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## Council of Economic Advisers

Rosen, Harvey - Subject Files

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Folder Title:

Dividend Repatriation Proposal

# Withdrawn/Redacted Material

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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Email	comments on HIA draft - To: Brian Reardon - From: Philip L. Swagel	1	08/21/2003	P5;
002	Email	RE: Wealth Effect - To: Harvey S. Rosen - From: Brian Reardon	2	08/01/2003	P5;
003	Email	FW: short report on CEA (Council of Economic Advisors) meeting - To: Harvey S. Rosen - From: Pam Olson	2	07/30/2003	P5;
004	Memorandum	The Economics of the Proposaed tax Holiday - To: N. Gregory Mankiw - From: Harvey S. Rosen, et al	4	07/17/2003	P5;
005	Memorandum	The Economics of the Proposaed Tax Holiday - To: N. Gregory Mankiw - From: Harvey S. Rosen, et al	4	07/17/2003	P5;

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5919

### RESTRICTION CODES

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006	Email	repatriation memo - To: Beth ann Wilson - From: Kristin J. Forbes	1	07/14/2003	P5;
007	Email	RE: repatriation stuff - To: Harvey S. Rosen - From: James Mackie	1	07/15/2003	P5;
008	Handwritten Note	Temporary Repatriation	1	N.D.	P5;
009	Memorandum	[Repatriation Proposal] - To: Pam Olson - From: Harvey S. Rosen, et al	2	06/12/2003	P5;
010	Email	RE: Repatriation Proposal Memo - To: Cesar Conda, et al - From: Keith Hennessey	2	06/12/2003	P5;

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011	Email	RE: Reducing tax on domestic reinvestment of foreign earnings - To: Harvey S. Rosen, et al - From: Nicholas G. Mankiw	4	06/11/2003	P5;
012	Email	RE: Temporary repatriation proposal - To: Nicholas G. Mankiw - From: Randall S. Kroszner	2	06/10/2003	P5;
013	Email	RE: Foreign dividend repatriation proposal - To: Nicholas G. Mankiw - From: Pam Olson	4	06/09/2003	P5;

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**Rosen, Harvey S.**

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**From:** Viard, Alan D.  
**Sent:** Thursday, October 02, 2003 9:38 AM  
**To:** Mankiw, Nicholas G.; Rosen, Harvey S.  
**Subject:** BNA's coverage of repatriation holiday

**Controversy on Repatriation**

However, the repatriation provision was vigorously debated, with an amendment from Sen. John Breaux (D-La.) that would have tightened language requiring the repatriated funds to be reinvested in the United States failing by a narrow margin.

As passed by the committee, the reduced 5.25 percent rate applies only to repatriations in excess of the taxpayer's average repatriation level over three of the five most recent taxable years, throwing out the highest and lowest of those five years.

In order to qualify for the reduced rate, dividends must be described in a domestic reinvestment plan approved by the taxpayer's senior management and board of directors, and used for worker hiring and training, infrastructure, research and development, and financial stabilization for the purposes of job retention or creation.

Breaux protested that the phrase "financial stabilization" leaves open a wide window for companies to use the repatriated income for stock repurchase and other financial bolstering activities. He proposed an amendment that would have required the funds be used only for increasing the number of workers, capital expenditures, research and development, and contributions to pension trust funds for workers.

The amendment was defeated by an 11-10 vote. Treasury Assistant Secretary for Tax Policy Pamela Olson, who was present at the markup, said the administration remains opposed to the idea of a one-year lower rate for repatriated income.

"The companies with income overseas knew what the tax rules were when they made their investments," Olson said. "This would give them a tax holiday from their decisions, and that is unfair to other taxpayers who pay taxes."

Olson said Treasury remains skeptical about the amount of income that would return to the United States, which some business stakeholders have predicted would be between \$200 billion and \$300 billion. "We feel it's going to undermine the belief of American taxpayers in the fairness of the system," she said.

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Email	RE: Wealth Effect - To: Harvey S. Rosen - From: Brian Reardon	2	08/01/2003	P5;

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Special report

# Introducing the Homeland Investment Act

- **A tax change is proposed that temporarily reduces obstacles to repatriating accumulated foreign earnings of US corporations**
- **Legislation to produce results; repatriation estimated at \$300 billion**
- **Survey suggests that firms would use funds for varied purposes; shoring up corporate finances is the top priority**
- **Estimated increase in business spending to lift GDP growth 0.5%**
- **Budget impact is negligible**

## Introduction

Amid the current flurry of activity on US tax policy, it is easy to neglect the Homeland Investment Act. This tax proposal, which has bipartisan support, would remove many of the tax obstacles that inhibit repatriation of foreign earnings by US corporations. The intention of this legislation is to make it less costly to repatriate earnings that might be used for investment spending and hiring in the United States.

However, there is little analysis available that bears on the likely impact of this legislation. To fill this gap, this special report draws on existing company information and provides new survey material to give rough guidance as to the potential effects of the Homeland Investment Act. The analysis suggests that there is a large pool of reinvested foreign earnings that would be repatriated if this legislation were passed. JPMorgan estimates that the gross flow that would result from the passage of the pending legislation is roughly \$300 billion. This number is more than twice the estimate of the Joint Committee on Taxation made in 2001.

