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The Effects of Repealing the Estate Tax and Reducing the Corporate Tax Rate Coupled with a Repatriation Act

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Honors Thesis

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Table of Contents

Abstract 3
Introduction 4
Effects of Estate Tax Repeal 4
What is the Estate Tax? 4
Wisconsin Case Study 5
Revenue Generated by The Estate Tax 6
The Impact of the Estate Tax on Individuals 6
The Wealthiest 1% of Americans 6
Small Businesses and Farmers 6
The Average American 6
Conclusion 6
Table 1: Estates Filing a Tax Return as a Percent of Total Deaths in the United States 7
Table 2: Estate and Gift Tax Receipts as a Percent of Total Receipts 8
Table 3: History of Federal Estate Tax Exclusion 9
Analysis of Reducing Corporate Taxes 9
How Corporate Taxes Affect Individuals 9
Current U.S. Corporate Tax Structure 9
Table 4: 2012 Corporate Tax Rates in G20 Countries 10
U.S. Corporate Effective Tax Rates 10
Relationship between Corporate Tax Rates and Economic Growth 10
Table 5: Relationship Between Corporate Statutory Tax Rate and Real GDP 11
A Shift in Corporate Tax Structures 11
The S Corporation 11
Table 6: Sources of Total Tax Revenue Collected by Federal Government 12
Table 7: Individual and Corporate Tax Revenue 12
Large Corporations and International Tax Avoidance 12
Repatriation Act or "Holiday" 13
What is it? 13
The American Jobs Creation Act of 2004 14
Impact of Legislation 14
How a New Repatriation Act May Affect Individuals 14
Repatriation Holidays Do Not Fix the International Tax Avoidance Issue 15

How Cutting Corporate Taxes Affects Americans 15
The Average American 15
The Wealthiest 1% of Americans 15
Conclusion 15

Abstract

Given that significant U.S. federal tax reform is taking place for the first time in over 30 years, this paper examines how changing specific tax provisions may affect the average individual taxpayer as well as the wealthiest 1% of Americans. Three potential federal tax law changes are addressed: repealing the estate tax, reducing the corporate statutory income tax rate, and offering a repatriation holiday for remitting the foreign profits earned by U.S. businesses. These changes are analyzed using publicly available data from U.S. Congressional hearings, the Bureau of Economic Analysis (BEA), and the Internal Revenue Service (IRS). Based on this information, it is estimated that repealing the estate tax would add approximately $20 billion to the federal government's annual budget deficit due to the wealthiest 1% of Americans no longer being subject to a wealth transfer tax on the value of their estates at time of death. The impact of the estate tax on families with closely-held businesses is also examined in greater detail because of the potentially adverse consequences of imposing a tax on the transfer of nonliquid assets.

When discussing the effects of reducing corporate income tax rates, a commonly expressed idea is that the economy will grow, leading to an increased tax base and the collection of new tax revenue to offset the loss in tax collections from lower rates. However, lowering corporate tax rates does not guarantee immediate economic growth. In addition, when the repatriation provisions of The American Jobs Creation Act of 2004 temporarily provided an incentive for U.S. multinational corporations to remit the profits earned by their foreign subsidiaries, the money brought back was not always spent on creating job growth domestically. Instead, many companies spent the repatriated funds on increased payouts to shareholders including share buyback programs, which benefited the wealthiest 1% of Americans more than the average American. There is a lack of evidence that offering another repatriation holiday would yield significantly different results.

Introduction

This paper focuses on the likely effects of potentially repealing the federal estate tax, reducing the corporate income tax rate, and offering an incentive for U.S. corporations to repatriate the earnings reported by their foreign subsidiaries. Because the majority of this thesis was completed before the President signed the Tax Cuts and Jobs Act of 2017 (TCJA) on December 22, 2017, these topics are generally addressed from a theoretical perspective rather than providing a detailed analysis of how the TJCA specifically changed the U.S. Internal Revenue Code.

The TJCA is the first major revision of the U.S. Internal Revenue Code since 1986. While there have been many papers written over the past 30 years that propose ideas for improving U.S. tax laws, examining these topics now is relevant given the various viewpoints expressed as the tax reform bill was debated in both the U.S. House of Representatives and U.S. Senate. In addition, this paper anticipates how the aforementioned changes may affect the wealthiest one percent of Americans as well as the average American. A 2012 article in *The New York Times* by Gebeloff and Dewan provides context for the difference between these two groups by stating, "the 1 percent threshold for net worth in the Fed data was nearly $8.4 million, or 69 times the median household's net holdings of $121,000."

Effects of Estate Tax Repeal

What is the Estate Tax?

A federal tax is generally assessed in the United States on transfers of property given as a gift or made at death. The property transfers are valued at fair market value with estates being subject to a tax rate as high as 40% when transferred wealth exceeds a threshold amount. According to the IRS website, the threshold was approximately $5.5 million in 2017 before considering other factors, such as an unlimited marital deduction for transfers to a spouse. Despite some recent tax reform proposals calling for a repeal of the estate tax (commonly referred to as the death tax), the TCJA doubled the exemption amount for estate purposes so that the federal estate tax will no longer apply to estates below a value of $11,200,000 in 2018.

