

Navigating the Homeland Investment Act

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Planning to repatriate funds to the US is a hot topic for many treasurers. Companies are currently finalising their repatriation intentions and some have indicated obstacles in structuring their plans. However the release of Inland Revenue Notice 2005-38 has helped to clarify some outstanding issues. The American Jobs Creation Act (AJCA) of 2004 includes a repatriation provision called 'Incentives to Reinvest Foreign Earnings in the United States', which provides a significant one-time tax break to US corporations that repatriate foreign earnings from controlled foreign subsidiaries (CFCs).

Under this repatriation provision, a US corporation is allowed a deduction equal to 85 per cent of cash dividends received from CFCs. This results in an effective tax rate of 5.25 per cent on repatriated dividends instead of the usual 35 per cent rate. The repatriated dividends must be reinvested in the US in certain permitted uses, aimed at creating jobs.

For some the AJCA is a 'touchy' subject. A company's position towards the law and how it will react to it will be driven by past and future strategy to use tax efficient financing structures. A company will also have to look long and hard at how it plans to use overseas cash in the medium to longer term. Some companies are reluctant to talk about their plans to repatriate funds publicly because of any immediate impact on corporate strategy. For some, keeping the cash outside the US will be a better option. But for those companies with 'trapped' cash in their overseas subsidiaries it is an opportunity that they cannot afford to miss.

Under the legislation a taxpaying company may choose to take advantage of the repatriation provision in one of two years: either the company's last taxable year which began before 22 October 2004, or the company's first taxable year which begins in the 12 month period after 22 October 2004.

Companies with financial years that coincide with calendar years could have chosen to use the repatriation provision in either 2004 or 2005. However, if a company has a July year-end, for example, then it could use the provision for its 1 August 2005 - 31 July 2006 year.

Exactly how much money will be repatriated to the US under the AJCA is unknown, although some authors on gtnews have placed the amount in the region of \$500bn. While this is a significant amount of money, Stephen Kuhl, of Travelex, points out in his article Repatriation of Foreign Earnings: Prudent Stimulus or a Null Event? that the impact of this legislation on the currency markets may be muted, as funds will be moved back over a period of time and not all at once.

The movement of funds back to the US is likely to stimulate the US economy over the next few years too. In Simon Miles's article Providing the US Economy with Needed Stimulus for Growth, Miles outlines that the reinvestment of his estimated \$200-400bn could, by rough analysis, equate to as many as four million jobs being created in the US. The repatriation of foreign earnings to the US is at the very least dollar neutral to modestly dollar positive, says Miles. But he adds that the immediate effects on the FX markets depend largely on whether the profits repatriated are in dollars or in other currencies.

And this is certainly a hot topic for treasurers at the moment, with many of the gtnews readers currently deciding if they will take advantage of the legislation. Whether a firm decides to repatriate their funds or not will depend on where it sees more attractive investment opportunities - abroad or in the US. Although many treasurers have indicated to gtnews that they do intend to move funds back to the US, at this stage they are staying quiet about their exact plans on how to effect the repatriation, and keeping tight-lipped on how much they intend to move back to their parent companies.

Privately several pharmaceutical and technology companies have commented on the difficulties they are encountering with their planning. Because of specific patent law limitations (i.e. where patents are owned), and the complexity of holding company structures, some treasurers are faced with formulating complex plans for repatriating funds.

The current dollar weakness is also making the timing of when the funds move back to the US less important. Several analysts told gtnews that they expect further weakness in the dollar - so FX hedging issues may be less of an issue than initially expected.

The release of the Internal Revenue's Notice 2005-38 in May 2005 clarified some details on the legislation. This notice sets out detailed rules on how taxpayers must calculate dividends eligible for the tax break under a five-year base period.

The new law limits the amount that can qualify under that tax break to the greater of \$500m or the amount listed on a financial statement as "permanently reinvested outside the US". This may upset some companies who had planned to move back more than \$500m.

Notice 2005-38 also sets out detailed guidelines on how the tax relief will operate in mergers and acquisitions. The notice provides a basic guideline that acquisitions and sales of foreign subsidiaries generally will not affect a taxpayer's base period.

The notice also clarified that taxpayers will not have to include foreign taxes paid on earnings that are deductible under the new relief. With respect to deductions for expenses, the IRS said deductions would be eliminated only for expenses that are directly allocable to the dividend. Marjie Rollinson, a tax partner at Ernst & Young's New York office, said: "The recent notice (Notice 2005-38) issued on 9 May 2005 has really answered most of the outstanding questions, and people should be in a position now to determine if they would like to take advantage of the provision."

But just how to structure moving funds back to the US is a huge challenge.

According to Elyse Weiner, of Citigroup, implementing a repatriation strategy could be one of the most vexing activities corporate treasuries will manage in 2005. "The interplay of the complex corporate finance analysis and the delicate balancing of tax benefits against global investment opportunity are complicated. And the execution of the strategy can involve numerous logistical issues that could impact success," she said. Read more in Weiner's article [Cash Management Considerations In Implementing an HIA Strategy](#)

According to Rollinson, at Ernst & Young, certain companies are having issues with how to pay the cash dividend. She said: "Some companies do not have sufficient cash to pay the cash dividends. Other companies are struggling with the fact that "cash equivalents" cannot be used to pay the cash dividends, and the cost of converting cash equivalents into cash, can be quite high. Still others face foreign law restrictions on the payments of dividends."

And some companies are choosing to raise money outside the US in order to take advantage of the legislation. Once the debt is taken on by the subsidiary company, and not by the ultimate parent, funds raised through debt can be brought back to the US under the legislation.

Country-specific issues also need to be addressed when considering the best way to repatriate funds. For example the opportunities for US subsidiaries based in India to repatriate cash are significant. But companies need to be aware of the regulatory framework and the local challenges if they are to achieve their objectives. Read more on the Indian situation in Ashish Bajaj's article [Repatriating Cash to the US from India](#).