PROPOSED TAX BREAK FOR MULTINATIONALS
WOULD BE POOR STIMULUS
“Dividend Repatriation Tax Holiday” Failed in 2004, Unlikely to Work Now
by Chye-Ching Huang

The Business Roundtable and Chamber of Commerce have proposed resurrecting, as a stimulus measure, the 2004 “dividend repatriation tax holiday,” which allowed firms to bring their foreign-generated profits back to the United States at a greatly reduced tax rate. The Joint Committee on Taxation estimates this proposal would cost $16 billion over ten years.¹

Yet the evidence shows that the 2004 tax holiday did little more than give windfall profits to a small number of large multinational corporations and did not lead to increased investment and jobs in the United States. Indeed, as a recent Goldman Sachs analysis concluded, this idea is more likely to help corporations’ balance sheets than to stimulate demand.²

Resurrecting the tax holiday would also encourage corporations to shift profits and jobs out of the United States by increasing the tax advantages of foreign over domestic investment. That is likely why Congress, when it enacted the 2004 measure, explicitly stated that it should be a one-time-only tax break that should not be repeated.


What Is a Dividend Repatriation Tax Holiday?

U.S. firms with overseas subsidiaries can generally defer paying U.S. income tax on their foreign earnings until they “repatriate” (send back) those earnings to the United States. This effectively allows such firms to delay indefinitely paying U.S. corporate income tax on their overseas profits. In 2004, Congress enacted a “dividend repatriation tax holiday” that allowed firms to bring their foreign-generated profits back to the United States at a greatly reduced tax rate — 5.25 percent, instead of the normal 35 percent corporate tax rate — for one tax year. Not only could firms defer paying corporate income tax on their foreign earnings, but the “holiday” then allowed them to largely escape that tax altogether.

To take advantage of the tax break, a firm was supposed to draft and adhere to a “dividend reinvestment plan” stating what “permitted investments” the firm would make with the repatriated earnings. Permitted investments included: hiring and training U.S.-based workers, investing in infrastructure located in the United States, research and development, and marketing performed in the United States. The law barred firms from spending earnings repatriated under the holiday on executive compensation, shareholder dividends, and stock buy-backs, among other things. These restrictions were supposed to ensure that firms reinvested the repatriated earnings in the United States and thereby boosted the U.S. economy.

Then as now, proponents of the tax holiday advocated it as an economic stimulus measure, predicting that “a repatriation holiday would produce a significant increase in the U.S. Gross Domestic Product, a large increase in capital spending, and a fall in the unemployment rate in the second year after enactment.” There is no evidence, however, that the holiday had any of these effects. Moreover, there is strong evidence that the restrictions Congress imposed on the use of the repatriated earnings were ineffective.

---

3 To qualify for this treatment, the earnings must be derived from “active” business operations in the foreign jurisdiction, among other requirements.

4 Altshuler, Auerbach, Cooper, and Knittel describe the current system of taxing the foreign earnings of U.S. corporations as follows: “Under current U.S. tax law, both the domestic and foreign earnings of U.S. corporations are subject to U.S. taxation. If foreign operations are organized as subsidiaries (i.e., they are separately incorporated in the foreign country), then active business profits are not generally taxed until they are remitted to the U.S. parent corporation. To alleviate the double taxation of foreign source income, firms are allowed to claim credits for income taxes paid to foreign governments against U.S. tax liability on foreign source income. The credit is limited to the U.S. tax liability on the foreign source income. If a firm’s foreign tax payments are less than the limitation, the firm pays a ‘repatriation tax’ equal to the difference between the U.S. and the foreign tax on the income remitted.” See Altshuler et al., “Understanding U.S. Corporate Tax Losses,” NBER Working Paper 14405, http://www.nber.org/papers/w14405.

5 The holiday is also sometimes referred to as “Section 965.”


7 Mock and Simon.

8 Lee A. Sheppard and Martin A. Sullivan, “Repatriation Aid for the Financial Crisis?” Tax Notes, January 5, 2009.
2004 Tax Holiday Did Not Boost U.S. Investment or Hiring

The 2004 dividend repatriation tax holiday induced firms to rush to repatriate their earnings at the temporarily lower rate. Some $315 billion in earnings were repatriated under the holiday. But studies show that firms effectively used these earnings overwhelmingly for purposes Congress had sought to prohibit, such as share buy-backs. There is no evidence that the holiday led either to an increase in the investments Congress sought or to increased hiring.

Analyses have found no evidence that firms used earnings repatriated under the holiday to fund growth by increasing expenditures on permitted investments or to create jobs:

- A 2008 study found that “[higher] levels of repatriations … were not associated with increased domestic capital expenditures, domestic employment, or research and development expenditures.”

