IIEA
Sharing Ideas
Shaping Policy

CUT TO THE CHASE:

US Corporate Tax Reform - The Implications for Ireland

by Frank Barry
30 October 18

Inward-FDI

Implications for Ireland of the New US Corporate Tax Regime[1]

Frank Barry
Trinity Business School
Trinity College Dublin
October 2018

Abstract

National corporate tax systems interact with each other in complex ways. Interactions with the US tax system are particularly important for Ireland given the strong presence of US MNCs in the Irish economy. The US system has changed dramatically in recent times. The paper outlines the history of corporate tax policy in the two jurisdictions and how the systems interacted up to the time of the recent changes. The likely implications of the new US tax regime for inward FDI in Ireland are then discussed.

1 This paper is based on presentations made to the Institute for International and European Affairs and the Foundation for Fiscal Studies. I am grateful to Seamus Coffey, Ron Davies and a range of tax practitioners for comments on the broader research project from which this material is drawn. Practitioners warn that the effects of the US tax changes depend very much on the circumstances of individual firms and that conclusions on aggregate effects are necessarily highly conjectural. Sole responsibility for the contents of the paper rests with the author.

1. Introduction

National corporate tax systems interact with each other in complex ways. The interactions became more complex in the late 1990s as opportunities expanded for aggressive tax planning practices around the offshoring of intellectual property (IP) from the US.[2] The nature of the interactions will change as a consequence of the passage of the US *Tax Cuts and Jobs Act* of late 2017. The purpose of this paper is to assess how Ireland might fare in light of these changes.

Hines and Rice (1994) outline the basic functioning of the US tax system as it operated up to the time of the recent changes. Unlike most other countries, the US had taxed its corporations on a worldwide rather than a territorial basis, meaning that US corporations owed taxes to the US government on all of their worldwide income. If a low tax rate was paid in Ireland by a US affiliate, for example, the remaining difference between the Irish and the US rate was owed to the US authorities.

Low-tax foreign environments remained attractive to US firms for two reasons however. The first related to the operation of the US tax credit system. To avoid subjecting its corporations to double taxation the US provided a foreign tax credit for income taxes paid overseas. If the corporation paid a rate higher than the US rate on its operations in Country H, nothing further was owed to the US, though the corporation was obviously unable to recoup the difference from either government. This left it in what is referred to as an "excess foreign tax credit" position.[3] The US foreign tax credit, however, applies to *aggregated* income taxes paid abroad. Hence, if the corporation had a subsidiary in Ireland in addition to its operation in Country H it could use these excess foreign tax credits to reduce the tax bill owing to the US authorities from the firm's Irish operation. Low-tax jurisdictions therefore allowed US firms to 'blend away' the disadvantage of maintaining operations in high tax overseas locations, hence facilitating these locations in retaining high tax rates while continuing to attract US investments.[4]

The second reason why low-tax foreign environments were attractive to US firms was because payment of US tax liabilities on overseas profits could be deferred until the profits were repatriated to the US. *Deferral* was essentially an interest-free loan from the US exchequer to the corporation in the amount of the deferred tax liabilities. The gains to the corporation from *deferral* were higher in the case of low-tax jurisdictions.

These advantages incentivised the assignment to Irish-incorporated companies of returns on patents derived from R&D that had largely been conducted elsewhere.[5] As Desai, Foley and Hines (2006) point out, "OECD governments require firms to use transfer prices that would be paid by unrelated parties, but enforcement is difficult, particularly when pricing issues concern differentiated or proprietary items such as patent rights. Given the looseness of the resulting legal restrictions, it is entirely possible for firms to adjust

2 Aggressive tax planning refers to the exploitation by multinational corporations of asymmetries between the tax laws of different jurisdictions in order to achieve 'double non-taxation'.

3 That significant numbers of US firms were in such positions even before the US rate was reduced from 46 to 34 percent under the US Tax Reform Act of 1986 points to the complexity of tax liability calculations (Altshuler and Fulghiere, 1994; Gravelle, 2013).

4 Desai et al. (2006) showed that firms with growing activity in high-tax countries were the ones most likely to initiate operations in low-tax jurisdictions.

5 CSO data do not count the IP return as arising in Ireland in the form of profits if the companies are tax-resident elsewhere (see below). These profits are included as 'Irish' in the US BEA data.

transfer prices in a tax-sensitive fashion without violating any laws".

To understand the aggressive tax planning practices that have grown up around the location of intellectual property assets, the next two sections detail the evolution of US policy and Ireland's role in the international payments flow. Section 4 outlines the recent changes to the US corporate tax system, Section 5 examines the potential implications for Irish inward FDI and a final section contains concluding comments.

2. The US Corporate Tax System and the Evolution of Aggressive Tax Planning

Until 1962, the US tax system largely reflected the principle that subsidiaries operating in foreign markets should face the same tax regime as local firms in these markets. US taxation could be avoided as long as foreign profits remained offshore.[6] Concerns about erosion of the tax base grew however as US corporations became increasingly globalised in the post-war period. The Kennedy Administration, in response, proposed in 1961 to switch to a regime based on the principle that the overseas income of US corporations should be taxed exactly the same as income earned in the US. The earnings of "controlled foreign corporations" (CFCs) were to be deemed a dividend to US shareholders.

