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The Effect of the Domestic Production Activities Deduction on Corporate Payout Behavior

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Abstract

The American Jobs Creation Act of 2004 created a tax holiday allowing firms to repatriate foreign earnings at a reduced tax rate and a domestic production activities deduction (DPAD) to encourage domestic investment. We investigate whether the DPAD affects firms' decisions to use repatriated earnings to increase investment versus shareholder payout. We find that firms receiving an incremental benefit from the DPAD decrease payout by approximately \$7.2 billion whereas firms receiving no incremental benefit from the DPAD increase payout by approximately \$18.3 billion. This suggests that, under certain conditions, firms retain repatriated funds which may lead to increased domestic investment.

Keywords: Corporate Taxation, Payout Policy, Repurchases, Section 199

JEL Classification: G35, H20, H25

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