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ANALYSIS OF THE REVENUE EFFECTS OF S. 1671, A PROPOSAL TO ALLOW THE TEMPORARY REPATRIATION OF FOREIGN EARNINGS OF U.S. CORPORATIONS AT A REDUCED RATE OF TAX

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INTRODUCTION

We have been asked to prepare a revenue estimate for S. 1671, introduced on October 6, 2011, by Senators Hagan, McCain, Boxer, Blunt, Graham, Isakson, Murkowski, Brown, and Manchin. This bill would modify current-law section 965 of the Internal Revenue Code of 1986 (section 965) to allow a temporary reduced rate of taxation for foreign earnings of U.S. corporations that are repatriated to the United States in the form of dividend payments to the U.S. parent. The bill contains substantive differences from the current-law provision.

The Joint Committee on Taxation staff recently prepared revenue estimates for an extension of current-law section 965 for Congressman Doggett, who released these estimates to the public. The letter to Congressman Doggett contains a thorough, updated description of the Joint Committee staff revenue estimating methodology for an extension of section 965.

In order to prepare our revenue estimates, we reviewed the letter to Congressman Doggett as well as a 2008 Tax Notes article written by then-Joint Committee Chief of Staff Ed Kleinbard and Joint Committee Staff Economist Patrick Driessen. We also reviewed other research that has been published on the potential revenue impact of a temporary repatriation provision. Because the Joint Committee staff methodology provides a guide to the development of the official revenue estimates for Congressional budget purposes, we use this methodology as our starting point.

Our goal in preparing this analysis was to prepare an objective and impartial analysis of the possible revenue effects of S. 1671 by (1) utilizing to the extent possible the Joint Committee staff methodology, (2) evaluating the substantive differences between the current bill and other repatriation proposals for which the Joint Committee staff has prepared estimates, and (3) exercising our best judgment with respect to the potential behavioral effects that influence the revenue estimates. We note that revenue estimates of repatriation proposals are highly sensitive to a variety of assumptions concerning taxpayer behavior. Relatively small changes in these behavioral assumptions can have significant effects on the revenue estimate.

This paper contains an overview of the provisions of S. 1671 and a detailed discussion of our revenue estimating methodology. For those interested in a more detailed discussion of the revenue estimating process with respect to repatriation proposals, we have included a number of appendices addressing specific issues in the estimating process. While funding for this research was provided by TechNet, the views and analysis expressed in this paper rely on our independent analysis of the potential revenue implications of the bill and do not necessarily represent the views of TechNet.

I. EXECUTIVE SUMMARY

S. 1671

S. 1671 would amend current-law section 965 to provide a temporary period during which foreign earnings of U.S. corporations can be repatriated at a reduced rate of tax. This is accomplished through a dividends-received deduction (DRD). Current-law section 965 provides an 85-percent DRD.

Under S. 1671, the base percentage for the DRD is 75 percent (compared to 85 percent for the 2004 Homeland Investment Act (HIA)). In addition, by increasing payroll levels taxpayers can qualify for a bonus deduction (applicable percentage) of up to 10 percent in the first taxable year following the election year (i.e., the year in which the base percentage deduction is claimed).

The amount eligible for the DRD is defined as the sum of current and accumulated foreign earnings for all controlled foreign corporations of the U.S. shareholder. Thus, the bill encompasses a pool of foreign earnings that is larger than the pool included in the 2004 HIA provision.

The bill eliminates the requirement in the 2004 HIA that limits the uses of amounts repatriated to the United States. Instead, the bill includes a provision that requires the taxpayer to maintain average employment levels in the United States for 24 months following repatriation. If the taxpayer violates this maintenance of employment provision, the taxpayer is required to include in income an amount equal to $75,000 times the number of employees by which the average employment level falls below the require average.

The bill would be effective, at the taxpayer's election, for the last taxable year beginning before the date of enactment or the first taxable year beginning during the one-year period beginning on the date of enactment.

Revenue Estimates for S. 1671

We estimate that S. 1671, the "Foreign Earnings Reinvestment Act," would result in a net decrease in Federal income tax revenues of no more than approximately $9.7 billion for fiscal years 2012 to 2021. Furthermore, our analysis shows that government receipts would actually increase for three years (i.e., fiscal years 2012 to 2014) before any potential net revenue losses for the remainder of the budget period.

Most of the possible revenue losses we estimate derive from the assumption that multinational corporations would move more of their operations overseas in anticipation of another temporary, tax repatriation period in the future, following enactment of S. 1671. We note that this assumption is both ***impossible to quantify with certainty and subjective*** because it requires the assumption that the primary reason that corporations will move additional operations outside the

United States derives from the expectation of a future temporary repatriation period.[1] Considering all the factors involved in the decisions of multinational corporations concerning where to locate their business activities, including current U.S. corporate tax rates, the expectation of future U.S. corporate tax reform, the benefits of the financial accounting treatment of permanently reinvested earnings (PRE) and the detriments of reversing a designation of PRE, and the general trend of U.S. corporations to conduct business in growing markets, we find it difficult to say that future behavior will be driven primarily by the expectation of another temporary repatriation period.

We summarize our estimate in Table 1 showing the location shifting effect separately.[2] Without this assumption, we estimate that S. 1671 would actually ***increase Federal revenues by approximately $5.5 billion*** over the period.

Table 1 – Summary of the Revenue Effects of S. 1671

S. 1671	Fiscal Years 2012 to 2021 *(Billions of Dollars)*
EstimateAssuming no Location Shifting	5.5
Revenue Effect of Location Shifting	-15.2
Total Revenue Effect	-9.7

We assume that approximately $535 billion of foreign earnings will be repatriated under the proposal. This number appears to be consistent with the amounts the Joint Committee staff assumes would be repatriated under an extension of the current-law section 965 provision. However, two recent studies suggest that the amount that would be repatriated could be significantly higher ($604 billion in one case and $742 billion in another). The discrepancies in these estimates highlight the difficulties in predicting how taxpayers will respond to the enactment of another temporary repatriation period. If the amount that is repatriated increases, the bill would have a larger revenue gain (disregarding the possible location shifting effect).

Revenue Estimating Methodology and the Importance of Behavioral Assumptions in Repatriation Revenue Estimates

Revenue estimates almost always take into account anticipated taxpayer behavior. In some cases, estimates of changes in taxpayer behavior have a significant effect on the revenue estimate; in extreme cases, relatively small changes in behavioral assumptions can mean the difference between a revenue estimate that is positive and a revenue estimate is negative. Under

[1] Representatives of the companies with whom we have spoken indicate that they intend (1) to repatriate most of their unrepatriated earnings if the current proposal is enacted and (2) do not anticipate that there will be any future opportunities to repatriate earnings temporarily at a reduce rate of tax.

[2] We assume an enactment date of January 1, 2012.

certain circumstances, accepted economic theory and actual prior experience may provide some evidence that helps to guide these assumptions.

Ultimately, these behavioral assumptions rely on the best judgment of the individual preparing the revenue estimate taking into account all of the available information at the time the proposal is estimated. In the case of proposals to allow U.S. corporations to repatriate earnings from offshore affiliates at a temporarily reduced tax rate, behavioral assumptions can have a significant impact on the revenue estimate.

In a manner similar to the Joint Committee staff, we separate our estimate into three separate components: (i) a "static" effect; (ii) the effects of taxpayer behavior; and (iii) the effect of taxpayers moving income and operations overseas in anticipation of another temporary reduction in the tax rate on repatriated earnings.

Static Effect

Static effects relate to revenue changes before any changes in taxpayer behavior are factored in. In this case, the static effect of another temporary repatriation period is the reduction in revenues attributable to those companies that would have repatriated foreign earnings in the absence of a reduced rate.

We calculate the static effect as the amount of estimated repatriated earnings under the present law baseline in 2012 ($60.8 billion) times the difference in the assumed rate under present law (11.3 percent) and the rate assumed under the proposal (5.51 percent). This results in a one-time revenue loss of about $3.5 billion.

Acceleration Effect

One can expect that a temporary reduction in the tax rate on repatriated foreign earnings will result in a significant taxpayer response as firms repatriate earnings to take advantage of the lower rate. In our approach, we identify three potential behavioral responses that taxpayers might undertake that would materially affect revenues. First, it is likely that firms would reevaluate their investment opportunities and their anticipated deployment of capital in order to accelerate repatriations from future years into the present in order to take advantage of the lower rate. While government tax receipts would increase as these earnings are taxed during the temporary period, there would be a corresponding reduction in revenues in the out-years from which those earnings were accelerated. The acceleration effect will result in a net reduction in tax revenues over the budget period.

We assume that taxpayers will accelerate approximately $162 billion of repatriated earnings from future years. We assume that the accelerated earnings are taxed at the temporary effective tax rate in place at the time the deduction is claimed (i.e., 5.51 percent) and that future revenues from those (undiscounted) earnings are taxed at present law effective tax rates (i.e., 11.3 percent). These calculations result in a net revenue effect of approximately -$11.0 billion over the budget period.

Induced Effect

A second behavioral effect that we estimate relates to repatriated earnings that, but for the temporary reduction in the tax rate, would have remained overseas indefinitely or at least would not have been repatriated during the budget period. This "induced" effect results in an increase in government revenues during the period in which the temporary rate is in place. This component of the revenue estimate results in a pure revenue gain as these earnings are not expected to return to the United States during the budget reporting period.

We estimate that during the period the temporary DRD is in place, approximately $312 billion dollars in induced repatriations will be taxed at 5.51 percent resulting in a one-time revenue increase of approximately $17.2 billion (= $312 billion x .0551). Total repatriations during the temporary period are about $535 billion under these assumptions (i.e., $162 billion of accelerated earnings, $312 billion of induced repatriations, and $61 billion in earnings that would have been repatriated under the present-law baseline).

Changes in U.S. Tax Base

A third behavioral response relates to actions taken by multinational corporations that have the effect of increasing the tax base of U.S. taxpayers. For example, if companies decide to increase dividend payments to shareholders, then these dividends will show up on the tax returns of those shareholders that are subject to U.S. income tax. The net revenue effect of increases to the U.S. tax base from dividends paid out of repatriated earnings results in a revenue gain of approximately $2.2 billion.

