return and FDII eligibility affect these incentives, Table 3 presents various tax shields—the difference between the tax rate on activity in the U.S. and the tax rate on the same activity in a CFC—under different assumptions about the rates of return and the probability of eligibility for the FDII deduction for the U.S. parent company. The statutory and average tax shields are computed by country and weighted by profits located in each country. The tangible and intangible EATR tax shields are also computed by country, with the tangible shields weighted by tangible assets and the intangible shields weighted by non-tangible assets. The low rates of return use the cost of capital, which is the break-even pretax rate of return. The medium return calculations use a 12 percent rate of return, and the high return calculations use a 20 percent rate. Note that while the high return is the same as used for intangible investment in Table 2, we use a 15 percent return for tangible investment in Table 3, intermediate between the medium and high returns used in Table 2.

TABLE 3.

Tax Shields for Foreign Investment Under Various Assumptions

		TCJA, no FDII		TCJA, some FDII		TCJA, full FDII		
	Pre-TCJA	Pre-2026	Post	Pre-2026	Post	Pre-2026	Post	Biden
Statutory	16.1	0.5	-0.3	-5.0	-3.5	-7.4	-4.9	2.8
Average	20.4	5.4	4.4	-0.1	1.2	-2.5	-0.2	5.8
Tangible EATR, low return	10.1	-0.7	0.6	3.2	2.9	4.6	3.8	-0.8
Tangible EATR, medium return	11.0	1.3	1.2	2.0	1.6	2.3	1.8	0.1
Tangible EATR, high return	12.8	3.4	2.3	1.6	1.3	0.9	0.8	0.8
Intangible EATR, low return	3.4	1.3	0.1	0.5	-0.4	0.2	-0.6	-3.2
Intangible EATR, medium return	10.2	3.8	2.1	1.1	0.5	0.0	-0.1	-0.2
Intangible EATR, high return	14.7	5.4	3.3	1.6	1.1	0.0	0.2	1.4

Note: We use the cost of capital (break-even return) for the low return, 12 percent for the medium return, and 20 percent for the high return.
Source: Tax Foundation's Multinational Tax Model, April 2021.

The administration's argument that the 10 percent QBAI exemption for FDII creates a tax shield for offshoring tangible investment relies critically on these tangible assets having low rates of return. For the tangible assets with only break-even returns, raising the probability of FDII eligibility increases the tax shield from offshoring, consistent with this narrative. However, this effect becomes smaller with a 70 percent probability of FDII eligibility, and it reverses under high rates of return. Depending on the assumptions used, Table 3 demonstrates that the implied forward-looking tax shields to offshoring tangible investment decrease under the Biden administration's proposals if the assets have low or medium returns, as well as for high returns if the parent is not currently eligible for the FDII deduction.

For intangible investment, the effects are also sensitive to rates of return and the probability of FDII eligibility. Ignoring FDII, the administration's proposals would reduce the tax shield from locating intangible assets abroad. However, if the potential for FDII eligibility is included, the proposals could increase the incentive to locate intangible assets in CFCs. For intangible assets with high returns—the most relevant case for profit shifting—the FDII made the EATRs for locating these assets domestically or abroad essentially identical, and the Biden administration's proposals would increase the incentive to locate these assets abroad.

Economic Impacts

The potential economic impacts of the Biden administration's corporate tax proposals operate through three channels: a change in measured GDP due to the profit shifting and the location of intangible assets; a reduction in foreign tangible investment and potential related changes in domestic tangible investment; and changes in asset ownership to avoid high U.S. taxes on worldwide income.

Changes in profit shifting and the location of intangible assets by U.S. MNEs do not affect the location of real economic activity, but they have measurement implications for GDP. For intangible assets moved to a foreign subsidiary, measured GDP decreases from reduced domestic corporate profits (on the income side of the ledger) and increased imports of intellectual property services to match the increased royalty and other payments made for use of that intellectual property. However, because these higher foreign profits are still owned by U.S. multinationals, GNP does not change. Note that under some proposed international tax rules—in particular, the OECD's proposed nexus requirements for real activity linked to intellectual property—relocating intangible assets would also require relocating real activity to accompany it. While this could reduce incentives to locate intangible assets in low-tax countries, it would also incentivize firms to relocate employees from high-tax countries to low-tax countries.

