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THE GEOMETRY OF INTERNATIONAL TAX PLANNING AFTER THE TAX CUTS AND JOBS ACT: A RIFF ON CIRCLES, SQUARES, AND TRIANGLES

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The enactment of the so-called Tax Cuts and Jobs Act of 2017 (TCJA) significantly changes the landscape for tax planning and compliance by U.S. multinational corporations (MNCs). The promised shift to a more territorial system actually results in a greater likelihood that more of a U.S. MNC's foreign income is subject to current U.S. taxation. The TCJA complicates effective tax planning for such firms, forcing them to reexamine their existing global structures and financial arrangements (i.e., the "geometry" of international tax planning). We briefly review international tax planning before the TCJA as well as some key international tax provisions in the TCJA. We then provide a method to estimate the new Global Intangible Low-Taxed Income (GILTI) tax from a U.S. MNC's financial statements when such information is not publicly disclosed and illustrate the effective tax rate (ETR) and GILTI tax effects for a small sample of public firms after the TCJA. Finally, we discuss some likely changes in international tax planning going forward.

Keywords: corporate tax, international tax, Tax Cuts and Jobs Act, organizational structure

JEL Codes: H25, H26, M41, M48

I. INTRODUCTION

The so-called Tax Cuts and Jobs Act of 2017 (TCJA) substantially reforms the federal taxation of U.S. multinational corporations (MNCs).[1] In particular, it shifts the taxation of cross-border transactions from a long-standing worldwide foreign tax credit (FTC) system to a more territorial-based approach. Due to the increasing globalization of U.S. businesses and declining corporate tax rates abroad, this long-anticipated reform of international taxation received considerable attention from firms, practitioners, news

[1] P.L. 115-97; 12/22/2017.

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media, think tanks, tax authorities, and researchers. However, the principal tax planning objectives of U.S. MNCs were not affected by the enactment of the TCJA. For example, MNCs will still seek to lower their worldwide effective tax rates (ETRs) and manage tax risks after the TCJA. However, the organizational structures and strategies used for such objectives are likely to evolve. Accordingly, we examine how the "geometry" of international tax planning changes in the first financial reporting period following the enactment of the TCJA.[2]

Following a discussion of international tax planning before the enactment of the TCJA, we review some of the key reform provisions in the Act: (1) a transition tax imposed on unrepatriated earnings, (2) 100 percent dividends received deduction (DRD) for certain foreign-sourced dividends, (3) Global Intangible Low-Taxed Income (GILTI) tax, and (4) Base Erosion and Anti-Abuse Tax (BEAT). We then introduce a method to infer information about a U.S. MNC's international tax costs, specifically the GILTI tax, when such information is not publicly disclosed. In doing so, for a small sample of firms from three industries, we observe that (1) ETRs in 2018 were generally less than average ETRs from 2014 to 2016 and (2) the U.S. tax savings related to the corporate tax rate reduction (from 35 to 21 percent) under the TCJA generally exceeds the estimated GILTI tax for most firms. Finally, we discuss some likely changes in international tax planning going forward.

II. A WALK DOWN MEMORY LANE: TAX PLANNING BEFORE THE TCJA

The organizational structures and strategies used by U.S. MNCs generally align with their missions and operations but are adaptable to the vagaries of ever-changing global tax rules (e.g., U.S. Government Accountability Office (GAO), 2011; Organisation for Economic Co-Operation and Development (OECD), 2011; Donohoe, McGill, and Outslay, 2012). For example, Blouin and Krull (2015) consider the role of the U.S. "check-the-box" rules on how entity type choice reported on the U.S. federal tax return affects firms' foreign operations, while Lewellen and Robinson (2014) examine foreign ownership structures of U.S. MNCs.[3] Such research generally finds that the international tax planning objectives of U.S. MNCs involve (1) "optimizing" worldwide ETRs, (2) reducing funding costs, (3) managing tax risks, and (4) mitigating compliance burdens (e.g., Donohoe, McGill, and Outslay, 2013, 2014). After the TCJA (i.e., post-2017), these goals remain the same but, as discussed later, the structures and strategies used to achieve them will likely evolve.

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[2] The geometry of tax planning refers to the long-standing practice of modeling business entity structures with shapes, lines, and symbols. For example, rectangles commonly represent corporate or limited liability entities, triangles reflect partnerships, pentagons reflect trusts, trapezoids reflect S corporations, ovals represent individuals and/or the public, and rectangles with triangles or ovals inside them represent hybrid entities. See andrewmitchel.com/topic.php for numerous graphical examples.

[3] The check-the-box rules (Internal Revenue Code (IRC) Section 7701) permit business entities to choose their entity classification for federal income tax purposes. These regulations can create discrepancies in how pass-through entities are treated across U.S. and foreign jurisdictions, enabling some tax avoidance strategies (Munden, Zimmermann, and Eason, 2002).

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Along with tax authorities and market participants, U.S. MNCs pay close attention to their accounting ETRs (e.g., Drucker, 2010), which results from the application of Accounting Standards Codification (ASC) 740, *Income Taxes*. A U.S. MNC can reduce its accounting ETR, for example, by conducting operations in jurisdictions with lower income tax rates than the United States and asserting that the earnings from such jurisdictions are indefinitely reinvested outside the United States.[4] The purpose of tax planning, of course, is to create organizational structures and business strategies that produce relatively low accounting ETRs that are sustainable over the long run. This ideal benchmark ETR is often referred to as the *optimal ETR* (Donohoe, McGill, and Outslay, 2013).

To achieve and sustain optimal ETRs, U.S. MNCs sought to (1) maximize the deferral of U.S. tax on (low-taxed) non-U.S. earnings, (2) increase the use of FTCs on the U.S. tax return, and (3) mitigate the double-taxation of non-U.S. earnings using income tax treaties. As a result, organizational structuring and planning focused on the migration of business functions (e.g., manufacturing, marketing, distribution, and research and development), risks, and intellectual property to lower-tax foreign jurisdictions. The outcome of this strategic process is often referred to as a tax-aligned supply chain (TASC) structure (U.S. Congress Joint Committee on Taxation (JCT), 2010).

The primary goal of a TASC structure is to separate profits into components according to different business processes, where profit follows risk (Graetz and Doud, 2013). In particular, the profit of a U.S. MNC is viewed to consist of (1) normal profit relating to the functions and risks of creating and selling products and (2) residual profit reflecting entrepreneurial remuneration. Along these lines, Grubert (2012) shows that profit margins (rather than sales) relate to a firm's ability to shift income to low-tax jurisdictions. In general, this phenomenon explains how U.S. technology and pharmaceutical firms with high profit margins reduce their worldwide accounting ETRs far more than U.S.-centric manufacturers and retailers with low profit margins.

