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Changes to Repatriation Policy Best Left to Tax Reform

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There is renewed discussion in Washington of changing the tax treatment of businesses' foreign earnings (known as repatriation). There are several proposals to use such changes to fill the gap between spending and revenue in the Highway Trust Fund (HTF), and possibly pay for additional transportation spending.

Under current law, U.S. businesses pay tax on their worldwide income when they repatriate those earnings back to the U.S. The U.S. is effectively the only country that taxes its businesses' foreign earnings, and fixing that glaring flaw by instituting a territorial system is a major objective of tax reform.

The goal of achieving a territorial system, however, has been confused with other changes to repatriation policy that would not have similar economic benefits. Furthermore, it is poor policy to use money raised by changing the taxation of multinational businesses' foreign earnings for transportation, or any other spending for which Congress wants revenue.

Repatriation Holiday Would Have Minimal Economic Impact

There are two versions of changes to repatriation policy making the rounds in Washington. The first involves granting businesses a repatriation holiday, during which Congress would allow businesses to bring back foreign earnings and pay a lower tax than they would under current law. Congress granted a similar holiday in 2004, and talk of another occurred in 2011 and 2013.[1]

The argument in favor of a holiday, in addition to using the money for the HTF, is that it would help the economy.

There is no doubt that the worldwide system of taxing U.S. businesses on their foreign earnings is an anachronism that is depressing domestic investment and stifling wage growth and job creation for American workers.[2] However, a repatriation holiday is not the way to rectify the problem because it cannot fix the past.

U.S. businesses have already accrued domestic tax liability on their previously earned foreign income. Businesses decided how to invest or distribute the after-tax profits when they earned them. Eliminating previously accrued tax liability would not change decisions they made long ago.

To grant them relief from that liability with a holiday would be a retroactive tax windfall because it would wipe that accrued liability off their books. This would make the big businesses that take advantage of the holiday more profitable on their books. While a boon for the management of those businesses, it would not create jobs by boosting investment domestically because businesses' incentives for investing would not increase. Given ongoing efforts to stamp out cronyism, a repatriation holiday is an odd choice at present since the businesses that would benefit would all be large multinational ones.

For a holiday to increase investment and create jobs in the U.S., businesses need to be capital constrained. That means that they either have little

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domestic cash on hand, or financial markets need to be tight and offering only high-interest rates. Neither condition holds right now. Businesses have plenty of retained earnings to finance any investments they want to make and financial markets are functioning well and offering low rates.

Shareholders of businesses that use the holiday would likely see increased dividend payouts, even if the law forbade repatriated funds from being used for that purpose.[3] There is certainly nothing wrong with businesses bringing more money back to the U.S., nor is there anything wrong with companies paying more dividends. But more dividend payouts would only be a portfolio shift since the stock price should already reflect the foreign earnings of the business. It would not provide an economic stimulus.

Revenue Impact of a Holiday Is Questionable

It is questionable whether a holiday would lower or raise revenues in the traditional 10-year budget window. Whether it does or does not depends almost entirely on how much foreign income the Joint Committee on Taxation (JCT) anticipates businesses will repatriate over the next decade under current law. However, given a one-year or two-year span, there is little doubt that a holiday would shift revenue forward to those years. Hence, a holiday could raise more revenue in those years even though it would cut taxes over the entire 10-year period relative to the current baseline.

Since Congress is beholden to the 10-year window, some have floated a more troubling change to repatriation policy that would unambiguously raise revenue in that window.

Deemed Repatriation: It's a Tax Hike

A policy known as "deemed repatriation" would undoubtedly raise revenue because it would be a tax hike. In addition to that, it is also more troubling than a holiday because it is compulsory rather than voluntary.

Under a repatriation holiday, businesses *choose* whether they want to exploit the lower tax rate on their foreign earnings. Under deemed repatriation, they have no choice. Instead, it assumes they have already brought all their accumulated foreign earnings back to the U.S. and applies a tax on that income immediately, even if businesses never actually bring the money back to the U.S. or never intended to do so.

