CHAPTER 4

EUROPEAN COUNTRIES: U.S.-Related Jobs, Trade and Investment

Europe[1] remains one of the most attractive regions of the world for U.S. foreign direct investment, yet its luster is fading.

Europe's cyclical economic slowdown; the region's numerous structural headwinds to growth; trade and investment sanctions against Russia; improving economic prospects in the United States; America's energy advantage relative to Europe; faster growth in many emerging markets—all of these dynamics have dampened Corporate America's confidence in Europe and depressed U.S. FDI outflows to the region over the past few years.

For 2014 we estimate that U.S. FDI outflows to Europe totaled $165 billion, a 4.5% drop from 2013. We make this estimate even though U.S. FDI outflows to Europe in the first nine months of 2014 totaled $115 billion, a decline of 19% from the same period a year earlier. As we explain in Chapter 2, this decline was due in large part to a $19 billion outflow from the Netherlands to the United States in the first quarter of the year. U.S. investment flows to the United Kingdom, a perennial favorite among U.S. firms, also fell 25% in the first nine months of 2014 versus the same period a year earlier. Total U.S. flows to Luxembourg also fell sharply, by nearly 50%, with the downdraft most likely related to more government scrutiny and public relations pressures related to corporate inversions and allegations of sweetheart tax deals, issues we explore in more detail below.

U.S. foreign direct investment to France rebounded in 2014, rising nearly 25% from the same period a year earlier. The sharp rise, however, comes off the depressed levels of 2013, when U.S. outflows to France totaled just $629 million. The year before, in 2012, U.S. investment in France amounted to just $360 million, well off the levels of 2009 ($10.3 billion) and 2010 ($4.8 billion). We estimate that U.S. investment to France in 2014 totaled $2.6 billion. That's hardly good — but the figures for Germany are even lower.

U.S. FDI flows to Germany totaled $1.2 billion in the first nine months of 2014, up from the depressed levels of 2013, when total U.S. flows were a negative $859 million (more U.S. capital going out than coming in). Capital flows were positive in 2014, but for the year, U.S. FDI flows to Germany are estimated at just $2 billion, well down from the annual average levels of $6.1 billion posted between 2009 and 2012.

Combined, U.S. FDI flows to Germany and France, two of Europe's largest economies, totaled just $4.6 billion in 2014 by our estimates. In contrast, combined U.S. FDI flows to China and India totaled roughly $10 billion in 2014, a clear signal that more and more U.S. firms are finding better market conditions in Asia's largest economies than in Europe's largest economies.

Ireland and Switzerland emerged as favorite locations for U.S. multinationals in 2014. U.S. FDI flows to Switzerland, for instance, surged by roughly 175% to $15.5 billion in the January-September period from the depressed levels of 2013, when U.S. FDI tallied $5.3 billion, a sizable drop from the year before ($12.5 billion).

Investment flows to Ireland were much stronger, totaling nearly $37 billion in the January-September period, a rise of 41% from the same period a year earlier. Why Ireland?

Consider a flexible and skilled English-speaking labor force, membership in the European Union, low corporate tax rates, pro-business government policies. Add in Ireland's economic rebound last year, with the economy expanding by over 4%, and one of Europe's smallest economies emerges as one of the most attractive in the world for U.S. firms. Even when adjusting U.S. FDI figures for flows of U.S. holding companies, Ireland still ranks as one of the most attractive places in the world for U.S. businesses.

At the other end of the spectrum are Russia and its European neighbors, where U.S. FDI flows have shrunk

TABLE 1: U.S. FDI IN EUROPE: THE LONG VIEW (MILLIONS OF $, (-) INFLOWS)

	1990-1999		2000-2009		2010-3Q2014	
	$ Aggregate Total	% of Total	$ Aggregate Total	% of Total	$ Aggregate Total	% of Total
EUROPE	465,337		1,149,810		852,945	
Austria	2,908	0.6%	501	0.0%	9,611	1.1%
Belgium	12,028	2.6%	40,120	3.5%	9,323	1.1%
Czech Republic	42	0.0%	1,941	0.2%	2,991	0.4%
Denmark	2,798	0.6%	5,782	0.5%	9,119	1.1%
Finland	1,485	0.3%	1,598	0.1%	-290	0.0%
France	29,063	6.2%	42,963	3.7%	9,366	1.1%
Germany	31,817	6.8%	60,363	5.2%	16,751	2.0%
Greece	413	0.1%	943	0.1%	-634	-0.1%
Hungary	375	0.1%	1,376	0.1%	-922	-0.1%
Ireland	21,369	4.6%	115,085	10.0%	150,905	17.7%
Italy	13,825	3.0%	26,462	2.3%	9,756	1.1%
Luxembourg	14,246	3.1%	107,512	9.4%	173,543	20.3%
Netherlands	70,770	15.2%	295,889	25.7%	248,230	29.1%
Norway	4,198	0.9%	5,118	0.4%	12,329	1.4%
Poland	931	0.2%	4,699	0.4%	-369	0.0%
Portugal	1,993	0.4%	2,212	0.2%	245	0.0%
Russia	1,555	0.1%	11,289	1.0%	-2,633	-0.3%
Spain	11,745	2.5%	28,371	2.5%	5,427	0.6%
Sweden	10,783	2.3%	2,472	0.2%	-9,271	-1.1%
Switzerland	32,485	7.0%	97,869	8.5%	39,947	4.7%
Turkey	1,741	0.4%	5,994	0.5%	3,250	0.4%
United Kingdom	175,219	37.7%	237,906	20.7%	158,057	18.5%
Other Europe	11,948	2.6%	16,471	1.4%	8,220	1.0%

Source: Bureau of Economic Analysis

over the past two years. Given imposition of sanctions on Russia following the Kremlin's annexation of the eastern Ukrainian territory of Crimea and direct Russia military incursions into Ukrainian territory in support of violent separatists, U.S. firms not surprisingly disinvested $638 million from Russia in the first nine months of 2014, following almost $1 billion in outflows in 2013. Given the formidable commercial climate between Russia and the United States and Europe, we expect more negative investment flows in future.

Disinvestment flows were also reported in Poland (-$4 million in the January-September 2014 period), Finland (-$142 million), Sweden (-$3.9 billion) and Hungary (-$293 million). Weak levels of growth in the EU combined with Western sanctions to curtail U.S. investment levels along Russia's periphery. As real economic growth ground to a halt across Europe in the past few years, U.S. firms have been forced to consolidate and rationalize their European operations, resulting in outright declines in investment (disinvestment) in many countries.