Figure 1 depicts a typical (albeit simplified) TASC structure (JCT, 2010).[5] In this structure, a U.S. MNC operates a principal company in a low-tax jurisdiction with a favorable tax treaty network (e.g., Switzerland). The principal company holds foreign intangible property and serves as the manager of the production and sales processes. It also uses a contract manufacturer (related or unrelated) for producing inventory and relies on limited risk distributors or commissionaires to market and sell products. Finished goods are then shipped directly from the contract manufacturer. A large majority of the profits in this structure are retained by the principal company.

Accordingly, under the worldwide tax system, U.S. MNCs generally behaved as expected. First, these firms used transfer pricing arrangements to maximize ("optimize") their worldwide earnings "sheltered" in low-tax jurisdictions, where such earnings were kept outside the United States to avoid U.S. repatriation tax. Second, U.S. MNCs used

[4] See Donohoe et al. (2012) for a detailed discussion of the accounting rules regarding unrepatriated foreign earnings.

[5] For detailed explanations of the TASC model and its implications, see JCT (2010), Donohoe et al. (2013), Oosterhuis and Spinowitz (2013), OECD (2013), Graetz and Doud (2013), and Lewellen and Robinson (2014).

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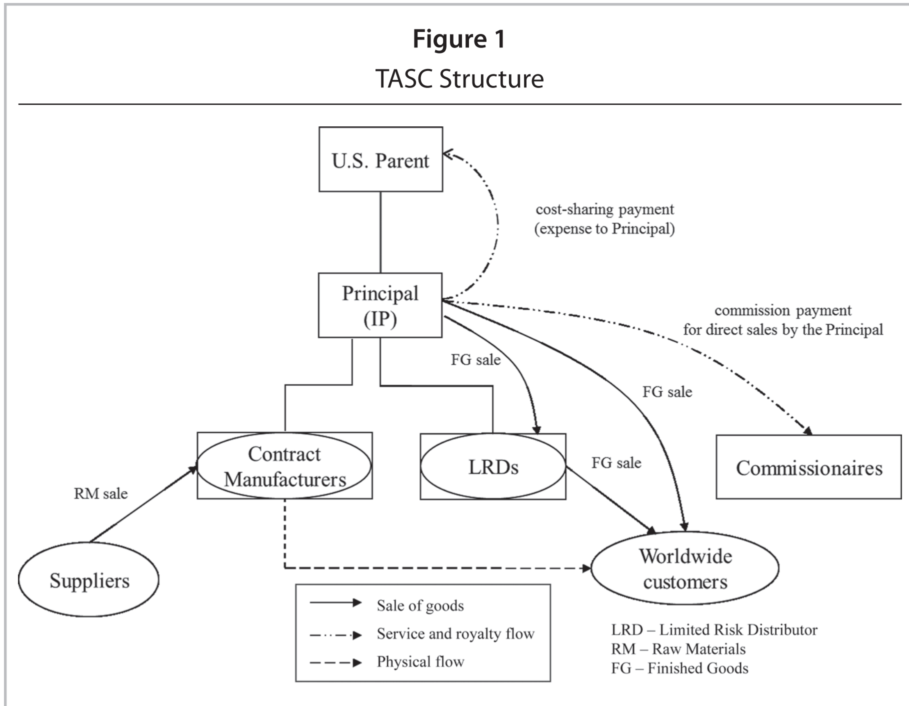
Figure 1
TASC Structure



organizational structures that avoided U.S. anti-deferral rules in Subpart F by relying on the check-the-box rules mentioned earlier. Finally, these firms developed so-called "Rube Goldberg contraptions" (i.e., used complex "machines" to perform simple tasks) that allowed them to repatriate cash to the United States without paying repatriation tax (e.g., Hesse, 2019). Some of the more well-known "contraptions" are referred to as the "Killer B" (IRS Notice 2006-85), "Deadly D," "Shanghai Lady" (IRC Section 304 intergroup stock sales), and "Outbound F" (McGill and Outslay, 2004; Toce, 2011).

To illustrate the first behavior noted above, consider Microsoft Corporation, a U.S. MNC with a significant amount of cash held by its foreign subsidiaries, a significant amount of foreign earnings permanently reinvested abroad, and a relatively low foreign ETR. As reported in its Form 10-Q on September 30, 2017:

> Cash, cash equivalents, and short-term investments totaled $138.5 billion and $133.0 billion as of September 30, 2017 and June 30, 2017.
>
> Of the cash, cash equivalents, and short-term investments as of September 30, 2017, $132.1 billion was held by our foreign subsidiaries and would be subject to material repatriation tax effects. The amount of cash, cash equivalents, and

> short-term investments held by foreign subsidiaries subject to other restrictions on the free flow of funds (primarily currency and other local regulatory) was $2.4 billion. As of September 30, 2017, approximately 88% of the cash equivalents and short-term investments held by our foreign subsidiaries were invested in U.S. government and agency securities, approximately 3% were invested in U.S. mortgage- and asset-backed securities, and approximately 2% were invested in corporate notes and bonds of U.S. companies, all of which are denominated in U.S. dollars.

Based on the reported amounts, 95.4 percent ($132.1/$138.5) of Microsoft's cash equivalents were held by its foreign subsidiaries.

Further, in its Form 10-K on June 30, 2017, the last annual filing before the TCJA effective date, Microsoft Corporation reported:

> As of June 30, 2017, we have not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences of approximately $142 billion resulting from earnings for certain non-U.S. subsidiaries which are permanently reinvested outside the U.S. The unrecognized deferred tax liability associated with these temporary differences was approximately $45 billion as of June 30, 2017.

Using this information, we solve for the foreign ETR as follows, where *FT* denotes foreign taxes: [($142 permanently invested foreign earnings + *FT*) × 35 percent] – *FT* = $45 of residual U.S. tax. *FT* is thus $7.23. With $7.23 billion of foreign taxes paid, Microsoft's foreign ETR equals 4.8 percent in this period (i.e., $7.23 of *FT* divided by $142 of foreign earnings grossed up by the $7.23 of *FT*). This analysis reveals that, with its tax planning and structuring, Microsoft generated foreign income taxed at a significantly lower rate than it would have paid in the United States, or in most of the countries in which the firm operates. This favorable outcome was a fairly common occurrence for many U.S. MNCs in the high-tech industry.

Over time, TASC structures have prompted considerable regulatory action. For example, the OECD launched its well-known Base Erosion and Profiting Shifting project (OECD, 2013) and global tax authorities now perform more intensive transfer pricing audits (e.g., Slemmer, 2018; Sarfo, 2019). These actions were also followed by the mandate for so-called country-by-country reporting (OECD, 2015; Hanlon, 2018; De Simone and Olbert, 2019) and the Anti-Tax Avoidance Directives of the European Commission (2016). Not to be outdone, the U.S. Senate Permanent Subcommittee on Investigations (2012, 2013) also held several hearings examining the international tax structures of companies such as Apple, Caterpillar, and Hewlett Packard.

