



Tax Cuts on Repatriation Earnings as Economic Stimulus: An Economic Analysis

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Summary

From the start of the 112th Congress, reform of the current U.S. corporate tax system has been widely debated as an option to stimulate the economy. Most of the debate has focused on lowering the corporate tax rate and moving toward a territorial system. An exception to this approach is a plan to reduce the tax rate on repatriated dividends that has received some consideration. Under such a plan, the U.S. tax that U.S. firms pay when their overseas operations remit (“repatriate”) their foreign earnings as dividends to their U.S. parent corporations would be reduced. Variations of this type of proposal have been introduced in several bills, including H.R. 937, H.R. 1036, H.R. 1834, H.R. 2862, S. 727, and S. 1671 in the 112th Congress.

A conceptually similar proposal was enacted as part of the American Jobs Creation Act (P.L. 108-357). The provision provided a temporary reduced rate for repatriated earnings, with the condition that the repatriated earnings be used for domestic investment. While empirical evidence is clear that this provision resulted in a significant increase in repatriated earnings, empirical evidence is unable to show a corresponding increase in domestic investment or employment. A similar provision was considered, but not adopted, as a floor amendment to a Senate version of the American Recovery and Reinvestment Act of 2009.

Viewed in the current debate on how to most efficiently stimulate the economy, economic theory suggests that the stimulative effect of a temporary tax cut for repatriations may be offset, or more than offset, by exchange rate adjustments that would reduce net exports. In addition, how businesses use repatriated earnings will impact the stimulative or contractionary effect of a tax cut for repatriations. For example, repatriated earnings will have a larger stimulative effect, or smaller contractionary effect, the greater the degree to which they are used to increase current investment. A smaller stimulative effect or a larger contractionary effect will result, in contrast, if more of the repatriated earnings are used to shore up “cash-flow” issues or pay dividends. This report will be updated as legislative events warrant.

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The legislative agenda at the start of the 112th Congress has been dominated by discussions concerning the deficit and the debt limit. In addition, reform of the current U.S. corporate tax system has been widely debated as an option to stimulate the economy. Most of the debate has focused on lowering the corporate tax rate and moving toward a territorial system. An exception to this is a plan to reduce the tax rate on repatriated dividends that has received some consideration. Under such a plan, the U.S. tax that U.S. firms pay when their overseas operations remit (“repatriate”) their foreign earnings as dividends to their U.S. parent corporations would be reduced. Variations of a basic repatriation proposal have been introduced in several bills, including H.R. 937, H.R. 1036, H.R. 1834, H.R. 2862, S. 727, and S. 1671 in the 112th Congress.

A conceptually similar proposal was enacted as part of the American Jobs Creation Act (P.L. 108-357). The provision provided a temporary reduced rate for repatriated earnings, with the condition that the repatriated earnings be used for domestic investment. While empirical evidence is clear that this provision resulted in a significant increase in repatriated earnings, empirical evidence is unable to show a corresponding increase in domestic investment or employment by firms that utilized the repatriation provisions. A similar provision was considered, but not adopted, as a floor amendment to a Senate version of the American Recovery and Reinvestment Act of 2009. Up until recently, the business community has largely continued to suggest another repatriation holiday.¹ In a May 2011 hearing before the Ways and Means Committee, chief financial officers from United Technology Corporation, Kimberly Clark Corporation, Zimmer Holdings Incorporated, and Caterpillar Incorporated unanimously opposed holding another repatriation holiday.² However, other firms have continued to support the holiday.

In the context of the current debate on stimulus, the use of the repatriations and not the magnitude of repatriations stimulated are likely to be the key to the proposal’s effect on U.S. economic growth. This follows from two points. First, even if sizeable repatriations occur, the rate of return on U.S. investment will be unaffected by the repatriations. Assuming firms are not liquidity-constrained, it is possible that the bulk of the repatriations will be used as dividends to stockholders or used to pay down corporate debt. This scenario is especially likely for large firms.³ Second, when the repatriations occur, those that are denominated in foreign currencies will be converted to dollars. The corresponding increase in the demand for dollars would be expected to drive up the price of the dollar in world currency markets. As a result, U.S. net exports would be expected to decline from levels that would otherwise occur, and the repatriation holiday could contract rather than stimulate the U.S. economy.

The U.S. International Tax System

The United States bases its jurisdiction to tax international income on residence. As a result, U.S.-chartered corporations are taxed on their worldwide income, but foreign corporations are taxed only on their U.S.-source income. Accordingly, a U.S. firm with overseas operations can

¹ John Chambers and Safra Catz, “The Overseas Profits Elephant in the Room,” *Wall Street Journal*, October 20, 2010, <http://online.wsj.com/article/SB10001424052748704469004575533880328930598.html#articleTabs%3Darticle>.

