Would a 'Repatriation Tax Holiday' Work?

Gary Clyde Hufbauer says the widely debated proposal to bring investment home from overseas might be a step in the right direction.

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Steve Weisman: The Republican presidential debate has focused on what candidates say are assets parked overseas that should come home and be invested in the United States. This is Steve Weisman at the Peterson Institute for International Economics with Gary Hufbauer, who has studied this issue. Gary, what were they talking about?

Gary Hufbauer: What they're talking about is the so-called "repatriation holiday," which has its precedent back in 2004 when the American Jobs Creation Act was passed and had various features to it. One was to allow companies to bring home money with a flat tax rate of 5.25 percent, as opposed to what was then and is today the normal rule, which is that if you bring it home you pay the residual US tax after allowing for the foreign tax credit. And that could be much more than 5.25 percent. Back in 2004 we got quite a rush of money coming back, $300 billion. The estimates prior to the enactment were much lower than that, $100 billion. That's the precedent and that's what they're talking about. They want to do this again.

Steve Weisman: Is there legislation before Congress?

Gary Hufbauer: Yes, Senator McCain has joined up with a Democrat on this [Senator Kay Hagan, D-NC], but Senator [Charles] Schumer from New York has also proposed the idea. So there is bipartisan support for it. There's also a lot of opposition. The senator from Michigan, Senator [Carl] Levin, held a hearing and he doesn't have a committee which has anything to do with taxes. So that was interesting.

He got a study from his own staff. So naturally he's going to say what he wants to say, but the gist of it was that the 2004 repatriation holiday was a big waste of money, and it all went to buy back some shares and corporate executive salaries. You get the idea. So he panned it pretty heavily. But more interestingly, the Heritage Foundation, which is on the conservative side of the spectrum, also put out a much more nuanced policy brief. They didn't like it because they thought we should go all the way to a true territorial system, which I happen to agree with. This would be a little bite that was going to deflect the bigger prize. And so therefore, don't do the little bite.

Steve Weisman: What's a territorial system?

Gary Hufbauer: A territorial system is where the United States would only tax income earned in the United States, and if a firm like Apple earns income in China, which it does, it would not be taxed by the United States on that income. Whatever China does is China's business. And that actually is the system that is by far the dominant system today in the world. The US is the only major country which still has a so-called "worldwide tax system."

Steve Weisman: Do you think this little bite, as you just put it, is a good idea or a step in the right direction?

Gary Hufbauer: I think it's a step in the right direction, because I think if we did it, it would set the tone for really going for a true territorial system in 2013 when we next revisit all these issues. Our system is terribly complicated and -- I've written about this -- is an obstacle to US firms doing business worldwide. This would be a step in the right direction.

Steve Weisman: It sounds like an appealing idea. It's got support on both sides of the aisle as you pointed out, but on the other hand, you're hearing a lot about increasing the corporate tax in the campaign. Do you think there's any chance of seeing movement on that as Congress grasps the nettle on the budget deficit?

Gary Hufbauer: Yes. The financial markets will at some point – and of course none of us knows what that point is – force the United States to grasp the nettle. But it might be in two years, it might be five years. And at that point revenues will be on the table. I would say that most congressmen or senators appreciate that the US is a very high tax country when it comes to large corporations. We're the highest outside of Japan. And it's harmful in terms of attracting business here, for US firms to do business here, as opposed to almost any place else in the world, including our northern neighbor Canada or including a country like Sweden.

But on the other hand, it is very painful to raise anybody's taxes. I mean, painful for the person whose taxes are raised, and it's painful for the politician who does the raising. So we may very well be faced in say two years time or four years time when the wolf is at the door with very substantial pressure to try to raise corporate taxes. I think that would be most unfortunate, but the political dynamic is clearly there.

Steve Weisman: The alternative that you would prefer, I think is some kind of consumption-oriented tax.

Gary Hufbauer: Yes. We have a system of entitlements now, which I think the next year will prove we don't really want to get rid of wholesale. And if we don't get rid of it wholesale, we've got this yawning budget deficit.

Steve Weisman: Sure.

Gary Hufbauer: Every other country which has this kind of pretty generous system, and more generous than ours, they all have a national consumption tax. Obviously, they've been through the same political debate that we have in democratic countries like Britain or France, and that's the way they went. And I think we will eventually go that way, but I know it's not on the political radar right now.

Steve Weisman: Gary, thanks.

Gary Hufbauer: Thank you.