A survey of firms suggests that this money would be put to varied use. Shoring up balance sheets would be a central priority. JPMorgan estimates suggest that the legislation would lead to a roughly 3% reduction in nonfinancial corporate debt. An important part of the funds would be used to increase business activity. Estimates suggest a 2-3% increase in capital spending over two years, during which the GDP level would likely be boosted by roughly one-half of a percentage point. The impact of the legislation on the Federal Budget is likely to be negligible.

## Introducing the Homeland Investment Act

Legislation was recently introduced in both the House (H.R.767) and Senate (S.596) to temporarily change the tax treatment of US subsidiaries foreign earn-

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ings. These bills, the Homeland Investment Act of 2003 and Invest in the USA Act of 2003, would temporarily reduce the US tax rate on foreign subsidiary earnings that are distributed to the United States parent company. Although the legislation has been proposed separately from the Bush administration's "jobs and growth" stimulus package, it is now being discussed as a possible element of this plan.

The current form of the proposed legislation reduces the tax rate to 5.25% on distributions in excess of a corporation's "normal" annual distribution, and would be effective for distributions made in either 2003 or 2004, depending on when the legislation becomes law.

The Senate Bill differs from the House version in requiring US corporations to provide a domestic reinvestment plan. This plan requires firms to describe how repatriated income will be reinvested in the United States. The Senate bill anticipates that an electing corporation's reinvestment plan would provide for use of the distributed cash as a source for funding worker hiring and training, infrastructure, research and development, capital investments and/or providing financial stability (of the corporation) for purposes of job retention or creation.

If the Homeland Investment Act becomes law on or before September 2, 2003, the temporary reduced tax rate will only apply to qualifying distributions made on or prior to December 31, 2003 for all calendar year taxpayers. This implies that any resulting capital flows would occur in a very short period of time. If the Act becomes law after September 2, 2003, the reduced tax rate would apply to distributions made during 2004 for calendar year taxpayers.

**Motivation for changing the law**

Unlike most other industrial countries, current US tax law provides multinational firms with strong incentives to keep earnings from foreign operations outside the United States, even when efficiency considerations would argue that the funds be used within the United States.

Under international tax principles, primary jurisdiction to tax income is given to the country where the foreign subsidiaries operate. The accumulated earnings of a US corporation's foreign subsidiaries are generally not subject to US corporate income taxation until the earnings are actually distributed to the corporate parent as a dividend. As a general principle, US tax on repatriated income is imposed to bring the total corporate tax rate to 35%. In countries in which tax rates are below 35%, an additional US tax gener-

**A stylized example of tax law proposal**

In this example, Acme International earns \$100 abroad and pays \$10 in foreign taxes. No US taxes are paid because earnings are not repatriated.

Under current law, if the profits were repatriated, the firm would also owe \$35 in US taxes and \$4.50 in additional foreign taxes for distributed earnings less a \$14.50 tax credit to offset the foreign corporate income tax and withholding tax paid. The additional tax cost of repatriating the \$90 is \$25.

Under the proposed law, the US corporate tax would be lowered by 85% from \$35 to \$5.25; the foreign tax credit would also be reduced by 85% to \$2.18, and Acme would still have to pay the \$4.50 foreign withholding tax on distributions. The tax cost to the firm of repatriating the \$90 in earnings to the United States is lowered by more than two-thirds from \$25 to \$7.57.

**Example**

Foreign Taxable Income	\$100
10% Foreign Corporate Tax	-\$10
Foreign Net Earnings	\$90

**Tax cost of repatriating foreign earnings**

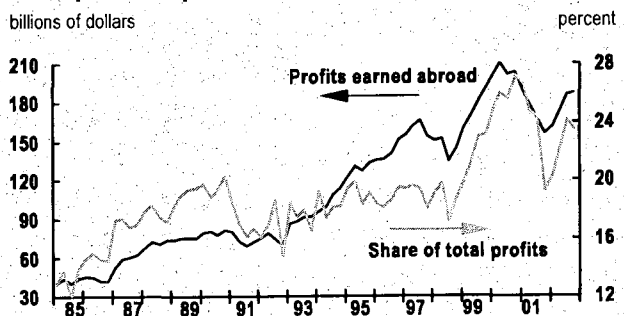
**Under Current Law**

US Corporate Tax at 35%	\$35
Foreign Tax Credit	\$14.50
Foreign Withholding Tax	\$4.50
Additional Tax Burden	\$25.00

**Under Proposed Law**

US Corporate Tax at 5.25%	\$5.25
Foreign Tax Credit	\$2.18
Foreign Withholding Tax	\$4.50
Additional Tax Burden	\$7.57

**US corporations: profits earned abroad**



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ally is paid when earnings are repatriated. Thus, foreign investments financed with foreign earnings of US multinationals typically have been more attractive than returns on domestic investments financed with foreign earnings (after additional taxes are paid to repatriate the earnings). To be sure, US tax rules are far more complex than this short description suggests. Often they operate to create disincentives to repatriate foreign earnings even when tax rates abroad are high.

In lowering the tax rate to 5.25%, the cost of repatriating earnings is significantly reduced. Firms can repatriate funds at a lower tax rate and may receive a partial tax credit for taxes paid abroad. A stylized example presented in the accompanying box (previous page) makes this point clear. In the example, costs of repatriating earnings are cut by more than two-thirds.