² These statements were made during the question and answer period of U.S. Congress, House Committee on Ways and Means, *The Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers*, 112th Cong., 1st sess., May 12, 2011.

³ See CRS Report RS21126, *Tax Cuts and Economic Stimulus: How Effective Are the Alternatives?*, by Jane G. Gravelle, for a more detailed discussion.

indefinitely postpone its U.S. tax on its foreign income by operating through a foreign subsidiary. Using the same principle, U.S. taxes are deferred as long as its foreign earnings remain in the control of its foreign subsidiary and are reinvested abroad. The U.S. firm pays taxes on its overseas earnings only when they are paid to the U.S. parent corporation as intra-firm dividends or other income.⁴

Another prominent feature of the U.S. tax system is the foreign tax credit. The foreign tax credit is designed to alleviate double taxation where U.S. and foreign governments' tax jurisdictions overlap—that is the U.S. firm pays taxes at the higher of the U.S. or foreign tax rate. With respect to repatriated dividends, U.S. firms can claim foreign tax credits for foreign taxes paid by their subsidiaries on the earnings used to pay the repatriated dividends. The ability to defer U.S. tax, thus, poses an incentive for U.S. firms to invest abroad in countries with low tax rates. Proposals to cut taxes on repatriations are based on the premise that even this deferred tax on intra-firm dividends discourages repatriations and encourages firms to reinvest foreign earnings abroad and that a cut in the tax would stimulate repatriations.

Repatriated Earnings Provisions in the American Jobs Creation Act

The repatriated earnings provision included in the American Jobs Creation Act (P.L. 108-357) reduced the taxes due on repatriated earnings. In particular, the provision provided a deduction equal to 85% of the increase in foreign-source earnings repatriated. For a firm paying taxes at the 35% corporate tax rate, this reduced the tax rate on repatriated earnings to the equivalent of 5.25%. Along with the rate reduction, credits for foreign taxes paid were reduced by a corresponding amount.

The act required firms to adopt domestic investment plans for qualifying repatriations and limited the maximum deduction allowed. The maximum allowable deduction was set equal to the greater of \$500 million or the amount of earnings shown to be permanently reinvested outside the United States in a firm's books of accounts certified before June 30, 2003.

The deduction was designed and intended to be available for one year. At the taxpayer's option, the year would be the first tax year beginning on or after the date of enactment of P.L. 108-357 or the last tax year beginning before that date. The conference report for the act stated the “conferees emphasize that this is a temporary economic stimulus measure, and that there is no intent to make this measure permanent, or to ‘extend’ or enact it again in the future.”⁵

⁴ Anti-abuse rules require some easily shifted passive income to be recognized currently (referred to as Subpart F income).

⁵ U.S. Congress, Conference Committees, 2004, *American Jobs Creation Act of 2004*, conference report to accompany H.R. 4520, H.Rept. 108-755, 108th Cong., 2nd sess. (Washington: GPO, 2004), p. 314.

Impacts of a Reduction in the Tax on Repatriated Earnings

A number of researchers have studied the impact of the reduction in the tax on repatriated earnings that came out of the American Jobs Creation Act. The studies have generally focused on two particular responses: the level of repatriations and the impact on economic growth. In short, the studies generally conclude that the reduction in the tax rate on repatriated earnings led to a sharp increase in the level of repatriated earnings, but that the repatriations did not increase domestic investment or employment. They further conclude that much of the repatriations were returned to shareholders through stock repurchases.

Impact on Repatriated Earnings

The impact of a reduction in the tax on repatriated earnings depends on whether the reduction is permanent or temporary. As mentioned above, the provision enacted in P.L. 108-357 was envisioned as being a temporary and one-time reduction.

Based on a common economic theory, a permanent reduction in the tax on repatriated earnings is not likely to result in an increase in repatriations. According to the “new view” of dividends, once a firm invests equity capital in a foreign subsidiary, the payment of home-country taxes is inevitable.⁶ Given this inevitability, once the capital is abroad, repatriation taxes have no impact on the firm’s decision whether to repatriate foreign earnings in the present or to reinvest them abroad. Instead, repatriations will follow a life-cycle model, unaffected by repatriation taxes, where young foreign subsidiaries will receive capital from their U.S. parent so long as there are profitable foreign investment opportunities, followed by a period of self-financing of foreign investment by the foreign subsidiary, and ending with a period of repatriations made by mature foreign subsidiaries.