In the recession-weary, debt-laden eurozone members of the south—Italy, Portugal, Spain and Greece—U.S. FDI flows were subdued again in 2014. U.S. firms continue to disinvest from Greece, with U.S. investment in Greece minus $43 million in 2013 and minus $31 million in the

TABLE 2: TOP 20 U.S. AFFILIATE SALES ABROAD BY DESTINATION* (MILLIONS OF $)

	1982		1990		2000		2012	
Rank	**Country**	**Value**	**Country**	**Value**	**Country**	**Value**	**Country**	**Value**
1	United Kingdom	33,500	United Kingdom	51,350	United Kingdom	94,712	Singapore	262,260
2	Switzerland	27,712	Canada	46,933	Canada	94,296	**Ireland**	**240,441**
3	Canada	25,169	Germany	41,853	Germany	69,522	Switzerland	219,254
4	Germany	19,117	Switzerland	38,937	Netherlands	67,852	United Kingdom	198,018
5	Netherlands	15,224	Netherlands	33,285	Singapore	56,961	Canada	164,184
6	Belgium	11,924	France	24,782	Switzerland	56,562	Netherlands	122,407
7	Singapore	11,579	Belgium	21,359	**Ireland**	51,139	Germany	117,298
8	France	11,255	Singapore	15,074	Mexico	37,407	Belgium	84,987
9	Indonesia	8,289	Hong Kong	9,951	France	35,797	Mexico	69,171
10	Hong Kong	4,474	Italy	9,562	Belgium	32,010	France	65,413
11	Italy	3,993	**Ireland**	9,469	Hong Kong	22,470	Hong Kong	58,041
12	Australia	3,710	Spain	7,179	Malaysia	16,013	China	53,615
13	**Ireland**	2,842	Japan	7,066	Sweden	15,736	Australia	41,936
14	United Arab Emirates	2,610	Australia	6,336	Italy	14,370	Brazil	35,354
15	Brazil	2,325	Mexico	5,869	Spain	12,928	Norway	30,308
16	Japan	2,248	Indonesia	5,431	Japan	11,845	Italy	28,639
17	Malaysia	2,046	Brazil	3,803	Australia	9,370	Malaysia	25,583
18	Panama	1,662	Norway	3,565	Brazil	8,987	Spain	24,616
19	Spain	1,635	Malaysia	3,559	China	7,831	S. Korea	23,500
20	Mexico	1,158	Nigeria	2,641	Norway	6,238	Japan	21,568
	All Country Total	**252,274**	**All Country Total**	**398,873**	**All Country Total**	**857,907**	**All Country Total**	**2,325,824**

Source: Bureau of Economic Analysis
**Destination = 3rd Market + Sales to U.S. for majority-owned foreign affiliates.*

first nine months of 2014. U.S. FDI flows to Italy and Spain were at least positive in 2014, but well off the levels of previous years. Flows to Spain were down 16.7% in the first nine months of the year, while U.S. FDI flows to Italy plummeted by nearly 76% over the same period. Not unexpected, as two of Europe's largest southern economies have struggled over the past years, U.S. firms have become more cautious about committing more investment capital to either country. U.S. investment to Portugal rose last year—to $97 million in the January-September timeframe—but remains small relatively to the overall total. Depressed levels of U.S. investment in the Club Med nations speaks volumes to the uneven pace of real economic growth in Europe, and the region's disparate levels of competitive endowments, all of which influence how and where U.S. firms invest in Europe.

Just as economic activity in the United States is diverse and dispersed across fifty states, economic activity across the European Union is just as distinct and differentiated by country. Different growth rates, differing levels of consumption, varying degrees of wealth, labor force participation rates, financial market development, innovation capabilities, corporate tax rates—all of these factors, and more, determine where and when U.S. firms in Europe. Firms are always rethinking and reconfiguring their European operations, a dynamic highlighted in Table 1. The figures represent cumulative U.S. FDI inflows to specific countries in each decade, and each country's corresponding share of total U.S. investment in Europe.

Table 1 underscores that U.S. investment in Europe has become very concentrated since the decade began. Luxembourg, the Netherlands, Ireland and the UK have accounted for a staggering 85.6% of cumulative U.S. investment in Europe since 2010, up from their already substantial share of 66% over the two decades before, with the UK making up the bulk of the total.

Meanwhile, France and Germany have experienced a decline in their share of U.S. investment, with France's share of U.S. investment in Europe dropping to just 1.1% this decade,

TABLE 3: CUMULATIVE U.S. FDI OUTFLOWS (MILLIONS OF $)

	All Countries	Europe	Europe as a % of World
1950-1959	20,363	3,997	19.6%
1960-1969	40,634	16,220	39.9%
1970-1979	122,721	57,937	47.2%
1980-1989	171,880	94,743	55.1%
1990-1999	869,489	465,336	53.5%
2000-2009	2,056,009	1,149,810	55.9%
2010Q1-2014Q3	1,540,035	852,945	55.4%

Source: Bureau of Economic Analysis

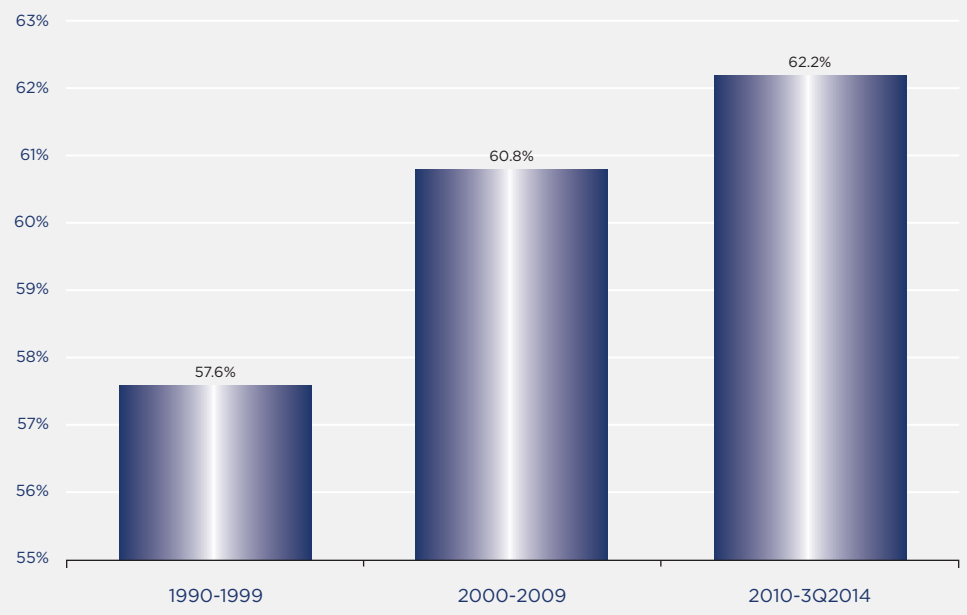
down from 3.7% over 2000-09, and Germany's share falling to 2% this decade from 5.2% during the first decade of this century. Some of these figures need to be taken with a grain of salt, since some U.S. investment in countries neighboring Germany, for instance the Netherlands, Luxembourg or Belgium, finds its way ultimately to Germany.