If or insofar as the Biden administration's proposal reduces offshoring of tangible investment, the net effect on domestic investment is ambiguous. In the short run, reduced offshoring should be accompanied by higher domestic investment, but this may be offset by complementarities between domestic and foreign investment; economists Mihir Desai, Fritz Foley, and James Hines in a 2009 study found that a 10 percent increase in foreign investment by U.S. multinationals is accompanied by a 2.6 percent increase in domestic investment.[8]

However, in the long run, this would not affect the U.S. capital stock. The capital stock over the long run is determined by the service price of capital. An increase in domestic investment from reduced offshoring would reduce the economy-wide marginal product of capital. Over time, this would in turn reduce other domestic investment until the marginal product of capital returned to equal the service price.

Finally, under the Biden administration's proposals, the U.S. would impose substantial taxes on the foreign operations of U.S. multinationals, 9.4 percentage points on average, putting these firms at a competitive disadvantage and over time resulting in reduced foreign activities of U.S. multinationals.

Table 4 presents the U.S. tax liabilities of U.S. multinationals arising from activities of CFCs. These computed liabilities arise from subpart F rules and GILTI net of their associated foreign tax credits. These computations are static, excluding firm responses to the changes in tax incentives.

Under current law, our model estimates that U.S. firms will face $412.1 billion in tax liabilities on the activities of their CFCs over 10 years. The Biden plan would increase that liability by $714.1 billion over the next 10 years, to more than $1 trillion.

8 Mihir A. Desai, C. Fritz Foley, and James R. Hines, "Domestic Effects of the Foreign Activities of US Multinationals," *American Economic Journal: Economic Policy*, 1:1 (February 2009), https://www.aeaweb.org/articles?id=10.1257/pol.1.1.181.

TABLE 4.

Multinationals' U.S. Tax Liabilities from Activities of Their CFCs ($ billions)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Current law	26.0	27.8	29.9	31.8	46.0	47.5	48.9	50.1	51.4	52.8	412.1
Biden plan	89.1	95.3	102.5	109.0	113.3	116.9	120.3	123.4	126.5	129.9	1126.2
Change	63.1	67.5	72.5	77.2	67.3	69.4	71.5	73.3	75.1	77.2	714.1

Note: All numbers presented are in billions of USD. Tax liabilities from CFC activities are attributed using taxes on subpart F and GILTI income net of their associated foreign tax credits. These tax liabilities do not include firm responses to tax policies.

Source: Tax Foundation's Multinational Tax Model, April 2021.

We have identified three channels through which U.S. MNEs may respond to high taxes levied on U.S. ownership of foreign activities. Due to competition, U.S. multinationals could be outbid or outpriced by foreign firms not subject to the higher U.S. taxes.

U.S. MNEs could also sell off part or all of their foreign assets to foreign investors. Because these foreign investors are not subject to U.S. taxes, the same economic activities would be more valuable when owned by foreign investors than by U.S. multinationals, creating incentives for mergers and acquisitions to shift these assets to those foreign owners. For example, as shown in Table 4, under current law, U.S. multinationals will pay $26 billion to the federal government in 2022 on the profits of their CFCs (the combined effects of subpart F and GILTI net of foreign tax credits). Under the administration's proposal, the multinationals would instead owe $89 billion to the U.S. government on these CFC profits. These U.S. taxes would create substantial tax savings from selling partial ownership of these CFCs to foreign investors, even if the U.S. parent maintained a majority stake in the CFC.

Finally, U.S. multinationals could contract with foreign firms to conduct foreign activities, instead of performing these activities in-house.