Deferral, the Kennedy administration argued, had led to the "unjustifiable use of tax havens" for practices that included "artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights and the shifting of management fees".[7] The Kennedy initiative was blocked by Congressional Republicans who argued that it would damage the international competitiveness of US corporations, who would be forced to pay higher taxes than competitors from most other jurisdictions – the US tax rate being among the highest in the world. "The political battle thus pitted global tax neutrality against international competitiveness" (Sweitzer, 2005). A compromise was reached with the enactment in 1962 of what is known as the Subpart F ("taxation anti-deferral") regime. US taxation on overseas profits could continue to be deferred, other than in the case of 'Subpart F income' – the latter derived from passive (inherently mobile) investments that produced only royalty, interest or dividend income.

Until 1984, US firms were permitted to transfer intellectual property developed in the US to foreign affiliates without triggering US tax liability as long as the goods produced by the intangibles were sold outside the United States. The Deficit Reduction Act of 1984 rescinded this exemption (Hines and Rice, 1994). Since then, IP offshoring had been subject to a cost-sharing agreement under which a US parent company and its foreign subsidiary agreed to share the costs of IP development – or the maintenance costs necessary to preserve its commercial value – in proportion to their relative shares of anticipated benefits.[8]

As Subpart F provisions increased in complexity the US Internal Revenue Service (IRS) was prompted to

6 This synopsis of US corporate tax history draws largely on Sweitzer (2005) and Avi-Yonah (2005-06).

7 Message from the President of the United States to Congress, April 20, 1961, the relevant section of which appears as Appendix A of Joint Committee on Internal Revenue Taxation (1961).

8 The terms of these cost-sharing agreements are contentious (Kleinbard, 2011). Shay (2008), a former US Treasury International Tax Counsel, remarks that the rules to protect US tax revenues are "easily avoided by the well advised" and suggests that "it would be interesting to know what percentage of related party cost sharing agreements involve one or more unsuccessful products compared with arm's length agreements".

introduce a new set of simplifying regulations in 1997. Under the new system, a range of foreign entities within the overall company structure could "check the box" (CTB) to allow themselves to be disregarded for tax purposes. The CTB regime paved the way for creative tax-avoidance options, typically involving the creation of a 'hybrid company' – defined as an "entity with a single owner that is treated as *a separate entity under the relevant tax laws of a foreign country* and *as a branch* of a foreign subsidiary that is its sole owner *for US tax purposes* (US Congress, X-37-10, p. 48).

IMF (2013, p.47) provides as an example a US corporation that sets up a holding company in a low-tax jurisdiction such as Ireland that in turn holds a controlling share in an operating company. In the absence of 'check the box', any interest, royalty, or dividend income paid by the operating company to the holding company could create a current US tax liability. With "check the box", the operating company can be disregarded and the monies received by the holding company treated as active rather than passive income, thereby thwarting the application of Subpart F.[9]

The US Treasury and the IRS attempted to reverse position as early as 1998 when the tax planning benefits offered by 'check the box' became clear. They were faced with opposition on a number of fronts however (Sweitzer, 2005, fn. 58). One influential argument was that foreign rivals were also using low-tax jurisdictions or tax havens to reduce their global tax burdens (Engel, 2001). The interest-group pressures against reversal proved victorious: the regulations issued by the Treasury Department in 1997 were enshrined in legislation by the US Congress as the Look-Through-Rule in 2006.[10] As US Senators Levin and Coburn (2012, p.13) note, "this section was enacted without significant debate as part of a larger tax bill". Check-the-box, they recognise, "further facilitated the increase in offshore profit shifting, which has gained significant momentum over the last 15 years" (Levin and Coburn, 2012, p.11).[11]

What of the deferral of taxation on non-Subpart F overseas profits? Accounting standards permit US MNCs to defer recognition of tax liability on foreign earnings if they assert that these earnings are permanently or indefinitely reinvested abroad. In 2011 more than 1,000 US MNCs made such a declaration on more than $1.5 trillion of overseas profits (Levin and Coburn, 2012, p.15). By 2018 this sum had risen to between 2 and 3 trillion dollars (Desai, 2017; Dharmapala, 2018), much of it held by leading pharmaceutical and technology firms (UNCTAD, 2018a).

The US Senate report (Levin and Coburn, 2012, p.16) noted that "because corporate management can easily change corporate investment plans, auditors may encounter difficulties in evaluating management claims". It can be difficult, it continued, to disprove an intent to reinvest these earnings. Evidence that significant amounts of 'reinvested earnings' have been held in the form of cash in low-tax jurisdictions is provided by Blouin, Krull and Robinson (2016).[12] Levin and Coburn (2012, p.18) draw attention to an earlier Senate

9 IMF (2013) portrayed this as an example of the 'double Irish' tax planning structure. The typical 'double Irish' however was based on the 'same-country exemption', under which "an exemption from subpart F income treatment exists for eligible dividends and interest received by a controlled foreign corporation from a related payor corporation that is created under the laws of the same foreign country" (KPMG, 2010). Many tax strategies are multi-layered in that several provisions can be used to achieve the same desired tax outcome.

10 This has been renewed on several occasions since then, most recently being extended out to 2021.

11 Altshuler and Grubert (2005) ascribe the pronounced change they identify in the effective foreign tax rates paid by US MNCs from 1996 to the effects of "check-the-box" tax planning.

12 They employ the Hines and Rice (1994) list of 'tax havens', which includes Ireland.

investigation that showed that of the MNCs surveyed, "on average 46 percent of their tax-deferred offshore funds were held in US bank accounts and invested in US assets such as US Treasuries or shares of unrelated US corporations".

