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Ben Haimowitz • Apr. 18, 2018

After years of national hand-wringing about trillions of dollars in profits held abroad by U.S. multinational corporations, the Tax Cuts and Jobs Act enacted in December has mandated repatriation of those earnings at a greatly reduced tax rate. At the same time, an upsurge in corporate stock buybacks has raised concerns that the benefits of this massive tax break will go mostly to the wealthy.

This concern should hardly come as a surprise. A wave of stock buybacks spurred by an earlier corporate tax holiday, the American Jobs Creation Act of 2004, provoked one of the nation's leading newspapers to accuse Congress of "us[ing] phony labels like 'job creation' and...'economic growth' to justify excessive tax cuts that increasingly serve to concentrate wealth among the few." Or, alternatively, as one much-cited academic study concluded, the 2004 legislation succeeded in “putting

2004 law on corporate research and development. It reports that, notwithstanding the surge in stock buybacks that occurred, repatriation resulted in an increase of R&D of about $30 billion, or about 11 percent of the total of $268 billion brought home by the large sample of nearly 400 companies included in the study.

Probing the four years preceding and following the bill’s enactment (2001 through 2009), Qi Dong and Xin Zhao of Penn State University at Erie report that the legislation resulted in an average annual increase in R&D of $47 million per repatriating company. “For comparison,” they write, “the average increase in R&D expenditure is $5 million for nonrepatriating firms during the same period. Therefore, the incremental increase in R&D expenditure for repatriating firms is $42 million.”

Among repatriating companies, the average annual expenditure on R&D increased from about $151 million to about $198 million, a boost of more than 30%.

The study contrasts with earlier research which concluded that companies that repatriated foreign earnings following the 2004 legislation tended to be those with rather limited investment opportunities both at home and abroad, a paucity, it was argued, that explains their failure to fund domestic investment through debt financing before the tax holiday. But that failure, Qi and Zhao maintain, may not apply to R&D, because R&D is not normally funded through debt but rather through internal equity, which is considerably enhanced by a large tax break.

Why focus on R&D? The professors provide three reasons: “(1) R&D is a critical driver of the competitiveness of the U.S. economy and therefore a relevant output for policy evaluation. (2) Unlike other forms of investment made by U.S. multinationals that could be spread all over the world, R&D expenditure is mostly incurred domestically…(3) The two industries with the highest amount of repatriation as disclosed by the IRS – pharmaceutical and medicine and computer and electronic equipment – are industries that are heavily reliant on R&D investment. Therefore,

while 46 were in healthcare, medical equipment or pharmaceuticals. The latter group accounted for about 36% of repatriated dollars, and the former for about 26%. An additional 27% of repatriation funds were accounted for by three industry sectors – manufacturing, consumer non-durables, and chemicals and allied products.

As would be expected, the professors took pains to ascertain that the greater increase in R&D spending by repatriating firms compared to non-repatriators was indeed attributable to the tax holiday, quite apart from other factors that can affect company spending. They achieved this in two principal ways – through matched controls (as indicated above) or, in the analysis involving the full sample of nonrepatriating firms, by controlling for such factors as company size, profitability, debt, and Tobin's Q (a measure of the appeal of companies' stocks to investors).

In both analyses, the relationship between post-legislative repatriation and increased R&D was statistically significant after controlling for other factors affecting expenditure. In the words of the study, "repatriating firms abnormally increased R&D expenditures after the [2004 bill] relative to nonrepatriating firms during the same period."

Asked whether they believe the current repatriation will result in an R&D increase similar to what occurred following the 2004 legislation, the professors say that it is too early to tell. Possibly, they add, the effect may even turn out to be greater, since the current repatriation tax break is accompanied by a permanent sharp reduction in the statutory corporate tax rate, offering firms pondering domestic investments a new incentive to make them.

Entitled "Do Firms Do What They Say? The Effect of the American Jobs Creations Act of 2004 on R&D Spending," the study is in the spring issue of ***The Journal of the American Taxation Association,*** published twice yearly by the **American Accounting**

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