Don't Fall For Corporate Repatriation

William G. Gale, Benjamin H. Harris

June 27, 2011
Published by Politico

ABSTRACT

In a contribution to Politico, Bill Gale and Ben Harris discuss a tax holiday on repatriated funds.

POLITICO:
DON'T FALL FOR CORPORATE REPATRIATION

Some observers are calling for a "repatriation holiday" on profits held by foreign subsidiaries. Some members of Congress, eager to stimulate our fragile economy, are listening.

They shouldn't. A tax holiday on repatriated funds is a proven failure — expensive in both direct and indirect ways. It was already tried in 2004 and didn't work.

A repatriation holiday would allow corporations to transfer profits from foreign subsidiaries to the U.S. parent company at a steep tax discount. Now, corporations can defer U.S. corporate tax on overseas income until profits are transferred back to the parent company.

Repatriation could allow a large proportion of foreign profits — probably 85 percent — to be distributed tax-free to the U.S. This would essentially reduce the effective tax rate to just 5.25 percent from 35 percent.

This sounds like it should be an effective strategy for jump-starting the economy. U.S. firms have roughly $1.5 trillion sitting on foreign balance sheets. In theory, that money could be put to productive uses in the U.S. economy.

But the idea is replete with problems. In many cases, these corporations have already accrued profits tax-free using techniques that shift reported income to tax havens like Bermuda or the infamous "Dutch sandwich," which was used by Google to avoid an enormous amount of tax. Certainly, taxes ought to be paid at some point.

In addition, firms are unlikely to invest the repatriated funds. Congress passed a similar repatriation tax holiday in 2004 and required firms to create domestic jobs or make new domestic investments to get the tax break. Nonetheless, the firms, on average, used the tax break to repurchase shares or pay dividends — not to increase investment.

The holiday, instead, turned into a massive tax break for shareholders — resulting in little or no economic gain or job market expansion. Why? Because money is fungible, to satisfy the requirements of the law, corporations reported repatriated funds as the source of money for investments or jobs they would have created anyway — and used other funds to increase shareholder wealth.

Today, domestic firms are sitting on near-record levels of liquid assets. The reason they're not investing or creating more jobs is not a cash shortage. Allowing them to repatriate foreign profits at low tax rates would only heap more cash onto their already huge stockpile.

There are also substantial costs associated with a repatriation holiday. First, allowing repatriation today means less taxable corporate profits in the future — which would translate into less government revenue.

Second, and perhaps even more costly than the lost revenue, would be the dangerous precedent that firms would expect regular repatriation holidays. This expectation may persuade firms to hoard profits overseas and perhaps even move production abroad, betting that Congress will eventually grant another "one-time" tax break.

Indeed, the prior tax holiday was supposed to discourage firms from holding profits overseas. But instead, firms stockpiled new reserves, presumably in anticipation of another holiday. The Joint Committee on Taxation estimates that these two factors would contribute to the $79 billion 10-year price tag on a second repatriation.

For years, companies that invest overseas claimed this practice bolsters U.S. jobs. Now, they argue sending the money back to the U.S. would spur economic expansion. They should make up their minds.

Reed Hundt of the Coalition for Green Capital and Thomas Mann of the Brookings Institution recently proposed a variant of the tax holiday. Their plan would allow firms to repatriate profits tax-free — if the funds are invested in an infrastructure bank. Given the current political divide, they argue this is the only way to increase U.S. investment in infrastructure.

While we agree smart infrastructure investment can help the economy, whatever the merits of an infrastructure bank, coupling it with a corporate tax holiday on repatriated funds is not a worthwhile idea. This is just the latest effort to marry a repatriation holiday with something productive — just as Congress made the link to domestic job creation and investment in 2004.

The notion that an infrastructure bank could be funded only from corporations' foreign stash of cash is untenable. There is plenty of money available to fund U.S. infrastructure. Multinational firms, for example, could use some of their cash to fund such a bank, if it were created. The U.S. also has access to large amounts of cheap capital from world financial markets.

The Treasury shouldn't become the Charlie Brown of the tax world — repeatedly being tricked into trying to kick a football that isn't there. We do need to stimulate a wavering economy and reform our tax system. But periodic tax holidays on repatriated funds are not the way to achieve either goal.

William G. Gale is the Arjay and Frances Fearing Miller chair in federal economic policy at the Brookings Institution and co-director of the Urban-Brookings Tax Policy Center. Benjamin H. Harris is a research economist at Brookings and is affiliated with the Urban-Brookings Tax Policy Center.