Federal Tax Revenue Impact of the TCJA's Transition Tax, GILTI, FDII and BEAT Provisions

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OVERVIEW OF PRESENTATION

- Background of My Research
- Transition Tax – FYB 2017
- GILTI, FDII and BEAT – FYB 2018
- Overall Conclusions

BACKGROUND OF MY RESEARCH

- My last large transfer pricing case settled in September 2018
- *Pro bono* research on impact of the international tax provisions of the TCJA based on SEC 10-K filings because:
  - Public domain data
  - Timely publication (45-60 days after corporation's fiscal year end)
- Three *Tax Notes International* articles
  - May 27, 2019 – Impact of TCJA on GAAP Effective Tax Rates (ETRs)
  - July 29, 2019 -- Analysis of Reserves for Tax Audit Adjustments
  - September 16, 2019 – Tax Revenue Effects of TCJA's International Provisions

TRANSITION TAX – FYB 2017

- One-time tax based on post-1986 E&P of 10%-owned CFCs
- Tax imposed om FYB 2017, but may be paid in 8 annual installments
- JCT's tax revenue impact shown in my Table 1, Column <A>
    - 10-year cumulative impact = $338.8 billion
- My tabulations based on text of corporation' SEC 10-Ks
    - $225.7 billion – 151 large U.S. nonfinancial corporations
    - $ 13.0 billion – 33 large U.S. financial corporations
    - $.   3.7 billion – 5 large inverted corporations (e.g., Medtronic Plc)
    - $242.4 billion – all 189 large corporations filing SEC 10-Ks for FYB 2017

TRANSITION TAX – FYB 2017

- My $242.4 billion estimate = 72% of JCT estimated $338.8 billion
- My GAAP financial statement database excludes:
  - U.S. public corporations with market capitalizations of less than $25 billion as of October 2018
  - Closely held U.S. corporations, including U.S. subsidiaries of foreign corporations,
- My rough estimate is that the transition tax revenues is less than 80% of the JCT's $338.8 billion.
- The JCT staff has advised me that they do not disagree with my estimate. They attribute the remaining 20% difference to other consequences of the transition to the participation exemption system (e.g., taxes on shareholders holding less than 10% of the CFC equity).

TRANSITION TAX – FYB 2017

- Caveat: My $242.4 billion estimate reflects corporations' tax <u>accruals</u> based on the GAAP more-likely-than-not standard.
- Transition taxes reported on corporations' <u>tax returns</u> will generally be lower than GAAP financial statement accruals.
- Will the IRS have the audit resources required to close the GAAP gap?

GILTI, FDII, & BEAT – FYB 2018

- My general method was to rely on ETR reconciliation tables that in theory identify specific tax provisions that result in a +/- 5% change in total tax at statutory rate (i.e., 5% of 21% = 1%)
- Disparate interpretations of SEC's ETR reconciliation requirements
  - 124 large U.S. nonfinancial corporations filed 10-K's for FYB 2018 as of 8/1/19
  - 22 "Type A" corps identified separately significant TCJA provisions (e.g., GILTI)
  - 10 "Type B" corps combined all TCJA provisions as a single ETR adjustment
  - 92 "Type C" corps reported no separate ETR adjustments for the TCJA
- Per my May *Tax Notes* article, I conclude that the adjustments reported by the 22 "Type A" corps are typical – see my Table 2

IMPACT OF GILTI – FYB 2018

- Per JCT estimates in Column <B> of my Table 1, GILTI revenue impact in FYB 2018 is approximately $10 billion.
- My estimate of the total before-tax income of all large U.S. nonfinancial corporations is $925 billion.
- Per last two lines of my Table 1, Column <B>, I assume average GILTI impact is 1% of $925 billion = $9.25 billion.
- Making any reasonable allowance for GILTI of all other U.S. corporations (financial, inverted, market cap < $25 billion, closely held), JCT estimate of $10 billion seems *too low.*

IMPACT OF FDII – FYB 2018

- JCT estimates in Column <C> of my Table 1. Note large *increase* in Federal tax revenues in Federal fiscal years 2019-2021.
- JCT Staff has confirmed that it assumed significant repatriation of CFC-owned, long-lived intangibles, which would result in Federal tax on excess of intangibles' FMV over tax basis.
- I am advised by a leading international tax practitioner that post-2017 repatriations of CFC-owned, long-lived intangibles would be free of Federal tax.
- Based on my Table 2, I would assume that average FDII impact would be a tax reduction of 1.8%-1.9% of total before-tax income.

IMPACT OF GILTI & FDII – FYB 2018

- The income tax notes in the SEC Forms 10-K of a few large U.S. corporations (e.g., Qualcomm FYB 2017 and Microsoft FYB 2018) disclose significant repatriations of CFC-owned, long-lived intangibles.
- But generally speaking, foreign affiliates' shares of U.S. corporations' worldwide before-tax income in FYB 2018 were similar to the foreign affiliates' shares in FYB 2015-16 prior to the TCJA – see my Chart 1.