As for the most favored countries in Europe for the United States, the attraction of Ireland, the Netherlands and the United Kingdom is due in part to each country's role as a strategic beachhead for U.S. multinationals hoping to penetrate the European Union in a competitive and cost-effective manner. For decades, the UK was the traditional export platform for U.S. affiliates to the European mainland, but the introduction of the euro, the Single Market and EU enlargement have enticed more American firms to invest directly in the continent itself. The extension of EU production networks and commercial infrastructure throughout a larger pan-continental Single Market has shifted the center of gravity in Europe eastward within the EU, with Brussels playing an important role in economic policies and decision-making.

The Netherlands and Switzerland, meanwhile, remain key export platforms and pan-regional distribution hubs for U.S. firms, evident by the fact that in 2012, the last year of available data, Switzerland ranked as the third largest export platform in the world for U.S. affiliates; the Netherlands ranked sixth, behind Canada and the United Kingdom; and Germany ranked seventh, ahead of Mexico (see Table 2).

Of all the countries of Europe, Ireland stands out as Corporate America's strategic beachhead to the rest

TABLE 4: U.S. FDI FLOWS TO EUROPE - (% OF WORLD TOTAL*)



**Excluding Caribbean and Other Western Hemisphere*
Source: Bureau of Economic Analysis
Data at of January 2015.

of the world. Ireland ranked well down the list as a strategic beachhead for U.S. firms in 1982, ranking 13th in the world in terms of U.S. foreign affiliate exports. Then, U.S. affiliate exports totaled $2.8 billion. By 1990 that figure had grown to $9.5 billion in 1990 and by 2000 to $51 billion. In the first decade of this century, as the industrial capacity of U.S. affiliates in Ireland surged, so did U.S. affiliate exports, soaring nearly five times between 2000 and 2012. Affiliate exports totaled $241 billion in 2012, trailing only Singapore, but ahead of Switzerland and the United Kingdom. U.S. multinationals have leveraged Ireland as an export base to a far greater degree than low-cost locales like Mexico, Hong Kong and China. The latter ranked 12th. U.S. affiliates export four times more from Ireland than from China. U.S. affiliate exports from Ireland were also around 3.5 times larger than U.S. affiliates from Mexico, despite strong NAFTA linkages between the United States and Mexico. On a stand-alone basis, U.S. affiliate exports from Ireland are greater than most countries' total exports. Such is the export-intensity of U.S. affiliates in Ireland and the strategic importance of Ireland to the corporate success of U.S. firms operating in Europe.

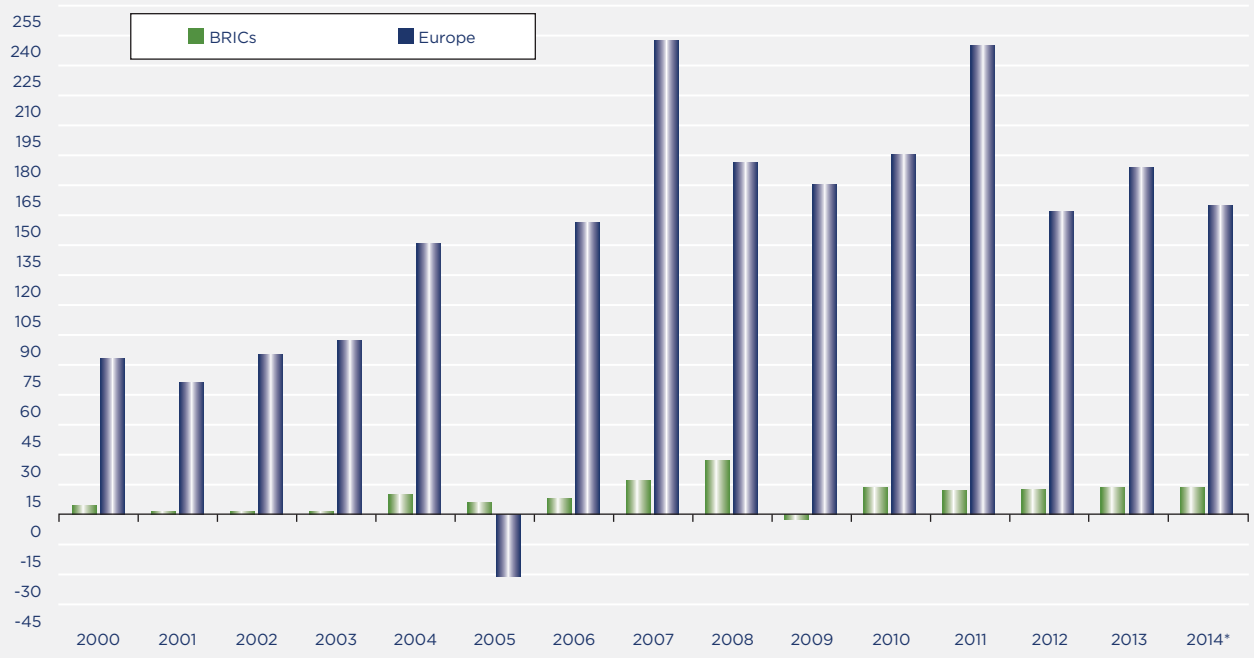
Moreover, U.S. firms have stuck with Ireland even though Ireland suffered through a catastrophic banking and property bust. The nation has subsequently emerged from recession and has returned to the global capital markets. By undergoing painful internal adjustments, the nation's export competitiveness has been restored and now ranks as among the best in Europe. Problems remain, but with the help of U.S. FDI, the country is back on a growth track.

