

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

Makoto Hasegawa[†] Kozo Kiyota[‡]

January 2, 2014

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.

*This research was conducted as part of the research project "Determinants of the Productivity Gap among Firms in Japan," which was undertaken at the Research Institute of Economy, Trade and Industry (RIETI). Hasegawa is especially grateful to the members of his dissertation committee, Joel Slemrod (Chair), James Hines, Stephen Salant, and Jagadeesh Sivadasan, for their invaluable advice, encouragement, and mentoring. We also appreciate the helpful comments and suggestions received from David Albouy, Fan Fei, Christian Gillitzer, Tom Neubig, Masanori Orihara, and the seminar participants at the Bank of Japan, the University of Michigan, the National Graduate Institute for Policy Studies (GRIPS), RIETI, Yokohama National University, and participants at the CAED 2013 and ETSG 2013. Hasegawa gratefully acknowledges the financial support of the Nakajima Foundation, and the Center for Japanese Studies and the Center for International Business Education and Research at the University of Michigan. The usual disclaimers apply.

[†]National Graduate Institute for Policy Studies (GRIPS). E-mail: m-hasegawa@grips.ac.jp.

[‡]Keio Economic Observatory, Keio University and RIETI. E-mail: kiyota@sanken.keio.ac.jp