The major US political parties have been divided on corporate tax matters since at least the Kennedy era. John Kerry, the 2004 Democratic Party candidate for the presidency, favoured complete anti-deferral, proposing to tax immediately *all* corporate income whether earned domestically or abroad (Sweitzer, 2005, fn. 100). This was the platform on which Barack Obama also ran in his first US presidential campaign. The Obama administration failed in its attempts to enact these proposals however (Barry and Bergin, 2012). Engel (2001) concluded that "[n]either the political forces in favour of a pure anti-deferral approach nor the political forces in favour of a pure territorial approach have the clout for complete victory."

3. The Irish Corporate Tax System and its Interactions with US Tax Law

Ireland's low corporation tax regime dates from 1956 when a new incentive – 'export profits tax relief' (or 'export sales relief') – was introduced. This offered "a remission of 50 per cent income tax on profits of a manufacturing industry derived from increased exports over a datum year". Over the following few years the tax remission was expanded to 100 percent, the exemption period was lengthened and a 25-year exemption was granted for the customs free zone at Shannon Airport (Barry, 2011).

The Irish tax regime has been amended on a number of occasions since then. Export profits tax relief was phased out from 1978 when it was identified by the European Commission as distortionary.[13] Ireland responded by replacing it with a low 10 per cent tax rate for manufacturing industry. This rate was extended to computer software in 1984 and to qualifying activities carried out at the newly-established International Financial Services Centre in Dublin in 1987. In the face of European Commission pressure to harmonise rates across sectors the Irish government decided in 1998 on a general tax rate of 12.5 per cent, to come into effect from 2003 (Barry, 2012).

Besides offering a low tax rate, Ireland also adhered to historic British case law which held that a company registered in the UK but without any UK activities was not subject to British taxation.[14] Apple employed this jurisdictional asymmetry to move to a non-resident branch structure for tax planning purposes when the grandfathering clauses associated with export profits tax relief expired.

The introduction by the US of the 'check-the-box' rules in 1997 raised the importance of this combination of characteristics and Ireland became a more significant location in the tax-planning payments chain of US MNCs. The ultimate aim of many MNCs is to have their offshore profits end up in micro state jurisdictions such as Bermuda, the Cayman Islands and the British Virgin Islands, which levy franchise taxes rather

13 Ireland's frequent inclusion in lists of tax havens, such as that of the US Government Accountability Office (GAO, 2008), stems from its appearance on an early list compiled by Hines and Rice (1994), which GAO (2008) accepted uncritically. Inclusion in the Hines and Rice (1994) list was based on the supposed availability of 'tax holidays' which had in fact disappeared long before 1994. Ireland nevertheless continues to appear on the most recent GAO list (Gravelle, 2013). Sharman (2010) criticises the self-referential nature of such lists, which occasionally leads to comic outcomes such as when Venezuela, by copying a Mexican blacklist word-for-word, actually blacklisted itself.

14 Many British Commonwealth member states also did so. The UK amended its legislation in this respect in 1988: http://www.hmrc.gov.uk/manuals/intmanual/intm120200.htm.

than corporation taxes (Palan, 2009; Gravelle, 2013). As the Netherlands traditionally differed from other European countries in its tax treatment of profits bound for these destinations, profits frequently transited through the Netherlands on their way from Ireland – the so-called 'Dutch sandwich'; (see e.g. House of Commons Committee of Public Accounts, 2013, p. Ev39).

A further tax planning practice with an Irish dimension was revealed in the UK House of Commons investigations of 2012-13. These showed how some 'new economy' firms book their UK sales in Dublin while a related UK company services the UK customers and is reimbursed on a cost-plus basis by the Dublin operation. This ensures that most of the sales are registered in Ireland rather than the UK.[15]

For reasons entirely unconnected with the introduction of 'check-the-box', Ireland's Finance Act of 1999 strengthened the restrictions on the class of companies that would be allowed to be Irish-registered non-resident (IRNR) under the management and control test. Henceforth, IRNR status was confined to Irish-incorporated companies either under the ultimate control of persons of tax-treaty countries such as the EU or the US and related through ownership to a company with substantive activities in Ireland. Finally, and more recently – in the wake of the US Senate Subcommittee findings on Apple and in anticipation of the OECD's 'Base Erosion and Profit Shifting' (BEPS) initiative – Irish law was changed such that companies would no longer be able to incorporate in Ireland without also being tax resident in the jurisdiction.[16]

The coming-on-stream of BEPS, which seeks to align taxation with economic substance, is one of a number of factors associated with the substantial on-shoring to Ireland of IP assets in recent years. BEPS should work to the advantage of jurisdictions such as Ireland where – unlike the micro states – substantive operations can be located (Mutti and Grubert, 2009). The tax deductibility in Ireland of the capital expenditures entailed in the purchase of these IP assets by Irish-resident companies has been an important factor, though further development work on this IP must apparently be undertaken in Ireland if the 25 percent Irish tax rate on passive income is to be avoided when the capital allowances have run their course.[17] The Irish Tax Institute's commentary on the 2014 Finance Act states that

> *The capital allowances will ultimately expire, making it difficult for companies to maintain a consistent effective tax rate on their IP profits in the longer term. It is hoped that the "knowledge development box" regime announced in the Budget will address these issues.*[18]

---

15 House of Commons Committee of Public Accounts (2013), p. Ev39; IMF (2013), p. 47. Other 'new economy' companies have used similar strategies to book profits from their sales to UK customers in Switzerland and the Netherlands (Financial Times, 14 October 2017). The 'commissionaire distributor model' operates in a similar way and has an even longer history (Siitonen, 2017).