Of the top ten export platforms for U.S. multinationals in the world, 7 out of 10 are located in Europe, a trend that reflects the intense cross-border trade and investment linkages of the European Union and the strategic way U.S. firms leverage their European supply chains.

Why Europe Still Matters

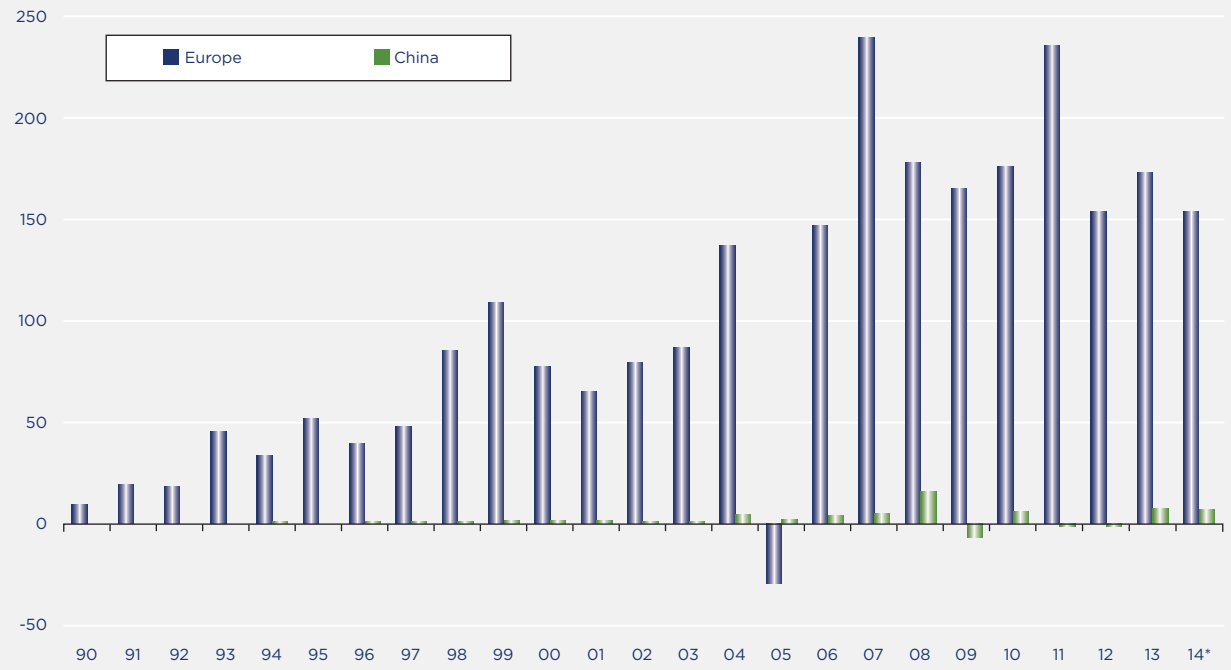
While U.S. foreign direct investment outflows to Europe are in the midst of a cyclical slowdown, the secular case for investing in Europe remains relatively positive. The European Union, after all, still accounts for roughly 17-18% of world GDP on a purchasing-power-parity basis, and next to the United States and China it is a critical pillar to the global economy. Notwithstanding the last few years

TABLE 5: U.S. FOREIGN DIRECT INVESTMENT OUTFLOWS TO THE BRICs VS. EUROPE[1] - (BILLIONS OF $)



Source: Bureau of Economic Analysis
[1] Europe does not include flows to Russia
** Data through 3Q2014. Data annualized for full year estimate.*

TABLE 6: U.S. FOREIGN DIRECT INVESTMENT FLOWS TO CHINA VS. EUROPE - BILLIONS OF $



Source: Bureau of Economic Analysis
** Data through 3Q2014. Data annualized for full year estimate.*

of sluggish growth, Europe still matters to the corporate success of U.S. firms, which helps explain America's large presence across the pond.

As Table 3 highlights, Europe—broadly defined here as the EU28 and other states like Switzerland, Norway, Russia, Turkey and other small nations—continues to attract more than half of U.S. aggregate FDI outflows. Europe's global share of U.S. FDI has remained relatively constant at 55% of the total over this decade, basically unchanged from the first decade of this century but up slightly from the 1990 levels. When U.S. FDI flows to Caribbean offshore financial centers are subtracted from the total, Europe's share of U.S. investment climbs to over 60% (see Table 4).

Even after adjusting for FDI flows related to holding companies, Europe remains the favored destination of U.S. firms, a reality that runs counter to the fashionable narrative that Corporate America prefers low-cost nations like Asia, Latin America and Africa to developed markets like Europe. Reality is different for a host of structural and cyclical reasons.

First, investing in emerging markets such as China and India remains very difficult; indigenous barriers to growth (poor infrastructure, dearth of human capital, corruption, etc.), as well as policy headwinds (foreign exchange controls, tax preferences for local firms) reduce the overall attractiveness of these markets to multinationals. Cyclically, real growth in the emerging markets has downshifted, notably in Brazil and Russia, two of the fabled BRICs. Both countries are in or near recession. Meanwhile, growth prospects in China have slowed sharply as Beijing shifts away from export- and investment-led growth and moves toward more consumption and services-led growth. India's growth has improved, but the country continues to present a very challenging environment to U.S. investors. In the end, for both cyclical and structural factors, the BRICs and the emerging markets remain a tough sale. Hence the wide divergence between U.S. FDI to the BRICs and U.S. FDI to Europe (see Tables 5 and 6).

Europe, meanwhile, still offers multiple attractions to U.S. firms. The EU Single Market is the largest economic entity in the world. And Europe is not just large, it is wealthy; 15 of the 25 wealthiest countries in the world are European. Per capita income levels in Europe are light years ahead of those in India and China. Wealth drives consumption; the EU accounted for nearly 25% of global personal consumption expenditures in 2013, a slightly lower share than that of the United States but well above that of China

TABLE 7: EASE OF DOING BUSINESS 2015

Rank	Country	Rank	Country
1	Singapore	16	Canada
2	New Zealand	**17**	**Estonia**
3	Hong Kong	18	Malaysia
4	**Denmark**	19	Taiwan
5	Korea		Switzerland
6	**Norway**	**21**	**Austria**
7	United States	22	United Arab Emirates
8	**United Kingdom**	**23**	**Latvia**
9	**Finland**	**24**	**Lithuania**
10	Australia	**25**	**Portugal**
11	**Sweden**	26	Thailand
12	**Iceland**	**27**	**Netherlands**
13	**Ireland**	28	Mauritius
14	**Germany**	29	Japan
15	Georgia	30	Macedonia, FYR

Source: World Bank, Ease of Doing Business Report 2015.

