

Tax Insights: Analysis of one-time repatriation deduction

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IRS statistics reveal \$265 million taken in dividend deduction

The IRS has recently made available new data on the one-time dividend deduction offered by the American Jobs Creation Act of 2004. An analysis of the new IRS figures by our National Tax Office shows that only 843 corporations took deductions, but that those corporations repatriated \$312 billion in qualified dividends for a total combined deduction of \$265 billion.

The provision

Congress wanted to encourage U.S. corporations to repatriate foreign earnings and in 2004 enacted a provision allowing corporations to deduct 85 percent of the qualifying dividends received from foreign corporations they controlled. Foreign earnings are generally not taxed until they are repatriated, but can be taxed as high as the top corporate rate of 35 percent when paid as dividends to U.S. corporations.

The one-time deduction was subject to several restrictions and limitations and required that the extraordinary dividends from the controlled foreign corporations (CFCs) qualifying for the deduction be reinvested in domestic activities. Almost 10,000 U.S. corporations had CFCs in 2004, but just 843 took advantage of the deduction.

Who took advantage?

Corporations with earnings in high-tax jurisdictions are often able to use foreign tax credits to reduce U.S. taxes on repatriated income, but companies with CFCs in low-tax jurisdictions have less incentive to bring profits home. Over 60 percent of cash dividends were repatriated from Europe, 26 percent from CFCs incorporated in the Netherlands, almost 10 percent from Bermuda CFCs and 5.5 percent from Cayman Islands CFCs.

The numbers are even sharper for only dividends qualifying for the deduction. In fact, CFCs in just eight countries accounted for over 80 percent of the total repatriated qualifying dividends (see figure 2). The CFCs in these eight countries paid an average qualified dividend of \$167 million, compared to just \$20 million for CFCs in all other countries.

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Corporations of all industries took the deduction, but manufacturers were most likely to use it. (See figure 1). They were responsible for over 80 percent of qualifying dividends. Pharmaceutical manufactures alone accounted for over 30 percent, with just 29 corporations claiming an average deduction of almost \$3 billion.

Success of provision

Almost 10,000 U.S. corporations had CFCs in 2004, but just 843 took advantage of the deduction. However, those corporations repatriated a total of \$312 billion in qualified dividends, giving them a combined deduction of \$265 billion – almost one-third of the total accumulated non-taxable earnings of all CFCs for tax year 2004.

While the percentage of companies using the one-time deduction was small, the total amount repatriated was very large. The provision was generally successful in prompting the repatriation of vast sums of foreign profits. As evidenced by the tables below, the provision was particularly effective for prompting repatriation of earnings from CFCs in low tax jurisdictions.

The amount of money repatriated matched the most ambitious estimates and appears to have exceeded the expectations of Congress's official scorekeeper, the Joint Committee on Taxation. The JCT predicted the provision would bring in about \$2.8 billion in new revenue in 2005. Final revenue numbers aren't available, but the \$312 billion in qualified dividends reported by the IRS should generate almost \$18 billion in tax revenue assuming a 35 percent corporate rate and an 85 percent deduction. The amount of that revenue that would be considered new revenue would be reduced to account for profits that would have been repatriated without the change in law.

The temporary provision's success is likely to encourage Congress to consider it again. At the end of 2004, there was \$804 billion in accumulated nontaxable earnings and profits reported for all CFCs controlled by U.S. corporations. Although over \$300 billion of those earnings have since been repatriated as qualified dividends, CFCs have also been accumulating new profits over the last several years.

Key figures in IRS data

- 9,700 U.S. corporations had CFCs in 2004.
- These corporations reported \$804 billion in accumulated nontaxable earnings in their CFCs at the end of 2004.
- Only 843 corporations used the one-time dividend deduction.
- These 843 corporations repatriated almost \$362 billion.
- \$312 billion of that repatriated amount qualified for the deduction, creating a total deduction of \$265 billion.
- Large firms were the primary beneficiaries of the deduction. The average total assets of corporations claiming the deduction were \$24 billion.
- The average qualifying dividend was \$370 million.
- Manufacturers were responsible for 81 percent of the qualifying dividends.

“Even though just a small percentage of companies took advantage of the deduction, it was very successful in prompting the repatriation of vast sums of foreign profits. It was a particularly effective way for U.S. corporations with CFCs in low tax jurisdictions to repatriate earnings without a high U.S. tax cost.”

Joseph Calianno,
International Technical
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- Pharmaceutical manufacturers alone accounted for over 30 percent of the qualifying dividends – just 29 corporations claiming an average deduction of almost \$3 billion.
- CFCs incorporated in Europe were responsible for 62 percent of the total repatriated cash dividends.
- Almost 83 percent of the qualifying dividends were paid by CFCs in just the top eight countries.
- The average qualifying dividend per CFC was \$167 million for CFCs in these eight countries compared to just \$20 million per CFC for in all other countries.

To access IRS taxpayer statistics, go to <http://www.irs.gov/taxstats/index.html>.

Figure 1
Repatriated dividend figures by industry of parent corporation

Industry	Number of returns	Total qualifying dividends for all corporations (in billions)	Average qualifying dividend per corporation (in millions)
Pharmaceutical and medical manufacturing	29	\$98.8	\$3,406
Electronic manufacturing	85	57.5	676
All other manufacturing	351	95.9	273
Wholesale, retail trade	133	12.9	97
Information	49	13.2	269
Finance, insurance, real estate and rental and leasing	49	11.9	243
All other industries	147	22.1	150
Total	843	\$312.3 billion	\$370 million

Figure 2
Qualifying dividends repatriated by country of Controlled Foreign Corporation (CFC)

Country	Number of CFCs	Qualifying dividends (in billions)	Percentage of total qualifying dividends	Average qualifying dividend per CFC (in millions)
Netherlands	253	\$89.9 billion	28.8 percent	\$355 million
Switzerland	155	32.4	10.4	209
Bermuda	82	31.8	10.2	388
Ireland	112	25.6	8.2	229
Luxemburg	87	23.4	7.5	269
Canada	426	21.4	6.9	50
Cayman Islands	101	18.4	5.9	182
U.K.	330	15.9	5.1	48
Totals for top 8 countries	1,546	258.8	82.9	167
All other countries	2,700	53.5	17.1	20
Total for all countries	4,246	\$312.3 billion	100.0 percent	\$74 million

All numbers are based on the most recently released IRS data. Some columns may not add up due to rounding. Some of the IRS information on CFCs has been based on sampling. IRS statistics can be accessed at <http://www.irs.gov/taxstats/index.html>.

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