The Effect of Moving to a Territorial Tax System on Profit Repatriations: Evidence from Japan*

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Abstract

The design of international tax policies, including whether and how to tax corporate incomes earned in foreign countries, has received a flurry of attention from policy-makers and economists. The United States taxes foreign source income upon repatriation under the worldwide tax system, and has long discussed changing the current corporate tax system to a territorial tax system that exempts foreign income from home taxation. Japan had a worldwide tax system similar to that used by the United States, but moved to a territorial tax system by introducing a foreign dividend exemption in April 2009. This paper examines the effect of dividend exemption on profit repatriations by Japanese multinationals. We find no evidence that the dividend exemption system stimulated dividend repatriations of the typical foreign affiliate that had paid no dividends under the worldwide tax system. However, the response of Japanese multinationals to dividend exemption is heterogeneous. Foreign affiliates that had accumulated large foreign profits and especially located in low tax countries increased dividend payments with the enactment of dividend exemption in 2009.

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