16 Some double taxation treaty exemptions remain in place however and are open to exploitation by MNCs. Ireland cannot revoke these exemptions unilaterally.

17 As the Revenue website explains: "A company whose only activity is the licensing in of the rights to intellectual property, and the on licensing of such rights, is unlikely to be regarded as trading…At the other end of the scale, income of a company that actually creates the intellectual property by engaging in Research and Development, continues to develop it and bears the costs and the associated risks and actively promotes and licenses out the rights for its use to multiple third parties would invariably be regarded as trading income." https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-02/02-02-06.pdf

18 IMF (2018) suggests however that the KDB "is generally perceived as most useful to small and medium-sized Irish enterprises".

Such 'balance sheet relocation' was a major component of the increased investment which, along with the increase in related exports, drove the dramatic revisions to the 2015 national accounts (McNamara and MacCoille, 2016; Purdue and Huang, 2016).

4. The New US Tax Regime

Following the reconciliation of the separate bills passed by the US Houses of Congress, the *Tax Cuts and Jobs Act* was signed into law by US President Donald Trump in December 2017. While the Act itself is extremely detailed, the most significant elements of the business tax dimension can be summarised as follows:[19]

- A reduction in the headline Federal tax rate from 35% to 21%
- A one-time toll charge on foreign profits held offshore
- A shift from a worldwide to a territorial tax system, and
- The introduction of a series of new taxes to police the offshoring incentives introduced by the shift to territoriality.

The first element is the new tax rate. The previous top rate of 35% was among the highest in the world. The law creates a new single corporate tax rate of 21%, to which state and local taxes will add around another 5%. This leaves the US rate slightly higher than the average for the rest of the OECD, but lower than most of the other G-7 countries (PWC, 2017b). Effective tax rates will be somewhat lower.[20]

The second element, as part of the transition to territoriality, is a one-time toll charge on profits currently held offshore. These are to be taxed at a rate of 15.5% for cash and 8% for investments in illiquid assets, whether the funds are repatriated to the US or not. The US Administration appears to hope that the repatriated cash will be used for domestic investment, though Mintz (2018) notes that many companies cite debt reduction as their priority.

The final elements are the most complicated. Shifting to a *pure* territorial tax system would further incentivise offshore activities since US MNCs' foreign profits would no longer be subject to residual US tax liabilities. A 'carrot and stick' approach is adopted to tackle the incentive for offshore profit shifting. There are two sticks, denoted GILTI and BEAT, and one carrot, denoted FDII (ReedSmith, 2017; PWC, 2017b).

GILTI ("global intangible low-taxed income") is defined as the excess income earned by a company's foreign subsidiaries over and above a 10% rate of return on their tangible business assets. If no foreign tax is paid

---

19 For a very broad overview see Desai (2018). For a detailed simulation analysis that takes into account a range of issues not considered here (including cross-border financing strategies and changes to expensing rules), see Spengel et al. (2018). The latter does not however take into account possible impacts on the incentive to reinvest offshore earnings abroad; Lundan (2006) shows that these have financed around 40 percent of US FDI in Europe. As discussed below, the new US regime reduces the incentive to hold such funds abroad, while raising the after-tax return on overseas investments.

20 Bilicka and Devereux (2012) provide examples of the wide divergences between effective average corporate tax rates and nominal rates. The annual PWC/World Bank reports on 'Paying Taxes' illustrate how specific the effective tax rate is to the exact characteristics of the type of investment undertaken. See also Annex 20A of C&AG (2017).

on the foreign pool of GILTI profits, the US will from 2018 impose an effective tax rate of 10.5% on these profits. Double taxation relief is available for only 80% of the foreign tax credits attributed to this type of income. If, for example, a non-US tax rate of around 13.1% were levied on this income, this would equate to the 10.5% effective US tax rate (13.1% @80% ≈ 10.5%) and no further US tax would be liable. From 2026 the effective US tax rate on GILT income increases, and the foreign tax rate required to pay no additional US tax under the new regime will rise to around 16.4% (KPMG, 2017).

The second 'stick' is a new Base Erosion Anti-Abuse Tax (BEAT). This tax will be levied on top of the new 21% corporate tax rate on large US corporations that make particular types of payments to related foreign companies (ReedSmith, 2017). The intention of BEAT, in the case of intellectual property, is to incentivise having IP services provided in the US rather than having them offshored to related parties. In the latter case US companies are charged for the use of the IP, which allows them deduct these payments as expenses on their tax returns (PWC, 2017a).

The 'carrot' consists of the new Foreign-Derived Intangible Income (FDII) provisions. If a US-parented group holds its intellectual property (IP) in the United States, the deduction it receives for the IP income deriving from sales and services to unrelated foreign parties reduces its effective tax rate to 13.1% – rising to 16.4% from 2025 (KPMG, 2017). Specifically, the policy offers from 2018 a 13.1% effective tax rate on excess returns earned directly by a US company from foreign sales (including licenses and leases) or services (KPMG, 2017). This is in essence a form of export subsidy.

5. Implications for Inward-FDI in Ireland

In terms of how US business taxes are structured, the changes introduced by the *Tax Cuts and Jobs Act* are genuinely historic. The act rewrites the broad fundamentals of how the US tax system has operated since the Reagan era at least, if not that of the Kennedy administration of the early 1960s. Many of the operational details remain to be fleshed out however: these will be provided in US Treasury guidelines to be issued over the coming years (IMF, 2018).