Location Shifting

Finally, the Joint Committee staff assumes that enactment of another temporary repatriation period will cause further eroding of the U.S. tax base as corporations move operations and income overseas in anticipation of another temporary repatriation period in the future. We have several concerns about this assumption. First, our own anecdotal evidence suggests that while U.S. multinationals support and look forward to bringing back income into the U.S. at a reduced rate, this is most definitely not part of their overall corporate planning strategy. Second, the Joint Committee staff points to the large increase in PRE in recent years as evidence that this pattern persists. But this ignores that there has been a pronounced, structural trend in this direction unrelated to temporary repatriation periods. U.S. corporations see growing, profitable investment opportunities and rapidly growing markets overseas and are moving to take advantage of them. Third, even if one accepts the fact that U.S. multinationals responded to HIA by moving more resources overseas, then this effect has already been subsumed in the current-law baseline. It seems inconsistent to ascribe additional, incremental location shifting as a result of S. 1671.

Nevertheless, our analysis incorporates an adjustment to take this potential effect into account, which results in a revenue loss of approximately $15 billion over the budget period.

Summary

Our estimates of repatriated earnings throughout the budget period seem in general agreement with those of the Joint Committee staff. For example, the Joint Committee staff indicates that their estimates assume about $700 billion in repatriated earnings during the period when the temporary provisions are in place under an 85 percent DRD and approximately $325 billion for a 70 percent DRD. Our estimates show repatriations of about $535 billion for an effective DRD of about 77.5 percent (a base DRD of 75 percent and an average Bonus Deduction of 2.5 percent as provided under S. 1671). Furthermore, our estimates of foreign earnings that are accelerated from future years seem equally consistent: the Joint Committee staff assumes about $200 billion for an 85 percent DRD and about $125 billion for a 70 percent DRD. Our figure for accelerated repatriations under a 77.5 DRD is about $162 billion. This implies that our estimate of induced repatriated earnings is similarly consistent with the Joint Committee staff.

We conclude that the primary source of revenue losses is due to the assumption that U.S. corporations will relocate their business in anticipation of another temporary repatriation period in the future. As we explain above, this assumption is subject to a large degree of uncertainty. Our estimates incorporate an assumption for relocating income to demonstrate the sensitivity of the estimates to this effect.

II. DESCRIPTION OF S. 1671

Congress is considering a temporary provision to allow companies to elect to repatriate to the United States a portion of their foreign earnings at a lower tax rate than would normally apply. The Congress enacted a similar provision (section 965 of the Internal Revenue Code) in 2004 that applied for tax years 2004 or 2005. Below we review the details of the 2004 provision and provide an explanation of the provisions of S. 1671.

2004 Provision

The 2004 provision allowed a temporary, 85-percent DRD for certain dividends paid by a controlled foreign corporation to its U.S. parent corporation. At a corporation's election, this temporary provision was available for either the last taxable year ending after October 22, 2004 (the date of enactment) or the first taxable year beginning during the one-year period beginning on October 22, 2004.

The amount of dividends eligible for the 85 percent DRD was the greater of (1) \$500 million or (2) the amount of earnings shown on the taxpayer's applicable financial statement as permanently reinvested outside the United States. The 85 percent DRD meant that no more than 15 percent of the dividends received would be included in income of the U.S. parent. At a maximum corporate tax rate of 35-percent, the maximum potential rate of tax on the repatriated earnings was 5.25 percent. The foreign tax credit was allowed with respect to the dividends that did not qualify for the dividend-received deduction.

The dividends eligible for the 85 percent DRD were those dividends that exceeded the taxpayer's average repatriation level (base period dividends) over three of the most recent five taxable years ending on or before June 30, 2003. The applicable years taken into account in calculating the average were determined by disregarding the years in which the highest and lowest repatriation levels occurred. The taxpayer was allowed to specify which dividends were eligible for the DRD and which dividends were treated as satisfying the base period dividends. Income attributable to the nondeductible portion of eligible dividends could not be offset by losses or deductions, but could be offset by alternative minimum tax credits and a pro-rata portion of the foreign tax credits attributable to these dividends.

The 2004 Act required the reinvestment of the repatriated amounts in the United States pursuant to a domestic reinvestment plan for worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the taxpayer for the purposes of job retention or creation.

The 2004 Act provision was available for the first taxable year beginning after the date of enactment (October 22, 2004) or the last taxable year beginning before the date of enactment.

S. 1671, introduced on October 6, 2011, by Senators Hagan, McCain, Boxer, Blunt, Graham, Isakson, Murkowski, Brown, and Manchin)

S. 1671 differs from the 2004 Act provision in significant respects.

Under S. 1671, the base percentage for the DRD is 75 percent (compared to 85 percent for the 2004 Act). In addition, taxpayers can qualify for a bonus deduction (applicable percentage) of up to 10 percent in the first taxable year following the election year (i.e., the year in which the base percentage deduction is claimed). The applicable percentage is defined as the amount that bears the same ratio to 10 percent as the (1) excess of qualified payroll for the calendar year beginning with or within the first taxable year following the election year over qualified payroll for calendar year 2010 bears to (2) 10 percent of qualified payroll for 2010. S. 1671 defines qualified payroll as the aggregate wages (as defined in section 3121(a)) paid by the corporation during the calendar year.

The amount eligible for the DRD is defined as the sum of current and accumulated foreign earnings for all controlled foreign corporations of the U.S. shareholder. The bill allows the DRD with respect to current and accumulated foreign earnings that are not permanently reinvested outside the United States, and foreign earnings reported as permanently reinvested outside the United States for financial statement purposes. Thus, the bill encompasses a pool of foreign earnings that is larger than the pool included in the 2004 Act provision.

The bill eliminates the requirement in the 2004 Act that limits the uses of amounts repatriated to the United States. Instead, the bill includes a provision that requires the taxpayer to maintain average employment levels in the United States for 24 months following repatriation. The employment levels are compared to the average employment level for the 25 calendar months preceding repatriation. If the taxpayer violates this maintenance of employment provision, the taxpayer is required to include in income an amount equal to $75,000 times the number of employees by which the average employment level falls below the require average.

At a taxpayer's election, the bill would be effective for the last taxable year beginning before the date of enactment or the first taxable year beginning during the one-year period beginning on the date of enactment.

III. ESTIMATE OF THE PROPOSAL

If enacted, we estimate that S. 1671, the "Foreign Earnings Reinvestment Act," would result in a net decrease in Federal income tax revenues of no more than approximately $9.7 billion for fiscal years 2012 to 2021. Furthermore, our analysis shows that government receipts would actually increase for three years (i.e., fiscal years 2012 to 2014) before any potential net revenue losses for the remainder of the budget period.

Most of the possible revenue losses we estimate derive from the assumption that multinational corporations would move more of their operations overseas in anticipation of another temporary, repatriation period in the future, following enactment of S. 1671.

We note that this assumption is both ***impossible to quantify and subjective*** because it requires the assumption that the primary reason that corporations will move additional operations outside the United States derives from the expectation of a future temporary repatriation period. Considering all the factors involved in the decision of multinational corporations concerning where to locate their business activities, including current U.S. corporate tax rates, the expectation of future U.S. corporate tax reform, the benefits of the financial accounting treatment of permanently reinvested earnings, and the general trend of U.S. corporations to conduct business in growing markets, we find it difficult to say that future behavior will be driven primarily by the expectation of another temporary repatriation period. Below we provide a detailed discussion of the implications and reasonableness of this assumption.

We summarize our estimate in Table 1 where the location shifting is shown separately.[3] Without this assumption, we estimate that S. 1671 would actually ***increase Federal revenues by approximately $5.5 billion*** over the period.

Table 1 – Summary of the Revenue Effects of S. 1671

S. 1671	Fiscal Years 2012 to 2021 *(Billions of Dollars)*
EstimateAssuming no Location Shifting	5.5
Revenue Effect of Location Shifting	-15.2
Total Revenue Effect	-9.7

In the following sections, we elaborate on these estimates including a discussion of our general approach, the construction of the present law baseline and a detailed description of each component of the estimate.

3 We assume an enactment date of January 1, 2012.

A. Discussion of General Approach and Assumptions

In a manner similar to the Joint Committee staff, we separate our estimate into three separate components: (i) a "static" effect; (ii) the effects of taxpayer behavior; and (iii) the effect of taxpayers moving income and operations overseas in anticipation of another temporary reduction in the tax rate on repatriated earnings.

Static effects relate to revenue changes before any changes in taxpayer behavior are factored in. In this case, the static effect of another tax repatriation period is the reduction in revenues attributable to those companies that would have repatriated foreign earnings in the absence of a reduced rate. To these firms, the temporary repatriation period represents a windfall and a corresponding loss in tax revenues to the government equal to the difference in the tax they would have paid anyway and the reduced taxes they would pay under S. 1671. Like the Joint Committee staff, our estimate of the static effect is the smallest component of our total estimate.

One can expect that a temporary reduction in the tax rate on repatriated foreign earnings will result in a significant taxpayer response as firms rush to take advantage of the lower rate. In our approach, we identify three potential behavioral responses that taxpayers might undertake that would materially affect revenues. First, it is likely that firms would reevaluate their investment opportunities and their anticipated deployment of capital in order to accelerate repatriations from future years into the present in order to take advantage of the lower rate. While government tax receipts would increase as these earnings are taxed during the temporary period, there would be a corresponding reduction in revenues in the out-years from which those earnings were accelerated. The acceleration effect will result in a net reduction in tax revenues over the budget period.

A second behavioral effect that we estimate relates to repatriated earnings that, but for the temporary reduction in the tax rate, would have remained overseas indefinitely or at least not have been repatriated during the budget period. This "induced" effect results in an increase in government revenues during the period in which the temporary rate is in place. This component of the revenue estimate results in a pure revenue gain as these earnings are not expected to return to the United States during the budget reporting period.

