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, regarding whether and how to tax corporate incomes earned in foreign countries, has received a great deal of attention from policymakers and economists. Japan’s worldwide tax system taxed foreign source income upon repatriation. To stimulate dividend repatriations from Japanese-owned foreign affiliates, Japan introduced a foreign dividend exemption in 2009 that exempts from home taxation dividends remitted by Japanese-owned foreign affiliates to their parent firms. 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 responses of Japanese multinationals to dividend exemption were heterogeneous. Foreign affiliates with a large stock of retained earnings increased dividend payments more than other affiliates with the enactment of dividend exemption in 2009, but the increase in dividend payments was not associated with foreign tax rates.

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