

ISSUE BRIEF

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A Repatriation Holiday Would Not Create Jobs

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The House and Senate have convened a conference committee in an attempt to reconcile the very different budgets they passed earlier this year.

Some have suggested that, if the Senate refuses to agree to tax reform in the course of negotiations, the House should seek a repatriation holiday instead.¹ A repatriation holiday would eliminate almost all the tax liability businesses accrued on foreign income.

Mixing tax reform with spending reforms would be a mistake in the budget conference,² as would asking for a repatriation holiday instead, because it would not increase business investment and job creation, as those arguing for it intend.

Repatriation Holiday Would Not Fix Uncompetitive Worldwide System. U.S. multinational businesses are overburdened by the U.S. corporate tax system. The U.S. has the highest corporate tax rate in the developed world,³ and it is essentially the only developed nation that taxes its businesses on the income their foreign subsidiaries earn abroad.

Under this antiquated policy, known as a “worldwide” tax system,⁴ U.S. multinational businesses owe U.S. tax on income their foreign subsidiaries earn when they bring those earnings back to the U.S. in the form of dividends (known as “repatriation”) if the subsidiaries paid less tax on their income than

they would have if they earned the income in the U.S. The worldwide system badly damages the competitiveness of U.S. businesses and is long overdue for reform.

Lifting this onerous burden from businesses by eliminating worldwide taxation would make more investments viable, which would increase job creation and raise wages. Supporters of a repatriation holiday are right to seek these beneficial impacts, but their immediate objective should be abolishing the worldwide system, which would free U.S. multinationals to increase investment.

Repatriation Holiday Would Not Increase Investment or Job Creation. According to one estimate, U.S. businesses hold accumulated foreign earnings of almost \$2 trillion offshore.⁵ Many businesses leave a large portion of those earnings abroad to pursue new opportunities in growing foreign markets. However, they undoubtedly also leave a substantial remaining portion abroad to logically delay payment of the U.S. tax.

A repatriation holiday would remove almost all the accrued tax liability on that income if businesses repatriate their foreign income to the U.S. during a certain period of time. The thinking is that businesses would invest domestically the large amounts of money they would bring back, which would mean more jobs and higher wages.

Businesses, like individuals, respond to incentives. If the U.S. offered a repatriation holiday, businesses would no doubt bring large amounts of foreign earnings back to the U.S. to reduce their deferred tax liability. Indeed, the last time the U.S. offered a repatriation holiday in 2004 businesses brought back \$362 billion.⁶

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However, the holiday did not have the anticipated positive economic benefit.⁷ Cutting taxes is generally a good thing, but it must be done in the right way to achieve its intended results. A repatriation holiday increases investment only if businesses face domestic cash constraints preventing them from acquiring the capital necessary to make planned investments. At the time of the 2004 holiday, businesses had ample cash on hand and ready access to capital in credit markets at reasonable rates.⁸ Since the businesses did not need the overseas cash to invest domestically, they brought it home and used it to pay dividends to shareholders, buy back shares, or acquire other businesses.

The 2004 holiday was supposed to prevent them from doing these things, but money is fungible, so there was no realistic way to stop it.

There is certainly nothing wrong with paying dividends, buying back shares, or acquiring other businesses, however these actions do not directly or necessarily increase businesses' investment and job growth—the purpose of the holiday.

Dividends do not increase investment because they are portfolio shifts for shareholders. Stock buy-backs slightly raise stock prices and potentially increase shareholder value if they are done when shares are undervalued relative to future anticipated

cash flows, but neither encourages investment or job growth. And acquisitions can improve efficiency but may or may not create jobs, even if businesses needed their overseas cash to carry them out.

Another holiday today would have a similar negligible impact on business investment and job creation, because businesses are again not cash constrained. Businesses had almost \$1.7 trillion of domestic after-tax net profits in the second quarter of 2013 at an annualized rate⁹ and even greater accumulations of cash. If they do not have enough cash or do not want to use it to fund investments, credit markets are functioning well and offering low interest rates. If they want to invest right now, businesses have access to the necessary capital to do so.

Although the law authorizing the holiday would likely specify that business could not use repatriated funds for purposes other than investment, job creation, or wage increases, because of the fungibility of money, little can be done to prevent businesses from using the funds the same way they did after the 2004 holiday.

Repatriation Holiday Is Backward Looking.