TABLE 8: TRANSATLANTIC ECONOMIES ARE THE MOST COMPETITIVE IN THE WORLD

Global Competitveness Index 2014-2015

Rank	Country	Rank	Country
1	**Switzerland**	16	Qatar
2	Singapore	17	New Zealand
3	**United States**	**18**	**Belgium**
4	Finland	**19**	**Luxembourg**
5	**Germany**	20	Malaysia
6	Japan	**21**	**Austria**
7	Hong Kong	22	Australia
8	**Netherlands**	**23**	**France**
9	**United Kingdom**	24	Saudi Arabia
10	**Sweden**	**25**	**Ireland**
11	**Norway**	26	Korea
12	United Arab Emirates	27	Israel
13	**Denmark**	28	China
14	Taiwan	**29**	**Estonia**
15	Canada	**30**	**Iceland**

Source: World Bank, Ease of Doing Business Report 2015.

(roughly 8%), India (less than 3%) and the BRICs combined (roughly 16%). Gaining access to wealthy consumers is among the primary reasons why U.S. firms invest overseas, hence the continued attraction of wealthy Europe to American companies.

Another attraction of Europe lies with the ease of doing business in the region. In the 2015 Ease of Doing Business rankings, 15 European economies ranked among the top 25 most business-friendly countries. Denmark ranked 4th overall, followed by Norway (6th), the United Kingdom (8th), Finland (9th), Sweden (11th), Iceland (12th), Ireland (13th), Germany (14th), Georgia (15th), Estonia (17th), Switzerland (20th), Austria (21st), Latvia (23th), Lithuania (24th) and Portugal (25th). See Table 7.

In addition, many European economies remain among the most competitive in the world. In the latest rankings of global competitiveness from the World Economic Forum, 7 European countries were ranked among the top 10, and eight more among the top 30 (see Table 8).

Meanwhile, Europe is no slouch when it comes to innovation and knowledge-based activities. Based on the 2014 Innovation Union Scoreboard, Denmark, Finland, Germany and Sweden rank as innovation leaders in Europe. Europe-based companies accounted for roughly 22-23% of total global R&D in 2012 and 2013. Led by European industry leaders like Volkswagen, Roche, Novartis, Daimler, Sanofi and GlaxoSmithKline, Europe remains a leader in a number of cutting-edge industries, including life sciences, agriculture and food production, automotives, aerospace, nanotechnology, energy, and information and communications. According to the National Science Board, of the world's global research pool, the EU housed 1.6 million researchers in 2013 — 26% of the global total. The United States housed 1.3 million.

All of the above underscores the continued long-term importance of Europe to corporate America's bottom line. Europe's wealthy consumer market, transparent rule of law, ease of doing business, and large and wealthy skilled labor pool set it apart from the rest of the world. On balance, the region's underlying attributes remain highly attractive — notwithstanding its current economic challenges and geopolitical tensions surrounding Ukraine.

"I'll have a Double Irish with a Dutch Sandwich"

Inversions, Transfer Pricing, and Sweetheart Deals

One consistent theme framing every annual survey we have conducted on the transatlantic economy is that investment, rather than trade, is the primary driver of healthy commercial relations across the Atlantic. Over the past year, heated political debates have erupted on both sides of the Atlantic regarding investment-related issues such as inversion, transfer pricing and state aid. Those debates underscore the importance of understanding the motivations guiding transatlantic investment flows, and unpacking the different types of investment flows.

Inversion has become a major political issue on both sides of the Atlantic. A corporate inversion occurs, for instance, when a U.S. company merges with a foreign firm and then the U.S. company dissolves its own domestic corporate status by reincorporating in the foreign country. The U.S. company becomes a subsidiary of the foreign one, but the foreign firm is actually controlled by the original U.S. firm. A U.S. corporation can invert if, after a merger, the owners of the U.S. corporation retain less than 80% of outstanding stock of the new merged company or the new merged company has "substantial business activities" in the foreign country equaling at least 25% of operations. So, with just a 20% change in ownership, a company can become "foreign" — and pay most of its taxes in the lower-tax foreign location — even if it largely operates in and is controlled from America.[2]

Most companies invert by acquiring a foreign company at least 25% their size. Burger King attracted headlines in 2014 by plans to turn Canadian by merging with Tim Horton; Medtronic announced that it planned to become Irish by meging with Covidien, a company incorporated in Ireland but run from Mansfield, Massachusetts; and in 2014 Pfizer sought to turn British, although its $118 billion bid to take over AstraZeneca was eventually rejected.[3]

The popularity of corporate inversions reflects the peculiarities of the U.S. tax code, which by near-universal agreement is too costly, too unwieldy and too packed with loopholes.[4]

The United States taxes both the worldwide income of U.S. corporations and the income of foreign firms earned within U.S. borders. All income earned within U.S. borders is taxed the same—in the year earned and at statutory tax rates up to 35%.[5] The U.S. corporate statutory tax rate is higher than the average of other OECD countries and of the 15 other largest economies in the world. On the other

hand, the effective tax rate — the percent of profits paid in taxes once all the deductions, credits and other complex provisions of the tax code are taken into account — is about 26%, slightly below the average of the big industrial countries. And there are significant variations in effective tax rates paid by different companies in different industries.

The United States is also one of the few countries that makes its companies pay that rate on all the worldwide income they bring home — even if the profit was generated by a subsidiary in a foreign country with low taxes. There is a wrinkle, however. Companies can defer their U.S. tax payments until the profits are repatriated, or brought home. This gives multinationals a big incentive to defer repatriation. Estimates of ''deferred'' profits are about $2 trillion.[6]

Many countries tax only profits earned inside, not outside their country. One perverse result is that an independent U.S. company can end up paying more taxes than an identical U.S. company owned by a foreign parent. By creating or buying a foreign parent, a company escapes U.S. tax on worldwide income — although it still needs to pay tax on any income that it earns in the United States.