A unique aspect of the estate tax is that it taxes capital, or accumulated wealth, not income. In a sense, it can be viewed as a double tax because regardless of the original source of earnings (wages, profitable business operations, investment returns, etc.), most income is taxed as it is earned during the lifetime of the individual. An exception would be income earned from tax-exempt securities, such as state or municipal bonds. By assessing a tax based on the value of wealth transferred upon an individual's death, the estate tax subjects previously taxed income to a second type of tax.

An ongoing debate for many years has been the degree to which the estate tax affects small businesses and farms because the payment of a wealth transfer tax can create cash flow burdens when assessed on the fair market value of a nonliquid asset. For example, if a family has most of its assets tied up in a business or farm operation, a potential lack of free cash flow could result in the family needing to sell some of the business or farm assets or take on a burdensome amount of debt to pay a related estate tax liability.

This situation is somewhat alleviated when a taxpayer is married because the exclusion amount for a married couple was approximately $11,000,000 in 2017. Also, there are many tax planning strategies that can greatly reduce the potential liability for estate tax. For example, subject to the unified estate and gift tax rules, a donor may make lifetime nonrevocable gifts to heirs to reduce the value of a future estate. In addition, it is not uncommon to establish trusts to strategically avoid the estate tax, and life insurance can be used as part of an overall plan to help manage future estate tax liabilities.

Another aspect to consider is the relatively low number of estates that are actually subject to the tax each year. According to a 2015 report by the Joint Committee on Taxation, of the 2,596,993 deaths in 2013, only 4,687 estate tax returns were filed that year, accounting for 0.18% of all deaths. Because estate tax returns are not always filed in the same year that a taxpayer passes away, Table 1 shows that this statistic is fairly consistent across years. For example, the percent of deaths for which an estate tax return was filed was 0.15% in 2012 and 0.06% in 2011. Although this statistic reached a high of 2.16% in 2000, in general an estate tax appears to be assessed on only a small percentage of overall deaths each year.

Wisconsin Case Study

In response to accusations that the federal estate tax was crippling small businesses, the *Business Insider* developed a case study to analyze the impact of the transfer tax. The following is an excerpt from the findings:

"The IRS said 61 estates in Wisconsin got hit with the tax. Is that a lot or a little? Here are some numbers for context. There are approximately 445,000 small businesses in Wisconsin, according to the US Small Business Administration. It's not clear how many small business owners die in any given year. But assuming that they succumb at the same rate as Wisconsin's population as a whole — 874 deaths per 100,000 people, according to the Centers for Disease Control and Prevention — that would translate into a total universe of just under 3,900 deceased small business owners whose estates might be taxed. Now assume that all 61 estates that actually paid taxes belonged to small business owners. That's unlikely, because some of the 61 probably accumulated their wealth another way — through stakes or executive positions in major corporations, for example. But even if our assumption were valid, it would mean that only 1.6% of small business owners left enough wealth to owe any federal estate tax. Another way to contextualize the data is to look at the overall number of deaths in Wisconsin. According to the state's Department of Health Services, about 50,000 Wisconsin residents die each year. Since 61 estates were taxed in 2015, only about one-tenth of 1% of all deaths in Wisconsin generate an estate tax bill. That's slightly lower than the US average. Nationally, about 1 in 500 estates are big enough to get hit with the federal estate tax, according to the Congressional Joint Committee on Taxation." (Podkul, C. 2016).

It is difficult to fully understand the effect of the federal estate tax by focusing on a given year in only one state, but the Wisconsin example provides context regarding who actually pays the estate tax. Overall, only a very small portion of the U.S. population is subject to the estate tax. While it is possible for a small business to create a taxable estate, the Wisconsin case study shows that this is not a common situation. A potentially fair criticism is that a market inefficiency is created when only a handful of small businesses and farms are required to pay an estate tax. However, if the fair market value of a small business or farm is large enough to fall into that category, there are several tax planning strategies to help minimize any related estate tax liability. Second, if an estate is large enough, it may be able to generate some liquidity to pay the estate tax.

Revenue Generated by The Estate Tax

In 2016, the estate and gift tax only represented 0.18% of the total tax revenue collected by the federal government, which is less than prior decades because the lifetime exclusion amount has drastically risen over time. Table 2 shows this percentage has generally declined over the past 30 years. Recent tax reform proposals have noted that eliminating the estate tax will not significantly hurt the federal budget because it only makes up less than 1% of federal receipts. However, the federal government needs every tax dollar it can collect, and estates that are required to pay the tax may be in the best position to do so relative to other taxpayers. In general, as a wealth transfer tax, the estate tax attempts to redistribute wealth from a small fraction of the population to help the average American.

