svb Silicon Valley Bank

Impacts of US Tax Reform

How profit repatriation may affect your company

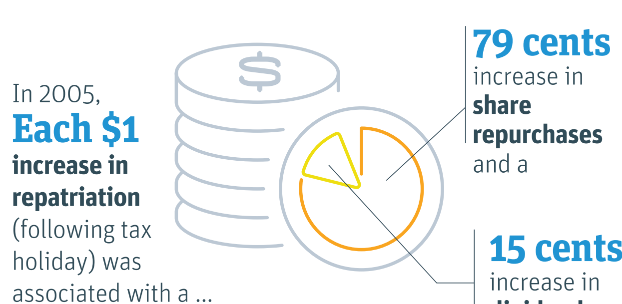
Reducing the corporate income tax rate to **21%** makes it likely that profit repatriation will sharply increase.

What will your company do with the windfall?

Some companies are spending their windfall on employee compensation and benefits. If companies in your industry are taking this approach, will you?

In 2005, shareholders benefited the most from profit repatriation[1]

History and recent sentiment surveys suggest most companies will use excess profits to buy back shares:



In 2005, **Each $1** increase in repatriation (following tax holiday) was associated with a ...

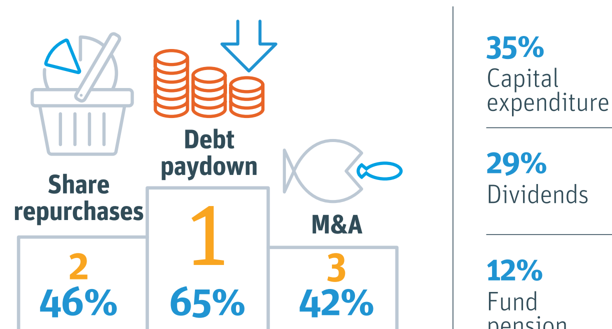
79 cents increase in share repurchases and a

15 cents increase in dividends

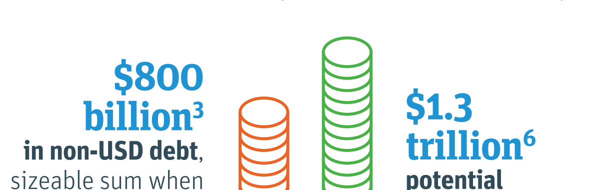
Despite a few high-profile cases of companies increasing employee pay and benefits,

profit repatriation in 2005 did not lead to an increase in domestic spending, employment, R&D or management compensation.

2017 survey suggests debt paydowns are the top priority:[2]



US firms collectively hold approximately:



$800 billion[3] in non-USD debt, sizeable sum when compared to the ...

$1.3 trillion[6] potential repatriation pool

To retain acceptable leverage ratios, it is likely repayment of non-USD debt will take priority over USD-denominated debt.[4] If repatriation proceeds are used, it will not lead to additional purchases of USD.

How will your global funding strategy be impacted?

While repatriation's impact on FX market volume will be negligible compared with daily turnover, history suggests tax reform may be bullish for the US dollar.

2005 Historic Precedent

The Homeland Investment Act of 2004 provided a one-time, year-long tax holiday that allowed US firms to repatriate foreign earnings.[8]

In 2004, daily spot turnover was **$621 billion[10]**

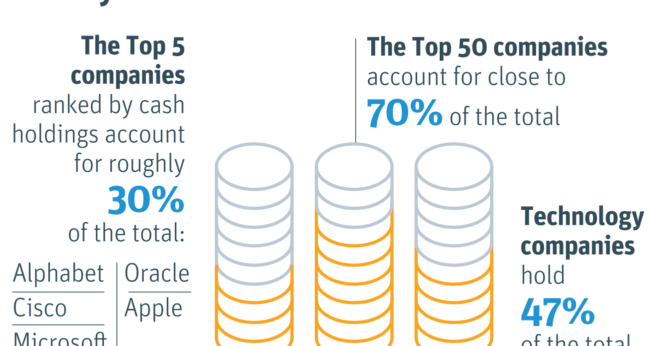
In 2005, US corporations repatriated approximately **$300 billion[9]**

Direct impact: The FX market volumes were not affected. Changes of sentiment introduce a bullish bias to the USD.

Despite small volume growth, USD appreciated during the Homeland Investment Act of 2005, disrupting a three-year bearish run - despite small FX market volume growth.[11]

% change in trade-weighted USD index by year

Cash overseas is highly concentrated and held by a small subset of firms[12]



The Top 5 companies ranked by cash holdings account for roughly **30%** of the total:

Alphabet | Oracle
Cisco | Apple
Microsoft

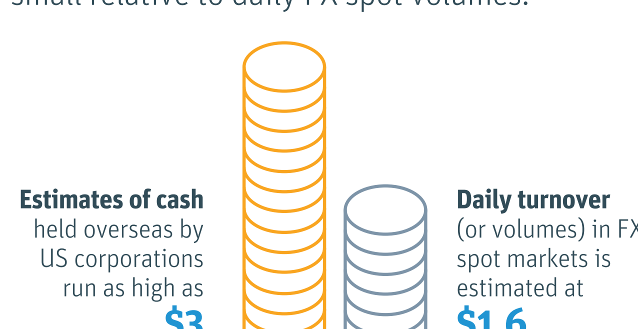
The Top 50 companies account for close to **70%** of the total

Technology companies hold **47%** of the total

A significant portion of overseas cash is in USD – so no foreign exchange transaction is needed.