A third behavioral response relates to actions taken by multinational corporations that have the effect of increasing the tax base of U.S. taxpayers. For example, if companies decide to increase dividend payments to shareholders, then these dividends will show up on the tax returns of those shareholders that are subject to U.S. income tax. Increasing the tax base of (taxable) U.S. taxpayers will result in an increase in tax revenues flowing into the Treasury during the temporary period to the extent these dividends are paid out of induced foreign repatriations. To the extent these dividends come from foreign earnings that are accelerated from future years then, there will be a corresponding reduction in revenues in those years (assuming that these earnings would have been paid out in dividends in those years).

The final component of our revenue estimate relates to the assumption that firms, after enactment of S. 1671, will move operations and income overseas in anticipation of another temporary

reduction in the tax rate. To the extent this occurs, Federal revenues are reduced as a result of relocating this income.

B. Constructing A Current-Law Baseline

As a first step in calculating the revenue effect of S. 1617, we estimate what revenues would be before enactment of the legislation. This is referred to as the present law baseline. Changes in revenues are then measured from this baseline. Constructing the baseline involves making assumptions about tax rates, repatriations, and the pool of undistributed foreign earnings from which repatriations are assumed to originate.[4]

Because permanently reinvested earnings (PRE) comprise the largest stock of undistributed foreign earnings, we use data relating to the stock of PRE as our starting point. Our principal data source for estimating the potential stock of PRE is a recent study from JP Morgan that analyzed the balance sheets of close to 900 multinational corporations that reported having PRE or who repatriated qualified dividends after enactment AJCA.[5] For 2010, the most recent year available, the study reports close to $1.4 trillion dollars of accumulated undistributed PRE for these firms. In order to project the stock of earnings throughout the budget period, we assumed that the rate of growth of the stock of PRE continued at the average growth rate observed in the three previous years, or about 12.2 percent. This resulted in a stock of PRE in 2012 of about $1.7 trillion rising to about $4.9 trillion by 2021.[6]

Next, we estimated the amount of repatriated earnings in the baseline as 3.5 percent of the stock of PRE. This resulted in baseline repatriations of approximately $61 billion in 2012 growing to about $171 billion in 2021. In addition, we assumed that these repatriated foreign earnings were taxed at a residual U.S. rate of 11.3 percent over the budget period. In arriving at this figure, we relied on a study that used survey data from the Bureau of Economic Analysis (BEA) on the effective tax rates of U.S. multinationals on repatriated earnings.[7]

C. Revenue Effects

In this section, we derive our estimate of the revenue effect of S. 1671 for each component: static effect, behavioral effect, and effects due to location shifting on the part of U.S. multinationals. In calculating these effects, we assume a date of enactment of January 1, 2012.[8]

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[4] Repatriated earnings can come from current foreign earnings, deferred foreign earnings, and the special category of deferred foreign earnings that are designated as permanently reinvested earnings (PRE).
[5] Mott, D. and A. Schmidt (2011), "Undistributed Foreign Earnings: $1.375 Trillion and Growing", JP Morgan, North America Equity Research, May 24th.
[6] We report all our figures and underlying assumptions in Appendix A.
[7] Blouin, J.L., et al. (2009), "Is U.S. Multinational Intra-Firm Dividend Policy Influenced by Capital Market Incentives?" We rely in the mean value of the effective tax rate reported by low-PRE, public firms. This figure is likely to overstate the true residual U.S. tax rate due to additional withholding taxes that are not reported.
[8] As such, our figures are not directly comparable to Joint Committee staff estimates that assumed an earlier enactment date. Letter to Hon. Lloyd Doggett, April 15th, 2011.

We estimate that approximately $535 billion of qualified dividends will be repatriated during the period when the temporary 75-percent DRD is in effect. We believe that this estimate is consistent with estimates of the Joint Committee staff of an extension of current-law section 965 with either an 85-percent DRD or 70-percent DRD. However, this estimate is somewhat lower than what has been assumed in two recent studies. For example, Shapiro and Mathur (2011) estimate that approximately $604 billion will be repatriated during this period while Tyson, et. al. (2011) set this figure at about $742 billion. While our figures are more in line with the Joint Committee staff's assumptions, the discrepancy highlights the uncertainty surrounding the estimates and the particular difficulties in predicting taxpayer behavior. On the other hand, we estimate that approximately $1.4 trillion in total qualified dividends will be repatriated during the 2012-2021 budget period, a figure that is substantially identical to that of Shapiro/Mathur.

Static Effect

As described above, the static effect relates to the windfall received by firms that would have repatriated foreign earnings anyway, without the incentives available under the bill. The static effect is calculated as the volume of repatriated earnings assumed under the present law baseline times the difference in taxes paid under present law and the tax rates in place during the temporary period.[9]

We calculate the static effect as the amount of estimated repatriated earnings under the present law baseline in 2012 ($60.8 billion) times the difference in the assumed rate under present law (11.3 percent) and the rate assumed under the proposal (5.51 percent). In arriving at the latter figure, we assumed that the average DRD for qualified dividends would be 77.5 percent. This figure assumes a slightly higher deduction because of the Bonus Deduction contained in the bill. We also assume that the effective tax rate under the bill (i.e., 22.5 percent times 35 percent = 7.875 percent) is further reduced by 30 percent due to available foreign tax credits. This results in a one-time revenue loss of about $3.5 billion.

Behavioral Effects

Acceleration Effect – We assume that taxpayers will accelerate the repatriation of foreign earnings from future years into the period when the temporary 75 percent DRD is in place with the predominance of the accelerated earnings coming from the most recent years. We assume that approximately 70 percent of repatriated earnings will be accelerated from the closest taxable year and that this figure will drop over subsequent years throughout the budget period. We also assume that these accelerated earnings from future years are discounted at 2.5 percent per year.[10] This produces approximately $162 billion of repatriated earnings accelerated from future years.

We assume that the accelerated earnings are taxed at the temporary rate in place at the time the deduction is claimed (i.e., 5.51 percent) and that future revenues from those (undiscounted)

[9] Taxpayers have some discretion as to which taxable year they can claim the deduction and take advantage of the lower rate.
[10] To the extent these earnings are in the form of foreign cash holdings, the discounting assumption reflects the time value of money over the budget period.

earnings are taxed at present law effective tax rates (i.e., 11.3 percent). These calculations result in a net revenue effect of approximately -$11.0 billion over the budget period.

Induced Repatriations – Induced repatriations represent a windfall and a revenue increase to the Treasury because these earnings would have remained overseas during the budget period and would not have been subject to any U.S. tax. We estimate that during the period the temporary DRD is in place, approximately $312 billion dollars in induced repatriations will be taxed at 5.51 percent resulting in a one-time revenue increase of approximately $17.2 billion (= $312 billion x .0551).[11] Total repatriations during the temporary period are about $535 billion under these assumptions (i.e., $162 billion of accelerated earnings, $312 billion of induced repatriations and $61 billion in earnings that would have been repatriated under the present-law baseline). This figure seems consistent with Joint Committee staff estimates of about $700 billion in repatriated earnings under an 85 percent DRD and $325 billion in repatriated earnings under a 70 percent DRD.

Increase in U.S. Tax Base – To the extent U.S. multinationals use repatriated earnings to increase dividend payments to their shareholders, then these dividend payments will be subject to U.S. Federal income tax to the extent the shareholders are taxable. Not all shareholders are taxable, though. For example, pension funds hold large portfolios of stock in U.S. corporations and would not pay any tax on these dividends. To calculate the tax effect of increased dividend payments accruing to taxpayers subject to tax in the United States, we first assume that 15 percent of repatriated earnings are paid in the form of dividends to shareholders.[12] Furthermore, we assume that one-third of shareholders are taxable and would pay tax on these earnings. We also assume that the dividend payments are taxed at the marginal rate of 24 percent.[13] For repatriated earnings accelerated from future years, we make the additional assumption that the same proportion of these earnings would be used for dividend payments in those years. This results in modest revenue losses in those years. The net revenue effect of increases to the U.S. tax base from dividends paid out of repatriated earnings results in a revenue gain of approximately $2.2 billion.

Location Shifting

The Joint Committee staff assumes that enactment of another temporary repatriation period will cause further eroding of the U.S. tax base as corporations move operations and income overseas in anticipation of another temporary repatriation period in the future. We have several concerns about this assumption. First, our own anecdotal evidence suggests that while U.S. multinationals support and look forward to bringing back income into the U.S. at a reduced rate, this is most

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[11] We arrive at the $312 billion figure by applying a response parameter to the stock of PRE that measures the elasticity of repatriations with respect to the tax rate. We calculated this response parameter to be the value that results in an elasticity of -1.0 at the top corporate tax rate of 35 percent.

[12] A study by Dharmapala, et. al. found that corporations estimated that each $1 in repatriated foreign earnings resulted in $0.60-$0.92 in payouts to shareholders and that most of these payouts were in the form of stock repurchases rather than dividends to shareholders.

[13] The marginal tax rate on dividends was calculated from Quantria Strategies individual income tax microsimulation model. For dividends received in 2012, we use an average marginal rate of 12.5 percent. The maximum statutory tax rate on dividends is 15 percent for 2012; after 2012, dividends will be taxed under the regular individual income tax rate schedule, with a maximum statutory tax rate of 39.6 percent.

definitely not part of their overall corporate planning strategy.[14] Second, the Joint Committee staff points to the large increase in PRE in recent years as evidence that this pattern persists. But this ignores that there has been a pronounced, structural trend in this direction unrelated to temporary repatriation periods. U.S. corporations see growing, profitable investment opportunities and rapidly growing markets overseas and are moving to take advantage of them.[15] Third, even if one accepts the fact that U.S. multinationals responded to HIA by moving more resources overseas, then this effect has already been subsumed in the current-law baseline. It seems inconsistent to ascribe additional, incremental location shifting as a result of S. 1671.

