Multinationals' "Trapped" Foreign Profits Not Key to Jobs and Growth

Center on Budget and Policy Priorities

U.S.-based multinationals pay U.S. corporate tax on their foreign profits only when they "repatriate" them to the United States. Many corporations use accounting maneuvers to report as much of their profits offshore as possible to avoid U.S. taxes; about $2.6 trillion in profits is booked offshore.[1] Multinationals often claim that the U.S. corporate tax "traps" these profits overseas and that they would invest the funds in the United States and create jobs if they received a tax break on repatriated profits as part of tax reform or if tax reform included a shift to a "territorial" tax system, with a zero percent tax rate on U.S. multinationals' foreign profits. The evidence does not support these claims:

- **The failed 2004 repatriation tax holiday led to large repatriations but not to new investment or jobs, and there's little reason to think repatriated profits would have a different impact today.** In 2004, lawmakers allowed multinationals to repatriate more than $300 billion in profits at a greatly reduced tax rate. But independent studies largely conclude that firms used those profits to pay cash to shareholders, not to invest or create U.S. jobs. In fact, many firms *laid off* large numbers of U.S. workers even while reaping multi-billion-dollar tax cuts. Today, offshore profits are concentrated in a few large multinationals that have recently made record cash payouts to shareholders by buying back stock, showing that they already have enough cash on hand to make whatever investments they project would be profitable. Repatriated profits would likely similarly be paid out to shareholders, not invested.
- **The profits aren't all "trapped," but the tax revenue is.** Multinationals' foreign profits are often portrayed as "trapped" offshore and unable to work in the U.S. economy. But a large share of those profits are already in U.S. banks, held in U.S. dollars, or invested in U.S. Treasury bonds or U.S. corporate securities. What's "trapped" is largely the U.S. taxes due on them. Sound tax reform would impose a one-time tax on existing offshore profits and use those revenues for one-time infrastructure investments or deficit reduction, while transitioning to a new tax code that reduces the tax advantage for foreign profits.[2]
- **Republican proposals to adopt a territorial tax system could hurt U.S. investment, jobs, and wages.** By setting a zero percent tax rate on U.S. multinationals' foreign profits, a territorial system would encourage firms to shift more profits and investment offshore, bleeding tax revenues and reducing investment and wages in this country.

Failed 2004 Repatriation Didn't Increase Investment or Jobs

In order to "encourage the investment of foreign earnings within the United States for productive business investments and job creation," Congress in 2004 enacted a repatriation tax holiday that allowed multinationals to repatriate their foreign profits at a greatly reduced tax rate. Firms repatriated $362 billion in earnings under the holiday, with $312 billion qualifying for the tax break. But the holiday did not produce the promised economic benefits:

- Multiple independent academic studies conclude that multinationals largely did *not* use the repatriated profits to invest in the United States or create U.S. jobs but for the very purposes that Congress sought to prohibit, such as repurchasing their own stock and paying bigger dividends to shareholders.
- Many firms laid off large numbers of U.S. workers even as they reaped multi-billion-dollar benefits from the tax holiday and passed them on to shareholders. The top 15 repatriating corporations repatriated more than $150 billion during the holiday while cutting their U.S. workforces by 21,000 between 2004 and 2007, a Senate Permanent Subcommittee on Investigations report found.

There is no reason to think that profits repatriated under tax reform would be used differently today. The only companies likely to invest repatriated earnings are those that are capital constrained — those that are unable to raise or borrow sufficient funds to make investments they project would be profitable. As in 2004, the bulk of the profits held offshore belong to a handful of technology and drug companies, many of which have made record cash payouts to shareholders in recent years. By definition, companies that buy back large amounts of their own stock aren't capital constrained.

The case that corporate rate cuts generate investment and higher wages for ordinary workers is already weak; the case that giving companies a low tax rate on repatriated profits would do the same is even weaker.[3] Such a tax cut would, in effect, be a retroactive tax cut that only cuts taxes on money that companies have already earned. It would do little to improve incentives for companies to invest in the future.