In contrast, a temporary reduction in the tax on repatriated earnings is likely to result in an increase in repatriations in the short run. Note that the long-run result, above, depended upon the tax on repatriated earnings being the same in the present and the future. This no longer holds for a temporary reduction, and thus repatriation taxes may affect the level of repatriations. This is not to say that all firms will increase repatriations in response to the tax reduction. It is expected that a young firm’s repatriation decisions would still be unaffected by repatriation taxes, as long as the reduction expires prior to the firm intending to repatriate profits. In addition, any short-term increase in repatriations may be offset by a decrease in repatriations in later years. This is especially likely to occur if corporations view a temporary rate reduction as likely to recur. Some of this decrease is projected to occur within the 10-year budget window and for that reason the

⁶ See Rosanne Altshuler, “Do Repatriation Taxes Matter? Evidence from the Tax Returns of U.S. Multinationals,” in . Martin Feldstein, James R. Hines Jr., and R. Glenn Hubbard, eds., *The Effects of Taxation on Multinational Corporations* (Chicago, University of Chicago Press, 1995). Note that there is also a “new view” theory associated with dividends taxes paid by final individual shareholders in the United States that was relevant to the payment of dividends to these shareholders when tax rates on dividends and capital gains differ but does not hold if firms were able to repurchase shares, which they clearly do. See also Jane Gravelle, “Federal Corporate Income Tax,” in Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle, eds., *The Encyclopedia of Taxation and Tax Policy* (Washington, DC: The Urban Institute, 1999), p. 175.

Joint Tax Committee estimates that a repatriation holiday will result in a revenue loss even though additional taxes will be collected in the short run.

The actual pattern of repatriations observed after enactment of the American Jobs Creation Act validated the short-run economic prediction. According to the Internal Revenue Service, 843 of the roughly 9,700 eligible corporations took advantage of the deduction.⁷ This sub-set of eligible corporations repatriated \$312 billion in qualified earnings and created total deductions of \$265 billion. Using the most recent year of data available, the data suggest that approximately one-third of all offshore earnings were repatriated in the tax year after enactment.⁸ As a way of comparison, base dividends for the same corporations total approximately \$34 billion and suggest a normal repatriation rate of little more than 4%. Thus, not controlling for other factors, the rate reduction resulted in a greater-than-eight-fold increase in repatriations.

The IRS study of the provision, cited above, provided information on the recipients. The benefits of the repatriation provision are not evenly spread across industries. The pharmaceutical and medicine industry accounted for \$99 billion in repatriations or 32% of the total. The computer and electronic equipment industry accounted for \$58 billion or 18% of the total. Thus these two industries accounted for half of the repatriations. Most of the dividends were repatriated from low tax countries or tax havens.

The benefits were also highly concentrated in a few firms. According to a recent study, five firms (Pfizer, Merck, Hewlett-Packard, Johnson & Johnson, and IBM) are responsible for \$88 billion, more than a quarter (28%) of total repatriations.⁹ The top 10 firms (adding Schering-Plough, Du Pont, Bristol-Myers Squibb, Eli Lilly, and PepsiCo) accounted for 42%. The top 15 (adding Procter and Gamble, Intel, Coca-Cola, Altria, and Motorola) accounted for more than half (52%). A recent report by the Senate Permanent Subcommittee on Investigations (hereafter Subcommittee Report) found a similar concentration using data not publicly available, although the report found the 15th firm to be Oracle rather than Motorola (which ranked 16th).¹⁰

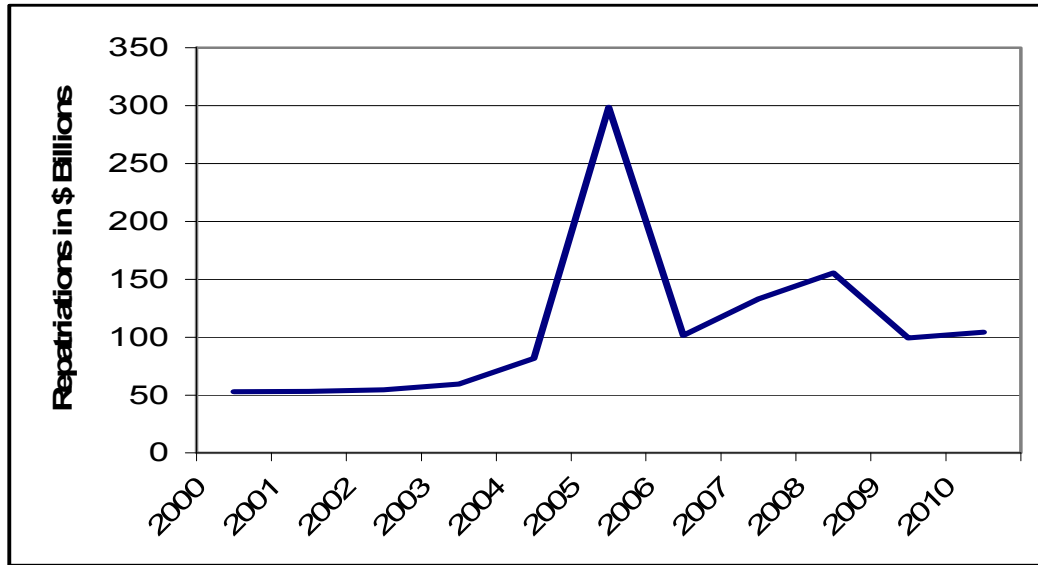
Using an alternative measure of repatriations also shows a large “spike” in repatriations resulting from the American Jobs Creation Act. As seen in **Figure 1**, U.S. multinationals increased their repatriations by approximately 266% from the prior year.