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III. INTERNATIONAL TAXATION AFTER THE TCJA

A. Overview of Key Changes

The TCJA made comprehensive changes to the international tax rules faced by U.S. MNCs. It characterizes these changes as moving the United States away from its historic worldwide FTC system toward a more "territorial" tax system. Note, however, that the enacted approach is *not* a completely territorial system as several limitations exist. In fact, in many cases, the TCJA has the effect of making most of the income from U.S. MNCs' *foreign* subsidiaries subject to immediate U.S. taxation—not the expected outcome under a completely territorial system.[6]

In a completely territorial system, income earned outside of a country's jurisdiction is generally *exempt* from home-country taxation (referred to as a "participation exemption"). Such income may or may not be taxed in the source jurisdiction. A common adjustment to a completely territorial system involves an exemption only for active business income.[7] As explained in detail later, the reforms in the TCJA subject all but a potentially small portion of a U.S. MNC's positive foreign income to immediate U.S. taxation, albeit with a portion of this income taxed at a lower rate. This result primarily stems from the imposition of the new GILTI tax.

To transition the U.S. tax system toward a more territorial-based system, the TCJA creates a one-time deemed repatriation of U.S. MNC's unrepatriated foreign earnings from certain foreign corporations, such as controlled foreign corporations (CFCs) (IRC Section 965). In other words, a U.S. MNC's pre-TCJA, post-1986 accumulated earnings and profits (E&P) are considered to be repatriated to the United States as a taxable dividend. Under this provision, the United States imposes a one-time tax on such unrepatriated foreign earnings at 15.5 or 8 percent depending on whether the earnings are held in cash or non-cash components, respectively. Other key changes to international taxation include a 100 percent DRD for the foreign-sourced portion of certain corporate dividends (IRC Section 245A), the GILTI provisions (IRC Section 951A), the BEAT provisions (IRC Section 59A), and the Foreign-Derived Intangible Income (FDII) provisions (IRC Section 250). Several other related provisions were also altered in major ways, including the deductibility of interest expense under IRC Section 163(j).[8] We review the transition tax, dividend participation exemption, GILTI tax, and BEAT provisions below.

1. Transition Tax on Unrepatriated Foreign Earnings

The TCJA imposes a one-time deemed repatriation tax on unrepatriated E&P of certain foreign subsidiaries of U.S. MNCs under IRC Section 965. This new provision levies an effective tax of 15.5 percent on the cash component of deemed repatriated

6 See Donohoe et al. (2013) for a detailed discussion of prior attempts to move the U.S. system to a territorial system with an associated global minimum tax approach.

7 See Pomerleau and Jahnsen (2017) for a review of OECD territorial tax systems.

8 See Dharmapala (2018) and Carrizosa et al. (2019) for a discussion of these changes.

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foreign E&P and 8 percent on the non-cash component of such E&P, all of which is payable (interest free) over an eight-year period. In addition, the newly taxed foreign E&P generates a special category of foreign subsidiary E&P referred to as "previously taxed earnings." Although such earnings have been subjected to U.S. tax and will *not* be taxed again, actual (rather than deemed) repatriation can generate additional taxes in other jurisdictions (e.g., withholding taxes in the foreign subsidiary's country).

Returning to Microsoft Corporation as an example, the rather significant effects of this one-time transition tax are discussed in its Form 10-K on June 30, 2018:

> We recorded an estimated $17.9 billion charge in fiscal year 2018 related to the transition tax, which was included in the provision for income taxes in our consolidated income statements and income taxes in our consolidated balance sheets. We have not yet completed our accounting for the transition tax as our analysis of deferred foreign income is not complete.

2. A 100 Percent DRD for Certain Foreign-Source Dividends

The new IRC Section 245A generally provides a 100 percent DRD for the foreign-source portion of dividends that a U.S. MNC receives from foreign corporations in which it owns at least 10 percent. This DRD approach is known as a participation exemption in other countries, and provides the basis for referring to the TCJA changes as a movement toward a more territorial system. However, in many cases, only a *portion* of the E&P generated each year will qualify for this 100 percent DRD. The E&P that qualifies is generally income other than income subject to (1) the GILTI tax or (2) immediate taxation under Subpart F. As explained in the GILTI tax discussion later, current (annual) E&P earned in excess of 10 percent of the foreign subsidiary's so-called qualified business asset investment (QBAI), essentially the subsidiary's tangible assets, is immediately taxed under the GILTI tax regime. Consequently, only the E&P representing non-Subpart F earnings less than or equal to the statutorily mandated 10 percent of tangible asset return is eligible for the 100 percent DRD.

Withholding taxes paid on the excluded dividend are not creditable against the pre-credit U.S. tax. Before the TCJA, dividends from foreign subsidiaries often carried with them an IRC Section 902 deemed-paid credit. While this credit was repealed by the TCJA, a similar IRC Section 960 deemed-paid credit remains in effect for certain foreign deemed dividends (e.g., Subpart F and GILTI inclusions under IRC Sections 951 and 951A).

3. New Anti-Deferral Rules: Subpart F and GILTI Tax

The prior Subpart F regime remains in place for CFCs under the TCJA. In particular, there is no deferral allowed of U.S. tax on Subpart F income that is earned outside the United States via a CFC. However, several exceptions to Subpart F income taxation

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exist, including the high-tax exception of IRC Section 954(b)(4). When taxed by the United States, a full deemed-paid credit is allowed under IRC Section 960, with a carryover period of 10 years. Subpart F deemed dividends are subject to a look-through rule for FTC "basket" purposes. The deemed dividend is placed in the FTC basket for the income out of which the dividend is deemed paid (i.e., general, passive, or branch, but not GILTI).

Congress realized that, with a participation exemption dividend regime, U.S. MNCs could shift income to lower-tax jurisdictions and then repatriate such income as non-taxable dividends. To prevent this possible tax base erosion, particularly with respect to intangible income, Congress enacted new provisions to currently tax certain income of CFCs, albeit at a reduced rate.

Specifically, the TCJA created a new anti-deferral rule in IRC Section 951A referred to as GILTI. This new rule is essentially a global minimum tax. GILTI income is that which is earned through a CFC that is more than 50 percent owned by "U.S. shareholders" and satisfies the definition of "CFC-tested income." This definition excludes income effectively connected with a U.S. trade or business, Subpart F income, income excluded from Subpart F under the high-tax exception, and certain related-person dividends. The CFC-tested income must exceed 10 percent of the foreign corporation's QBAI to incur a GILTI tax. Such "tainted" income is treated as an income inclusion to the U.S. shareholders and taxed by the United States currently. On the U.S. tax return, the included GILTI *income* is eligible for a 50 percent deduction under IRC Section 250. Foreign taxes associated with GILTI are included in the income inclusion computation (gross-up), and an FTC equal to 80 percent of the gross-up is also permitted. The GILTI income inclusion and the gross-up are both placed in a separate GILTI FTC limitation basket. Any excess FTC associated with the GILTI inclusion is not eligible for carryback or carryforward. The tax is imposed on the U.S. shareholders of the CFC.

