
***BARRIERS TO MOBILITY:
THE LOCKOUT EFFECT OF U.S. TAXATION OF WORLDWIDE
CORPORATE PROFITS***

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Using data from a survey of tax executives, we examine the corporate response to the one-time dividends received deduction in the American Jobs Creation Act of 2004. We describe the firms' reported sources and uses of the cash repatriated and we also examine non-tax costs companies incurred to avoid the repatriation tax prior to the Act. Finally, we examine whether firms would repatriate cash again if a similar Act were to occur in the future. Overall, the evidence is consistent with a substantial lockout effect resulting from the current U.S. policy of taxing the worldwide profits of U.S. multinationals.

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I. INTRODUCTION

In a frictionless world, capital would flow freely across countries. Within multinational firms, capital would be allocated across divisions, regardless of the location of those divisions, to maximize marginal product and firm value. In reality, tax laws create barriers to capital mobility. Taxes also create incentives for firms to expend resources in an effort to avoid or minimize capital taxes. In this paper, we investigate whether, how, and to what extent taxation distorts the mobility of capital within firms. In particular, we survey tax executives to examine their firm's response to the one-time dividend received deduction in the American Jobs Creation Act of 2004 (the Act). The Act granted a temporary dividends received deduction of 85 percent of the extraordinary dividend from foreign earnings repatriated back to the United States, which effectively reduced the rate of tax on the repatriated dividends to 5.25 percent (15 percent \times 35 percent statutory tax rate); we provide more details about the Act below. This dramatic rate reduction was a temporary change in the tax price of dividend repatriation and thus provides an ideal setting to study the incentives firms face when deciding whether to repatriate earnings back to the United States and the effects of U.S. tax policy on capital mobility. Most estimates of the amount of dividends repatriated under the provisions of the Act exceed \$300 billion (Redmiles, 2007).

Empirically, prior research suggests that firms retain a large share of their earnings abroad when faced with a high tax upon repatriation and that changes in tax rates can affect repatriation behavior. For example, Hines and Hubbard (1990) analyze 1984 tax return data and report that a 1 percent decrease in the repatriation tax is associated with a 4 percent increase in dividend payments by foreign subsidiaries in a sample of U.S. multinationals. Further, Desai, Foley, and Hines (2001) use Bureau of Economic Analysis (BEA) data on dividend repatriations

from foreign subsidiaries to conclude that repatriations are sensitive to repatriation taxes. They also find that repatriations from foreign branches which are not subject to the repatriation tax are not sensitive to the tax, mitigating concerns that time varying changes in repatriations might be due to other non-tax factors. They infer from their data that repatriation taxes reduce aggregate dividend payments by 12.8 percent. In addition, Foley et al. (2007) hypothesize that the repatriation tax cost is a reason that firms hold significant amounts of cash, an empirical observation previously explained by the existence of transaction costs and precautionary motives. They report evidence consistent with their prediction — firms that face higher repatriation tax burdens hold higher levels of cash, hold the cash abroad, and hold the cash in affiliates that would trigger high tax costs when repatriating earnings.

Furthermore, there is anecdotal evidence that firms incur non-tax costs to avoid repatriation taxes, indicating that these taxes are important. For example, in 1993 Apple Computer Inc. (now Apple Inc.) filed a \$500 million shelf offering. The company stated they were considering the debt offering to pay for new research and development facilities. Analysts at the time noted that it was an unusual offering because Apple had more than \$1 billion in cash on hand and no long-term debt obligations. The investor relations spokesperson for Apple, Bill Slakey, responded that Apple was reluctant to draw on the cash reserves because much of the cash was outside the United States and repatriating those assets would produce a significant tax bill (Weber, 1993). Potentially even more costly than raising debt capital, a few years later Apple considered merging or selling itself to Sun-Microsystems because its “financial condition was worsening” and noted that its board may have “decided a merger is the best way to save the company, which is facing a cash crunch to pay future restructuring charges and an upcoming debt payment.” An analyst from Brown Brothers Harriman said that although Apple had \$1.1

billion in cash, most of it was in foreign subsidiaries. He stated, “If they were to draw it out it would be subject to taxation. It’s liquid, but it’s like drawing money from a 401K (retirement plan) or something” (Poletti, 1996).

In contrast to these anecdotes and above-cited research, Hartman (1985) concludes that U.S. repatriation taxes do not affect the decision of mature firms (i.e., those making positive repatriations) to either reinvest funds abroad or repatriate them home *if* the repatriation and U.S. taxation of foreign earnings is inevitable and tax rates are a known intertemporal constant. The only factors that matter in Hartman’s (1985) model, given his assumptions, are the after-local-tax rate of return (r_f) and the home country, or domestic, after-tax rate of return (r_d). In addition, some argue that firms tax-plan to bring the money back to the United States in ways that avoid the U.S. tax (Altshuler and Grubert, 2003). If these strategies are prevalent, the repatriation tax should not result in a substantial lockout of foreign earnings.¹

We contribute to the literature by asking over 400 tax executives at firms with foreign source earnings about their firm’s response to the one-time dividend received deduction in the 2004 Act. Our survey approach allows us to examine issues that are difficult to examine using traditional archival methods. For example, we ask the tax executives to describe: (1) the sources of funds repatriated, (2) the uses of funds repatriated, and (3) the costs incurred to avoid repatriating earnings prior to the tax holiday under the Act.

Surveys can be helpful because they allow one to directly ask agents about their intent. However, we must acknowledge that our analysis is subject to the usual caveats of survey data. First, the respondent firms may not be representative of the population of firms. We present data that compares our respondent firms to firms that did not respond and to all Compustat firms.

¹ However, the shutdown of what were known as “Killer B” transactions (through IRS Notices 2006-85 and 2007-48) likely eliminated many of the tax planning opportunities to effectively repatriate without paying the repatriation tax.

However, if our respondent firms are different from nonrespondent firms for some unknown reason, our results may not generalize to the entire population. Second, the respondents could obfuscate the truth in their answers so as to prevent any accusation of wrongdoing. While we, of course, cannot prevent this type of action we were careful in how we asked questions so as not to ask incriminating questions. For example, we asked firms to report what they did with the funds repatriated and to separately report what they did with the “freed up” funds from using the repatriated cash for other uses. This type of questioning allows respondents to say what the firms did with the total cash shock yet shows that they technically spent the repatriated funds on “permitted uses,” thus, clearing them from any accusation of legal wrongdoing. Even still, the survey responses are ultimately tax executives’ *reported answers* of what their firm did in response to the Act. Although this method of testing allows us to ask unique questions, if the respondents for some reason did not respond truthfully, our results would be affected.

With the above caveats in mind, our findings are as follows. Our survey data indicate that on average over 60 percent of the repatriated funds came from overseas cash holdings. This result is consistent with the observations in Foley et al. (2007) that large cash balances are held overseas to avoid the tax and with Dharmapala, Foley, and Forbes’s (2010) finding that firms with high levels of cash abroad were more likely to repatriate in response to the Act. The reported uses of the specific cash brought back to the United States under the provisions of the Act are wide ranging but are generally consistent with uses explicitly permitted by Congress (e.g., U.S. capital investment, the hiring and training of U.S employees, and U.S. research and development expenditures).

Respondent firms report that the two most common uses for “freed up” cash were paying down domestic debt and repurchasing shares. This result sheds light on an empirical finding (in

Blouin and Krull (2009), for example) that firms used the repatriated cash to repurchase shares, which the authors point out would not be a “permitted use” of the funds. The more detailed data from the survey allow us to separate the direct use of repatriated funds from the use of “freed-up” cash. We document that to a large extent the firms say that they used the repatriated cash for permitted uses and used “freed-up” cash to repurchase shares. This distinction may seem superficial; however, the distinction is very important given the writing in the Act and subsequent guidance from the Internal Revenue Service (described below) that did not require the spending in the dividend reinvestment plan to be incremental and specifically allowed overall spending on “unpermitted” uses to increase following the repatriation.

The third highest use of freed-up cash was additional U.S. capital investment (36 percent of the respondents). This result might suggest that the current repatriation tax inhibits investment. An alternative explanation is that firms would have otherwise borrowed to invest, but instead invested using the freed-up funds from the repatriation. Consistent with this explanation, our data reveal that for our full sample only 3 percent of firms claim that they have foregone investment because the repatriation tax discouraged them from repatriating earnings.

Our survey data reveal that firms incur substantial nontax costs to avoid the tax in periods in which the AJCA provisions are not in effect. The most common reported action taken to avoid repatriation tax is the issuing of debt capital in the United States, with nearly 44 percent of companies stating they had done this. In addition, nearly 20 percent of the respondents noted that their company had invested their foreign earnings in financial assets with a lower rate of return than they could have earned in the United States. Finally, our data reveal that most firms report that they believe this was a one-time opportunity, though many firms would take advantage of another such Act if available in the future.

The paper proceeds as follows. The second section provides a brief discussion of taxation of foreign earnings of U.S. multinationals. The third section discusses our survey approach and sample. The fourth section presents descriptive data about the respondents, the results, and our interpretation of these results in the context of the prior literature. The final section concludes.

II. TAXATION OF FOREIGN SOURCED EARNINGS OF U.S. MULTINATIONALS

A. Taxation of Foreign Earnings

The U.S. taxes income on a worldwide basis. This means that U.S. taxes are incurred on income earned in the United States as well as on income earned abroad. In order to avoid subjecting U.S. multinationals (and individuals) to double taxation, the United States allows a foreign tax credit against U.S. taxes for income taxes paid to foreign governments. These credits are limited, however, to the amount of U.S. tax liability on foreign income (before any foreign tax credit). Thus, in general, if a firm has an average foreign tax rate that exceeds the U.S. tax rate, then the firm will not owe any incremental U.S. tax upon repatriation (nor will it receive a rebate from the U.S. government). These firms are said to be in an excess credit position (or are said to have binding foreign tax credits).

Deferral is another important feature of the U.S. tax system. The earnings for the foreign subsidiaries are not taxed currently; instead taxation is deferred until the foreign subsidiary repatriates the earnings in the form of dividends back to the parent corporation.² Until repatriation, earnings reinvested in foreign operations are allowed to grow U.S.-tax free.^{3 4}

² Deferral is only available for U.S. taxes on earnings of foreign subsidiaries of U.S. parents; it is not available for the earnings of a foreign branch.

³ If the foreign subsidiary had income effectively connected with a U.S. trade or business then that income would be subject to U.S. tax, however the foreign subsidiary still would not be part of the tax consolidation with the U.S. parent.

⁴ Under the current accounting standards SFAS 109 and APB 23, companies that have deferred U.S. cash taxes on earnings of foreign subsidiaries also do not have to record any related tax expense on their income statement for these taxes as long as the earnings are designated as permanently reinvested. This deferral of the income tax expense for financial accounting increases net income of the firm, all else constant; see Graham, Hanlon, and Shevlin (2010)

Finally, there are provisions, such as the Subpart F rules, which aim to limit U.S. firms from taking full advantage of deferral. Under these rules, certain foreign income of foreign subsidiaries is not eligible for deferral and is subject to immediate taxation in the United States. Subpart F income includes, among other items, passive income of the foreign subsidiary.

