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Break on Foreign-Profit Tax Means Billions to U.S. Firms

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Prompted by a one-time tax holiday on profits earned abroad, pharmaceutical giant Eli Lilly and Co. announced early this year that it would bring home \$8 billion to boost research and development spending, capital investments and other job-creating ventures.

Six months into the year, Lilly's R&D spending had increased by 10 percent. But that \$134 million is only a small fraction of the \$8 billion that is boosting the company's coffers.

For proponents of the tax holiday, including the corporations that lobbied for it, Lilly proves that the tax provision is working. For skeptics, it means the opposite: A measure designed to create jobs is instead rewarding the companies that are most adept at stashing overseas profits in tax havens, allowing them to bring money home at a severely discounted tax rate. Once here, that money is simply freeing up domestic profits that would have been spent on job creation and investment anyway.

"There will be some stimulative effect because it pumps money into the economy," said Phillip L. Swagel, a former chief of staff on President Bush's Council of Economic Advisers, which had opposed the tax holiday. "But you might as well have taken a helicopter over 90210 [Beverly Hills] and pushed the money out the door. That would have stimulated the economy as well."

A well-organized business coalition, led by pharmaceutical firms and high-technology companies, pushed hard last year to get a long-sought tax holiday into the corporate tax bill moving through Congress, called the American Jobs Creation Act. Treasury Secretary John W. Snow objected that the measure would unfairly benefit multinational corporations over domestic firms, while White House economists said it would produce no substantial economic benefit.

But with bipartisan backing, the business groups prevailed. Most companies with substantial cash holdings overseas have until the end of this year to bring them home at an effective tax rate of 5.25 percent, rather than the standard corporate tax rate of 35 percent.

So far, the effects have been muted. Martin Gonzalez, a principal at Banc of America Securities, estimated that by midyear, \$30 billion to \$40 billion in foreign profits had been brought home, just 10 percent of the \$300 billion to \$400 billion he said could be repatriated by the end of the tax holiday.

Pfizer Inc. has led the pack with a promised \$37 billion repatriation. Procter & Gamble Co. intends to bring home \$10.7 billion, and Johnson & Johnson Inc. has an \$11 billion plan. Schering-Plough Corp. could bring back \$9 billion. This week, Hewlett-Packard Co. announced it will repatriate \$14.5 billion in the second half of the year, mainly for "strategic acquisitions," said Ryan Donovan, an HP spokesman.

Robert S. McIntyre, a critic of corporate tax policy at Citizens for Tax Justice, questioned why "strategic acquisitions" would create jobs. "Usually it means layoffs. That's the strategic part," he said.

Of the roughly 100 companies that disclosed permanently reinvested foreign earnings over \$500 million in 2002, 20 percent announced repatriation plans in the first three months of the year, said Susan M. Albring of the University of South Florida and Lillian F. Mills of the University of Arizona, who are tracking the response. Fifteen percent said such plans were likely.

Under the law and subsequent Treasury regulations, the repatriated money is supposed to go toward hiring and training, infrastructure development, R&D, capital investments, or other job-creating activities. None of the money could be used to feather the nests of shareholders or bosses through executive compensation, stock buybacks or dividend increases.

But Treasury officials warned from the beginning that such requirements were virtually unenforceable, Swagel said.

For proponents of the policy, there may be no better example than Dell Inc., the personal-computer maker, which said it will bring home \$4.1 billion in foreign profits, in part to build a new manufacturing plant in Winston-Salem, N.C.

But of that \$4.1 billion, just over \$100 million is going to the plant, which Dell says would have been built anyway. Dell spokesman Jess Blackburn said other expenditures will include compensation and benefits for non-executives, research and development, advertising, marketing, and some capital investments outside North Carolina.

What it will not be used for is a \$2 billion stock buyback announced April 6, two months after the repatriation plan was announced, Blackburn said. That buyback, although double the level initially planned for the firm's second quarter, was merely the latest in a long series of buybacks used to boost Dell stock prices, he said.

"If we had never bought stock back and we bought stock back this year, I would raise my own eyebrows," he said.

In June, after the release of its repatriation plan, Pfizer said it would buy back up to \$5 billion in common stock.

No one is suggesting that companies are violating the law, said Pamela F. Olson, who as assistant Treasury secretary for tax policy opposed the provision. But the new cash from abroad has "loosened company balance sheets," she said. Some of the new investments would not have been made without the measure, but most of it is simply displacing money that would have been spent anyway.

"Money is in some sense always fungible," said Jonah Rockoff, a Columbia University economist.

Another concern is the incentive the holiday may provide to tax shelterers.

Companies with operations in countries with corporate tax rates close to the U.S. rate had nothing to gain, since they already can deduct taxes paid abroad from tax bills on repatriated earnings. Companies with profits in tax havens with little or no corporate income taxes stand to gain the most.

It made sense that the provision was pushed by technology and pharmaceutical companies, because so much of their profits come from "intangible" property, such as patents and licensing, Mills said. "The profit from a new drug for pain relief is easier to shelter in a low-tax country than is the profit from making and selling shirts," she said.

But such companies also have large R&D operations in the United States that could be funded by repatriated profits.

"Companies are making the decision," Mills said. "Would I ever have repatriated these earnings?' If the answer is yes, they're taking it. If it's no, they will not even want to pay a 5.25 percent rate."

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