Treasury guidelines are also issued in response to emerging aggressive tax planning practices. Such practices thrive on complexity, and the shift to territoriality combined with the range of carrots and sticks designed to counteract some of the associated incentive effects leaves huge scope for tax-planning innovations (Kamin et al., 2017). Though Treasury responses can be stymied by political pressure – as seen above in the case of 'check the box' – the fact that the Act was opposed by Congressional Democrats increases the likelihood of its bite being sharpened in the future (Mintz, 2018). Dharmapala (2018) suggests, furthermore, that "given that there is politically no current prospect of a US VAT, an expectation that the corporate tax rate will increase in the future is far from unreasonable".

This uncertainty can be expected to dampen any short-term response. Further uncertainly is engendered by the fact that concerns have been raised as to the compatibility of aspects of the new tax regime with World Trade Organisation rules (as well as with existing double taxation agreements): components such as the FDII provisions and to a lesser extent BEAT face an uncertain future for this reason (Desai, 2017;

Kamin et al., 2017; Mintz, 2018; Chalk, Keen and Perry, 2018).[21]

The analysis that follows focuses on the implications of the tax package *as currently constituted*. Take first the case of corporate inversion, whereby a US company changes its legal domicile by merging with (or 'backing into') a company from another jurisdiction that offers a more favourable tax treatment of income. Prominent examples over recent years have included Burger King, which redomiciled to Canada, and Medtronic, which redomiciled to Ireland, though Pfizer's plans to follow in Medtronic's wake were stymied by regulations introduced by the Obama administration. The US tax regime is clearly in direct competition with foreign rates and regimes in these cases. The Trump administration's tax package will remove the incentive to redomicile under most circumstances.[22] This effect is likely to be of benefit to Ireland in that FitzGerald (2013) found redomiciling to increase the state's financial obligations to the EU while leaving national income largely unchanged.

A next case to consider is that of US firms that currently service non-US markets from Ireland. For firms ineligible for the FDII export subsidy (for whatever reason) there is likely to be little incentive to consider shifting these operations to the US.[23] Current sales would not necessarily be replaced by US exports: existing markets would instead be vulnerable to capture by non-US competitors. US exports could indeed be damaged as a substantial proportion of current exports consists of parent company sales to foreign affiliates (Slaughter, 2009, pps. 6, 14).

Other considerations arise in the case of US-MNC exports from Ireland *to the United States*. The FDII 'export subsidy' is again irrelevant to the decision as to whether to shift these operations to the US since US sales would not be eligible for the export subsidy. BEAT may come into play in this case however. The BEAT imposes an extra tax liability on large corporations whose payments of interest, royalties and management fees to foreign affiliates exceed a certain proportion of their total deductible expenses (Chalk, Keen and Perry, 2018). That the provision does not apply to deductible expenses based on 'goods purchased' may shield US-affiliate Irish pharmaceutical exports from the tax; these must already satisfy US transfer pricing rules. As payments of interest, royalties and management fees vary from firm to firm however, it is impossible to determine what the aggregate effects might be. Note though that royalty and license *exports to* (i.e. *payments from*) the US represent only a small share of total exports to the US.[24] Chalk, Keen and Perry (2018), on the other hand, allude to concerns that the BEAT "may prove punitive for a range of legitimate commercial activities", including in the financial sector.[25]

---

21 Avi-Yonah and Vallespinos (2018) describe the FDII as a 'direct descendent' of the earlier 'border adjustment tax' which was widely considered to be incompatible with World Trade Organisation rules and was ultimately jettisoned (Avi-Yonah and Clausing, 2017). They also judge FDII however to be 'a blatant and obvious violation' of WTO rules. (See also IMF, 2018).

22 As Chalk et al. (2018) note, 'the favorable treatment of deemed repatriations is [also] rescinded if inversion takes place in the decade following the TCJA'.

23 IMF (2018) judges that even eligible firms are unlikely to shift operations to the US given the uncertainties surrounding the future of FDII.

24 Data on the values pertaining solely to US-owned firms are not available. Though royalty and licence payment flows from the US to Ireland continue to be dwarfed by flows in the opposite direction, the ratio has been increasing since at least 2003, presumably reflecting the increased location of IP assets in Ireland: CSO: BPA04 – Exports and Imports of Services by Geographic Location, Component, Year and Statistic: https://www.cso.ie/px/pxeirestat/Statire/SelectVarVal/Define.asp?maintable=BPA04&PLanguage=0 As Stewart (2010) notes, however, it can be difficult to track the flows relating to royalty and license payments in the balance of payments statistics.

25 See also IMF (2018).

Where European-bound US FDI is motivated by logistical or market-access considerations rather than tax, it is the relationship between Irish and other European tax rates that is of primary significance. In assessing the consequences of the new US regime in this case the relevant questions are, firstly, how are US FDI inflows to Europe affected, and secondly, is Ireland advantaged or disadvantaged relative to other European locations?

While a cut in the US tax rate incentivises increased investment in the US, there are offsetting impacts on US outbound FDI. The substitution effect discourages it while the income effect – the increase in investable funds – works in the opposite direction. The empirical evidence brought to bear by Davies (2017) suggests that the latter is likely to dominate, a conclusion strengthened by the disappearance of the residual US tax liability on most overseas profits (which moderates the substitution effect). The simulation analysis of Spengel et al. (2018, Figure 7) predicts *a large increase* in FDI flows between Europe and the US *in both directions*.