In short, U.S. companies benefit from inversions in four ways: they free up overseas cash without paying U.S. tax; they avoid paying taxes on offshore profits; they reduce domestic taxable earnings over time through intra-company transactions; and they insulate future overseas growth from U.S. taxes.[7]

Many experts agree the only way the United States could curtail inversions would be to switch to a "territorial" system that would tax corporations only on the income they earn in the United States. The UK, for instance, stemmed its inversion problem and bolstered its tax competitiveness by moving to a territorial system and lowering the corporate tax rate from over 50% in 1981 to 20% in 2015. Despite this lower rate, today the UK — and the OECD on average — raises more corporate tax revenue per capita than does the United States. President Obama has proposed raising $238 billion to pay for infrastructure projects at home by levying a one-off 14% ''transition tax'' on the estimated $2 trillion in earnings U.S. companies have amassed abroad. He has proposed lowering the the corporate tax rate on domestic earnings from 35% to 28%. Tax reform is stalled in the U.S. Congress, however, and progress is likely to be slow.[8]

Pharmaceutical and technology companies find inversions particularly tempting, because their profits stem from intellectual property, which is easily transportable across borders. This has led to

a related procedure called ''transfer pricing,'' by which these firms can easily shift large portions of profits to other countries by assigning intellectual property rights to subsidiaries located in countries that offer advantageous tax treatment to income derived from intellectual property.[9]

U.S. corporate inversions and related procedures have generally targeted countries with low corporate tax rates that offer advantageous tax treatment to income derived from intellectual property, and that offer sophisticated double taxation relief mechanisms and extensive networks of bilateral tax treaties. Major European destinations have included Ireland, Switzerland,[10] the UK, Luxembourg and the Netherlands.[11]

The Netherlands, for instance, is the number one global location of gross profits reported by the subsidiaries of U.S. companies, even though it does not figure in the top 10 of their reported employment. A variety of tax treaties, exemptions and loopholes favor multinational companies. 23,000 ''letterbox companies'' managed by 176 licensed trust firms attract huge flows of money and made €8 trillion worth of transactions in 2011 — 13 times the country's gross national product.[12]

A further twist has been the 'Double Irish With A Dutch Sandwich,' a technique by which firms exploit different definitions of residence in the U.S. and Irish tax codes, and use a combination of Irish and Dutch subsidiary companies, to shift profits to tax havens like Bermuda.[13] Profits flowing directly from Ireland to Bermuda face high taxes, so the funds are funneled through the Netherlands, since Ireland doesn't tax such payments to other EU member states. Dutch tax laws, in turn, allow earnings from Irish subsidiaries to flow to Bermuda without being taxed. And since the subsidiary in Bermuda is technically Irish, it's a ''double Irish'' — even though the profits are ultimately for a U.S. company.

Inversions and tax competition among EU member states are not illegal. But if a government offers some companies special deals not available to others, such action can be considered illegal state aid. This issue has combined with the inversion theme to generate considerable political heat and calls for reform in Europe and beyond. The OECD is considering an overhaul of international tax rules to boost the taxing powers of countries where consumers are based. The Irish government supports the OECD initiative and has now closed the infamous "Double Irish" tax loophole by requiring all companies newly registered in Ireland also to be tax residents in Ireland, and for companies already registered to become tax residents by 2020. Ireland insists, however, that it will stick to its 12.5% corporate tax rate.[14]

Germany, France and Italy are pressing the European Commission to draw up EU-wide laws to curb companies from exploiting tax competition among EU member states to pay less. The European Commission is investigating allegations of sweetheart deals among four companies and three EU countries: Apple in Ireland, Starbucks in the Netherlands, and both Amazon and Fiat Finance and Trade in Luxembourg.[15] The high-profile cases in Luxembourg are particularly awkward for new European Commission President Jean-Claude Juncker, the former Prime Minister of Luxembourg.

Putting Inversions in Perspective

While tax inversions and other techniques have become super-hot political topics, their significance for the U.S. and transatlantic economy must be placed in perspective. Corporate inversion deals account for a miniscule 0.1% of global merger activity. Inversions are estimated to cost $33.6 billion, or 0.7%, of the $4.5 trillion in U.S. corporate tax revenues estimated over the next decade, according to the Congressional Joint Committee on Taxation.[16]

Granted, reduced taxes are powerful incentives for U.S. firms to invest abroad. Yet tax benefits alone — while impossible to ignore — are not typically large enough to become the primary driver of a decision to relocate a corporate headquarters.[17] Such decisions are usually motivated by a host of additional considerations. Above all, white-knuckled global competition dictates that U.S. companies operate locally and be close to their foreign customers. "Build where you sell" has long been a key global competitive advantage of many U.S. firms. Stiff competition and shifting consumer demands and preferences in markets such as the EU, Japan and China demand a local presence.

While Ireland is a favored destination for U.S. tax inverters, its 12.5% corporate tax rate — and much lower effective tax rate — is not the exclusive motivation for corporations deciding to invert or for holding companies to invest.[18] For instance, in 2011 Ireland received roughly $110 million from U.S. non-holding companies, more than the roughly $80 million it received from U.S. holding companies. The UK received $375 billion from non-holding companies, far more than the $130 billion it received from holding companies.

The Netherlands, on the other hand, received $350 million in direct investments from U.S. holding companies, far more than the $150 million it received from other U.S. companies, and Luxembourg received $260 million from U.S. holding companies, significantly more than the $80 million it received from U.S. non-holding companies.[19]

TABLE 9: INVERSION DECADE

Year	U.S. company	Foreign acquisition target	New Incorporation
Pending	Steris	Synergy Health	England
Pending	Civeo	-	Canada
Pending	Burger King	Tim Hortons	Canada
Pending	Mylan	Abbott's generics unit	Netherlands
Pending	Medtronic	Covidien	Ireland
Pending	Applied Materials	Tokyo Electron	Netherlands
2014	Horizon Pharma	Vidara Therapeutics	Ireland
2014	Theravance Biopharma	-	Cayman Islands
2014	Endo International	Paladin Labs	Ireland
2013	Perrigo	Elan	Ireland
2013	Actavis	Warner Chilcott	Ireland
2013	Liberty Global	Virgin Media	England
2013	Tower Group	Canopious Holdings Bermuda	Bermuda
2012	Stratasys	Objet Geometries	Israel
2012	Eaton	Cooper Industries	Ireland
2012	DE Master Blenders 1753	-	Netherlands
2012	Tronox	Exxaro Resources	Australia
2012	Rowan	-	England
2012	Aon	-	UK
2012	Jazz Pharmaceuticals	Azur Pharma	Ireland
2011	Alkermes	Elan Drug Technologies	Ireland
2010	Valeant	Biovail	Canada
2009	Altisource Port. Solut.	-	Denmark
2009	Hungarian Telephone	-	Denmark
2009	Ensco	-	England
2009	Tim Hortons	-	Canada
2007	Western Goldfields	-	Canada
2007	Argonaut Group	PXRe	Bermuda
2005	Lazard	-	Bermuda

Source: Zachary R. Mider, "Tax Inversion. How U.S. Companies Buy Tax Breaks," Bloomberg, January 13, 2015, http://www.bloombergview.com/quicktake/tax-inversion.

