

FDII Deduction Supports Significant U.S. Economic Activity

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In this article, Pizzola and Gelfond-Gross analyze the economic effects of the foreign-derived intangible income deduction, the economic activity supported by the deduction, and the macroeconomic impacts of repealing it.

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The foreign-derived intangible income deduction has significant effects on the U.S. economy by supporting jobs, wages, and gross domestic product. This article analyzes the economic effects of the FDII deduction from two perspectives: (1) the economic activity supported by the FDII deduction and (2) the macroeconomic impacts of repealing the FDII deduction.

As referenced in this article, the economic activity supported by the FDII deduction reflects the economic activity that could be affected or would be at risk if the provision were repealed. Estimates of the macroeconomic impacts reflect the extent by which economic activity would be shifted between sectors and industries in response to its repeal.

The analysis finds:

- 690,000 jobs earning \$53 billion in wages and benefits and generating \$106 billion of GDP in the United States (relative to the size of the

2024 U.S. economy) would potentially be at risk if the FDII deduction were repealed; and

- job equivalents are estimated to decrease by 200,000 jobs in each of the first 10 years and 300,000 jobs each year thereafter if the FDII deduction were repealed, after accounting for the shifting of economic activity throughout the economy.

Background

The Tax Cuts and Jobs Act enacted the 37.5 percent FDII deduction, which effectively reduces the corporate income tax rate on certain foreign-derived sales and service income from 21 percent to 13.125 percent ($13.125\% = 21\% * (1 - 37.5\%)$). After 2025 the FDII deduction will be reduced to 21.875 percent and the effective FDII tax rate will increase to 16.4 percent ($16.4\% = 21\% * (1 - 21.875\%)$). The deduction is targeted at the income earned from the sale of goods and services to foreign markets that is attributable to a company's U.S.-based intangible assets. Importantly, the FDII deduction creates a financial incentive for a company's intangible assets (e.g., patents and trademarks) and high-return operations to be moved to or developed and retained in the United States rather than being offshored.¹

Table 1 displays Internal Revenue Service tax return data from Form 8993 ("Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)"). As seen in Table 1, in 2018 the FDII deduction totaled \$52.5 billion. This was about 2.6

¹The FDII deduction promotes tax parity with the global intangible low-taxed income regime, which in isolation may encourage a company to locate its intangible assets and high-return operations outside the United States. Note, however, that increasing domestic tangible capital in isolation (e.g., without also increasing income) reduces the amount of the FDII deduction and, consequently, increases income taxes. This is because the FDII deduction applies to the export share of income in excess of 10 percent of domestic tangible capital.

[AUTHORS: SHOULD DATA BE UPDATED TO 2021?]

**Table 1. IRS Tax Return Data on FDII and GILTI Deduction From Form 8993 (2018)
(in billions of USD)**

Industry	FDII Deduction	GILTI Deduction
Total [AUTHORS, should this line be at the bottom of the table?]	\$52.5	\$186.0
Manufacturing	34.1	67.1
Information	7.1	51.5
Wholesale trade	4.2	13.3
Finance and insurance	1.5	12.6
Professional, scientific, and technical services	1.2	6.6
Retail trade	1.2	7.4
Accommodation and food services	0.7	4.2
Management of companies (holding companies)	0.7	15.6
Administrative and support and waste management and remediation	0.5	4.0
Transportation and warehousing	0.5	1.1
Real estate and rental and leasing	0.2	1.0
Arts, entertainment, and recreation	*	*
Agriculture, forestry, fishing, and hunting	*	0.1
Mining	*	1.0
Utilities	*	0.1
Construction	*	0.1
Educational services	*	*
Healthcare and social assistance	*	0.1
Other services	*	0.1
<p>* Amounts are less than \$0.05 billion.</p> <p><i>Note:</i> Industries are from the North American Industry Classification System (NAICS). The manufacturing industry is defined as businesses that engage in the mechanical, physical, or chemical transformation of materials, substances, or components into new products. The information industry is defined as businesses that produce and distribute information and cultural products; provide the means to transmit or distribute these products, as well as data or communications; or process data. Figures rounded.</p> <p><i>Source:</i> IRS, "SOI Tax Stats — International Tax Studies Based Upon Provisions Introduced by the Tax Cuts and Jobs Act (TCJA)" (Table 2. Form 8993: Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI), Selected items, by Industrial Sector (2018)). [AUTHORS, SHOULD THIS BE UPDATED TO 2021 DATA?]</p>		

percent of the total pre-FDII deduction taxable income of C corporations.² More than three-quarters of the FDII deduction was in the manufacturing and information industries. In 2018 the FDII deduction (\$52.5 billion) was less than one-third the amount of the GILTI deduction (\$186.0 billion).