Many firms have large pools of accumulated earnings from foreign operations but lack promising investment opportunities for use of the funds abroad. In particular, tax laws make it difficult to structure direct investments from one subsidiary to another. And while the US parent can generally borrow as an alternative to repatriating funds, the current environment is one in which firms have strong incentives to deleverage. Risk considerations should also promote repatriation. Absent a US tax bite, the risk of political change or shifting foreign tax regimes create disincentives for holding assets in many parts of the world.

The primary motivation of the change in the law is to allow firms to repatriate these foreign earnings to promote long-term growth. The hope is that some of these funds would be used in ways that boost US investment and hiring. That a reduction in the tax rate on repatriating earnings might have little if any net cost to the US Treasury is also appealing. There would be a net loss in revenues from firms that planned to repatriate earnings in the future and would now bring these funds home at a lower tax rate. However, firms that keep virtually all their foreign earnings abroad to avoid additional taxes under current law would have incentive to repatriate earnings currently under the proposal.

**Foreign subsidiary earnings: a large pool exists**

Although the motivation of the legislation is clear, there is little information available to assess the likely size of inflows that will be generated under the new law and its macroeconomic effects.

**Foreign undistributed earnings by credit rating**

	share of undistributed earnings
AAA	22.9
AA	9.9
AA-	11.5
A+	13.6
A	10.3
A-	9.4
BBB+	3.3
BBB	10.3
Lower	8.8

**Foreign undistributed earnings by sector**

	share of undistributed earnings
Manufacturing	39.7
High tech and telecom	17.7
Pharmaceuticals and health care	27.0
Consumer	12.2
Energy	9.6
Finance and insurance	6.5
Other	5.0

Note: Both tables based on the sample of 237 S&P 500 corporations that report reinvested foreign earnings.

The Joint Committee on Taxation analyzed a proposal similar to the current one in 2001. It estimated that repatriated earnings would rise by \$135 billion in the first year after legislation is effective. The estimated revenue impact was modest. A small positive \$4.1 billion gain in the first year was estimated to be temporary. Over ten years the legislation was estimated to reduce revenues by a net \$3.9 billion. The Joint Committee has provided little detail in how it arrived at these estimates.

JPMorgan's assessment of the Homeland Investment Act begins with an estimate of the size of the accumulated foreign subsidiary earnings that would be available for repatriation to the United States. In the audited financial statements of many S&P 500 corporations, the cumulative amounts of foreign subsidiary earnings that are permanently or indefinitely reinvested outside the US ( hereafter, reinvested foreign earnings) are disclosed.

These figures generally appear in the tax footnote to audited financial statements. They are available because, under

GAAP, all corporations that consider all or some of their foreign subsidiary earnings as permanently or indefinitely reinvested outside the US—and therefore do not accrue a deferred tax liability—are required to disclose the amount in their audited financial statements. Financial statements indicate that the reinvested foreign earnings of the S&P 500 corporations that could potentially be repatriated following passage of the Homeland Investment Act is \$406 billion.

Most of these earnings are held by companies with high credit ratings (tables, page 3). Based on S&P ratings, more than three fourths of the earnings are held by companies that are rated A or higher. Sectorally, manufacturing and pharmaceutical companies account for the largest concentration of accumulated foreign earnings, more than one-half of earnings held abroad.

There are good reasons to think that this \$406 billion figure underestimates the total pool of earnings that would be eligible for repatriation (box, page 4). Indeed, this view is confirmed by an alternative estimate based on IRS data for a larger sample of firms. Taken together, the total pool of reinvested foreign earnings eligible for repatriation is estimated at about \$500 billion.

**Survey points to large-scale repatriation**

The existence of a large pool of reinvested foreign earnings provides little insight as to the likely size of repatriated funds under the tax plan. In order to estimate the likely effect of the legislation, an informal survey of large firms was conducted. The survey sampled tax and treasury departments of 28 firms. Their reinvested foreign earnings represent about one-quarter of the aggregate \$406 billion measured in the S&P 500 sample. The results of the survey highlight the following:

- A strong incentive to repatriate. Respondents representing slightly over half of the sample—both as a share of the number of respondents and as a share of reinvested foreign earnings—indicate that substantially all of their earnings would be repatriated. Most other companies indicated that some of their earnings would be repatriated. Only two respondents, accounting for about 8.7% of reinvested foreign earnings of the sample, did not plan to repatriate foreign earnings to the United States.

- Cash flow and repatriation. Adequate liquidity appears to be an important consideration for firms willingness to repatriate. Firms with large cash balances globally appear more committed to repatriating all their reinvested foreign earn-

1. Corporations may change their reinvestment strategies, however, at which time deferred taxes may be required to be accrued.

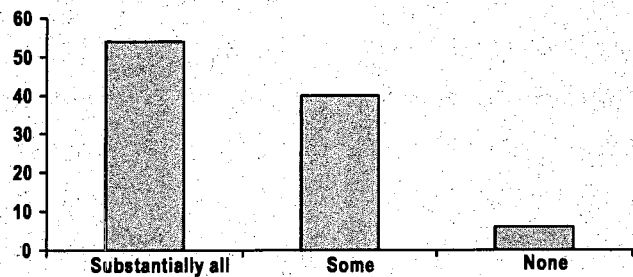
**\$500 billion in estimated retained foreign earnings**

Financial statements show \$406 billion in accumulated foreign subsidiary earnings for the S&P 500. This figure likely underestimates the size of the total pool of foreign earnings that could potentially be repatriated.

