

DEPARTMENT OF THE TREASURY
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FACT SHEET:

Guidance on Repatriation of Foreign Earnings Under the American Jobs Creation Act

Overview:

The Treasury Department and IRS today announced the first in a series of notices that will provide detailed guidance for U.S. companies planning to repatriate earnings from overseas subsidiaries subject to the temporary reduced tax rate available under the American Jobs Creation Act (AJCA). The notice released today gives guidance to companies on how to satisfy the domestic reinvestment plan requirement and on the kinds of investments in the United States for which the repatriated funds may be used under this provision.

Background:

Internal Revenue Code Section 965, enacted as part of the AJCA in October 2004, is a temporary provision that allows U.S. companies to repatriate earnings from their foreign subsidiaries at a reduced tax rate provided that the specified conditions and restrictions are satisfied. Section 965 provides that U.S. companies may elect, for one taxable year, an 85% dividends received deduction for eligible dividends from their foreign subsidiaries.

Section 965 contains several limitations on the repatriated dividends that are eligible for the reduced tax rate. One such requirement is that the repatriated funds must be invested by the company in the United States pursuant to a domestic reinvestment plan approved by company management before the funds are repatriated. Today's notice focuses on this requirement and provides detailed guidance to assist companies in satisfying this requirement.

How it works:

- Under the new law, for one year only, companies that repatriate earnings from foreign subsidiaries to the United States and meet the specified requirements are subject to a reduced tax rate on the repatriated earnings.
- Before repatriating the earnings, the company must have a domestic reinvestment plan for such earnings that is approved by the company's CEO or President and is subsequently approved by its board of directors.
- There are limits on what constitutes an investment in the United States as required under this provision.

Domestic Reinvestment Plan:

The domestic reinvestment plan must be approved by the company's president, CEO, or comparable official before the dividend is paid. The plan must also be approved

subsequently by the company's board of directors, management committee, executive committee, or similar body.

The plan must describe specific anticipated investments in the United States. There is no required form or template that must be used for the plan. The plan must describe the anticipated U.S. investments in reasonable detail and specificity.

The plan must state a reasonable time period during which the company anticipates completing the investments. The plan may provide for alternative investments to be made if the principal investments specified cannot be made. The plan must state the total dollar amount for each principal investment.

Permitted investments:

Section 965 identifies types of U.S. investments for which repatriated funds may be used under a domestic reinvestment plan.

Today's notice provides guidance on the following U.S. investments:

- ✓ Hiring and training workers
- ✓ Infrastructure and capital investments
- ✓ Research and development
- ✓ Financial stabilization for the purposes of U.S. job retention or creation
 - This would include debt repayment and the funding of qualified benefit plan obligations
- ✓ Certain acquisitions of business entities with U.S. assets
- ✓ Advertising and marketing
- ✓ Acquisition of rights to intangible property, such as a patent rights

Expenditures that are not permitted investments:

Some expenditures do not constitute investments for which repatriated funds may be used under a domestic reinvestment plan.

Today's notice provides guidance on the following non-permitted investments:

- ✓ Executive compensation
- ✓ Intercompany transactions
- ✓ Dividends and other shareholder distributions
- ✓ Stock redemptions
- ✓ Portfolio investments
- ✓ Debt instruments
- ✓ Tax payments

Neither the list of permitted investments nor the list of non-permitted investments is exhaustive.

Administrative guidance:

The election to apply the section 965 repatriation provision is made by attaching an election form or statement to the tax return for the year.

Information must be reported to the IRS annually regarding investments made under a domestic reinvestment plan.

A safe harbor, based on a showing of progress toward completion of the planned U.S. investments, may be used to establish that the domestic reinvestment plan requirement has been satisfied.

QUESTIONS AND ANSWERS

When is the provision effective?

The provision generally applies to the first taxable year beginning on or after the October 22, 2004 enactment (which means 2005 for calendar-year taxpayers). Alternatively, the provision could be applied to the preceding taxable year (which means 2004 for calendar-year taxpayers).

Exactly what is the tax reduction to companies on the foreign earnings they repatriate?

The U.S. company is permitted to deduct 85% of the repatriated dividends. If the company is subject to the 35% corporate tax rate on the other 15% of the repatriated amount, that represents effectively a 5.25% tax rate on the total repatriated dividend.

Do firms have to use the tax break in 2005 or could they save it and use it in 2006 or in later years?

The provision applies only for the year specified and cannot be used in later years.

Are companies required to use the exact funds they repatriate to make the required U.S. investment?

No, companies are not required to trace or segregate the repatriated funds. Companies simply must demonstrate that an amount equal to the amount of repatriated funds is invested under the domestic reinvestment plan.

Do the investments have to be completed in a specific time frame? Do they have to be completed in the same year that the company takes the tax break?

No, there is no specific time limit for making the investments. Investments may be completed in a tax year after the year in which the funds are repatriated. The domestic reinvestment plan must state a reasonable time period anticipated for completion of the investments.

Does payment of tort liabilities qualify as a permitted use of repatriated funds?

Today's notice provides general guidance on the domestic investment of repatriated funds and provides specific guidance on several categories of permitted and non-permitted investments. The investments addressed in the guidance are illustrative and the guidance is not intended to provide an exhaustive list. The notice does not specifically address expenditures for tort liabilities. The notice does provide general guidance that expenditure for financial stabilization for domestic job retention or creation is a permitted use, which could encompass payments to satisfy a company's outstanding liabilities.