The Impact of the Estate Tax Affect on Individuals

The Wealthiest 1% of Americans

In 2017, for the estate tax to affect an individual, he or she must have owned assets with a fair market value at the time of death of more than $5.5 million, or over $11 million for a married couple, before considering the impact of lifetime gifts. Thus, the estate tax directly impacts only the wealthiest of Americans. If the estate tax is repealed, the related tax break will primarily benefit this segment of the population. Table 3 shows that the amount of the federal estate tax lifetime exclusion, which was indexed for inflation in the 1990s, has risen sharply over the last 15 years. TCJA further increased the exclusion amount to over $11 million in 2018. Based on the definition of the wealthiest 1% of Americans provided in the introduction, an estate valued at $8.4 million dollars would not be subject to the estate tax before considering the value of gifts made during the decedent's lifetime. Therefore, the current estate tax appears to affect only the more affluent of the wealthiest 1% of Americans.

Small Businesses and Farmers

As shown, the estate tax does not always hamper owners of small businesses and farms. There are numerous estate planning techniques that can be used to minimize or eliminate any potential estate tax liability.

The Average American

In general, repealing the estate tax will not provide a significant benefit to the average American. The approximate tax revenue loss of $20 billion would leave less funding for federal projects and contribute to the already growing wealth disparity gap by no longer assessing a transfer tax on relatively wealthy taxpayers.

Conclusion

Maintaining a U.S. federal gift and estate tax with a large lifetime exclusion results in a very small percentage of estates owing a related tax liability. If the Wisconsin example is representative of other states, the federal estate tax does not appear to hamper most small businesses and farms. Therefore, keeping the estate tax preserves a source of federal tax revenue that is owed by a segment of the U.S. population that appears to have the greatest wherewithal to pay. The beneficiaries of further reducing or repealing the estate tax would be taxpayers who surpass the definition of the wealthiest 1% of Americans based on household net worth.

Table 1: Estates Filing a Tax Return as a Percent of Total Deaths in the United States

Year	Deaths	Number of taxable estate tax returns filed	Filing estate percentage of deaths[2]
1988	2,167,999	18,948	0.87%
1990	2,148,463	23,104	1.08%
1992	2,175,613	27,397	1.26%
1994	2,278,994	31,918	1.40%
1996	2,314,690	37,711	1.63%
1998	2,337,256	47,475	2.03%
2000	2,403,351	52,000	2.16%
2002	2,443,387	45,018	1.84%
2004	2,397,615	31,329	1.31%
2006	2,426,264	22,798	0.94%
2008	2,471,984	17,144	0.69%
2010	2,468,435	6,711[1]	0.27%
2011	2,515,458	1,480[1]	0.06%
2012	2,543,279	3,738[1]	0.15%
2013	2,596,993	4,687[1]	0.18%

[1] The estate tax exclusion more than doubled from its 2008 exlcusion of $2,000,000 to the 2010 exclusion of $5,000,000

[2] Computed by dividign the number of taxable estate tax returns filed to the number of deaths in the yeaer

[3] Something to note is an estate doesn't have to file a return in the year the individual passes away

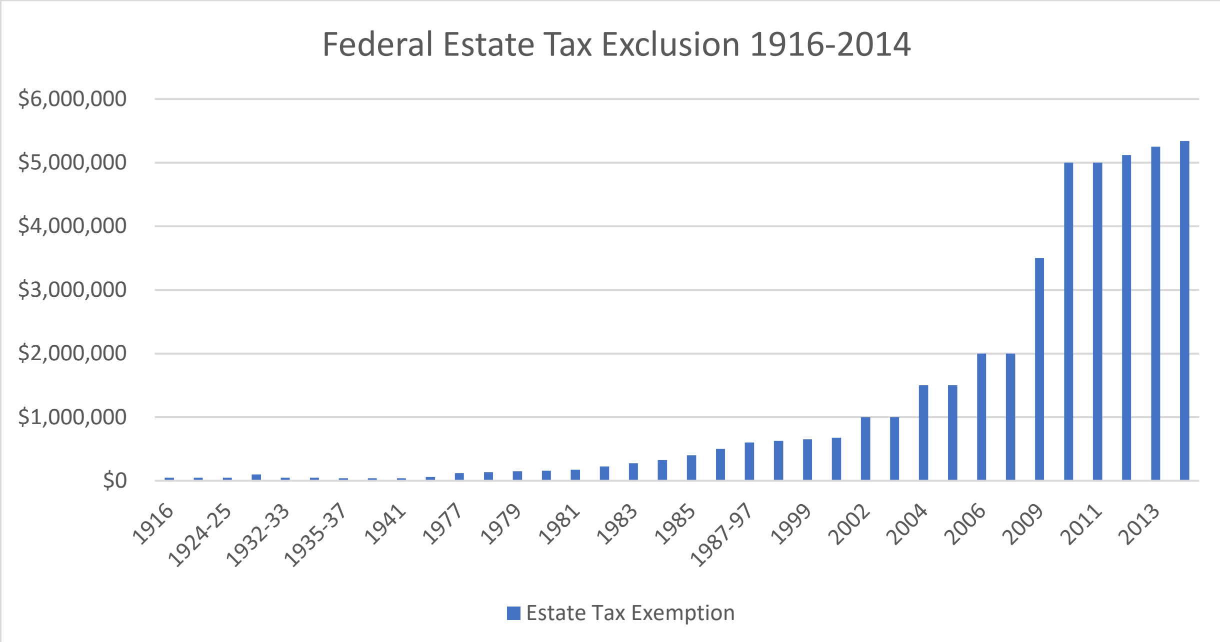
Sources: Internal Revenue Serivce, Statistics of Income (for number of taxable estate tax returns filed) and the U.S. National Center for Health Statistics (for number of deaths in the year).