- The S&P 500 is a subset of the entire corporate sector. S&P 500 operating earnings has recently averaged about 60% of overall after-tax earnings. Its share of foreign earnings is likely larger, although no official breakdown is available.
- The aggregate reinvested foreign earnings of corporations in the S&P 500 includes reinvested foreign earnings of only 237 corporations. The remaining 263 corporations did not overtly disclose reinvested foreign earnings. In some cases, the tax effects but not the total amount of foreign subsidiary earnings are disclosed. For our calculation, these companies are treated as if they have no reinvested foreign earnings.
- There are foreign subsidiary earnings that have not been repatriated but also not been treated as permanently reinvested. These earnings could also be repatriated if the bill becomes law.

An alternative exercise employs IRS data for the 7500 largest controlled foreign corporations for 1998 and points to accumulated foreign subsidiary earnings in 2002 of close to \$500 billion. This level appears consistent with a scaled up estimate from the smaller S&P sample.

**Survey results, repatriation of reinvested foreign earnings**  
 percent of reinvested foreign earnings



**Estimate of repatriated earnings**

	From Firms		Dollars Repatriated
	Repatriating Substantially All	Repatriating Some	
Share of sample	50.3%	41.2%	
Percent repatriated:			
Higher estimate	100%	60%	\$375
Lower estimate	80%	30%	\$265

Note: Estimates are based on a JPMorgan survey of 28 firms accounting for roughly 25% of all accumulated earnings by the S&P 500 sample of very large firms.

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ings. Corporations that do not have sufficient cash would have to borrow the cash at the foreign subsidiary level, liquidate operating assets, or distribute property, all of which have collateral consequences and make the decision significantly more complex. Liquidity is also significant as there would be cash taxes due on the distributed earnings. In addition to US taxes, most countries impose a withholding tax when earnings are distributed.

The results of the survey point to a substantial flow of repatriated foreign earnings (table, page 4). The estimates range from \$265- 375 billion.

The possibility that the survey sample is biased towards companies with high levels of liquidity— and therefore a greater proclivity to repatriate earnings— was also examined (top table, page 5). In the aggregate, companies in the survey sample do not appear to have a larger cash position relative to those in the broader S&P 500 sample. This finding holds when the data are aggregated such that repatriated flows are no larger than a corporation's available cash position.

In all, \$300 billion looks to be a reasonably conservative estimate of the magnitude of foreign earnings that could be repatriated under the proposed legislation. This estimate is more than twice as large as that produced by the Joint Committee on Taxation.

**A modest boost to growth and deleveraging**

The ultimate intent of the Homeland Investment Act is to provide a boost to US macroeconomic performance. In considering the possible benefits of repatriating \$300 billion in foreign earnings, once again the survey provides guidance (bottom table, page 5). Most corporations point to shoring up corporate finances— buying back debt, increasing levels of liquid assets, rebuilding pension funds or even retiring equity— as a key priority for the use of these funds. However, a substantial number of corporations also indicate that a portion of the funds will be used to finance activity: capital spending, research and development, and the like.

There are no hard numbers on how the money would be allocated among these varied purposes. As a rough translation of the survey results, assume that 50% of the \$300 billion is used for debt repayment and 35% is used for spending— on research and development or capital expenditure— spread out over a two-year period. The remaining 15% remains in

**S&P sample and survey group**

Group	\$ billion		
	Reinvested Foreign Earnings	Global Cash & Cash Equivalents	Lesser of Reinvested Foreign Earnings or Global Cash and Equiv.
S&P 500 sample	407	374	193
Survey Group	102	76	59

Note: The S&P sample represents the 237 corporations in the S&P 500 that disclose reinvested foreign earnings. The survey group represents the 28 corporations sampled by JPMorgan. The amount of global cash and cash equivalents for each company is the amount reflected on each company's audited financial statements. The aggregation of corporations using the lesser of their reported reinvested foreign earnings or global cash is reported in the last column.

**Survey results: uses of repatriated funds**

survey of 28 firms; respondents could mention more than one use

	Number	Percent of respondents
Pay down outstanding debt	13	46
Finance capital spending	11	39
Fund R&D, venture capital, or acquisitions	11	39
Buy back stock	5	18
Use cash for working capital	3	11
Might pay dividend (if double taxation ends)	3	11
Fund underfunded pension fund	1	4

cash or is used for stock buy-backs and shoring up pension funds.

Under these assumptions, \$150 billion of corporate debt would be paid down, equivalent to about 3% of total nonfinancial corporate debt. For many firms repatriating funds, the percentage reduction in debt would be much greater.

The share allocated to new expenditures amounts to about \$50 billion per year in new spending. At this magnitude, GDP would likely be boosted by about one half a percentage point. The biggest benefits would likely come in spending on equipment and software and new plant. The boost to the total national level of capital spending would be 2-3% in each of the two years.

May 2, 2003

**JPMorgan Chase Bank, New York**  
Anne Swope (1-212) 834-7566  
anne.swope@jpmorgan.com

**Economic & Policy Research**  
**Introducing the Homeland Investment Act**  
Page 6



## **Budget impact is expected to be small**

The effects of the proposed change in the tax law on the federal budget are likely to be relatively modest: positive in the short run and slightly positive in the longer run as well. Based on the estimate of the repatriated earnings, cash tax payments of roughly \$10-15 billion as a direct result of the legislation would accrue to the Treasury in the first year. This assumes an effective tax rate of 3.5-5.0%, after adjusting for foreign tax credits.