Another holiday would do nothing to encourage investment in the long run either, since it would absolve businesses of tax liabilities they have already accrued. Businesses decided how to invest

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1. Heidi Przybyla, "Budget Panel Taking Up Spending Cuts as Expectations Low," Bloomberg, October 28, 2013, <http://www.bloomberg.com/news/2013-10-28/budget-panel-taking-up-spending-cuts-as-expectations-low.html> (accessed October 28, 2013).
 2. See Curtis S. Dubay, "Leave Tax Reform and Tax Increases Out of Budget Conference," Heritage Foundation *Issue Brief* No. 407, October 29, 2013, <http://www.heritage.org/research/reports/2013/10/leave-tax-reform-and-tax-increases-out-of-budget-conference>.
 3. See Curtis S. Dubay, "U.S. to Have Highest Corporate Tax Rate in the World," The Heritage Foundation, *The Foundry*, December 15, 2010, <http://blog.heritage.org/2010/12/15/u-s-to-have-highest-corporate-tax-rate-in-the-world/>.
 4. See Curtis S. Dubay, "A Territorial Tax System Would Create Jobs and Raise Wages for U.S. Workers," Heritage Foundation *Background* No. 2842, September 12, 2013, <http://www.heritage.org/research/reports/2013/09/a-territorial-tax-system-would-create-jobs-and-raise-wages-for-us-workers>.
 5. Dena Aubin, "U.S. Companies' Overseas Earning Hit Record \$1.9 Trillion: Study," May 8, 2013, <http://www.reuters.com/article/2013/05/08/us-usa-taxes-overseas-idUSBRE9470Z920130508> (accessed October 25, 2013).
 6. Melissa Redmiles, "The One-Time Received Dividend Deduction," Internal Revenue Service *Statistics of Income Bulletin*, Spring 2008, <http://www.irs.gov/pub/irs-soi/08codivdeductbul.pdf> (accessed October 24, 2013).
 7. Dhammika Dharmapala, C. Fritz Foley, and Kristin J. Forbes, "Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act," National Bureau of Economic Research *Working Paper* No. 15023, June 2009, <http://www.nber.org/papers/w15023> (accessed October 24, 2013); and Michael Faulkender and Mitchell Petersen, "Investment and Capital Constraints: Repatriations Under the American Jobs Creation Act," National Bureau of Economic Research *Working Paper* No. 15248, August 2009, <http://www.nber.org/papers/w15248.pdf> (accessed October 24, 2013).
 8. See J. D. Foster and Curtis S. Dubay, "Would Another Repatriation Tax Holiday Create Jobs?," Heritage Foundation *Background* No. 2610, October 4, 2011, http://www.heritage.org/research/reports/2011/10/would-another-repatriation-tax-holiday-create-jobs#_ftn10.
 9. See U.S. Department of Commerce, Bureau of Economic Analysis, "National Income and Product Accounts," Table 11 ("Corporate Profits: Level and Percent Change"), September 26, 2013, http://www.bea.gov/newsreleases/national/gdp/2013/pdf/gdp2q13_3rd.pdf (accessed October 24, 2013).

or distribute the after-tax profits when they earned them. Eliminating previously accrued tax liability would not change decisions that were made long ago.

It would, however, create a tax windfall for the businesses that repatriate funds, because it would remove the accrued foreign tax liability from their financial statements. This would improve these businesses' financial standing and benefit current management, but it would do nothing to make profitable potential investments that the worldwide system currently makes unprofitable. Nor would a holiday create new opportunities for businesses to invest.

Focusing on a temporary and ultimately unproductive repatriation holiday would distract from the ongoing legislative efforts by the House Ways and Means Committee to establish a much-needed "territorial" system.¹⁰

And since a repatriation holiday is closely tied to a territorial system in many people's minds, the inevitable failure of the holiday could hurt the

credibility of those arguing—correctly—that a territorial system would succeed at increasing investment and job creation.

Focus on a Permanent Territorial System. Instead, a forward-looking policy change is needed to lower government-imposed burdens on potential investments to make more of them viable. A permanent switch to a territorial system would serve that purpose.¹¹

The budget conference should not consider a repatriation holiday in its negotiations, and Congress should drop such efforts altogether. Those concerned about the competitiveness of U.S. businesses and increasing investment should instead assist ongoing efforts to establish a permanent territorial system that would succeed where a repatriation holiday would surely fail.

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10. U.S. House of Representatives, Committee on Ways and Means, "Technical Explanations of the Ways and Means Discussion Draft Provisions to Establish a Participation Exemption System for the Taxation of Foreign Income," October 26, 2011, http://waysandmeans.house.gov/uploadedfiles/final_te_-_ways_and_means_participation_exemption_discussion_draft.pdf (accessed October 24, 2013).

11. See Dubay, "A Territorial Tax System."