⁷ Melissa Redmiles, *The One-Time Received Dividends Deduction*, Internal Revenue Service, Statistics of Income Bulletin, Washington, DC, spring 2008, <http://www.irs.gov/pub/irs-soi/08codivdeductbul.pdf>.

⁸ Further, the rules associated with repatriation allow firms to “cherry pick” which earnings to repatriate under the holiday—as opposed to repatriating according to aggregate holdings. Evidence from the 2004 repatriation holiday shows that a large majority of funds repatriated were from low-tax countries, preserving most of their foreign taxes paid to offset taxes on repatriations made after the expiration of the holiday and non-dividend income, such as interest and royalties.

⁹ Rodney P. Mock and Andreas Simon, “Permanently Reinvested Earnings: Priceless,” *Tax Notes*, November 17, 2008, pp. 835-848.

¹⁰ U.S. Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Repatriating Offshore funds: 2004 Tax Windfall for Select Multinationals*, Majority Staff Report, October 11, 2011, http://hsgac.senate.gov/public/index.cfm?FuseAction=Press.MajorityNews&ContentRecord_id=f3063308-5056-8059-76ad-ff573eb2df8c.

Figure I. Repatriations by U.S. Multinational Corporations, 2000-2010

Source: Bureau of Economic Analysis, International Transactions, Table 7a.

The empirical evidence also suggests that corporations expect the temporary rate reduction to recur. According to several researchers, unrepatriated earnings have rapidly grown since 2005.¹¹ In fact, since the last repatriation rate reduction, unrepatriated earnings for all corporations have grown by 72% to \$958 billion and by 81% to \$639 billion for firms that repatriated under the American Jobs Creation Act.

Impact on Economic Growth

Given the empirical evidence that a temporary reduction in taxes on repatriated earnings leads to an increase in repatriated earnings, how does this affect economic growth? Two factors that will impact the answer are how the repatriated earnings are used and the role of flexible exchange rates. Simply put, the more the repatriated earnings are used to shore up a corporation's balance sheet or paid to shareholders the less the stimulative effect of the repatriations. On top of that, flexible exchange rates will likely further depress, or perhaps reverse, the stimulative impact of the repatriations.

Use of Repatriated Earnings and Economic Stimulus

Fiscal policy, such as a reduction in the tax rate on repatriated earnings, boosts economic activity by increasing the short-run demand for goods and services. Put bluntly, the earning must be spent, in order to stimulate the economy. With this in mind, the American Jobs Creation Act required

¹¹ Allen Sinai, Macro Economic Effects of Reducing the Effective Tax Rate on Repatriated Foreign Subsidiary Earnings in a Credit- and Liquidity-Constrained Environment, Decisions Economics, Inc, Economic Studies Series, December 11, 2008, http://www.accf.org/media/dynamic/3/media_304.pdf; and Lee A. Shepard and Martin A. Sullivan, "Multinationals Accumulate to Repatriate," Tax Notes, January 19, 2009, pp. 295-298. Thomas J. Brennan, "What Happens After a Holiday? Long-Term Effects of the Repatriation Provision of the AJCA," Northwestern Journal of Law and Social Policy, vol. 5, spring 2010, <http://www.law.northwestern.edu/journals/njls/v5/n1/1/>.

that corporations have an approved plan to reinvest the repatriated earnings prior to claiming the 85% deduction. The main criticism of the reinvestment plan provision was that it allowed an overly generous range of reinvestment options—all but executive compensation and stock repurchase programs—and that it was not explicitly linked to specific uses. Proponents of the reinvestment plan argue that the range of options allowed reflects a recognition of the fungibility of money.

Economic theory finds that changes in the after-tax cost of new investment are most likely to induce new investment. In contrast, incentives which increase after-tax profits (and benefit mainly cash-flow) without changing the incentive for new investment do not generally induce much new hiring or production, because these types of incentives do not alter the conditions of the pre-incentive investment equilibrium.

