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National Economic Council

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Repatriation

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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Memorandum	The Economics of the Proposed Tax Holiday - To: N. Gregory Mankiw - From: Henry S. Rosen, et al	4	07/17/2003	P5;
002	Memorandum	Memorandum for Pam Olson - To: Pam Olson - From: Henry S. Rosen, et al	2	06/12/2003	P5;
003	Draft	Homeland Investment Proposal	1	02/07/2003	P5;

COLLECTION TITLE:
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SERIES:
Thomas, Jason
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RESTRICTION CODES

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

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P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advise between the President and his advisors, or between such advisors [a)(5) of the PRA]
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Bank of America

July 11, 2003

Alert: Homeland Investment Act

An Update

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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.

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 levering 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.

German Sub
Borrow Euro's

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.

For more information, log on to bofa.com/capitalmarkets

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Homeland Investment Act
S&P500 Data (Based on most recently issued audited financial statements prior to April 2003)

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Ticker	Company	Undistributed Foreign Earnings
MMM UN Equity	3M Co	3,900,000,000
ABT UN Equity	Abbott Laboratories	4,304,400,000
ADCT UQ Equity	ADC Telecommunications Inc	38,500,000
AMD UN Equity	Advanced Micro Devices Inc	366,000,000
AES UN Equity	AES Corp/The	1,200,000,000
A UN Equity	Agilent Technologies Inc	970,000,000
APD UN Equity	Air Products & Chemicals Inc	1,003,000
ACV UN Equity	Alberto-Culver Co	235,600,000
AA UN Equity	Alcoa Inc	5,893,000,000
AGN UN Equity	Allergan Inc	674,000,000
AW UN Equity	Allied Waste Industries Inc	37,000,000
ALTR UQ Equity	Altera Corp	84,900,000
MO UN Equity	Altria Group Inc	7,100,000,000
AHC UN Equity	Amerada Hess Corp	1,900,000,000
AXP UN Equity	American Express Co	2,400,000,000
AM UN Equity	American Greetings	66,327,000
AIG UN Equity	American International Group	5,100,000,000
APCC UQ Equity	American Power Conversion	361,100,000
AMGN UQ Equity	Amgen Inc	368,000,000
ANDW UQ Equity	Andrew Corp	26,200,000
AOL UN Equity	AOL Time Warner Inc	1,200,000,000
APA UN Equity	Apache Corp	2,100,000,000
AAPL UQ Equity	Apple Computer Inc	755,000,000
ABI UN Equity	Applera Corp - Applied Biosystems	417,100,000
AMAT UQ Equity	Applied Materials Inc	252,000,000
ADM UN Equity	Archer-Daniels-Midland Co	758,000,000
ASH UN Equity	Ashland Inc	96,000,000
ADSK UQ Equity	Autodesk Inc	335,000,000
AV UN Equity	Avaya Inc	632,000,000
AVY UN Equity	Avery Dennison Corp	800,000,000
AVP UN Equity	Avon Products Inc	444,400,000
BAC UN Equity	Bank of America Corp	899,000,000
BOL UN Equity	Bausch & Lomb Inc	804,800,000
BAX UN Equity	Baxter International Inc	725,000,000
BSC UN Equity	Bear Stearns Cos Inc/The	454,000,000
BDX UN Equity	Becton Dickinson & Co	1,614,000,000
BMS UN Equity	Bemis Co	172,209,000
BGEN UQ Equity	Biogen Inc	339,400,000
BMET UQ Equity	Biomet Inc	129,000,000

Ticker	Company	Undistributed Foreign Earnings
BJS UN Equity	BJ Services Co	410,000,000
BDK UN Equity	Black & Decker Corp	1,200,000,000
BMC UN Equity	BMC Software Inc	656,700,000
BCC UN Equity	Boise Cascade Corp	70,500,000
BSX UN Equity	Boston Scientific Corp	1,046,000,000
BMY UN Equity	Bristol-Myers Squibb Co	9,000,000,000
BF/B UN Equity	Brown-Forman Corp	161,000,000
CPN UN Equity	Calpine Corp	29,100,000
CPB UN Equity	Campbell Soup Co	578,000,000
CAH UN Equity	Cardinal Health Inc	453,800,000
CD UN Equity	Cendant Corp	539,000,000
CVX UN Equity	ChevronTexaco Corp	10,108,000,000
CHIR UQ Equity	Chiron Corp	72,000,000
CINF UQ Equity	Cincinnati Financial Corp	14,000,000
CTAS UQ Equity	Cintas Corp	28,500,000
CSCO UQ Equity	Cisco Systems Inc	1,200,000,000
C UN Equity	Citigroup Inc	3,200,000,000
CLX UN Equity	Clorox Co	54,000,000
CMS UN Equity	CMS Energy Corp	2,000,000
KO UN Equity	Coca-Cola Co/The	6,100,000,000
CCE UN Equity	Coca-Cola Enterprises Inc	226,000,000
CL UN Equity	Colgate-Palmolive Co	954,500,000
CA UN Equity	Computer Associates International	242,000,000
CSC UN Equity	Computer Sciences Corp	276,100,000
COP UN Equity	ConocoPhillips	569,000,000
CVG UN Equity	Convergys Corp	72,100,000
CTB UN Equity	Cooper Tire & Rubber Co	176,000,000
GLW UN Equity	Corning Inc	1,000,000,000
BCR UN Equity	CR Bard Inc	792,300,000
CR UN Equity	Crane Co	126,200,000
CSX UN Equity	CSX Corp	341,000,000
CUM UN Equity	Cummins Inc	62,000,000
DCN UN Equity	Dana Corp	673,000,000
DE UN Equity	Deere & Co	574,000,000
DELL UQ Equity	Dell Computer Corp	2,000,000,000
DOV UN Equity	Dover Corp	160,000,000
DOW UN Equity	Dow Chemical Co/The	6,056,000,000
DD UN Equity	Du Pont EI de Nemours & Co	10,320,000,000
EMN UN Equity	Eastman Chemical Co	402,000,000
EK UN Equity	Eastman Kodak Co	1,817,000,000
ETN UN Equity	Eaton Corp	873,000,000
ECL UN Equity	Ecolab Inc	210,000,000
EP UN Equity	EL Paso Corp	975,000,000
ERTS UQ Equity	Electronic Arts Inc	259,000,000
LLY UN Equity	Eli Lilly & Co	8,000,000,000
EMC UN Equity	EMC Corp/Massachusetts	2,729,400,000
EMR UN Equity	Emerson Electric Co	1,531,000,000
EC UN Equity	Engelhard Corp	586,900,000
ETR UN Equity	Entergy Corp	11,200,000
EOG UN Equity	EOG Resources Inc	543,000,000
EFX UN Equity	Equifax Inc	38,800,000
XOM UN Equity	Exxon Mobil Corp	17,000,000,000
FLR UN Equity	Fluor Corp	20,000,000
F UN Equity	Ford Motor Co	860,000,000
FRX UN Equity	Forest Laboratories Inc	441,558,000
FO UN Equity	Fortune Brands Inc	300,800,000
BEN UN Equity	Franklin Resources Inc	1,894,000,000
GPS UN Equity	Gap Inc/The	709,000,000
GE UN Equity	General Electric Co	15,000,000,000
GIS UN Equity	General Mills Inc	87,000,000
GM UN Equity	General Motors Corp	11,900,000,000
GENZ UQ Equity	Genzyme Corp-Genl Division	58,800,000