Although GILTI is computed similar to Subpart F income, GILTI is not considered Subpart F income. Subpart F income is computed at a CFC-level basis. The GILTI inclusion is computed at a U.S. shareholder-level basis (i.e., aggregate ownership in CFCs). Theoretically (i.e., assuming no deduction apportionment), no residual U.S. tax is owed on GILTI if the foreign ETR imposed on GILTI is 13.125 percent or higher. If a dollar of foreign earnings subject to GILTI is taxed at exactly 13.125 percent by the foreign government, it results in \$0.86875 (\$1.00 – \$0.13125) of E&P, ignoring complexities in the calculation of E&P itself. The residual U.S. tax on such E&P thus would be zero, as shown below:

$$\{[[\$0.86875\ (\text{E\&P}) + 0.13125\ (\text{FT})] - (0.50 \times \$1.00)] \times 21\ \text{percent (U.S. tax rate)}\} - (0.80 \times \$0.13125).$$

To further illustrate the concept of GILTI, consider an example. USCo, a U.S. corporation, owns 100 percent of a single CFC, IrishCo. IrishCo has \$400 of pre-tax income on which it pays Irish income tax of \$50 (i.e., a 12.5 percent tax rate), resulting in

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current E&P of $350 ($400 – $50). IrishCo has no QBAI, as it owns only self-created intangibles. USCo will thus pay $2 of incremental U.S. income tax as a result of the GILTI provisions, as shown below:

CFC-tested income	$350
Less: 10% QBAI	$0
GILTI	$350
IRC Section 78 gross-up	$50
IRC Section 951A inclusion	$400
Less: 50% GILTI deduction	$200
Taxable income	$200
U.S. tax rate	21%
Precredit U.S. tax	$42
Less: IRC Section 960 FTC ($50 × 80%)	$40
Net U.S. tax	$2

This relatively simple example ignores the effect of any deductions allocated to the GILTI FTC basket under IRC Section 904. Any such allocated and apportioned deductions might reduce the available FTC, which is already reduced by a so-called 80 percent "haircut."

The introduction of GILTI has already produced some unintended results by imposing a tax on U.S. MNCs with significant tangible assets operating in jurisdictions with an ETR greater than 13.125 percent. For example, Rubin (2018) discusses the effects of GILTI on Kansas City Southern. In its December 31, 2018 Form 10-K, the firm explains that a 1.3 percent increase in its ETR is due to the effects of GILTI:

> The GILTI tax expense is primarily caused by a U.S. foreign tax credit limitation which requires an allocation of interest expense to the GILTI income, effectively rendering the allocated interest expense non-deductible. As a result of the GILTI provisions, the Company's effective tax rate increased by 1.3% for 2018.

With its issuance of proposed regulations under IRC Section 951A in June 2019, the U.S. Treasury acknowledged that imposing GILTI tax on high-taxed foreign income was inadvertent.[9] As a result, it proposes to allow U.S. MNCs to elect to apply a high-tax GILTI exception based on their foreign ETR. If finalized, this new approach could solve the problem faced by firms such as Kansas City Southern.[10]

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[9] See REG-104390-18, *Guidance related to Section 957A (Global Intangible Low-Tax Income)*.

[10] See Sullivan (2019) for more extensive GILTI calculation examples. For a detailed background discussion of GILTI and FDII, see Fleming, Peroni, and Shay (2018) and Camacho and White (2019).

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4. BEAT Provisions

U.S. MNCs can reduce their U.S. income tax base by making deductible payments (e.g., interest, rents, and royalties) to their foreign subsidiaries. Moreover, due to various tax treaties, such payments may be exempt from withholding taxes or subject to a reduced tax rate. Finally, the foreign taxation of such payments may end up rather favorable to firms. Thus, the purpose of the newly enacted BEAT provisions is to curtail the tax benefits of such income shifting behavior.

Specifically, the BEAT provisions (IRC Section 59A) impose a minimum tax on "excess base erosion payments" made by a U.S. corporation to related parties that are owned 25 percent or more by the U.S. corporation. The minimum tax is 10 percent of the corporate taxpayer's modified taxable income (MTI) over the shareholder's regular tax liability for the tax year net of certain tax credits. Base erosion payments are defined as deductible amounts (e.g., interest, royalties, rent, and fees) paid to a related party that effectively "erode" the taxpayer's U.S. taxable income. In particular, excess base erosion payments are those payments that are collectively 3 percent or more of the taxpayer's total deductions. The BEAT only applies to C corporations with average annual gross receipts of at least $500 million for the three tax years ending with the preceding tax year. Unlike the corporate alternative minimum tax (AMT), the BEAT cannot be carried forward to future years when the regular tax liability exceeds the BEAT. Furthermore, BEAT payments can produce CFC-tested income for GILTI tax purposes, a so-called "boomerang effect," in which the payment to the CFC is subject to the BEAT and creates GILTI income from the CFC.[11] The BEAT is computed as

MTI × 10 percent – adjusted regular tax liability (ARTL),

where MTI is defined as follows:

Regular taxable income
\+ Base erosion payments
\+ Base erosion percentage of net operating loss deduction; and

ARTL is defined as

Regular tax liability
– Tax credits other than the research credit.

B. Detecting the Effects of GILTI from Financial Statements

The discussion so far summarizes the key international tax changes for U.S. MNCs under the TCJA. One of the most significant changes is the introduction of the new GILTI tax. However, at present, it is unclear whether the financial statements of U.S. MNCs will provide sufficient information to evaluate the effects of the GILTI tax. We consider this issue below.

[11] See Sheppard (2018) for a detailed discussion of the BEAT and associated issues.

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ASC 740, *Income Taxes*, requires the effect of a change in income tax law to be recognized in the period of enactment. Accordingly, calendar year-end domestic companies were required to recognize the effect of the TCJA in their 2017 year-end financial statements. The Securities and Exchange Commission (SEC) acknowledged the challenge involved in determining the effects of the TCJA in the short window of time allowed. As a result, Staff Accounting Bulletin (SAB) 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act," permitted firms to record estimates (i.e., provisional amounts) or disclose that they could not determine the tax accounting effects of the TCJA. Such firms were then given a period of up to one year to adjust their original estimates and fully account for the effects of the TCJA.[12]

While firms were required to disclose the effects of the TCJA in their financial statements, they were not explicitly required to separate and report the impact of specific tax rule changes. For example, the Financial Accounting Standards Board (FASB) stated in a meeting handout:

> While existing or proposed disclosures address several of the key changes to the U.S. Federal Tax Code (for example, paragraphs 740-10-50-9(g) and 740-10-50-12 require disclosures that address a change in the corporate income tax rate), there are no existing or proposed disclosures that explicitly address a company's exposure to certain of the new international tax provisions in the Tax Cuts and Jobs Act (for example, taxes on GILTI or BEAT).[13]

Consequently, there are conflicting opinions on required disclosures concerning the effects of the TCJA provisions. For instance, in its handout, the FASB noted that financial statement users:

> [I]ndicated that it would be useful to understand the specific effect of GILTI, BEAT, and FDII on the ETR and income tax expense. One user commented that if the amount of GILTI or BEAT is material, investors would benefit from a required separate line item in the entity's ETR reconciliation.

