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on
Repatriation of Foreign Earnings as a Source of Funding for the
Highway Trust Fund

Traditionally, the highway trust fund has been financed by user fees, primarily the gasoline tax and to a lesser extent the tax on diesel fuels. The collections from these taxes have declined both because they have not been adjusted for inflation (if they were, the 18.3 cents per gallon excise tax on gasoline would be 31 cents) and because of increases in fuel economy. As a result, the highway trust fund faces a shortfall in revenues relative to spending.[1]

Proposals have been made to use taxes on the repatriation of previously untaxed foreign earnings of U.S. multinationals to fund investment in highways or infrastructure, including the Invest in Transportation Act (S. 981), introduced by Senators Paul and

[1] For a discussion of the financing of the trust fund, see CRS Report RL30304, *The Federal Excise Tax on Motor Fuels and the Highway Trust Fund: Current Law and Legislative History*, by Sean Lowry. See also Joint Committee on Taxation, Long-Term Financing of the Highway Trust Fund, JCX-92-15, June 15, 2015, at https://www.jct.gov/publications.html?func=startdown&id=4790, for data and estimates of inflation indexed rates. H.R. 680 would increase fuel taxes to address financing.

Boxer. This proposal would rely on taxing a voluntary repatriation at a lower rate. A different type of repatriation, called deemed repatriation, as an element of a broader tax reform proposal, has also been proposed to be used for infrastructure spending. A deemed repatriation would impose a tax on the stock of untaxed overseas earnings and is normally discussed as part of a transition in an international tax reform. The Tax Reform Act of 2014 (H.R. 1) introduced in the 113th Congress by then Chairman of the Ways and Means Committee, Dave Camp, would have transferred $126.5 billion of taxes to the trust fund through a deemed repatriation.[2] This bill embedded transition provisions in a broad individual and corporate income tax reform. The administration's FY2016 budget proposals also include a deemed repatriation as a transition to a new international system embedded in a general business tax reform proposal. In the proposal, the revenues from the tax on the current stock of unrepatriated earnings ($205 billion) are allocated to surface transportation (both new spending and shortfalls in the trust fund).[3]

There are several issues surrounding the use of taxes on the repatriation of accumulated earnings as a source of revenue for the highway trust fund. First, these are one-time sources of funding, and will not address the long-term needs of the trust fund. Second, voluntary repatriations, or "holidays" are scored as revenue losers rather than revenue gainers. Third, deemed repatriations, subject to a mandatory tax, have never been suggested as a stand-alone policy; if they were, they might also lose revenue. Past proposals for deemed repatriations were for a transition rule for a shift to a new type of

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[2] See Ways and Means Committee, Tax Reform Act of 2014 Discussion Draft Section-by-Section, p. 143, http://waysandmeans.house.gov/UploadedFiles/Ways_and_Means_Section_by_Section_Summary_FINAL_022614.pdf. The tax raised $170 billion, including income taxes on dividends paid by U.S. multinationals to their shareholders, as a result of access to the deemed repatriations.

[3] U.S. Department of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals (Green Book), Washington, DC, February 2015, http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf.

international tax system, which involves numerous contentious and difficult issues that are unrelated to the more narrow concern about highway trust fund finance. In addition, much of the interest in international tax reform has been associated with a proposal to lower the corporate statutory tax rate, which would require a broader corporate reform. That corporate reform, in turn, has implications for unincorporated businesses and may lead to an even broader reform involving the individual income tax, as in the case of the Camp proposal.

If, however, there is a desire to link spending on transportation infrastructure with increased revenue from foreign source income, there are a number of anti-abuse proposals that have been presented in previous administration budgets that could be considered to fill the gap in highway trust fund revenues on a permanent basis.

