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If there is one thing generally agreed about the Tax Cut and Jobs Act (TCJA), the tax reform signed into law by President Trump in December 2017, it is that the legislation engendered great expectations. Through such measures as sharply reducing the U.S. corporate tax rate, speeding depreciation deductions, and greatly lowering the cost of repatriating vast undistributed earnings of foreign subsidiaries, the legislation would provide "rocket fuel" to the U.S. economy, the president said, envisioning increased capital investment and resultant boosts in jobs for Americans.

Has the legislation proved a spur to capital investment? New research to be presented in August at the annual meeting of the **American Accounting Association** presents evidence that among the key group of firms that faced high repatriation costs pre-

function in the change in…depreciation rules or the reduced statutory tax rate," comment the study's co-authors, Brooke Beyer of Kansas State University, Jimmy Downes of University of Nebraska – Lincoln, Mollie E. Mathis of Auburn University, and Eric Rapley of Colorado State University.

Focusing, therefore, on the bill's effect on multinationals, the researchers find an increase in capital investment of about 14% among firms that would have faced high repatriation costs under prior regulations (and so had a strong incentive previously to keep their foreign subsidiaries' profits abroad) while such investment was flat among those that would previously have faced no repatriation costs (perhaps because their foreign subsidiaries were in high-tax countries). As the professors report, "firms with repatriation costs in the top quartile increased their capital expenditures from 0.86% of assets to 0.98% of assets." In contrast, "firms with zero repatriation costs kept their capital expenditures at 0.98% of assets."

This contrast may evoke nods from the reform bill's proponents, who anticipated that freeing up massive cash troves held abroad by U.S. firms would spur capital investment. What may not be pleasing is where the greatest boost in investment has occurred. As the professors report, "Firms with high repatriation costs have a significantly greater increase in foreign property, plant, and equipment (PPE) investments post-TCJA than pre-TCJA, while these same firms…have no change in domestic PPE. Our results are consistent with foreign capital expenditures rather than domestic capital expenditures influencing the increase in investment post-TCJA, which is opposite of Congressional intent."

Thus, among firms that formerly would have faced the highest repatriation costs (the top decile in this regard) domestic PPE as a percentage of company assets increased by about 50% more post-TCJA (i.e., from 2017 to 2018) than it did pre-TCJA (from 2015 to 2016). In contrast the companies' foreign PPE increased by almost

300% more post-TCJA than it did pre-TCJA. In further analysis that controls for an

reduction in [repatriation costs] to increase domestic investment than they are incentivized to increase foreign investment to take advantage of [these two] tax incentives."

Why, then, were GILTI and FDII included in the law? In all likelihood because they were viewed as inhibiting a growing practice of U.S. multinationals of concern to policy-makers – namely, shifting their ownership of highly profitable intangible assets, like patents, trademarks, or other kinds of intellectual property, to subsidiaries in low-tax countries – and doing so with minimal tangible assets in those places. For example, at a Senate hearing in 2012 that attracted a fair amount of attention, it was revealed that Microsoft transferred important intellectual property to three subsidiaries in low-tax jurisdictions – Singapore, Ireland, and Puerto Rico – with an average tax rate of 4%. Although between them the three subsidiaries accounted for 55% of the parent company's income before taxes, only about 2% of Microsoft's 90,000 employees were located there.

While the new tax bill's reduction of the corporate levy, from a top marginal rate of 35% to a flat 21% rate, might be expected to lower the incentive to shift intangible assets abroad, another feature of the act could be anticipated to increase that incentive – namely, exempting the income of foreign subsidiaries from federal taxation. Where formerly that income escaped federal taxation only as long as it was kept abroad but not when it was repatriated, now those taxes can not only be delayed but avoided entirely for qualifying firms. That being the case, what is there to prevent U.S. multinationals from being even more likely than before to shift intellectual property to subsidiaries abroad?

Thus GILTI and FDII.

The creation of a category of corporate profits called GILTI (Global Intangible Low-Taxed Income) enables the federal government to tax intangible income earned by foreign subsidiaries of U.S. multinationals. GILTI is taxed at only about half the rate

may motivate firms to make foreign capital investments as a way of reducing GILTI, which, the new research suggests, is what has been happening to a considerably greater extent than probably was anticipated.

The category Foreign Derived Intangible Income (FDII) was created to motivate U.S. firms to export products and services to foreign markets while maintaining ownership of intellectual property at home. TCJA grants a tax deduction for 37.5% of income from foreign sales deriving from domestic investment in homegrown ideas. While hardly definitive, the researchers' analysis of FDII's effect in one hypothetical case raises the possibility that it may make little difference in firms' U.S. tax liabilities.

Given that GILTI and FDII were intended to keep intellectual property at home, is it conceivable, the authors are asked, that these provisions are achieving that goal even if they have had the perverse effect of boosting U.S firms' capital investment more abroad than domestically? While not investigating this question, the professors know of no findings to that effect. Meanwhile, the unintended consequences of GILTI and FDII revealed by their own research should, they believe, be of serious concern to policy-makers.

The paper, "The Effect of the Tax Cuts and Jobs Act of 2017 on Multinational Firms' Capital Investment: Internal Market Frictions and Tax Incentives," will be among hundreds of scholarly studies presented at the **American Accounting Association** annual meeting, which is expected to attract some 4,000 scholars and practitioners to San Francisco from August 9th to 14th. The AAA is a worldwide organization devoted to excellence in accounting education, research, and practice. Journals published by the AAA and its specialty sections include *The Accounting Review, Accounting Horizons, Issues in Accounting Education, Behavioral Research in Accounting, Journal of Management Accounting Research, Auditing: A Journal of Practice*

& Theory, The Journal of the American Taxation Association, Journal of Financial