Quantifying the effects of these competitiveness arguments is difficult, as the U.S. has not previously imposed such high taxes on activities in CFCs. Note that none of these shifts in foreign ownership of CFCs or their activities requires corporate inversions, so anti-inversion regulations would not limit these ownership shifts.

Net Effects on Multinationals

Table 5 presents the effects on federal tax liabilities of U.S. MNEs from the different components of the Biden administration's proposals. Note that the changes in these tax liabilities are not the same as changes in federal tax revenue. Because of double taxation, the increase in tax liabilities reduces dividend and capital gains income, as well as labor income insofar as the burden of the corporate income tax accrues to labor, which in turn reduces individual income and payroll tax revenues.[9]

9 Julie-Anne Cronin, Emily Y. Lin, Laura Power, and Michael Cooper, "Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology," *National Tax Journal* 66:1 (March 2013), https://www.ntanet.org/NTJ/66/1/ntj-v66n01p239-62-distributing-corporate-income-tax.html; Joint Committee on Taxation, "Modeling the Distribution of Taxes on Business Income", JCX-14-13, Oct. 16, 2013, https://www.jct.gov/publications/2013/jcx-14-13/; James R. Nunns, "How TPC Distributes the Corporate Income Tax", Tax Policy Center, Sept. 13, 2012, https://www.taxpolicycenter.org/publications/how-tpc-distributes-corporate-income-tax#:~:text=Based%20on%20these%20recent%20research,to%20corporate%20equity%20(shareholders); and Stephen J. Entin, "Labor Bears Much of the Cost of the Corporate Tax", Tax Foundation, Oct. 24, 2017, https://www.taxfoundation.org/labor-bears-corporate-tax/.

Moreover, the increase in the statutory corporate tax rate and repeal of FDII also raise the tax liabilities of non-multinational corporations.

TABLE 5.

Changes in Federal Tax Liabilities of U.S. MNEs ($ billions)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Raise corporate tax rate to 28%	58.5	62.6	67.3	71.6	82.0	84.6	87.1	89.3	91.6	94.0	788.6
Repeal FDII deduction	4.0	4.3	4.7	5.0	3.0	3.1	3.2	3.3	3.4	3.5	37.6
Raise GILTI rate to 21%	32.2	34.4	37.0	39.4	21.0	21.7	22.3	22.9	23.5	24.1	278.4
Tighten GILTI rules	16.6	17.8	19.1	20.3	21.1	21.8	22.4	23.0	23.6	24.2	209.8
Profit-shifting effect	-7.1	-7.6	-8.1	-8.6	-6.8	-7.1	-7.3	-7.5	-7.6	-7.8	-75.5
FDI effect	0.0	0.1	0.2	0.3	0.4	0.5	0.5	0.6	0.7	0.7	4.0
Combined	104.3	111.6	120.1	127.9	120.7	124.6	128.3	131.7	135.1	138.7	1242.9

Note: All numbers presented are in billions of USD. Tightening GILTI rules consists of eliminating the 10 percent QBAI exemption and applying the GILTI foreign tax credit on a per country basis.
Source: Tax Foundation's Multinational Tax Model, April 2021.

Ignoring firm responses to tax changes, raising the corporate tax rate to 28 percent raises the federal tax liabilities of U.S. MNEs by $788.6 billion over a decade. Repealing FDII raises their total liabilities by $37.6 billion. Raising the GILTI tax rate to 21 percent only raises $278.4 billion, as the effective GILTI rate was already increased from 10.5 percent to 14 percent due to the higher corporate tax rate. However, tightening GILTI by eliminating the 10 percent QBAI exemption and making it apply on a country-by-country basis instead of a global basis raises $209.8 billion over a decade.

These higher tax liabilities are partially offset by higher profit shifting, which reduces their U.S. tax liabilities by $75.5 billion over a decade, modeled using a semi-elasticity of reported CFC profits of 0.8 with respect to the tax shield. The reduction in the higher U.S. tax liabilities under new profit shifting includes higher profit shifting in response to the lower corporate tax rate and FDII repeal as well as less profit shifting in response to GILTI. Table 6 presents the change in U.S. tax liabilities of these multinationals in response to each of the modeled provisions.