It is important to distinguish however between financial and non-financial sector FDI inflows, particularly for countries such as Ireland, Switzerland and the Netherlands. As noted by Forfás (2002), inflows to the international financial services sector entail "large movements of capital by parent companies to their treasury, fund management and other IFSC financial subsidiaries, mostly to be reinvested in overseas assets. In this sense, such flows of direct investment into IFSC companies are roughly matched by outward flows of portfolio investment, and have little impact on the real domestic economy".[26] The reference above to increased two-way flows between the US and Europe relates to 'real economy' investments.

Spengel et al. (2018) note, furthermore, that with an "end to US taxation of worldwide income [European] high-tax jurisdictions like Germany or France will become less attractive relative to European low-tax jurisdictions like Ireland or Eastern Europe from the perspective of US investors" (Spengel et al., 2018, page 6 and Figure 8).[27]

Finally, we come to the question of where IP might be located *for use outside the US* – in which case BEAT considerations might safely be ignored. KPMG (2017) states that:

> *Of some concern from an Irish competitive perspective are the proposals to offer a reduced US tax rate on foreign source intangible profits. These measures could see foreign source profits from intangible assets taxed in the US at a federal corporate income tax rate of 13.125% (increasing to 16.4% from 2026).*

When the choice is solely between an Irish and a US location, the tax differences appear to be relatively minor. If GILTI profits were *taxed at the full rate of 12.5% in Ireland*, then – applying the 80% double-

26 A similar point is made by an UNCTAD official in an interview with UN Radio on the agency's finding of a sharp fall in FDI inflows to these countries in the wake of the US tax changes: https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1883&Sitemap_x0020_Taxonomy=UNCTAD%20Home. These declines result from the repatriation of funds formerly held offshore for 'deferral' purposes (UNCTAD, 2018b). See Barry and O'Mahony (2004/05) for a discussion of these and other complexities in the interpretation of FDI data.

27 A recent IMF working paper (Liu, 2018) finds that UK MNCs engaged in significantly more overseas investment in low-tax countries after the UK's shift to a territorial tax system in 2009.

taxation relief – a further 0.5% tax would be owed to the US authorities, bringing the effective Irish rate to 13%.

Such calculations are unlikely to be the ones of most significance however. As Griffith et al. (2014) note, the corporate tax rate is unlikely to be the sole determinant of where legal ownership of intellectual property is to be located: externalities may dictate that some IP be co-located with the innovative activities that are concentrated in R&D-intensive high-tax countries.[28] In this case also, as discussed earlier, a low-tax location like Ireland can be used to *blend away* the disadvantages of simultaneously holding IP in higher-tax jurisdictions.[29]

IMF (2018) judges that "Ireland's 12.5 percent CIT rate on trading income [appears] well-positioned with respect to GILTI", while Wagman et al. (2018) comment that "it is unclear how strong [the US export incentive] will prove to be", as sales to overseas customers made by a non-US subsidiary of a US parent generally are subject to a lower tax than the rate imposed on the US parent's FDII.[30]

One further point of note is that the GILTI provisions encourage US companies to hold more tangible assets overseas in support of their foreign IP operations.[31] While these tangible assets can be held anywhere overseas, this factor too has the potential to work to Ireland's advantage.

Conclusions

The most significant consequences for inward FDI in Ireland on which conjectures can reasonably be made can be summarised as follows. Firstly, the incentive for US corporations to redomicile is sharply diminished. Redomiciling has been argued to be disadvantageous to Ireland (FitzGerald, 2013). Secondly, the net effect of the US tax changes is likely to increase gross "real economy" FDI inflows to Europe (as well as in the opposite direction), and Ireland is likely to be further advantaged relative to competitor EU locations. Thirdly, in the event that the US export subsidy for IP-intensive goods and services survives a likely challenge at the WTO, the margin associated with locating IP assets in Ireland rather than the US will diminish but is unlikely to disappear completely. Fourthly, an Irish location for IP can still be used to blend away the disadvantages of locating IP-related R&D projects in higher-tax European economies. These various effects in combination may well prove advantageous for Ireland. The many uncertainties surrounding the sustainability of the new regime however, and the fact that key details remain to be clarified, can be expected to dampen any short-

28 Large, rich, R&D-intensive economies exploit the innate advantages associated with these characteristics by levying higher tax rates than smaller, peripheral, less R&D-intensive economies.

29 As Chalk, Keen and Perry (2018, p. 21) note, the GILTI provision taxes *the aggregate* of the relevant income *that is earned in all foreign jurisdictions* (see also p. 24). That the micro state jurisdictions appear to have lost favour in recent years enhances Ireland's attractiveness for such blending purposes.

30 Kamin et al. (2017, fn. 46) reach a similar conclusion.

31 Recall that GILTI is the excess income earned by a company's foreign subsidiaries over and above a 10% rate of return on their tangible business assets. Holding more tangible assets overseas reduces the amount of such income. This effect has been remarked upon by numerous scholars, including Kamin et al. (2017), Mintz (2018), Chalk, Keen and Perry (2018) and Dharmapala (2018).

term investment response, though substantial intra-firm financial restructuring is to be expected. An issue not considered here is whether – and to what extent – the tax rates of high-tax European economies will adjust downwards in response to the US initiative.

REFERENCES

Altshuler, R., and P. Fulghiere (1994) "Incentive Effects of Foreign Tax Credits on Multinational Corporations", *National Tax Journal*, 47, 2, 349-61.

Altshuler, R., and H. Grubert (2005) "The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational Companies", *Florida Tax Review*, 7, 1-33.

Avi-Yonah, R. (2005-06) "All of a Piece Throughout: The Four Ages of US International Taxation", *Virginia Tax Review*, 25, 313-338.

