BEA BRIEFING

The Effects of Corporate Inversions on the International and National Economic Accounts

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RECENTLY, a growing number of articles in the media have noted U.S. corporations announcing that they intend to move their headquarters overseas. This practice is known as a corporate inversion, which occurs when a U.S. corporation that is currently the ultimate owner of its worldwide operations takes steps to become a wholly owned subsidiary of a foreign corporation. A U.S. corporation can initiate an inversion either by creating a foreign corporation to be its new parent or by merging with an existing foreign corporation and ceding control.

It is often reported in the media that U.S. corporations invert in order to reduce their global corporate tax obligation and to access more of their overseas profits. The U.S. Internal Revenue Service employs a worldwide tax system, in which it seeks to tax all income, domestic or foreign, from U.S.-based corporations at the same rate. In contrast, the tax authorities of some other countries, such as Luxembourg, employ territorial tax systems that tax only income that was generated in the taxing country. These tax systems allow resident multinational corporations to reduce their global tax obligation by realizing income in foreign countries with favorable corporate tax rates where the income is beyond the reach of the home country tax authority. Many U.S. corporations retain a sizable portion of the profits earned by their foreign subsidiaries overseas, partly because foreign corporate income tax rates in some countries are lower than those in the United States and because U.S. taxes on overseas earnings are due when the earnings are repatriated. By moving their global headquarters from the United States to foreign countries with different tax systems, U.S. corporations that invert may reduce their global tax obligation.

This BEA Briefing takes a quick look at how corporate inversions affect the Bureau of Economic Analysis (BEA)'s international and national economic accounts.

Inversions and BEA's international statistics

When a U.S. corporation inverts, it becomes foreign owned and is then included in the statistics on foreign direct investment in the United States, or inward direct investment, produced by BEA. To compile these statistics, BEA collects data on all U.S. companies in which a foreign investor has at least 10 percent voting ownership through mandatory quarterly, annual, and benchmark surveys of foreign direct investment in the United States. The foreign direct investment position in the United States—which comprises the direct investors' equity in, and net outstanding loans to, their U.S. affiliates—generally increases after an inversion because the inverting U.S. corporation becomes an asset of a foreign investor. Cross-border equity and debt flows into the United States will generally also occur as a result of the newly created equity and debt positions of the foreign owner in its U.S. affiliate. The activities of multinational enterprises (AMNE) statistics—which provide data on the overall operations of U.S. affiliates of foreign multinational enterprises (MNEs) and include data items such as employment, capital expenditures, value added, and research and development (R&D) expenditures—generally also increases as a result of inversions.

BEA's direct investment surveys do not collect information on whether a U.S. corporation became foreign owned as a result of a corporate inversion, but BEA used publicly available sources of information on corporate inversions to estimate the share of the AMNE statistics accounted for by inverted corporations for 2012, the most recent year for which data are available. According to these estimates, the shares ranged from 6.3 percent of R&D expenditures to 1.2 percent of net income (table 1). The significance of inversions in

Table 1. Inverted Companies' Share of the Activities of U.S. Affiliates of Foreign MNEs, 2012 [1]
[Percent]

Research and development expenditures	6.3
Direct investment equity position	5.4
Value added	4.6
Employment	4.0
Property, plant, and equipment expenditures	2.3
Assets	2.3
Net income	1.2

MNEs Multinational enterprises
1. The data for all items except the direct investment equity position are for majority-owned affiliates; the equity position also includes minority-owned affiliates.

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BEA's direct investment statistics may have grown appreciably since 2012, as some sources in the media indicate that the number of new U.S. corporate inversions has accelerated recently.[1]

Corporate inversions may also affect BEA's U.S. direct investment abroad, or outward direct investment, statistics. If a U.S. multinational enterprise transfers the ownership of some or all of its foreign affiliates to its new foreign owner, both the outward position and the outward AMNE statistics will generally be affected. The outward position will generally decrease, and associated equity and debt inflows will result from the removal of the equity and debt positions of the U.S. parent in its foreign affiliates when they are transferred to the new foreign owner. The outward AMNE statistics will also generally decrease when the activities of the transferred foreign affiliates are removed. At this time, the effect of inversions on the outward AMNE statistics cannot be quantified. Additionally, if the inversion does not result in a change in the ownership of the foreign affiliates, that is, if the U.S. corporation that is now a U.S. affiliate of a foreign MNE continues to own overseas affiliates, the inversion would probably not affect the statistics.

Inversions and BEA's national statistics

The effect of inversions on outward and inward direct investment statistics are reflected in select aggregates of the national income and product accounts (NIPAs), most notably, the income receipts from, and payments to, the rest of the world and the NIPA aggregates that include these data in their derivation—corporate profits and gross national income.

While BEA is not currently able to estimate the effects of corporate inversions on the NIPAs, the shaded aggregates in table 2 are those that would be affected by corporate inversions. Generally inversions would reduce gross national income, that is, income resulting from the current production of goods and services by U.S.-owned labor and capital. Corporate profits, the portion of the total gross national income earned from current production that is accounted for by U.S. corporations, would also be reduced by a decrease in net profit receipts from the rest of the world (profit receipts from the rest of the world less profit payments to the rest of the world). The introduction of a new foreign owner generates a payment to the rest of the world in the form of direct investment income on equity that includes the worldwide profits of the inverting corporation. However, this payment may be offset to some extent by a receipt from the rest of the world in the form of dividends that are paid by the new foreign corporation to its U.S. shareholders, some of whom may be former shareholders in the U.S. corporation that inverted. Given that corporations rarely pay dividends equal to, or more than, their total current earnings, the inversion's effect on profit payments to the rest of the world would typically be greater than its effect on profit receipts from the rest of the world, and therefore the effect on net profit receipts from rest of the world would be negative. This negative impact also affects the higher level aggregates that include net profit receipts from the rest of the world in their derivation—corporate profits and total gross national income.

Gross domestic income, which is income resulting from the current production of goods and services in the domestic economy, would not be affected by inversions because it excludes net profit receipts from the rest of the world.

Table 2. Gross National Income by Type of Income, Third Quarter of 2014

[Billions of dollars; seasonally adjusted at annual rates]

Line	Item	Value
1	Gross national income	15,222.9
2	Compensation of employees	9,238.7
3	Proprietors' income with IVA and CCAdj	1,386.4
4	Rental income of persons with CCAdj	646.7
5	Corporate profits with IVA and CCAdj	2,170.7
6	Domestic profits	1,760.3
7	Net profit receipts from rest of world [1]	410.4
8	Gross profit receipts	685.8
9	Dividends	335.0
10	Reinvested earnings on U.S. direct investment abroad	350.9
11	Gross profit payments	275.4
12	Dividends	146.4
13	Reinvested earnings on foreign direct investment in the United States	129.0
14	Net interest and miscellaneous payments	479.3
15	Taxes on production and imports	1,212.4
16	*Less:* Subsidies	57.4
17	Business current transfer payments (net)	182.4
18	Current surplus of government enterprises	–36.3

CCAdj Capital consumption adjustment
IVA Inventory valuation adjustment
1. Net profit receipts from the rest of world equals gross profit receipts (line 8) less gross profit payments (line 11).

1. Shayndi Raice, "How Tax Inversions Became the Hottest Trend in M&A," *Wall Street Journal*, August 5, 2014. (accessed online on February 2, 2015)