REPATRIATION TAX HOLIDAY 2.0

Understanding how a cash repatriation tax holiday could allow multinational corporations to move offshore earnings back to the United States at a greatly reduced tax rate.

Among the many propositions that have arisen following the presidential election of Donald Trump and other Republican victories in November is the opportunity to bring corporate cash currently held offshore back to the United States. While the government has yet to decide whether to mandate or incent voluntary cash repatriation, or take any action at all, we can look to the recent past to gain some insight into how this activity may evolve. Herewith, we review the 2004 Homeland Investment Act policy and its effects on corporate finance decisions as well as leading theories by experts who have weighed in on how a second tax repatriation holiday might look under a Trump administration.

$2.5 trillion is currently held offshore according to most recent estimates.[1]

KEY TAKEAWAYS

A tax repatriation holiday provides an opportunity for multinational businesses to avoid a heavy tax burden when moving income they earned and paid taxes on offshore back to the United States.

Allowing companies to bring earnings back to the United States at a reduced tax rate, in theory, may act as incentive for multinationals to create American jobs, expand operations in the United States and stimulate shareholder distributions, primarily in the form of share repurchases.

With an incoming majority Republican-elected government, much speculation surrounds the potential for corporate tax reform. Our research has found three likely options regarding the repatriation of cash held overseas.

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LESSONS FROM THE PAST

In 2004, Congress passed the Homeland Investment Act (Section 965) as a component of the American Jobs Creations Act. The goal of the bill was to spur investment by providing financially constrained companies access to internal capital that was sitting idle outside of U.S. tax jurisdiction. In order for corporations to repatriate funds at a discounted tax rate of 5.25% versus the standard corporate tax rate of 35%, repatriations were restricted by the following criteria:

1. Repatriation allowance was limited to “extraordinary cash” in excess of the average repatriation, only being available for repatriations that exceeded the benchmark measurement.
    - To qualify as extraordinary, the repatriations had to exceed the average repatriation of the past five years, excluding the maximum and minimum repatriation amounts in the calculation.
    - Additionally, repatriations were limited to $500 million or the total amount of earnings permanently reinvested outside the United States.
    - Eligible funds only included section 302 and 304 redemptions of stock, section 316 dividends and liquidations considered a dividend according to section 367(b) of the U.S. tax code.
    - All other forms of dividends were not eligible.
2. Any increase in related party debt reduced the amount of eligible repatriation by the increase in debt.
3. The full pretax extraordinary amount of the repatriation had to be invested in order to receive the discounted tax rate.
4. The full amount of the repatriation was required to be invested in the United States and a plan for that investment was required to be approved by the CEO and board of directors, making it subject to Sarbanes-Oxley requirements.
    - No incremental investment versus previous year’s investments was required.
    - Permitted uses included any methods that contributed to the financial stabilization of the company. This was broadly and vaguely stated intentionally to reduce the need of corporations to adjust their strategies in order to fulfill the reinvestment requirement.
    - Specific uses not permitted included executive compensation, intercompany transactions, shareholder distributions, stock redemptions, portfolio investments, local, state or federal tax payments and purchases of Treasury bills and municipal or corporate bonds.[2]

APB 23 IMPLICATION

Companies should review the accounting implications of the repatriation of cash if and when a formal policy is adopted. One of the main issues that arose from the 2004 tax holiday was the impact of Accounting Principal Board (“APB”) Opinion Number 23, which required U.S. companies to accrue for repatriation taxes on foreign earnings if it was apparent that repatriation activity was a regular annual occurrence for the company. Companies managed around this requirement using Paragraph 31 of the opinion, which provided an exception to the accrual requirement if a specific plan for reinvestment of the undistributed earnings was provided to regulators. This requirement dovetailed with the requirements under the 2004 tax holiday but that may not be the case with future repatriation tax policies.[3]

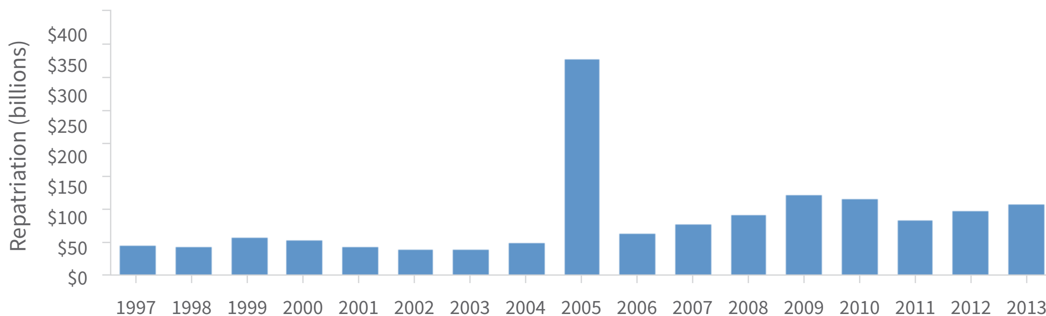
TAX REPATRIATION BY THE NUMBERS

Since the bill was enacted into law and the benefits were received, numerous studies analyzed the actions and effectiveness of the policy. According to data from the IRS:

