Tax Break on Big Tech Windfall Profits Should be Repealed by Congress:

Briefing Memo on Foreign-Derived Intangible Income (FDII)

The 2017 tax reform massively reshaped how U.S. multinationals are taxed on their foreign income, including through the application of a global minimum tax that grants corporations a substantial discount on their foreign profits. This discount gave big multinationals new incentives to stash their most valuable intangible assets – intellectual property like patents, trademarks, and other highly mobile properties – in foreign tax havens to avoid taxation at the full U.S. domestic rate. In an attempt to balance this perverse incentive, the 2017 law sought to bring investment back to the United States through a provision known as the Foreign-Derived Intangible Income (FDII) deduction, a massive tax break for corporations that earn income from their U.S. intellectual property by selling goods and services abroad.

This provision distorts the free market by favoring export sales over domestic sales, benefits relatively few companies, costs the U.S. tens of billions annually in lost revenue, and perversely encourages corporations to move jobs and investment abroad. The FDII tax rate is currently 13.125 percent, and is scheduled to step up to 16.406 percent after 2025. Major multinationals, however, are lobbying hard to keep this massive handout as-is. Fully eliminating this provision would be a big revenue raiser: projections indicate that repealing FDII would raise between $158 billion and $224 billion over ten years. Conversely, any proposals to permanently extend the current low FDII rate (rather than allow for the rate to step up as scheduled) would be an even more costly giveaway.

With Congress headed to the negotiating table to discuss tax policy ahead of the expiration of much of the 2017 law next year, it is important to both understand what FDII is, and why it should be on the chopping block as lawmakers look to fund more productive, popular programs.

A Wasteful Handout for Big Tech

According to an analysis by the Institute on Taxation and Economic Policy, from 2018 to 2022 just ten companies (Google, Meta, Microsoft, Intel, Texas Instruments, Qualcomm, Amazon.com, Apple, Cisco Systems, and Moderna) reported more than $31 billion of combined tax benefit from FDII – almost 60% of the total benefit reported by all Fortune 1000 companies.

This trend is not slowing down. Just five of these companies (Cisco, Google, Microsoft, Meta, and Amazon) received a combined tax benefit of $9.5 billion from FDII in 2023 alone. FDII is a major reason Big Tech firms pay so much less than the statutory corporate tax rate on U.S. income.
An Incentive to Ship Jobs and Investment Overseas

FDII is a preferential rate for export income above a 10% return on U.S. tangible assets. Because the threshold is calculated in reference to the value of domestic assets – such as factories, buildings, and machinery – a company’s tax break goes up as those domestic assets go down, effectively encouraging U.S. companies to offshore factories and jobs. Moreover, FDII can subsidize not only exports of goods and services but also of intellectual property itself. Lastly, the FDII rate of 13.125% is higher than the 10.5% GILTI rate for foreign income, further encouraging companies to reduce investment in tangible assets in the United States, and hence offshore U.S. jobs.

An Illegal Export Subsidy

The FDII deduction distorts the free market by favoring sales to foreign rather than domestic consumers. Not only is this unfair to American consumers, it also likely violates international trade treaties. FDII has ruffled the feathers of international partners, who may challenge it as an illegal export subsidy under World Trade Organization (WTO) rules. Additionally, FDII is under peer review as a “harmful tax practice” by the Organization for Economic Cooperation and Development (OECD), the only provision in the US tax code that is under such scrutiny.

A Poor Driver of Research and Development

Despite corporate claims, fully eliminating this provision would not stifle innovation. Although FDII was created to spur domestic innovation, there is no evidence that it has increased domestic innovation or jobs. FDII is not tied to actual spending on research and development in the United States, but only applies to super-profits that may reflect previous spending on research and development, whether carried out in the United States or abroad. The FDII deduction is effectively a tax break on windfall income.

Futile in a Pillar 2 World

Extending FDII at the current low rate could result in companies paying tax below the globally agreed 15% minimum tax, known as Pillar 2, leaving such companies vulnerable to top-up taxes by other countries that are implementing the undertaxed payments rule. Effectively, the U.S. would not be subsidizing its companies, but other governments.

Solution: Full Repeal of FDII

A number of proposals, including the Biden Administration’s budget proposal for FY2025, eliminate FDII entirely. The No Tax Breaks for Outsourcing Act eliminates both FDII and the root cause of the problem that FDII was meant to address by equalizing the domestic and foreign corporate tax rates, entirely removing the tax incentive to move investment and jobs offshore.