INVEST BUT REFORM

Establish a National Infrastructure Bank Capitalized by a Repatriation Tax Holiday

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Summary

Congress should establish a National Infrastructure Bank (NIB) capitalized with the proceeds from a one-time repatriation tax holiday. The primary barrier to an NIB—a targeted mechanism for financing infrastructure projects of national significance— is finding a way to build the loan fund. Untaxed overseas corporate profits, which currently provide little support to overstretched federal budgets, represent an untapped revenue source that could quickly fund an NIB, without a direct appropriation. While a similar repatriation holiday created through the 2004 American Jobs Creation Act failed to generate significant domestic stimulus, a targeted program focused on infrastructure has the potential to deliver job creating and economy building projects for decades to come.

Background

According to the Congressional Budget Office, federal investment in infrastructure dropped by one-third over the past 30 years, leaving trillions of dollars in necessary competitiveness-boosting improvements unmade. These inefficiencies produce quantifiable drags on the economy. Increased travel times, wasted resources, and systemic unreliability in American infrastructure assets limit the growth of companies and disproportionately impact low-income communities.

The McKinsey Global Institute estimates that the United States needs to spend an additional $150 billion a year through 2020 to meet America's infrastructure needs. This investment is expected to add nearly 1.5 percent to annual GDP and create at least 1.5 million jobs. Despite the key role infrastructure plays in the economy and the high expected return on investment, the federal government is currently unprepared to meet this funding goal.

Congressional aversion to raising taxes or taking on more debt means that infrastructure programs are likely to see static or declining funding levels for the foreseeable future, while the need for infrastructure investment is only projected to grow over the next decade. Lingering financial challenges at the state and local level further compound these problems.

Simultaneously, the United States is forgoing large amounts of revenue due to loopholes in the international tax code. To avoid double taxation of internationally generated corporate profits, the Internal Revenue Service (IRS) gives filers a tax credit equal to their international taxation liabilities. However, multi-national corporations are permitted to defer taxation on certain classes of foreign income until it is repatriated from foreign subsidiary accounts back to the parent firms. Through this complex system, corporations can use a number of different ownership and subsidiary structures spread across low-tax countries to hold large sums of money in foreign accounts.

An economic analysis by Harry Gubert and John Muttis showed that the effective tax rate for overseas profits can be less than three percent. In total, American corporations hold between $1.45 and $1.70 trillion in domestically untaxed deferred dividend payments that are routed through foreign countries including Ireland, the Netherlands, the Cayman Islands, Barbados, and other so called "tax-havens." Because of the intricacy and risk of these tax structures, the majority of firms that take advantage of these shelters are large and well-established corporations.

Short of comprehensive tax reform, the American government has few options to recoup lost tax revenue on overseas corporate profits. One recent attempt to inject a portion of these funds directly into the American economy came through the American Jobs Creation Act of 2004 (AJCA). The bill was originally drafted to eliminate the Extraterritorial Income Provision, a tax deduction for exported goods, which was ruled an illegal trade subsidy by the World Trade Organization. However, a number of other provisions, including a one-time tax repatriation holiday, made it into the final legislation.

Under this measure, the IRS gave a one-time 85 percent tax exemption on repatriated overseas corporate profits, temporarily reducing the standard corporate tax rate of 35 percent to 5.25 percent for one year. Individual corporations could repatriate up to $500 million, but were required to adopt a plan to invest funds domestically in the hopes of creating jobs and stimulating spending. According to the IRS, 843 out of 9,700 eligible corporations used the deduction and repatriated $312 billion in overseas earnings. A small number of corporations, primarily high-tech firms, accounted for the majority of the repatriated funds. Not controlling for other factors, the Congressional Research Service found that corporations increased repatriations by almost 8 times their normal levels because of the reduced tax rate.

