How Off-Shore Capital Repatriation Affects California Innovation Hubs

Executive Summary

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By The Numbers

$360 BILLION
Estimated amount of money repatriated in 2004

33% DECREASE
Change in Clean Technology Investment since last quarter

58% OF ALL
corporate venture capital investments are made in California

53 FORTUNE 500
companies in California, 13 in the Fortune 100

44% TAX EXECUTIVES
Incur significant nontax costs to avoid the repatriation tax

43% OF INVESTMENTS
in Clean Technology are made in California

BACKGROUND

U.S multinational corporations store profits in off shore subsidiaries because of high domestic taxes. Unlike all other developed economies, the United States taxes corporate income made in other countries when that income is repatriated – paid to the U.S parent as a dividend. While corporations receive U.S foreign tax credits for taxes paid in other countries, the cost of repatriation causes companies to permanently reinvest in other countries or store profits abroad.

CORPORATE TAXES IMPACT COMPANY DECISIONS

The cost of repatriation hurts the competitiveness of U.S multinational corporations. 43% of tax executives admit nontax costs for avoiding paying the repatriation tax. Companies deploy a number of tactics – such as "round tripping" – to avoid paying taxes on foreign-held profits.

REPATRIATION HOLIDAYS INEFFECTIVE

The last repatriation holiday did not increase domestic investment. In fact, companies began storing even more profits overseas in hopes of another holiday. Investors do not see foreign profits as permanently reinvested; rather, they anticipate remittance. Holidays damage the integrity of the tax system by giving a "golden parachute" to multinational companies.

TWO TONES OF REFORM: HOLIDAY OR OVERHAUL

Current bipartisan legislation advocates for repatriation holidays with specific restrictions on how the money can be spent. H.R 1036 specifies that repatriated funds must be applied to proof of concept centers or research and development efforts. H.R 1834 mandates repatriating firms maintain average historic employment levels. Others in Congress and the Obama administration will consider repatriation only as part of comprehensive corporate tax reform.

TECHNOLOGY START-UPS STRUGGLING TO FIND FINANCING

Clean technology and green energy start-ups require significant capital investments in early stages due to the highly sophisticated nature of the technology. However, investors and venture capitalists currently prefer later stage investments. Investment in clean technology is falling.

CALIFORNIA DOMINATES CORPORATE VENTURE CAPITAL

Many multinational corporations within California operate venture capital arms. These companies occupy the same technological spaces as the GOED state-designated innovation hubs. Corporate venture capital investments are rising – especially in California. Such investments serve as a window for technological observation and for potential firms for merger or acquisition.

REPATRIATION REFORM HELPS INNOVATION

Injecting repatriated capital into California – whereby a repatriation holiday or a broader corporate tax reform – improves the investment potential for innovation hubs in the areas of clean technology and green energy. The mutual innovative benefits of corporate venture capital are strong incentives for strategic alliances between companies and innovation hubs.