Nevertheless, our analysis results in an estimated revenue loss based on a modest amount of incremental location shifting resulting from the enactment of S. 1671. We calculate this amount by assuming that, beginning in 2014, U.S. corporations will gradually increase the amount of PRE over-and-above the present law baseline by moving U.S. income and investment overseas. We assume that this relocation starts slowly, at 1 percent of the annual change in baseline PRE and rises to 4 percent by 2021. We assume that these forgone earnings would have been taxed in the United States at an effective tax rate of 24.5 percent. This results in a revenue loss of approximately $15 billion over the budget period.

Estimate of S. 1671

Table 2 shows our estimate of the revenue effect of S. 1671 with and without assumptions about U.S. multinationals relocating operations.[16] We estimate that this provision would result in a net reduction in Federal receipts of $9.7 billion for fiscal years 2012 to 2021. Without the assumption of relocating operations, we estimate the bill would actually increase Federal revenues by about $5.5 billion.

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[14] A proposal to enact legislation similar to HIA was defeated soundly (55-43) in the Senate as an amendment to the Administration's stimulus proposal, the American Recovery and Reinvestment Act. This legislation was never even considered in the House. Logically, major corporate decisions will not be based on the uncertain legislative success of a proposal with significant opposition and a mixed history of success.

[15] We do recognize that, subject to longstanding transfer pricing rules and audits by the IRS and other countries, corporations can locate intangible assets outside the United States. However, we also recognize that a number of industries identified foreign markets as areas for future growth. As a result, it is important for these multinational companies to maintain a presence in these markets.

[16] The estimates are in fiscal years, so the figures do not match exactly the calendar year figures in the body of this report.

Table 2 – Revenue Effect of S. 1671, "The Foreign Earnings Reinvestment Act"

Item	Fiscal Years (Billions of Dollars)										
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
75 Percent DRD (no location shifting)	6.0	10.7	2.4	-3.5	-2.8	-1.9	-1.4	-1.6	-1.3	-1.0	5.5
Effect of Location Shifting under 75 Percent DRD	-	(1)	(1)	-0.3	-0.9	-1.3	-1.9	-2.7	-3.5	-4.6	-15.2
Total Revenue Effect	6.0	10.7	2.4	-3.8	-3.7	-3.3	-3.3	-4.2	-4.9	-5.6	-9.7

(1) Negligible revenue effect

D. Summary

Our estimates of repatriated earnings throughout the budget period seem in general agreement with those of the Joint Committee staff. For example, the Joint Committee staff indicates that their estimates assume about $700 billion in repatriated earnings during the period when the temporary provisions are in place under an 85 percent DRD and approximately $325 billion for a 70 percent DRD. Our estimates show repatriations of about $535 billion for an effective DRD of about 77.5 percent (a base DRD of 75 percent and an average Bonus Deduction of 2.5 percent as provided under S. 1671). Furthermore, our estimates of foreign earnings that are accelerated from future years seem equally consistent: the Joint Committee staff assumes about $200 billion for an 85 percent DRD and about $125 billion for a 70 percent DRD. Our figure for accelerated repatriations under a 77.5 DRD is about $162 billion. This implies that our estimate of induced repatriated earnings is similarly consistent with the Joint Committee staff.[17]

We conclude that the primary source of revenue losses is due to the assumption that U.S. corporations will relocate their business in anticipation of another temporary repatriation period in the future. As we explain above, this assumption is subject to a large degree of uncertainty. Our estimates incorporate an assumption for relocating income to demonstrate the sensitivity of the estimates to this effect.

[17] It is possible that our estimate of baseline repatriations differs from the Joint Committee staff. Since the Joint Committee staff has not provided an exact number for their assumption concerning baseline repatriations, we cannot know the extent of any differences, but we would expect that this difference should be relatively small.

APPENDIX A: Assumptions Used In the Model

The assumptions and parameters used in preparing the revenue estimate of S. 1671, "The Foreign Earnings Reinvestment Act" and referenced in the main body of the report are presented in the following tables.

Item	Value
Annual Growth Rate of Accumulated Foreign Earnings	0.1220
Fraction of Total Earnings that is Foreign-Sourced	0.2500
Percent of Accumulated Foreign Earnings that is Repatriated	0.0350
US Corporate Tax Rate	0.3500
Dividend Received Deduction Under Proposal (Including Bonus Deductio	0.7750
Discount Rate	0.0250
Percent of Total Repatriated Earnings Paid Out as Dividends	0.1500
Percent of Shareholders that are taxable	0.3300
Average Marginal Tax Rate on Dividends	0.2400
Average Marginal Tax Rate on Dividends (Blended Rate for 2012)	0.1750
Effective Tax Rate Under Present Law	0.2450
Effective Tax Rate Under Proposed Law	0.0551
Average Effective Tax Rate on Repatriated Foreign Earning	0.1130
Beta Coefficient (Elasticity Parameter)	-2.8570

Item	2012	2013	2014	2015	2016
Acceleration of Future Repatriated Foreign Earnings	0.0000	0.7000	0.4000	0.3000	0.2000
Portfolio Effect: Domestic Earnings Shifted Overseas	0.0000	0.0000	0.0000	0.0100	0.0150

Item	2017	2018	2019	2020	2021
Acceleration of Future Repatriated Foreign Earnings	0.1000	0.1000	0.1000	0.0500	0.0500
Portfolio Effect: Domestic Earnings Shifted Overseas	0.0200	0.0250	0.0300	0.0350	0.0400

For purposes of calculating induced repatriations under the bill, we relied on a semi-log functional form:

$$LN\ (Repatriations) = \alpha + \beta \bullet TXRT.$$

In this equation, LN(R) represents the natural logarithm; α is a constant term; β is the response parameter; and TXRT is the effective tax rate on repatriations. We chose a value of β (-2.8570) that results in a unitary elasticity at the statutory corporate tax rate (i.e., 35 percent).

APPENDIX B: JOINT COMMITTEE ON TAXATION REVENUE ESTIMATES OF REPATRIATION PROPOSALS

A. Overview

In April 2011, the Joint Committee on Taxation provided estimates of the revenue effects of a temporary repatriation provision similar to the one enacted in 2004 (i.e., 85 percent dividends-received deduction). These estimates, provided to Congressman Lloyd Doggett (TX), showed a revenue loss from a temporary repatriation provision of approximately $78.7 billion over the 10-year budget reporting period.[18] At the same time, the Joint Committee staff estimated that the provision would lose $41.7 billion over the 10-year budget reporting period with a 70 percent dividends-received deduction.

In 2004, the Joint Committee staff estimated that the original temporary repatriation provision would reduce revenues by $3.3 billion over the 10 year budget reporting period.[19] In addition, in 2009, the Joint Committee staff estimated that a temporary repatriation provision similar to the 2004 Act would reduce revenues by approximately $29 billion.[20]

The Joint Committee staff has provided considerable detail on the assumptions surrounding their estimates of the revenue effects of temporary repatriation provisions. What follows in this section is a brief overview of these assumptions derived from the September 22, 2008, Tax Notes article authored by Ed Kleinbard and Pat Driessen and the 2011 letter to Congressman Doggett.

B. Baseline Revenues

In constructing a revenue estimate, the starting point is generally the revenue expected to be collected under current law. This is the so-called revenue baseline. The revenue baseline shows the estimates of revenue relating to a particular provision that can be expected to be collected during the budget reporting period assuming current law is in effect. If provisions are scheduled to expire during the budget reporting period and have not been extended legislatively, then the estimates of the revenue baseline are made assuming the scheduled expiration takes place. In general, the revenue baseline will also take into account broad projections of the state of the economy during the budget reporting period. For this purpose, the Joint Committee staff uses the macroeconomic assumptions used by the Congressional Budget Office.

Thus, the revenue baseline used as the starting point for a revenue estimate is not a number that can be derived directly from any one source. Constructing the revenue baseline involves the use of (1) historical data from the Internal Revenue Service (IRS), (2) reliable data from other sources, (3) macroeconomic projections from the CBO, and (4) the best judgment of the economist preparing the revenue estimate concerning how taxpayers will behave under current

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[18] Letter to the Honorable Lloyd Doggett from the staff of the Joint Committee on Taxation, April 15, 2011.

[19] See, Kleinbard, Edward D. and Patrick Driessen, *A Revenue Estimate Caste Study: The Repatriation Holiday Revisited,* Tax Notes, September 22, 2008.

[20] See, Congressional Record, pages S1408-S1420, February 3, 2009.

law over the budget reporting period. Even data that is readily available may not provide a reliable measure for the revenue baseline. For example, the September 2008 Tax Notes article noted that IRS data on residual U.S. corporate income tax with respect to foreign earnings might not be reliable because of the recession and slowing of economic growth that occurred worldwide in 2001-2002.

The Joint Committee staff does not publish its estimates of the revenue baseline. Thus, any analysis of Joint Committee estimates will necessarily involve judgment concerning what baseline assumptions have been made. However, the September 2008 Tax Notes article indicated that the Joint Committee revenue baseline for the 2004 repatriation proposal assumed that there would normally be approximately $10 to $20 billion of U.S. corporate income tax paid on foreign source income. The article further noted that IRS data for years prior to 2004 showed residual U.S. corporate income tax of approximately $2 billion each year of low-taxed, voluntarily repatriated dividends. Importantly, the article notes that the Joint Committee assumes the payment of taxes with respect to low-tax, voluntarily repatriated dividends represented the types of foreign earnings that would not normally be repatriated absent an intervening event, such as financial distress of the company or a major acquisition.

The 2011 Doggett letter states that annual repatriations under current law range from $50-100 billion per year, but notes that measuring the residual U.S. tax on these dividends is difficult because the repatriations tend to mix with other types of foreign source income. In addition, the Joint Committee staff estimates assume that dividend repatriations will increase under the current law revenue baseline because of what they refer to as “the tension between domestic needs and the growing stock of deferred overseas income.”

The 2008 Tax Notes article and the 2011 Doggett letter also noted that the normal revenue estimating convention required the Joint Committee staff to assume that the active finance exception to Subpart F would expire as scheduled. Thus, the Joint Committee baseline assumed that deferral under Subpart F would not be available to the same extent during the later years of the budget reporting period as it was at the time the 2004 Act provision was enacted. This assumption, while consistent with Joint Committee staff scoring conventions, may overstate significantly actual behavior.