It also found that “firms that increased contributions to Congressmen responsible for drafting the [tax holiday] and belonged to a lobbying coalition that asserted that the tax holiday would allow them to increase domestic investment did not significantly increase their domestic expenditures.”

- Another study found that “firms enjoying disproportionately larger gains under the act were no more likely to spend repatriated funds on growth-generating activities than other firms.”

- Other studies found that many firms laid off workers even as they reaped substantial benefits from the tax holiday and passed them on to shareholders. One analysis reported that “Pfizer, for example, which took advantage of the [holiday] and repatriated the largest amount (around $37 billion), started a number of layoffs in its U.S. workforce (around 3,500 jobs) and closed U.S. factories in 2005.”

Other companies that took advantage of the holiday but laid off workers shortly thereafter included Ford Motor Company (which repatriated around $850 million under the holiday but then began laying off about 10,000 U.S. workers in 2005), Merck (which repatriated $15.9 billion but announced layoffs of 7,000 workers in 2005), Motorola, Procter & Gamble, PepsiCo, and Honeywell International.

---


10 See text below, and also see Sheppard and Sullivan.

11 Dharmapala, Foley, and Forbes.

12 Dharmapala, Foley, and Forbes.


Studies also found that instead of increasing permitted domestic investment or hiring more workers, firms effectively were able to use earnings repatriated under the holiday for purposes that Congress had barred, such as stock repurchases:

- Before the holiday took place, a J.P. Morgan Chase survey found that most firms intended to use their repatriated funds for repurchasing stock or paying dividends. The firms surveyed eventually accounted for about 25 percent of all earnings repatriated under the holiday.15

- Subsequent analysis found that repatriated earnings were spent mostly on share repurchases, a prohibited expenditure. One study found, “Firms that valued the tax holiday the most and took greatest advantage of it did not increase domestic investment or employment, but instead returned virtually all of the cash they repatriated to shareholders.”16

- Other analysts noted that the “dividend reinvestment plans” that firms had to file did not prevent them from effectively using repatriated funds for prohibited purposes: “[nothing] could stop them from doing whatever they wanted with the money.”17 This is because money is fungible: companies could list approved purposes in their plans but then use the earnings “to replace other planned spending [for the approved purposes] while engaging in new spending on prohibited purposes.”18

In short, the evidence suggests that the dividend repatriation tax holiday failed in its objective to encourage firms to increase their U.S. investment and hiring. Instead, these firms — predominantly large multinational corporations19 — effectively passed the earnings repatriated under the holiday to their shareholders.

No Reason to Expect Better Results This Time

Despite the damning evidence cited above, some businesses and policymakers are now advocating another such tax holiday, arguing once again that it would lead to increase U.S. investment and job creation20. They argue that a dividend repatriation tax holiday would be good stimulus because firms are facing liquidity problems that the holiday could relieve.21


16 Dharmapala, Foley and Forbes.


18 Sheppard and Sullivan.


20 See for example, Allen Sinai, “Macroeconomic Effects of Reducing the Effective Tax Rate on Repatriated Foreign Subsidiary Earnings in a Credit- and Liquidity-Constrained Environment,” Decision Economics, Study performed by Decision Economics, Inc. (DE) for the American Council on Capital Formation, revised December 7, 2008. Also see the critique of this study by Lee A. Sheppard and Martin A. Sullivan, “Repatriation Aid for the Financial Crisis?” Tax Notes, January 5, 2009.

Proponents used this same argument in 2004. But the evidence shows that “despite the arguments of legislators and the assertions of lobbyists, U.S. multinationals did not respond in a way that is consistent with their facing domestic financial constraints.”

Multinational corporations passed repatriated cash to shareholders instead of investing it, which suggests they were not especially capital-constrained.

To be sure, some businesses may be more cash-constrained now than in 2004, but there are two key reasons to be wary of the argument that a dividend repatriation holiday would be a sound way to address those liquidity constraints.

- **During a recession, the primary problem that firms usually face is a shortage of demand for their products, not a shortage of cash.** Without sufficient demand, firms benefiting from another tax holiday would likely retain the repatriated earnings and the accompanying tax windfall or pass them on to shareholders and business owners, two groups that tend to have higher incomes and thus to save, rather than spend, additional income that they receive.

- **A dividend repatriation tax holiday would be a poor way of getting cash to the firms that might actually spend it on domestic investment or hiring.** A dividend repatriation tax holiday is an extremely targeted tax break that only a small number of firms are likely to benefit from directly. There is no evidence these firms need more relief from credit constraints than other U.S. firms.