Conversely, the FASB handout also stated that financial statement preparers opposed the separate disclosure of the effects of GILTI, BEAT, or FDII on income tax expense:

> Preparers commented that if GILTI, BEAT, or FDII had a significant effect on the ETR, then they would already be required to disclose the separate effect because of the 5 percent threshold for the ETR reconciliation (a current SEC requirement and a proposed disclosure). For example, an entity's tax strategy

[12] See Nichols, Duxbury, and Scott (2019) for an analysis of SAB 118 adjustments reported in 2018 by 139 of *Fortune* 250 companies. Their analysis extends prior research (Nichols, Duxbury, and Scott, 2018) on the effect of the TCJA on tax provision and tax footnote disclosures by *Fortune* 250 firms in 2017.

[13] FASB Meeting Handout, Disclosure Framework—Disclosure Review: Income Taxes, November 14, 2018 (p. 8).

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> may result in a higher amount of GILTI in a given year but a lower income tax amount in a foreign jurisdiction. In this case, the preparer would consider its overall tax burden on foreign earnings instead of the components. Preparers also did not support requiring disclosure of specific provisions of the Tax Cuts and Jobs Act because they are similar to other provisions of the tax law that result in U.S. taxes on foreign earnings (for example, Subpart F income, which taxes income on passive investments held by foreign subsidiaries) for which no specific disclosure is required. Therefore, requiring disclosures for those specific provisions in the tax bill would be inconsistent with how other aspects of tax law are treated.

The existing SEC requirement for a 5 percent threshold for separate rate reconciliation reporting referenced by the FASB above would require reporting the effects of GILTI, BEAT, or FDII only if the reconciling item had a 1.05 percent or greater effect on a firm's ETR (i.e., 21 percent tax × 5 percent). It is thus little surprise that only 17 percent of firms in a sample of 139 *Fortune 250* firms provided a footnote disclosure in their 2018 Form 10-K regarding the effects of the GILTI tax (Nichols, Duxbury, and Scott, 2019).

For this reason, we develop a method for roughly estimating the GILTI tax using financial statement information when such information is not otherwise disclosed. We illustrate this method for a U.S. MNC, Biogen Inc., that provided GILTI tax disclosures in its income tax footnote. These disclosures, in turn, allow us to compare our estimate to the reported GILTI tax amount.

Figure 2 reproduces Biogen Inc.'s relevant 2018 Form 10-K information. The firm reports an item in its income tax footnote rate reconciliation for GILTI, indicating that it caused the ETR to increase by 1.6 percent. With reported book income before income taxes of $5,900 (in millions), this item implies a GILTI tax of $94 million ($5,900 × 1.6%).

To estimate the GILTI tax, our approach computes the hypothetical U.S. tax on the reported foreign profit before income taxes ($2,023) at 21 percent ($425). From this amount, we then subtract the reported foreign current income tax provision of $140, resulting in a difference of $285. The rate reconciliation for the foreign tax differential is 1.9 percent, producing an income tax equivalent of $112 ($5,900 × 1.9%). Subtracting $112 from $285 results in an estimated GILTI tax amount of $173. We refer to this amount as the "GILTI tax plug-in," as shown below:

Foreign profit before income tax	$2,023
U.S. tax at 21%	$425
Foreign current income tax provision	$140
Difference between hypothetical U.S. tax and foreign tax	$285
Rate reconciliation foreign tax differential ($5,900 × 1.9%)	$112
GILTI tax plug-in	$173

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Figure 2

Selected Income Tax Footnote Information from Biogen Inc. (2018 Form 10-K)

17. Income Taxes

Income Tax Expense

Income before income tax provision and the income tax expense consist of the following:

(In millions)	For the Years Ended December 31, 2018	2017	2016
Income before income taxes (benefit):			
Domestic	$ 3,877.0	$ 3,540.4	$ 3,655.4
Foreign	2,022.6	1,588.4	1,277.6
Total	$ 5,899.6	$ 5,128.8	$ 4,933.0
Income tax expense (benefit):			
Current:			
Federal	$ 1,131.8	$ 2,201.4	$ 1,304.3
State	45.5	57.0	55.1
Foreign	140.0	108.6	52.9
Total	1,317.3	2,367.0	1,412.3
Deferred:			
Federal	$ (62.0)	$ 241.0	$ (125.6)
State	(7.4)	9.9	(3.8)
Foreign	177.7	(159.2)	(45.6)
Total	108.3	91.7	(175.0)
Total income tax expense	$ 1,425.6	$ 2,458.7	$ 1,237.3

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Tax Rate

A reconciliation between the U.S. federal statutory tax rate and our effective tax rate is summarized as follows:

	For the Years Ended December 31, 2018	2017	2016
Statutory rate	21.0%	35.0%	35.0%
State taxes	0.6	0.8	0.9
Taxes on foreign earnings	(1.9)	(11.1)	(9.6)
Credits and net operating loss utilization	(0.9)	(0.8)	(1.4)
Purchased intangible assets	1.2	1.4	1.2
Manufacturing deduction	—	(1.9)	(1.9)
Other permanent items	0.3	0.7	0.5
2017 Tax Act	2.1	22.9	—
GILTI	1.6	—	—
Impairment of ZINBRYTA related tax assets	—	0.9	—
Other	0.2	—	0.4
Effective tax rate	24.2%	47.9%	25.1%

As such, these calculations suggest a foreign current ETR of 15.5 percent (i.e., the foreign current income tax provision of $140 (6.9 percent ETR) plus the estimated GILTI tax of $173 (8.6 percent ETR), divided by foreign profit before income tax of $2,023).

As mentioned earlier, the GILTI item reported in Biogen Inc.'s ETR reconciliation is $94, a difference of $79 from our estimate of $173. This difference is attributable to several factors: (1) financial accounting income used in our calculations does not equate

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to taxable income; (2) not all foreign pre-tax profit is subject to GILTI treatment; (3) foreign profit before tax in the tax footnote is based on entity location; (4) accounting ETRs are distorted by discrete items unrelated to changes in international tax; and (5) tax footnotes and ETR reconciliations are inconsistent (i.e., diversity in disclosures is common). In general, these factors could either understate or overstate our GILTI tax estimates. However, the second factor — not all foreign pre-tax profit is subject to GILTI tax — should only serve to overstate GILTI tax estimates. Thus, even though our estimation approach provides only a rough approximation of the GILTI tax, it is still informative when actual GILTI items are not otherwise disclosed in firms' financial statements.