C. Joint Committee Estimates and Assumptions

Overall, in 2004, the Joint Committee staff assumed that $235 billion of qualifying dividends would be repatriated under the temporary repatriation provision. In 2011, the Joint Committee staff assumes that approximately $700 billion would be repatriated under an 85 percent dividends-received deduction and approximately $325 billion would be repatriated under a 70 percent dividends-received deduction.

The Joint Committee staff assumes three main components to the revenue estimates for a temporary repatriation provision. These components are referred to below as the (1) static effect, (2) acceleration effect, and (3) behavioral effect.

The static effect measures the revenue loss of allowing the temporary reduced tax rate for dividends that would have been repatriated in the year the temporary provision is in effect. In essence, this component of the revenue estimate applies the lower U.S. tax rate under the repatriation proposal to those dividends that would have been repatriated to the United States in the year(s) the repatriation proposal is in effect (in essence, the dividends assumed in the revenue baseline). In 2004, the Joint Committee staff assumed that these dividends equaled approximately $30 billion of the $235 billion (approximately 13 percent) of estimated dividends qualifying for the reduced rate of tax. The 2011 Joint Committee staff estimates do not provide an estimate of the dividends in this category. However, the 2011 Joint Committee staff estimates also indicate that there may be an "announcement" effect under which companies may delay planned dividend repatriations in anticipation of the enactment of a temporary dividend repatriation provision. Theoretically, if the delay of dividend repatriations moves dividend payments from a year before the budget reporting window into the budget reporting window, then these payments should represent a pure revenue gain as they represent the payment of dividends that would have otherwise occurred outside the budget reporting window.

The acceleration effect represents dividends that would have been repatriated under current law in a later year that are repatriated during the time the temporary reduced rate of tax is available. There can be both revenue losing and revenue raising components to this category of dividends. If the accelerated dividends are repatriated from a later year in the budget reporting period, then there is a revenue gain in the year the dividends are repatriated and a revenue loss in the year the dividends would have otherwise been repatriated during the budget reporting window. The size of the net revenue gain or loss would depend in part upon the estimated difference in the U.S. corporate income tax rate that would apply under the temporary provision and under current law. In addition, the way in which these accelerated dividends are used may also affect the U.S. income tax base. For example, if corporations make dividend payments to their shareholders as a result of the acceleration of dividends, then these dividend payments are subject to U.S. tax that would not otherwise have been paid during the budget reporting period.

Dividends that are assumed to be accelerated from a period outside the budget reporting window (i.e., dividends attributable to foreign earnings that would not have been repatriated in the foreseeable future in the absence of the temporary repatriation provision) represent a pure revenue gain. These "induced" dividends represent amounts that, absent the repatriation provision, would not be returned to the United States. Thus, these dividends raise revenue from the U.S. corporate income taxes that are paid when the dividends are repatriated and on any shareholder dividends that may be paid as a result of the repatriation.

In 2004, the Joint Committee staff assumed that approximately $75 billion of dividends (almost 32 percent) would be accelerated from other years in the budget reporting window and that approximately $130 billion (55 percent) would be accelerated from periods outside the budget reporting window. The 2011 Doggett letter does not identify the specific components of these dividends in the Joint Committee staff's current estimates. In 2011, the Joint Committee staff assumes that approximately $200 billion (approximately 29 percent) of the estimated $700 billion in repatriations represent accelerations from other years in the budget reporting period under an 85 percent dividends-received deduction proposal Under a 70 percent dividends-received deduction proposal, the Joint Committee staff assumes that approximately $125 billion

(approximately 38 percent) of the $325 of total estimated dividends represent accelerations from other years in the budget reporting period. The Joint Committee staff notes that the $200 billion and $125 billion amounts "include some dividends that we assume would be repatriated under present law in the 2011-2021 budget period without any direct connection to a PRE reversal, and some dividends that we assume would be associated with PRE reversals we anticipate under present law in the 2011-2021 budget period."[21] The Joint Committee staff does not provide an estimate of the amount of dividends that are assumed to be repatriated from outside the budget reporting window, but presumably these amounts represent a smaller percentage of the total in 2011 than in 2004.

The final primary component of the Joint Committee staff revenue estimates is what we refer to as the behavioral effect. The Joint Committee staff indicated that their revenue estimates (both in 2004 and in 2011) take into account changes in the prospective investment and income location decisions of U.S. corporations. In effect, the Joint Committee staff assumes that U.S. corporate behavior will change in years after a temporary repatriation provision is enacted because U.S. corporations will anticipate that there will be other, future temporary provisions. The 2008 Tax Notes article states ". . .at least some taxpayers would change their future behavior to anticipate a second round of section 965-type relief, by investing more offshore than they would have done had a one-time tax repatriation period not been enacted, and keeping the resulting offshore indefinitely."[22] In 2004, the Joint Committee attributed $1 billion of revenue loss to this behavior.

[21] Refer to Kleinbard, Edward D. and Patrick Driessen. *A Revenue Estimate Case Study: The Repatriation Holiday Revisited.* Tax Notes, September 22, 2008. .

[22] Ibid.

APPENDIX C: PREDICTING TAXPAYER BEHAVIORAL RESPONSES TO REPATRIATION PROPOSALS

A. Interplay of U.S. Tax Laws and U.S. Financial Accounting Rules

Publicly traded corporations have a fundamental goal of maximizing earnings reported to shareholders in order to increase the value of their stock. Detailed accounting rules specify how and when earnings are reported on a corporation's annual financial statement, including the earnings or foreign affiliates in the case of a multinational corporation. An important element to estimating the revenue effects of a temporary repatriation provision entails understanding the interplay of the U.S. tax system with the rules that publicly traded U.S. corporations must follow to report their earnings to shareholders. Since the 2004 temporary repatriation provision was enacted, researchers have begun to look more closely at how the U.S. tax laws interact with the financial accounting standards to encourage U.S. corporations to keep their foreign earnings permanently reinvested outside the United States. However, even before 2004, there was evidence that this interplay played an important role in the way that corporations conduct business. A separate, but relevant, issue relates to the tax rates that multinational corporations face on income earned outside the United States.

As the Joint Committee on Taxation noted in its 2001 report of investigation regarding Enron's Federal tax issues,

> "In Enron's case, the U.S. international tax rules. . .combined with the relevant financial accounting standards, created a significant incentive for the company not to repatriate foreign earnings to the United States."[23]

This section discusses these issues because they can have a significant impact on both the baseline with respect to permanently reinvested earnings and with respect to the projected future behavior of multinational corporations if another temporary repatriation provision is enacted. Because the focus of our review is on the revenue estimating issues surrounding a temporary repatriation provision, the discussion below represents a very broad overview of the issues. Consequently, there may also be other rules (both tax and accounting) and exceptions to rules that are relevant in a more thorough review of these issues.

International Corporate Tax Rates

As a general principle, corporations tend to operate in a manner that minimizes their overall tax liability. Corporations engage in this behavior because the more money corporations pay in taxes, the lower the earnings the corporations can report to their shareholders. In the case of multinational corporations, the management of overall tax liability involves not only the U.S. tax

[23] Joint Committee on Taxation. *Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations, Vol. I: Report.* Prepared by the staff of

system (Federal, state, and local), but also the tax systems of each country in which the multinational corporation must operate.

The U.S. corporate statutory income tax rates are among the highest in the world. In addition, over the last decade, many countries have enacted lower corporate statutory income tax rates.

Many commentators and researchers have suggested that these high rates create an incentive for U.S. corporations to relocate their activities outside the United States. However, merely examining statutory tax rates does not provide an accurate picture because statutory tax rates do not take into account various deductions, credits, and exclusions that may make a corporation's average or effective tax rate lower than the statutory rate. Thus, effective tax rates present a better measure of how the United States ranks in the world with respect to corporate income taxes.

Markles and Shackelford constructed a database of publicly available financial statement information for 11,602 corporations from 82 countries to examine effective tax rates over the 1988 to 2009 period.[24] The authors note that it is widely accepted that U.S. domicile results in higher total worldwide taxes, which creates a strong preference for multinational corporations to domicile outside the United States. However, the authors note that relocating to reduce global taxes is not a problem limited to the United States.

In order to test how domicile affects the total worldwide taxes of multinational corporations, Markel and Shackelford used firm-level financial statement information to estimate country-level effective tax rates (ETRs).[25] As a general rule, ETRs provide a more accurate measure of tax burden than statutory tax rates.

Markel and Shackelford found that domicile substantially affects multinational corporations ETRs, even considering the ability of corporations to use transfer pricing, hybrid entities, and other strategies to lower their overall tax burden. The authors found the ETRs for multinationals in high-tax countries to be roughly double those in low-tax countries.

Table 3, below, provides a breakdown of the total ETRs faced by companies (both domestic and multinational) for the 2005-2009 period. A couple of points are worth noting. First, the drop in ETR in the United States in 2009 most likely relates to the effects of the recession, given the way that ETRs were calculated for purposes of the study. Second, the United States consistently ranked second in ETR, behind Japan. Third, the ETRs for tax haven countries (for example, the Cayman Islands has a zero percent corporate tax rate) reflects multinational corporations that may be headquartered in the tax haven and paying some tax in jurisdictions outside the tax haven.

[24] Markle, Kevin S. and Douglas A. Schackelford. *Cross-Country Comparisons of Corporate Income Taxes.* National Bureau of Economic Research, NBER Working Paper Series, Working Paper 16839, February 11, 2011.

[25] For purposes of this analysis, ETR is derived from financial statement data as the ratio of current tax expense to pre-tax income. They note that this measure is not necessarily the best measure of ETR, but in the absence of micro-level tax return data, is the best that can be used.

The total ETRs confirm that the U.S. corporate income tax system tends to impose higher tax rates than other countries.

