The Global Con Hidden in Trump's Tax Reform Law, Revealed

Brad Setser, *The New York Times*, February 6, 2019

Why would any multinational corporation pay the new 21 percent rate when it could use the new "global minimum" loophole to pay half of that?

Last night, President Trump reserved a few minutes of his State of the Union address to praise his tax reform law, which turned a year old last month. To promote its passage, Mr. Trump and his congressional allies promised Americans that drastically lowered corporate tax rates would bring home large sums of capital that had been stashed overseas and finance a surge of domestic investment.

"For too long, our tax code has incentivized companies to leave our country in search of lower tax rates," he said, pitching voters in the fall of 2017. "My administration rejects the offshoring model, and we have embraced a brand-new model. It's called the American model."

The White House argued they wanted a system that "encourages companies to stay in America, grow in America, spend in America, and hire in America." Yet the bill he signed into law includes a sweetheart deal that allows companies that shift their profits abroad to pay tax at a rate well below the already-reduced corporate income tax — an incentive shift that completely contradicts his stated goal.

Why would any multinational corporation pay America's 21 percent tax rate when it could pay the new "global minimum" rate of 10.5 percent on profits shifted to tax havens, particularly when there are few restrictions on how money can be moved around a company and its foreign subsidiaries?

These wonky concerns were largely brushed aside amid the political brawl. But now that a full year has passed since the tax bill became law, we have hard numbers we can evaluate.

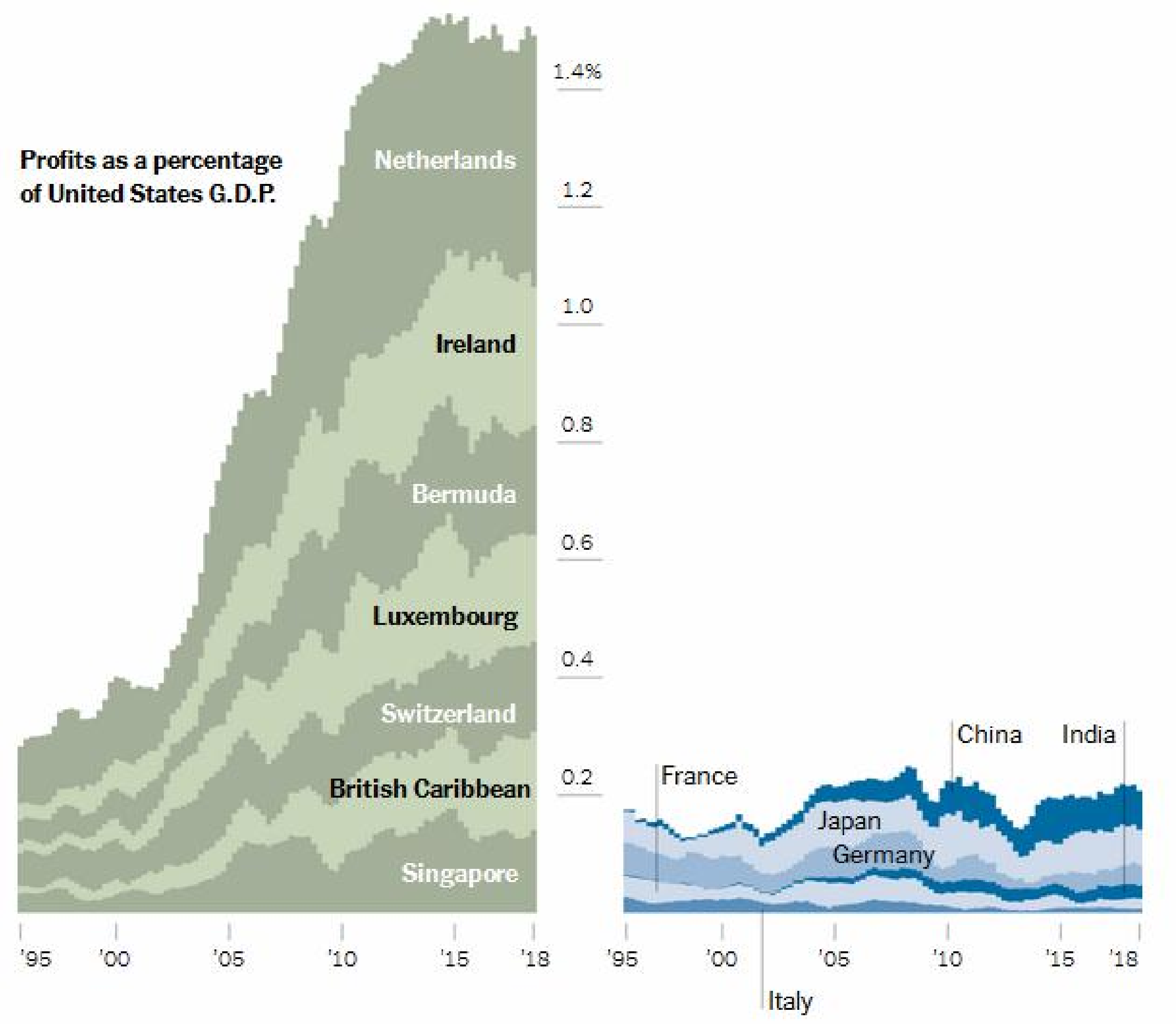
For starters, the law's repatriation deal did prompt a brief surge in offshore profits returning to the United States. But the total sum returned so far is well below the trillions many proponents predicted, and a large chunk of the returned funds have been used for record-breaking stock buybacks, which don't help workers and generate little real economic activity.