Two studies have attempted to quantify the impact of cash-flow incentives. According to the Sinai study, instituting repatriation provisions similar to those in the American Jobs Creation Act would have improved the net cash-flow of participating companies by approximately \$535 billion in 2009. The Congressional Budget Office (CBO) estimates that the stimulative impact (or multiplier) of a specific cash-flow proposal, for loss carrybacks, at between 0 and 40 cents of GDP per tax dollar not received.¹² This range of the stimulative effect for loss carrybacks should likely be viewed as an upper-bound estimate for the cash-flow effect of a repatriation rate reduction. This follows from the observation that corporations with current losses—and thus having losses to carryback—are more likely to be cash constrained and able to benefit from a cash-flow provision than the relatively large multinational corporations that are likely to have a better cash-flow position. (By contrast, CBO sets the multiplier for federal spending at 1 to 2.5, for transfer payments at 0.8 to 2.2, and for individual tax cuts at 0.5 to 1.7.)¹³

Which category of incentive a reduction in the tax on repatriated earnings belongs in depends upon the degree to which repatriated earnings change the incentive for new investment. This in turn depends upon the degree to which the reinvestment plan compels investment. Given a weak focus of the reinvestment plan, economic theory suggests that it is likely that a reduction in the tax on repatriated earnings falls into the less stimulative category.¹⁴

Empirical analyses of the stimulative effects of the repatriation provisions in the American Jobs Creation Act also suggest a limited stimulative impact from the provisions. They conclude that much of the repatriated earnings were used for cash-flow purposes and little evidence exists that new investment was spurred.

¹² U.S. Congress, House Committee on the Budget, *The State of the Economy and Issues in Developing an Effective Policy Response*, The Economic Outlook and Budget Challenges, 111th Cong., 1st sess., January 27, 2009.

¹³ The CBO multipliers are similar to those used by other forecasters. See CRS Report R40104, *Economic Stimulus: Issues and Policies*, by Jane G. Gravelle, Thomas L. Hungerford, and Marc Labonte for a complete discussion on multiplier effects.

¹⁴ Dhammika Dharmapala, C. Fritz Foley, and Kristin J. Forbes, “The Unintended Consequences of the Homeland Investment Act: Implications for Financial Constraints, Governance, and International Tax Policy,” unpublished working paper, September 2008; Roy Clemons and Michael R. Kinney, “An Analysis of the Tax Holiday for Repatriations Under the Jobs Act,” *Tax Notes*, August 25, 2008, pp. 759-768; and Jennifer Blouin and Linda Krull, “Bringing it Home: A Study of the Incentives Surrounding the Repatriations of Foreign Earnings Under the Jobs Creation Act of 2004,” Unpublished Working Paper, Wharton School and University of Oregon, July 2008.

Several analysts have used public data sources, such as annual reports and press releases, to report the subsequent actions of participants in the American Jobs Creation Act, primarily firms that repatriated but also reduced employment, a sign that the scale of domestic operations was not increasing. In **Table 1** we summarize selected information from these reports for these firms. Taken together, the firms identified in **Table 1** account for nearly one-third of all repatriations under the American Jobs Creation Act. In general, two trends emerge from these analyses: (1) corporations that used the repatriation provisions were unable to expand domestic operations and (2) corporations in several industries appear to have increased their rate of repatriations after the expiration of the repatriation provisions.

The Subcommittee Report¹⁵ also examined the employment effects in its survey. It found that 10 of the top 15 repatriating corporations had job losses from 2004 to 2007. Oracle, the corporation with the largest gain, had job gains because it acquired other firms.

Table 1. Selected Information on 12 Corporations that Utilized the Repatriation Provisions in the American Jobs Creation Act

| Company | JOBS Act Repatriation Amount (\$ Billions) | Jobs Lost in 2005-2006 | Pre-JOBS Act Accumulation of Foreign Earnings (2 years, \$ Billions) | Post-JOBS Act Accumulated Foreign Earnings (\$ Billions) |
|---------------------------|---|---------------------------|---|---|
| Pfizer | 37 | 10,000 | 29 | 60 |
| CitiGroup | 3.2 | n/a | 6 | 21 |
| Merck | 15.9 | 7,000 | 18 | 17 |
| Hewlett-Packard | 14.5 | 14,500 | 14 | 8 |
| Proctor & Gamble | 10.7 | unspecified # lost | 14 | 17 |
| IBM | 9.5 | n/a | 18 | 18 |
| PepsiCo | 7.5 | 200-250 | 9 | 15 |
| Motorola | 4.4 | unspecified # lost | 6 | 4 |
| Honeywell | 2.7 | 2,000 | 3 | 4 |
| Ford | 0.9 | 30,000-40,000 | n/a | n/a |
| National Semiconductor | 0.5 | 5% of workforce | n/a | n/a |
| Colgate-Palmolive | 0.8 | 4,000 | n/a | n/a |

Sources: Columns 2 and 3: Lee A. Sheppard and Martin A. Sullivan, "Multinationals Accumulate to Repatriate," *Tax Notes*, January 19, 2009, pp. 295-298; and various media reports; Column 4: Sheppard and Sullivan.

These event studies, while informative, are not able to imply any causal relationship between use of the repatriation provisions and subsequent firm responses, because they are unable to compare the response with an alternative response in the absence of use of the repatriation provisions. They also cannot be generalized to other firms.