Table 3.—Total Effective Tax Rates Faced by Companies in Various Countries and Areas of the World, 2005-2009*

	2005	2006	2007	2008	2009
Japan	34%	34%	34%	36%	30%
United States	24	23	24	23	20
France	25	21	22	18	25
South Africa	20	21	20	21	20
United Kingdom	19	20	20	22	18
Australia	21	23	21	18	17
Germany	18	21	19	20	19
India	17	17	18	18	
Canada	19	18	18	16	15
Taiwan	15	15	15	18	16
Malaysia	20	17	16	17	15
Switzerland	20	17			11
Sweden	15	15	13	15	11
Cayman Islands	12	11	9	13	13
Bermuda	10	11	12	12	7

Source: Markel and Schakelford, *Cross-Country Comparisons of Corporate Income Taxes.*

*Estimates were reported for country-years with at least 20 observations.

It is also interesting to consider the ETRs for U.S. domestic corporations compared to U.S. multinational corporations. During the 2005-2009 period, Markel and Schakelford estimated that U.S. domestic corporations faced an ETR of 29 percent compared to an ETR of 30 percent for multinational corporations.[26] However, as discussed below, multinational corporations are subject to a complex set of rules to determine the treatment of income from sources outside the United States.

U.S. Tax Rules for Multinational Corporations

The United States maintains what is predominantly a "worldwide tax system," under which U.S. corporations are subject to tax on their worldwide income, without regard to where the income is earned. This system can be contrasted with a "territorial tax system," under which U.S. corporations would be taxed only on income earned within U.S. borders. There are advantages and disadvantages to either type of system. In addition, while the United States system can be categorized as a worldwide tax system, there are elements of the U.S. system that make it operate more like a territorial system.

[26] Markel and Schakelford, Table 2, Main Results, Pooled sample 2005-2009.

Under the U.S. tax system, income earned by a U.S. corporation from the operations of a foreign subsidiary generally is taxed when a dividend is distributed to the U.S. parent corporation. However, the U.S. tax system has specific anti-deferral provisions (Subpart F and the passive foreign investment company rules) that require U.S. parent corporations to recognize currently certain income of foreign subsidiaries without regard to whether a dividend has been paid. Subpart F income includes passive income and other highly mobile income that can be moved from one country to another. Passive foreign investment company income includes income from passive investments.

Thus, under current law, multinational corporations can defer U.S. taxation on the income earned by their foreign subsidiaries until such time as the income is repatriated to the United States by the payment of dividends from the foreign subsidiary to the U.S. parent unless the income is subject to one of the anti-deferral regimes.

In general, the United States also allows a foreign tax credit to offset the U.S. tax owed on foreign-source income. The foreign tax credit is designed to take into account taxes that have been paid on a corporation's foreign earnings. The foreign tax credit is available whether foreign income is earned directly by a U.S. corporation, received in a dividend payment from a foreign subsidiary, or required to be included in income because of an anti-deferral regime. The foreign tax credit generally is limited to the U.S. tax liability on a corporation's foreign income. Separate foreign tax credit "baskets" are utilized to prevent the use of excess foreign taxes paid in a high-tax jurisdiction to be "cross-credited" against the residual U.S. tax on low-taxed foreign income. Foreign tax credits that cannot be used currently can be carried back one year and carried forward 10 years on a separate basket basis.

Thus, purely from a U.S. tax perspective, U.S. multinational corporations prefer not to repatriate earnings attributable to their foreign operations unless (1) they need the earnings to finance current business operations in the United States, (2) they have excess foreign tax credits to use, or (3) they have net operating losses for U.S. tax purposes to offset the repatriated foreign earnings.[27]

U.S. Financial Accounting Standards

In the United States, General Accepted Accounting Principles (GAAP) require corporations to report the tax effects of income and expense in the period in which the income is earned, without regard to when the taxes are actually paid. This rule can lead to a disparity of reporting of taxes for financial statement purposes and the reporting of taxes for corporate income tax purposes.

In the case of a multinational corporation with affiliates outside the United States, this general principle requires that corporations report income of a foreign affiliate in the period when the related foreign income is being reported. At the same time, a resulting tax expense would be reported accompanied by the recognition of a deferred tax liability because there would be no current cash outflow.

[27] Corporations with net operating losses will generate foreign tax credits that they cannot use.

However, the U.S. tax laws permit the indefinite deferral of U.S. tax on the earnings of foreign affiliates. An exception to the general rule for financial reporting purposes permits companies to assert that the earnings of foreign affiliates will be indefinitely reinvested and not returned to the United States. This results in the reporting of permanently reinvested earnings (PREs) on multinational corporation financial statements. In these situations, corporations are not required to recognize the income tax expenses associated with the foreign affiliate income. As Epstein and Macy point out, "this practice results in a higher ratio of reported post-tax earnings to pre-tax earnings, lower effective tax rates, greater profitability and higher returns on sales, assets and equity, than would otherwise be the case.[28]

In addition, if in later years, the earnings are in fact repatriated to the United States, a higher tax expense will be reported for financial statement purposes, but the earnings will have been previously reported. In fact, according to guidance from the Financial Accounting Standards Board (FASB), if any portion of a subsidiary's earnings previously designated as permanently reinvested overseas are repatriated to the U.S. parent, then any all potential U.S. income taxes which have previously been deferred on those earnings must be taken as a charge to the U.S. parent in the current reporting period.[29] Thus, the effective tax rates reported to shareholders will be higher than they otherwise would be, which will negatively impact reported shareholder earnings.[30]

Blouin, Krull, and Robinson studied the impact of the financial accounting rules on repatriation behavior of U.S. multinational firms.[31] The authors tested the repatriation behavior of public and private companies and found that public corporations have a strong disincentive to repatriate foreign earnings because they are required to report the tax expense in the year of repatriation, which reduces their overall earnings for financial statement purposes. In a sample of public corporations, firms with a high price-sensitivity to earnings or that make extensive use of the PRE designation (i.e., would recognize a larger repatriation tax upon repatriation) are more sensitive to the repatriation tax rate than other corporations, "raising the possibility that reporting incentives help explain the unexpectedly large surge in repatriations under the AJCA because the financial statement tax expense, along with the cash outflow for taxes, was temporarily reduced."

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[28] Id..

[29] "If circumstances change and it becomes apparent that some or all of the undistributed earnings of a subsidiary will be remitted in the foreseeable future but income taxes have not been recognized by the parent company, it should accrue as an expense of the current period income taxes attributable to that remittance." *FASB Accounting Principles Board Opinion No. 23, Accounting for Income Taxes - Special Areas*, at para. 12

[30] Id.

[31] Blouin, Jennifer L., Linda K. Krull, and Leslie A. Robinson. *Is U.S. Multinational Intra-Firm Dividend Policy Influenced by Reporting Incentives?* February 2011. Available at: http://ssrn.com/abstract=1468135.

[32] *Id.*

[33] Blouin, Jennifer L., Linda K. Krull, and Leslie A. Robinson. *Is U.S. Multinational Intra-Firm Dividend Policy Influenced by Reporting Incentives?* February 2011. Available at: http://ssrn.com/abstract=1468135.

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Putting It All Together

One of the biggest challenges in constructing a revenue analysis of a temporary repatriation tax proposal involves identifying what assumptions should be used to (1) calculate the baseline level of repatriation activity and (2) predict how multinational corporations will react after the temporary provision expires. Much of what has been written concerning the 2004 temporary repatriation provision suggests that the desire to avoid current U.S. corporate income tax drives the behavior of corporations. However, recent research finds that the financial accounting rules play a critical role in how corporations behave. If this is true, then the anticipation of future tax benefits (such as the anticipation of another temporary repatriation period) is not necessarily responsible for increases in the amount of PREs reported by multinational corporations to their shareholders.

Shackelford, Slemrod, and Sallee examined empirically the effect of the U.S. tax system and financial reporting principles on the real and accounting decisions of corporations.[34] By combining the study of both tax and financial accounting rules, the paper develops a framework to explore how the attractiveness of some corporate decisions are enhanced by providing corporations with some discretion over the timing of income for tax and/or financial accounting purposes. The authors find that the desire for this discretion modifies the optimal decisions of firms. The tax policy of deferring U.S. tax liability on foreign earnings provides corporations with valuable discretion with respect to the reporting of income for financial accounting purposes. Thus, foreign investments by corporations in countries with tax rates lower than the United States, in addition to increasing real earnings, provides discretion for financial accounting purposes that reduces the effective cost of capital for this type of investment.

Graham, Hanlon, and Shevlin surveyed 600 tax executives to understand better how corporate decisions are made about where to locate investment and whether to repatriate earnings.[35] The main objective of this study was to examine whether the ability to defer the reporting of income tax expense for financial accounting purposes plays an important role in corporate decisions to locate investments outside the United States and to repatriate foreign earnings back to the United States or to reinvest them overseas. The authors concluded:

[34] Shackelford, Douglas A., Joel Slemrod, and James M. Sallee. *A Unifying Model of How the Tax System and Generally Accepted Accounting Principles Affect Corporate Behavior.* January 12, 2007. Available at: http://ssrn.com/abstract=958436.
[35] Graham, John R., Michelle Hanlon, and Terry Shevlin. *Real Effects of Accounting Rules: Evidence from Multinational Firms' Investment Location and Profit Repatriation Decisions.* October 19, 2010.