The FDII deduction reduces capital income taxes. Specifically, by lowering the amount of tax due on investment returns, the FDII deduction decreases the cost of capital, encourages investment, and results in more capital formation in the United States. With more capital available per worker, labor productivity rises. This ultimately increases the real wages of workers, GDP, and U.S. living standards.

Capital income taxes are generally viewed as a relatively less economically efficient form of taxation (i.e., they have a larger negative impact on economic activity per dollar of revenue raised).³ Taxes on labor decrease the after-tax return to work, which can be expected to reduce the number of workers or the number of hours they work, but are generally thought to have smaller economic impacts than taxes on capital income. Taxes on consumption, which generally do not tax the economically important portion of an investment's return, are generally viewed as relatively efficient.

In its fiscal 2025 revenue proposals, the Biden administration proposed repealing the FDII deduction and replacing it with more targeted research and development incentives.⁴ Repealing the FDII deduction is estimated to raise \$118

billion over the 10-year budget window.⁵ This revenue estimate could make the proposal interesting to policymakers looking for revenue to address expired and expiring TCJA provisions.

Scope of Analysis

This article estimates (1) the amount of economic activity supported by the FDII deduction and (2) the macroeconomic impacts of the repeal of the FDII deduction.⁶

- *Economic activity supported by the FDII deduction.* This analysis provides a static snapshot of the economic activity supported at businesses directly benefiting from the FDII deduction, as well as the economic activity connected to these businesses (i.e., related supply chain activity and consumer spending). **This is [AUTHORS, IS THIS OK?]** the economic activity that can reasonably be regarded as potentially at risk from repeal of the FDII deduction.
- *Macroeconomic impacts of repealing the FDII deduction.* This analysis simulates how markets would respond to the repeal of the FDII deduction. It differs from the first analysis, a static snapshot, through simulating market adjustments in the EY Macroeconomic Model (e.g., some no-longer-employed workers may shift to other companies, industries, or sectors, albeit at a potentially lower wage).

All estimates are produced comparing the benefit of the current effective FDII tax rate of 13.125 percent with no FDII deduction.

Economic Activity Supported by the FDII Deduction or at Risk if Repealed

General

This analysis looks at a static snapshot of the economic activity supported by the FDII

²See Table 1 of this article for aggregated, industry-level information from the IRS regarding [AUTHORS: IS THIS OK?] Form 8993, which covers the section 250 deduction for FDII and global intangible low-taxed income. See also IRS, "SOI Tax Stats – Corporation Income Tax Returns Complete Report (Publication 16)" (Table 5.4: Returns With Net Income, Other Than Forms 1120S, 1120-REIT, and 1120-RIC (2021)) [AUTHORS, IS THIS OK?]. The IRS reports FDII by the two-digit North American Industry Classification System (NAICS) code. This analysis disaggregated the IRS data further using data from company financial statements.

³See, e.g., Jens Matthias Arnold, "Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence From a Panel of OECD Countries," OECD Economics Department Working Papers No. 643 (2008); U.S. Department of the Treasury, "A Dynamic Analysis of Permanent Extension of the President's Tax Relief" (2006).

⁴See U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals" (Mar. 2024). Note that the administration's proposal includes using the revenue raised from the repeal of the FDII deduction to create incentives for R&D in the United States through an unspecified policy.

⁵Treasury estimates that repealing the FDII deduction (relative to a 28 percent corporate income tax rate) would raise \$158 billion over the 2025-2034 budget window; scaled to a 21 percent corporate income tax rate, this would be \$118 billion over the 10-year budget window. *Id.*

⁶Formally, the estimated economic activity supported by the FDII deduction is from a partial equilibrium analysis, and the estimated macroeconomic impacts of the repeal of the FDII deduction is from a general equilibrium analysis that accounts for the shifting of economic resources throughout the economy.

deduction and estimates the cost of capital with and without the 37.5 percent FDII deduction. In addition, it considers three different effects of the FDII deduction: the direct effect, the supply chain activity effect, and the consumer spending effect.

The direct effect relates to the economic activity supported at businesses with a tax liability that decreases because of the FDII deduction. The supply chain and related consumer spending effects relate to the economic activity connected to the businesses benefiting from the deduction.

The supply chain effect is the economic activity supported at suppliers of goods and services for the economic activity supported by businesses directly benefiting from the FDII deduction. Additional rounds of economic activity result from purchases of the goods and services as suppliers buy operating inputs from their suppliers.