Ticker	Company	Undistributed Foreign Earnings
GP UN Equity	Georgia-Pacific Corp	608,000,000
GS UN Equity	Goldman Sachs Group Inc	209,000,000
GR UN Equity	Goodrich Corp	244,300,000
GT UN Equity	Goodyear Tire & Rubber Co/The	1,727,000,000
GDT UN Equity	Guidant Corp	1,485,600,000
HRB UN Equity	H&R Block Inc	82,913,000
HAS UN Equity	Hasbro Inc	460,000,000
HPC UN Equity	Hercules Inc	227,000,000
HPQ UN Equity	Hewlett-Packard Co	14,500,000,000
HNZ UN Equity	HJ Heinz Co	2,410,000,000
HON UN Equity	Honeywell International Inc	2,200,000,000
HI UN Equity	Household International Inc	461,500,000
RX UN Equity	IMS Health Inc	682,600,000
INTC UQ Equity	Intel Corp	6,300,000,000
IBM UN Equity	International Business Machines C(	16,631,000,000
IFF UN Equity	International Flavors & Fragrance:	587,700,000
IP UN Equity	International Paper Co	2,500,000,000
IPG UN Equity	Interpublic Group Cos Inc	847,700,000
ITT UN Equity	ITT Industries Inc	48,600,000
JBL UN Equity	Jabil Circuit Inc	261,000,000
JNJ UN Equity	Johnson & Johnson	12,300,000,000
JCI UN Equity	Johnson Controls Inc	612,000,000
JNY UN Equity	Jones Apparel Group Inc	24,800,000
JPM UN Equity	JP Morgan Chase & Co	1,900,000,000
K UN Equity	Kellogg Co	857,000,000
KMB UN Equity	Kimberly-Clark Corp	3,400,000,000
KLAC UQ Equity	Kla-Tencor Corp	37,000,000
LEH UN Equity	Lehman Brothers Holdings Inc	178,000,000
LXK UN Equity	Lexmark International Inc	683,900,000
LIZ UN Equity	Liz Claiborne Inc	4,000,000
LPX UN Equity	Louisiana-Pacific Corp	40,100,000
LSI UN Equity	LSI Logic Corp	107,000,000
LU UN Equity	Lucent Technologies Inc	3,374,000,000
MRO UN Equity	Marathon Oil Corp	322,000,000
MAR UN Equity	Marriott International Inc	263,000,000
MMC UN Equity	Marsh & McLennan Cos Inc	1,200,000,000
MAS UN Equity	Masco Corp	530,000,000
MAT UN Equity	Mattel Inc	2,300,000,000
MYG UN Equity	Maytag Corp	12,000,000
KRB UN Equity	MBNA Corp	893,700,000
MDR UN Equity	McDermott International Inc	85,900,000
MCD UN Equity	McDonald's Corp	3,200,000,000
MHP UN Equity	McGraw-Hill Cos Inc/The	180,000,000
MCK UN Equity	McKesson Corp	80,800,000
MWV UN Equity	MeadWestvaco Corp	423,000,000
MDT UN Equity	Medtronic Inc	933,700,000
MRK UN Equity	Merck & Co Inc	15,000,000,000
MERQ UQ Equity	Mercury Interactive Corp	327,000,000
MER UN Equity	Merrill Lynch & Co Inc	4,300,000,000
MU UN Equity	Micron Technology Inc	386,900,000
MSFT UQ Equity	Microsoft Corp	780,000,000
MIL UN Equity	Millipore Corp	272,350,000
MIR UN Equity	Mirant Corp	428,000,000
MOLX UQ Equity	Molex Inc	407,000,000
MON UN Equity	Monsanto Co	155,000,000
MCO UN Equity	Moody's Corp	13,000,000
MWD UN Equity	Morgan Stanley	4,000,000,000
MOT UN Equity	Motorola Inc	7,600,000,000
NBR UA Equity	Nabors Industries Ltd	212,000,000
NSM UN Equity	National Semiconductor Corp	433,200,000
NAV UN Equity	Navistar International Corp	128,000,000
NCR UN Equity	NCR Corp	466,000,000

Ticker	Company	Undistributed Foreign Earnings
NWL UN Equity	Newell Rubbermaid Inc	72,700,000
NKE UN Equity	Nike Inc	361,100,000
NE UN Equity	Noble Corp	650,000,000
NOC UN Equity	Northrop Grumman Corp	78,000,000
NOVL UQ Equity	Novell Inc	15,000,000
NVDA UQ Equity	Nvidia Corp	236,000,000
ODP UN Equity	Office Depot Inc	778,700,000
ORCL UQ Equity	Oracle Corp	2,300,000,000
PCAR UQ Equity	Paccar Inc	1,551,000,000
PTV UN Equity	Pactiv Corp	105,000,000
PLL UN Equity	Pall Corp	327,000,000
PH UN Equity	Parker Hannifin Corp	267,093,000
PEP UN Equity	PepsiCo Inc	7,500,000,000
PFE UN Equity	Pfizer Inc	29,000,000,000
PHA UN Equity	Pharmacia Corp	8,600,000,000
PD UN Equity	Phelps Dodge Corp	571,000,000
PBI UN Equity	Pitney Bowes Inc	308,000,000
PPG UN Equity	PPG Industries Inc	922,000,000
PPL UN Equity	PPL Corp	295,000,000
PX UN Equity	Praxair Inc	1,145,000,000
PG UN Equity	Procter & Gamble Co	10,698,000,000
PRU UN Equity	Prudential Financial Inc	2,240,000,000
QCOM UQ Equity	Qualcomm Inc	455,000,000
QTRN UQ Equity	Quintiles Transnational Corp	180,700,000
RBK UN Equity	Reebok International Ltd	496,820,000
ROK UN Equity	Rockwell Automation Inc	261,000,000
COL UN Equity	Rockwell Collins Inc	51,000,000
R UN Equity	Ryder System Inc	170,000,000
SWY UN Equity	Safeway Inc	805,500,000
SANM UQ Equity	Sanmina-SCI Corp	65,000,000
SLE UN Equity	Sara Lee Corp	1,800,000,000
SGP UN Equity	Schering-Plough Corp	9,400,000,000
SEE UN Equity	Sealed Air Corp	39,645,000
S UN Equity	Sears Roebuck and Co	429,000,000
SRE UN Equity	Sempra Energy	304,000,000
SHW UN Equity	Sherwin-Williams Co/The	266,000
SEBL UQ Equity	Siebel Systems Inc	183,000,000
SNA UN Equity	Snap-On Inc	180,000,000
SLR UN Equity	Solectron Corp	592,800,000
STJ UN Equity	St Jude Medical Inc	430,885,000
SPC UN Equity	St Paul Cos	67,000,000
SWK UN Equity	Stanley Works/The	62,200,000
SPLS UQ Equity	Staples Inc	124,500,000
HOT UN Equity	Starwood Hotels & Resorts Worldv	142,000,000
SYK UN Equity	Stryker Corp	660,700,000
SUNW UQ Equity	Sun Microsystems Inc	1,463,000,000
SBL UN Equity	Symbol Technologies Inc	32,308,000
TLAB UQ Equity	Tellabs Inc	611,768,000
TER UN Equity	Teradyne Inc	63,100,000
TXN UN Equity	Texas Instruments Inc	1,293,000,000
TXT UN Equity	Textron Inc	618,000,000
TMO UN Equity	Thermo Electron Corp	576,000,000
TNB UN Equity	Thomas & Betts Corp	135,000,000
TMPW UQ Equity	TMP Worldwide Inc	29,000,000
TOY UN Equity	Toys R US Inc	506,000,000
UIS UN Equity	Unisys Corp	830,000,000
X UN Equity	United States Steel Corp	260,000,000
UCL UN Equity	Unocal Corp	1,900,000,000
VZ UN Equity	Verizon Communications Inc	4,500,000,000
VFC UN Equity	VF Corp	107,400,000
VIA/B UN Equity	Viacom Inc	1,900,000,000
VC UN Equity	Visteon Corp	1,070,000,000