Table 2: Estate and Gift Tax Receipts as a Percent of Total Receipts

Year	Total Receipts	Estate and Gift Tax Receipts	Estate and Gift Tax Receipts as a Percent of Total Receipts
		In Millions	
1985	734,037	6,422	0.87%
1990	1,031,958	11,500	1.11%
1995	1,351,790	14,763	1.09%
2000	2,025,191	29,010	1.43%
2005	2,153,611	24,764	1.15%
2006	2,406,869	27,877	1.16%
2007	2,567,985	26,044	1.01%
2008	2,523,991	28,844	1.14%
2009	2,104,989	23,482	1.12%
2010	2,162,706	18,885	0.87%
2011	2,303,466	7,399	0.32%
2012	2,449,990	13,973	0.27%
2013	2,775,105	18,912	0.06%
2014	3,021,491	19,300	0.15%
2015	3,249,887	19,232	0.18%
2016	3,267,961	21,354	0.18%

Sources: Budget of the United States Government, Fiscal Year 2017: Historical Tables, Table 2.1 for total receipts and table 2.5 for estate and gift tax receipts

Table 3: History of Federal Estate Tax Exclusion



Sources: Internal Revenue Service, CCH Inc.; Julie Garber's "Annual Exclusion from Gift Taxes, 1997-2010," and "Federal Estate, Gift and GST Tax Rates and Exemptions," McDermott Will and Emery

Analysis of Reducing Corporate Taxes

How Corporate Taxes Affect Individuals

Corporate income tax rates can affect individuals in different ways. In theory, reducing the corporate tax rate will result in corporations reporting greater amounts of after-tax profits. Corporations can do several things with the savings, such as returning some of the after-tax profits to owners in the form of higher dividends. Corporations could also choose to expand through reinvestment by hiring more individuals or spending more on property, plant and equipment acquisitions that would help support other sectors of the economy.

U. S. Corporate Tax Structure

In historical terms, the U.S. corporate income tax rate in the decades immediately prior to the TCJA of 2017 was relatively low. Between 1950 and 1980, the highest rate was between 46% and 52%. Since 1993, the highest statutory rate was 35% for the most profitable corporations until TCJA reduced the rate to a flat 21%.

Table 4 presents information from the Congressional Budget Office (2017) and shows 2012 corporate tax rates for the Group of 20 countries corresponding to the largest economies in the world. The table shows that prior to TCJA, the United States had one of the highest statutory corporate income tax rates in the world. The rate of 39.1% combined the impact of federal, state and local income taxation.

Table 4: 2012 Corporate Tax Rates in G20 Countries

Top Statutory Corporate Tax Rate[a]		Average Corporate Tax Rate[b]		Effective Corporate Tax Rate[c]	
United States	**39.1**	Argentina	37.3	Argentina	22.6
Japan	37.0	Indonesia	36.4 [d]	Japan	21.7
Argentina	35.0	**United States[e]**	**29.0**	United Kingdom	18.7
South Africa	34.6	Japan	27.9	**United States**	**18.6**
France	34.4	Italy	26.8	Brazil	17.0
Brazil	34.0	India	25.6	Germany	15.5
India	32.5	South Africa	23.5 [d]	India	13.6
Italy	31.4	Brazil	22.3	Mexico	11.9
Germany	30.2	Russia	21.3	Indonesia	11.8
Australia	30.0	South Korea	20.4	France	11.2
Mexico	30.0	Mexico	20.3	Australia	10.4
Canada	26.1	France	20.0	China	10.0
China	25.0	Turkey	19.5	South Africa	9.0
Indonesia	25.0	China	19.1	Canada	8.5
South Korea	24.2	Australia	17.0	Saudi Arabia	8.4
United Kingdom	24.0	Canada	16.2	Turkey	5.1
Russia	20.0	Germany	14.5	Russia	4.4
Saudi Arabia	20.0	United Kingdom	10.1	South Korea	4.1
Turkey	20.0			Italy	-23.5

Source: Congressional Budget Office (2017).