Unfortunately, the lack of enforcement mechanisms for the investment plans, paired with the fungibility of the repatriated dollars on corporate balance sheets, led to limited domestic economic stimulus. Jennifer Blouin and Linda Krull found that the majority of firms taking advantage of the program used the funds to repurchase their own stock, and did not primarily use the repatriated money to invest in infrastructure, research and development, or education. Furthermore, a study by Dhammika Dharmapala showed that every dollar repatriated was associated with a $0.60 to $0.92 increased payout to shareholders.

As a result, criticism of the AJCA was withering. The Economist called it a "lobbyists' delight" and a new low in American tax policy. But if 2004's repatriation holiday succeeded in one thing, it proved that preferred tax treatment is a highly effective way to reshore overseas corporate profits.

The Problem

As states and metropolitan areas rush to capitalize on new economic opportunities in trade, services, and production, infrastructure is an essential part of the national conversation. Yet the poor condition of our infrastructure is well established. There is also growing concern that the infrastructure that exists today is woefully obsolete, geared more for a prior generation than for the challenges of the 21st century global economy.

While most of the attention has been on increasing funding for projects, there are also renewed calls to improve the way the federal government invests in infrastructure. Today, the federal government does not usually select projects on a merit basis. It is biased against maintenance, and involves little long term planning. In this context, there is interest in a new federal entity for funding and financing infrastructure projects through a national infrastructure bank (NIB).

If designed and implemented appropriately, and with sufficient political autonomy, an NIB has the potential to leverage billions of dollars of private investment in important projects across the country. It can not only provide a streamlined selection process for projects, but will also apply a more rigorous standard for evaluating critical investments in energy, transportation, water, telecommunications, and other infrastructure assets. Beyond just traditional projects, the NIB could spur cutting-edge investments in clean energy, smart grids, as well as the research and development needed to spur innovation and partnerships across sectors.

The establishment of an NIB will send a strong signal to the private sector: the federal government is committed and open to private involvement in infrastructure financing and delivery. Today, private-sector financiers and investors are understandably frustrated with the lack of clarity concerning the rules of engagement when working with the federal government. This confusion hinders the development of robust public-private partnership markets in many states and localities.

An NIB would also provide technical assistance and expertise to states and other public entities that cannot develop internal capacity to deal with the projects themselves. Some of the most potentially transformative investments are inherently complex and require a mix of investors across all levels of government, along with the private sector, and may even include financing from international sovereign wealth funds. Expertise to consider such deals and fully protect the public interest is paramount to successfully executing these projects.

However, funding to start up this essential tool is not forthcoming. Budgetary and political gridlock in Washington continues to hamper even basic appropriations while formerly bipartisan bills, including transportation and energy reauthorizations, also languish. In this tense environment, a repatriation holiday offers a way for policymakers to capitalize an NIB without any new appropriations and with a limited net cost to the overall federal budget.

Proposal

The Metropolitan Policy Program at Brookings recommends **the establishment of a national infrastructure bank, initially capitalized at around $25 billion. This appropriation would be directly offset through the authorization of a one-time tax reduction on repatriated corporate profits, temporarily decreasing the standard corporate tax rate to approximately 10 percent, and capped at $500 million per firm.**

Based on analyses regarding the prior repatriation holiday, and estimates from the Joint Committee on Taxation, this general range will generate nearly $25 billion, which is consistent with recent NIB capitalization proposals.

By directing a percentage of the taxes attributable to a repatriation holiday into an NIB, Congress can:

- **Stimulate the development of economically-critical infrastructure projects**, that should create jobs and increase American global economic competiveness;

- **Unlock billions of dollars in domestically untaxed corporate profits,** which will further leverage billions more in investment from private, state, and local investors;

- **Assist state and local governments by lowering the costs of borrowing**, offering greater financial certainty, and easing the burden on tight budgets;

- **Increase transparency** by directly connecting repatriated funds to an infrastructure finance program that can drive the next American economy.