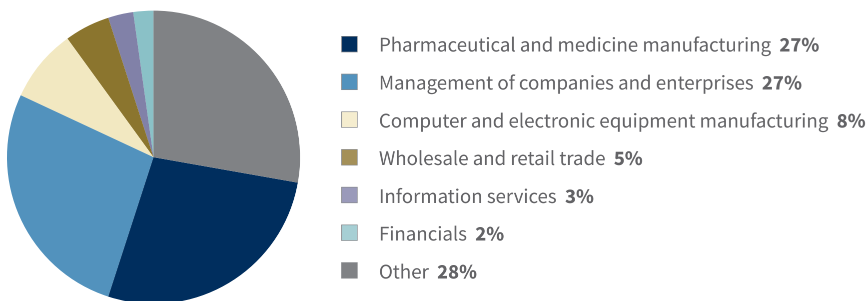
- **843** corporations out of 9,700 with foreign subsidiaries as of 2004 took advantage of the tax holiday.
- **$362 billion** was repatriated in total.
- **$312 billion** of that $362 billion qualified for the tax repatriation holiday.

Studies show that the industries that benefited the most from the tax holiday were pharmaceutical and computer/electronic manufacturing, followed by wholesale/retail trade, information services and financial companies.[4]

FOREIGN CASH REPATRIATION [4]



ALLOCATION OF REPATRIATIONS AMONG THE MOST ACTIVE SECTORS [4]



THE SHAREHOLDERS' STAKE

Although the rule prohibited using repatriated cash for shareholder distributions, the inflow of foreign cash for growth investments freed up domestic cash for shareholders. For every $1 of cash repatriated, it is estimated that $0.93 was used for shareholder distributions. Data from academic papers showed that a majority of the increase in repatriated cash holdings was utilized for shareholder distributions, most notably share repurchases. As long as corporations met their investment plans, they were free to spend an equivalent amount on something else. It appears that with a lump sum of cash, corporations decided to return the cash back to shareholders both through a special dividend and share repurchases, predominantly by the latter method.[5, 6]

THREE THEORIES FOR CORPORATE TAX BREAKS

With an incoming majority Republican-elected government, much speculation surrounds the potential for corporate taxes to be lowered as well as a possible new tax repatriation bill to be enacted. Our research has found three likely options regarding the repatriation of cash held overseas by U.S. multinational corporations. The three leading theories for a new repatriation effort are a transition tax (mandatory), a stand-alone deemed repatriation (mandatory) or another repatriation tax holiday similar to 2004 (optional).

- A transition tax would be passed in combination with a reformed U.S. tax code. If this method were to be implemented, the reform likely would reduce the U.S. corporate tax rate and include a one-time transition tax on current foreign cash holdings of U.S. corporations. The House GOP put forth a proposal in September 2016 that encompasses this method for taxing repatriated cash of U.S. multinationals. Their proposal calls for a reduction of the corporate tax rate to 20% and a transition tax rate of 8.75%. Corporations would have eight years to complete the payment of these taxes under the transition tax plan and would be required to repatriate, which was not required under the original tax holiday. Trump's corporate tax reform proposal also includes a reduction of the corporate tax rate and a one-time transition tax. His plan calls for a reduction of the corporate tax rate to 15% and a one-time transition tax of 10%. Under his plan, corporations would have 10 years to complete their tax payments and would be required to repatriate as well.
- A stand-alone deemed repatriation would entail a one-time reduction of the tax on the repatriation of corporate cash held overseas. Similar to the transition tax, companies would be required to repatriate cash held overseas. Experts believe this method to be the least likely to be passed.
- A repatriation tax holiday similar to the 2004 tax holiday would have the same characteristics as stand-alone deemed repatriation but would not require corporations to repatriate cash held overseas.