U. S. Corporate Effective Tax Rates

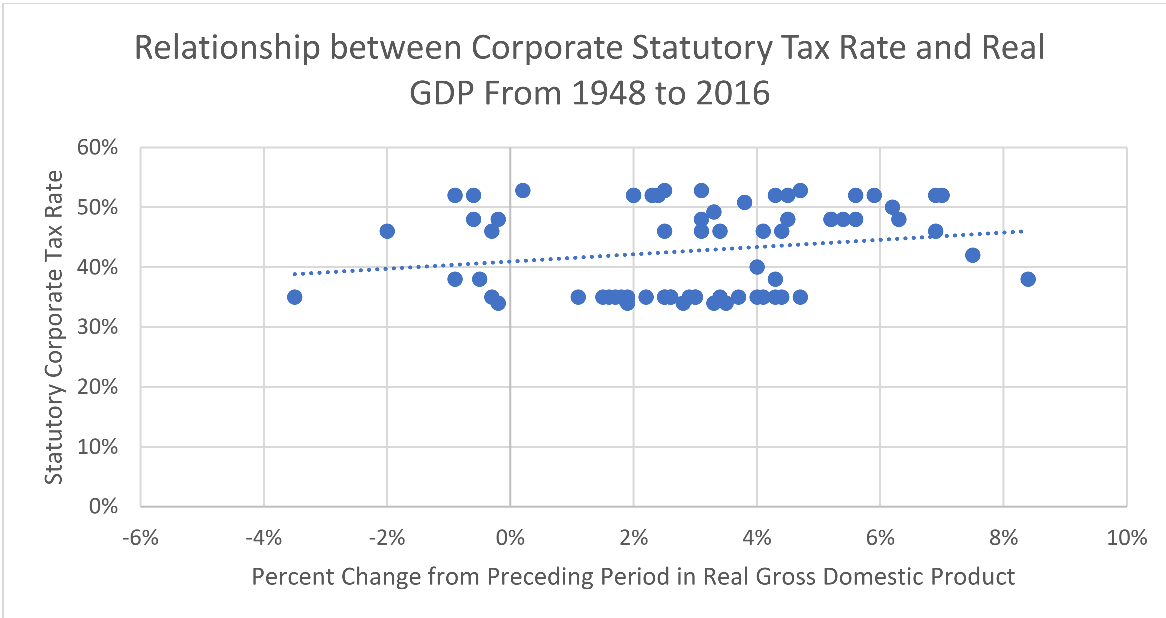
The United States maintained one of the highest statutory corporate income tax rates prior to TCJA, but corporations do not always pay tax at the statutory rate on all of their book income. In some cases, a more informative measure is the effective tax rate, which is calculated as the total amount of taxes paid divided by total income. Table 4 shows that the effective corporate tax rate in the United States is 18.6%. An effective tax rate significantly less than the statutory rate indicates that a corporation is effectively pursuing strategies to minimize the recognition of taxable income and the amount of related tax liabilities.

There are numerous ways corporations in the United States have reduced taxable income relative to book income in a given year. For example, using accelerated depreciation methods, utilizing net operating losses that originated during the economic downturn of 2008, and claiming the domestic production activities deduction (DPAD) have been some of the common techniques found in corporate tax practice. In addition, many of the large U.S. multinational corporations find ways to shelter their income outside the United States, where it can be taxed at a lower rate, commonly referred to as international tax avoidance. By lowering its statutory rate, the United States may find that its effective corporate tax rate will become one of the lowest among G20 countries, potentially reducing the total amount of tax revenue collected by the federal government if the current level of corporate taxable income does not increase.

Relationship between Corporate Tax Rates and Economic Growth

A common assumption supporting the reduction of corporate federal income tax rates is that lower tax rates will spur increased economic growth. A generally accepted method for measuring economic growth is gross domestic product (GDP). Table 5 compares real GDP growth reported by the BEA and historical corporate tax rates reported by the IRS using a scatter plot. Surprisingly, Table 5 shows a slight positive relationship between the two variables, but it is difficult to draw meaningful conclusions from this plot without addressing other relevant variables that impact GDP, allowing for alternative time lags, and testing for statistical significance. Despite these limitations, the plotted data points show that in a given year, a relatively high statutory corporate tax rate does not preclude a relatively high increase in real GDP.

Table 5: Relationship between Corporate Statutory Tax Rate and Real GDP



Data Sources: U.S. Bureau of Economic Analysis (Table 1.1.1) and Internal Revenue Service Historical (Table 24).

