Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515-6453

APR 3 0 2015

MEMORANDUM

TO: [redacted]

FROM: Thomas A. Barthold T.A.B.

SUBJECT: Revenue Estimate

This memorandum corrects my April 29, 2015, response to your request of April 23, 2015, for a proposal by Senators Boxer and Paul for a temporary reduced rate on some dividend repatriations from foreign subsidiaries of U.S. corporations. In my response of April 29, 2015, the table's legend mistakenly was labeled "millions of dollars" and should have read "billions of dollars." The proposal allows U.S. corporations to make a one-time election of an 81.4-percent dividends-received deduction ("DRD") for certain dividends they receive from their controlled foreign corporations ("CFCs") during the five years following the election.

The temporary tax holiday enacted in 2004 (in section 965) provided an elective, 85-percent DRD for certain dividends received by a domestic corporation from CFCs, subject to a number of conditions and limitations. Included in these limitations were requirements that eligible dividends be: (1) in excess of a specified level of historical average repatriations; (2) no more than the greater of $500 million or the amount of overseas earnings identified for financial accounting purposes as permanently reinvested abroad; and (3) reinvested in the United States under a dividend reinvestment plan approved by the management and board of directors of the electing corporation and meeting certain other criteria. An election under section 965 was available only for either the taxpayer's (i) last taxable year beginning before the date of enactment of section 965 (which was October 22, 2004) or (ii) first taxable year beginning during the one-year period beginning on that date of enactment.

Senator Boxer and Senator Paul's proposal differs from the 2004 temporary tax holiday in a number of ways in addition to the deduction percentage and the duration of the holiday. The proposal limits the amount of dividends eligible for the deduction to the U.S. shareholder's proportionate share of the nonpreviously taxed earnings of its CFCs as of the end of the last taxable year ending on or before December 31, 2014. Additionally, if in any year the amount taken into account under the elective DRD is less than 20 percent of the amount designated in the taxpayer's election, the amount of dividends allowed to be taken into account in future years is reduced by the shortfall. The proposal also provides different domestic reinvestment plan requirements than the 2004 holiday. For example, the proposal requires that a U.S. corporation's

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plan must provide that at least 25 percent of the dividends taken into account under the proposal will be used for at least one of a number of specified purposes including to increase employment, wages and benefits, or pension contributions; to provide for energy efficiency, environmental, or capital improvements; to invest in public infrastructure; for research and development; or for the acquisition of other businesses. The domestic reinvestment plan also must provide that none of the dividends taken into account under the proposal will be used during the plan period to compensate certain highly paid employees. The proposal also denies the deduction for companies that invert at any time in the 10-taxable year period beginning with the first taxable year after 2013 to which the proposal applies, and it imposes a tax of 20 percent of any amount elected under the proposal by a corporation that inverts during this period. This 20-percent tax would apply in the year of the inversion.

Assuming that the proposal would be enacted June 1, 2015, we estimate that the proposal would change Federal fiscal year budget receipts in the following manner:

Fiscal Years
[Billions of Dollars]

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
4.3	24.5	1.0	-5.8	-12.5	-12.4	-15.9	-23.0	-27.1	-26.6	-24.4	-0.9	-117.9

Our revenue estimate draws from the evidence on the usage of section 965 in the 2004-2006 period, as well as evidence from other temporary reductions or holidays in areas such as sales taxation and the taxation of capital gain income. For example, the Internal Revenue Service has produced a descriptive analysis of the tax holiday and found that corporations repatriated $362 billion under the 2004 holiday, which resulted in a total deduction of $265 billion.[1] In addition, there has been extensive research regarding the effects of the section 965 tax holiday on repatriation behavior and the location of income, economic activity and investment, and firm governance.

[1] Vanessa Redmiles, "The One-Time Received Dividend Deduction," *SOI Bulletin*, vol. 27, no. 4, Spring 2008, pp. 102-114. The paper also analyzed the distribution of qualifying dividends, finding that they were highly concentrated in a few industries and source countries.