REPATRIATION POSSIBILITIES COMPARED TO THE 2004 TAX HOLIDAY [7, 8]

	TRUMP'S PLAN	HOUSE GOP PLAN	2004 REPATRIATION HOLIDAY
TRANSITION TAX RATE	10%	8.75%	5.25% (Reduced Tax)
CORPORATE TAX RATE	15%	20%	35%
PAYMENT TIME (YEARS)	10	8	2
MANDATORY	Yes	Yes	No

HOW WE CAN HELP

Analyzing the previous tax repatriation holiday offers valuable insight into the current corporate tax and repatriation tax discussions. When corporations elected to benefit from the reduced tax rates on repatriations, their investments freed up more capital that was eventually returned to shareholders. However, because of the one-time nature of the original tax repatriation, management teams elected to return the capital to shareholders in the form of share repurchases rather than dividends.

Looking ahead, should your firm repatriate earnings, one of the main initial benefits would be for safety of capital and balance sheet cash investment programs. The domestic cash investment options are much more transparent, carry higher yields (and lower fees), and greatly reduce counterparty risk. Raymond James Corporate & Executive Services team has built a fully independent cash investment platform that focuses on investment-grade fixed income options for public and private companies in the United States. We would be happy to help discuss your investment policy and potential solutions.

Additionally, should your firm decide to distribute excess capital following repatriation through a share repurchase, we would welcome the opportunity to serve as your advisor and partner. Raymond James Corporate & Executive Services' expertise and trading execution related to share repurchases is supported by seasoned professionals with over 15 years of experience working together. Our clients have ranged from blue chip $100 billion plus market capitalization to small and micro capitalization companies working across all sectors and industries.

HOW WE STAND OUT

Raymond James' share repurchase platform drives value in three key areas, differentiating us from the commoditized approach of traditional credit banks:

Expert development of a repurchase strategy through:
- Institutional investor intelligence
- Seasoned professionals providing a high-touch customized trading approach
- Technical analysis

Legal expertise surrounding the laws regulating corporate share repurchases:
- Rule 10b5-1 plan design
- Rule 10b-18

Customized communication via:
- Email, phone calls, Bloomberg chat
- Intraday performance reporting
- Post-rotation analysis

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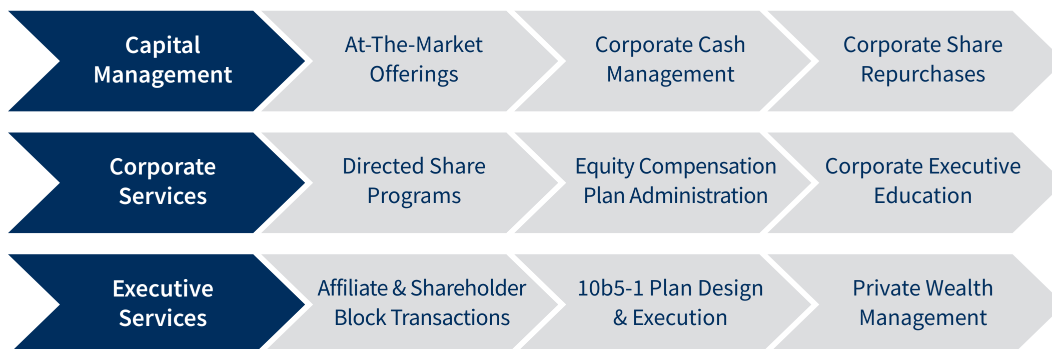

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Source 1: "US Companies are Hoarding $2.5 Trillion in Cash Overseas"
Author: Jeff Cox
Date: September 20, 2016

Source 2: "Effects of 2004 Int'l Tax Holiday, Recommendations Going Forward"
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Date: August 31, 2011

Source 3: "What your Auditor May Want to Know About APB 23 Representations and Section 965 Repatriation"
Author: Todd B. Reistein
Date: January 10, 2005

Source 4: "The One-Time Received Dividend Deduction"
Author: Melissa Redmiles
Date: Spring 2008

Source 5: "Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act"
Authors: Dhammika Dharmapala, University of Illinois at Urbana-Champaign; C. Fritz Foley, Harvard University and NBER; Kristin J. Forbes, MIT and NBER
Date: April 2010
Data Source: Repatriation Data – Bureau of Economic Analysis, Firm data – Compustat, Multiple cited repatriation studies were retested to confirm results combining the findings of all reports

Source 6: "Bringing it home: A study of the incentives surrounding the repatriation of foreign earnings under the American Jobs Creation Act of 2004"
Authors: Jennifer Blouin – The Wharton School: Linda Krull – University of Oregon
Date: July 2008
Data Source: Repatriation Data – SEC Filings 10-K and 10-Q, Firm data – Compustat

Source 7: "Three Types of 'Repatriation Tax' on Overseas Profits: Understanding the differences
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Source 8: "An Analysis of the House GOP Tax Plan"
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Date: September 16, 2016

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