A Shift in Corporate Tax Structures

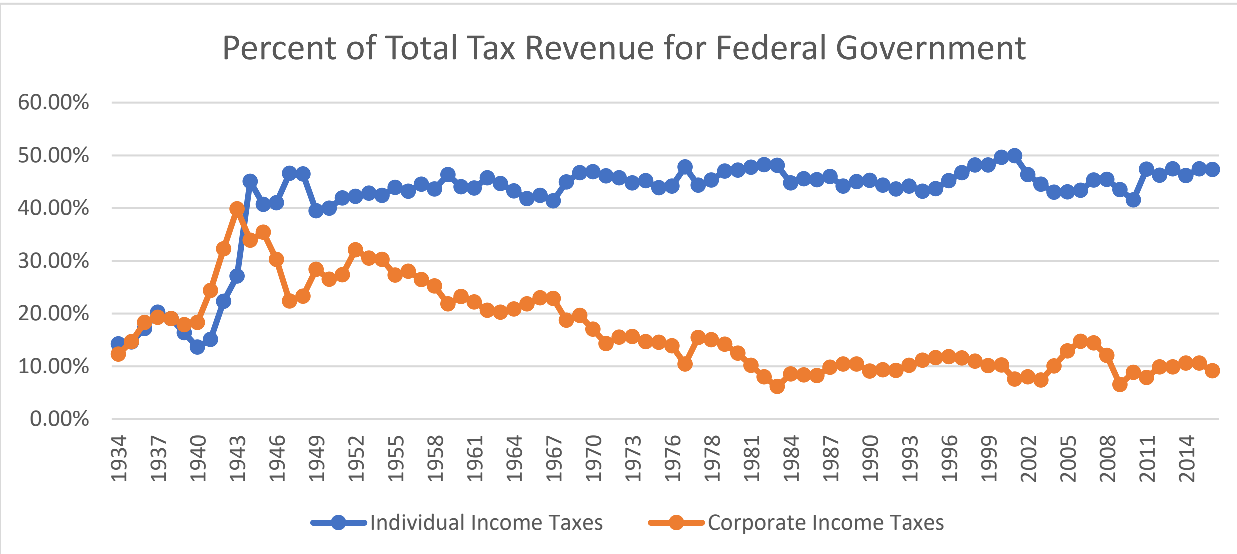
In theory, rising corporate profits would help every American. An ideal result would be the federal government collecting more tax revenue and corporations reinvesting their after-tax profits back in the United States. However, rising corporate profits due to lower income tax rates does not necessarily mean that the federal government will ultimately collect significantly increased amounts of corporate tax revenue in the future.

The S Corporation

The next two tables report historical budget data provided by the White House. Table 6 shows that corporate income tax as a percentage of total tax revenue has generally declined over the last 30 years. While it may appear that corporations have paid less income tax in recent years compared to historical time periods, it is important to note that a large percentage of corporations shifted how their income was taxed at the federal level.

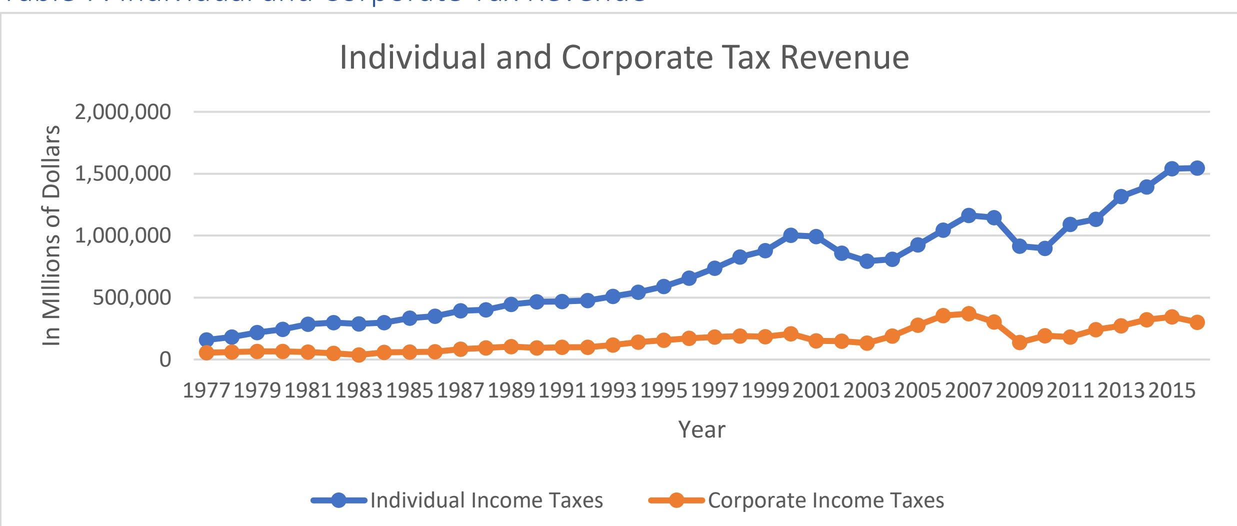
In 1958, a new business structure, called an S corporation, provided shareholders with an opportunity to elect "pass through" treatment of business income and deduction items for federal tax purposes. In other words, an S corporation generally does not pay a federal income tax on its profits, but rather allocates income and losses to shareholders pro rata based on the number of outstanding shares owned by each shareholder. In general, the business amounts flow through to the shareholders, who then report the amounts on their own individual income tax returns. According to a 2003 IRS bulletin, S corporations are the most common type of corporate structure in the United States and account for approximately 62% of all corporate income tax returns filed. While the popularity of S corporations does not entirely explain why corporate tax revenue has decreased as a percentage of total tax revenue over the last 60 years, the availability of S corporation elections has contributed to a shift away from subjecting all corporate profits to taxation at both the corporate and individual levels.