The related consumer spending effect occurs when wages and benefits are supported at businesses benefiting from the FDII deduction and their suppliers, which in turn affects consumer spending that supports economic activity at other businesses (e.g., **grocery stores and restaurants**) [AUTHORS, COULD THIS BE REMOVED? THE FULL EXAMPLE FOLLOWS]. For example, the earnings spent on food at a restaurant support jobs at the restaurant as well as at farms, transportation companies, and other businesses involved in the restaurant's supply chain.

How Economic Activity Is Measured

The analysis measures economic activity in terms of employment, wages and benefits, and GDP. Employment is measured as the total head count of U.S. workers. Wages and benefits includes employee cash compensation and benefits, which are a component of GDP. GDP is the total market value of final goods and services produced in the United States.

To determine those numbers, the snapshot estimates the cost of capital with and without the 37.5 percent FDII deduction. An elasticity of investment regarding the cost of capital, which reflects the responsiveness of investment to its tax treatment from economic research, is then applied to the difference in the cost of capital with and

without the FDII deduction. This results in an estimate of investment supported by the FDII deduction. The change in investment is then translated into estimates of the jobs, wages and benefits, and GDP supported by the FDII deduction based on the composition of industries benefiting from the FDII deduction.

To estimate the supplier purchases and consumer spending related to the economic activity directly supported by the FDII deduction, the analysis uses the Impact Analysis for Planning (IMPLAN) input-output model of the U.S. economy.

Findings

The FDII deduction is estimated to support 690,000 jobs, earning \$53 billion in wages and benefits and generating \$106 billion of GDP in the United States (relative to the size of the 2024 U.S. economy). As illustrated in Table 2, these estimates reflect the economic activity at businesses directly benefiting from the FDII deduction, as well as the related supplier activity and consumer spending:

- *Businesses directly benefiting from the FDII deduction.* The FDII deduction is estimated to support 206,000 workers earning \$19 billion in wages and benefits and generating \$39 billion of GDP at businesses directly benefiting from the FDII deduction.
- *Related supplier activity.* The FDII deduction is estimated to support 209,000 workers earning \$17 billion in wages and benefits and generating \$33 billion of GDP at suppliers to businesses directly benefiting from the FDII deduction.
- *Related consumer spending.* The FDII deduction is estimated to support an additional 275,000 workers earning \$17 billion in wages and benefits and generating \$34 billion of GDP via the consumer spending of supported workers at businesses directly benefiting from the FDII deduction and their suppliers.

**Table 2. Economic Activity Supported by the FDII Deduction
(Estimates are relative to the size of the 2024 U.S. economy)**

	Jobs	Wages and Benefits	GDP
Businesses directly benefiting from the FDII deduction	206,000	\$19 billion	\$39 billion
Suppliers to businesses directly benefiting from the FDII deduction	209,000	\$17 billion	\$33 billion
Related consumer spending	275,000	\$17 billion	\$34 billion
Total economic activity supported	690,000	\$53 billion	\$106 billion
<p><i>Note:</i> Table 2 provides a static snapshot of the economic activity supported at businesses directly benefiting from the FDII deduction, as well as the economic activity connected to these businesses (i.e., supply chain activity and related consumer spending). Estimates are produced comparing the benefit of the current effective FDII rate of 13.125 percent with no FDII deduction and are quantified relative to the size of the U.S. economy in 2024. Wages and benefits is a component of GDP. Figures are rounded.</p> <p><i>Source:</i> EY analysis.</p>			

Table 3 shows the amount of economic activity supported by the FDII deduction (including the economic activity supported at businesses directly benefiting from the FDII deduction, as well as the economic activity connected to these businesses) by state (plus the District of Columbia).⁷ The states estimated to have the largest amount of economic activity supported by the FDII deduction are California (86,000 jobs), Texas (58,000 jobs), Florida (49,000 jobs), New York (42,000 jobs), and Illinois (29,000 jobs).

Macroeconomic Impacts of Repealing the FDII Deduction

EY Macroeconomic Model

The EY Macroeconomic Model is used to estimate the macroeconomic impacts of repealing the FDII deduction on the U.S. economy. This model simulates how markets respond to policy changes (e.g., workers leaving one business may then be employed by a different business, albeit at a potentially lower wage).

Specifically, the model includes a detailed modeling of industries and inter-industry

linkages. Businesses choose the optimal mix of capital and labor based on relative prices and industry-specific characteristics. Each industry has a different relative size of capital, labor, and intermediate inputs associated with its output.