B. The American Jobs Creation Act of 2004

The American Jobs Creation Act was enacted into law on October 22, 2004. A portion of the Act (codified in IRC Section 965(a)) provided that a corporation that is a U.S. shareholder of a controlled foreign corporation (CFC; essentially a foreign subsidiary of a U.S. parent corporation) could elect, for one taxable year, an 85 percent dividends received deduction with respect to certain cash dividends it receives from its CFCs.⁵ This deduction provision effectively reduced the applicable U.S. rate on the repatriations from 35 percent to 5.25 percent.

The dividend received deduction was subject to several limitations. First, the amount of dividends eligible for the deduction was limited to the greater of the following: (1) \$500 million, (2) the amount shown on the taxpayer's applicable financial statement as being permanently reinvested outside of the United States (which means the company has stated that they do not intend to repatriate the earnings for the foreseeable future), or (3) if only the tax attributable to the permanently reinvested earnings was disclosed, the amount of tax divided by 35 percent.⁶

Second, the dividends eligible were limited to the excess of the dividends received during the

for a discussion and tests of the importance of financial accounting effects in location and repatriation decisions. In sum, their results indicate that the financial accounting effects contribute to the lockout of foreign earnings. Note that Graham, Hanlon, and Shevlin (2010) utilizes the same survey instrument to gather data but that paper examines the responses from different questions than those analyzed in the current paper. They address a separate research question, namely, how financial accounting rules affect corporate location and reinvestment decisions. Thus, the focus of Graham, Hanlon, and Shevlin (2010) is on financial accounting effects and incentives whereas the current paper is focused on firm responses to the American Jobs Creation Act and the sources and uses of funds and costs incurred to avoid the repatriation tax. The current paper is not about financial accounting effects.

⁵ See IRS Notice 2005-10 for the definition of cash dividends.

⁶ The applicable financial statement is the most recently audited statement which is certified on or before June 30, 2003 as being prepared in accordance with GAAP, and if the taxpayer is required to file with the SEC did so file on or before June 30, 2003.

taxable year by the U.S. shareholder from CFCs over the annual average dividends during the “base period years.” The base period was the three taxable years among the five most recent taxable years ending on or before June 30, 2003, determined by disregarding the year for which the total amount is highest and the year for which such total amount is lowest among the five years (Section 965(c)(2)). Third, the amount of qualified dividends was reduced by any increase in related-party indebtedness of the CFC between October 3, 2004 and the close of the election year. Finally, the amount of the eligible dividend was to be invested in the U.S. pursuant to a domestic reinvestment plan that was approved by the taxpayer’s president, CEO, or comparable official before the payment of the dividend and that was subsequently approved by the board of directors or similar body. Companies could elect the application of the dividend received deduction for either their last taxable year which began before October 22, 2004 or the first taxable year which began during the one year period beginning on October 22, 2004.

The taxpayer was to prepare a written domestic reinvestment plan that describes the specific anticipated investments in the United States that the firm would make with the repatriated funds, the time period over which the investments would be made, and whether factors beyond the taxpayer’s control could affect its ability to make the contemplated investment. The plan was required to provide sufficient detail to enable the taxpayer to show upon examination that the expenditures that subsequently occurred were of the kind that were in fact contemplated at the time of the adoption of the plan, and the plan had to include the total dollar amount to be invested for each respective principal investment in the United States.

The IRS provided lists of both permitted and disallowed uses of the funds that qualified for the dividend received deduction but stated that neither list was intended to be exhaustive. The items specifically permitted include: (1) the funding of worker hiring, training and other

compensation in the United States, (2) infrastructure and capital investments in the United States, (3) research and development in the United States, (4) financial stabilization of the corporation for purposes of job retention and creation (including the repayment of debt — United States or foreign⁷, qualified pension plan funding, and other expenditures), (5) acquisitions of certain interests in business entities, (6) advertising and marketing expenditures in the United States, and (7) purchases of intangible property in the United States. The items specifically not permitted include: (1) executive compensation, (2) intercompany distributions, obligations, and transactions, (3) dividends and other distributions with respect to stock, (4) stock redemptions, (5) portfolio investments in business entities, (6) debt instruments or other evidences of indebtedness, and (7) tax payments.

It is important to note that specific tracing or segregation of the funds was not required nor was the spending required to be incremental spending. In fact, Notice 2005-10 specifically states that “provided a sufficient amount of funds is properly invested in the United States pursuant to the domestic reinvestment plan... the fact that other non-permitted investments are made during the period covered by such plan generally will not affect the eligibility of the dividend under section 965” (Section 4.05). By examining corporate behavior in response to the one-time dividend received deduction, we can infer whether and to what extent the U.S. policy of taxing worldwide income impedes capital mobility.

III. SURVEY APPROACH AND SAMPLE

We developed the survey instrument with the support of Tax Executives Institute and PricewaterhouseCoopers (PwC). We solicited feedback from members of both

⁷ Temporary repayment of debt is not permissible but on the other hand the taxpayer is not required to demonstrate that there has been a net global reduction in indebtedness of the taxpayer’s corporate group in order for repayment to be a permissible use of funds. The overall facts and circumstances of each case will be considered upon examination.

groups as well as from academic researchers. We had two companies beta test the online survey and we made revisions based on their suggestions. Survey Sciences Group (SSG), a survey research consulting firm, assisted with the final survey design and programmed an online version of the survey. SSG also professionally formatted a paper version of the survey to be distributed with the final reminder. The final survey contained 64 questions, most with subparts. The paper version of the survey was 12 pages long. The survey contained many branching questions and as a result many firms were directed to answer only a portion of the questions.⁸

An initial email invitation was sent on August 9, 2007 to the highest ranking tax executive who is a member of Tax Executives Institute (TEI) at 2,794 firms (thus, only one invitation was sent to each company); three of these were returned as undeliverable. We also sent a letter via two-day express mail to fifteen companies for which we did not have email addresses. Thus, a total of 2,806 companies received invitations to complete the survey. SSG sent three email reminders throughout August and September. We then sent a paper version of the survey (along with a letter with instructions about how to complete the survey online) during the last week of September and the first week of October. We closed the online survey on November 9, 2007.

A total of 804 firms entered the online version of the survey or sent back a paper version. Sixty of these firms entered no more than one or two responses and thus we

⁸ We asked a wide range of questions in the survey instrument in order to address several sets of research questions. The first part of the survey gathered descriptive data of the respondents. The second part of the survey asked questions about general location and reinvestment and repatriation decisions. The third part focused on the American Jobs Creation Act of 2004 and the repatriation decisions in response to that Act, the subject of the current paper. The final part of the survey asked general questions about tax aggressiveness, tax rates, and tax planning. The data in the second and last part of the survey are analyzed in separate papers. In the current paper we retain only firms with foreign source earnings whereas in the other papers we retain firms both with and without foreign source earnings and thus the samples are different across the papers as are the research questions addressed. The online survey is available at www.ssgresearch.com/taxsurvey and the paper version is available upon request.

delete them from our usable sample, leaving 744 complete responses. The response rate for our survey is 26.5 percent (744/2,806), much higher than most prior survey studies of corporate executives. For example, Graham, Harvey, and Rajgopal (2005) obtain a response rate of 10.4 percent, Trahan and Gitman (1995) report a response rate of 12 percent in a survey mailed to 700 executives, Graham and Harvey (2001) obtain a 9 percent response rate, and Brav et al. (2005) have a 16 percent response rate. Slemrod and Venkatesh (2002) survey tax preparers and corporate taxpayers about compliance costs and obtain a 12 percent response rate from the tax professionals and 9 percent from the taxpayer corporations, and Slemrod and Blumenthal (1996) survey large corporate taxpayers about compliance costs and obtain a response rate of 21.8 percent (365/1,672). We believe that our relatively high response rate is in large part attributable to the support of Tax Executives Institute.⁹

Because we are interested in U.S. companies' decisions with respect to taxes, we eliminate forty respondents that indicate they are an S-corporation or state that they did not file a Form 1120 (under the assumption these companies are also some type of pass-through entity). We restrict the sample further by eliminating observations which are subsidiaries of foreign parents (105 firms) or which state in their comments that their foreign operations were insignificant and thus they were not sure how to respond to the foreign earnings questions (four firms).¹⁰ Finally, because we are interested in corporate

⁹ In addition, the respondents seem to have a genuine interest in the topics. For example, one company wrote, "Appreciate the survey. Interestingly, the survey touches on those tax management areas most important to our company at the moment..." Another commented, "I rarely fill out surveys, but was impressed by your questions. The U.S. system for taxing foreign dividends is terrible in so many ways and doesn't even raise revenue." Another respondent wrote simply, "Good survey!"

¹⁰ We exclude the U.S. subsidiaries of foreign parents because we do not view them as equivalent to U.S. parent firms located in the United States. For example, when these firms report that they used repatriated funds to pay shareholders, this does not mean the investor level shareholder but instead refers to the foreign parent. In addition, the tax planning strategies are likely different for these firms. We called a tax executive at one of these companies

decisions with respect to the repatriation of foreign earnings, we delete 184 observations where the respondent states that the firm had no foreign earnings during the last 10 years. This leaves us with a final sample of 411 firms. The sample size varies across questions due to branching or incomplete responses for a particular question.

IV. DESCRIPTIVE DATA, RESEARCH QUESTIONS, AND RESULTS

A. Descriptive Statistics

The first part of the survey asked general descriptive questions about the companies. These data are summarized in Table 1 Panel A. In terms of ownership, 80.5 percent of the respondents are publicly traded on the NYSE, NASDAQ or AMEX, while 19 percent are privately held, and 0.5 percent are “other” such as over-the-counter stocks. Our respondent firms represent a variety of industries, with roughly 39 percent being from manufacturing, 14 percent classified as holding companies, 7 percent from professional, scientific, and technical services, and nearly 6 percent from wholesale trade (industry classifications are derived from the companies’ responses about their principal business activity code on Form 1120). In all, 18 different industry classifications are represented. Nearly 10 percent of the respondents did not enter an industry code.

and he concurred saying he was somewhat surprised that any other similar company besides his took advantage of the Act’s provisions because his company was in a very unusual position. He added that normally foreign parents do not set up subsidiaries in foreign locations under the U.S. subsidiary (unless due to a legacy issue from many years ago) because of the associated tax disadvantages. In our data, we find that seven of the 105 U.S. subsidiaries of foreign parents took advantage of the one-time dividends received deduction. In more detailed examination, we find that only five of the seven firms answered the sources and uses questions. These data reveal that these five firms report that 78 percent of the repatriated cash, on average, came from cash or liquidating financial assets. One firm reported an increase in debt from a related party for all of the repatriated funds and one firm reported an increase of debt from unrelated parties for 10 percent of the funds. In terms of what the repatriated cash was spent on, one firm reported that it used 80 percent on U.S. capital expenditures and 20 percent to acquire another firm or its assets; two companies reported that they used 100 percent of the repatriated cash in acquisitions; one firm used 100 percent of the funds for hiring in the United States; and one firm reported that it used all the funds to loan money to a foreign subsidiary. Further, three of the five firms reported that they used the freed-up funds for U.S. capital investment; one firm reported that it used freed-up funds to pay dividends to shareholders; and one used the funds in acquisitions.