Avi-Yonah, R., and K. Clausing (2017) "Problems with Destination-Based Corporate Taxes and the Ryan Blueprint", *Columbia Journal of Tax Law*, 8, 2, 229-55.

Avi-Yonah, R., and M. Vallespinos (2018) 'The Elephant Always Forgets: Us Tax Reform and the WTO', Law & Economics Research Paper No. 18-006, University of Michigan.

Barry, F. (2011) "Foreign Investment and the Politics of Export Profits Tax Relief 1956", *Irish Economic and Social History*, Volume XXXVIII, 54-73.

Barry, F. (2012) "Trade, Investment, Integration: the Economics of Irish Foreign Policy", in B. Tonra, M. Kennedy, J. Doyle and N. Dorr (eds.) *Irish Foreign Policy*, Dublin: Royal Irish Academy and Gill and Macmillan, 2012, 184-202.

Barry, F., and A. Bergin (2012) "Inward Investment and Irish Exports over the Recession and Beyond", *World Economy*, 35, 10, 1291-1304.

Barry, F., and C. O'Mahony (2004/05) "Making Sense of the Data on Ireland's Inward FDI", *Journal of The Statistical and Social Inquiry Society of Ireland*, XXXIV, 28-65.

Bettendorf, L., A. Van Der Horst, R. De Mooij and H. Vrijburg (2010) "Corporate Tax Consolidation and Enhanced Cooperation in the European Union", *Fiscal Studies*, 31, 4, 453-479.

Bilicka, K., and M. Devereux (2012) *CBT Corporate Tax Ranking 2012*, Oxford University: Centre for Business Taxation.

Blouin, J., L. Krull and L. Robinson (2016) "The Location, Composition, and Investment Implications of Permanently Reinvested Earnings", unpublished ms.

Chalk, N., M. Keen and V. Perry (2018) 'The Tax Cuts and Jobs Act: An Appraisal', IMF Working Paper WP/18/185.

Comptroller and Auditor General (2017) *Report on the Accounts of the Public Service 2016*, Dublin: C&AG.

Davies, R. (2017) "Parent-Country Taxes and FDI", presentation to the Foundation for Fiscal Studies, Dublin, May 3, available at: https://www.slideshare.net/FFSIreland1985/parent-country-taxes-and-fdi (accessed October 31, 2017).

Desai, M. (2017) "Breaking Down the New U.S. Corporate Tax Law", interview conducted with Harvard Business Review, 26 December: https://hbr.org/ideacast/2017/12/breaking-down-the-new-u-s-corporate-tax-law , (accessed 28 January 2018).

Desai, M., C.F. Foley and J.R. Hines Jr. (2006) "The Demand for Tax Haven Operations", *Journal of Public Economics* 90, 513– 531.

Dharmapala, D. (2018) 'The Consequences of the TCJA's International Provisions: Lessons from Existing Research', University of Chicago Law School, unpublished ms. (revised August 2018).

Engel, K. (2001) "Tax Neutrality to the Left, International Competitiveness to the Right, Stuck in the Middle With Subpart F", *Texas Law Review*, 00404411, 79, 6.

Financial Times (2017) "Netflix and eBay pay total UK tax of less than £1.9 million", 14-15 October 2017.

FitzGerald, J. (2013) "The Effect of Redomiciled PLCs on GNP and the Irish Balance of Payments", Research Note, *ESRI Quarterly Economic Commentary*, Spring.

Forfás (2002) *Half-Year Trade and Investment Brief*, June 2002.

Government Accountability Office (2008) *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, Washington, D.C.: GAO.

Gravelle, J. (2013) *Tax Havens: International Tax Avoidance and Evasion*, US Congressional Research Service report.

Griffith, R., H. Miller and M. O'Connell (2014) "Ownership of Intellectual Property and Corporate Taxation", *Journal of Public Economics*, 112, 12–23.

Hines, J. R. (2001) Tax Sparing and Direct Investment in Developing Countries, chapter 2 in Hines (ed.) *International Taxation and Multinational Activity*, Chicago: University of Chicago Press.

Hines J, R., and E. Rice (1994) "Fiscal Paradise: Foreign Tax Havens and American Business", *Quarterly Journal of Economics* 109, 1, 149–182.

House of Commons Committee of Public Accounts (2013) *Ninth Report of Session 2013-14*, available at: https://publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/112/112.pdf (accessed October 31, 2017).

IMF (2013) *Fiscal Monitor: Taxing Times*, World Economic and Financial Surveys.

IMF (2018) "The Impact of International Tax Reforms on Ireland", in *Ireland: Selected Issues,* IMF Country Report No. 18/195, 18-44.

Irish Tax Institute (2014) "Finance Act 2014: Key Corporate Tax Measures",

http://www.taxinstitute.ie/Portals/0/Publications/ITR/ITR2014/Issue4_2014/ITR_Issue4_2014_Flipbook/files/assets/downloads/page0088.pdf

Joint Committee on Internal Revenue Taxation (1961) *Tax Effects of Conducting Foreign Business through Foreign Corporations*, Washington D.C.: US Government Printing Office.

Kamin, D., et al. (2017) "The Games They Will Play: An Update on the Conference Committee Tax Bill", (December 22 revision), https://ssrn.com/abstract=3089423

Kleinbard, E. (2011) "Stateless Income", *Florida Tax Review*, 11, 9, 700-773.

KPMG (2010) "Look-Through Treatment of Partnerships under Same Country Exemption".

KPMG (2017) "US Tax Reform – agreement reached on Tax Reform bill", Dec. 19, https://home.kpmg.com/ie/en/home/insights/2017/12/us-tax-reform-agreement-reached-bill.html, (accessed 28 Jan. 2018).