To the extent that some of the reinvested foreign earnings would have been distributed in the foreseeable future and taxed at the statutory rate of 35% absent the proposed legislation, the present value of the foregone taxes on these earnings (difference between 35% and 5.25%) would be a par-

tial offset to the \$10 billion to \$15 billion gain. Most likely, the past trend of earnings accumulating abroad would continue to prevail, and this partial offset would be minimal.

## **Close to \$100 billion shift to dollar assets**

Regarding the currency impact of the tax change, the key issue is the extent of the shift from nondollar to dollar assets that takes place. Anecdotal evidence gained from talking to US corporations suggest that a large portion of foreign earnings held abroad are held in US dollars. Although no hard information is available, a reasonable estimate places the dollar share of reinvested foreign earnings at between one-half and three-quarters. As a result, the repatriation of \$300 billion in foreign earnings is likely to produce a one-time currency shift of around \$100 billion.

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Viard 7/3/03

JCT revenue estimates

- saves \$5m first year
- loses \$45 over 10-yr period

Thomas bill -

- you have to maintain prior level of dividend repatriations or else you lose the benefits of the holding
- only some of the ~~dividend~~ earnings from abroad ("permanently" invested abroad) are eligible.

# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	FW: short report on CEA (Council of Economic Advisors) meeting - To: Harvey S. Rosen - From: Pam Olson	2	07/30/2003	P5;

**This marker identifies the original location of the withdrawn item listed above.  
For a complete list of items withdrawn from this folder, see the  
Withdrawal/Redaction Sheet at the front of the folder.**

**COLLECTION:**

Council of Economic Advisers

**SERIES:**

Rosen, Harvey - Subject Files

**FOLDER TITLE:**

Dividend Repatriation Proposal

**FRC ID:**

5919

**OA Num.:**

5009

**NARA Num.:**

4849

**FOIA IDs and Segments:**

2015-0056-F

**RESTRICTION CODES****Presidential Records Act - [44 U.S.C. 2204(a)]**

- P1 National Security Classified Information [(a)(1) of the PRA]
- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
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- P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

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**Records Not Subject to FOIA**

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July 11, 2003

## Alert: Homeland Investment Act An Update

The Homeland Investment Act (HIA) is proposed legislation that will provide US corporations with a window of six months to one year to repatriate offshore earnings at a significantly reduced tax rate.

- ◆ We assign a greater than 50% probability to the proposed HIA legislation being enacted within this Congressional session.
- ✓ ◆ If enacted in its current form, we expect more than \$400 billion to be repatriated in 2004.
- ◆ Given that Congress is not expected to focus on the HIA until after the Medicare issue is addressed, corporations still have an opportunity to join the lobbying effort to ensure their particular tax situation is considered.
- ◆ Because the repatriation window is narrow and given the large amount of time required to properly structure transactions to realize the maximum benefit (and to structure the associated liability-management transactions), we encourage clients who have not already done so to initiate debt structuring preparations with our capital markets desk as soon as possible.
- ◆ We remain of the view that the impact on the USD will be both direct and indirect. With the recent decline in the US dollar, we think it is prudent to protect the shareholder value of non-USD assets, especially those that may be affected by this act.

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### Background

The Homeland Investment Act proposes to amend the 1986 Internal Revenue Code with the objective of encouraging the re-investment of foreign earnings into the United States. **The bill proposes to reduce the applied tax rate on excess qualified foreign distributions from 35% to 5.25% for a period of one year.** Excess qualified foreign distribution is the excess of:

- ◆ Dividends received by the taxpayer during the taxable year from corporations that are controlled foreign corporations in which the taxpayer is a United States shareholder on the date such dividends are paid, over the base dividend amount.
- ◆ The base dividend amount means an amount not less than the average amount of dividends received during the fixed base period from corporations that are controlled foreign corporations in which the taxpayer is a United States shareholder on the date such dividends are paid.

The proposed effective date is the first taxable year of the electing taxpayer ending 120 days after the date of enactment.

If passed, we believe that dividend repatriation will be in excess of \$400 billion. The influx of capital into the US would be extremely beneficial across both the public and private sectors. Multi-national corporations (MNCs) participating in a recent survey have identified the following as probable areas to which they would allocate any repatriated HIA capital:

- ◆ Working capital, inventory, plant & equipment (30%)
- ◆ Reduction of debt (30%)
- ◆ Stock repurchase (10%)
- ◆ Contributions to under-funded pensions (5%)
- ◆ Portfolio investments (10%)
- ◆ M&A and other (15%)

We remain of the view that the impact of this act on the USD will be both direct and indirect. The direct impact will be the spot exchange required to convert non-USD cash into USD. Relative to the size of the market, the flows and timing will be both small and spread out. In addition, a significant percentage of the offshore accounts are already denominated in US dollars. Nonetheless, even if only 20–40% of \$400 billion or more is converted, this would still be a large number. Indirectly, repatriated HIA flows represent a significant amount of money relative to the trade balance. As seen above, HIA repatriated funds will be used to pay down debt and buy back stock, and the residual flows will at least temporarily be invested in short-term, high-quality securities.

On May 15, the Senate passed (75–25) its version of the HIA bill (S. 596). S 596 was included in the Senate's proposed tax and growth package. Despite strong bipartisan support, the bill was ultimately axed in the final compromise with the Administration, in which a decision was reached to more narrowly focus this year's tax bill.