In terms of size, 23 percent of our sample have assets of \$500 million or less, 16.7 percent have assets that range from \$500 million to \$1 billion, 33.8 percent have assets between \$1 billion and \$5 billion, 8.6 percent have assets ranging from \$5 billion to \$10 billion, and nearly 18 percent have assets in excess of \$10 billion. Thus, our firms are on average larger than the typical firm on Compustat (e.g., 76 percent of our sample firms fall in the upper two quintiles of Compustat firms ranked by assets). Indeed, our sample contains many household names and some of the largest firms in the economy.

It is difficult using publicly available archival data to obtain information on the location of a firm's assets. In our sample, 38 percent of the companies indicate they have one-tenth or less of their assets in foreign locations. Slightly more than 11 percent of the firms have more than half of their assets in foreign locations.

The responses for our sample indicate that 95 percent of the firms file a consolidated corporate income tax return, Form 1120. The number of entities included in the consolidated filings varies greatly, with nearly 36 percent of respondents including fewer than ten entities. On the high end, 8.8 percent of respondents report that their firm includes more than 100 entities in their consolidated return. Because these data have not been collected previously, we have no benchmark against which to compare them.

We next ask how many Form 1120s were filed by the company (where "company" means the entity that files a consolidated 10-K or financial accounting statement). Roughly 59 percent of the firms file one Form 1120. Slightly more than 29 percent file between 2–10 Form 1120 and 9 percent file between 11–50 Form 1120. The multiple filings reflect the fact that the consolidation rules differ for tax purposes and book purposes. For tax purposes, the consolidated filing is an election available only when ownership exceeds 80 percent. Financial accounting,

however, requires consolidation when ownership exceeds 50 percent. Our question gathered data about the tax filings for the financial accounting group. It is therefore not surprising that there are multiple Form 1120s filed for the accounting group due to the differing consolidation rules.

In addition to the data on number of Form 1120s filed, we gather data regarding how many Form 5471s (Information Returns of U.S. Persons with Respect to Certain Foreign Corporations required to be filed when the U.S. company has a greater than 10 percent ownership share of a foreign corporation) are filed by our sample firms. Of the sample, 6 percent did not file a Form 5471. The majority of the sample, almost 75 percent, report that they file between 2–50 Form 5471s and 8 percent of the respondents filed more than 100 of the forms. These data reveal that the majority of the firms in the sample have at least a 10 percent ownership of at least one (and in most cases more than one) foreign corporation. Thus, many of our sample firms are relatively large, file a consolidated Form 1120 and/or multiple Form 1120s, and have ownership interests in foreign subsidiaries. Our sample is therefore not composed of small, domestic only firms but rather is more representative of a broad cross-section ranging from simple to very complex in terms of tax structure and filings.

Finally, in our sample, almost 53 percent of the companies say that they generally have had excess foreign tax credits (i.e., foreign tax credit carryforwards) over the last five years. Prior research (e.g., Altshuler and Grubert, 2003) suggests that many companies are able to cross-credit, meaning they use tax credits from high tax foreign jurisdictions against the U.S. tax due on repatriated earnings from low-tax foreign jurisdictions. The data from the survey, that so many firms have excess foreign tax credits, calls into question the extent and availability of cross-crediting strategies, especially because there are not currently many countries with higher statutory tax rates than the United States. When we discussed the issue with one of our test

companies, the executive said that it is well-known that many companies have excess credits so he did not think that cross-crediting is as easily available in practice as some believe. Further, an examination of Statistics of Income data for the year 2002 reveals that the excess foreign tax credit carryovers into the year 2002 were significant: the carryover was equivalent in amount to 42 percent of the total foreign taxes paid, accrued, and deemed paid for the year 2002.¹¹

In Panel B of Table 1, we report additional descriptive data about the net operating losses of the firms. The data reveal that 195 respondents indicate they have a U.S. net operating loss (NOL) carryforward and the mean (median) U.S. NOL over all sample firms, including those that have a zero NOL, is \$111 million (\$0). In terms of foreign NOL carryforwards, 228 firms report having a foreign NOL and the mean (at the median) foreign NOL, including those that have a zero NOL, is \$58 million (\$2). More companies report having a state NOL (268 firms) and the mean (median) NOL over the entire sample is \$129 million (\$10).

Panel C of Table 1 presents a comparison of descriptive statistics for our sample firms, non-responders to the survey, and all Compustat firms in order to examine whether our respondent firms are significantly different than non-responders, as well as whether our responders are significantly different than the average Compustat firm. The data reveal that the public firms that are members of TEI (the only firms for which we could gather the data) are larger in terms of *Assets*, market value of equity (*MVE*), and *Sales* than the average Compustat firm (column (1)). This result seems reasonable because it is more likely that larger firms have a tax department and the resources to join such organizations. The TEI firms have slightly higher debt-to-assets (*Debt*), slightly less *Cash*, a lower market-to-book ratio (*MB*), higher return on assets (*ROA*), and a higher effective tax rate (*ETR*), which makes sense if they are more

¹¹ These data include 138,000 corporate returns sampled from over 5.3 million active corporate returns (Forms 1120, 1120-L, 1120-F, 1120-PC, and 1120-REIT).

profitable. The responders are roughly the same size in terms of *Assets*, *MVE*, and *Sales*, have less *Debt*, higher *Cash*, similar market-to-book ratios, a higher return-on-assets, and the same effective tax rate as the non-responders.¹²

In terms of industry representation, manufacturing firms (industry numbers 2 and 3) appear to be overrepresented in our sample of survey respondents relative to all of Compustat and relative to the TEI group of firms. Our respondent sample seems to be underrepresented in the transportation, communication, and electric industry (number 4) as well as in the finance, insurance, and real estate industries (number 6).

In Panel D of Table 1, we provide general descriptive statistics for our sample responders but show them separately for firms that repatriated foreign earnings under the one-time dividends received deduction provisions of the Act and for those sample firms that did not repatriate under the Act. We also provide the same descriptive statistics from Blouin and Krull (2009) for comparative purposes (columns labeled BK). We first note that our sample of repatriating firms (N=105 for which we received data about the *amount* repatriated) repatriated \$142.30 billion of qualifying dividends which constitutes 46 percent of the total qualifying repatriations documented in Redmiles (2007) in her sample of 851 tax returns. In addition, the number of firms in our respondent, repatriating sample comprises 30 percent of the sample that Blouin and Krull report and includes 49 percent of the total qualified repatriations under the Act that they report. Thus, our sample constitutes a substantial fraction of the total amount repatriated under the Act.

In comparing the repatriating and non-repatriating companies we observe that the repatriating firms are much larger in terms of *Assets*, market value of equity, and *Sales*. This difference is consistent with the data reported in Blouin and Krull as well. The repatriating firms

¹² Details on how the variables are computed and the Compustat data are in Table 1.

have a higher market-to-book ratio and a higher U.S. effective tax rate, both consistent with results reported in Blouin and Krull (2009). In addition, our data reveal that the repatriating firms have a much higher amount of permanently reinvested earnings. The larger amount of permanently reinvested earnings is consistent with the repatriating firms having more foreign earnings overseas. Overall, the descriptive statistics of our repatriating survey respondents appear consistent with the descriptive data on repatriating firms provided in Blouin and Krull (2009).

The frequency and average size of net operating loss carryovers is greater for repatriating firms than non-repatriating firms. This result may seem counterintuitive because net operating losses can be used to offset U.S. taxes due upon repatriation. However, it is not often beneficial for taxpayers to offset the dividend income from repatriating foreign sourced earnings with their net operating losses. If a firm would do this, the foreign tax credit associated with the foreign dividends would not be able to be used in the current period and would be carried over. Thus, net operating loss carryforwards, which can be used against any type of income and carried forward for 20 years, would be reduced and foreign tax credit carryovers, which are limited in usage against U.S. tax on foreign earnings and can be carried forward for only five years, would be increased.¹³ Similarly, the firms that repatriated earnings are just as often, and indeed slightly more often, in a general excess foreign tax credit position than the non-repatriating firms. This frequency is surprising because the literature normally interprets excess foreign tax credits to mean the firm faces high foreign tax rates, and would not need to repatriate earnings under the Act because we would normally think these firms could repatriate their earnings U.S. tax free after taking the, on average, high foreign tax credit. One possible explanation is that these

¹³ In addition, we asked one company about this and the response was that a U.S. taxpayer would not use a U.S. NOL to offset fully taxable dividends that could be left offshore (i.e., the firm would rather use the U.S. NOL to offset other earnings).

companies' foreign tax credits are limited because of U.S. expense allocation rules or possibly because of the foreign tax credit basket rules and thus, again, cannot really be fully utilized to offset the U.S. tax.¹⁴

Another concern could be that only companies that complied with the explicitly listed “permitted uses” of funds would respond to the survey. In an attempt to investigate this possibility, we examine whether our respondent sample differed in terms of “unexpected repatriations” as defined in Blouin and Krull (2009). We compare our respondent firm repurchases over the years 2004–2007 to the average repurchase level of the firms in the Blouin and Krull (2009) study.¹⁵ If our firms have a significantly lower average level of repurchases than the Blouin and Krull (2009) sample, then there may be some concern about response bias. However, in both univariate and multivariate tests analogous to those in Blouin and Krull (2009), we find that our sample firms actually repurchase a higher average amount of shares relative to the amounts for the entire sample of repatriating firms in their paper; therefore our sample does not appear biased towards “permitted use” companies.

While we cannot completely eliminate all concerns about response bias because we do not know why the non-responding firms did not respond nor whether the respondents are systematically being less than truthful, we find no evidence in the data of obvious bias that goes in the expected direction discussed above. With the caveats and descriptive statistics in mind, we now turn to our research questions and results.

¹⁴ See Scholes et al. (2009, chapters 10 and 11) for a description of these items. Briefly, in calculating the allowed foreign tax credits, firms must allocate some portion of the U.S. domestic interest and research and development expense against foreign source income, reducing the amount of available tax credits. In calculating the available foreign tax credit, foreign income is allocated into different baskets based on type of income, and a tax credit is calculated for each basket.

¹⁵ We appreciate Jennifer Blouin and Linda Krull supplying us with their sample firm names so that we could conduct this test.