IMPACT OF BEAT – FYB 2018

- JCT BEAT estimates in Column <D> of my Table 1.
- Note that JCT's 10-year cumulative value, $149.6 billion, is larger than the comparable tax revenue increase of the GILTI or (in absolute terms) the revenue loss from FDII.
- By contrast, I found only one large U.S. corporation (Goldman, Sachs) that noted a material impact of the BEAT in FYB 2018. Possible explanations for absence of BEAT adjustments:
  - Primary impact of the BEAT is on U.S. subsidiaries of foreign parent companies, which are not included in my database.
  - BEAT at 5% rate in FYB 2018, 10% rate in subsequent years.
  - Impact of IRS/Treasury regulations

IMPACT OF BEAT

- In my recent meeting, the JCT staff indicated that its large projected revenue effects were based not on projected tax revenues from the BEAT per se, but rather were additional payments of the regular income tax resulting from corporations' strategies for avoiding the BEAT.
- The JCT also indicated that the IRS/Treasury regulations would have resulted in a material reduction in its BEAT revenue estimates.
- Does OTA agree with the JCT Staff's views on one or both of these points?

MY OVERALL CONCLUSIONS

- Transition Tax: I accept the JCT Staff's conclusion that its revenue estimates are 25% larger than my estimate because it includes other tax effects in its December 2017 revenue-estimate table.
- GILTI: I conclude that the JCT's GILTI estimates err on the *low* side.
- FDII: I disagree with the JCT's assumption that CFC's repatriations of long-term Intangible property result in a current U.S. tax liability. Since the U.S. parent would have a carryover basis, the CFC's repatriation will produce additional taxable income in subsequent years. My best estimate is based on the 1.8%-1.9% average adjustment for the 22 Type A corporations in my Table 2.

MY OVERALL CONCLUSIONS

- BEAT: Based on my conversations with the JCT Staff (and not the financial statements I have reviewed), I conclude that the Federal tax revenues from the BEAT *per se* will be a small fraction of the large revenue gains the JCT Staff estimated in December 2017.
- The combined impact of GILTI, FDII and the BEAT *per se* will be a reduction, not an increase, in Federal tax revenues.