¹⁵ U.S. Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Repatriating Offshore funds: 2004 Tax Windfall for Select Multinationals, Majority Staff Report, October 11, 2011, http://hsgac.senate.gov/public/index.cfm?FuseAction=Press.MajorityNews&ContentRecord_id=f3063308-5056-8059-76ad-ff573eb2df8c.

Building upon the event study literature, a series of empirical econometric studies have concluded that the American Jobs Creation Act repatriation provisions did not increase domestic economic activity. Dharmapala et al. found that repatriations had a small and statistically insignificant impact both on domestic capital expenditures and employment.¹⁶ Clemons and Kinney, similarly, are unable to find evidence that investment expenditures increased in corporations that used the repatriation provisions of the JOBS Act.¹⁷ Faulkender and Peterson found no effect on investment (actually a negative effect that was statistically insignificant) in the firms that were not capital constrained (who accounted for 73% of repatriations) but found an effect for the firms that were capital constrained, suggesting about overall about 20% of total repatriations were spent on investment.¹⁸ In summary, these studies both found the repatriation provisions to be an ineffective means of increasing economic growth.

There is some empirical evidence, however, that the repatriations were used to return money to shareholders through stock repurchase programs.¹⁹ Dharmapala et al. found that a \$1 increase in repatriations increased stock repurchases by \$0.91, a use prohibited under the American Jobs Creation Act. (Note that because of the fungibility of money, firms that use part of the repatriation to repurchase shares may not violate the law.) Clemmons and Kinney also concluded that the only significant increase in expenditures for participating corporations was on stock repurchases. Another study found similar results, estimating that 20% of the repatriation was used for stock repurchases.²⁰

A study of the uses of repatriated funds and funds freed up by repatriation by Graham, Hanlon, and Shevlin is probably less reliable because the answers to questions could be biased, but, surprisingly, only 6% of repatriating firms surveyed said they had foregone U.S. investment opportunities because of taxes on repatriations.²¹

Several studies have projected, using simulations or multipliers, the overall economic effect of a repatriation holiday. The simulations conducted in the Sinai study for a repatriation holiday in 2009 found that a temporary reduction in the tax on repatriated earnings would have increased domestic economic activity in the 2009-2013 time period.²² They are based on his

¹⁶ Dhammika Dharmapala, C. Fritz Foley, and Kristin J. Forbes, "The Unintended Consequences of the Homeland Investment Act: Implications for Financial Constraints, Governance, and International Tax Policy," unpublished working paper, September 2008.

¹⁷ Roy Clemons and Michael R. Kinney, "An Analysis of the Tax Holiday for Repatriations Under the Jobs Act," *Tax Notes*, August 25, 2008, pp. 759-768.

¹⁸ Michael Faulkender and Mitchell Petersen, *Investment and Capital Constraints: Repatriations Under the American Jobs Creation Act*, October 2011.

¹⁹ In addition to stock repurchases, increasing dividends are a way of returning money to shareholders. Given the temporary nature of the repatriation provisions, however, stock repurchases would be the expected vehicle to return money to shareholders, because they represent less of a commitment to ongoing distributions.

²⁰ Jennifer Blouin and Linda Krull, "Bringing it Home: A Study of the Incentives Surrounding the Repatriations of Foreign Earnings Under the Jobs Creation Act of 2004," Unpublished Working Paper, Wharton School and University of Oregon, July 2008.

²¹ John R. Graham, Michelle Hanlon, and Terry Shevlin, "Barriers to Mobility: The Lockout Effect of U.S. Taxation of Worldwide Corporate Profits," *National Tax Journal*, vol. 63, no. 4, part 2, December 2010, pp. 1111-1144. The authors find that firms report uses of repatriated earnings consistent with the purposes in the law but note that because money is fungible this money could have displaced cash already used for this purpose. Although they asked questions about the uses of freed-up cash, the answers were in a yes or no format and thus could not indicate the distribution of uses even if the responses were deemed reliable.

²² Allen Sinai, *Macro Economic Effects of Reducing the Effective Tax Rate on Repatriated Foreign Subsidiary* (continued...)

macroeconomic model and apparently presume that most of the cash flow would be spent on investment; the results imply a multiplier of 1.13. According to the simulation results, the reduction in the tax on repatriated earnings would increase gross domestic product (GDP) by an average of \$62 billion per year, and business capital spending and research and development by an average of \$7 billion per year. The study also finds an increase in employment that peaks at 614,000 additional jobs in 2011. An earlier study by Shapiro and Mathur during the debate in 2008 uses a mix of methods (non of them a standard macroeconomic stimulus approach) to project unemployment but base their results on the Graham, Hanlon, and Shevlin survey results for repatriated funds, which the authors note is not an appropriate measure of the final effects of repatriations.²³ Neither of these studies took into account the contractionary effects of exchange rate adjustments.