Levin, C., and T. Coburn (2012) *Offshore Profit Shifting and the US Tax Code*, Memorandum to Members of the Senate Permanent Subcommittee on Investigations, Washington D.C.

Liu, L. (2018) "Where Does Multinational Investment Go with Territorial Taxation? Evidence from the UK", IMF Working Paper 18/7, Washington, D.C.: International Monetary Fund.

Lundan, S. (2006) "Reinvested earnings as a component of FDI: an analytical review of the determinants of reinvestment", *Transnational Corporations*, 15, 3, 35-66.

McNamara, D., and C. MacCoille (2016) "Problems with Ireland's National Accounts: A User's Perspective", paper presented to Annual Conference of the Dublin Economics Workshop, Wexford, September 24.

Mintz, J. (2018) "Global Implications of US Tax Reform", EconPol Working Paper 08-2018, European Network of Economic and Fiscal Policy Research.

Mutti, J., and H. Grubert (2009) "The Effect of Taxes on Royalties and the Migration of Intangible Assets Abroad", in M. Reinsdorf and M. J. Slaughter (eds.), *International Trade in Services and Intangibles in the Era of Globalization*, pp. 111–137, Chicago: University of Chicago Press.

Palan, R. (2009) The History of Tax Havens, *History & Policy*, http://www.historyandpolicy.org/papers/policy-paper-92.html

Purdue, D. (2016) "Understanding Ireland's Corporate Tax Revenue", Dublin: National Treasury Management Agency.

Purdue, D., and H. Huang (2016) "Irish Exports: the Facts, the Fiction and the Risks", Dublin: National Treasury Management Agency.

PWC/World Bank (2014) *Paying Taxes 2014: The Global Picture – a Comparison of Tax Systems in 189 Economies Worldwide*.

PWC (2017a) "US Tax Reform – The Final Tax Legislation as approved for enactment", Dec, 21: https://news.pwc.ch/38696/us-tax-reform-final-tax-legislation-approved-enactment/, (accessed, 28 Jan. 2018)

PWC (2017b) "Congress gives final approval to tax reform conference committee agreement", December 20, https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-congress-gives-final-approval-to-tax-reform.pdf, (accessed, 28 Jan. 2018)

ReedSmith (2017) "President Signs Federal Tax Bill into Law – What You Need to Know Before the End of 2017", 22 December, https://www.reedsmith.com/en/perspectives/2017/12/president-signs-federal-tax-bill-into-law (accessed, 28 Jan. 2018).

Sharman, J. C. (2010) "Dysfunctional Policy Transfer in National Tax Blacklists", *Governance: An International Journal of Policy, Administration, and Institutions*, 23, 4, 623–639.

Shay, S.E. (2008) "Testimony to US Senate Committee on Finance", *Hearing on The Foundation of International Tax Reform*, June 26, 2008.

Siitonen, W. (2017) "The Commissionaire Distributor Model in a Post-BEPS Environment",

Unpublished ms., University of Helsinki: https://helda.helsinki.fi/bitstream/handle/10138/175449/The%20Commissionaire%20Distributor%20Model%20in%20a%20Post-BEPS%20Environment.pdf?sequence=2

Slaughter, M. (2009) *How U.S. Multinational Companies Strengthen the U.S. Economy*, New York: Business Roundtable and The United States Council Foundation.

Spengel, C., F. Heinemann, M. Olbert, O. Pfeiffer, T. Schwab and K. Stutzenberger (2018)

Analysis of US Corporate Tax Reform Proposals and their Effects for Europe and Germany, Final Report – Update 2018, Centre for European Economic Research (ZEW), Mannheim.

Stewart, J. (2010) Comment on K. Walsh, 'The Economic and Fiscal Contribution of US Investment in Ireland', *Journal of the Statistical and Social Inquiry Society of Ireland*, Vol. XL, 53-55.

Sweitzer, C. (2005) "Analyzing Subpart F in Light of Check-The-Box", *Akron Tax Journal*, 20, 1-33.

UNCTAD (2018a) "Tax Reforms in the United States: Implications for International Investment", *Investment Trends Monitor*, Special Edition, Issue 29, Geneva: UNCTAD

UNCTAD (2018b) *Investment Trends Monitor*, Issue 30, Geneva: UNCTAD.

Wagman, P., R. Catalano and A. Kravitz (2018) "Tax Reform Implications for U.S. Businesses and Foreign Investments", Harvard Law School Forum on Corporate Governance and Financial Regulation, https://corpgov.law.harvard.edu/2018/01/05/tax-reform-implications-for-u-s-businesses-and-foreign-investments/ (accessed: May 11, 2018).

The IIEA acknowledges the support of the Europe for Citizens Programme of the European Union.

The Institute of International and European Affairs (IIEA) is Ireland's leading international affairs think tank. Founded in 1991, its mission is to foster and shape political, policy and public discourse in order to broaden awareness of international and European issues in Ireland and contribute to more informed strategic decisions by political, business and civil society leaders.

The IIEA is independent of government and all political parties and is a not-for profit organisation with charitable status. In January 2017, the Global Go To Think Tank Index ranked the IIEA as Ireland's top think tank.

IIEA
iiea.com
Sharing Ideas
Shaping Policy

The Institute of International and European Affairs,

8 North Great Georges Street, Dublin 1, Ireland

T: +353-1-8746756 F: +353-1-8786880

E: reception@iiea.com W: www. iiea.com