CHART 1: FOREIGN AFFILIATES' SHARE OF BEFORE-TAX GAAP INCOME FYB 2018 VS. AVERAGE FYB 2015-16

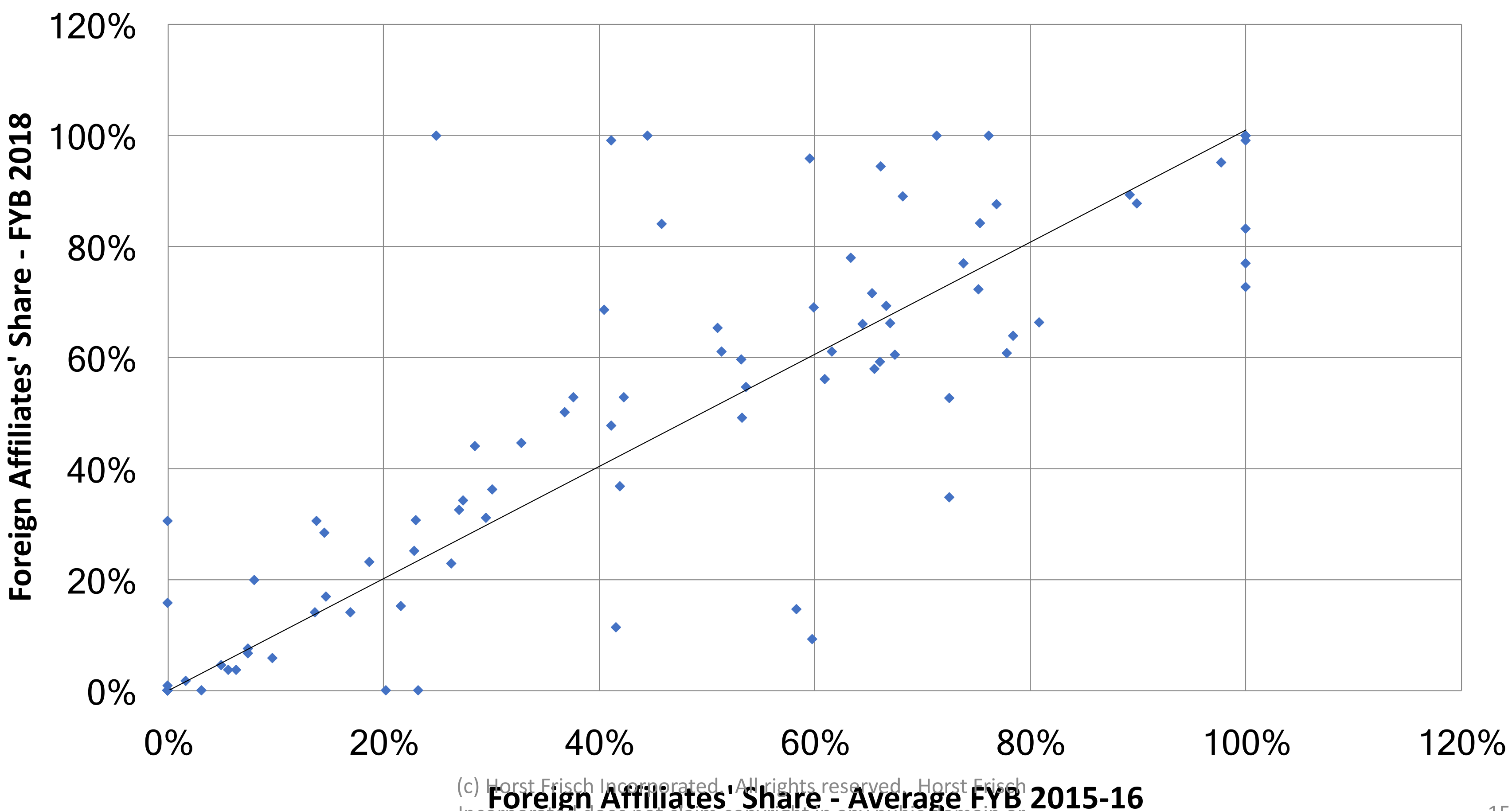

Table 1: Joint Committee on Taxation's Projections of the Impact of Certain International Tax Reform Provisions on Federal Tax Revenues, FY2018-2027

[$ Billions]

	<A>	<B>	<C>	<D>	<E>	<F>
Fiscal	Transition	Recurring Provisions				
Year	Tax	GILTI	FDII	BEAT	Subtotal	Total
2018	78.6	7.7	-0.2	0.8	8.3	86.9
2019	49.6	12.5	4.8	4.3	21.6	71.2
2020	16.5	9.6	6.9	13.3	29.8	46.3
2021	15.6	9.5	6.6	16.1	32.2	47.8
2022	15.7	9.3	0.2	17.1	26.6	42.3
2023	27.2	9.0	-11.4	16.8	14.4	41.6
2024	47.5	9.2	-15.7	15.9	9.4	56.9
2025	64.4	9.3	-20.2	16.5	5.6	70.0
2026	33.0	15.1	-18.4	21.6	18.3	51.3
2027	-9.4	21.2	-16.3	27.0	31.9	22.5
2018-22	176.0	48.6	18.2	51.7	118.5	294.5
2018-27	338.8	112.4	-63.8	149.6	198.2	537.0

Source: Joint Committee on Taxation, December 18, 2017, JCT-67-17, Pages 7 - 8.

Table 2: Impact of GILTI, FDII and BEAT on Effective Tax Rates of Type A U.S. Corporations

Based on SEC 10-K Filings as of August 1, 2019

	<A>	<B>	<C>	<D>	<E>
	Company Name	GILTI	FDII	BEAT	TOTAL
1	3M COMPANY	1.1%	-1.3%	0.0%	-0.2%
2	ABBOTT LABORATORIES	0.0%	-1.9%	0.0%	-1.9%
3	ARCHER-DANIELS-MIDLAND COMPANY	1.0%	-1.0%	0.0%	0.0%
4	BIOGEN INC.	1.6%	0.0%	0.0%	1.6%
5	BOEING COMPANY	0.0%	-4.7%	0.0%	-4.7%
6	BRISTOL-MYERS SQUIBB COMPANY	1.6%	0.0%	0.0%	1.6%
7	CORNING INCORPORATED	3.6%	0.0%	0.0%	3.6%
8	FIDELITY NATIONAL INFORMATION SERVICES, INC.	0.0%	-1.8%	0.0%	-1.8%
9	GENERAL DYNAMICS CORPORATION	0.0%	-1.2%	0.0%	-1.2%
10	INTEL CORPORATION	0.0%	-3.7%	0.0%	-3.7%
11	IQVIA HOLDINGS INC	10.7%	-7.6%	0.0%	3.0%
12	LOCKHEED MARTIN CORPORATION	0.0%	-1.0%	0.0%	-1.0%
13	MICROSOFT CORPORATION	0.0%	-1.4%	0.0%	-1.4%
14	NETFLIX, INC.	3.5%	0.0%	0.0%	3.5%
15	NEXTERA ENERGY, INC.	0.0%	0.0%	0.0%	0.0%
16	PHILIP MORRIS INTERNATIONAL	1.2%	-1.1%	0.0%	0.1%
17	RAYTHEON COMPANY	0.0%	-4.2%	0.0%	-4.2%
18	REGENERON PHARMACEUTICALS, INC.	0.0%	-1.0%	0.0%	-1.0%
19	ROPER TECHNOLOGIES, INC.	1.1%	-1.2%	0.0%	-0.1%
20	TEXAS INSTRUMENTS INCORPORATED	0.4%	-5.3%	0.0%	-4.9%
21	THERMO FISHER SCIENTIFIC CORPORATION	5.1%	-1.4%	0.0%	3.7%
22	VALERO ENERGY CORPORATION	2.1%	0.0%	0.0%	2.1%
23	Simple Average - All Companies	1.5%	-1.8%	0.0%	-0.3%
24	Weighted Average - All Companies*	0.5%	-1.9%	0.0%	-1.4%

* Weighted average is based on corporations' worldwide earnings before tax.