U.S. FDI Outflows to Europe adjusted for flows of Holding Companies

In this year's report, we highlight for the first time the role of U.S. holding companies in determining U.S. investment flows to Europe. The figures come courtesy of the Bureau of Economic Analysis (BEA).

This additional lens is warranted since holding companies account for a growing share of total U.S. FDI outflows to Europe. In 2013, for instance, holding companies accounted for $154 billion, or more than half, of global U.S. FDI of $328 billion, and 70% of total U.S. foreign direct investment to the European Union of $169 billion. As the BEA notes,

"The growth in holding-company affiliates reflects a variety of factors. Some holding-company affiliates are established primarily to coordinate management and administration of activities—such as marketing, distribution, or financing—worldwide or in a particular geographic region. In addition, the presence of holding-company affiliates in countries where the effective income tax rate faced by affiliates is relatively low suggests tax considerations may have also played a role in their growth. One consequence of the increasing use of holding companies has been a reduction in the degree to which the USDIA position (and related flow) estimates reflect the industries and countries in which the production of goods and services by foreign affiliates actually occurs."

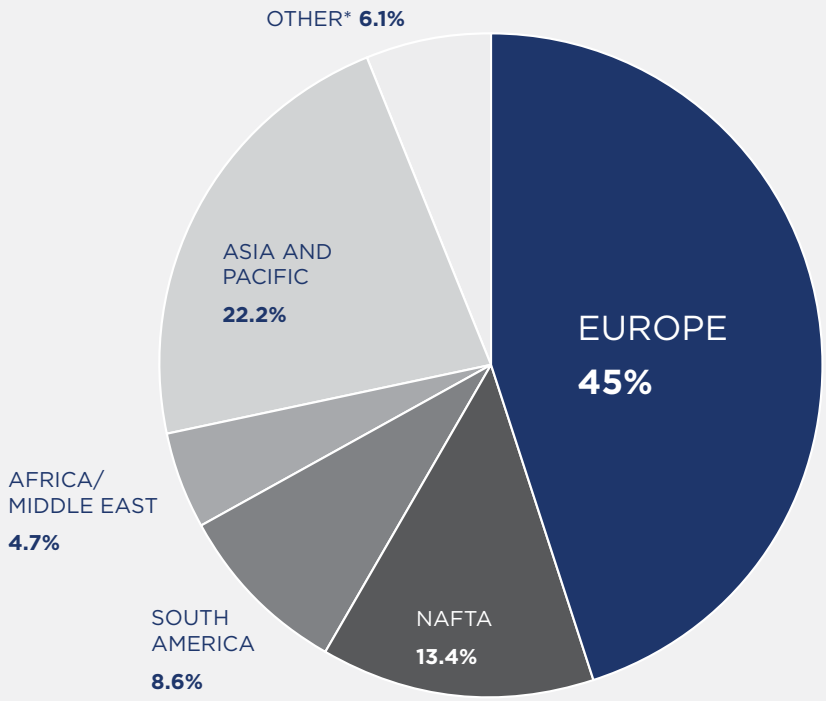
Table 10 depicts total U.S. FDI outflows to Europe by 1) holding companies and 2) non-holding companies. The former is likely to be more of a financial transaction, involving little or nominal participation of U.S. firms in the host country, while the latter is considered investment in the "real economy," or more bricks and mortar-type investment in the host economy.

Table 10 underscores that total U.S. FDI outflows to Europe since 2009 have been driven largely by holding companies, which accounted for 51% of total U.S. FDI outflows to Europe in 2009. In 2010 and 2011, the shares were 73% and 62%, respectively. Holding companies accounted for 56% of total U.S. FDI outflows to Europe in 2012 and 63% in 2013. The countries attracting the most investment of holding companies, not surprisingly, are those with some of the lowest corporate tax rates in Europe. Luxembourg, the Netherlands, the UK and Ireland top the list.

The bottom line: when FDI related to holding companies is stripped from the numbers, U.S. FDI outflows are not as large as typically reported by the BEA. Nonetheless, Europe remains the top

destination of choice among U.S. firms even after the figures are adjusted. Between 2009 and 2013, for instance, Europe still accounted for 45% of total U.S. FDI outflows when flows from holding companies are removed from the aggregate.

TABLE 10: U.S. FDI OUTFLOWS EXCLUDING FLOWS TO NONBANK HOLDING COMPANIES 2009 - 2013 - (% OF TOTAL)



**Includes Central America (excluding Mexico) and Other Western Hemisphere*
Source: Bureau of Economic Analysis
Data as of January 2015.