Ticker	Company	Undistributed Foreign Earnings
WMT UN Equity	Wal-Mart Stores Inc	722,000,000
DIS UN Equity	Walt Disney Co	200,000,000
WMI UN Equity	Waste Management Inc	167,000,000
WEN UN Equity	Wendy's International Inc	19,000,000
WY UN Equity	Weyerhaeuser Co	1,100,000,000
WHR UN Equity	Whirlpool Corp	440,000,000
WWY UN Equity	WM Wrigley Jr Co	631,920,000
WYE UN Equity	Wyeth	2,500,000,000
XEL UN Equity	Xcel Energy Inc	345,000,000
XRX UN Equity	Xerox Corp	5,000,000,000
XLNX UQ Equity	Xilinx Inc	199,000,000
ZMH UN Equity	Zimmer Holdings Inc	53,700,000
ACE UN Equity	ACE Ltd	none mentioned
ADBE UQ Equity	Adobe Systems Inc	mentioned, but not explicit
AET UN Equity	Aetna Inc	none mentioned
AFL UN Equity	Aflac Inc	none mentioned
ABS UN Equity	Albertson's Inc	none mentioned
AYE UN Equity	Allegheny Energy Inc	none mentioned
ATI UN Equity	Allegheny Technologies Inc	mentioned, but not explicit
ALL UN Equity	Allstate Corp/The	none mentioned
AT UN Equity	Alltel Corp	none mentioned
ABK UN Equity	AMBAC Financial Group Inc	none mentioned
AEE UN Equity	Ameren Corp	none mentioned
AEP UN Equity	American Electric Power Co Inc	none mentioned
ASD UN Equity	American Standard Cos Inc	none mentioned
ABC UN Equity	AmerisourceBergen Corp	none mentioned
ASO UN Equity	AmSouth Bancorp	none mentioned
APC UN Equity	Anadarko Petroleum Corp	none mentioned
ADI UN Equity	Analog Devices Inc	none mentioned
BUD UN Equity	Anheuser-Busch Cos Inc	none mentioned
ATH UN Equity	Anthem Inc	none mentioned
AOC UN Equity	AON Corp	none mentioned
AIV UN Equity	Apartment Investment & Managem	REIT
APOL UQ Equity	Apollo Group Inc	none mentioned
AMCC UQ Equity	Applied Micro Circuits Corp	none mentioned
T UN Equity	AT&T Corp	none mentioned
AWE UN Equity	AT&T Wireless Services Inc	none mentioned
ADP UN Equity	Automatic Data Processing	none mentioned
AN UN Equity	Autonation Inc	none mentioned
AZO UN Equity	Autozone Inc	none mentioned
BHI UN Equity	Baker Hughes Inc	none mentioned
BLL UN Equity	Ball Corp	mentioned, but not explicit
BK UN Equity	Bank of New York Co Inc/The	none mentioned
ONE UN Equity	Bank One Corp	none mentioned
BBT UN Equity	BB&T Corp	none mentioned
BBBY UQ Equity	Bed Bath & Beyond Inc	none mentioned
BLS UN Equity	BellSouth Corp	none mentioned
BBY UN Equity	Best Buy Co Inc	none mentioned
BLI UN Equity	Big Lots Inc	none mentioned
BA UN Equity	Boeing Co/The	none mentioned
BRCM UQ Equity	Broadcom Corp	none mentioned
BC UN Equity	Brunswick Corp	none mentioned
BNI UN Equity	Burlington Northern Santa Fe Corp	none mentioned
BR UN Equity	Burlington Resources Inc	mentioned, but not explicit
COF UN Equity	Capital One Financial Corp	none mentioned
CCL UN Equity	Carnival Corp	mentioned, but not explicit
CAT UN Equity	Caterpillar Inc	none mentioned
CNP UN Equity	Centerpoint Energy Inc	mentioned, but not explicit
CTX UN Equity	Centex Corp	none mentioned
CTL UN Equity	CenturyTel Inc	none mentioned
SCH UN Equity	Charles Schwab Corp/The	none mentioned
CF UN Equity	Charter One Financial Inc	none mentioned

Ticker	Company	Undistributed Foreign Earnings
CB UN Equity	Chubb Corp	explicitly mentions that it doesn't consider its foreign net earnings as permanently invested
CIEN UQ Equity	CIENA Corp	none mentioned
CI UN Equity	Cigna Corp	none mentioned
CIN UN Equity	Cinergy Corp	none mentioned
CC UN Equity	Circuit City Stores Inc	none mentioned
CZN UN Equity	Citizens Communications Co	none mentioned
CTXS UQ Equity	Citrix Systems Inc	mentioned, but not explicit
CCU UN Equity	Clear Channel Communications In(	none mentioned
CMCSA UQ Equity	Comcast Corp	none mentioned
CMA UN Equity	Comerica Inc	none mentioned
CPWR UQ Equity	Compuware Corp	none mentioned
CMVT UQ Equity	Comverse Technology Inc	mentioned, but not explicit
CAG UN Equity	ConAgra Foods Inc	none mentioned
CE UN Equity	Concord EFS Inc	none mentioned
ED UN Equity	Consolidated Edison Inc	none mentioned
CEG UN Equity	Constellation Energy Group Inc	none mentioned
CBE UN Equity	Cooper Industries Ltd	mentioned, but not explicit
RKY UN Equity	Coors (Adolph)	none mentioned
COST UQ Equity	Costco Wholesale Corp	none mentioned
CFC UN Equity	Countrywide Financial Corp	none mentioned
CVS UN Equity	CVS Corp	none mentioned
DHR UN Equity	Danaher Corp	none mentioned
DRI UN Equity	Darden Restaurants Inc	none mentioned
DPH UN Equity	Delphi Corp	none mentioned
DAL UN Equity	Delta Air Lines Inc	none mentioned
DLX UN Equity	Deluxe Corp	none mentioned
DVN UA Equity	Devon Energy Corp	mentioned, but not explicit
DDS UN Equity	Dillard's Inc/AR	none mentioned
DG UN Equity	Dollar General Corp	none mentioned
D UN Equity	Dominion Resources Inc/VA	none mentioned
DJ UN Equity	Dow Jones & Co Inc	none mentioned
DTE UN Equity	DTE Energy Co	none mentioned
DUK UN Equity	Duke Energy Corp	none mentioned
DYN UN Equity	Dynegy Inc	none mentioned
EBAY UQ Equity	eBay Inc	none mentioned
EIX UN Equity	Edison International	none mentioned
EDS UN Equity	Electronic Data Systems Corp	none mentioned
EOP UN Equity	Equity Office Properties Trust	REIT
EQR UN Equity	Equity Residential	REIT
EXC UN Equity	Exelon Corp	none mentioned
FDO UN Equity	Family Dollar Stores	none mentioned
FNM UN Equity	Fannie Mae	none mentioned
FD UN Equity	Federated Department Stores	none mentioned
FDX UN Equity	FedEx Corp	says its immaterial
FITB UQ Equity	Fifth Third Bancorp	none mentioned
FDC UN Equity	First Data Corp	none mentioned
FTN UN Equity	First Tennessee National Corp	none mentioned
FE UN Equity	FirstEnergy Corp	none mentioned
FISV UQ Equity	Fiserv Inc	none mentioned
FBF UN Equity	FleetBoston Financial Corp	none mentioned
FPL UN Equity	FPL Group Inc	none mentioned
FRE UN Equity	Freddie Mac	none mentioned
FCX UN Equity	Freeport-McMoRan Copper & Gold	none mentioned
GCI UN Equity	Gannett Co Inc	none mentioned
GTW UN Equity	Gateway Inc	none mentioned
GD UN Equity	General Dynamics Corp	none mentioned
GPC UN Equity	Genuine Parts Co	none mentioned
G UN Equity	Gillette Co/The	none mentioned
GDW UN Equity	Golden West Financial Corp	none mentioned
GLK UN Equity	Great Lakes Chemical Corp	none mentioned
HAL UN Equity	Halliburton Co	mentioned, but not explicit
HDI UN Equity	Harley-Davidson Inc	none mentioned