Table 6: Sources of Total Tax Revenue Collected by Federal Government



Source: The White House Historical Budget Table 2.1 and Table 2.2

Table 7: Individual and Corporate Tax Revenue



Source: The White House Historical Budget Table 2.1 and Table 2.2

Large Corporations and International Tax Avoidance

It has become no secret lately that many large U.S. multinational corporations have been sheltering their income overseas to reduce the amount of federal taxes that they pay. As shown previously in Table 4, the corporate effective tax rate in the United States is considerably lower than the statutory rate, which is consistent with international tax avoidance. Corporations engage in tax avoidance when they plan and pursue transactions that legally minimize their tax liabilities, such as creating favorable, permanent differences between tax and book income. For example, under tax law prior to TCJA, a U.S.

corporation could defer the recognition of foreign earnings for U.S. income tax purposes until the amounts were repatriated to the United States. Legal tax avoidance generally becomes illegal tax evasion when significant amounts of income are intentionally underreported or deductions are intentionally overstated.

Among the ways U.S. multinational corporations lower their current taxable income, one of the most common is to establish favorable transfer pricing practices. When a controlled foreign company operating as a subsidiary in a low-tax jurisdiction conducts business with its U.S. parent, the value of goods and services transferred between the two entities needs to be established for the calculation of each entity's taxable profits. For example, when the domestic parent transfers an inventory item to its foreign subsidiary for an advantageously low price, the amount of profit recognized in the relatively high-tax United States is minimized, while the amount of profit recognized in the relatively low-tax foreign country is maximized. Therefore, transfer pricing can make profits that were actually earned in America look like they were earned overseas. This is one of the many ways that U.S. corporations can maintain an effective tax rate in the United States that is lower than the statutory rate.

A downside to this type of international tax avoidance is that it has resulted in hundreds of billions of dollars in corporate profits being "trapped" overseas. Even after accounting for the foreign tax credit, U.S. parent corporations will typically be subject to paying some federal income tax if they repatriate their foreign profits to the United States. The impact of international tax avoidance is difficult to measure, but a 2015 report from the Congressional Research Service states that the annual cost to the United States of offshore tax abuses may be as high as $100 billion per year.

A common argument for lowering U.S. corporate tax rates is that it would encourage U.S. corporations to recognize a greater amount of their profits in America. While this perspective may be credible at face value, there is no guarantee that corporations will behave in this manner if some foreign tax rates remain lower than the new U.S. rate. In fact, if amounts of domestic taxable income are stagnant, lowering the U.S. corporate tax rate may diminish the ability of the United States to collect adequate tax revenue while foreign income continues to be recognized in overseas jurisdictions to take advantage of relatively low foreign tax rates. Therefore, lowering the U.S. corporate income tax rate will not necessarily eliminate the international tax avoidance problem previously discussed, and such concerns may be accentuated by offering temporary repatriation incentives as discussed in the following section.

Repatriation Act or "Holiday"

What is it?

The general idea of a repatriation act, or holiday, is to allow U.S. multinational corporations to bring back their cash trapped overseas (as a result of recognizing income as being earned in relatively low-tax foreign jurisdictions) to the United States at a reduced tax rate. Simply stated, the federal government's perspective is that it is better to tax something compared to not being able to tax anything at all. In general, the cash currently trapped overseas cannot be spent in the United States without triggering a U.S. income tax liability. Therefore, U.S. corporations have an incentive to leave the cash overseas unless the federal government offers to waive or reduce the related U.S. tax liability that normally results when foreign profits are repatriated to the United States.

The American Jobs Creation Act of 2004

A repatriation holiday is not a new concept. In fact, a provision in the American Jobs Creation Act (AJCA) of 2004 temporarily allowed U.S. corporations to bring back a portion of their previously recognized foreign-source income (subject to restrictions) at a reduced effective tax rate of 5.25% while preserving some of the related foreign tax credit benefits. As a condition of receiving this tax break, corporations were required to spend the repatriated funds on pursuing domestic investment initiatives. The intent of the legislation was to promote and support job growth for Americans. According to a 2012 report by the Permanent Subcommittee on Investigations, U.S. corporations returned $312 billion in qualified repatriations and avoided an estimated $3.3 billion in tax payments.

