Tax Break Brings Billions to U.S.,
But Impact on Hiring Is Unclear

By TIMOTHY AEPPPEL
Staff Reporter of THE WALL STREET JOURNAL
October 5, 2005

Nine months into 2005, U.S. companies have announced plans to repatriate about $206 billion in foreign profits under a special one-year tax break.

But it's far from clear whether the spending has spurred the job growth that backers of the break touted.

A law signed by President Bush shortly before the 2004 election allows companies to transfer profit from overseas operations back to the U.S. this year at a special low tax rate of 5.25%. Businesses often keep such funds outside the country in part to avoid paying taxes in the U.S., where the effective rate on repatriated profit for many companies is normally closer to 25%. Backers said the measure would provide an incentive to companies to invest those funds in U.S. operations.

Most companies using the break have offered only broad outlines for how they intend to use their windfall. For the most part, they say they are using the bulk of the money for tasks such as paying down debt and meeting payrolls. Direct job creation rarely appears on the list.

Some companies are even bringing home piles of cash while continuing to downsize. Colgate-Palmolive Co., of New York, said in July that it planned to repatriate $800 million, at a time when the company also is pursuing plans to shut a third of its factories and eliminate roughly 12% of its work force, or 4,450 people, over four years.

So far, 91 large companies have disclosed some profit repatriation under the break, according to International Strategy & Investment Group Inc., an investment advisory company.

The one-year break was an amendment in the American Jobs Creation Act.
legislation began as a corrective to an export tax break for U.S. companies that had been ruled illegal by the World Trade Organization.

Though U.S. firms generally pay annual taxes on all their income world-wide, there normally is a broad exception for profits "permanently" reinvested in overseas operations. Money moved back to the U.S. gets taxed. Under the one-year law, repatriated funds still generate a tax bill, but one not nearly as hefty as it would have been otherwise.

No statistics break out how much of overall U.S. job growth can be tied directly to the provision. Job growth has been respectable this year, though the data don't yet reflect the hurricane shocks, which are expected to take a toll. Nonfarm payroll employment has grown an average of 188,000 a month over the past six months. In August, the unemployment rate fell to 4.9%, a four-year low, from 5% in July.

There was much debate when the measure was passed a year ago whether it would create jobs. Many advocates pointed to a study by economist Allen Sinai, released in October 2003, which suggested a temporary cut in the tax on foreign earnings would create 666,000 jobs over five years.

Mr. Sinai now says that number may be overstated. "The bottom of the range could be 450,000 jobs, but that's still 90,000 jobs a year," he says. "It looks to me like the act is roughly working as it was expected to." He adds: "We never found huge impact -- but certainly in our work we found improvement in growth, capital expenditures, and jobs coming from the measure."

Companies that beef up their balance sheets are stronger competitors and "better positioned to grow in the future," says Daniel Clifton, executive director of the American Shareholders Association, a group that lobbies for shareholder interests. He and others say there also is an indirect impact; for instance, companies using the funds to buy capital equipment may create jobs on factory floors for workers making those machines.

"It filters down into the broader economy -- by people who are making the equipment that's being bought," Mr. Clifton says. "It's going to continue to increase factory output. And so the people who are not repatriating are still getting jobs created."
The tax break got off to a slow start, partly because of confusion over how the Treasury Department would enforce the law. But companies have stepped up repatriation in recent months, with another burst of announcements expected in conjunction with third-quarter earnings reports in the coming weeks.

The deadline for acting is the end of December, though some companies that operate on fiscal calendars will be able to extend that into 2006. U.S. companies ultimately are expected to repatriate as much as $350 billion.

Companies plan a wide range of uses for the funds. Intel Corp. has begun the process of repatriating about $6.3 billion, says spokesman Chuck Mulloy. Asked about job creation, he notes that the Santa Clara, Calif., chip maker is building a $3 billion wafer fabrication facility in Chandler, Ariz., and recently announced $345 million in investments in two existing U.S. plants.

"I can't say dollar-for-dollar how much of the funding for those comes from off-shore cash," he says. "We have other investments that qualify." He notes Intel has capital and research and development projects that were previously planned and that some of the repatriated funds will help offset those expenses.

