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As corporate tax reform emerges as a national legislative priority, a key proposal is to scrap the current worldwide system of taxation (in which income earned abroad by subsidiaries of U.S. multinationals is subject to federal taxes when brought home) in favor of a territorial system that would enable U.S. parent companies to receive profits from those subsidiaries without incurring a federal levy.

With the lifting of this considerable inhibition to bringing foreign profits home, what would be the impact on company payments to shareholders? Despite the vast sums potentially affected by the reform, the overall boost in payouts is likely to be



principal kinds of multinationals' payouts to shareholders – dividends and stock repurchases. Yet, in recent years the relationship appears to have weakened, and even earlier it was mixed, with repatriation taxes constraining dividends substantially but diminishing the likelihood of share repurchases only slightly and the volume of repurchases not at all.

The paper's author, Prof. Michelle L. Nessa of Michigan State University, investigated the impact of repatriation tax costs over two periods chosen to skirt a pair of extraordinary events – namely, the repatriation tax holiday authorized by the American Jobs Creation Act of 2004 and the economic dislocations caused by the Great Recession of 2008.

The main portion of the study draws on data from many hundreds of U.S. multinationals during the 18 years prior to the American Jobs Creation Act – a trove of 12,444 firm-years. The professor analyzed the relation between, on the one hand, corporate payouts to shareholders via dividends or stock repurchases and, on the other hand, the tax cost that firms incurred in repatriating foreign profits (essentially, the difference between tax rates in the countries where the earnings occurred and the higher U.S. tax rate).

Prof. Nessa found that, in general, the greater the cost of repatriation, the less likely firms were to pay dividends to shareholders and the less munificent the dividends they did award were likely to be. For example, a multinational firm with a single-year repatriation tax obligation at the payout group's mean level (0.61% of assets) would have been 4.35% less likely to issue a dividend than a firm owing no repatriation tax. Further, the size of the dividend as a portion of company assets would have been 14.32% less than that paid by a non-owing firm, leading the author to comment that the "economic magnitude of the effect is substantial."

In contrast, no significant relation was found between repatriation tax costs and



latter. Investigating further, she finds high stock repurchases strongly correlated with high debt, a result "consistent with U.S. multinationals…incur[ring] borrowing costs to avoid U.S. repatriation taxes."

As to why the taxes might affect dividends and repurchases differently, Prof. Nessa writes: "U.S. multinationals could occasionally incur costs (e.g., borrowing, utilizing tax attributes, engaging in complex transactions) that allow them to access the wealth represented by their foreign cash without triggering U.S. repatriation taxes. If these cash inflows to the U.S. parent are non-recurring, they are likely to be distributed through share repurchases, because [unlike dividends] share repurchases do not implicitly commit the firm to similar future payouts."

Yet, the differing patterns between the two kinds of payouts disappear in the later period investigated in the research, 2009 through 2014. Over those six years, neither dividends nor repurchases were significantly related to repatriation tax costs.

Why this should have been goes beyond the scope of the study. "It may have to do with the extremely low cost of borrowing in the post-recession years," Prof. Nessa surmises. "There were not any changes in U.S. tax laws related to repatriation that would account for the different results from those of the earlier period studied."

She adds: "If shifting to a territorial system results in more payouts to shareholders, it will most likely occur at financially constrained firms, which constitute a minority of U.S. multinationals. But will such a reform occasion a bonanza for the majority of multinationals' shareholders? That does not seem likely. When it comes to payouts, many companies seem to have worked their way around this particular tax barrier already."

The study, entitled "Repatriation tax costs and U.S. multinational companies' shareholder payouts," is in the July/August issue of ***The Accounting Review***, published six times yearly by the **American Accounting Association**, a worldwide



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