And despite Mr. Trump's proud rhetoric regarding tax reform during his State of the Union address, there is no wide pattern of companies bringing back jobs or profits from abroad. The global distribution of corporations' offshore profits — our best measure of their tax avoidance gymnastics — hasn't budged from the prevailing trend.

Well over half the profits that American companies report earning abroad are still booked in only a few low-tax nations — places that, of course, are not actually home to the customers, workers and taxpayers facilitating most of their business. A multinational corporation can route its global sales through Ireland, pay royalties to its Dutch subsidiary and then funnel income to its Bermudian subsidiary — taking advantage of Bermuda's corporate tax rate of zero.

Where American Profits Hide

Seven low-tax nations, some with relatively tiny economies, generate an increasingly greater share of U.S. corporate profits than do the major economies shown here, thanks to complex accounting arrangements.



By *The New York Times* | Source: analysis of Bureau of Economic Analysis data, via Haver Analytics, by Brad Setser and Cole Frank of the Council on Foreign Relations

No major technology company has jettisoned the finely tuned tax structures that allow a large share of its global profits to be booked offshore. Nor have major pharmaceutical companies stopped producing many of their most profitable drugs in Ireland. And Pepsi, to name just one major manufacturer, still makes the concentrate for its soda in Singapore, also a haven.

Eliminating the complex series of loopholes that encourage offshoring was a major talking point in the run-up to the 2017 tax bill, but most of them are still in place. The craftiest and largest corporations can still legally whittle down their effective tax rate into the single digits. (In fact, the new law encourages firms to move "tangible assets" — like factories — offshore).

Overall, the Tax Cuts and Jobs Act amounted to a technocratic sleight of hand — a scheme set to shift an even greater share of the federal tax burden onto the shoulders of American families. According to the Treasury Department's tally for fiscal year 2018, corporate income tax receipts fell by 31 percent, an unprecedented year-over-year drop in a time of economic growth (presumably a time when profits and government revenue should rise in tandem).