Endnotes

1. Broadly defined here as the EU28+Switzerland+Norway+Russia+Turkey and smaller, non-EU states.
2. http://knowledge.wharton.upenn.edu/article/can-tax-inversions-be-prevented/; http://taxfoundation.org/blog/everything-you-need-know-about-corporate-inversions; http://fortune.com/2014/09/23/tax-inversion-target-companies-hit-by-u-s-crackdown/. This section also draws on Donald J. Marples and Jane G. Gravelle, ''Corporate Expatriation, Inversions, and Mergers: Tax Issues,'' Congressional Research Service, September 25, 2014, available at http://fas.org/sgp/crs/misc/R43568.pdf.According to the Congressional Research Service, as of September 2014 had approximately 76 companies that have either inverted or are planning to do so since 1983. Fourteen of those planned inversions occurred in 2014 and 47 happened in the past decade. The last big wave of tax inversions occurred prior to 2004, when the U.S. government passed the American Jobs Creation Act, which imposed stiff penalties on companies that moved overseas in search of lower taxes.
3. An alternative to ''inversion'' is ''spinversion,'' where a U.S. company sells a foreign subsidiary to another and the buyer gets to move its tax address overseas. Pfizer's failed inversion with AstraZeneca in the UK would have enabled it to avoid $1 billion a year in taxes in the United States. Public outcry against the deal's potential impact on jobs and science research forced prime minister David Cameron to demand stronger guarantees that the company would keep jobs and investment in the UK. Philippa Maister, ''Are tax inversion-related relocations facing an uncertain future? FDI Intelligence, October 16, 2014, http://www.fdiintelligence.com/Locations/Americas/USA/Are-tax-inversion-related-relocations-facing-an-uncertain-future; http://www.bloombergview.com/quicktake/tax-inversion.
4. Conservatives claim that corporations are forced to leave America because the corporate income tax rate is too high. Progressives argue that corporations are already avoiding paying their fair share of taxes due to many loopholes, including inversions. Republicans want to use revenue gained from repatriated profits to reduce permanently overall corporate and personal tax rates, while Democrats want to tax repatriated profits and use the money for public investments in infrastructure, community colleges and other investments. See ''Megan Murphy, Sam Fleming and Vanessa Houlder, ''Obama seeks to raise $238 bn by tax on US offshore cash piles,'' *Financial Times,* February 2, 2015; Steven Pearlstein, ''Tax Man,'' Washington Post, October 27, 2013, p. G1.
5. 39.1% when combined with state rates.
6. http://www.stltoday.com/business/columns/david-nicklaus/nicklaus-tax-rules-won-t-stop-wave-of-corporate-inversions/article_2d83a41a-e30a-501f-bd4e-5b9989eb4e49.html. Companies argue that if they were allowed to bring that money home tax-free, or at a tax rate of 2-3%, it would create tens of thousands of American jobs. But this argument was made about a decade ago on behalf of an earlier ''tax holiday'' that brought home $300 billion in corporate profits. A subsequent review showed that little of that money was used for job creation. Instead, it was mostly used to pay down debt, pay dividends and buy back stock.
7. Nicklaus, op. cit.; http://www.centerwatch.com/news-online/article/7075/treasurys-tax-inversion-changes-scuttle-some-big-biopharma-mergers-modify-others-prompting-calls-for-congressional-corporate-tax-reform#sthash.Wk6s41Nw.dpbs. Medtronic reportedly could use $20.5 billion in its untaxed profits now offshore to invest back in the United States and avoid paying taxes on those funds. http://www.americansfortaxfairness.org/tax-fairness-briefing-booklet/fact-sheet-corporate-tax-inversions/;.
8. Because of EU freedom of movement rules, the UK cannot have anti-inversion laws, a consideration that may have pushed the UK to move to a territorial tax and to lower the corporate tax rate. Maister, op. cit; http://www.taxand.com/taxands-take/news/corporate-inversions-two-sides-story; http://taxfoundation.org/article/tax-reform-uk-reversed-tide-corporate-tax-inversions; Wharton, op. cit.; also Marples and Gravelle, op. cit.
9. http://www.nbcnews.com/id/39784907/ns/business-us_business/t/dutch-sandwich-saves-google-billions-taxes/; http://www.bloombergview.com/quicktake/tax-inversion; http://www.investopedia.com/terms/d/double-irish-with-a-dutch-sandwich.asp.
10. Switzerland was once regarded as a tax haven for corporations, but has lost favor in recent years because of tighter banking regulations and new rules stipulating that shareholders should be allowed to vote on executives' compensation.
11. http://www.taxand.nl/en/news/corporate-inversions-two-sides-to-the-story/; http://www.reuters.com/article/2014/07/24/deals-taxinversions-lawfirms-idUSL2N0PK1L820140724; CRS.
12. While the Dutch corporate tax rate is 25%, there is lack of withholding tax on royalties; exemption from withholding tax on dividends, interest and capital gains for related companies, i.e. those in which the owner has a share larger than 5%. This exemption can allow groups to create tax deductions through complicated constructions. See Matt Steinglass, ''Dutch focus reform efforts on 'letterbox companies,' *Financial Times,* April 29, 2013.
13. http://www.nytimes.com/interactive/2012/04/28/business/Double-Irish-With-A-Dutch-Sandwich.html?_r=0
14. http://www.forbes.com/sites/joeharpaz/2014/10/09/how-do-you-tax-the-cloud-netflix-and-google-may-soon-find-out/
15. http://www.euractiv.com/sections/euro-finance/germany-france-and-italy-urge-eu-write-common-corporate-tax-laws-310489; http://www.reuters.com/article/2014/11/05/us-luxembourg-tax-idUSKBN0IP30L20141105; http://www.dailymail.co.uk/news/article-2868322/Disney-Microsoft-dragged-Luxembourg-tax-avoidance-scandal-engulfing-EU-chief-Jean-Claude-Juncker.html#ixzz3OvnVFdM8. The European Commission is already investigating the tax arrangements of Starbucks in the Netherlands, of Apple in Ireland and of a unit of Fiat and The Amazon inquiryin Luxembourg. The International Consortium of Investigative Journalists published a report accusing more than 300 companies, including the Pepsi Bottling Group, Ikea and FedEx, of benefiting from preferential tax deals.

16. http://www.ibtimes.com/preventing-inversions-would-save-05-us-corporate-tax-revenue-1695163; http://www.bloomberg.com/news/2015-01-14/how-inversions-leaped-from-the-shadows-to-doom-treasury-nominee.html
17. According to Thomson Reuters, seven corporate tax inversions have been announced over the past 12 months accounting for 1.2% of all global deals over $1 billion (565). By value, those deals total $152.7 billion, accounting for 7.1% of the combined value of worldwide deals over $1 billion ($2.15 trillion) announced since October 2013. http://www.forbes.com/sites/joeharpaz/2014/10/09/how-do-you-tax-the-cloud-netflix-and-google-may-soon-find-out/
18. The U.S. Bureau of Economic Analysis has calculated that the effective tax rate for U.S. subsidiaries in Ireland is 3.8%, the lowest in the EU [Germany 33.1%; France 42.8%] and even lower than Bermuda [4.0%], often considered a tax haven. U.S. Bureau of Economic Analysis, U.S. Direct Investment Abroad, Table III.G.7 and Table II.F.7, various years. See also Jim Stewart, PwC/World Bank Report 'Paying Taxes 2014," an Assessment, https://www.tcd.ie/iiis/documents/discussion/pdfs/iiisdp442.pdf; Vanessa Houlder and Vincent Boland, ''The Irish inversion,'' *Financial Time*s, April 30, 2014, p. 9; Maister, op. cit.
19. Figures and comparisons derived from Financial Times, OECD, SOMO, DNB. See Matt Steinglass, ''Dutch focus reform efforts on 'letterbox companies,' *Financial Times*, April 29, 2013.