C. Small Sample Estimates of the Effects of the TCJA and GILTI Tax

To provide further insight on the potential effects of the TCJA, we examine 25 U.S. MNCs with calendar year-ends from three industries: pharmaceuticals ($n = 10$), technology ($n = 10$), and medical devices ($n = 5$). Table 1 reports the following for each firm by industry: (1) ETRs for 2014, 2015, and 2016; (2) average ETR for 2014–2016; (3) ETRs for 2018 (i.e., the effective date of the TCJA); (4) estimated U.S. tax savings related to the corporate tax rate change in the TCJA (i.e., the difference between reported U.S. pre-tax book income taxed at 21 percent versus 35 percent); and (5) the GILTI tax plug-in described earlier. To consider firms' "sustainable" ETRs, all reported ETRs are adjusted for the effects of stock option exercises, and ETRs for 2018 are also adjusted for any one-time effects of the TCJA.

Using statistics reported in Table 1, Figure 3 depicts sample firms' average ETR for 2014–2016 compared to 2018. Figure 4 plots this same information by industry. Further, Figure 5 depicts sample firms' estimated U.S. tax savings related to the reduction in the tax rate from 35 to 21 percent as well as the estimated GILTI tax plug-in. Although the estimated GILTI tax plug-in represents a tax *cost* while the estimated U.S. tax savings from the tax rate reduction (if positive) reflects a tax *benefit*, we plot these amounts on the same axis and in the same direction to facilitate magnitude comparisons. Finally, Figure 6 depicts the same information (in Figure 5) by industry.

Collectively, this graphical evidence suggests that, for many of these 25 firms, the ETR in 2018 was less than the average ETR from 2014 to 2016. This observation exists, on average, across all three industries. More importantly, the key takeaway from this evidence is that the median U.S. tax savings related to the tax rate reduction appears to outweigh the median estimated GILTI tax for most firms in our small sample.

IV. LOOKING AHEAD: TAX PLANNING AFTER THE TCJA

Discussions with tax practitioners suggest that, after the TCJA, corporate tax departments are focusing on (1) modeling tax reform legislation; (2) computing the transition tax, with special attention on documenting E&P; (3) evaluating new anti-deferral and anti-base erosion provisions; (4) identifying and implementing new tax planning strategies and prospective favorable filing positions (as applicable); (5) refining intellectual property alignment plans; (6) identifying costs and/or complications of distributions

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Table 1

Summary of ETRs, Estimated U.S. Tax Savings Due to Rate Change, and GILTI Tax Plug-Ins

	ETRs (%)					Est. U.S. Tax Savings Related to Tax Rate Change ($)	GILTI Tax Plug-In ($)
	2014	2015	2016	Average 2014–2016	2018		
Pharmaceutical							
Johnson & Johnson	20.62	19.73	16.48	18.94	16.91	781	0
Pfizer	24.03	19.99	13.45	19.15	10.95	–616	0
Merck	29.78	15.42	12.26	19.15	25.50	520	0
Abbvie	22.75	21.67	23.80	22.74	–17.63	–598	63
Gilead	15.58	13.70	19.97	16.42	29.89	990	141
Eli Lilly	20.23	11.08	18.85	16.72	10.25	85	0
Amgen	4.74	9.74	13.64	9.38	12.06	680	347
Bristol-Myers	9.28	14.40	22.25	15.31	18.05	327	110
Celgene	3.22	5.93	7.93	5.69	17.17	–84	482
Biogen	18.67	18.04	21.33	19.35	22.07	543	173
Median	19.45	14.91	17.66	17.83	17.04	424	87
Technology							
Amazon	–145.05	53.00	15.31	–25.58	12.02	1,562	0
IBM	20.65	16.02	3.58	13.42	5.09	88	0
Alphabet	21.08	16.81	19.35	0.00	11.96	2,212	1,052
Intel	25.28	18.44	19.06	20.93	0.00	2,065	0
Danaher	19.06	10.05	15.63	14.91	19.50	128	0
Xerox	16.51	18.83	10.92	15.42	29.68	53	11
Facebook	2.38	12.67	18.38	11.15	12.81	1,232	951
Texas Instruments	24.34	27.04	27.08	26.15	13.04	794	0
eBay	129.74	15.34	–99.67	15.14	24.03	42	247
Netflix	–1.82	–42.71	3.66	–13.63	7.07	118,356	10,395
Median	19.85	16.42	15.47	14.17	12.42	1,013	6
Medical							
Stryker	53.79	15.56	12.39	27.25	–52.11	71	58
Boston Scientific	100.98	87.38	–182.49	1.96	–12.81	5	13
Baxter	6.73	8.18	–0.24	4.89	15.95	2	147
Abbott	28.51	15.05	17.69	20.42	12.46	–60	0
Zimmer Biomet	23.43	4.58	23.75	17.25	–36.83	–54	0
Median	28.51	15.05	12.39	17.25	–12.81	2	13
Sample median	20.62	15.42	15.63	15.42	12.46	128	13

Notes: All ETRs are computed absent the effects of the one-time repatriation tax under the TCJA and the non-qualified stock option expense. The estimated tax savings related to the tax rate change in the TCJA is the difference between reported U.S. pre-tax book income taxed at 35 percent versus 21 percent. The GILTI tax plug-in is computed as described in Section III.B.

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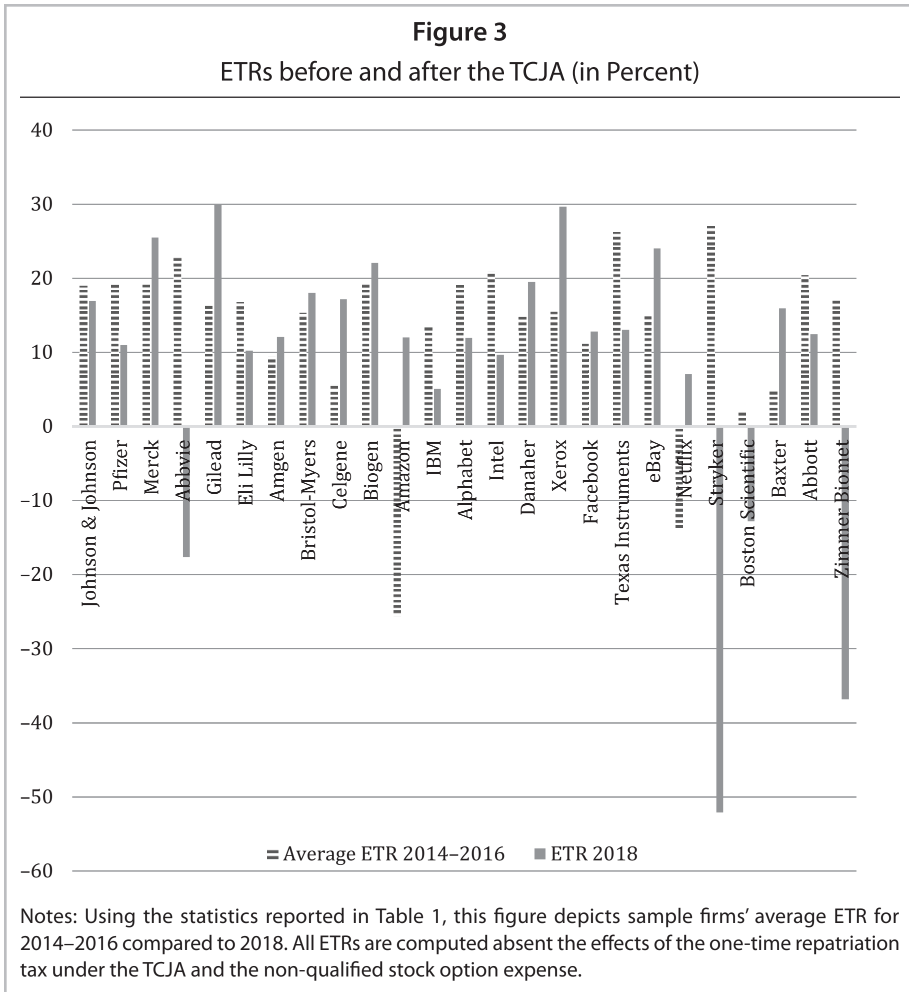
Figure 3