> "In sum, for both decisions – where to locate operations and whether to reinvest or repatriate – the importance of the financial accounting tax expense deferral is not statistically different than the importance of cash tax deferral when making these decisions. . .Our results show that the accounting expense deferral is important to companies and appears to provide an incentive, along with the relatively high corporate tax rates in the U.S., to move operations and investments overseas and to reinvest foreign earnings overseas. This statement is particularly true for companies that are publicly traded, already have a relatively substantial foreign presence, and have significant intangible assets."[36]

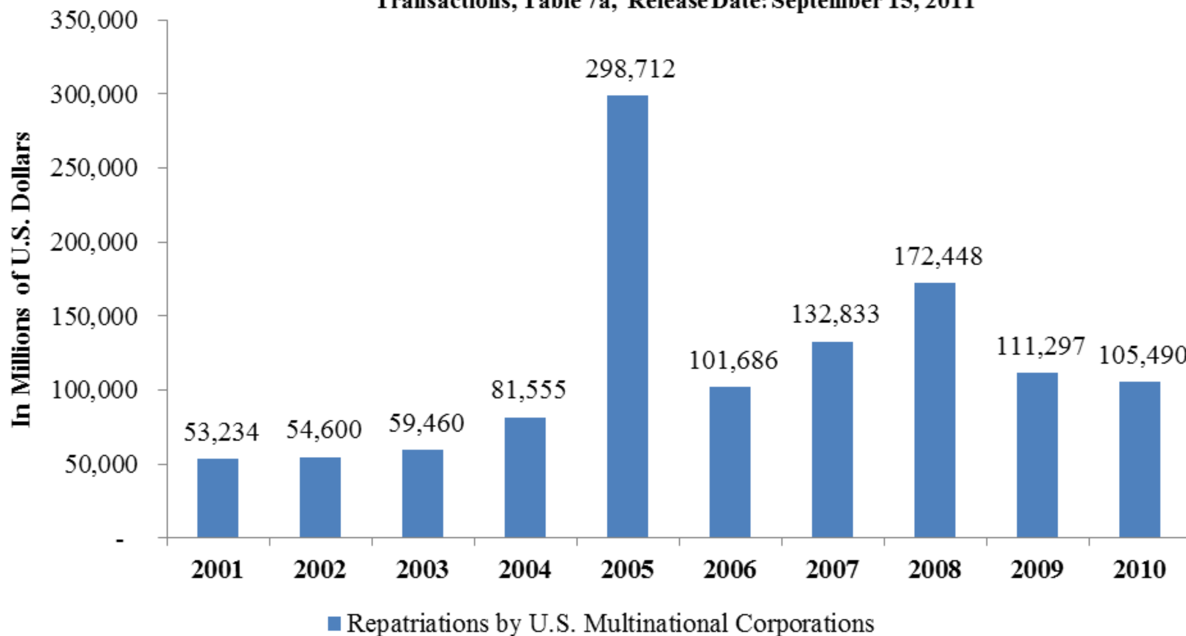
As the authors note, the decisions to locate investments outside the United States and to reinvest foreign earnings rather than repatriate them are driven substantially by two factors: (1) the relatively high rates that taxpayers would face on the earnings in the United States and (2) the financial accounting benefits that accrue if the earnings are reinvested rather than repatriated (i.e., increase in current earnings, but a deferral of the reporting of the corresponding tax expense). While a temporary repatriation provision may affect the decision to reinvest earnings outside the United States by temporarily reducing the tax cost of repatriation, after the repatriation period, the incentives return to where they were before the period. Thus, after a temporary repatriation period, corporations continue to have a strong incentive to locate investments outside the United States and reinvest earnings rather than repatriate them. The anticipation of a future repatriation period plays an insignificant role in the corporate decision-making process.

B. Examining the Data

1. Repatriations of Foreign Earnings

The actual pattern of repatriations observed prior to enactment of the 2004 Homeland Security Act provided a stable and predictable pattern. According to the U.S. Bureau of Economic Analysis, International Transactions, multinational firms repatriated between $53 and $81 billion in foreign earnings prior to enactment. (Refer to Graph 1.)

[36] *Id.*

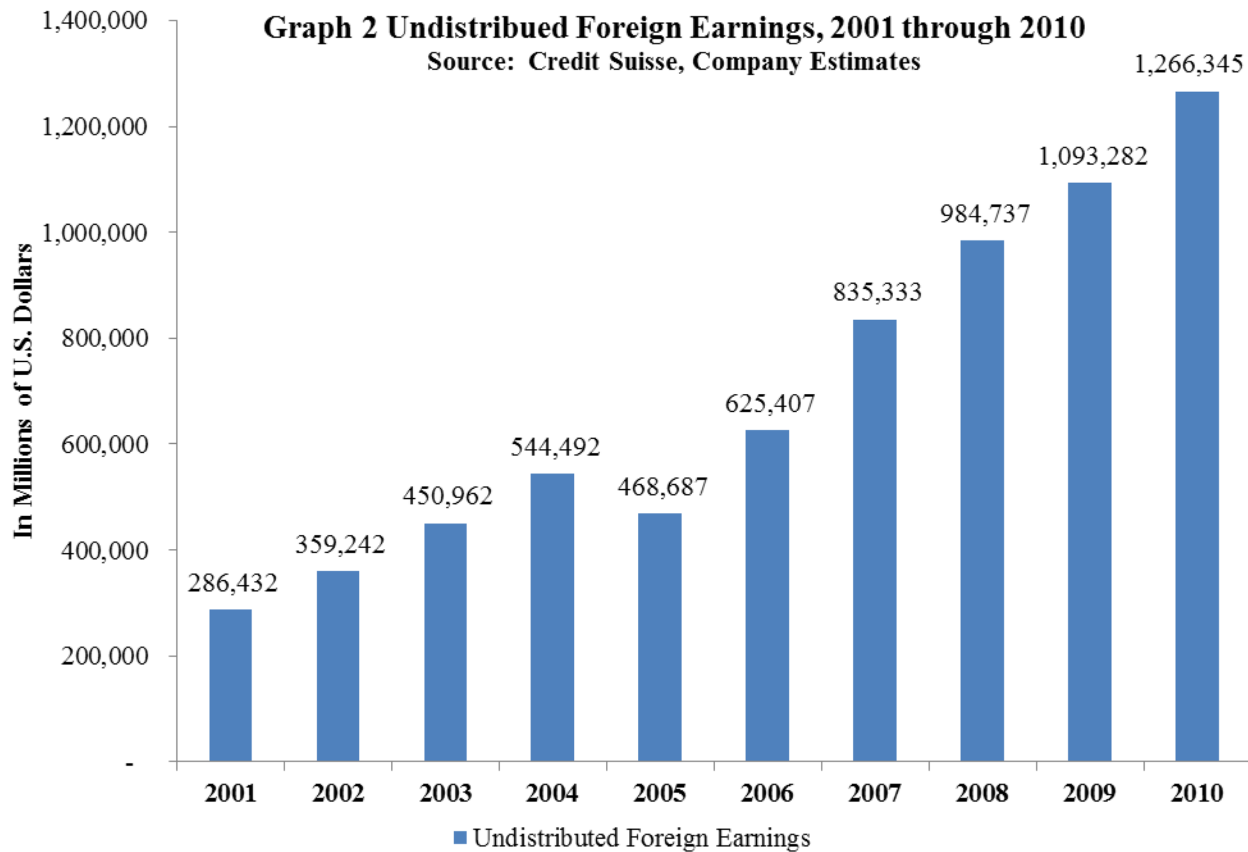


According to the Internal Revenue Service, 843 of the roughly 9,700 eligible corporations took advantage of the deduction following enactment of the 2004 HIA.[37] The most recent available data indicates that this subset of firms repatriated approximately $300 billion. Following the tax reduction, the multinational corporations returned to more modest levels, but still exceeded the pre-2004 amounts.

2. Undistributed Foreign Earnings

Multinational corporations have accumulated foreign earnings at a steady pace since the late 1990's and early 2000's. The rate of earnings accumulation grew at an annual rate of 18 percent over the 2001 to 2010 period. However, the rate of earnings accumulation grew at an annual rate of 22 percent from the 2005 to 2010 period.[38]

[37] Refer to Redmiles, Melissa, *The One-Time Received Dividend Deduction*, Internal Revenue Service, Statistics of Income Bulletin, Spring 2008.
[38] Refer to Credit Suisse, *Parking Earnings Overseas $1.3 Trillion Parking Lot for the S&P 500?*, Equity Research, April 2011



We observe a robust growth in accumulated foreign earnings, however as noted above, this is most likely to represent a trend in increased investment by U.S. multinationals to establish a presence in markets with the greatest potential for future growth, as well as a growth in sales in those markets.

C. Behavioral Effects in the Revenue Estimates of Repatriation Proposals

1. Behavioral Effects and Revenue Estimates

Revenue estimates almost always take into account anticipated taxpayer behavior. In some cases, estimates of changes in taxpayer behavior have a significant effect on the revenue estimate; in extreme cases, relatively small changes in behavioral assumptions can mean the difference between a revenue estimate that is positive and a revenue estimate is negative.[39] Under certain circumstances, accepted economic theory and actual prior experience may provide some evidence that helps to guide these assumptions. In addition, the Joint Committee and Treasury Department staffs have the advantage of access to micro-level tax return data to help inform their assumptions concerning taxpayer behavior.

Ultimately these behavioral assumptions rely on the best judgment of the individual preparing the revenue estimate taking into account all of the available information at the time the proposal is estimated.

Many people have tried to look retrospectively at actual data to determine whether the assumptions surrounding a particular revenue estimate is valid or invalid. However, such an analysis is fraught with problems. In the first place, a revenue estimate does not necessarily represent the revenue gain or loss from the operation of a single provision of the Internal Revenue Code. Rather, a revenue estimate will provide the estimated total effect of a provision on Federal budget receipts. In many cases, the revenue estimate will incorporate the potential revenue effects on other provisions of the Internal Revenue Code. For example, a temporary repatriation provision will have the direct revenue effect from the repatriation of foreign earnings of U.S. corporations. In addition, to the extent the corporations repatriating earnings increase payments to shareholders in the form of dividends, there will also be the revenue effect resulting from larger than anticipated dividend income.

There may also be interactions between the provision being amended and other provisions of the Internal Revenue Code. It is difficult to look at a revenue estimate and isolate the revenue effects attributable to one single provision in the Internal Revenue Code.

Further, intervening changes in the law affect the revenue that is ultimately collected with respect to any provision of the Internal Revenue Code. In general, in preparing a revenue estimate, the Joint Committee staff will assume that current law will continue throughout the budget period. Thus, the Joint Committee staff assumes that expiring provisions will expire as scheduled. If these expiring provisions are ultimately extended, then the estimated revenue effects of a proposal that interacts with an expiring provision will differ from the actual revenue.

[39] A classic example of this were the differences between revenue estimates of the Joint Committee staff and the Treasury Department staff in the late 1980's of a proposed reduction in the tax rate on capital gains income. Behavioral responses assumed by the Joint Committee staff caused their revenue estimate to be negative, while a slightly different behavioral response assumed by the Treasury Department staff caused their revenue estimate to be positive. The net difference in estimates of approximately $45 billion was attributable to a relatively minor difference in assumed taxpayer behavior.