Ticker	Company	Undistributed Foreign Earnings
HET UN Equity	Harrah's Entertainment Inc	none mentioned
HIG UN Equity	Hartford Financial Services Group	none mentioned
HCA UN Equity	HCA Inc	none mentioned
HMA UN Equity	Health Management Associates Inc	none mentioned
HRC UN Equity	Healthsouth Corp	none mentioned
HSY UN Equity	Hershey Foods Corp	none mentioned
HLT UN Equity	Hilton Hotels Corp	none mentioned
HD UN Equity	Home Depot Inc	none mentioned
HUM UN Equity	Humana Inc	none mentioned
HBAN UQ Equity	Huntington Bancshares Inc	none mentioned
ITW UN Equity	Illinois Tool Works Inc	none mentioned
IR UN Equity	Ingersoll-Rand Co	mentioned, but not explicit
IGT UN Equity	International Game Technology	none mentioned
INTU UQ Equity	Intuit Inc	none mentioned
JNS UN Equity	Janus Capital Group Inc	none mentioned
JCP UN Equity	JC Penney Co Inc Holding Co	none mentioned
JDSU UQ Equity	JDS Uniphase Corp	none mentioned
JP UN Equity	Jefferson-Pilot Corp	none mentioned
JHF UN Equity	John Hancock Financial Services Ir	none mentioned
KBH UN Equity	KB Home	mentioned, but not explicit
KMG UN Equity	Kerr-McGee Corp	mentioned, but not explicit
KEY UN Equity	Keycorp	none mentioned
KSE UN Equity	KeySpan Corp	none mentioned
KMI UN Equity	Kinder Morgan Inc	none mentioned
KG UN Equity	King Pharmaceuticals Inc	none mentioned
KRI UN Equity	Knight-Ridder Inc	none mentioned
KSS UN Equity	Kohl's Corp	none mentioned
KR UN Equity	Kroger Co	none mentioned
LEG UN Equity	Leggett & Platt Inc	none mentioned
LNC UN Equity	Lincoln National Corp	none mentioned
LLTC UQ Equity	Linear Technology Corp	mentioned, but not explicit
LMT UN Equity	Lockheed Martin Corp	none mentioned
LTR UN Equity	Loews Corp	none mentioned
LOW UN Equity	Lowe's Cos Inc	none mentioned
LTD UN Equity	Ltd Brands	none mentioned
HCR UN Equity	Manor Care Inc	none mentioned
MI UN Equity	Marshall & Ilsley Corp	none mentioned
MXIM UQ Equity	Maxim Integrated Products	none mentioned
MAY UN Equity	May Department Stores Co/The	none mentioned
MBI UN Equity	MBIA Inc	none mentioned
MEDI UQ Equity	Medimmune Inc	mentioned, but not explicit
MEL UN Equity	Mellon Financial Corp	none mentioned
MDP UN Equity	Meredith Corp	none mentioned
MET UN Equity	Metlife Inc	none mentioned
MTG UN Equity	MGIC Investment Corp	none mentioned
NCC UN Equity	National City Corp	none mentioned
NTAP UQ Equity	Network Appliance Inc	mentioned, but not explicit
NYT UN Equity	New York Times Co	none mentioned
NEM UN Equity	Newmont Mining Corp	mentioned, but not explicit
NXTL UQ Equity	Nextel Communications Inc	none mentioned
GAS UN Equity	Nicor Inc	none mentioned
NI UN Equity	NiSource Inc	none mentioned
JWN UN Equity	Nordstrom Inc	none mentioned
NSC UN Equity	Norfolk Southern Corp	none mentioned
NFB UN Equity	North Fork Bancorporation Inc	none mentioned
NTRS UQ Equity	Northern Trust Corp	none mentioned
NVLS UQ Equity	Novellus Systems Inc	none mentioned
NUE UN Equity	Nucor Corp	none mentioned
OXY UN Equity	Occidental Petroleum Corp	none mentioned
OMC UN Equity	Omnicom Group	none mentioned
PMTC UQ Equity	Parametric Technology Corp	none mentioned
PAYX UQ Equity	Paychex Inc	none mentioned