Impact of Legislation

According to the same Permanent Subcommittee on Investigations report, the 15 corporations repatriating the largest amounts under the temporary holiday slashed their overall U.S workforce by 20,931 jobs. There was also little evidence of the other repatriating corporations increasing the level of their overall U.S employment. What happened to the $312 billion in qualified repatriations if it was not used to create American jobs? The 15 repatriating corporations mentioned before increased their stock buybacks by 16% from 2004 to 2005, and 38% from 2005 to 2006. In addition, it was estimated that for each dollar of repatriated earnings, corporations increased payouts to shareholders between 60 and 92 cents. Executive pay for the same 15 repatriating corporations jumped 27% from 2004 to 2005, and another 30% from 2005 to 2006. Although the amounts repatriated were targeted for use in creating jobs, the money brought back was difficult to track due to the fungible nature of cash, and corporations appear to have used the funds for whatever purposes they deemed best.

How a New Repatriation Act May Affect Individuals

Looking back at the generally ineffective tax policy of the temporary repatriation provisions of the AJCA of 2004, it seems that the shareholders of large U.S. corporations were the primary beneficiaries of allowing the companies to bring back their offshore funds at a reduced tax rate.

Currently, the amount of cash that corporations have on hand seems sufficient to meet their needs. In another Permanent Subcommittee on Investigations report issued in 2011, U.S. corporations were found to have roughly $2 trillion in domestic cash assets. Therefore, the availability of cash does not appear to be the determining factor preventing U.S. corporations from making investments that would help to produce domestic jobs. Although offering corporations another repatriation holiday would increase the already large amount of cash that U.S corporations have on hand to spend, the lessons learned from the AJCA of 2004 suggest that such a tax break would most likely not spur domestic job growth that would benefit the average American.

Although another repatriation act sounds good in theory, if its provisions are similar to the AJCA of 2004, shareholders in U.S. corporations will be the primary beneficiaries rather than the average American. For a repatriation holiday to provide benefits through creating domestic job growth, there would need to be a substantial penalty for failures to spend the repatriated funds on domestic initiatives, such as infrastructure improvements. However, practical difficulties in tracking the actual source of cash expenditures and adequately accounting for commitments to previously adopted domestic initiatives may again lead to shareholders benefiting the most.

Repatriation Holidays Do Not Fix the International Tax Avoidance Issue

Another concern with allowing another repatriation holiday is that it sends a message to corporate taxpayers that international tax avoidance is a successful strategic tax planning technique because if businesses wait long enough, they can bring back their foreign earnings at a reduced tax rate. The AJCA of 2004 helped to establish this precedent. The Permanent Subcommittee on Investigations report showed that corporations repatriating the most amount of money actually increased the rate of funds being sent offshore to tax havens after the AJCA tax break. Therefore, repatriation holidays allowing tax-favorable repatriations in the short-term can cause a significant problem in the long-term by contributing to the future recognition of even larger amounts of income in foreign jurisdictions that will escape federal taxation until the next holiday.

How Cutting Corporate Taxes Affects Americans

The Average American

First, the current trend of U.S. corporations engaging in international tax avoidance generally has negative effects on the average American. It reduces the amount of money that is kept in America, leaving fewer funds for domestic job creation and reinvestment. This also keeps tax revenue collections lower than expected, which means that government spending cannot be as high as it would be otherwise without creating a budget deficit.

Second, a reduction in corporate tax rates could generally help the average American if U.S. corporations would keep their resulting tax savings in the United States and reinvest domestically to create value in America. Overall, if worldwide tax havens continue to offer relatively low foreign tax rates, and U.S. corporations continue to recognize significant amounts of income offshore, the average American may not stand to gain much from a cut in U.S. corporate tax rates.

The Wealthiest 1% of Americans

The current trend of international tax avoidance by U.S. corporations primarily benefits shareholders, and relatively wealthy Americans are likely to be included in this group compared to the average American. Therefore, reducing corporate income tax rates and offering corporations another opportunity to repatriate foreign earnings at a relatively low tax rate would be expected to result in increased payouts to corporate shareholders as mentioned earlier.

Conclusion

When it comes to lowering corporate tax rates and determining how it will affect individuals and tax revenue collections, repatriation policies also need to be considered at the same time. A reduction in U.S. corporate taxes will not unilaterally fix the international tax avoidance problem because corporations can be expected to continue recognizing income in foreign jurisdictions with lower tax rates. Unless the United States lowers it corporate rate to be among the lowest statutory tax rates in the world, corporations will continue to seek opportunities for income tax savings. Offering a repatriation holiday without changing how the foreign profits of corporations are taxed will only provide a temporary fix to the problem until another holiday is made available again.

As stated earlier, large corporations based in the United States have over one trillion dollars in cash at their disposal. If corporations wanted to reinvest in the United States, thereby helping the average American, it would already be happening. Providing another repatriation holiday will most likely lead to a repeat of how corporations responded to the AJCA of 2004, with most of the repatriated money being used to fund stock repurchases and the payment of dividends that will generally benefit relatively wealthier Americans.

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