SENATOR JOHN ENSIGN

TESTIMONY BEFORE SENATE FINANCE COMMITTEE

JULY 15, 2003

- **The United States has maintained a tax system for decades that makes it prohibitively expensive for our U.S.-based companies to bring foreign earnings back for investment in the United States and thus encourages reinvestment of those earnings offshore.**

- **Under international tax principles, primary jurisdiction to tax income is the country where the business operates rather than the country where the business is based.**

- **Many countries (but not the U.S.) exclude foreign dividends from domestic taxation, which encourages the reinvestment of surplus foreign earnings back home into these countries.**

- **In the U.S., by contrast, companies are required to pay tax on foreign subsidiary earnings when the earnings are brought back to the U.S. at a 35-percent U.S. tax rate.**

- **As a result, foreign earnings of U.S.-based companies have accumulated abroad because companies are reluctant to repatriate these funds at this high tax rate.**

- **In the simplest and worst case, a company that is faced with a 35% U.S. tax on a $100 profit can invest $65 dollars in the United States or $100 in a foreign country. Obviously, the foreign investment is the better choice.**

- **This aspect of U.S. tax law is a significant incentive to leave foreign earnings offshore. As a result, less desirable foreign investments are frequently more profitable for U.S. companies despite better investment opportunities in the United States.**

- **Based on an examination of the financial statements of the S&P 500, JP Morgan conservatively estimates that the pool of foreign earnings that has accumulated over the years and is eligible to be brought to the United States is about $300 billion.**

- **Much of this accumulated foreign investment is designated for financial reporting purposes as permanently invested overseas and thus there is no expectation of any U.S. tax being paid in the future.**

Invest in the U.S.A. proposal included in S. 1056

- **The Senate-passed Jobs and Economic Growth tax bill included a provision originally introduced as S. 596 by myself, and Senators Boxer, Smith, Bayh, Allen and Enzi. It was adopted by voice vote after a 75-25 vote adopting a procedural motion on the floor to consider it.**

- **All the Republicans and half the Democrats voted in favor. Similar bipartisan proposals have been introduced in the House.**

Proposed Change

- **For a one-year period, the 35% tax rate on transfers to the U.S. of foreign corporate earnings would be replaced with a 5.25% toll charge on transfers in excess of the company's historical average.**

- **No foreign tax credit would be allowed for 85% of the foreign taxes associated with dividends and other transfers qualifying for the 5.25% toll charge. The 5.25% toll charge could not be reduced by net operating losses.**

- **This amounts to about a <u>3.75 percent</u> U.S. tax after foreign tax credits – about the same as what companies have show that they are willing to pay on average.**

- **PricewaterhouseCoopers examination of the most recent IRS tax data shows that, on average, companies repatriate earnings when the additional U.S. tax burden is about 3.7 percent. If the rate were increased it would encourage less investment in the United States. Reducing the rate could result in less U.S. revenue.**

- **To encourage immediate economic stimulus, the reduced rate of tax would be effective for the first taxable year ending 120 days or more after the date of enactment. Thus, for example, if the bill was enacted on May 25, 2003 and the electing taxpayer is on a calendar year, the bill will apply to the taxpayer's taxable year ending December 31, 2003.**

- **Obviously, since the bill was not enacted as part of the growth package, I will encourage this Committee to select an effective date that maximizes the economic benefit in the next twelve months – to encourage the maximum amount of U.S. reinvestment as quickly as possible.**

Estimated additional U.S. investment from accumulated foreign earnings

- **<u>JP Morgan</u> performed an independent study of S&P 500 financial data for its investors and conservatively estimates <u>that it would bring in about $300 billion</u> and advises that the proposal will result in a significant amount of economic stimulus including:**
  - **A 2-3% cumulative increase in domestic investment during 2003-04,**
  - **A 1% cumulative increase in GDP growth (.5 % in 2003 and .5% in 2004) and**
  - **A 3% reduction in nonfinancial corporate debt that strengthens corporate balance sheets and lowers corporate bond rates.**

- **To provide a sense of the significance of this one-percent of additional GDP, we can compare it to the stimulus in the just passed growth bill.**

- **Standard & Poor and Morgan Stanley Company estimated that the portion of the President's tax proposals that were enacted this year would increase GDP by about one-percent in 2003. Bank of American estimated the impact as about .5 percent in 2004.**

- **Prudential Financial published a Research Report in June on the proposal, stating:**

  > **"We believe that a fund transfer of this magnitude would have significant macroeconomic implications, spurring growth, driving employment, stimulating domestic U.S. capital expenditures, easing the burden of under-funded pension programs, and in particular, helping hard-pressed U.S. manufacturing corporations to pay down debt and de-lever their balance sheets to better cope with deflationary pressures."**

- **A PricewaterhouseCoopers survey of just 14 companies showed that the proposed change would result in an additional $47 billion reinvestment in the United States from just those 14 companies.**

This would increase domestic investment in plant, equipment, R&D, and pension plans depleted by decline in the stock market; reduce domestic debt loads; increase dividends that could be productively redeployed; and raise equity market valuations by increasing funds available for share repurchases.

- **The extent to which this is beneficial to the U.S. economy is determined by the use of the funds when they are reinvested. Although the PricewaterhouseCoopers survey on use of the funds focuses on 14 relatively large companies, the change will improve the financial condition of all U.S.-based companies regardless of size.**

- **I ask unanimous consent that the results of this survey be entered into the record:**

Uses of Additional Dollars Brought to the U.S. as a Result of S. 596 PricewaterhouseCoopers Survey of 14 Companies (4/11/03)	
Percent of foreign subsidiaries' accumulated untaxed earnings at end of 2002 that would be distributed to the U.S. as a result of S. 596	**54%**
Additional distributions to U.S. in the survey (note that this is just the amount in excess of the base amount of normal distributions)	**$47,045,799,109**
Use of additional distributions shown above –	
1. Additional investment in U.S. plant, equipment, inventory, land or working capital	**32%**
2. Additional U.S. debt reduction[1]	**32%**
3. Additional repurchase of company stock	**12%**
4. Additional portfolio investment in the U.S.	**9%**
5. Additional/accelerated contributions to U.S. pension plans	**4%**
6. Additional dividends to shareholders	**1%**
7. Additional compensation to corporate officers	**0%**
8. Additional compensation to other than corporate officers	**0%**
9. Other investments in the U.S. (identified by respondents as additional expenditures on R&D, business start-ups, and business & technology acquisitions)	**10%**
Total	**100%**

[1] The additional debt reduction is reported by some as a first step prior to a determination as to how best to use resources that were previously invested abroad. For others, the U.S. debt reduction is the intended improvement in the U.S. operations (to stabilize or improve debt ratings).

Revenue estimate

- **The Joint Committee on Taxation's preliminary revenue estimates is that S. 596 will increase tax receipts by about $3.8 billion in the first year, and reduce net revenue by $3.8 over the 10-year budget period. I believe that the JCT estimating work is ongoing.**

- **PricewaterhouseCoopers, JP Morgan and a statement by House Ways and Means Committee Chairman Thomas at a hearing disagree with the JCT estimate. PwC and JP Morgan both estimate that the proposal increases federal receipts over the 10-year period.**

- **The Invest in the U.S.A. Act is a bipartisan, sensible, fiscally-responsible way to encourage companies to invest these earnings here at home and provide immediate investment and growth in the American economy.**

- **Lowering the tax burden on foreign subsidiary income for a limited time will open the floodgates for privately held foreign funds to be brought back into the American economy to provide immediate economic stimulus.**

- **Thank you for allowing me to testify here before you today.**