Ticker	Company	Undistributed Foreign Earnings
PGL UN Equity	Peoples Energy Corp	none mentioned
PSFT UQ Equity	Peoplesoft Inc	none mentioned
PBG UN Equity	Pepsi Bottling Group Inc	mentioned, but not explicit
PKI UN Equity	PerkinElmer Inc	mentioned, but not explicit
PCG UN Equity	PG&E Corp	none mentioned
PNW UN Equity	Pinnacle West Capital Corp	none mentioned
PCL UN Equity	Plum Creek Timber Co Inc (REIT)	REIT
PMCS UQ Equity	PMC - Sierra Inc	mentioned, but not explicit
PNC UN Equity	PNC Financial Services Group Inc	none mentioned
PWER UQ Equity	Power-One Inc	mentioned, but not explicit
PFG UN Equity	Principal Financial Group	none mentioned
PGN UN Equity	Progress Energy Inc	none mentioned
PGR UN Equity	Progressive Corp/The	none mentioned
PVN UN Equity	Providian Financial Corp	none mentioned
PEG UN Equity	Public Service Enterprise Group In	none mentioned
PHM UN Equity	Pulte Homes Inc	none mentioned
QLGC UQ Equity	QLogic Corp	none mentioned
DGX UN Equity	Quest Diagnostics	none mentioned
Q UN Equity	Qwest Communications Internatio	none mentioned
RSH UN Equity	RadioShack Corp	none mentioned
RTN UN Equity	Raytheon Co	none mentioned
RF UN Equity	Regions Financial Corp	none mentioned
RJR UN Equity	RJ Reynolds Tobacco Holdings Inc	none mentioned
RHI UN Equity	Robert Half International Inc	none mentioned
ROH UN Equity	Rohm & Haas Co	says it wouldn't be material
RDC UN Equity	Rowan Cos Inc	mentioned, but not explicit
DNY UN Equity	RR Donnelley & Sons Co	none mentioned
TSG UN Equity	Sabre Holdings Corp	none mentioned
SAFC UQ Equity	Safeco Corp	none mentioned
SBC UN Equity	SBC Communications Inc	none mentioned
SLB UN Equity	Schlumberger Ltd	non-US
SFA UN Equity	Scientific-Atlanta Inc	none mentioned
SIAL UQ Equity	Sigma-Aldrich Corp	mentioned, but not explicit
SPG UN Equity	Simon Property Group Inc	REIT
SLM UN Equity	SLM Corp	none mentioned
SO UN Equity	Southern Co/The	none mentioned
SOTR UQ Equity	SouthTrust Corp	none mentioned
LUV UN Equity	Southwest Airlines Co	none mentioned
FON UN Equity	Sprint Corp-FON Group	none mentioned
PCS UN Equity	Sprint Corp-PCS Group	none mentioned
SBUX UQ Equity	Starbucks Corp	none mentioned
STT UN Equity	State Street Corp	none mentioned
SDS UN Equity	Sungard Data Systems Inc	none mentioned
SUN UN Equity	Sunoco Inc	none mentioned
STI UN Equity	SunTrust Banks Inc	none mentioned
SVU UN Equity	Supervalu Inc	none mentioned
SNV UN Equity	Synovus Financial Corp	none mentioned
SYY UN Equity	Sysco Corp	none mentioned
TROW UQ Equity	T Rowe Price Group Inc	none mentioned
TGT UN Equity	Target Corp	none mentioned
TE UN Equity	TECO Energy Inc	none mentioned
TEK UN Equity	Tektronix Inc	none mentioned
TIN UN Equity	Temple-Inland Inc	none mentioned
THC UN Equity	Tenet Healthcare Corp	none mentioned
TIF UN Equity	Tiffany & Co	mentioned, but not explicit
TJX UN Equity	TJX Cos Inc	mentioned, but not explicit
TMK UN Equity	Torchmark Corp	none mentioned
RIG UN Equity	Transocean Inc	none mentioned
TAP/B UN Equity	Travelers Property Casualty Corp	none mentioned
TRB UN Equity	Tribune Co	none mentioned
TUP UN Equity	Tupperware Corp	none mentioned
TXU UN Equity	TXU Corp	none mentioned

Ticker	Company	Undistributed Foreign Earnings
TYC UN Equity	Tyco International Ltd	none mentioned
UNP UN Equity	Union Pacific Corp	none mentioned
UPC UN Equity	Union Planters Corp	none mentioned
UPS UN Equity	United Parcel Service Inc	none mentioned
UTX UN Equity	United Technologies Corp	none mentioned
UNH UN Equity	UnitedHealth Group Inc	none mentioned
UVN UN Equity	Univision Communications Inc	none mentioned
UNM UN Equity	UnumProvident Corp	none mentioned
USB UN Equity	US Bancorp	none mentioned
UST UN Equity	UST Inc	none mentioned
VRTS UQ Equity	Veritas Software Corp	none mentioned
VMC UN Equity	Vulcan Materials Co	none mentioned
WB UN Equity	Wachovia Corp	none mentioned
WAG UN Equity	Walgreen Co	none mentioned
WM UN Equity	Washington Mutual Inc	none mentioned
WAT UN Equity	Waters Corp	none mentioned
WPI UN Equity	Watson Pharmaceuticals Inc	none mentioned
WLP UN Equity	WellPoint Health Networks	none mentioned
WFC UN Equity	Wells Fargo & Co	none mentioned
WMB UN Equity	Williams Cos Inc	none mentioned
WIN UN Equity	Winn-Dixie Stores Inc	none mentioned
WOR UN Equity	Worthington Industries	none mentioned
GWW UN Equity	WW Grainger Inc	mentioned, but not explicit
XL UN Equity	XL Capital Ltd	none
YHOO UQ Equity	Yahoo Inc	none mentioned
YUM UN Equity	Yum! Brands Inc	mentioned, but not explicit
ZION UQ Equity	Zions Bancorporation	none mentioned

	Undistributed Earnings
Total	407,261,265,000

Notes

1. The amount of "Undistributed Earnings" is usually found in the tax note or occasionally in Note 1 (under the sub-header on taxes) in the auditied financial statements, and is identified as either undistributed foreign earnings or permanently reinvested foreign earnings.

2) On the financial statements of some of these companies, the listed amount referred to a tax amount instead of an earnings amount. In these cases, we included this tax amount in the list above. It would be too subjective to assume a tax rate and gross up this tax amount to calculate the earnings amount. Since the tax amount would be less than the earnings amount, including the tax amount provided is consistent with our effort to be conservative in our estimate.

3) In those cases where the financial statements did not mention a specific undistributed foreign earnings amount but indicated that there were such earnings, we did not attempt to approximate the amount. We assumed zero to be conservative.

Economic & Policy Research
J.P. Morgan Securities Inc.
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JPMorgan

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.

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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 dividendAs 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

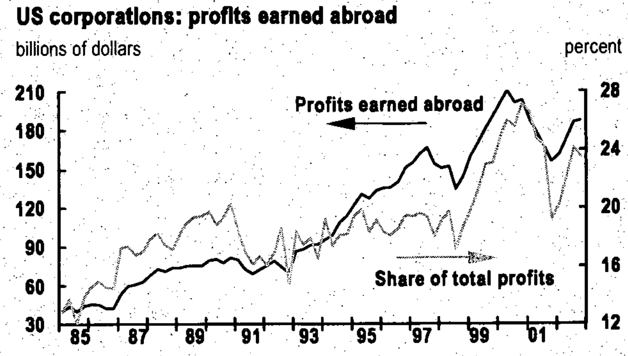
Under Current Law

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

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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.[1] 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 figures likely underestimates the size of the total pool of foreign earnings that could potentially be repatriated.

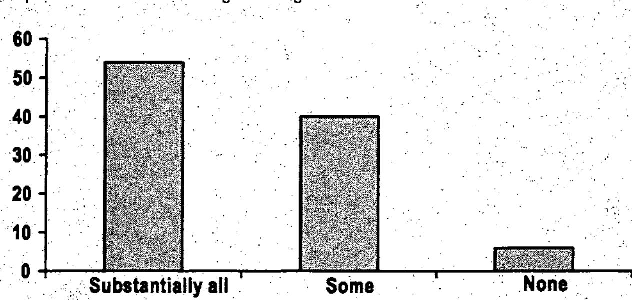
• The S&P 500 is a subset of the entire corporate sector. S&P 500 operating earnings has recently averaged about 60% of overall after tax earnings. Its share of foreign earnings is likely larger, although no official breakdown is available.

• 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
billions of dollars

	From Firms Repatriating Substantially All	From Firms Repatriating Some	Dollars Repatriated
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 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.

S&P sample and survey group

$ billion

Group	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

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

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 partial 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.