A Repatriation Holiday

The U.S. tax system imposes a tax on worldwide income, with a credit against U.S. tax liability allowed for income taxes paid to foreign countries. Income from foreign subsidiaries of U.S. firms is not taxed until it is repatriated, or paid to the U.S. parent as a dividend. This feature of the tax code produces an incentive to retain earnings abroad that have not been subject to significant foreign taxes. This effect may be more important because of profit shifting to low-tax jurisdictions, which has been increasing due to the growth of intangible assets.[4]

In 2004, the American Jobs Creation Act of 2004 (P.L. 108-357) provided for a repatriation "holiday." Firms were allowed a deduction equal to 85% of the increase in foreign earnings repatriated. At a corporate statutory rate of 35%, the effective rate on

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[4] See CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by Jane G. Gravelle, pp. 16-19 for a discussion of the evidence on the magnitude and growth of profit shifting by U.S. multinational firms.

repatriated earnings was 5.25%. Proportional foreign tax credits were allowed. The rationale for the provision was to increase investment and employment in the United States by bringing back cash that was trapped abroad. The legislation restricted certain uses of funds, including the payment of dividends to the U.S. parent's shareholders.

Since money is fungible, there was no way to effectively enforce the restrictions on use. Subsequent studies indicated that most of the repatriated funds were used for share repurchase (equivalent to a dividend payment), acquisition of other firms, or debt reduction.[5] These effects would not increase investment or stimulate the economy, thus undermining the stimulus justification for a repatriation holiday.

Moreover, repatriation holidays are expected to lose, not gain, revenue. A proposal in 2014 to provide a one-time repatriation provision similar to that in 2004, with an 85% deduction (equivalent to a 5.25% rate given the 35% corporate rate) was estimated by the Joint Committee on Taxation (JCT) to lose $95.8 billion over FY2014-FY2024.[6] The JCT estimated that the Paul-Boxer proposal, which imposes a slightly higher rate (an 81.4% deduction for a 6.5% rate), but allows for a longer time period to repatriate, would, while gaining $30 billion in the first three years, lose $148 billion over the next eight years, for a total loss of $117.9 billion from FY2015-FY2025.[7]

These voluntary repatriation proposals lose revenue because some of the funds would have been repatriated in any case, but would have been taxed at the statutory tax

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[5] Most of these studies are reviewed in CRS Report R40178, *Tax Cuts on Repatriation Earnings as Economic Stimulus: An Economic Analysis*, by Donald J. Marples and Jane G. Gravelle. See also Thomas J. Brennan, Where the Money Really Went: A New Understanding of the AJCA Tax Holiday, Northwestern Law and Economics Research Paper 13-35, March 6, 2014.

[6] Letter to Honorable Orrin Hatch, from Thomas Barthold, Staff Director, Joint Committee on Taxation, June 6, 2014, http://www.hatch.senate.gov/public/_cache/files/1b24c4cf-6005-4a4e-bab7-3d9e3820c509/JCT%206-6-14.pdf.

[7] Letter from Thomas Barthold, Staff Director, Joint Committee on Taxation, April 30, 2015, http://newsletters.usdbriefs.com/2015/Tax/TNV/150501_2suppA.pdf.

rate of 35%. For each dollar that falls into this category during the budget horizon, there is an overall revenue loss due to the difference in the normal tax rate and the lower repatriation rate. They also lose revenue because repatriation holidays create an incentive to delay future repatriations in anticipation of future holidays. Although there is some gain in revenue due to individual income taxes on dividends paid from repatriated funds to shareholders, overall the losses offset the gains, as illustrated by the JCT cost estimates cited above.

Increasing the tax rate applying to the repatriations during the holiday may reduce the revenue loss but is unlikely to result in significant (or any) gain. In 2011, a revenue estimate provided to Representative Doggett estimated a 10-year revenue loss of $78.7 billion for a 5.25% rate for a tax holiday; the revenue estimate for doubling the rate to 10.5% was a $41.7 billion loss.[8] As the rate rises, firms would be expected to repatriate less so that the loss shrinks, but a gain is still unlikely.

A Stand Alone Deemed (Mandatory) Repatriation

As noted above, there have been proposals for a deemed, or mandatory, repatriation tax. These proposals deem the accumulated untaxed earnings abroad subject to a repatriation tax (although there is no requirement to actually repatriate them). To date, all of these deemed or mandatory repatriation proposals have been part of are transitions to an alternative international tax system.

Such a deemed repatriation tax could be made as stand-alone policy. Recent estimates by Credit Suisse indicate that at the end of 2014, $2.1 trillion of unrepatriated

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[8] See letter to Honorable Lloyd Doggett from Thomas Barthold, Chief of Staff, Joint Committee on Taxation, April 15, 2011, at http://doggett.house.gov/images/pdf/jct_repatriation_score.pdf.

earnings were held abroad.[9] For the companies that disclosed cash (accounting for $1.5 trillion of the total), the cash share was 45%. The authors of the study suggest the percentage held in cash might be less if the firms that did not disclose cash had smaller holdings.

