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Research Report

Corporate inversions and FDI in the United States

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Corporate inversions and FDI in the United States*

by

Sarah Atkinson and Jessica Hanson**

From 1982 until 2016, multiple waves of corporate inversions resulted in many US-based companies shifting their legal headquarters to countries offering tax advantages, i.e. redomiciling. A corporate inversion occurs when a US corporation that is the ultimate owner of its worldwide operations takes steps to become a wholly-owned subsidiary of a foreign corporation. Generally, the primary motivation for inversion is to minimize global tax obligations and access overseas profits without incurring additional taxes.¹ Corporate inversions are a form of FDI in the United States.

The inversion phenomenon largely ended after the US Department of the Treasury changed the regulations governing these transactions in 2016.² Analysts have speculated that the passage of the 2017 Tax Cuts and Jobs Act (TCJA) would lead many inverted companies to take advantage of the decrease in the US corporate tax rate from 35% to 21% and the general elimination of the tax on repatriated foreign earnings, and become US-owned companies again. However, according to preliminary Bureau of Economic Analysis (BEA) US FDI statistics, there was not a widespread reversal of corporate inversions in the year following passage of the TCJA, though companies may choose to do so in the future.

Corporate inversions first gained public and legislative attention in the 1990s because of the erosion of the US tax base, the cost advantages to foreign-controlled firms and the movement of assets and economic activity outside of the US.³ The first wave of inversions involved reincorporation abroad with minimal change in corporations' physical operations, shareholders or business decisions. The 2004 American Jobs Creation Act included provisions to curtail inversions, but did not stop them completely. The second wave of corporate inversions met the new legal requirements by merging domestic firms with existing foreign companies. Additional Treasury regulations in 2014 and 2016 sought to end inversions altogether. Evidence suggests that these regulations were instrumental in decreasing inversions in subsequent years.

BEA publishes FDI statistics based on data it collects on mandatory surveys of foreign-owned US companies. These statistics include transactions resulting from corporate inversions. However, the surveys do not collect information on whether a US corporation became foreign-owned as a result of a corporate inversion. Consequently, these transactions cannot be separately identified in the statistics

based only on the survey data. Using publicly available information, such as commercial databases and media reports, BEA estimates that inversions led to substantial FDI equity inflows into the US in 2015, which then dropped off after the Treasury regulation changed in 2016.⁴ In 2015, net equity inflows into the US were US\$340.9 billion, compared with US\$51.6 billion in 2014. BEA estimates that approximately one-third of the increase was due to corporate inversions.

While the TCJA further reduced the advantages of inversions, some provisions, such as limitations on earnings stripping and the loss of some tax deductions on intercompany loans, may limit the US appeal as a base of operations for MNEs. Furthermore, regulations for some TCJA provisions are still being finalized, and parts of the law are being challenged in the WTO.⁵ CEO statements and shareholder reports indicate that some firms considering a reversal of prior corporate inversions are waiting for the resolution of some of these uncertainties.⁶ Equity decreases—transactions that result in a decrease in foreign ownership of US companies—were larger in 2018 than in 2017 according to BEA’s FDI statistics. However, the larger equity decreases in 2018 do not suggest widespread redomiciling by inverted companies but rather firm-specific factors.

It may be too early to tell the TCJA’s ultimate effect on corporate inversions in the US as firms are still adjusting to the new US tax system.⁷ Additionally, lower US tax rates could spur other countries to adjust their rates or implement other measures to encourage FDI. Finally, unwinding direct investments tends to be a much more difficult and costly exercise than unwinding portfolio investments. While firms are still adapting to the new law, BEA’s statistics suggest that, so far, the TCJA has not led to significant redomiciling of inverted companies. If it ultimately results in widespread redomiciling, this model of using tax incentives to encourage inverted companies to become U.S.-owned again will appear to have achieved one of its policy objectives.⁸

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¹ Non-tax related reasons for inversion include access to foreign markets and technology, lower labor costs, diversification, reduced regulations, greater operational flexibility, improved cash management, and access to international capital markets.

² [Congressional Research Service \(CRS\), *Corporate Expatriation, Inversions, and Mergers: Tax Issues*, \(CRS: Washington, D.C., 2019\).](#)

³ CRS, op. cit.

⁴ [Derrick Jenniges and James Fetzer, “Direct investment positions for 2015,” *Survey of Current Business*, vol. 96 \(2016\), pp. 9–11.](#)

⁵ [Allyson Versprille, “Ireland-based affiliates moved to U.S., but most companies will wait,” *Bloomberg News*, Sept. 10, 2018.](#)

⁶ CRS, op. cit.

⁷ CRS, op. cit.

⁸ Other policy objectives of the TCJA include reducing the movement of assets, economic activity and retained earnings abroad as well as encouraging companies to hire and invest in the US.

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