More recent simulation studies that simulated the effects of a new repatriation holiday included Tyson, Serwin, and Drabkin, who projected \$977 billion in repatriations (mostly in 2012) with an eventual output increase of \$178 billion to \$336 billion for implied multipliers of 0.18 to 0.34.²⁴ The upper limit of the effects in this study derived largely from induced investment based on the Faulkender and Petersen study cited above; this induced investment accounted for more than 80% of the stimulus. The remaining effect was largely due to a very small effect from the dividend increases on consumption. In estimating the effects of this study, the authors assumed repatriation amounts that were about 40% larger than the \$700 billion projected by the Joint Committee on Taxation (JCT).²⁵ The JCT limits the repatriation to estimated permanently invested earnings and if this \$700 billion figure were used, the estimates would be \$128 billion to \$242 billion. A study by Doug Holtz-Eakin used the CBO multipliers for the American Recovery and Reinvestment Act²⁶ to project an increase in output of between \$140 billion and \$654 billion with a central tendency of \$360 billion, about 36% of their midlevel repatriation estimate and the midpoint of ARRA multipliers. This multiplier of 0.36 is at the high end of multipliers for cash flow effects and the range of projected repatriations were from \$800 billion to \$1.5 trillion, or 14% to 114% larger than the JEC estimates, with the midlevel repatriation of \$1 trillion 40% higher. If the JCT's estimates of repatriation were used, the effects would be \$260 billion, and if the midpoint of the cash flow elasticities were used, the effect would be \$140 billion. As with the Sinai and the Shapiro and Mathur studies, neither of these studies took into account the contractionary effects of the exchange rate adjustments to repatriation, discussed next.

(...continued)

Earnings in a Credit- and Liquidity-Constrained Environment, Decisions Economics, Inc, Economic Studies Series, December 11, 2008, http://www.accf.org/media/dynamic/3/media_304.pdf.

²³ Robert J. Shapiro and Aparna Mathur Using What We Have to Stimulate the Economy: The Benefits of Temporary Tax Relief for U.S. Corporations To Repatriate Profits Earned by Foreign Subsidiaries, April 2009, http://www.sonecon.com/docs/studies/Report_on_Repatriation-Shapiro-Mathur-Jan2009.pdf.

²⁴ Laura D'Andrea Tyson, Kenneth Serwin, and Eric J. Drabkin, "The Benefits for the U.S. Economy of a Temporary Tax Reduction on the Repatriation of Foreign Subsidiary Earnings," New America Foundation, http://newamerica.net/sites/newamerica.net/files/policydocs/brg_repatriation_tax_paper.pdf.

²⁵ U.S. Congress, Joint Committee on Taxation, *Revenue Estimates for Two Dividends-Received Deductions Proposals*, 112th Cong., 1st sess., April 15, 2011, available at http://doggett.house.gov/images/pdf/jct_repatriation_score.pdf.

²⁶ Douglas Holtz-Eakin, *The Need for Pro-Growth Corporate Tax Reform: Repatriation and Other Steps to Enhance Short- and Long-Term Economic Growth*, Prepared for the U.S. Chamber of Commerce, August 2001, http://www.uschamber.com/sites/default/files/reports/110907_corp_tax_reform_study.pdf.

Exchange Rate Adjustments and Economic Stimulus

The stimulative effect of the reduced tax rate on repatriated earnings is expected to be muted or reversed by the international system of flexible exchange rates and, subsequently, by trade. This effect will occur, because as foreign denominated earnings of foreign subsidiaries are repatriated they are also converted to U.S. dollars. This result increases the demand for dollars, which leads to an appreciation, or increase, in the price of the dollar in foreign exchange markets. This stronger dollar makes U.S.-made exports more expensive and foreign imports less expensive. As a result, net U.S. exports (from reductions in the output of export industries and import competing industries) would decline, further straining the economy and at least partially offsetting any stimulative effect of the repatriated earnings. This effect could make the repatriation holiday contractionary overall during a period of less than full employment.

In recent testimony by the Director of the Congressional Budget Office, the repatriation holiday was rated the lowest per dollar of revenue cost of any of the stimulative options discussed,²⁷ ranging from negligible to very small positive effects. Their estimates assumed that the investment stimulus would be offset by the contraction due to the demand for dollars, with the remaining effect coming from the wealth effect of the tax cut on spending.

Subsequent evidence, not available at the time of this testimony, provides some support for a negative or contractionary effect of the repatriation holiday. The Senate Committee of Permanent Investigations released the results of a survey of 27 multinationals that held \$538 billion out of the \$1.4 trillion of tax deferred earnings.²⁸ These companies held 46% of their deferred earnings in U.S. dollar assets. If this same ratio applied to all repatriated earnings, and no other effects occurred, the contraction in net exports would be the same as the increased inflow from foreign currency, 54% of the repatriated amounts.²⁹ This contractionary effect can be contrasted with the 18% to 34% range largely arising from investment, reported in the Tyson, Serwin, and Drabkin study discussed above. Moreover, with \$700 billion in projected repatriation, a net contractionary effect could be quite significant. Even if the net contractionary effect were only 20% of the total, the contraction would be \$140 billion; this amount is larger in absolute value than the projected stimulative effects of the 2% payroll tax holiday currently under consideration.