If an objective, in addition to gaining revenue, is to unlock earnings abroad, it is important to separate the two types of earnings. Some portion of the earnings (apparently over half) is invested in physical assets such as plant and equipment. Short of liquidating property, these funds would not be repatriated in any case and imposing a mandatory stand-alone tax is basically a lump sum tax on assets. (The Camp bill imposed a lower tax rate of 3.5% on these types of holdings investments as part of its transition rule, compared to an 8.75% rate on cash holdings.)

Unless a large tax is imposed to include physical plant and equipment abroad, which cannot be repatriated, it is unlikely that a stand-alone deemed tax will raise revenue. If a tax is imposed on deemed cash held abroad at the rate of the Paul-Boxer bill (6.5%), the deemed repatriation tax could raise slightly over $60 billion (45% of $2.1 trillion times 0.065) from the repatriation tax.[10] Some of this tax would be offset, however, by the foreign tax credit. If the offset is similar to the foreign tax credit offset reported for the 2004 holiday, the yield would decline by 11.4% or to $54 billion.[11] Potential revenues would also be reduced by the regular tax that would have been paid on the portion of funds that would otherwise be repatriated. There would be an additional

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[9] David Zion, Ravi Gomatam, and Ron Graziano Parking A-Lot Overseas, Credit Suisse, March 17, 2015.

[10] If it were imposed on all earnings abroad including plant and equipment, at the same rate, it would initially raise $136.5 billion, offset to some extent by foreign tax credits as well.

[11] Melissa Redmiles, The One-Time Received Dividend Deduction, Internal Revenue Service Statistics of Income http://www.irs.gov/pub/irs-soi/08codivdeductbul.pdf http://www.irs.gov/pub/irs-soi/08codivdeductbul.pdf.

revenue gain from dividend taxes to the extent cash was used to pay the shareholders of the parent firm, which amounts to about $44 billion.[12] But once earnings abroad have been subject to tax and are available to return to the parent company, these earnings could be used to satisfy cash needs, such as dividend payment, and reduce the need to repatriate future earnings. Thus there would still be an offsetting negative effect that would likely overwhelm the deemed repatriation tax.[13]

It is important to note that the estimates of a revenue gain in the Camp proposal of $170 billion ($126 billion in transition taxes by the firm and the remainder from dividend taxes of the U.S. parent's shareholders) is not a useful guide for the revenue gain from a stand-alone deemed repatriation, even if the same rates were used. The revenue gain estimate was stacked after the shift to a territorial tax; that is, it was made under the assumption that future repatriations would be subject to a virtually zero tax rate.[14] Thus, there would be no offsetting loss of significance from reductions in future repatriations.

A Deemed (Mandatory) Repatriation as a Part of Tax Reform

Both the Camp proposal in the 113th Congress and the Administration's current budget proposal, as well as a set of tax reform discussion papers released by the Senate Finance Committee in 2013 under Chairman Baucus, have two items in common: they all proposed moving to a system of taxation of foreign source income where repatriation no longer triggers a tax[15] and they both embedded the international proposals in a broader

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[12] The estimate of dividend tax payments in the Camp bill, the difference between the total gain of $170 billion and the amount dedicated to the highway trust fund, was $44 billion.
[13] The positive revenue gain from the repatriation tax would be eliminated if future repatriations were reduced by 18.4% of the deemed cash repatriation (which would occur if the revenue from the repatriation tax were dividend by 0.35). A somewhat larger effect would be required to offset the dividend tax.
[14] Because of the 5% "haircut," 5% of future dividends would be subject to tax, which at a 25% rate would be a 1.25% tax.
[15] As noted in the previous footnote, the inclusion of 5% of dividends in income creates a small repatriation tax of 1.25%.

tax reform proposal. The move to a system where foreign source income would not trigger a tax on repatriation meant that a mechanism was needed to address the existing accumulated untaxed earnings abroad. H.R. 625 (Delaney) would begin with a stand-alone deemed repatriation at an 8.25% rate, but the bill also has a trigger that would automatically enact an unspecified international reform after 18 months if such a reform is not separately adopted.[16]