B. Research Questions and Results

1. What Was the Source of the Repatriated Cash?

Foley et al. (2007) argue that companies maintain large cash balances in part because of the repatriation tax — that is, the earnings are locked out of the United States, or “trapped” overseas. Consistent with Foley et al. (2007), our data, presented in Figure 1, indicate that across our sample firms, the percentage of the funds repatriated under the Act that came from cash holdings was slightly more than 60 percent, on average. In addition, slightly more than 10 percent of funds repatriated under the Act came from the liquidation of financial assets. Thus, on average, nearly 75 percent of repatriated funds obtained from cash or near cash sources held overseas. The fact that the repatriated funds were already in liquid form, but not repatriated until the repatriation tax burden was reduced, is consistent with U.S. tax policy causing a lockout effect and impeding capital mobility.

However, we note that not all repatriations were from cash holdings and that approximately 23 percent was from borrowed funds. Anecdotal evidence also suggests some firms borrowed money to repatriate to the United States. For example, Merck in its 2005 annual report states that, “Loans payable also includes \$1.6 billion of commercial paper issued by a foreign subsidiary under a \$3.0 billion commercial paper borrowing facility established in October 2005 to provide funding for a portion of the Company’s AJCA repatriation.” In our survey data an average of approximately 20 percent of repatriated funds was borrowed from unrelated parties, 3 percent from related parties, and about 1 percent from the U.S. parent company. This borrowing suggests that some of the foreign earnings were reinvested in a non-liquid activity. If this non-liquid activity generally consists of operations, then the earnings are not necessarily what one might call “locked-out,” i.e., the company was apparently not just

holding trapped funds in cash or passive activities but it really did have overseas investments in which to use the funds.¹⁶

In sum, the most common source of funds was cash or the liquidation of a financial asset (an average of nearly 75 percent of the funds repatriated). The second most common source was borrowed funds (an average of 24 percent). All other reported sources of funds such as the infusion of equity by the parent or selling investments (e.g., property, plant and equipment) in the foreign subsidiary are trivial in comparison and in sum average only 1 percent of the funds repatriated.

2. How Were the Repatriated Funds Spent?

We next examine how firms spent the repatriated cash. The actions companies took in response to the Act should be of interest to policymakers in considering current and future tax policy options. In addition, examining corporate behavior in response to the domestic cash shock contributes to our understanding of what firms do with cash or windfall profits. Prior research has examined whether firms repurchase shares in order to reduce the agency costs of free cash flow (Jensen, 1986) or whether the funds are invested.¹⁷

As described above, companies were required to have a dividend reinvestment plan in place detailing their planned reinvestment of the repatriated funds in the United States. While the government described permitted and unpermitted uses of the funds, it was careful not to require tracing of the funds and it did not require incremental or increased spending on the permitted uses. Several papers have investigated the use of funds using archival publicly available data. For

¹⁶ However, some of the data below suggests that perhaps these investments were not as profitable as alternative investments in the United States suggesting that the investments are perhaps suboptimal investments and thus, also consistent with a lock out of earnings.

¹⁷ See, for example, Blanchard, Lopez-de-Silanes, and Shleifer (1994) who show that plaintiff firms increase investment in response to windfalls from lawsuits, and Lamont (1997) who shows that investment by non-oil divisions of conglomerates owning oil-producing divisions fell in response to a negative shock to oil prices. In addition, Rauh (2006) shows that investment responds positively to cash flows associated with nonlinearities in required pension contributions.

example, Blouin and Krull (2009) examine firms that repatriated dividends and their spending activities following the repatriation. The authors conclude that firms used the cash to repurchase shares and that there was not an increase in capital investment. However, archival data are limited in their ability to discern the ultimate outcome because we cannot observe what would have happened had the firm not repatriated the cash. In addition, financial statement data such as that used in Blouin and Krull (2009) do not reveal actions such as a company shifting investment that otherwise would have occurred overseas but because of the repatriation, occurred in the United States.¹⁸

Finally, archival data cannot distinguish between the cash repatriated and freed up cash because the Act did not require a specific tracing (or reporting) of the funds. For example, an aggregate increase in repurchases is not technically against the terms of the Act as stated in IRS Notice 2005-10 (described above). Thus, a company can use the repatriated funds for investment and growth in the United States, and use the freed-up funds that otherwise would have been invested to repurchase shares.¹⁹ Using a survey approach enables us to directly ask questions designed to provide a more detailed understanding of the actions companies say that they took in response to the Act with respect to how the repatriated funds were spent.

Figure 2 presents the responses to the use of funds question and reveals the percentage of the repatriated funds that were used for specific causes as of the end of the year 2006. Our survey responses reveal that on average 24 percent of the dividends repatriated by our sample firms

¹⁸ This limitation of prior research applies to papers using Compustat data (e.g. Blouin and Krull, 2009) but not to papers using BEA data where foreign and U.S. activities can be identified (Dharmapala, Foley, and Forbes, 2009).

¹⁹ See Brennan (2007) and Blouin and Krull (2009) for a theoretical discussion of what firms should have done with the cash if trying to maximize shareholder value. In brief, more cash in the United States does not mean more investment opportunities in the United States. Thus, the options that maximize shareholder value the most are to pay down debt or return the capital to shareholders in the form of a repurchase or dividend. See Faulkender and Petersen (2009) for a detailed examination of financially constrained firms versus unconstrained firms. The authors find that, for a subset of financially constrained firms, a majority of the aggregate domestic cash shock was invested in approved domestic investment.

were reportedly used for U.S. capital investment. Our respondents report that on average they used 23.5 percent of the repatriated cash for the hiring and training of U.S. employees, an average of 14.7 percent of the funds on U.S. research and development, and an average of 12.4 percent was used to pay down domestic debt. An average of 10 percent of the funds was reportedly used for “other” items that we did not specifically delineate in the survey but which were typed in and described by the respondents. The most common of the additional descriptions of uses include: (1) U.S. advertising and marketing, (2) U.S. non-executive compensation, and (3) qualified benefit plan contributions. On average, the respondents report that 7 percent of the funds repatriated were used for acquisitions and an average of 4.6 percent were still held in cash at the end of 2006.

Prior research such as Blouin and Krull (2009), Clemons and Kinney (2008), and Dharmapala, Foley, and Forbes (2010) document that firms used the repatriated funds for share repurchases. We do not find an overwhelming indication that firms used the repatriated cash to repurchase shares. In fact, on average, only 3.4 percent of the repatriated funds were reported to have been used to repurchase shares and only 0.3 percent on average were used to pay dividends. However, the research using archival data can only look at aggregate spending. To compare the archival data to our survey results, we have to combine the data from our question about the spending of the repatriated cash with the spending of the cash freed up from the repatriation. We discuss this aggregation below.

In Table 2, we provide more detail on the use of funds by industry, firm size, profitability and leverage. For example, companies in the wholesale trade industry spent more than the average firm on hiring and training U.S. employees and less on research and development and debt repayments. Professional and scientific firms also spent more than average on the hiring and

training U.S. employees and less on capital investment. Firms in the information industry spent the highest percentage of any industry on U.S. research and development. From the table, the data also show that small firms spent a higher percentage of the funds on capital investment and less on research and development than large firms (split at the sample median of assets for responder firms in the table). There are not large differences in spending patterns conditional on return-on-assets. However, it appears that firms with lower return-on-assets spent fewer funds on hiring and more on capital investment. Finally, firms with greater leverage used more funds to pay down debt and on capital investment. In addition, more highly levered firms used much less of the repatriated cash on research and development, perhaps just reflecting that research oriented firms use less debt.

Thus, the survey respondents indicate that for the most part the repatriated funds were used for the purposes explicitly stated as permitted. While in general survey respondents may be disinclined to indicate that “unpermitted” actions were taken, our asking the questions in two parts (i.e., direct repatriation and “freed up” cash) likely allows respondents to answer questions that reflect their actions (e.g., using incremental cash to repurchase shares) while remaining consistent with the rules under the Act (e.g., the source of the incremental cash was freed-up funds). We now turn to the evidence on the spending from the freed-up funds.

3. How Were the “Freed-Up” Funds Spent?

We ask this question in a simple yes-no format — “...did the availability of the repatriated funds for the purposes indicated above [Figure 2 purposes] free up other cash for any of the following?” Thus, the tabulated responses are not the average percentage of the funds repatriated across our sample firms but the percentage of firms that responded yes for each action. The most common yes response from 47.4 percent of the firms was that they used the

freed-up funds to pay down domestic debt. Consistent with the archival data (e.g., Blouin and Krull, 2009), the second most common response was that 40.4 percent of the firms used freed-up cash to repurchase shares. In addition, 17.5 percent of the respondents say they paid dividends to shareholders with the freed-up funds. Thus, the firms used the repatriated funds for the permitted purposes but then apparently had excess cash (relative to that needed to fund positive net present value investments) in the United States that they reported they used to pay down domestic debt and return to shareholders. These results are consistent with efficient use of the funds per financial theory.

A large number of companies responded that they used the freed-up cash for U.S. investment. For example, 36.8 percent of the respondents reported that they used some of the freed-up cash for U.S. capital investment, 25.5 percent reported that they used some of the cash for hiring and training of U.S. employees, 24.6 percent used some of the cash for U.S. research and development and 21.9 percent used some of the cash for the acquisition of another firm or assets. Thus, the firms appear to have made some level of investments in the United States that otherwise they would have had to raise capital to fund or forego.

In the results discussed so far (Figures 2 and 3) there is not much survey evidence of “round-tripping” occurring. Some have suspected that companies brought the money back to the United States and then sent it back overseas. Our responses indicate that this was rare — at least in the manner we asked: very little capital or debt infusions were returned from the U.S. parent to the foreign subsidiaries.²⁰ Thus, the funds appear to have remained in the United States,

²⁰Some research examines round-tripping directly. For example, Bradley (2010) examines whether firms changed transfer prices prior to the repatriation so otherwise domestic sourced earnings were labeled foreign sourced and immediately brought back to the U.S. under the Act. Also see Dharmapala, Foley, and Forbes (2010) for additional tests and evidence of round-tripping.

presumably the ultimate goal of the Act. However, we note that we did not directly ask or attempt to directly address the round tripping issue in our questions.

Table 3 breaks out many of these results by industry, firm size, and other characteristics. In this table the percentages listed are the percentage of firms that answered that yes, they did spend some of the “freed-up” cash on the purpose listed. The data show that a greater percentage of wholesale trade and management holding company firms used some of the “freed-up” funds to pay down domestic debt relative to the average firm. In addition, a greater percentage of professional and scientific services firms used the “freed-up” funds to repurchase shares. The data also reveal that larger firms, firms with higher return-on-assets, and firms with less debt repurchased shares with the “freed-up” cash more often than the average firm. In addition, companies with above median levels of debt (in the sample) use the “freed-up” funds to pay down debt more often. Finally, firms with higher than median return-on-assets used the “freed-up” funds more often to pay for capital investment and to hire and train U.S. employees.