The model is designed to include key economic decisions of businesses and households affected by tax policy, as well as major features of the U.S. economy. The post-tax returns from work and savings are incorporated into businesses' and households' decisions on how much to produce, save, and work.

This contrasts with the previously discussed static snapshot of the economic activity supported by the FDII deduction.

Macroeconomic Estimates

This analysis assumes that the revenue generated from repealing the FDII deduction is used to fund government transfers, a standard assumption for macroeconomic analysis of tax changes.⁸ Government transfer programs are assumed not to boost private sector productivity

⁷The economic activity supported by the FDII deduction was estimated for the U.S. economy by the three-digit NAICS code for manufacturing and the two-digit NAICS code for other industries and then apportioned to states based on each state's relative share of these industries. An exception for this is the related consumer spending, which was apportioned to states based on each state's share of direct and supply-chain wages and benefits supported. Results were generally not sensitive to the use of alternative allocation methodologies.

⁸This is discussed, for example, in Jane G. Gravelle, "Dynamic Scoring for Tax Legislation: A Review of Models," Congressional Research Service, R43381 (2023). For papers modeling a tax increase where changes in revenue are offset by changes in government spending (transfers or government consumption) see, for example, Rachel Moore and Brandon Pecoraro, "Quantitative Analysis of a Wealth Tax for the United States: Exclusions and Expenditures," 78 *Journal of Macroeconomics* 103559 (2023); Shinichi Nishiyama, "Fiscal Policy Effects in a Heterogeneous-Agent Overlapping-Generations Economy With an Aging Population," Congressional Budget Office Working Paper 2013-07 (Dec. 2013); Treasury, *supra* note 3.

Table 3. Economic Activity Supported by the FDII Deduction, by State
 (Estimates are relative to the size of the 2024 U.S. economy; in millions of USD)

	Jobs	Wages and Benefits	GDP		Jobs	Wages and Benefits	GDP
United States	690,000	\$52,803	\$105,634	Missouri	13,000	\$977	\$1,953
Alabama	9,000	\$662	\$1,340	Montana	2,000	\$126	\$269
Alaska	1,000	\$89	\$192	Nebraska	4,000	\$323	\$637
Arizona	14,000	\$1,007	\$2,014	Nevada	6,000	\$396	\$827
Arkansas	5,000	\$381	\$767	New Hampshire	3,000	\$251	\$484
California	86,000	\$7,010	\$14,351	New Jersey	20,000	\$1,526	\$3,040
Colorado	13,000	\$1,019	\$2,075	New Mexico	3,000	\$219	\$440
Connecticut	8,000	\$615	\$1,177	New York	42,000	\$3,300	\$6,700
Delaware	2,000	\$162	\$331	North Carolina	20,000	\$1,524	\$3,102
D.C.	3,000	\$233	\$443	North Dakota	2,000	\$122	\$266
Florida	49,000	\$3,280	\$6,402	Ohio	25,000	\$1,943	\$3,795
Georgia	22,000	\$1,637	\$3,308	Oklahoma	7,000	\$488	\$984
Hawaii	2,000	\$150	\$311	Oregon	9,000	\$674	\$1,346
Idaho	3,000	\$263	\$534	Pennsylvania	27,000	\$2,085	\$4,043
Illinois	29,000	\$2,242	\$4,395	Rhode Island	2,000	\$160	\$308
Indiana	14,000	\$1,053	\$2,095	South Carolina	10,000	\$731	\$1,470
Iowa	7,000	\$546	\$1,091	South Dakota	2,000	\$129	\$255
Kansas	6,000	\$481	\$964	Tennessee	14,000	\$1,027	\$2,003
Kentucky	8,000	\$610	\$1,208	Texas	58,000	\$4,362	\$8,988
Louisiana	8,000	\$551	\$1,232	Utah	8,000	\$643	\$1,319
Maine	3,000	\$188	\$384	Vermont	1,000	\$96	\$190
Maryland	12,000	\$938	\$1,796	Virginia	18,000	\$1,440	\$2,764
Massachusetts	17,000	\$1,533	\$2,946	Washington	16,000	\$1,316	\$2,701
Michigan	20,000	\$1,535	\$2,981	West Virginia	2,000	\$175	\$387
Minnesota	14,000	\$1,188	\$2,237	Wisconsin	13,000	\$1,012	\$1,975
Mississippi	5,000	\$313	\$642	Wyoming	1,000	\$69	\$172

Note: Table 3 provides a static snapshot of the economic activity supported at businesses directly benefiting from the FDII deduction, as well as the economic activity connected to these businesses (i.e., supply chain activity and related consumer spending). Estimates are produced comparing the benefit of the current effective FDII rate of 13.125 percent with no FDII deduction and are quantified relative to the size of the U.S. economy in 2024. Wages and benefits is a component of GDP. Figures are rounded.