Bausch & Lomb Inc. in Rochester, N.Y., plans to repatriate up to $805 million, says Margaret Graham, a spokeswoman for the maker of eye-care products. "We plan to use that cash for capital expenditures, investment in research and development and paying nonofficer compensation," she says.

Lubrizol Corp., of Wickliffe, Ohio, says it plans to repatriate as much as $250 million under the act. The specialty-chemical producer will apply the funds "to operating expenses that relate to employee salaries," a spokeswoman says.

Dell Inc., the Round Rock, Texas, computer maker, is spending about $100 million of its planned $4.1 billion in repatriated cash on a new factory in North Carolina, set to open today, which eventually will employ up to 1,500 people, says spokesman Jess Blackburn.

However, Dell says job creation isn't the main use of its repatriated funds.

"When you're talking about $4.1 billion, [$100 million] is not a big chunk of it," says Mr. Blackburn. "In general, we're going to use it for some R&D spending, some advertising and marketing and for compensation and benefits for nonexecutive people at Dell."

Some say it is still too early in the process to offer specifics. Jeff Weir, a spokesman
for National Semiconductor Corp. in Santa Clara, Calif., says his company is studying its options, but its fiscal year doesn't end until May 28, "so this is still very early for us."

And others have concluded they have better uses for their money overseas or that it isn't worth the trouble to repatriate. Xerox Corp., Stamford, Conn., has said it doesn't see a material benefit from using the incentive and therefore doesn't plan to take advantage of it to bring foreign profits to the U.S.

Given the large amounts involved, repatriation can still hammer earnings. PepsiCo Inc., the soft-drink and snack maker, said last week that its third-quarter profit was hit by a tax charge of $468 million, or 27 cents a share, for repatriating $7.5 billion.

Bruce Kasman, head of economic research at J.P. Morgan Chase, estimates the average effective tax rate on repatriated profits ultimately will be between 7% and 8%, because it includes taxes already paid by the companies to foreign governments.

The impact for individual companies varies widely, depending on where overseas they generate the profits. The biggest advantage arises for those bringing profits back from foreign countries with the lowest tax rates.

Mr. Kasman and other economists contend that most companies wouldn't repatriate the funds if it weren't for the break. He notes that while the standard U.S. corporate tax rate is 35%, the average effective rate paid by companies expected to repatriate funds is closer to 25% under normal circumstances. The effective rate is lower because it includes tax benefits companies accrue overseas.

Using this gauge, companies would need to spend about $37 billion more to repatriate the $206 billion so far earmarked for repatriation under the bill.

Some analysts contend that by offering a one-year break, the law actually encourages companies to horde profits overseas in the future, since they are likely to expect this to happen again.

Critics also question whether the money is being funneled indirectly into improper uses. Companies aren't supposed to use repatriated funds for stock buybacks, dividends, or executive compensation, but there is no requirement that companies isolate funds or show that spending on approved uses is above what the company would have spent normally.

Companies are required to file board-approved plans to the Treasury Department, mapping out how they plan to use the money for approved uses, notes Nicholas Bohnsack, associate managing director of International Strategy & Investment
Group Inc., an investment advisory company. "Companies are filing reports that fall within the regulations," he says, "but that just frees up money in another kitty."

ISI believes increased dividend payouts and stock buybacks will be two of the top five end results of the repatriation. The other main uses will be mergers and acquisitions, capital expenditures and debt retirement, all of which are allowed under the law, ISI says.

"Since cash is fungible, there's really no way to track it," says Christopher Senyek, accounting analyst at Bear Stearns.

Write to Timothy Aeppel at timothy.aeppel@wsj.com

URL for this article:
http://online.wsj.com/article/SB112847525167060248.html

Hyperlinks in this Article:
(1) http://online.wsj.com/public/page/0,,8_0000-BcInPEW79xkmKKBqB8H10EdWKN7xeZwRnn-TzlsD8nriz7DTs5eQ830sZivrNLkYUae,00.html?mod=VIDEO_CENTER
(2) http://online.wsj.com/public/page/0,,8_0000-BcInPEW79xkmKKBqB8H10EdWKN7xeZwRnn-TzlsD8nriz7DTs5eQ830sZivrNLkYUae,00.html?mod=VIDEO_CENTER
(3) mailto:timothy.aeppel@wsj.com

Copyright 2006 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.