Thus, because we asked our firms how they spent the funds “freed up” by the repatriated cash, we are able to reconcile our survey results with some of the recent literature (contemporaneous to our paper) that argues the repatriated funds were used for repurchases. After aggregating responses to the two questions discussed thus far, the incremental spending was often on repayments of debt capital and share repurchases. However, spending of the repatriated cash was primarily on permitted uses.

4. Did Firms Shift Investment to the United States?

To address whether firms shifted investment to the United States that otherwise would have been done in a foreign location, we asked the following question: “As a result of the repatriation, did your company shift investment (or does your company plan to shift investment)

to the United States that otherwise would have been done in a foreign location?” Our data on this question (untabulated) reveal that out of 113 respondents, 24 percent answered that they did or they planned to shift investment to the United States from a foreign location. For these 24 percent, once the U.S. repatriation tax rate was effectively reduced, the firms altered their investment location decisions, bringing the cash back to the United States and investing domestically.

5. Non-Tax Costs Firms Are Willing to Incur to Avoid the Repatriation Tax

Another indicator of whether firms view overseas earnings as trapped is whether they incur non-tax costs instead of repatriating earnings and paying the tax. These actions to avoid the U.S. repatriation tax, while cheaper than the repatriation tax itself, are costly and represent a distortion in corporate behavior as a result of a tax. In our survey, we directly ask, “Because of the U.S. tax policy to tax foreign earnings, has your company taken any of the following actions to finance U.S. operations in order to avoid repatriating the foreign earnings (in years where the Section 965 election was not available)?” By far the most common response, given by 43.6 percent of the respondents, is that their companies had raised capital via debt in the United States instead of bringing the cash needed back to the United States from a foreign subsidiary (Figure 4). This result is consistent with the data in Figures 2 and 3 that show firms used repatriated funds and funds freed up from repatriations to pay down debt.

When asked whether the firm had invested in financial assets with a lower rate of return than U.S. investments, nearly 20 percent said yes they had accepted a lower rate of return (by investing overseas) in order to avoid the tax. This evidence is directly consistent with tax law constraining or distorting investment decisions. The remaining choices received few positive responses; however, we find the fact that 9 percent of the respondents indicate that they had

considered selling the entire company, some divisions, or some assets rather than repatriating funds to be astonishing given the gravity of such an action (consistent with the press story about Apple in the introduction). Nearly 5 percent of the sample said that they decreased or did not increase a dividend to shareholders because they could not bring the cash back to the United States from foreign subsidiaries, and 3 percent responded that they decided not to invest in a profitable project in the United States (presumably the associated cost of raising capital was thought to be too high). A review of the “other” responses (i.e., those filled in by respondents) reveals that one company raised capital via a stock issuance, one company inverted to avoid the repatriation tax,²¹ two companies used foreign subsidiaries (rather than the U.S. parent) to acquire a target company, and two companies managed their transfer pricing arrangements.

In Panel B of Figure 4, we report the same information for the subsample of firms that repatriated earnings under the Act. Among these firms, a higher percentage of firms take action to avoid the tax relative to the average firm in our entire sample. For example, 56 percent of the firms that repatriated under the Act said that they had raised debt in the United States to avoid repatriating earnings (before the Act) compared to the 43.6 percent of firms claiming to have done so for the full sample. In addition, in the repatriating firm sample, 30 percent of the firms state that they have invested in foreign assets with a lower return in order to avoid the repatriation tax, relative to the 20 percent of the firms that said they did so in the full sample. Note that within the subsample of repatriating firms, approximately 6 percent say that they did not invest in a profitable project in the United States because they did not want to incur the repatriation tax on the earnings that they would have repatriated to fund the investment. Thus, the repatriation tax leads to distortions in investment choices for these firms.

²¹ A corporate inversion is where the company relocates the place of legal incorporation to another location, generally a tax haven country, in order to avoid (or minimize) the U.S. corporate income tax. For studies on corporate inversions, see Desai and Hines (2002), and Cloyd, Mills, and Weaver (2003).

6. Other Questions

Altshuler and Grubert (2003) propose that many firms avoid the repatriation tax via the parent borrowing against foreign passive assets or through the use of related affiliates to effectively achieve tax free repatriations.²² They argue that a multinational corporation can engage in a variety of strategies that effectively repatriate foreign earnings without incurring the home country tax. The evidence above with respect to firm borrowings and the repayment of debt provides some evidence consistent with their hypothesis. While this borrowing strategy avoids the U.S. tax on repatriation and must be cheaper than paying the tax for firms to choose this option, it is not costless as evidenced by many firms unwinding the positions and paying a maximum 5.25 percent tax on the repatriations under the Act.

We further examine the general issue of whether firms repatriate earnings and whether they pay tax on these repatriations by asking our respondent firms what their cash effective tax rate is on non-Act repatriations.²³ In untabulated data we find that out of the 406 firms that answered this question, 42 percent of the respondents do not normally repatriate earnings, 11 percent of the firms pay a 0 percent tax rate, and roughly 12 percent respond that their average cash rate is between 0 and 5 percent. Thus, 65 percent of the sample either do not repatriate or pay a cash tax rate of less than 5 percent. That leaves 35 percent of our respondents that normally pay a rate greater than 5 percent; indeed approximately 12 percent report that they pay a cash rate greater than 30 percent on their non-965 repatriations.

²² For example, a low-tax subsidiary could lend to or invest in a related high-tax foreign affiliate, the high-tax affiliate then could repatriate all of its earnings back to the United States while using the funds from the low-tax affiliate to fund operations. Another strategy is for a low-tax affiliate to be capitalized by an equity injection from an upper-tier subsidiary facing a higher local tax rate. Then any dividends paid from the low-tax affiliate to the high-tax affiliate would receive the blended higher rate for foreign tax credit computations. The authors refer to these as “triangular” strategies.

²³ Note that for the denominator of their cash effective tax rate we asked respondents to use the cash dividends received in the United States and not the dividend grossed-up by the foreign taxes paid. We wanted a measure of cash taxes paid on actual cash received in the United States; however, this results in a rate that is generally overstated relative to the rate computed as U.S. tax paid on the grossed-up dividend.

Of the sample firms that repatriated earnings under the Act (N=114), 14 percent report that they halted some form of tax planning intended to mitigate the tax burden on repatriated earnings in order to take advantage of the one-time dividend received deduction in the Act. This result is intriguing given the Altshuler and Grubert (2003) evidence that firms tax plan around the repatriation tax.²⁴ Further, it is possible that our response of 14 percent is understated because firms that tax plan to avoid the repatriation tax may not have repatriated anything under the Act (because 5.25 percent is still too high), in which case they would not be in our respondent sample for this particular question (because only firms that took advantage of the Act were directed to answer this question).²⁵

7. Tax Policy Implications of the American Jobs Creation Act

Clausung (2005) argues that one effect of the dividend received deduction in the Act is that it may “send the signal that the U.S. government may grant such holidays in the future, or perhaps even move toward exempting foreign dividends from U.S. taxation.” She points out that the one-time dividend received deduction shares many features of a tax amnesty that is expected to reduce future compliance (see, for example, Alm, McKee and Beck, 1990). The worry is that

²⁴ Firms could have also done additional tax planning to maximize tax benefits under the Act. For example, Merck states in its 2005 report to shareholders that “... the Company repatriated \$15.9 billion during 2005. The Company recorded an income tax charge of \$766.5 million in Taxes on Income in 2005 related to this repatriation, \$185 million of which was paid in 2005 and \$582 million which will be paid in the first quarter of 2006. This charge was partially offset by a \$100 million benefit associated with a decision to implement certain tax planning strategies.” The additional expense for financial accounting results because Merck repatriated earnings designated as permanently reinvested (PRE) and thus no tax expense was previously recognized for the earnings on their income statement (see footnote 5 above). When the PRE earnings are repatriated and the tax is owed, albeit at a relatively low rate, the related expense must be recorded/recognized for financial accounting purposes.

²⁵ On the other hand, the large cash holdings on balance sheets (Foley et al., 2007) and the amount of funds repatriated in response to the Act are prima facie evidence that the U.S. repatriation tax locks-out earnings and that many firms have no less costly (less than the 5.25 percent tax rate on the repatriations under the Act) method of repatriating the funds. Furthermore, discussions with executives reveal that many do view the earnings as trapped. In the beta testing stage of the survey, we asked the executives if there were other important questions we should ask in the survey. One executive started laughing and said, “Yes, ask how the ... are you going to get these earnings back without another AJCA?”

firms anticipate that a similar amnesty will occur in the future and thus change their behavior going forward, in anticipation of that future amnesty.

We asked our sample firms to assess the probability that there would be another one-time dividend received deduction (or similar rate reduction). Roughly 29 percent responded that their firm assessed a 0 percent chance of another rate reduction in the foreseeable future (Figure 5). In addition, 65 percent indicated that they assessed the probability to be greater than 0 but less than or equal to 50 percent. Thus, few firms believe there is greater than a 50-50 chance of there being another one-time dividend received deduction (only 5 percent assessed a probability of greater than 50 percent). One might expect that repatriating firms have a different expectation of a future act than non-repatriating firms. We partition the sample into repatriating firms and non-repatriating firms and find very little difference in terms of expectations between the two groups. The average probability assessed on the likelihood of another act is 3.1 percent for repatriating firms and 3.0 percent for non-repatriating firms. Thus, both groups have a similarly low expectation of another Act. Of the 286 firms that responded to the follow up question, 93 percent indicate that they have not reduced repatriations in expectation of another rate reduction (2 percent respond that they have reduced repatriations, and a little more than 4 percent respond that they are not sure). Thus, most firms, at least at the time of the survey, report they believe that this was a one-time rate reduction.

What if another rate reduction were offered? The data in Table 4 show that 65 percent of our sample firms (N=286) respond that they would take advantage of another such provision if enacted, and the 166 firms that answered the follow-up question said they would repatriate an average of nearly 60 percent of the permanently reinvested earnings they currently have overseas. These results reveal that these firms would have greater mobility of capital if the U.S.

tax on repatriated earnings were reduced or eliminated. In addition, the highest level of consensus that we received on any question on the entire survey occurred when 77 percent of the respondent firms (N=296) indicated that yes, their company believes that the U.S. policy to tax worldwide income harms their companies relative to non-U.S. competitors.

V. CONCLUSION

We survey tax executives about their companies' decisions surrounding the American Jobs Creation Act of 2004 in order to gain a deeper understanding of the corporate responses to the Act and to potentially infer whether U.S. tax on foreign earnings generally creates barriers to capital mobility. In contrast to a world where capital flows freely across countries, we find evidence consistent with the U.S. tax on repatriated earnings being a significant barrier to mobility. We again remind readers that because we use survey data what we show in this paper is what firms self-report they did surrounding the Act.