★ Manufacturing

★ Pharmaceutical

★ Tend to be • higher credit quality

★ 200 odd companies that report foreign income

Joseph R. Korsmo
07/17/2003 04:39:34 PM

Record Type: Record

To: Brian Reardon/OPD/EOP@EOP
cc:
Subject: Re: Senate Vote

Grouped By Vote Position

Democrat: YEAs ---23

Akaka (D-HI)
Baucus (D-MT)
Bayh (D-IN)
Boxer (D-CA)
Cantwell (D-WA)
Carper (D-DE)
Corzine (D-NJ)
Dodd (D-CT)
Feinstein (D-CA)
Hollings (D-SC)
Landrieu (D-LA)
Lautenberg (D-NJ)
Leahy (D-VT)
Lieberman (D-CT)
Lincoln (D-AR)
Miller (D-GA)
Murray (D-WA)
Nelson (D-NE)
Pryor (D-AR)
Reid (D-NV)
Schumer (D-NY)
Stabenow (D-MI)
Wyden (D-OR)

Demcorat: NAYs ---25

Biden (D-DE)
Bingaman (D-NM)
Breaux (D-LA)
Byrd (D-WV)
Clinton (D-NY)
Conrad (D-ND)
Daschle (D-SD)
Dayton (D-MN)
Dorgan (D-ND)
Durbin (D-IL)
Edwards (D-NC)
Feingold (D-WI)
Graham (D-FL)
Harkin (D-IA)
Inouye (D-HI)
Johnson (D-SD)
Kennedy (D-MA)
Kerry (D-MA)
Kohl (D-WI)
Levin (D-MI)
Mikulski (D-MD)
Nelson (D-FL)
Reed (D-RI)
Rockefeller (D-WV)
Sarbanes (D-MD

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

SERIES:
Thomas, Jason

FOLDER TITLE:
Repatriation

FRC ID:
6719

OA Num.:
9054

NARA Num.:
8958

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]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

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Tax = 50% Asset = 2000

Dep = 10 yr Rate Payers = 100

	Tax Deprec.	Tax Effect	Reg Dep.	Tax Effect	Deffered Tax	DFIT Reserve	Δ Reg Rate	Δ Norm Rate
Year 1	400	200	200	100	100	100	-2	-1
* 2	400	200	200	100	100	200	-2	-1
3	400	200	200	100	100	300	-2	-1
4	400	200	200	100	100	400	-2	-1
5	400	200	200	100	100	500	-2	-1
6	0	0	200	100	(100)	400	~~+2~~ 0	-1
7	0	0	200	100	(100)	300	~~+2~~ 0	-1
8	0	0	200	100	(100)	200	~~+2~~ 0	-1
9	0	0	200	100	(100)	100	~~+2~~ 0	-1
10	0	0	200	100	(100)	0	~~+2~~ 0	-1

- A company sells its generation plant in year 5 has 500 in DFIT reserves ~~to~~ remaining.
- Consumer Advocates would argue this 500 is a windfall to the utility and needs to pass through to ratepayers.
- Utilities argue this 500 disappears with the sold — now deregulated — facility. No cost recovery, no flow through.
  - Pass through of cost is parralell w/ pass through of tax benes.
- Are Ratepayers getting a

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

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COLLECTION:
National Economic Council
SERIES:
Thomas, Jason
FOLDER TITLE:
Repatriation
FRC ID:
6719
OA Num.:
9054
NARA Num.:
8958

FOIA IDs and Segments:
2015-0056-F

RESTRICTION CODES

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FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Draft	Homeland Investment Proposal	1	02/07/2003	P5;

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COLLECTION:
National Economic Council
SERIES:
Thomas, Jason
FOLDER TITLE:
Repatriation
FRC ID:
6719
OA Num.:
9054
NARA Num.:
8958

FOIA IDs and Segments:
2015-0056-F

RESTRICTION CODES

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DRAFT 2-6-03

108TH CONGRESS
1ST SESSION

H.R. __

To amend the Internal Revenue Code of 1986 to encourage investing of surplus foreign earnings at home.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY __, 2003

Mr. ENGLISH introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1986 to encourage investing of surplus foreign earnings at home.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE

This Act may be cited as the "Homeland Investment Act of 2003".

SEC. 2. TOLL CHARGE ON EXCESS QUALIFIED FOREIGN DISTRIBUTION AMOUNT.

Subchapter N of the Internal Revenue Code of 1986 is amended by adding at the end the following new section:

SEC. 965. TOLL CHARGE IMPOSED ON EXCESS QUALIFIED FOREIGN DISTRIBUTION AMOUNT

(a) TOLL CHARGE IMPOSED ON EXCESS QUALIFIED FOREIGN DISTRIBUTION AMOUNT. – If a taxpayer elects the application of this section, a tax shall be imposed on the taxpayer in an amount equal to 5.25 percent of (i) the excess qualified foreign distribution amount and (ii) the amount determined under section 78 that is attributable to such excess qualified foreign distribution amount. Such tax shall be imposed in lieu of the tax imposed under section 1 or 11 on such amounts.

(b) EXCESS QUALIFIED FOREIGN DISTRIBUTION AMOUNT. –

(1) IN GENERAL. – The term "excess qualified foreign distribution amount" means the excess (if any) of –

(A) 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

(B) the base dividend amount.

(2) BASE DIVIDEND AMOUNT. – The term "base dividend amount" means 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.

(3) FIXED BASE PERIOD. –

(A) IN GENERAL – The term "fixed base period" means each of 3 taxable years which are among the 5 most recent taxable years of the taxpayer ending on or before December 31, 2002, determined by disregarding:

i. the one taxable year for which the corporation had the highest amount of dividends from controlled foreign corporations relative to the other 4 taxable years, and

ii. the one taxable year for which the corporation had the lowest amount of dividends from controlled foreign corporations relative to the other 4 taxable years.

(B) SHORTER PERIOD. – If the taxpayer has fewer than 5 taxable years ending on or before December 31, 2002, then in lieu of applying subparagraph (b)(3)(A), the fixed base period shall mean such shorter period representing all of the taxable years beginning on or before December 31, 2002.

Rules similar to the rules of section 41(f)(3) shall apply in the case of acquisitions or dispositions of controlled foreign corporations beginning after the fixed base period.

(c) DEFINITIONS AND SPECIAL RULES. –

(1) DIVIDENDS. – For purposes of this section, the term "dividend" means a dividend as defined in section 316, except that the term shall also include amounts described in section 951(a)(1)(B), and shall exclude amounts described in section 78.

(2) CONTROLLED FOREIGN CORPORATIONS AND UNITED STATES SHAREHOLDERS. – For purpose of this section, the term "controlled foreign corporation" shall have the same meaning as under section 957(a) and the term "United States shareholder" shall have the same meaning as under section 951(b).

(3) FOREIGN TAX CREDITS. – The amount of any income, war, profits, or excess profits taxes paid (or deemed paid under sections 902 and 960) or accrued by the taxpayer with respect to the excess qualified foreign distribution amount for which a credit would be allowable under section 901 in the absence of this section shall be reduced by 85 percent.

(4) FOREIGN TAX CREDIT LIMITATION. – For all purposes of section 904, there shall be disregarded 85 percent of (i) the excess qualified foreign distribution amount, and (ii) the amount determined under section 78 that is attributable to such excess qualified foreign distribution amount.

(5) TREATMENT OF CONSOLIDATED GROUPS. – Members of an affiliated group of corporations filing a consolidated return under section 1501 shall be treated as a single taxpayer in applying the rules of this section.

(6) DESIGNATION OF BASE DIVIDEND AMOUNT. – The taxpayer shall designate the particular dividends received during the taxable year from one or more controlled foreign corporations in which it is a United States shareholder that are dividends excluded from the excess qualified foreign distribution amount. The total amount of such designated dividends shall equal the base dividend amount.