While the macroeconomic effects of the repatriation holiday are difficult to project with accuracy, the risk of a contractionary effect, and a significant one, is important to consider.

²⁷ Statement of Douglas W. Elmendorf, Director, Congressional Budget Office, Policies for Increasing Economic Growth and Employment in 2012 and 2013, before the Committee on the Budget, United States Senate, November 15, 2011 http://www.cbo.gov/ftpdocs/124xx/doc12437/11-15-Outlook_Stimulus_Testimony.pdf.

²⁸ Permanent Subcommittee on Investigations, U.S. Senate, Press Release, December 15, 2011. http://hsgac.senate.gov/public/index.cfm?FuseAction=Press.MajorityNews&ContentRecord_id=3e176928-5056-8059-7688-d5fe059c39d0.

²⁹ In equilibrium, the decline in net exports which is a direct component of output would be equal to the net capital inflow converted from foreign currency. This flow could be reduced if interest rates declined and investment increased, although that seems unlikely given the large cash reserves already currently held. It could also be less if the rise in the price of the dollar discouraged other inflows from abroad. At the same time, the repatriation is limited to permanently reinvested earnings (about half of the amounts deferred) and those earnings could be more heavily denominated in foreign currency.

Policy Options

As mentioned above, the main *a priori* criticism of the reinvestment plan provision was that it allowed an overly generous range of reinvestment options—all but executive compensation and stock repurchase programs—and that it was not explicitly linked to specific uses. Empirical evidence has shown these *a priori* concerns to have merit. In addition, concerns have been raised that repeated repatriation holidays may encourage U.S. firms to move operations overseas or engage in profit shifting in anticipation of future repatriation holidays. Finally, a repatriation holiday similar to that enacted in 2004 is estimated to reduce federal receipts by \$78.7 billion over 10 years—some of which would be claimed by firms for actions that would have occurred without a rate reduction.³⁰

Given the prior experience, several options to improve the target efficiency of a dividends-received deduction proposal present themselves. Note that these options are fundamentally limited in their ability to improve the target efficiency of a rate reduction by the fungibility of money.

Incremental “Trigger”

One option to improve target efficiency is to tie the ability to use or the magnitude of the rate reduction to increases in desired activity (such as domestic employment, wages, or investment).³¹ This type of incremental “trigger” would only provide a benefit if increases in desired activity (over past behavior) occur and attempts to address the concern that the money repatriated is insufficiently tied to U.S. outcomes. In practice, such a trigger could be implemented to determine eligibility for the provision as well as create “tiers” of reductions based upon the amount of additional activity. Given difficulties in defining the base, it is a non-trivial exercise, especially in the case of permanent provisions.

Pooled Sourcing of Repatriated Earnings

Pooled sourcing of repatriated earnings would likely reduce the revenue cost of a repatriation holiday and concerns that firms are “cherry picking” earnings to preserve foreign taxes paid for repatriations occurring without a dividends received deduction or for cross-crediting against non-dividend income. Such a modification of the 2004 law could, conceivably, mirror proposals to determine the foreign tax credit on a pooled basis. In practice, such a provision would require that the sourcing of aggregate repatriated earnings be made on a country-by-country basis proportional to the country’s share of retained earnings abroad.

³⁰ U.S. Congress, Joint Committee on Taxation, *Revenue Estimates for Two Dividends-Received Deductions Proposals*, 112th Cong., 1st sess., April 15, 2011. Available at http://doggett.house.gov/images/pdf/jct_repatriation_score.pdf.

³¹ A variation on this theme is present in H.R. 1834 that would reduce provision benefits if employment levels are not maintained. Given the economy’s current economic recovery and the limited gains, to date, in employment since the end of the recession, this restriction may not be binding for many firms.

Combining the Holiday with an Infrastructure Bank

A proposal has recently been made to combine a repatriation holiday with an infrastructure bank, with the tax revenue collected from the repatriation holiday used to finance the bank. The rationale for combining these proposals is not clear because the size of the infrastructure bank would hinge on the small amount of revenue collected initially. Moreover, the revenue loss over the remainder of the 10-year horizon is about four times as large. That is, the short-term revenue gain is about \$26 billion, but will be followed by a subsequent revenue loss of \$105 billion. The net revenue loss for the budget horizon is \$79 billion.³²

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³² U.S. Congress, Joint Committee on Taxation, Revenue Estimates for Two Dividends-Received Deductions Proposals, 112th Cong., 1st sess., April 15, 2011, available at http://doggett.house.gov/images/pdf/jct_repatriation_score.pdf.