Our results are consistent with Foley et al. (2007), who hypothesize that earnings are retained overseas due, at least in part, to the U.S. tax due upon repatriation. Indeed, 75 percent of our firms obtained the funds they repatriated from cash or liquid financial assets. When asking how the repatriated cash was used, we distinguish between the cash repatriated and other cash "freed up" by the repatriation. The Act did not require specific tracing of funds and use of repatriated funds was not required to be incremental to spending that would have occurred without the repatriation, thus the "freed up" funds could be spent on anything. Our analysis indicates that the repatriated funds were used for capital reinvestment, training and hiring of employees, U.S. research and development, and the payment of domestic debt. The "freed-up" funds on the other hand appear to have been used primarily to pay down domestic debt and to

repurchase shares. This result offers some explanation and reconciliation of the recent literature, which suggests firms on net used the repatriated funds to repurchase shares.

We specifically ask about actions taken to avoid the repatriation tax in years in which the Act was not in effect. Our sample firms say that they have taken costly actions to avoid the tax, primarily raising capital via debt (44 percent of firms), and investing in foreign assets with a lower rate of return than alternative investments in the United States (20 percent). In addition, roughly 9 percent of our sample considered selling the entire company or individual divisions to raise cash rather than repatriate, and 3 percent (6 percent of repatriating firms) responded that avoiding the repatriation tax caused them to bypass investing in an otherwise profitable U.S. investment. Although few firms take these actions, they are clear indications of distortions in investment decisions due to the tax on repatriated foreign earnings and the view that the foreign earnings are locked out of the United States.

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Figure 1
Sources of Repatriated Cash
(N=112)

Survey responses to question: How were the funds obtained that were repatriated (specifically consider only the qualifying dividends under Section 965)?

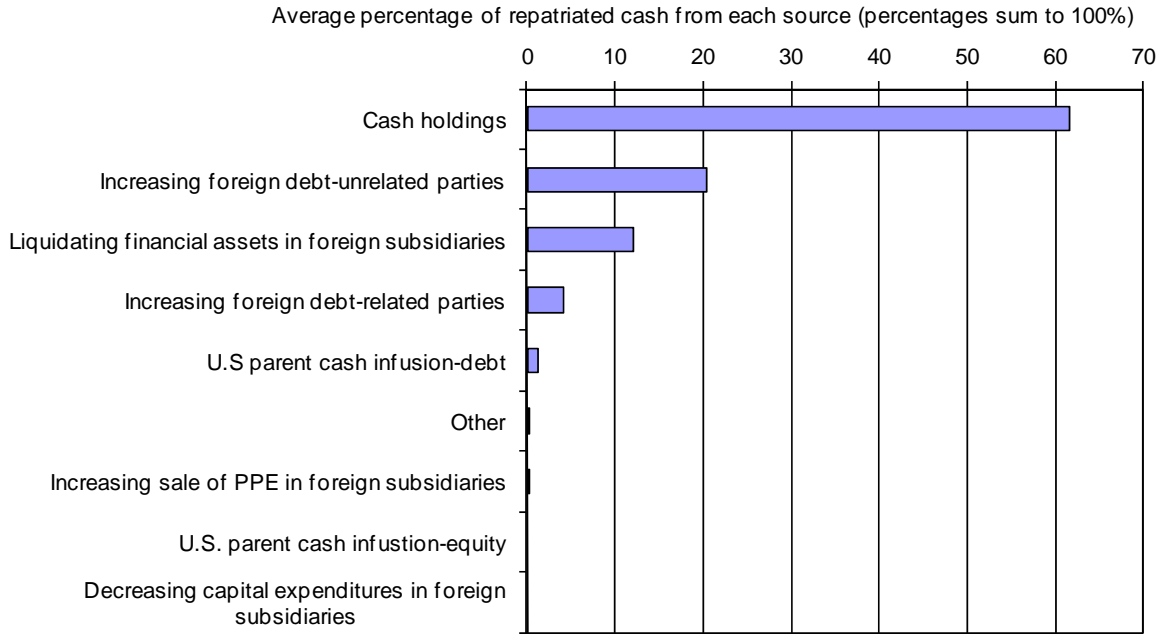


Figure 2
Uses of Repatriated Cash
 (N=111)

Survey responses to question: At the end of the tax year 2006, what have been the uses of the cash dividends repatriated to the U.S. (specifically consider only the qualifying dividends under Section 965)?

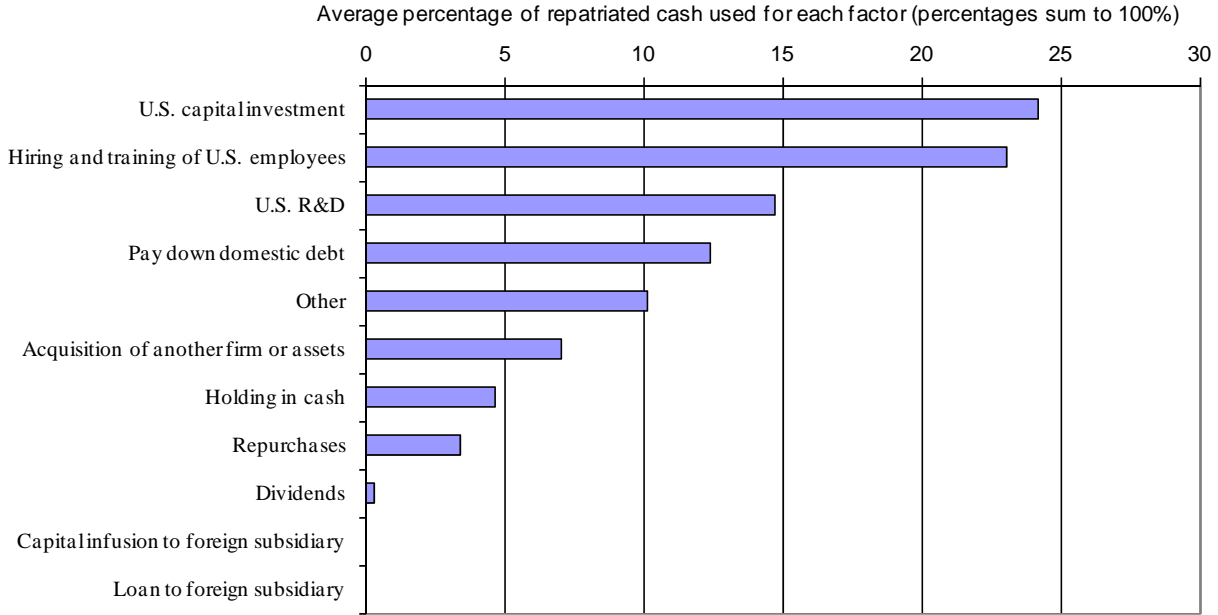


Figure 3
 Uses of Cash “Freed Up” by the Cash Repatriated
 (N=109)

Survey responses to the question: Recognizing the fungibility of cash, did the availability of the repatriated funds for the purposes indicated above free up other cash for any of the following?

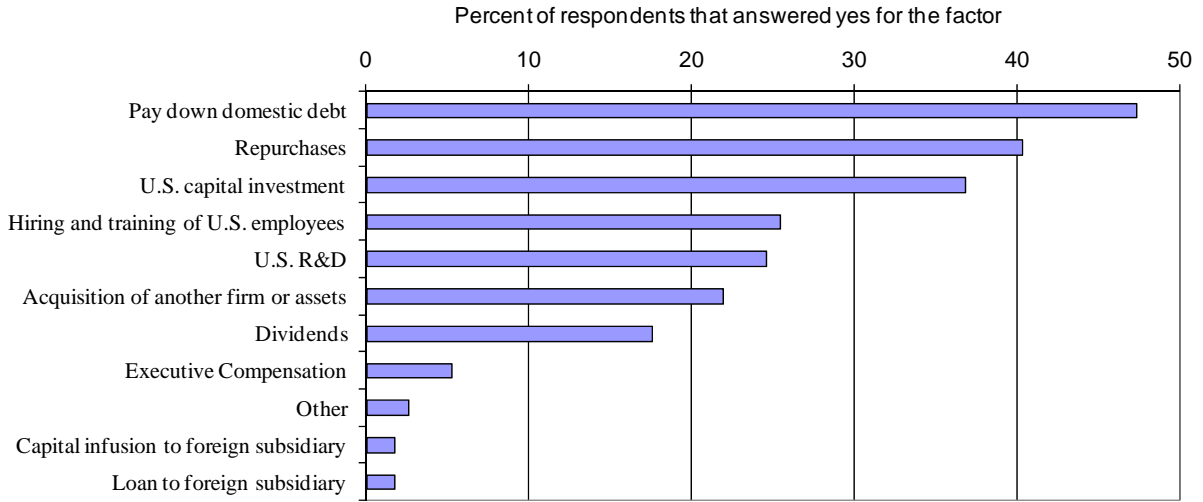


Figure 4
Actions Taken to Avoid the Repatriation Tax

Survey responses to the question: Because of the U.S. tax policy to tax foreign earnings, has your company taken any of the following actions to finance U.S. operations in order to avoid repatriating the foreign earnings (in years where the Section 965 election was not available)?

Panel A: All Respondent Firms

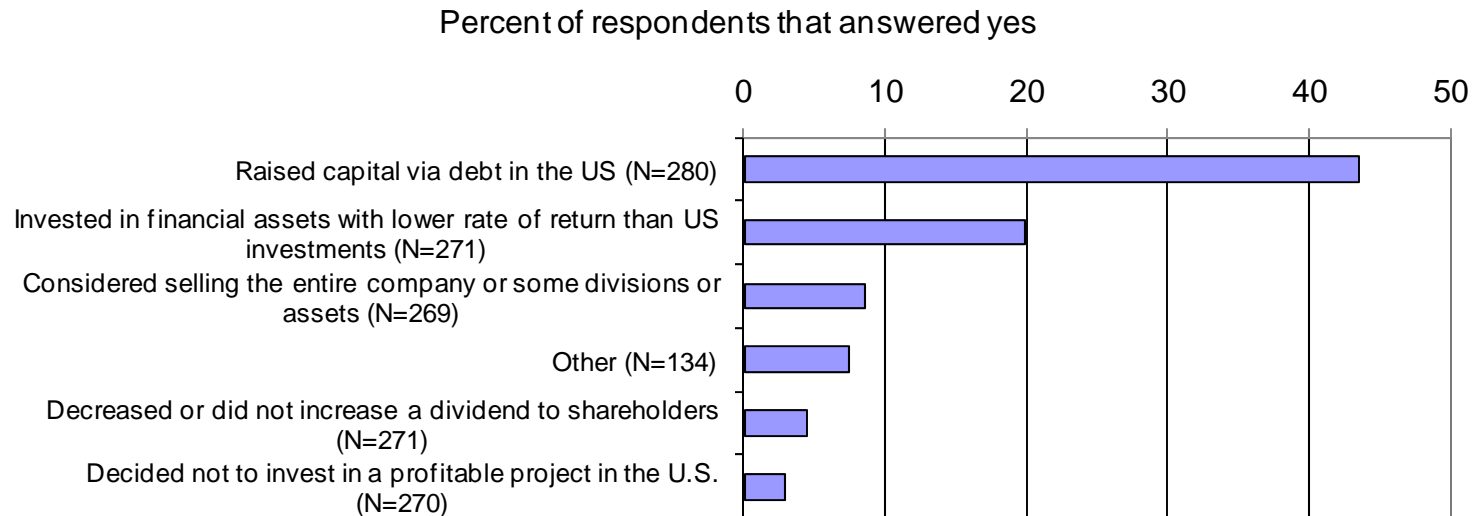


Figure 4 (continued)
Actions Taken to Avoid the Repatriation Tax

Survey responses to the question: Because of the U.S. tax policy to tax foreign earnings, has your company taken any of the following actions to finance U.S. operations in order to avoid repatriating the foreign earnings (in years where the Section 965 election was not available)?