Profit repatriation from volumes alone is unlikely to move foreign currency markets ...

The amount of non-USD cash held overseas is small relative to daily FX spot volumes.



Estimates of cash held overseas by US corporations run as high as **$3 trillion[6]**

Daily turnover (or volumes) in FX spot markets is estimated at **$1.6 trillion[7]**

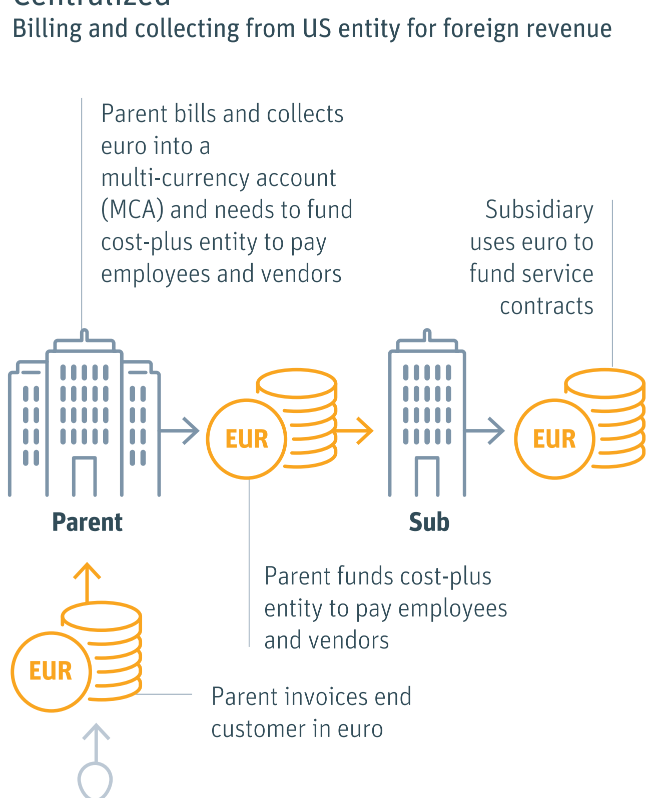
Should you change your global corporate structure?[5]

Windfall or not, companies are realizing that their current or planned global corporate structure may not be optimal.

If your US corporate profits will no longer be held overseas, the benefit tradeoffs between centralized and decentralized global corporate structures will change:

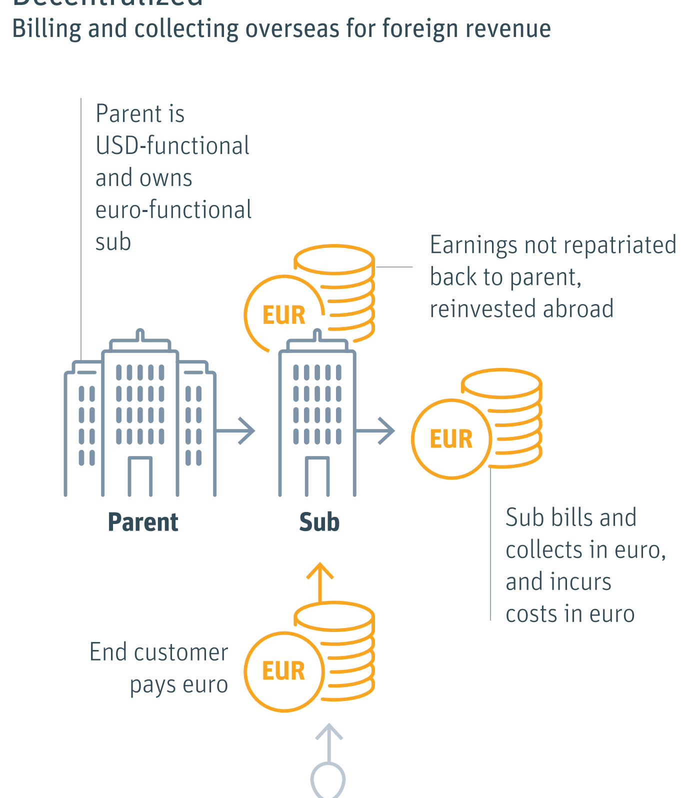
Centralized

Billing and collecting from US entity for foreign revenue



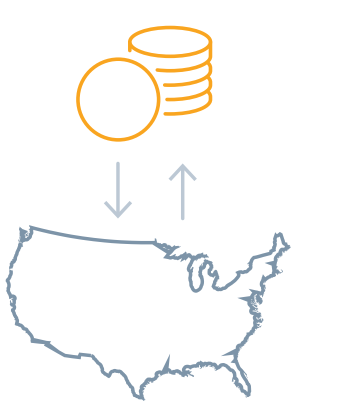
Decentralized

Billing and collecting overseas for foreign revenue



Tradeoffs related to FX risk management

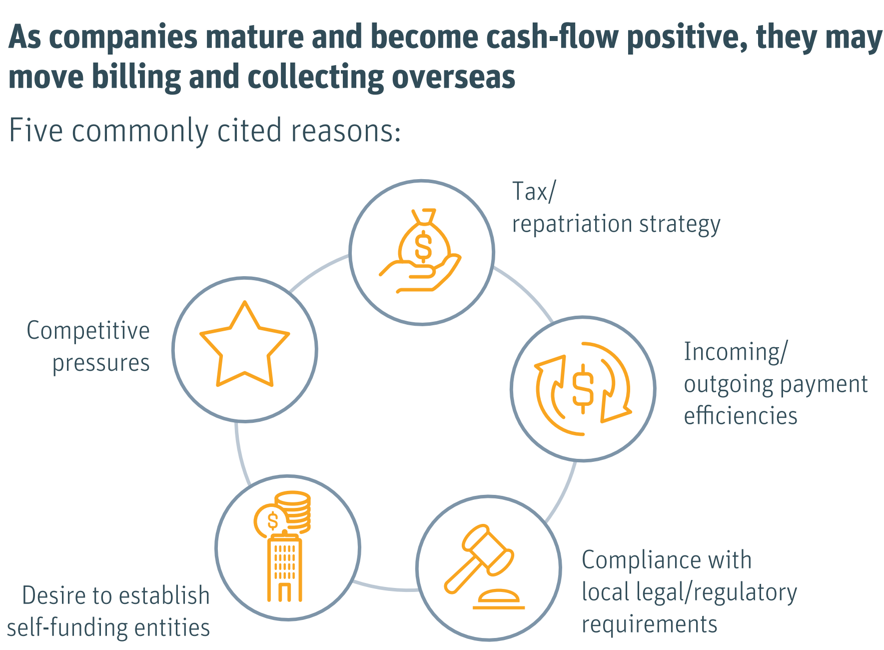
	Centralized	Decentralized	
Hedge accounting adoption benefit	More	Less	It is easier to quality for ASC 815 cash flow hedging treatment if revenues are denominated in a different currency than the functional currency of the entity.
Control of management KPI's	More	Less	Hedge accounting adoption yields greater control of management performance metrics such as top-line revenues, EBITDA, cash-burn rates, etc.
Translation FX exposure	Less	More	More FX exposure is created upon ASC 830 translation of foreign entities under decentralized structures where billing and collecting is done overseas.
Income statement FX volatility	More	Less	Billing non-USD revenue out of a US or USD-denominated entity makes the risk more visible when compared to situations in which billing and functional currencies match, however it is easier to manage.



Early-stage innovation companies generally operate with centralized global structures

As companies mature and become cash-flow positive, they may move billing and collecting overseas

Five commonly cited reasons:



Some early-stage firms are holding off on plans to transfer IP overseas until the full impact of tax reform has been understood.

Such decentralized billing and collecting structures, however, also may result in negative tradeoffs related to foreign currency risk management.

Later-stage companies that currently bill out of stand-alone foreign entities are assessing the benefits of US-centralization.

Want to discuss your specific situation?

Contact your SVB FX Advisor or the SVB FX team at fxadvisors@svb.com

1. Source: Dharmapala, Dhammika, C. Fritz Foley, and Kristin J. Forbes (2009). "Watch what I do, not what I say: The unintended consequences of the Homeland Investment Act". NBER Working Paper #15023.
2. Source: BofA Merrill Lynch Global Advisors. Responses from BofAML's 20th Risk Management Survey. Percentages do not add up to 100% since respondents can select more than one.
3. Source: Bloomberg query (SRCH <Go>).
4. Non-USD debt is often used to hedge the USD value of retained earnings in foreign subs (i.e. net investment hedging). Thus if cash is repatriated, hedges must be unwound.
5. Source: SVB FX Risk Advisory.
6. Moody's Investor Service: $1.3trn, US Joint Committee of Taxation: $2.6trn, Goldman Sachs: $3.1trn, etc.
7. According to the 2016 Triennial Central Bank Survey of foreign exchange and OTC derivatives markets published by the Bank of International Settlements.
8. Domestic tax rate on repatriated funds was cut to 5.25%, down from 35%.
9. According to Bureau of Economic Analysis. $300bn estimate is based on a 5x trailing 5-year average repatriation.
10. According to the 2016 Triennial Central Bank Survey of foreign exchange and OTC derivatives markets published by the Bank of International Settlements.
11. One other important reason the USD appreciated in 2005: Fed hiked rates 8 times that year.
12. Moody's report - "US Non-Financial Companies: Cash pile grows 9.2% to $1.84 trillion; tech extends lead over other sectors".

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