Profits Not All "Trapped" Outside U.S. Economy

Multinationals often describe their foreign profits as "trapped" offshore and thus unable to work in the U.S. economy until repatriated. But a large share of those profits are already used directly or indirectly in the U.S. economy.[4]

Multinationals can delay paying U.S. tax on their foreign subsidiaries' earnings if they declare them "permanently reinvested" offshore. But that's an accounting illusion: companies can declare earnings "permanently reinvested" even if they are in U.S. banks, held in U.S. dollars, or invested in U.S. Treasury bonds or U.S. corporate securities. Multinationals do not routinely disclose how their subsidiaries invest their cash holdings. However:

- A 2010 survey of 27 large U.S. multinationals found nearly half of their "overseas" tax-deferred profits were invested in U.S. assets, including U.S. dollars deposited in U.S. banks or invested in U.S. Treasury bonds or other U.S. government securities, securities and bonds issued by U.S. corporations, and U.S. mutual funds and stocks.
- A 2013 *Wall Street Journal* report found that Google, Microsoft, and the data-storage firm EMC Corp. kept more than three-quarters of their foreign subsidiaries' cash in U.S. dollars or U.S. dollar-denominated securities.

"Offshore" money shows up in the U.S. economy in other ways as well. A multinational cannot use money that its foreign subsidiaries hold in U.S. dollars or assets to directly fund U.S. operations unless it pays U.S. tax on it. But those funds can *indirectly* support U.S. activities. For instance, companies with large amounts of cash offshore are generally considered low-risk borrowers, which allows them to borrow funds for U.S. activities at cheaper rates.

What's "Trapped" Is U.S. Tax Revenue

Sound tax reform would require multinationals to pay a one-time tax on existing foreign profits — whether they repatriate them or not — to clear the slate of existing tax liabilities. Most such proposals would allow companies to pay the tax over several years. Revenues from this transition tax could help fund one-time infrastructure investments or reduce deficits, either of which could have economic benefits. (Because the tax revenue would be one-time, it couldn't pay for permanent corporate rate cuts or other ongoing costs.)

Future overseas profits would then be taxed under new rules set in tax reform. If the new rules were sound, they would reduce or eliminate tax advantages for reporting profits offshore and eliminate the incentive to hold profits offshore.

Territorial Tax System Could Hurt U.S. Investment and Wages

In contrast, President Trump and congressional Republicans have suggested a one-time tax on existing foreign profits as part of a transition to a territorial tax system, one in which multinationals would pay no U.S. taxes on their foreign profits. That approach would likely encourage multinationals to move even more profits and investment offshore, thereby bleeding tax revenues and reducing investment and wages in the United States. That's because it would give foreign profits a massive tax advantage over the U.S. tax rate on domestic profits, even if that tax rate were cut as Republicans propose. If a lower U.S. tax rate on foreign profits encouraged U.S. corporations to move investments offshore, it could hurt U.S. workers' wages and productivity. The revenue loss could also raise deficits and reduce national investment.[5]

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[1] Joint Committee on Taxation, August 31, 2016, http://bit.ly/2wFZUFM.
[2] Chye-Ching Huang, "Three Types of 'Repatriation Tax' on Overseas Profits: Understanding the Differences," CBPP, updated October 7, 2016, http://bit.ly/2xdCSns.
[3] Center on Budget and Policy Priorities, "Large Job Growth Unlikely to Follow Tax Cuts for the Rich and Corporations," http://bit.ly/2vYa4Ri.
[4] Testimony of Edward Kleinbard, House Committee on Ways and Means, June 13, 2013, http://bit.ly/1K92owM; "Offshore Funds Located Onshore," Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, December 14, 2011, http://bit.ly/1OOE3hu; Kate Linebaugh, "Firms Keep Stockpiles of 'Foreign' Cash in U.S.," *Wall Street Journal,* January 22, 2013, http://on.wsj.com/2iqca7X.
[5] Center on Budget and Policy Priorities, "'Territorial Tax' Is a Zero Rate on U.S. Multinationals' Foreign Profits, Threatens U.S. Revenues and Wages," http://bit.ly/2vowuYs.