(d) ELECTION. –

(1) IN GENERAL. – An election under this section shall be made on the taxpayer's timely filed income tax return for the taxable year (determined by taking extensions into account) and, once made, may be revoked only with the consent of the Secretary.

(2) ALL CONTROLLED FOREIGN CORPORATIONS. – The election shall apply to all controlled foreign corporations in which the taxpayer is a United States shareholder during the taxable year.

(3) CONSOLIDATED GROUPS. – If a taxpayer is a member of an affiliated group of corporations filing a consolidated return under section 1501 for the taxable year, an election under this section shall be made by the common parent of the affiliated group which includes the taxpayer, and shall apply to all members of the affiliated group.

(e) REGULATIONS. – The Secretary shall prescribe such regulations as may be necessary and appropriate to carry out the purposes of this section, including regulations under section 55 and regulations addressing corporations that, during the fixed base period or thereafter, join or leave an affiliated group of corporations filing a consolidated return.

(f) EFFECTIVE DATE. – The amendments made by this section shall apply only to the first taxable year of the electing taxpayer ending 90 days after the date of enactment.

CSPP

Computer Systems Policy Project

1341 G Street, NW / Suite 1100 / Washington, DC 20005 / Voice: 202.393.2260 / Fax: 202.393.0712 / www.cspp.org

February 5, 2003

President George Bush
The White House
Washington, DC 20500

Dear Mr. President:

We write to express our support for your economic growth package. As CEOs of the nation's leading information technology companies we commend you on your leadership in constructing this proposal and in offering the nation a package that is responsive to our current economic situation.

As Congress considers this proposal, we know that there will be opportunities to consider adding provisions to the package. We look forward to these discussions with you, your administration and the Congress.

The package you have presented is one that we support and we look forward to working with you toward its enactment. We congratulate you on your proposals and stand prepared to assist in any way we can.

Sincerely,

Michael Dell
Chairman & CEO
Dell Computer Corporation
CSPP Chair

Craig R. Barrett
CEO
Intel Corporation

Carly Fiorina
Chairman & CEO
Hewlett-Packard Company

Christopher B. Galvin
Chairman & CEO
Motorola Inc.

Lars Nyberg
Chairman & CEO
NCR Corporation

Samuel J. Palmisano
Chairman & CEO
IBM Corporation

Joseph Tucci
President & CEO
EMC Corporation

Lawrence A. Weinbach
Chairman & CEO
Unisys Corporation

**DO REPATRIATION TAXES MATTER?
EVIDENCE FROM THE
TAX RETURNS OF U.S. MULTINATIONALS***

by

**Rosanne Altshuler
T. Scott Newlon
William C. Randolph****

OTA Paper 70 **August 1994**

Office of Tax Analysis
U.S. Treasury Department
Washington, DC 20220

*** Prepared for the 1994 NBER Conference on International Taxation. We are very grateful to Gordon Wilson for his assistance in using the Treasury tax data. We thank Bill Gentry and other conference participants for valuable comments. We also thank seminar participants at the University of Pennsylvania, the University of Toronto, and the 1993 NBER Summer Institute for helpful comments.**

****Rosanne Altshuler, Rutgers University and National Bureau of Economic Research. T. Scott Newlon, Office of Tax Analysis, U.S. Treasury Department. William C. Randolph, Congressional Budget Office, U.S. Congress.**

DO REPATRIATION TAXES MATTER? EVIDENCE FROM THE TAX RETURNS OF U.S. MULTINATIONALS

ABSTRACT

An open question in the literature on the taxation of multinational corporations is whether repatriation taxes influence whether the profits of foreign subsidiaries are repatriated or reinvested abroad. Theoretical models suggest that dividend remittances should not be influenced by repatriation taxes. The results of recent empirical work indicate that dividend remittances are sensitive to repatriation taxes. This paper investigates whether the empirical evidence can be reconciled with the theoretical results by recognizing that repatriation taxes on dividends may vary over time and provide firms with an incentive to time repatriations so that they occur in years when repatriation tax rates are relatively low. We use information about cross-country differences in tax rates to separately estimate the influence of permanent tax changes, as would occur due to changes in statutory tax rates, and transitory tax changes on dividend repatriations. Our data contains U.S. tax return information for a large sample of U.S. corporations and their foreign subsidiaries. We find that the permanent tax price effect is significantly different from the transitory price effect and is not significantly different from zero, while the transitory tax price effect is negative and significant. This suggests that repatriation taxes do affect dividend repatriation behavior but only to the extent that they vary over time. Previous empirical work has apparently measured the effect of timing behavior.

JEL Classification: H32, H25, H87.

An open question in the literature on the taxation of multinational corporations is whether taxes due on repatriation of foreign source income influence whether the profits of foreign subsidiaries are repatriated or reinvested abroad. Theoretical arguments by Hartman (1985) suggest that dividend payments by foreign subsidiaries should not be influenced by such repatriation taxes. Under this view, which is analogous to the "new view" of dividend taxation applied to domestic firms, taxes due upon repatriation are unavoidable costs for "mature" foreign subsidiaries that finance investment out of retained earnings.[1] As a result, investment and dividend payment decisions are unaffected by those taxes. The results of recent empirical work that used cross-sectional data on U.S. multinationals seem to contradict Hartman's theoretical result. These studies indicate that dividend remittances are sensitive to repatriation taxes. This presents a puzzle.

Hartman's analysis (and the "new view" of dividend taxation) is based on the assumption that taxes on dividends are constant over time. This paper investigates whether the empirical evidence can be reconciled with the theoretical results by recognizing that repatriation taxes on dividends may vary over time. This variability may provide firms with an incentive to repatriate relatively more profits from a subsidiary when the tax cost of doing so is temporarily relatively lower than normal, and to retain more profits when the tax cost of repatriation is higher than normal.[2] Such timing behavior could be revealed in cross-sectional data by a relationship between dividend payout levels and the current level of the tax cost of dividend payments, when the actual relationship is between dividend payout levels and the current level of the tax cost *relative* to its normal level. If timing opportunities are important to dividend payout decisions, then it becomes difficult to interpret the tax effects estimated in previous papers. In particular, these estimates will tend to confuse the effects of permanent tax changes, as would occur due to changes in statutory tax rates, with the effects of tax changes due to transitory changes in the situation of the taxpayer.

It is important to distinguish whether cross-sectional differences between subsidiaries in dividend payout behavior are due to the current level of the tax cost of paying dividends or the difference between the current and the normal, or expected future, tax cost. Making this distinction will help us evaluate the effects of tax policy on the location of investment, the form of finance, and tax revenues. More specifically, it has implications for the evaluation of policies such as the reduction of withholding tax rates in bilateral tax treaties and the repeal of the deferred taxation that foreign profits generally enjoy in the United States. The policy implications of this work are discussed in more detail in the final section of the paper.

Micro data can be used to distinguish the effects of transitory variation in tax costs from the effects of permanent differences in tax costs. This paper uses a recently created data set containing U.S. tax return information for a large sample of U.S. corporations and their foreign subsidiaries. For some of our empirical work, we link the subsidiary-specific data across time to create a panel data set. To our knowledge, this is the largest panel data set in existence that contains tax information on multinationals. It is also the only panel data set that has detailed tax information on both the parent corporations and their foreign subsidiaries.