Panel B: Repatriating Companies Only

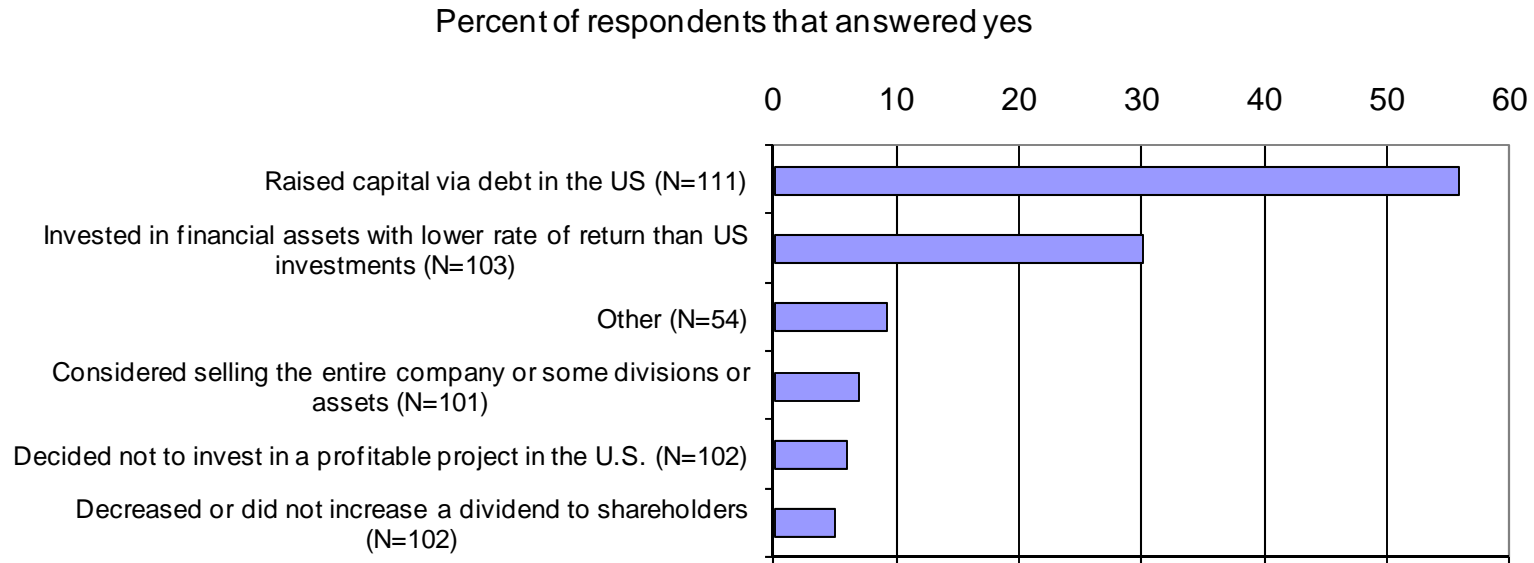
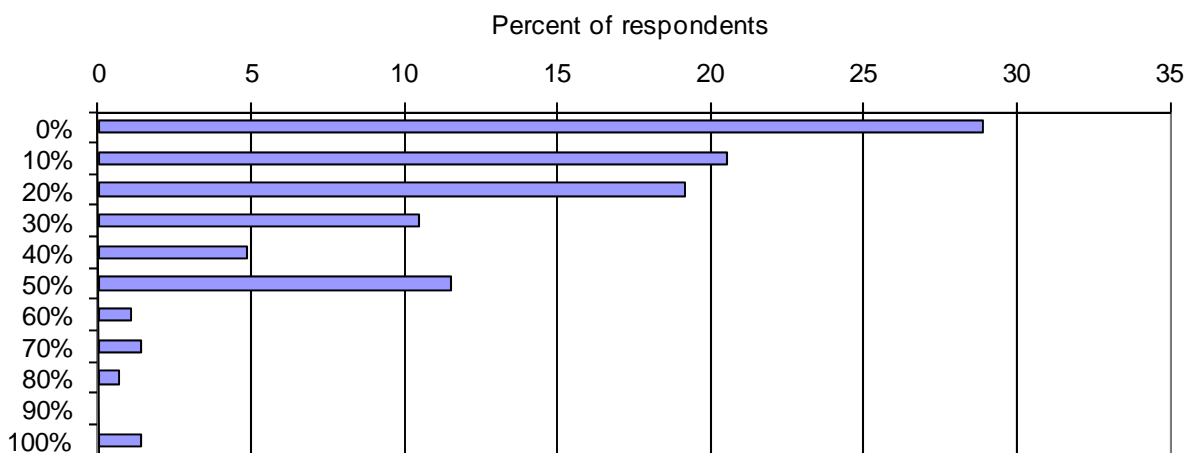


Figure 5

Probability of Another 'One-Time' Dividends Received Deduction

Panel A:

Survey responses to the question: Approximately what probability does your company assess on the likelihood that sometime during the foreseeable future there will be another tax rate reduction on repatriated foreign earnings (similar to the one-time dividends received deduction under Section 965). (Check one probability.) (N=287)



Panel B:

Survey responses to the question: Following the AJCA of 2004, has your company reduced its repatriations from foreign subsidiaries because your company expects a future rate reduction for repatriated earnings? (N=286)

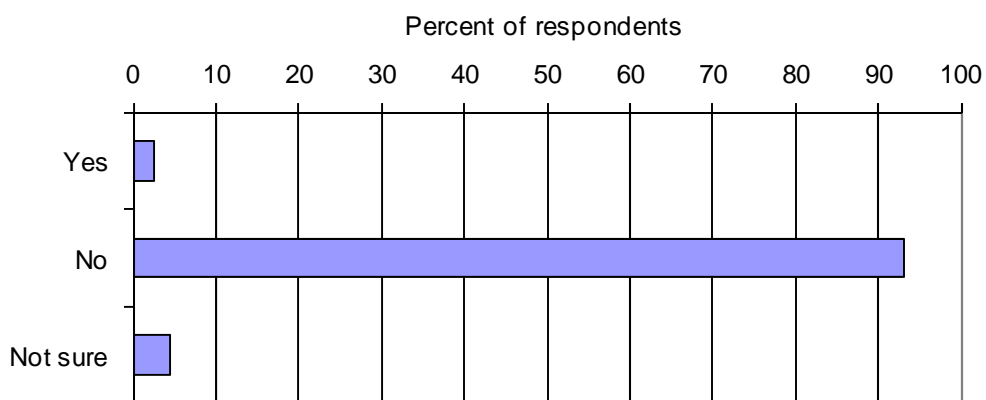


Table 1
Descriptive Statistics

Panel A: General Descriptive Statistics: Survey Respondents

	Percent		Percent
<u>Ownership (N=411)</u>		<u>File a consolidated Form 1120 (N=407)</u>	
Public - NYSE	52.3	Yes	95.1
Public - Nasdaq/Amex	28.2	No	4.9
Private	19.0		
Other (e.g., OTC)	0.5	<u>Entities included in 1120 group (N=387)</u>	
		1	0.26
		2–10	35.66
<u>Industry (N=411)</u>		11–50	46.25
Agriculture, Forestry, Fishing, and Hunting	0.00	51–100	9.04
Mining	1.95	> 100	8.79
Utilities	0.73		
Construction	0.73	<u>Number of Form 1120s filed (N=403)</u>	
Manufacturing	38.93	Zero	0.00
Wholesale Trade	5.84	1	59.31
Retail Trade	3.65	2–10	29.28
Transportation and Warehousing	1.95	11–50	8.93
Information	4.14	51–100	0.50
Finance and Insurance	3.16	101–1,000	1.74
Real Estate, Rental and Leasing	2.92	> 1,000	0.25
Professional, Scientific, and Technical Services	7.06		
Management of Companies (Holding Companies)	13.87	<u>Number of Form 5471s filed (N=411)</u>	
Admin., Support, Waste Mgt. and Remediation Services	1.70	Zero	6.08
Educational Services	0.49	1	5.60
Health Care and Social Assistance	0.49	2–10	31.39
Arts, Entertainment, and Recreation	0.97	11–50	37.47
Accommodation and Food Services	0.73	51–100	11.44
Other services	0.97	> 100	8.03
No code reported	9.73		
<u>Assets (N=396)</u>		<u>Generally have excess foreign tax credits? (N=408)</u>	
<\$500 million	23.0	Yes	52.9
\$500–\$999 million	16.7	No	47.1
\$1–\$4.9 billion	33.8		
\$5–10 billion	8.6		
> \$10 billion	17.9		
<u>Percent of Assets in Foreign Location (N=395)</u>			
0%	7.34		
0–10%	30.63		
11%–20%	14.68		
21%–30%	13.92		
31%–40%	12.15		
41%–50%	9.87		
51%–60%	3.29		
61%–70%	3.54		
71%–80%	2.28		
81%–90%	1.01		
91%–100%	1.27		

Notes: These data were obtained through survey questions. Form 1120 is the U.S. Corporate Income Tax form. Form 5471 is an informational return filed in the United States about the activities of a foreign controlled corporation owned more than 10 percent by a U.S. person (the definition of which includes a U.S. corporation).