Source: EY analysis.

or private sector output but could achieve other

policy objectives. To the extent this revenue is used for other purposes (e.g., productivity-enhancing government spending or deficit reduction), results could differ from those presented.⁹

The analysis shows that a significant portion of the effects of repealing the FDII deduction would fall on U.S. workers through decreased labor productivity, wages, and employment. Repealing the FDII deduction is estimated to decrease job equivalents.¹⁰ The negative impact on the U.S. economy steadily grows over time from, on average, a decrease of 200,000 jobs in each of the first 10 years to 300,000 jobs each year thereafter (relative to the size of the 2024 U.S. economy).

U.S. GDP is estimated to decrease by \$25 billion annually, on average, over the first 10 years and then by \$35 billion annually in each year thereafter (relative to the size of the 2024 U.S. economy). The repeal also is estimated to decrease employee compensation by \$20 billion annually on average over the first 10 years and then by \$30 billion annually in each year thereafter (relative to the size of the 2024 U.S. economy).

Conclusion

The FDII deduction has a positive effect on the U.S. economy. It supports about 690,000 jobs, \$53 billion of wages and benefits, and \$106 billion of U.S. GDP. Repealing the FDII deduction would have a negative effect on the U.S. economy, with a significant reduction in job equivalents, employee compensation, and U.S. GDP.

Appendix: Caveats and Limitations

Any modeling effort is only an approximate depiction of the economic forces it seeks to represent, and the economic models developed for this analysis are no exception. Although

various limitations and caveats might be listed, several are particularly noteworthy:

- **Estimated macroeconomic impacts are based on a stylized depiction of the U.S. economy.** The economic models used for this analysis are, by their very nature, stylized depictions of the U.S. economy. As such, they cannot capture all the detail of the U.S. economy, the existing U.S. tax system, or **changes in tax policy** [AUTHORS: IS THIS OK?].
- **Estimates are limited by available public information.** The analysis relies on information reported by government agencies (primarily the Bureau of Economic Analysis, the Congressional Budget Office, the Internal Revenue Service, and the Joint Committee on Taxation). The analysis did not attempt to verify or validate this information using sources other than those described in this article.
- **Macroeconomic estimates are sensitive to how tax revenue from the policy change is used.** Because tax and spending policies must ultimately be funded (e.g., tax cuts must ultimately be paid for), it is not possible to separate entirely the impact of a given tax increase from the impact of the use of the revenues it may generate. Revenue raised in this analysis must eventually be used in some way, and how the revenue is used can affect the estimated impacts. Typical uses of the revenue in analyses like this have included deficit reduction, government spending or transfer increases, tax reductions, or a combination thereof. Assuming different uses of the revenue could produce different results than those obtained in this analysis.
- **Full employment model.** The EY Macroeconomic Model, like many general equilibrium models, focuses on the longer-term incentive effects of policy changes. It also assumes that all resources throughout the economy are fully employed; that is, there is no slackness in the economy (i.e., a full employment assumption with no involuntary unemployment). Any increase in labor supply is a voluntary response to a change in income or the return to labor that

⁹ That said, proposals to limit or otherwise repeal the FDII deduction sometimes include some type of R&D incentive, which could have productivity-enhancing effects. For example, the Biden administration's fiscal 2025 budget proposes using the revenue raised from the repeal of the FDII deduction to create incentives for R&D in the United States through an unspecified policy. See Treasury, *supra* note 4.

¹⁰ Job equivalents summarize the impact of both the reduction in hours worked and reduced wages. Specifically, job equivalents are calculated as the total change in labor income divided by average labor income per job.

makes households choose to substitute between consumption and leisure. To provide a high-level measure of the potential employment impacts, a job equivalents measure has been included in this analysis's results. Job equivalent impacts are defined as the change in total labor income divided by the baseline average labor income per job.

- **Estimated macroeconomic impacts limited by calibration.** This model is calibrated to represent the U.S. economy and then forecast forward. However, because any

particular year may reflect unique events and also may not represent the economy in the future, no particular baseline year is completely generalizable.

- **Industries are assumed to be responsive to normal returns on investment.** The industries comprising the U.S. economy in the EY Macroeconomic Model are assumed to be responsive to the normal returns on investment. This contrasts to industries that earn economic profits and thereby have an increased sensitivity to statutory tax rates relative to marginal effective tax rates. ■