These three international tax reform proposals (Camp, the Administration, and the Baucus discussion proposals) are quite different in the details. Achieving tax reform, even a narrow one that focused on international reform, could be difficult because of major disagreements about elements of the reform. Questions that would have to be agreed upon to move forward with international reform include:

- Is there a revenue gain, loss, or neutrality? The Camp international provisions, excluding the transition gains, lose $102 billion over ten years: the Administration proposal gains $34 billion—not enough revenue to close the highway trust fund spending gap for the next few years.[17]
- What rate is imposed going forward? The Camp proposal was 1.25% on dividends, the Administration proposal would impose a 19% minimum tax on earnings per country regardless of repatriation, and the Senate Finance draft discussion from 2013 would tax all foreign earnings at 80% of the tax rate (which had not been determined, but would have been 20% at a

[16] Absent such action a minimum tax, similar to that of the administration, but smaller, would go into effect.
[17] See Joint Committee on Taxation, Estimated Revenue Effects of the Tax Reform Act of 2014, JCX-February 26, 2014, https://www.jct.gov/publications.html?func=startdown&id=4562 for estimates of the Camp proposal and U.S. Department of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals (Green Book), Washington, DC, February 2015, http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf .

statutory 25% tax rate) or alternatively taxing active income at 60% and passive at 100%.

- What rate would be imposed on the existing accumulated untaxed earnings abroad? The Camp proposal would have imposed a 3.5% tax on non-cash investments and 8.75% on cash investments; the Administration proposal would impose a 14% rate.
- There are numerous other technical issues. Among them are what types of anti-abuse provisions are included to deal with profit shifting (both through leveraging and transfer pricing of intangibles); changes to the existing Subpart F income provisions (which taxes income easily subject to relocation), including how to treat the now expired "extender" that exempts active financing income from Subpart F; whether relief should be provided for royalties as the new systems eliminate most or all excess foreign tax credits that have been used in the past to shield foreign royalties; provisions to address earnings stripping by foreign parents of U.S. subsidiaries; provisions to deal with inversions; and whether special provisions are needed to address reinsurance and the extractive industries.

In short, while there is some common ground in these proposals, there are also broad differences in the details and numerous issues to discuss which may make adoption of an overall international reform difficult.

There is also some uncertainty as to whether a stand-alone international reform would be considered. Much of the interest by the corporate sector in tax reform is to lower the statutory corporate tax rate. A corporate tax reform which lowers the rate would, however, rely on base broadening provisions that would affect both corporations and unincorporated businesses (such as slower depreciation). Not only would many other issues arise in determining what provisions would be revised, but an increase in taxes on unincorporated firms may a barrier to a corporate-only tax reform.

Even a reform limited to corporate-only tax reform may not be feasible. While administration proposals have focused on corporate or business reform, interest in Congress has generally been for broader reform that would encompass changes in the individual income tax, a major policy initiative that raises broader issues than revenue for the highway trust fund. The Camp proposal, once revenue is allocated to the trust fund, has an overall general revenue loss that may be of concern, with even larger losses likely in the future. The Camp proposal, the only recent fully developed broad tax reform plan, did not advance in the legislative process, and no proposal is yet under consideration at the committee level.

Permanent International Provisions to Finance the Highway Trust Fund

An issue with using repatriation taxes is both that they are unlikely to yield sufficient (or even positive) revenue and they are transitory. If there is a desire to use taxes on foreign source income for a permanent revenue source, a number of proposals have been made by the Obama Administration over the years. They include disallowing interest and overhead deductions for the share of the firm's income that is earned abroad and not currently repatriated and taxed, and allowing foreign tax credits only in proportion to the income repatriated. The most recent administration budget proposal eliminated some of these provisions because of the proposal for an international tax reform, but the previous FY2015 budget contains a number of provisions, which at that time were projected to raise $276 billion in revenue.[18] They are also discussed in a CRS report on international taxation.[19]

[18] U.S. Department of Treasury, and U.S. Department of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals (Green Book), Washington, DC, February 2015, http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf.

[19] See CRS RL34115, *Reform of U.S. International Taxation: Alternatives*, by Jane G. Gravelle, pp. 19-20.