Table 1 (continued)
Descriptive Statistics

Panel B: Net Operating Losses

Survey responses to the question: As of your latest fiscal year-end, your company had tax net operating loss carryforwards in the following jurisdictions of approximately:
(all dollar amounts below are in millions of dollars)

All respondents

	Mean	Stdev	25th	50th	75th	Maximum	N
U.S. NOLs	111	344	0	0	53	3,400	385
Foreign NOLs	58	204	0	2	29	2,300	370
State NOLs	129	427	0	10	80	5,900	374

Responses conditional on the firm having an NOL

	Mean	Stdev	25th	50th	75th	Maximum	N
U.S. NOLs	219	459	10	50	197	3,400	195
Foreign NOLs	94	253	5	20	62	2,300	228
State NOLs	180	495	8	30	120	5,900	268

Table 1 (continued)
Descriptive Statistics

Panel C: Descriptive Statistics for Responders versus Non-Responders versus all of Compustat (all data from Compustat)

	N	All Compustat (1) Mean	N	All Firms We Contacted With Available Data (2) Mean	N	Survey Non- responders with Available Data (3) Mean	N	Survey Responders with Available Data (4) Mean	t-statistic			
									(1)	(1)	(2)	(3)
									vs (2)	vs (4)	vs (4)	vs (4)
Assets	4,996	4,066.26	1,259	9,373.01	863	9,617.72	396	8,677.29	-7.43	-4.14	0.54	0.68
MVE	4,654	2,709.19	1,096	8,516.55	813	7,831.8	283	9,958.74	-9.67	-5.28	-0.97	-1.43
Sales	4,977	1,991.09	1,147	5,735.76	863	5,499.1	284	6,458.30	-10.41	-5.94	-0.88	-1.14
Debt	4,980	0.19	1,145	0.22	861	0.22	284	0.19	-5.20	-0.20	2.54	2.69
Cash	4,994	0.20	1,146	0.14	862	0.13	284	0.16	10.58	3.71	-1.93	-2.89
MB	4,653	3.75	1,096	3.26	813	3.26	283	3.27	4.33	2.75	-0.07	-0.05
ROA	4,976	-0.03	1,147	0.05	863	0.05	284	0.07	-18.78	-17.84	-3.24	-3.86
ETR	3,723	0.26	1,008	0.3	756	0.30	252	0.30	-5.26	-3.53	0.17	0.08
Industry	N	(%)	N	(%)	N	(%)	N	(%)				
0	12	0.24	3	0.26	3	0.35	0	0.0				
1	241	4.82	53	4.58	44	5.10	9	3.1				
2	687	13.75	191	16.49	144	16.69	47	15.9				
3	1,115	22.32	345	29.79	232	26.88	113	38.3				
4	484	9.69	122	10.54	102	11.82	20	6.8				
5	404	8.09	130	11.23	102	11.82	28	9.5				
6	1,237	24.76	126	10.88	104	12.05	22	7.5				
7	563	11.27	147	12.69	103	11.94	44	14.9				
8	196	3.92	37	3.20	26	3.01	11	3.7				
9	57	1.14	4	0.35	3	0.35	1	0.3				

Table 1 (continued)
Descriptive Statistics

Panel D: Repatriating responders versus non-repatriating responders (Compustat and survey based data)

	Repatriating Firms (on Compustat)				Non-Repatriating Firms (on Compustat)				t- statistic
	N	Mean	Median	BK Mean	N	Mean	Median	BK Mean	
Assets	118	13,058.8	3,199.6	15,382.5	173	4,866.2	1,045.0	2,449.38	3.38
MVE	95	17,747.3	4,505.3	14,801.7	124	4,623.6	1,219.8	2,085.55	3.85
Sales	96	9,699.2	3,170.3	N/R	124	4,188.0	1,215.4	N/R	3.09
Debt	96	0.20	0.17	0.216	124	0.19	0.16	0.197	0.37
Cash	96	0.16	0.10	0.177	124	0.17	0.12	0.228	-0.80
MB	95	3.80	2.85	3.538	124	2.89	2.22	2.948	2.42
ROA	96	0.08	0.08	0.070	124	0.06	0.06	0.011	1.57
ETR	86	0.28	0.30	0.294	108	0.29	0.33	0.231	0.21
USTR	64	0.36	0.30	0.184	72	0.20	0.27	0.052	2.19
FTR	77	0.30	0.23	0.220	78	0.36	0.25	0.081	-0.81
PRE	99	1,639.3	179.7	1,136.8	99	181.1	15.0	N/R	3.03
Total Repatriation	106	1,534.5	139.4	N/R	0				
Qualifying Repatriation	105	1,355.2	125.0	833.1	0				

Additional Data	N	Mean	Median	N	Mean	Median	t- statistic
U.S. NOLs							
- indicator variable set to 1 if NOL is positive	114	51.75		168	46.43		
- dollar amount for non-zero observations	55	353.4	67.0	90	181.0	39.5	1.81
Foreign NOLs							
- indicator variable set to 1 if NOL is positive	112	25.89		160	40.63		
- dollar amount for non-zero observations	83	152.5	25.4	95	64.1	20.0	2.06
State NOLs							
- indicator variable set to 1 if NOL is positive	111	28.83		164	24.39		
- dollar amount for non-zero observations	79	188.5	30.0	124	211.9	40.0	-0.33
Excess Foreign Tax Credit (FTC)							
- indicator variable set to 1 if company answered yes that they have excess FTC	120	60.00		179	55.31		

Notes Panels C and D:

All Compustat data items are measured in the year 2006. All dollar amounts are in millions. All variables are winsorized at 1 percent and 99 percent of the distribution.

Panel C presents the mean values of each of the variables listed at left. Column (1) consists of all the firms on Compustat except for firms with a negative book value, firms whose name ends with LP, and firms incorporated outside of the United States. Column (2) includes all the firms we contacted in our survey process (described earlier in the manuscript), which essentially are all the firms in the Tax Executives Institute organization. Those listed above are only those for which we could match to and retrieve the data on Compustat. Column (3) consists of the group of firms that we sent a survey to but did not receive a response. Column (4) includes the survey responders with data available on Compustat. We define all variables as in Blouin and Krull (2009) in order to perform comparisons. *Assets* is defined as world-wide assets (Compustat data item AT). *MVE* is the market value of equity (data item PRCC_F times data item CSHO). *Sales* are total sales (data item SALE) divided by total assets (data item AT). *Debt* is the ratio of long-term debt (data item DLTT) plus the debt included in current liabilities (data item DLC) to total assets (data item AT). *Cash* is cash and marketable securities (data item CHE) scaled by total assets. *MB* is the market-to-book ratio (MVE/data item CEQ). *ROA* is return-on-assets defined as net income (data item NI) divided by total assets. *ETR* is the GAAP effective tax rate defined as total tax expense (data item TXT) divided by pre-tax accounting income (data item PI). Industries are as follows: 0 = Agriculture, Forestry, and Fishing; 1 = Mining and Construction; 2 = Manufacturing (Food, Tobacco, Lumber, Furniture, Paper, Chemicals); 3 = Manufacturing (Rubber, Leather, Stone, Metal, Electronics); 4 = Transportation, Communication, Electric, Gas and Sanitary; 5 = Wholesale and Retail Trade; 6 = Finance, Insurance, and Real Estate; 7 = Hotel and Business Services; 8 = Health, Legal, and Educational Services; and 9 = Public Administration.

Panel D presents data for repatriating and nonrepatriating firms in our sample of survey responders. All variables are as described for Panel C. *USTR*, the U.S. effective tax rate, is domestic tax expense (data item TXFED) divided by domestic pre-tax income (data item PIDOM). *FTR* is the foreign effective tax rate calculated as foreign tax expense (data item TXFO) over foreign pre-tax income (data item PIFO). *PRE* is the amount of permanently reinvested foreign subsidiary earnings as reported by the firms in the survey for the *PRE* on the financial statements filed on or before June 30, 2003. *Total Repatriation* is the total amount of cash dividends repatriated in the year the one-time dividends received deduction was elected as reported on the survey (line 1 of the Form 8895 used to make the election to take the one-time dividend received deduction). *Qualifying Repatriations* are repatriations eligible for the one-time dividends received deduction (line 11 of Form 8895). Net operating loss (NOL) and excess foreign tax credit (FTC) data are from the survey.

Table 2
Data by Industry and Firm Characteristic
Question: How were the repatriated funds used?
 Percentage in table is the percentage of funds spent on each purpose

	N	Percent Spent on Capital Investment	Percent Spent Hiring and Training of U.S. Employees	Percent Spent U.S. R&D	Percent Used to Pay Down Domestic Debt
Full Sample	109	24.0	23.5	14.8	12.5
Industry					
Manufacturing	62	25.6	18.4	17.6	14.1
Wholesale Trade	6	28.3	45.8	3.3	8.3
Retail Trade	2	25.0	0.0	0.0	10.0
Information	4	10.0	25.0	25.0	7.5
Finance and Insurance	2	0.0	0.0	0.0	0.0
Professional, Scientific Services	9	15.1	50.0	16.7	2.8
Mgmt (holding) Companies	10	36.0	25.9	3.1	19.4
Other	14	20.7	20.7	15.1	11.1
Firm size (assets)					
Small firms	54	29.3	25.5	10.8	12.5
Large firms	54	19.5	21.1	18.8	12.5
ROA					
Below median	43	27.7	18.9	15.0	11.0
Above median	43	22.4	23.3	17.0	14.0
Debt					
Below median	43	21.5	22.8	24.9	9.3
Above median	43	28.6	19.5	6.8	15.5

Notes: Only the top four choices as graphed in Figure 2 are tabulated here.

Table 3
Data by Industry and Firm Characteristic
Question: How were the “freed-up” funds used?
 Percentage in table is the percentage of firms that said yes for each purpose

	N	Capital Investment (%)	Hiring and Training of U.S. Employees (%)	U.S. R&D (%)	Pay Down Domestic Debt (%)	Repurchase Shares (%)	Dividends (%)
Full Sample	114	36.5	25.5	24.5	47.5	41.0	16.5
Industry							
Manufacturing	65	40.0	29.2	23.1	44.6	43.1	18.5
Wholesale Trade	6	50.0	50.0	33.3	83.3	16.7	0
Retail Trade	2	0.0	50.0	0	50.0	100.0	50.0
Information	5	40.0	20.0	20.0	40.0	40.0	20.0
Finance and Insurance	2	50.0	0.0	0	0	0	0
Professional, Scientific Services	9	22.2	0	22.2	11.1	55.6	11.1
Mgmt (holding) Companies	11	50.0	50.0	33.3	83.3	16.7	0.0
Firm size (assets)							
Small firms	57	36.8	28.1	24.6	45.6	33.3	12.3
Large firms	56	37.5	23.2	25.0	50.0	48.2	23.2
ROA							
Below median	46	23.9	19.6	23.9	45.6	32.6	15.2
Above median	45	42.2	33.3	22.2	42.2	64.4	26.7
Debt							
Below median	46	37.0	23.9	21.7	37.0	56.5	17.4
Above median	45	28.9	28.9	24.4	51.1	40.0	24.4

Table 4
 Questions about a Future Tax Act that Would Provide Another Dividends Received Deduction

Panel A: Would your company take advantage of another IRC Section 965 (that is, another one-time dividend received deduction)?

	Yes	No
286 companies responded (%)	64.7	35.3

Panel B: Survey responses to the question: If the answer to question C-11 [the question in Panel A] is yes, approximately what percentage of permanently reinvested earnings would your company repatriate in qualified dividends based on the expected unremitted foreign earnings as of the end of tax year 2007?

	Mean	Std Dev	25%	Median	75%
166 companies responded (%)	58.5	33.9	25	50	100