Our estimate includes the following major components. The first is the loss in revenue associated with the reduced tax liability afforded under the proposal for certain dividends that taxpayers are predicted to repatriate even in the absence of enactment of the proposal. Although there are tax costs associated with repatriating dividends, recent research using experience from the repatriation holiday has shown that there is also an implicit (and potentially high) cost with deferring repatriations, with the cost rising as the amount of tax-deferred earnings grows.[2] This suggests that, under present law, repatriations are likely to increase in the future as corporations expand their economic activity overseas.

The second major component of our estimate captures the U.S. tax effects associated with taxpayers changing their dividend repatriation amounts and/or timing in response to the proposal. These tax effects will increase or decrease revenue collected in the budget period depending on the source of those dividend repatriations that are accelerated into the five-year period following elections made by U.S. corporations. Dividend repatriations accelerated from within the budget period into the five-year period following an election will reduce federal receipts. Dividend repatriations may also be accelerated from outside the budget period into the five-year period, and these repatriations will increase federal receipts.

The third major component of the estimate reflects the moral hazard problem that the proposal creates. By encouraging taxpayers to increase total dividend repatriations with a special deduction, the proposal may also discourage taxpayers from repatriating certain dividends within the budget window if they anticipate that similar legislation may be enacted in the future that will enable them to repatriate dividends at a lower tax cost. This will have a direct effect on revenue collections as multinational corporations may delay dividend repatriations that would have occurred in the 10-year budget period absent the proposal even if the corporations do not alter the locations of their investment and income. Tax revenue may also fall indirectly under the proposal if multinational corporations locate more income and investment overseas. This could be a profitable strategy if they expect that future dividends can be repatriated with little U.S. residual taxation, and research has found evidence that corporations increased overseas investment and reported greater amounts of permanently reinvested earnings as a result of the 2004 temporary tax holiday.[3] A second and longer lasting repatriation holiday may be interpreted

[2] Rosanne Altshuler and Harry Grubert, "Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax," April 1, 2013, available at ftp://snde.rutgers.edu/Rutgers/wp/2013-05.pdf.

[3] Thomas Brennan, "What Happens After a Holiday: Long-Term Effects of the Repatriation Provision of AJCA," *Northwestern Journal of Law and Social Policy*, vol. 5, Spring 2010, pp. 1-18.

by firms as a signal that such holidays will become a regular part of the tax system, thereby increasing the incentives to retain earnings overseas rather than repatriating those earnings and to locate more income and investment overseas.

The final major component is the predicted distribution of the repatriated funds to shareholders in the form of dividends or share repurchases, and the subsequent changes in individual income tax liability, mainly from increases in dividend tax payments or capital gains recognized. Academic research on how companies deployed dividends repatriated under the section 965 tax holiday is mixed but generally suggests that most of the funds were used to increase dividend payments and share repurchases even though there were restrictions placed on the use of repatriated dividends for these purposes.[4] However, some research has found that there was little change in firm payouts as a result of the holiday.[5]

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[4] See, for example Dhammika Dharmapala, C. Fritz Foley, and Kristin J. Forbes, "Watch What I Do, Not What I Say: The Unintended Consequences of the of the Homeland Investment Act, *Journal of Finance*, vol. 66, no. 3, June 2011, pp. 753-787, and Jennifer Blouin and Linda Krull, "Bringing It Home: A Study of the Incentives Surrounding the Repatriation of Foreign Earnings Under the American Jobs Creation Act of 2004," *Journal of Accounting Research*, vol. 47, no. 4, September 2009, pp. 1027-1059. These papers found that the holiday had no effect on investment.

[5] Michael Faulkender and Mitchell Petersen. "Investment and Capital Constraints: Repatriations Under the American Jobs Creation Act," *The Review of Financial Studies*, vol. 25, no. 11, November 2012, pp. 3351-3388. This paper found that investment increased among the subset of firms facing capital constraints.