It is a tax hike because a portion of the income that would be taxed would be money that businesses decided to permanently invest offshore. Because businesses do not pay tax on their foreign income until they return it to the U.S., they would have never paid U.S. tax on that income.

President Barack Obama's fiscal year 2016 budget includes a version of this problematic idea. He would apply a 14 percent tax on foreign income deemed repatriated and use the money for the HTF and for a six-year surface-transportation reauthorization.[4] There are similar proposals in Congress.[5]

Congress should be working to eliminate tax on businesses' foreign earnings through tax reform. Raising taxes on that income through deemed repatriation goes in the wrong direction.

Repatriation Wrong Way to Pay for HTF and Other Spending

Even if changes in repatriation policy provided an economic boost or did not raise taxes, it would still be

1. J. D. Foster and Curtis Dubay, "Would Another Repatriation Holiday Create Jobs?" Heritage Foundation *Backgrounder* No. 2610, October 4, 2011, http://www.heritage.org/research/reports/2011/10/would-another-repatriation-tax-holiday-create-jobs, and Curtis Dubay, "A Repatriation Holiday Would Not Create Jobs," Heritage Foundation *Issue Brief* No. 4078, October 31, 2013, http://www.heritage.org/research/reports/2013/10/impact-of-repatriation-holiday-on-the-economy-jobs-and-investment.
2. Curtis Dubay, "A Territorial Tax System Would Create Jobs and Raise Wages for U.S. Workers," Heritage Foundation *Backgrounder* No. 2843, September 12, 2013, http://www.heritage.org/research/reports/2013/09/a-territorial-tax-system-would-create-jobs-and-raise-wages-for-us-workers.
3. Jennifer L. Blouin and Linda K. Krull, "Bringing It Home: A Study of the Incentives Surrounding the Repatriation of Foreign Earnings Under the American Jobs Creation Act of 2004," Social Science Research Network, July 21, 2008, http://ssrn.com/abstract=925348 (accessed February 10, 2015).
4. Office of Management and Budget, "Fiscal Year 2016 Budget of the U.S. Government," February 2015, http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/budget.pdf (accessed February 10, 2014).
5. Deirdre Shesgreen, "Bipartisan Bill Could Break Highway Funding Gridlock," *USA Today*, January 28, 2015, http://www.usatoday.com/story/news/politics/2015/01/28/roy-blunt-highway-funding-congress/22479423/ (accessed February 10, 2015).

the wrong choice for funding the HTF. Highways have traditionally been funded on the user-pays principle as exemplified by the gas tax. Congress should not break that commonsense policy by tapping the foreign incomes of multinational businesses.[6]

Furthermore, either a repatriation holiday or deemed repatriation would be a temporary fix. Congress would be back looking for other sources of revenue in a few years if it took this path. It should instead focus on other reforms to the highway program that would be sustainable, would not break the user-pays principle, and would not raise taxes.

Using repatriation to pay for any new spending is the wrong approach. Members of Congress should not look to taxes on offshore earnings as a reservoir to tap when they want more money to spend.

Repatriation Changes Best Left to Tax Reform

Changes to repatriation policy are best left to tax reform. For instance, in his tax reform proposal, then-Chairman of the House Ways and Means Committee Dave Camp (R–MI) incorporated deemed repatriation as a transition method to a territorial system.[7]

This was acceptable because it was part of broader tax reform—it was not a tax hike and it made way for a territorial system. Taking changes to policy on previously earned foreign income off the table by misguidedly using them to pay for transportation would make achieving tax reform more difficult.

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6. Emily Goff, "Empowering the States by Turning over the Federal Highway Program," Heritage Foundation *Issue Brief* No. 4087, November 15, 2013, http://www.heritage.org/research/reports/2013/11/impact-of-turning-over-the-federal-highway-program-to-the-states.
7. Curtis Dubay and David Burton, "Chairman Camp's Tax Reform Plan Keeps Debate Alive Despite Flaws," Heritage Foundation *Backgrounder* No. 2890, March 14, 2014, http://www.heritage.org/research/reports/2014/03/chairman-camps-tax-reform-plan-keeps-debate-alive-despite-flaws.