Repatriation ("Deemed" vs. "Holiday")

There is approximately $2.1 trillion dollars in foreign earned income held overseas by the foreign subsidiaries of U.S. based companies. Under current law, U.S. multinational companies do not pay U.S. federal taxes on the profits made by their foreign subsidiaries until these profits are repatriated—known as deferral—as long as the earnings are reinvested in the ongoing activities of their foreign subsidiaries. Various repatriation proposals have been discussed by the administration and some Members of Congress in conjunction with plans to pay for infrastructure investment. There are a few key issues to keep in mind: first, the statutory tax rate for U.S. corporations is 35%; and, second, there is a large discrepancy between a repatriation “Holiday” (i.e. the 2004 policy), and “Deemed” repatriation that is included in many of the current proposals.

Repatriation “Holiday”
The repatriation “Holiday” is essentially a temporary reduced repatriation tax rate that creates an incentive to encourage corporations to return income that they need to use in the United States. According to IRS estimates, the last repatriation tax “Holiday” in 2004 saw 843 companies repatriate $312 billion at a rate of 5.25%. Currently Senators Boxer (D-CA) and Paul (R-KY) are talking about using a temporary repatriation “Holiday” that would allow companies to bring back foreign earned income at a 6.25% rate, rather than the nominal corporate income tax rate of up to 35% when repatriated. They theorize that their legislation could incentivize the repatriation of as much foreign earned income as the last repatriation “holiday” brought back. The proposal requires the tax to be paid into the highway trust fund, but it has some limitations that were not present on the 2004 repatriation “Holiday.” The legislation would only apply to repatriations above the companies repatriations in recent years, and it would prohibit the repatriated income from funding increased dividends, share buybacks, or increased executive compensation. In addition, companies that make use of the “Holiday” and invert within the next ten years would have to repay the tax incentive from the “Holiday” with interest.

“Deemed” Repatriation
The administration proposed: Imposition of a transition (one-time) tax that would force companies to pay U.S. tax right now on the $2 trillion they hold overseas that was not previously subject to U.S. taxation. U.S. companies would have all retained earned income held overseas to be subject to immediate taxation at a 14% rate. The proposal would be effective on the date of enactment and would apply to all earnings (whether or not they were destined for future U.S. investments) accumulated for taxable years beginning before January 1, 2016 (essentially a mandatory retroactive tax known as “Deemed” repatriation). The tax would be payable ratably over five years.

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1 $2.1 trillion, a sixfold increase over the past 12 years, according to Capital Economics database as well as that of Audit Analytics and other sources including Credit Suisse, Center for Effective Government and Institute for Policy Studies.
After the first round of “Deemed” repatriation, all future foreign earned income would be subject to a 19% rate. A credit would be allowed for the amount of foreign taxes associated with such earnings. The proposal pays for outlays associated with: (1) new spending associated with the administration’s surface transportation reauthorization proposal; and (2) shortfalls between revenue and surface transportation spending that exist under current law for the proposal period.

Mandatory taxing foreign profits retroactively is known as “Deemed” repatriation because earnings are considered to be taxed immediately whether they are brought back to the U.S. or left overseas. “Deemed” repatriation proposals have also been contemplated in previous congresses, for instance former Ways and Means Chairman Dave Camp proposed a 5.25% rate payable over 8 years. Former Senate Finance Chair Max Baucus included a rate as high as 20% in some of his discussion drafts.

John Delaney’s (D-MD) Infrastructure 2.0 Act uses “Deemed” repatriation with an effective rate of 8.75% on repatriated earnings and profits payable over 8 years. It creates an additional incentive that would establish the American Infrastructure Fund to provide assistance to states, local governments, and other public and private entities for investment in public infrastructure projects including putting tax revenues into the highway trust fund.

Conclusion
The various forms (Repatriation “Holiday” vs. “Deemed” Repatriation) can raise significant sums of money. “Deemed” repatriation at the top rate proposed by the administration is estimated to bring in about $200 billion, while the “Holiday” is estimated to bring in as much as $20 billion (although the estimates vary). No current proposal in Congress is as high of a rate as the President’s.

Repatriation has support among both Democrats and Republicans in both chambers of Congress, who increasingly agree that they cannot continue to avoid passing a multi-year transportation funding mechanism. However, significant disagreements remain about whether it is a “Holiday” or “Deemed” and what the rate will be, as well as how much is allocated to infrastructure versus reducing the domestic marginal rate for corporations and pass-through businesses. Moreover, U.S. multinational corporations are weary of “Deemed” repatriation absent comprehensive tax reform that includes shifting to a territorial tax system, in order to address competitive disadvantages with foreign-owned companies that domicile in countries with significantly lower tax rates.