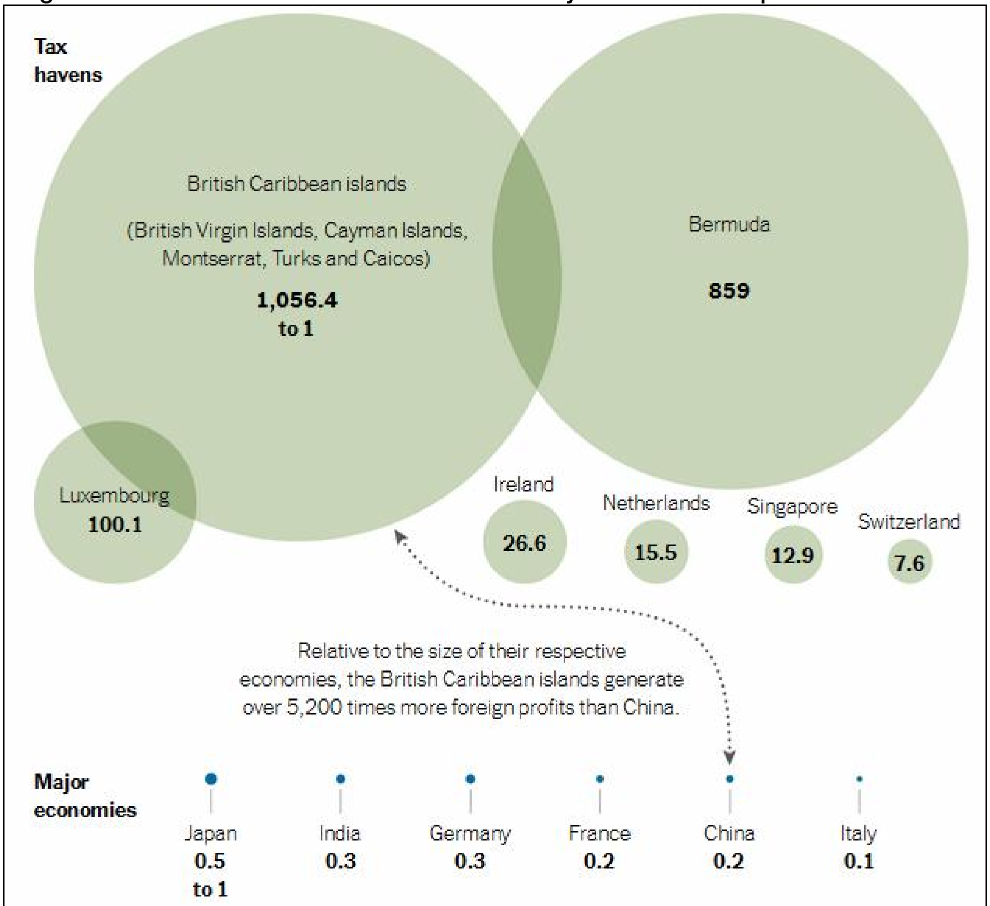
These damning results, to be sure, don't make for a good defense of what came before the new law. In theory under the old system, American-based firms still owed the government a cut of their global profits. In practice, large firms could indefinitely defer paying this tax until the funds could be repatriated — usually when granted a tax holiday by a friendly administration.

Over a generation, this political dance was paired with rules that made it relatively easy for firms to transfer their most prized intellectual property — say, the rights to popular software or the particular mix of ingredients for a hot new drug — to their offshore subsidiaries. Taken together, they created a tax nirvana of sorts for multinational corporations, particularly in intellectual-property-intensive industries like tech and pharmaceuticals. But it wasn't enough.

For their next trick, the companies worked with their political allies to favorably frame the 2017 tax debate. When he was the House speaker, Paul Ryan was fond of talking about $3 trillion in "trapped" profits abroad. But those profits weren't actually, physically, sitting in a few tax havens.

Dwarf Economies, Giant American Profits

Chart shows the ratio of American direct investment income to share of global G.D.P. in tax havens and in major industrial powers.



By *The New York Times* | Sources: British Virgin Islands Finance; Economics and Statistics Office, Government of the Cayman Islands; United Nations (Turks and Caicos); all other G.D.P. figures from the International Monetary Fund; Bureau of Economic Analysis (profits)

They were largely invested in United States bank accounts, securities and bonds issued by the Treasury or other companies headquartered in the States. As Adam Looney — a Brookings Institution fellow and former Treasury Department official — has explained, companies that needed to finance a new domestic investment could simply issue a bond effectively backed by its offshore cash. (For instance, Apple could bring its “trapped” funds onshore by selling a bond to Pfizer’s offshore account, or vice versa.)

Put plainly, they got the best of both worlds: Uncle Sam could tax only a small slice of their books while they traded with one another based on the size of the entire pie.

The scale of the tax shifting has become so immense that some economists believe curbing it could raise reported G.D.P. by well over a percentage point — something Mr. Trump, who’s been absorbed by opportunities to brag about the economy, should notionally welcome.

President Trump’s economic advisers and the key architects of the bill on Capitol Hill must have known their reform wasn’t going to end business incentives that hurt American workers. Honest reform would have meant closing corporate loopholes — a move they originally promised to make.

Should the opportunity present itself, perhaps to the next president, there are a couple of viable options for a fundamental tax overhaul that wouldn’t require reinstating the 35 percent corporate tax rate.

One of several possibilities is to return to a system of global taxation without the deferrals that enabled empty repatriations. That would mean profits sneakily booked tax-free in Bermuda would be taxed every year at 21 percent. Profits booked in Ireland — or other low-tax nations — would be taxed at the difference between Ireland’s rate and America’s rate.

It’s an approach that would protect small and midsize American companies while cracking down on bad corporate actors with enough fancy accountants and lawyers to rig the game to their advantage. And it would be far better than the fake tax reform passed a year ago.

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