Estimated impacts of proposed changes to GILTI provision on US domestic economic activity

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Overview

- This analysis finds that the Biden Administration's proposed expansion of the GILTI tax may adversely impact the US economy with reductions in US jobs and investment
- The economic literature indicates that the proposed changes to GILTI are likely to reduce US employment of US MNCs, and the reduction could be anywhere from 200,000 to 3.1 million jobs; these effects span a very wide range because they are high-level estimates based on parameters from a diverse set of empirical papers
- Nonetheless, professional judgement informed by this analysis and combined with the results of other somewhat similar tax policy changes suggests that plausible employment effects for the US MNCs could range somewhere between 500,000 and 1,000,000 lost jobs

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Background on GILTI

- Global Intangible Low-Taxed Income (GILTI) is a definition of certain earnings of foreign affiliates of US-based multinational corporations (MNCs) that was adopted as part of the Tax Cuts and Jobs Act (TCJA) of 2017

- The GILTI rules operate as a form of minimum tax on the profits of US-based MNCs; GILTI is targeted at the income earned by the foreign affiliates of US-based MNCs on intangible assets such as patents, trademarks, and copyrights

- In effect, GILTI is an attempt to balance somewhat competing goals:
  1. Allowing US MNCs to compete with foreign rivals by imposing little or no US tax in addition to the tax imposed by the foreign jurisdiction
  2. Discouraging tax-induced shifting of profits and real economic activity out of the United States

Proposed changes to GILTI

- The Biden Administration has proposed three key changes to the GILTI calculation:
  1. Raise the effective GILTI statutory tax rate from 10.5% to 21%
  2. Eliminate the currently allowed deduction against taxable income for a 10% rate of return on tangible assets
  3. Change the basis of the GILTI tax assessment from world-wide to country-by-country

- The proposed changes are intended to reduce the incentive to shift profits and real economic activity to low-tax jurisdictions by raising the tax rate on the foreign earnings of US MNCs

- Some policymakers have argued that the lower tax on foreign source income may lead to offshoring of American jobs because companies have a tax incentive to produce and earn income outside the United States

Analysis framework

- There is, however, significant research – both conceptual and empirical – that suggests that the overseas businesses of US MNCs are complementary to the US domestic businesses; that is, when the foreign investment and employment of US MNCs increases, so does the domestic investment, exports, R&D, and employment of the US MNCs

- US MNCs face foreign competition and relying on foreign operations can result in cost savings because, for example, of savings on transportation costs, establishing local distribution and sales networks, and building local good will; some products are too heavy to ship and services cannot be shipped

Effective tax rate on foreign income

- Overall, this analysis estimates the effective tax rate on foreign income would rise by, on average, approximately 8 percentage points
  - Uses IRS country-by-country reporting data (incl. data on the effective tax rate of the foreign operations of the seven industries, which is available for more than 60 jurisdictions) supplemented with other publicly available industry-level data

- Estimates produced are consistent with other research
  - Estimated 16.3% effective tax rate on foreign source income under current law is similar to the 17.7% effective tax rate reported by Dowd et al. (2020) for a sample of 81 US MNCs
  - IRS data used in this report finds 44% of foreign income is in <5% ETR jurisdictions, which is consistent with the range in Clausing (2020)
  - Recent Penn Wharton Budget Model analysis found that the proposed GILTI changes would raise the effective tax rate by approximately 10 percentage point

Key results

- Estimated effects span a very wide range because they are high-level estimates based on parameters from a diverse set of empirical papers

- The economic literature indicates that the proposed changes to GILTI are likely to reduce US employment of US MNCs, and the reduction could be anywhere from 200,000 to 3.1 million jobs; these effects span a very wide range because they are high-level estimates based on parameters from a diverse set of empirical papers

- Nonetheless, professional judgement informed by this analysis and combined with the results of other somewhat similar tax policy changes suggests that plausible employment effects for the US MNCs could range somewhere between 500,000 and 1,000,000 lost jobs

Select caveat and limitations

- Any modeling effort is only an approximate depiction of the economic forces it seeks to represent, and the economic model developed for this analysis is no exception; several are particularly noteworthy
  - **Proposed GILTI changes are modeled in isolation**. The GILTI tax increases are part of a wider proposed set of corporate and individual tax increases. Spending for which these tax increases pay are not modeled. Certain types of spending increases are productivity enhancing or may have other potential benefits.
  - **Estimates are limited by public information and use industry-level data.** One key limitation to this analysis is the limited publicly available company-level data ideal for doing an analysis of changes to the GILTI regime. Ideally this analysis would, for example, rely on company-level tax return data as aggregating such data – as is necessary when using publicly available data – will generally reduce the accuracy of the results
  - **Ongoing international negotiations intended to establish a world-wide minimum tax on corporate income.** If all countries imposed a higher corporate minimum tax, the effects of a higher US minimum tax on the decision of US MNCs to reduce foreign affiliate investment might be smaller than otherwise, since the US tax increase would have a smaller effect on the competitive position of US MNCs.

Questions/comments?

- EY report with additional information can be found at: https://www.nam.org/wp-content/uploads/2021/08/EY-NAM-Analysis-of-proposed-GILTI-changes-FINAL.pdf
  - There is, significant research – both conceptual and empirical – that suggests that the overseas businesses of US MNCs are complementary to the US domestic businesses; it is summarized in the report
  - Any modeling effort is only an approximate depiction of the economic forces it seeks to represent, and the economic model developed for this analysis is no exception; these caveats and limitations are discussed in detail in the report

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