### Legislative Strategy

**Take Away.** Given that Congress is not expected to focus on the HIA until after the Medicare issue is addressed, corporations still have an opportunity to join the lobbying effort to ensure their particular tax situation is considered. Note that a coalition of thirty companies (primarily from the technology and pharmaceutical industries) are the principal sponsors of this legislation. We believe that a broader corporate representation would greatly improve probability of passage. **Should you wish to join the coalition or find out more about it, please contact us.**

The HIA is expected to be wrapped into the International Tax Bill (ITB). The ITB has yet to be introduced, but this is expected to happen in the next month. Congress' first priority is to address the Medicare issue. We expect this to be resolved and signed by the Executive branch by month-end. Once Medicare has been addressed, we expect the ITB to be the next major issue on Washington's agenda.

A key ITB concern is the resolution of FSC/ETI (Foreign Sales Corps and the Extraterritorial Income Act of 2000). FSC/ETI's are US business vehicles that the WTO has ruled are illegal. In its November ruling, the WTO granted the EU the ability to levy \$4 billion in retaliatory tariffs on US exporters. Resolving the FSC/ETI will be a central goal of the International Tax Bill.

The next step will be to introduce the ITB (with the HIA provision included) and get it passed before the summer recess. For reference, Washington adjournment is in the October-November timeframe. We expect end of August to early September to be a critical period for this legislation. Ideally, the ITB will be passed this year, making dividend repatriation a 2004 event.

Several Washington lobbyists have indicated that Chairman Thomas' HIA proposal to be included in the ITB will have two key modifications from the original bill (H.R. 767):

- ◆ **An increase in the tax rates from 5.25% to 7%.** (Note: the Senate version still calls for 5.25%.)
- ◆ **A shortened repatriation window from twelve to six months.**

Washington recognizes the importance and positive economic implications of a large influx of capital. Thus, shortening the repatriation window is consistent with having a quick impact. Offsetting the "benefit" to a shortened window are 1) foreign tax credit sign-off (if needed); and 2) having a reasonably long enough period that ensures that all companies will have the time needed to execute an appropriate strategy. We do not expect the window to be lengthened, and we believe that it is extremely unlikely that the proposed short-term tax relief will be changed to permanent relief.

In addition to the probable allocations (above), we are also aware of companies conceptually discussing a one-time special dividend to shareholders from the repatriated HIA cash net of immediate needs. Although there are risks to this legislation, we still assign a greater than 50% probability of the HIA ultimately being enacted.

### **Debt Strategy**

**Take Away.** Given the narrow window in which corporations will be able to repatriate earnings—and timing needed to properly structure transactions to maximize the tax benefit and to structure the associated asset-liability management transactions—we encourage clients who have not already done so to initiate debt structuring preparations to take advantage of the HIA with our capital markets desk as soon as possible.

The passage of the legislation presents corporations that have significant "trapped" offshore earnings with three potential capital markets structuring opportunities:

1. **Maximizing value of HIA benefit via additional offshore issuance.** Issue proceeds will allow clients with offshore assets invested in illiquid assets to take full advantage of tax holiday that they might not otherwise have been able to. Similarly, even clients with offshore assets invested in liquid assets could maximize the benefit of the tax holiday by further leveraging their subsidiaries.
2. **Managing net investment exposure via additional offshore issuance.** Subject to local limitations regarding capitalization structure and the historical earnings and profits account (E&P), companies can reduce their consolidated net investment risk by issuing local currency denominated debt. In addition to maximizing the tax holiday afforded by the HIA, this structural move reduces overall balance sheet risk to the shareholders from exchange rate fluctuations.
3. **Structuring onshore liability management solutions with repatriated earnings.** Naturally, liability management solutions should be considered in conjunction with the expected wave of repatriated funds.

### **FX Strategy**

**Take Away.** We remain of the view that the impact on the USD will be both direct and indirect. Given the recent decline in the US dollar, we think it is prudent to protect the shareholder value of non-USD assets that are either in the form of cash or illiquid assets. For specific hedging strategies, please contact your foreign exchange sales advisor.

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**For more information, log on to [bofa.com/capitalmarkets](http://bofa.com/capitalmarkets)**

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Alan D. Viard  
07/22/2003 09:15:29 AM

Record Type: Record

To: See the distribution list at the bottom of this message  
cc:  
Subject: Pam Olson criticized repatriation holiday at July 15 Senate Finance hearing

According to the July 21 *Tax Notes*:

**Olson did her best to puncture the repatriation bubble. "We don't think that a tax holiday like this is the best way to address the issues in our international tax rules. It would be far better to do something on a long-term, permanent basis that would improve the competitiveness regime," she said...Olson said temporary fixes are not on the administration's radar. "We do think that it would be worthwhile taking a long-term look at the structure of the tax code to see whether or not a worldwide system continues to make sense, or whether we'd be better off with a territorial system," she said.**

**"What we don't think would be good policy would be to just do it on a one-year basis," Olson said. "We do think that if the committee considers and moves forward with modifications on the subpart F rules, and modifications on the foreign tax credit rules, we will go some distance to address this issue."**

Message Sent To:

---

Nicholas G. Mankiw/CEA/EOP@EOP  
Harvey S. Rosen/CEA/EOP@EOP  
Kristin J. Forbes/CEA/EOP@EOP  
Andrew A. Samwick/CEA/EOP@EOP  
Julia Stahl/CEA/EOP@EOP

# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Memorandum	The Economics of the Proposed tax Holiday - To: N. Gregory Mankiw - From: Harvey S. Rosen, et al	4	07/17/2003	P5;

**This marker identifies the original location of the withdrawn item listed above.  
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**COLLECTION:**

Council of Economic Advisers

**SERIES:**

Rosen, Harvey - Subject Files

**FOLDER TITLE:**

Dividend Repatriation Proposal

**FRC ID:**

5919

**FOIA IDs and Segments:**

2015-0056-F

**OA Num.:**

5009

**NARA Num.:**

4849

### RESTRICTION CODES

**Presidential Records Act - [44 U.S.C. 2204(a)]**

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Pam.Olson@do.treas.gov  
07/17/2003 04:32:06 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP

cc:

Subject: FW: Repatriation Holiday

A better answer came in as soon as I sent you my reply.

-----Original Message-----

From: Randolph, William  
Sent: Thursday, July 17, 2003 4:22 PM  
To: Olson, Pam  
Cc: Angus, Barbara  
Subject: RE: Repatriation Holiday

Harvey,

Whether passive or active, the income can be shielded by foreign tax credits, but companies are most likely to be able to shield it with excess foreign tax credits from other sources if it is active. I think that confusion may arise because many companies have accumulated substantial active earnings abroad by reinvesting in passive financial assets. Earnings on the financial assets would be considered to be passive and, as such, would be subject to U.S. tax as they are accrued and would be treated as passive income under the foreign tax credit rules. However, the repatriation holiday proposal is about the companies' principle in those financial assets. The principle represents accumulated active earnings that have not yet been repatriated and subject to U.S. income tax. If the companies sell the financial assets and pay dividends (the liquidated principle) back to the U.S. parent, the dividends are subject to U.S. tax and may be shielded by foreign tax credits as active income.

Accumulated foreign earnings are not necessarily reinvested in passive assets, but passive assets are the most likely assets to be liquidated. Note also that the holiday proposal does not require foreign assets to actually be liquidated, but I will not go into the mechanism unless you are interested.

Bill

-----Original Message-----

From: Olson, Pam  
Sent: Thursday, July 17, 2003 3:40 PM  
To: Angus, Barbara; Randolph, William  
Subject: FW: Repatriation Holiday

-----Original Message-----

From: Harvey\_S.\_Rosen@cea.eop.gov [mailto:Harvey\_S.\_Rosen@cea.eop.gov]  
Sent: Thursday, July 17, 2003 3:25 PM  
To: Pam.Olson@do.treas.gov  
Subject: Re: Repatriation Holiday

hi pam. can you help me out with this query?  
thanks.  
--harvey

----- Forwarded by Harvey S. Rosen/CEA/EOP on 07/17/2003  
03:25 PM -----

Brian Reardon  
07/17/2003 02:24:21 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP  
cc:  
bcc:  
Subject: Re: Repatriation Holiday (Document link: Harvey S. Rosen)

hey harvey... thanks for this...

Question: You mention excess foreign tax credits several times, but my impression is the money that would be repatriated doesn't qualify for these, since its likely passive income from a low-tax regime. Is that not the case.

Harvey S. Rosen  
07/17/2003 01:32:43 PM

Record Type: Record

To: Brian Reardon/OPD/EOP@EOP  
cc:  
Subject: Repatriation Holiday

brian,  
here's my shot at the proposed tax holiday for repatriated foreign earnings.

i hope that you find it convincing! best, harvey

(See attached file: temporary repatriation 7.17hr2.doc)

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FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Memorandum	The Economics of the Proposed Tax Holiday - To: N. Gregory Mankiw From: Harvey S. Rosen, et al	4	07/17/2003	P5;

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#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

5919

#### OA Num.:

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#### NARA Num.:

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2015-0056-F

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Pam.Olson@do.treas.gov  
07/17/2003 04:30:13 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP  
cc:  
Subject: RE: Repatriation Holiday

I'll get you a more complete answer than I can give, but, for starters, the multiplicity of foreign tax credit baskets (i.e., it's more than the passive basket) results in excess FTCs for many companies, as does the interest allocation rule, which can artificially reduce foreign source income, and as does the overall foreign loss rule. I don't expect much of the income to be in the passive basket. The arbitrary reductions in foreign source income for purposes of calculating the FTC and multiple limitations on the FTC all can result in companies being unable to use all their FTCs currently or even within the extended period allowed under the carryforward rules. As I recall from Commerce Department statistics, the lion's share of U.S. MNC foreign direct investment is in the developed world, particularly Europe, where with the exception of Ireland (and possibly Switzerland), the tax rates are not significantly different from those in the U.S. I believe the companies most interested in the repatriation proposal have significant operations in Ireland, Singapore, and Hong Kong where the tax rates are relatively low.

-----Original Message-----

From: Harvey\_S.\_Rosen@cea.eop.gov [mailto:Harvey\_S.\_Rosen@cea.eop.gov]  
Sent: Thursday, July 17, 2003 3:25 PM  
To: Pam.Olson@do.treas.gov  
Subject: Re: Repatriation Holiday


hi pam. can you help me out with this query?  
thanks.  
--harvey

----- Forwarded by Harvey S. Rosen/CEA/EOP on 07/17/2003  
03:25 PM -----


Brian Reardon  
07/17/2003 02:24:21 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP  
cc:


 Alan D. Viard  
07/17/2003 03:49:56 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP  
cc:  
bcc:  
Subject: Re: Repatriation Holiday 

Right - the firms with excess foreign tax credits won't repatriate their money and therefore, as our memo states, will not benefit - the firms that repatriate will, as Brian says, be the ones that don't have excess foreign tax credits.

