Q. What is the TCJA repatriation tax and how does it work?

A. The Tax Cuts and Jobs Act repatriation tax is a one-time tax on past profits of US corporations' foreign subsidiaries.

Before the 2017 Tax Cuts and Jobs Act (TCJA), the United States generally taxed its corporations and residents on their worldwide income. However, a US corporation could defer foreign income by retaining earnings indefinitely through a foreign subsidiary. The US corporation would pay US tax on the foreign earnings only when they were repatriated (by a dividend from the foreign subsidiary, for example). Upon repatriation, the earnings would be subject to US taxation at a rate up to 35 percent, with a credit for foreign taxes paid. The repatriation typically resulted in a net US tax obligation because the US tax rate was usually higher than the foreign tax rate. As of 2015, US corporations accumulated more than $2.6 trillion of earnings in foreign subsidiaries, according to the Joint Committee on Taxation.

Pursuant to the TCJA, the United States now generally exempts the earnings of a US firm from active businesses of foreign subsidiaries, even if the earnings are repatriated (i.e., there now is a 100 percent dividend-received deduction). But, as a transition to the new system and to avoid a potential windfall for corporations that had accumulated unrepatriated earnings abroad, the new law taxes these earnings as if they were repatriated but at preferred lower rates.

There are two tax-preferred rates for the foreign earnings deemed repatriated: foreign earnings held in cash and cash equivalents were taxed at 15.5 percent and those not held in cash or cash equivalents at only 8 percent. The TCJA permits a US corporation to pay any tax on the deemed repatriations in installments over eight years. The tax revenue raised by this transition tax on earnings accumulated abroad was estimated at $340 billion over the 10 years from 2018 to 2027.

Further Reading

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