Finally, the Joint Committee uses Congressional Budget Office projections concerning the economy as the starting point for their revenue estimates. Changes in economic conditions that occur subsequent to a proposal being enacted will not be reflected in the original revenue estimate, making it difficult to assess whether the original revenue estimate was accurate or not.

For all these reasons, we do not attempt to revisit the Joint Committee staff revenue estimates of the 2004 Act. However, we do believe that it is important to consider the extent to which assumptions concerning taxpayer behavior influence the revenue estimates for repatriation proposals. In the case of proposals to allow U.S. corporations to repatriate earnings from offshore affiliates at a temporarily reduced tax rate, behavioral assumptions can have a significant impact on the revenue estimate. The revenue estimates for repatriation proposals typically involve four significant behavioral assumptions. The remainder of this section discusses in greater detail each of the significant potential behavioral effects.

2. Baseline Estimates of Repatriation Behavior

The first element to a revenue estimate for a repatriation proposal requires an estimate of the repatriations that will occur under current law during the budget period and the residual U.S. tax rate that will apply to these repatriations. This estimate involves examining historical patterns of repatriation and then making assumptions concerning whether a similar pattern will continue into the foreseeable future or whether there will be changes in repatriation patterns and why these changes will occur. The estimate of repatriations that will occur under current law is complicated by the revenue estimating convention that assumes that provisions scheduled to expire under current law do, in fact, expire even if the provisions have been extended repeatedly in the past. Thus, for example, the assumption about repatriations that will occur under current law must take into account the fact that two temporary provisions that allow deferral of U.S. tax on certain foreign earnings expire during the budget reporting period. When these provisions are assumed to expire, more foreign earnings will be subject to current U.S. taxation than would have occurred if the provisions were assumed to be extended, which affects the assumed levels of repatriation under current law.

In a letter to Congressman Lloyd Doggett in April 2011, the Joint Committee staff states that annual repatriations in recent years have ranged from $50 to $100 billion. They note a study by the Government Accountability Office suggesting that the residual U.S. tax rate on all foreign source income was approximately four percent and dividend repatriation was less than 25 percent of the total foreign source income. The Joint Committee staff goes on to state that they believe the four percent rate understates the rate of tax that applies to marginal repatriations, which the Joint Committee staff says are less likely to be protected by cross crediting (the netting of foreign taxes against foreign income in all countries that is permitted under certain circumstances). The Joint Committee staff notes that this residual U.S. taxation inhibits the repatriation of deferred earnings of U.S. corporations under current law.

Based on conversations with representatives of companies potentially affected by a temporary repatriation provision, we believe that companies generally repatriate earnings under current law

(1) from higher tax countries and (2) to utilize available foreign tax credits.[40] We believe that the financial accounting consequences of repatriating earnings that have been designated as permanently reinvested earnings (PRE) further increases the likelihood that these earnings will remain outside the United States. If companies had a productive use for the earnings that are held outside the United States, they might be more likely to repatriate. An example of this was Pfizer's 2009 reversal of a PRE designation and repatriation of earnings to help finance its acquisition of Wyeth.

In general, the Joint Committee staff assumes that the levels of repatriations under current law will increase during the budget period because of the "tension between domestic needs and the growing stock of deferred overseas income." The Joint Committee staff uses Pfizer as an example of why it is reasonable to assume that certain extraordinary repatriations would occur under the baseline and, correspondingly, why a higher rate of assumed residual tax should be assumed on the current law repatriations.

However, we also find convincing the arguments made by some companies that earnings held outside the United States can be used as collateral for close to zero percent borrowing within the United States to finance U.S. activities. Thus, while an occasional extraordinary repatriation may occur, we believe that the current economic situation with virtually no-cost borrowing allows U.S. corporations to effectively access their overseas earnings without actually repatriating them. This is, in fact, the most economically optimal behavior, given the options available.

For purposes of our analysis, we have assumed that annual repatriations under current law will roughly match historical trends with growth patterns consistent with recent experience and that these repatriations will generally represent earnings that have not been designated as PRE and will generally represent earnings from high-tax countries.

3. Estimates of Repatriations That Will Occur During a Temporary Repatriation Period

The second component involves estimating how much unrepatriated foreign earnings will be repatriated during the time that a temporary repatriation provision is in effect. For example, with respect to the 2004 temporary repatriation provision, the Joint Committee staff estimated that approximately $235 billion of qualifying dividends would be paid. A 2008 study in the IRS Statistics of Income bulletin noted that U.S. corporations using actual tax return data found that taxpayers reported $312 billion of qualifying dividends during the time the 2004 temporary repatriation provision was in effect.

We note that this provision differs from others that the Joint Committee staff has estimated. Section 965 permits the repatriation of the greater of (1) $500 million or (2) the amount reported

[40] As other countries that have historically been considered high-tax jurisdictions move to lower their corporate income tax rates, the differential between the tax imposed by these jurisdictions and the residual tax imposed by the United States will increase and the amount of foreign earnings that are repatriated under current law may will be affected.

as PRE on a company's financial statement. The current proposal amends section 965 to permit the repatriation of all current and deferred unrepatriated earnings, without regard to whether the earnings are PRE. Thus, the proposal that we have examined applies to a broader category of unrepatriated earnings than the earnings eligible under section 965.

In the April 15, 2011, letter to Congressman Doggett, the Joint Committee staff estimated that approximately $325 billion of dividends would be repatriated under a 70-percent dividends received deduction (DRD) provision and approximately $700 billion would be repatriated under an 85-percent DRD provision. Under the current proposal, which provides a base 75-percent DRD and the possibility of an additional 10-percent DRD in the following year, we assume that repatriations would total approximately $500 billion.

4. Estimates of Repatriations That Are Accelerated From Other Years During the Budget Reporting Period

The estimate of how much of the estimated repatriated earnings would have otherwise been repatriated during the budget reporting window can have a significant effect on the total revenue effect from a temporary repatriation provision. This is the so-called acceleration effect in which it is assumed that taxpayers will receive the benefit of the temporary repatriation provision with respect to dividends that would have otherwise been repatriated during the budget period.

If taxpayers accelerate dividends from later years in the budget window to the time when the temporary repatriation provision is in effect, then there is both a revenue gaining and revenue losing component to the estimate. In the year when the temporary repatriation provision applies, there will be a revenue gain from the dividend repatriations that are accelerated into the current year. On the other hand, there will be a revenue loss in the later years of the budget period when those dividends would have otherwise been repatriated and the residual U.S. tax paid.

In the case of an 85-percent DRD, the Joint Committee staff assumes that approximately 28-29 percent of the dividends repatriated are accelerations from later years in the budget period ($200 billion of a total of $700 billion). In the case of a 70-percent DRD, the Joint Committee staff assumes that approximately 38 percent are accelerations ($125 billion of a total of $315 billion).

For purposes of this proposal, we assume that approximately 31 percent of the dividends repatriated (approximately $156 billion) would be accelerations, an estimate that is consistent with the Joint Committee assumptions.

However, it is also necessary to make assumptions concerning the residual U.S. tax rate that would apply to these dividends under current law. The GAO study suggests a residual tax rate under current law of four percent, but the Joint Committee staff have indicated their belief that this rate is too low with respect to marginal repatriations. Our analysis assumes that the repatriations that would have occurred under current law during the budget period (and are accelerated under the proposal) would have been subject to an average effective U.S. tax rate of 26.3 percent.

5. Estimates of Effects of a Temporary Repatriation Provision on Future Behavior of U.S. Corporations

There is one final component to the Joint Committee estimates of a temporary repatriation provision – the estimate of how the behavior of U.S. corporations might change in the future because of the enactment of another temporary repatriation provision. The Joint Committee staff refers to this as the "effect on prospective decisions about where to locate investment and/or income." We refer to this as a potential "portfolio" effect as it affects a U.S. corporation's mix of activities and investments. This potential behavioral effect is highly speculative.

A significant component of the Joint Committee revenue effect ($1 billion of a total $3.3 revenue loss in 2004) was attributable to this location shifting effect. The Joint Committee staff believes that another temporary repatriation provision will cause U.S. corporations to move even more of their activities outside the United States after another temporary repatriation provision and attributes this behavior to the expectation that future repatriations will occur with little residual U.S. taxation.

Many factors drive the behavior of U.S. corporations. As the Joint Committee staff notes, "some of this high overseas profitability is related to overseas marketing and production opportunities aimed at sales of third parties located overseas which is part of a secular movement that has been underway for many decades, while some of it can be linked to U.S.-based activities such as research and development or third-party demand in the U.S. market."

The financial accounting rules create an opportunity for U.S. corporations to report higher earnings to their shareholders if they move activities outside the United States and defer both U.S. taxation and U.S. financial accounting treatment for the potential residual U.S. taxation on their foreign earnings.

Further, U.S. corporations locate activities and investments outside the United States because of the more favorable tax systems that apply in some jurisdictions. The United States has one of the highest statutory tax rates in the world and U.S. corporations take advantage of opportunities to locate their activities in countries with lower statutory and effective rates of tax.

In order to attribute a revenue loss to the location shifting effect, one must assume that the "primary" reason for changes in the location of investments and activities of U.S. corporations will be driven by the expectation that there will be another temporary repatriation provision enacted at a future date. Given all of the reasons why U.S. corporations already have incentives to move as much as they possibly can outside the United States, we think that this particular behavioral effect is highly speculative. It is impossible to attribute with any certainty the decision to move activities outside the United States to be primarily attributable to the anticipation of a future temporary repatriation provision.

Indeed, we believe that the most likely reason that U.S. corporations continue to locate activities outside the United States is in response to demand in nascent foreign markets. Further, corporations tend to reinvest those earnings in response to the existing U.S. corporate tax system. Until the United States passes structural corporate income tax reform, we believe that U.S.

corporations are likely to continue the decades-long trend to move activities outside the United States.

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