We use information about cross-country differences in tax rates to estimate separate effects for the permanent and transitory components of the tax price of dividend repatriation. The idea is that variations across countries in average repatriation tax prices or in statutory tax rates will be correlated with the permanent component of tax price variation, but uncorrelated with transitory variations. Using these measures to construct instrumental variables for the tax price allows us to separately identify permanent and transitory tax price effects. Our estimation strategy is similar to that of Burman and

Randolph (1993), who used state tax rates as instruments to separate permanent from transitory effects of taxes on capital gains realizations.

To preview our results, we find that the permanent tax price effect is significantly different from the transitory price effect and is not significantly different from zero, while the transitory tax price effect is negative and significant. This suggests that previous cross-sectional analysis has measured the effect of timing behavior, either through tax planning that affects both the tax price and dividend payments or through companies timing their repatriations to take advantage of exogenous transitory variations in tax prices.

The remainder of the paper is organized as follows. Section I briefly reviews Hartman's analysis, the related empirical literature, and some more recent theoretical work in this area. Section II derives the tax price of a dividend repatriation, Section III presents the empirical model, and Section IV describes the data. Results are presented in Section V, followed by concluding remarks.

I. The Hartman Analysis and Subsequent Studies

The United States system for taxing the income earned by the foreign subsidiaries of U.S. corporations defers taxation of foreign income until it is brought back to the United States and provides a credit for foreign taxes paid.[3] Under this credit and deferral system, the two main forms of repatriation tax that a firm incurs on income remitted from a foreign subsidiary are the residual home country tax liability (if any) not offset by the foreign tax credit, and any withholding tax imposed by the source country. Hartman (1985) argued that, under a credit and deferral tax system, the repatriation tax on foreign source income is irrelevant to the investment and dividend payment decisions of foreign subsidiaries that are financed through retained earnings ("mature" subsidiaries). Hartman's insight was

Economic & Policy Research
J.P. Morgan Chase Bank
June 30, 2003

JPMorgan

Status report

Homeland Investment Act: Still alive and kicking

- **Homeland Investment Act (HIA) was not included as part of the growth and jobs bill**
- **It is now being considered as part of international tax legislation**
- **Homeland Investment Act has high-level political backing**
- **There is a good chance of passage this year – to give the economy a lift before the 2004 elections**

The Homeland Investment Act (HIA) is still alive and kicking. Since the release of JPMorgan's special report on the potential impact of the HIA on the U.S. economy (*Introducing the Homeland Investment Act*, May 1, 2003) there has been quite a bit of activity surrounding this proposed legislation on Capital Hill. Although the Act has not been passed, it is still under active consideration as part of a broader bill covering international tax law and has very high level Congressional backing. Events could move very quickly from here, and political negotiations this summer will be watched very carefully.

Legislative status: still under active consideration

The Homeland Investment Act (HIA) was actively considered as part of this year's fiscal stimulus package, but was not included in the end.The HIA was included in the Senate version of the growth and stimulus bill by a vote of 75 to 25, surprising many and sending an important signal of bipartisan support. However, the HIA was not included in the House growth and stimulus bill, even though it is believed to have significant House support, particularly in the House Ways and Means Committee.The HIA was stripped from the final growth and stimulus package passed by Congress and signed by President Bush.

But Congressional leaders are still pushing for passage of the HIAThe HIA is expected to be reintroduced by House Ways and Means Chairman Thomas (R-CA) as part of international tax legislation after the July 4th recessThe broader international tax legislation to be introduced by Chairman Thomas addresses the repeal of the foreign sales corporation/extraterritorial income exclusion provisions ("FSC/ETI") currently part of US international tax law, ruled an illegal trade subsidy by the WTO.Alternative legislation addressing the repeal of the FSC/ETI provisions has already been introduced to the House by Reps. Crane (R-IL) and Rangel (D-NY).

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Supporters of these competing proposals will have to find common ground before FSC/ETI repeal legislation reaches the House floor

The EU has set a January 1, 2004 deadline for the US to abolish the FSC/ETI provisions to avoid $4 billion in sanctions. While Congress will work heard to meet this deadline, the Congressional calendar is crowded and passage of FSC/ETI repeal legislation may not be possible prior to the announced late October adjournmentIf international tax legislation is passed this year we understand that the HIA will most likely be included as part of the package. Senator Ensign (R-NV) is simultaneously leading an effort to include the HIA in other unrelated legislation, in the event that the international tax legislation referred to above is delayed.

Political considerations argue for passage this year

As written, the HIA must be passed prior to Congress's summer recess late in July to be effective for 2003. However, if the legislation is passed after the summer recess (following Labor Day) the effective date could be modified so that the HIA would nevertheless be effective for 2003

We believe the 2004 elections are a factor in the HIA's chances for passage. If the HIA is passed and is effective for 2003 (for calendar year corporations) the repatriation of an estimated $300 billion could occur before year end. The economic impact of this substantial inbound flow of funds over a relatively short period of time would likely to boost the economy in advance of the 2004 elections.

Repatriated funds paid through to consumers via dividend/extraordinary dividends (given the passage of the growth and stimulus legislation taxing dividends at new capital gain rates) would have an even more immediate impact on consumer spending and wealth

If the bill is effective for 2004, the inbound flow of funds would likely occur over a longer period and the impact on the US economy would not be felt until late 2004 and 2005, after the elections

JPMorgan

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 dividendAs 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

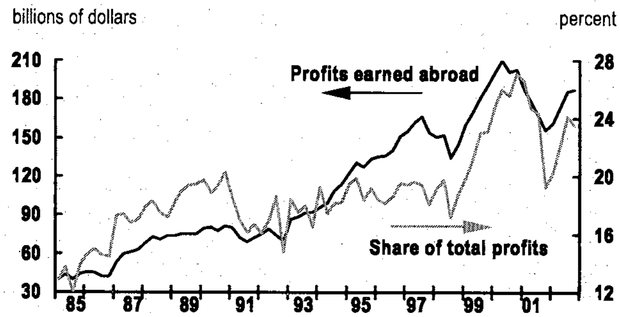
In this example, Acme International earns $100 abroad and pays $10 in foreign taxes. No US taxes are paid because earnings are not repatriated.

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

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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[1]. 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 figures likely underestimates the size of the total pool of foreign earnings that could potentially be repatriated.

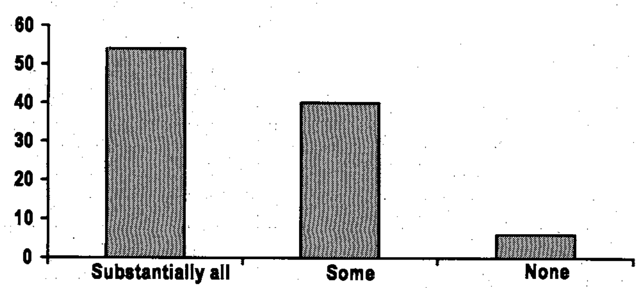
• The S&P 500 is a subset of the entire corporate sector. S&P 500 operating earnings has recently averaged about 60% of overall after-tax earnings. Its share of foreign earnings is likely larger, although no official breakdown is available.

• 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
billions of dollars

	From Firms Repatriating Substantially All	From Firms Repatriating Some	Dollars Repatriated
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.

S&P sample and survey group

$ billion

Group	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.

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

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

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.

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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 partial 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.

Increase Value of Dollar