Harvey S. Rosen


 Harvey S. Rosen  
07/17/2003 03:25:34 PM

Record Type: Record


To: Alan D. Viard/CEA/EOP@EOP  
cc:  
Subject: Re: Repatriation Holiday

alan,  
any thoughts on how to respond to this query?  
--harvey

----- Forwarded by Harvey S. Rosen/CEA/EOP on 07/17/2003 03:25 PM -----

 Brian Reardon  
07/17/2003 02:24:21 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP  
cc:  
bcc:  
Subject: Re: Repatriation Holiday 

hey harvey... thanks for this...

Question: You mention excess foreign tax credits several times, but my impression is the money that would be repatriated doesn't qualify for these, since its likely passive income from a low-tax regime. Is that not the case.

Harvey S. Rosen



Harvey S. Rosen  
07/17/2003 01:32:43 PM

Record Type: Record

To: Brian Reardon/OPD/EOP@EOP

cc:

Subject: Repatriation Holiday

brian,  
here's my shot at the proposed tax holiday for repatriated foreign earnings. i hope that you find it convincing!  
best,  
harvey




temporary repatriation 7.17hr2.



Brian Reardon  
07/17/2003 02:24:21 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP  
cc:  
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Subject: Re: Repatriation Holiday 

hey harvey... thanks for this...

Question: You mention excess foreign tax credits several times, but my impression is the money that would be repatriated doesn't qualify for these, since its likely passive income from a low-tax regime. Is that not the case.  
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07/17/2003 01:32:43 PM

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cc:  
Subject: Repatriation Holiday

brian,  
here's my shot at the proposed tax holiday for repatriated foreign earnings. i hope that you find it convincing!  
best,  
harvey



temporary repatriation 7.17hr2.

Nirupama Rao  
07/15/2003 02:47:58 PM

Record Type: Record

To: Harvey S. Rosen/CEA/EOP@EOP

cc:

Subject: Investment (Nat. Acct. Values)

Harvey,

Still tracking down the info on MNC domestic investment; thought I'd pass these numbers along first.

Gross Investment, SAARs in billions:

2003Q1	\$1404.8
2002FY	\$1456.2
2001FY	\$1545.1
2000FY	\$1679.4

Gross Private Domestic Investment, SAARs in billions:

2003Q1	\$1611.2
2002FY	\$1593.2
2001FY	\$1586.0
2000FY	\$1755.4

-nirupama

best guess  
is \$406.6 bn  
domestic  
CAPEX  
for  
multi-nationals  
based  
in US.

# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	repatriation memo - To: Beth ann Wilson - From: Kristin J. Forbes	1	07/14/2003	P5;

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#### COLLECTION:

Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

5919

#### FOIA IDs and Segments:

2015-0056-F

#### OA Num.:

5009

#### NARA Num.:

4849

#### RESTRICTION CODES

##### Presidential Records Act - [44 U.S.C. 2204(a)]

- P1 National Security Classified Information [(a)(1) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

##### Deed of Gift Restrictions

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- C. Closed in accordance with restrictions contained in donor's deed of gift.

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##### Records Not Subject to FOIA

Court Sealed - The document is withheld under a court seal and is not subject to the Freedom of Information Act.

# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	RE: repatriation stuff - To: Harvey S. Rosen - From: James Mackie	1	07/15/2003	P5;

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Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

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# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Handwritten Note	Temporary Repatriation	1	N.D.	P5;

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#### COLLECTION:

Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

5919

#### FOIA IDs and Segments:

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March 7/11/03

strong incentive to accelerate repatriation

They can use a "95% exclusion" only  
cost of the

at the excess credit companies

- about 1/2 the companies are in  
excess credit position.

multinational investment in U.S. is about  
~ \$300b. if would there be a 1/3  
increase?

lot of companies like Dell have lots of \$  
from cash already ~~there~~ \$36 in cash in  
The U.S.

# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Memorandum	[Repatriation Proposal] - To: Pam Olson - From: Harvey S. Rosen, et al.	2	06/12/2003	P5;

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#### COLLECTION:

Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

5919

#### OA Num.:

5009

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2015-0056-F

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# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	RE: Repatriation Proposal Memo - To: Cesar Conda, et al - From: Keith Hennessey	2	06/12/2003	P5;

**This marker identifies the original location of the withdrawn item listed above.  
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#### COLLECTION:

Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

5919

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# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	RE: Reducing tax on domestic reinvestment of foreign earnings - To: Harvey S. Rosen, et al - From: Nicholas G. Mankiw	4	06/11/2003	P5;

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#### COLLECTION:

Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

#### FRC ID:

5919

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2015-0056-F

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# Withdrawal Marker

## The George W. Bush Library

FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	RE: Temporary repatriation proposal - To: Nicholas G. Mankiw - From: Randall S. Kroszner	2	06/10/2003	P5;

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#### COLLECTION:

Council of Economic Advisers

#### SERIES:

Rosen, Harvey - Subject Files

#### FOLDER TITLE:

Dividend Repatriation Proposal

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FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Email	RE: Foreign dividend repatriation proposal - To: Nicholas G. Mankiw - From: Pam Olson	4	06/09/2003	P5;

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