During the last dividend repatriation tax holiday, only about 843 corporations — most of them large multinationals — applied for the holiday, out of roughly 9,700 corporations that had offshore subsidiaries.”

The Congressional Research Service recently concluded that even if some firms are currently credit-constrained and cash flow might have an effect on their levels of investment, this would likely apply primarily to small firms.

Moreover, the only firms that could benefit from a tax holiday are those that have accumulated profits in foreign subsidiaries; the more such profits a firm holds, the more it stands to benefit from the holiday. Companies that have accumulated considerable foreign profits are not likely to be especially credit-constrained or in need of liquidity.

Not only would a dividend repatriation tax holiday likely benefit only a small number of large multinationals, but those firms are likely to be concentrated in just a few industries. Of the earnings repatriated under the 2004 holiday, large pharmaceutical and bank holding companies together accounted for half of all repatriations, with pharmaceutical companies accounting for

---

22 Dharmapala, Foley, and Forbes.
23 Dharmapala, Foley, and Forbes.
24 Mock and Simon.
27 Sheppard and Sullivan.
about one-third (and Pfizer alone accounting for one-tenth) of repatriations. There is no compelling reason to think that in the current recession, large multinationals in these specific industries have a particularly pressing need for credit that smaller firms and firms in other industries do not have, and that these large multinationals deserve a lucrative tax break that would flow overwhelmingly to them.

All of these factors suggest that targeting tax relief to large multinational corporations via a dividend repatriation tax holiday is not likely to get cash to the firms most likely to spend it quickly on new investments in the United States. Policymakers should be extremely skeptical of the claim that despite the evidence that the 2004 holiday failed as stimulus, the results would be different a second time.

**Congress Said 2004 Tax Holiday Should Not Be Repeated**

When it enacted the 2004 dividend repatriation tax holiday, Congress explicitly stated that it should not be repeated: “[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.” Ignoring this intention and resurrecting the tax holiday would lead U.S. multinationals to expect more such tax holidays in the future. That, in turn, would give them a powerful incentive to keep or even shift profits and jobs out of the United States in anticipation of the next tax holiday.

Most of the funds repatriated under the 2004 holiday came from low-tax countries and tax havens, including the Netherlands, Luxembourg, Bermuda, and the Cayman Islands. As two journalists who examined this issue noted, “[it] is important to step back and consider how all these funds got bottled up in low-tax countries. It’s not just the result of U.S. multinationals investing in plant and equipment in attractive low-tax, low-wage locations. U.S. multinationals engage in aggressive tax planning . . . in order to shift profits out of the United States and other high-tax countries and into havens like Ireland and Bermuda.”

They also observed, “[repeated] tax holidays would mean that over the long term, the tax cost of overseas investment by U.S. multinationals would be reduced, just as if the law provided a tax credit for foreign investment. So the economic effect would be to further increase the tax advantages of foreign over domestic investment in the long term.” Finally, “the turbocharge created when low foreign rates are combined with easy profit shifting would encourage further foreign investment and foreign job creation.”

Analysts have observed that multinationals already are shifting earnings overseas in anticipation of a new tax holiday. Another holiday would confirm that this is the right corporate strategy and

---

28 Sheppard and Sullivan.


31 Sheppard and Sullivan.

32 Sheppard and Sullivan.

33 Sheppard and Sullivan.

34 Sheppard and Sullivan.
encourage such firms to keep shifting profits overseas.

Repeated temporary tax provisions also constitute unsound tax policy. Such measures create uncertainty and reduce corporations’ ability to plan for their tax liability in advance. They also create inequities between similar corporations: a firm that repatriated its earnings just before the announcement of a repatriation tax holiday could see competitors that had not yet repatriated their earnings getting a tax windfall out of the holiday.

Some commentators have warned that business interests will press for repeated tax holidays until there is international tax reform that removes the incentive for corporations to delay paying U.S. income tax by sheltering their profits overseas. The solution, however, is not repeated tax holidays that constitute unsound economic and tax policy, but rather to tackle the underlying problem.

Conclusion

A dividend tax repatriation holiday failed as economic stimulus in 2004, and there is no evidence that repeating it would produce different results under current conditions. Instead, it would create an additional incentive for multinational companies to shift profits and jobs out of the United States, weakening the U.S. economy in the long run.

---


36 Numerous reforms have been proposed, including limiting the ability of multinationals to claim deductions against foreign earnings, moving toward a “territorial” system of taxation, and imposing U.S. taxes on foreign-earned income when it is earned rather than when it is repatriated.