An NIB is an internationally-proven tool that helps get nationally significant infrastructure projects off the ground. A repatriation tax holiday has the potential to be an effective, simple, and relatively low-cost way to fund this economically important institution. Both need to be directed appropriately in order to improve the federal investment process and address the primary failing of the previous holiday; lax investment criteria that allowed repatriated funds to be recycled back into corporate balance sheets and not into high order domestic investment priorities.

Budget Implications

Although it is impossible to exactly predict how hundreds of corporations would respond to a repatriation holiday, the Joint Committee on Taxation estimates that a one year, seventy percent deduction on repatriated profits capped at $500 million per firm would cost the Treasury $41.7 billion over the next decade.

The overall cost of the holiday results from the direct loss of revenue on regularly repatriated funds that are taxed at standard rates and from the long-term consequences of corporate behavior change. A repatriation holiday may incentivize corporations to restructure their foreign subsidiaries to hold more funds overseas and to relocate workers to tax-haven countries, in hopes of reaping the benefits of future tax breaks. Among other effects, the holiday further complicates an already byzantine tax-code and increases horizontal tax inequality, giving special privileges to firms that chose to hold funds overseas and effectively rewarding tax-evading behavior.

However, policymakers must also weigh the long- and short-term tax consequences of a repatriation holiday against the strategic and financial benefits of a well-constructed NIB. Using historical figures from the Environmental Protection Agency's state revolving fund program, an NIB could conservatively expect to leverage $2 to $4 from state, local, and private partners for every dollar it invests, effectively doubling or quadrupling the overall impact of the repatriated funds. Furthermore, the McKinsey Global Institute finds that infrastructure spending has one of the highest economic multiplier effects in government, ranging from $1.44 to $2 in GDP growth for every federal dollar invested.

The budgetary impact of federal investment through an NIB depends heavily on its governance structure. Its investment would be included in the federal budget and the federal budget deficit, if it is designed as a federal financing entity. A shareholder–owned corporation would remove an NIB and its debt from the federal budget, but would increase its borrowing cost and the concerns about implicit federal liabilities resulting in another Fannie Mae crisis.

State of Play

Several congressional leaders, including Senator Barbara Boxer (D-CA) and House Majority Leader Eric Cantor (R-VA), along with major corporations like General Electric and Microsoft, back another repatriation holiday. Separately, the creation of a special financing entity for infrastructure has been around in the policy circles for at least 20 years. President Obama proposed an NIB in his most recent budget and several members of Congress, including Representative Rosa DeLauro (D-CT) and Senator Sherrod Brown (D-OH), also strongly advocated for it.

Yet, the idea of linking a repatriation holiday directly to infrastructure investment is relatively new. In 2011, Senator Charles Schumer (D-NY) introduced a new holiday structured to incentivize infrastructure investment and to close loopholes that allowed corporations to simply pursue stock buybacks. More recently, both Senator Rand Paul (R-KY) and Congressman John Delaney (D-MD) separately introduced legislation to finance infrastructure funded through a repatriation holiday. Outside Congress, Chicago Mayor Rahm Emanuel and former President Bill Clinton support the idea of tying a repatriation holiday to an infrastructure bank.

However, there are detractors on all sides of the issue. Leading Democrats, including Senator Carl Levin (D-MI), disapprove of repatriation holidays, fearing that corporations will simply hoard more profits overseas. Organizations including Americans for Tax Fairness, the Center for Effective Government, U.S. PIRG, and Tax Justice Networks USA, also oppose a holiday, which they consider "corporate welfare." Restricting the use of repatriated funds will also likely face some resistance from companies who want to maximize the flexibility that comes with a tax holiday.

Members of both major parties generally see comprehensive tax reform as a preferred alternative to a repatriation holiday and desire more sustainable sources of revenue for American infrastructure investment. However, an NIB funded through a repatriation holiday offers an attractive alternative across both sides of the aisle. Outside of the partisan fray, this proposal has the potential to return infrastructure investment to its historically bipartisan roots.

Implementation Requirements

A tax repatriation program tied to an infrastructure bank would require legislative action, possibly as part of a major tax reform bill.

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