TABLE 6.

Effect of Profit Shifting on Federal Tax Liabilities of U.S. Multinationals ($ billions)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Raise corporate tax rate to 28%	-5.0	-5.3	-5.7	-6.1	-6.4	-6.7	-6.8	-7.0	-7.2	-7.4	-63.7
Repeal FDII deduction	-14.1	-15.1	-16.2	-17.3	-9.4	-9.7	-10.0	-10.2	-10.5	-10.8	-123.2
Raise GILTI rate to 21%	8.8	9.4	10.1	10.8	5.0	5.1	5.3	5.4	5.5	5.7	71.1
Tighten GILTI rules	3.2	3.5	3.7	4.0	4.0	4.1	4.3	4.4	4.5	4.6	40.3
Combined	-7.1	-7.6	-8.1	-8.6	-6.8	-7.1	-7.3	-7.5	-7.6	-7.8	-75.5

Note: All numbers presented are in billions of USD. Tightening GILTI rules consists of eliminating the 10 percent QBAI exemption and applying the GILTI foreign tax credit on a per country basis.
Source: Tax Foundation's Multinational Tax Model, April 2021.

The $75.5 billion revenue loss figure is net of a combination of effects that the Biden plan would encourage and discourage MNE profit shifting activities. Contributing to the loss of revenues over the 10-year window would include profit shifting in response to the higher corporate tax rate, which would reduce their U.S. liabilities by $63.7 billion over 10 years. Repealing FDII would increase the loss to profit shifting by a further $123.2 billion, reflecting that much profit shifting is conducted by firms eligible for FDII. Factors that would reduce this loss include the 21 percent GILTI rate (which would reduce this profit shifting loss by $71.1 billion) and making GILTI apply by country and eliminating the 10 percent QBAI exemption (which would reduce the loss to profit shifting by $40.3 billion). The combined effect of these provisions is a net reduction in U.S. tax liabilities by $75.5 billion.

To model the foreign investment response by U.S. multinationals, we apply a semi-elasticity of 0.5 for tangible investment to the change in the EATR on foreign tangible investment. This reduces foreign investment by U.S. MNEs. If we assume that this tangible investment is instead made in the U.S., net of the complementarity between domestic and foreign investment from Desai, Foley, and Hines (2009), this increases U.S. multinational corporate tax liabilities by only $4 billion over a decade, a small revenue effect. If we apply a semi-elasticity with respect to the tax shield instead of with respect to the tax rate, this reduces the revenue gain to only $0.3 billion over a decade. If we instead assume that reduced foreign investment is not re-shored to the U.S., then the effect of the foreign investment response would be to further reduce U.S. tax revenues.

Conclusion

The Biden administration's proposed changes to the corporate income tax, and particularly taxes on multinationals, would substantially raise tax liabilities of these U.S. multinationals, including higher taxes on both their domestic and foreign activities. However, the proposed changes would increase taxes on domestic income more than on foreign income, resulting in increased profit shifting relative to current law.

We also analyzed forward-looking investment incentives under pre-TCJA law, under current law, and under the administration's proposals. While the TCJA's 10 percent exemptions for tangible assets in the FDII and GILTI provisions create incentives to offshore tangible assets, these incentives under current law are much smaller than under pre-TCJA law. The administration's proposed changes to the corporate income tax would further reduce these incentives, but any resulting re-shoring of tangible assets would be small in magnitude.

Moreover, the high U.S. taxes on foreign activities of U.S. multinationals under the proposal would put U.S. MNEs at a disadvantage relative to non-U.S. corporations. This disadvantage would be sizable, potentially resulting in substantial restructuring of foreign ownership and activities of U.S. multinationals in response to the high U.S. taxes.