ETRs before and after the TCJA (in Percent)



Notes: Using the statistics reported in Table 1, this figure depicts sample firms' average ETR for 2014–2016 compared to 2018. All ETRs are computed absent the effects of the one-time repatriation tax under the TCJA and the non-qualified stock option expense.

made to the United States (e.g., local country withholding taxes and state tax implications); and (7) analyzing and computing the financial accounting implications of the more territorial tax system.

Given the complexity of the changes to international taxation under the TCJA and general lack of guidance from the Treasury (until very recently), financial statements for 2018 only likely capture some of the major changes caused by the TCJA. Nevertheless, corporate tax departments and their advisors are catching up to the new rules. While some U.S. MNCs may have implemented strategic plans to address the effects of the TCJA, many others have not undertaken the kind of organizational restructuring and planning that will need to occur over the long run.

Consequently, there are many important, unanswered questions as to how U.S. MNCs will respond to the new tax system, which is arguably more global than territorial. For example, will U.S. MNCs significantly restructure their international operations? Will

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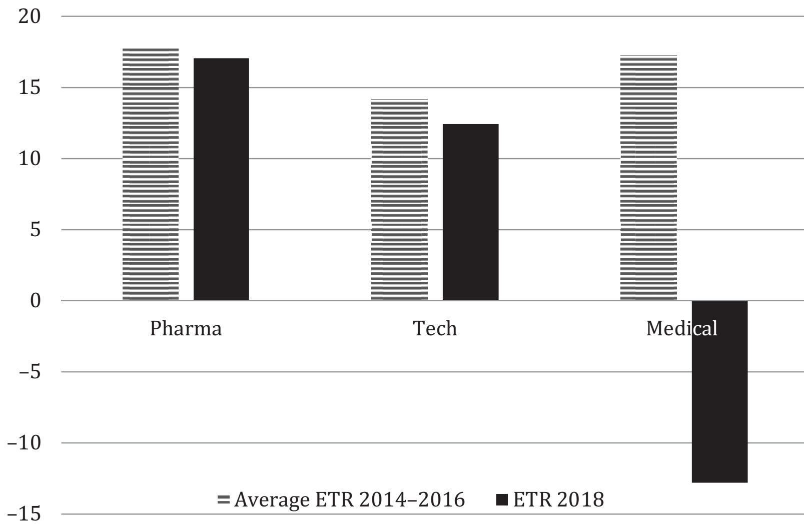
Figure 4

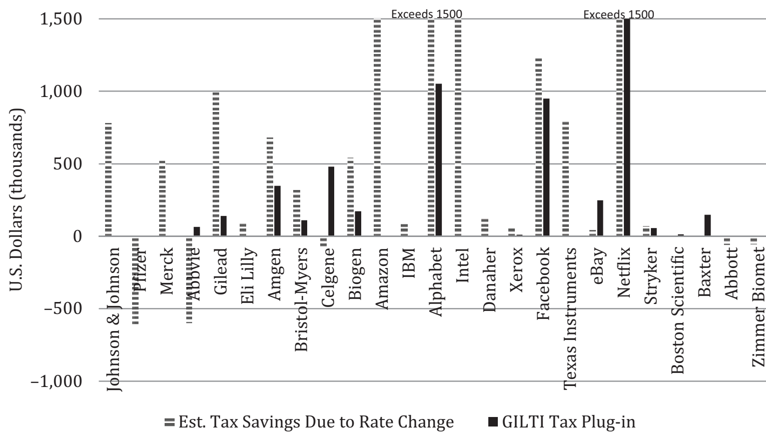
Median ETRs by Industry before and after the TCJA (in Percent)



Notes: Using the statistics reported in Table 1, this figure depicts the average ETR by industry for 2014–2016 compared to 2018. All ETRs are computed absent the effects of the one-time repatriation tax under the TCJA and the non-qualified stock option expense.

Figure 5

Estimated U.S. Tax Savings Due to Tax Rate Change and GILTI Tax Plug-In



Notes: Using the statistics reported in Table 1, this figure depicts sample firms' estimated U.S. tax savings related to the reduction in the tax rate from 35 to 21 percent as well as the estimated GILTI tax plug-in. The estimated tax savings related to the tax rate change in the TCJA is the difference between reported U.S. pre-tax book income taxed at 35 percent versus 21 percent. Although the estimated GILTI tax plug-in represents a tax cost while the estimated U.S. tax savings from the tax rate reductions (if positive) reflects a tax benefit, we plot these amounts on the same axis and in the same direction to facilitate magnitude comparisons.

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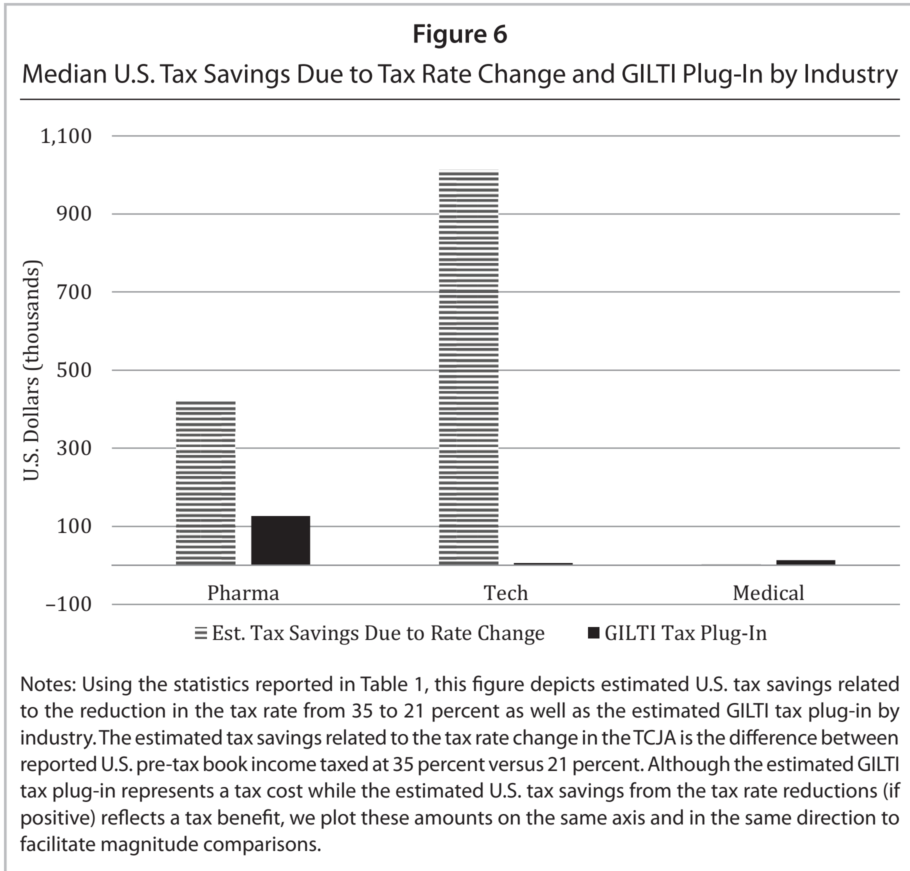
Figure 6

Median U.S. Tax Savings Due to Tax Rate Change and GILTI Plug-In by Industry



Notes: Using the statistics reported in Table 1, this figure depicts estimated U.S. tax savings related to the reduction in the tax rate from 35 to 21 percent as well as the estimated GILTI tax plug-in by industry. The estimated tax savings related to the tax rate change in the TCJA is the difference between reported U.S. pre-tax book income taxed at 35 percent versus 21 percent. Although the estimated GILTI tax plug-in represents a tax cost while the estimated U.S. tax savings from the tax rate reductions (if positive) reflects a tax benefit, we plot these amounts on the same axis and in the same direction to facilitate magnitude comparisons.

these firms allocate costs differently, such as capitalizing more costs into inventory to avoid the BEAT? Will they realign TASC structures and/or return intangible assets to the United States in hopes of maximizing FDII and reducing GILTI? Will we observe more or less use of corporations, partnerships, branches, or hybrid entities to operate abroad (i.e., a change in the geometry of international tax planning)?

Presently, there are no clear answers to these questions. For example, Qualcomm states in its Form 10-Q for December 31, 2018 that it will treat several of its foreign subsidiaries (previously classified as CFCs) as domestic branches in order to reduce GILTI and BEAT:

> As a result of the Tax Legislation, in fiscal 2019, several of our foreign subsidiaries made tax elections to be treated as U.S. branches for federal income tax purposes (commonly referred to as "check-the-box" elections) effective beginning in fiscal 2018 and 2019. We believe that by treating these foreign subsidiaries as U.S. branches for federal income taxes, rather than controlled foreign corporations, we will significantly reduce the risk of being subject to GILTI and BEAT taxes.

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Prior to the TCJA, if these subsidiaries were operated in low-tax jurisdictions, the deferral of the U.S. incremental income tax would favor the use of CFCs. Even if these subsidiaries were operated in high-tax jurisdictions, the use of CFCs would facilitate tax planning with regard to the timing of U.S. income inclusions and use of related FTCs (as opposed to operating as a branch, whereby all foreign income was included in U.S. income each year). After the TCJA, the benefits of deferral using CFCs clearly did not offset the cost of new taxes imposed by GILTI and BEAT, particularly given that the foreign branch income is now subject to a lower U.S. tax rate.

Qualcomm also indicated in the same quarterly report that it returned certain intangible property back to the United States after 2017:

> Additionally, during fiscal 2018, one of our foreign subsidiaries distributed certain intellectual property to a U.S. subsidiary resulting in a difference between the GAAP basis and the U.S. federal tax basis of the distributed intellectual property. Upon adoption of new accounting guidance in the first quarter of fiscal 2019, we recorded a deferred tax asset of approximately $2.6 billion, primarily related to the distributed intellectual property, with an adjustment to opening retained earnings.

With more of its foreign operations being run through unincorporated branches, there is less benefit to owning intangible property outside the United States, as income generated by such assets is no longer deferred from U.S. taxation. These actions by Qualcomm are encouraging to those in Congress hoping that foreign income and foreign income-producing assets will be brought back into the U.S. tax "net" after the enactment of the TCJA (e.g., York, 2018).

However, other examples of post-TCJA behavior are not as clear or as encouraging. For example, Stryker, in its 2018 Form 10-K, reported the following in the income tax footnote:

> Our effective tax rate was (50.8)%, 50.6% and 14.3% for 2018, 2017 and 2016. The effective income tax rate for 2018 reflects the tax effect related to the transfer of intellectual properties between tax jurisdictions, the continuing impact of complying with the Tax Cuts and Jobs Act of 2017 (the Tax Act), and continued lower effective income tax rates as a result of our European operations.

While not explicitly stated, it seems that Stryker's movement of intellectual property was *not* back to the United States after all.

The overall effect of income shifting as a result of the TCJA remains to be seen. Whatever the decisions made by U.S. MNCs and their tax advisors, international tax planning after the TCJA is not for the faint of heart. Careful modeling of tax outcomes is more important than ever given the subtle interactions among many of the new provisions. The adage, "the tax code works in mysterious ways," which Ed Outslay

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"famously" used in many presentations, has never been more relevant. The GILTI tax for a U.S. MNC with a "low" foreign ETR along with positive domestic and foreign income will generally increase the foreign structural ETR to about 12 percent. Given this outcome, where is the incentive for firms to return intangible property to the United States and pay 21 percent?

Going forward, international tax planning geometry is likely to focus first on avoiding the BEAT — a deadweight tax cost relative to other taxes — and then maximizing FTCs (specifically, avoiding the lost foreign taxes produced by the GILTI tax regime). As discussed earlier, the BEAT tax is a deadweight cost because it is a minimum tax based on payments to certain related foreign parties. If the BEAT tax is imposed, it never reverses such that there are no future credits for previously paid BEAT. In contrast, the AMT repealed by the TCJA was only a timing difference. If a U.S. MNC paid the AMT, in future years, when regular tax exceeded the AMT, the firm could reduce the regular tax by the prior AMT payment. After the TCJA, maximizing FTC use becomes particularly important when no FTCs are allowed for dividends eligible for the 100 percent DRD, FTCs in the GILTI basket are subject to an 80 percent haircut (i.e., 20 percent permanently lost), and any excess FTCs in the GILTI basket are lost (i.e., no carryback or carryforward).

V. SUMMARY

In its short existence, the TCJA has significantly changed the landscape for tax planning and compliance by U.S. MNCs. The shift from a worldwide FTC system to a more territorial approach has ostensibly increased the likelihood that more of a U.S. MNC's foreign income is subject to current U.S. taxation. The TCJA has complicated tax planning and structuring for U.S. MNCs, requiring most firms to closely examine their global structures and arrangements; that is, the geometry of international tax planning.

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DISCLOSURE

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