114TH CONGRESS 2ND SESSION

SENATE
ORRIN G. HATCH, UTAH
CHAIRMAN
CHUCK GRASSLEY, IOWA
MIKE CRAPO, IDAHO
RON WYDEN, OREGON
DEBBIE STABENOW, MICHIGAN

HOUSE
KEVIN BRADY, TEXAS
VICE CHAIRMAN
SAM JOHNSON, TEXAS
DEVIN NUNES, CALIFORNIA
SANDER M. LEVIN, MICHIGAN
CHARLES B. RANGEL, NEW YORK

THOMAS A. BARTHOLD
CHIEF OF STAFF

BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF

Congress of the United States
JOINT COMMITTEE ON TAXATION
502 FORD HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621
http://www.jct.gov

AUG 3 1 2016

Honorable Kevin Brady
U.S. House of Representatives
301 Cannon House Office Building
Washington, D.C. 20515

Honorable Richard Neal
U.S. House of Representatives
341 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Brady and Mr. Neal:

This letter is in response to your request of August 25, 2016, for an estimate of the total amount of undistributed, non-previously-taxed post-1986 foreign earnings of foreign corporations, taking into account earnings attributable to all 10-percent U.S. shareholders of such foreign corporations.

Under present law, domestic corporations generally are taxed on their worldwide income, including income earned from the direct conduct of a foreign business by the domestic corporation (by means of direct sales, licensing or branch operations in the foreign jurisdiction) or through a pass-through entity such as a partnership. Income earned indirectly by domestic corporations from the foreign operations conducted by their foreign corporate subsidiaries is generally not subject to U.S. tax until the income is distributed to the domestic parent corporation. Thus, the U.S. tax on foreign earnings of foreign corporate subsidiaries is said to be "deferred" unless it is otherwise captured by the anti-deferral regime of subpart F. U.S. corporations can claim a foreign tax credit for income taxes paid to foreign countries on any income that is taxed either because it is voluntarily repatriated or is captured by subpart F.

The ability to defer the tax on some foreign earnings creates an incentive for corporations to reduce the amount of money that they otherwise would repatriate to the parent corporation. In addition, under U.S. GAAP principles, the earnings of a foreign subsidiary are generally included in the consolidated financial statements of the U.S. parent during the period in which they are earned. However, for U.S. tax purposes, tax is deferred for earnings that are not distributed to the U.S. parent or otherwise includible, such as under subpart F. These undistributed earnings of a foreign subsidiary that are included in financial statement consolidated income but which are deferred from U.S. taxation represent a temporary difference for which a tax liability and associated tax expense is currently accrued, unless the relevant tax

laws provide a means by which the investment in the subsidiary can be recovered tax-free.[1] It is generally presumed for U.S. GAAP purposes that all undistributed earnings of a foreign subsidiary will be repatriated to the U.S. parent entity.

A firm may overcome the presumption that it will repatriate all undistributed earnings of a foreign subsidiary to the U.S. parent company by providing evidence of specific plans for reinvestment of the undistributed earnings that demonstrate that remittance of the earnings will be postponed indefinitely and by demonstrating that the U.S. parent company has adequate cash flows from other sources and will not require remittances from the foreign subsidiary. These criteria required to overcome the presumption are sometimes referred to as the "indefinite reversal criteria."[2]

When a parent entity makes an assertion regarding its intent to indefinitely reinvest foreign earnings, and has demonstrated its ability to do so, it is required to disclose the gross amount of foreign earnings in the footnotes of its financial statements. The parent entity is also required to disclose the nature of events that would give rise to taxation of the earnings in the parent jurisdiction, as well as an estimate of the tax liability associated with the foreign earnings or a statement that providing a reasonable estimate of the tax liability is impractical.

Management of each multinational firm makes a decision and reports in its financial statement regarding its indefinite reinvestment posture based on its facts. Some firms assert indefinite reinvestment of all untaxed (that is, non-subpart F) foreign earnings. Other firms assert indefinite reinvestment of some, but not all, of their foreign earnings. However, their actual repatriation of taxable dividends in any given period may be less than the amount of earnings in respect of which they have accrued a U.S. tax liability for financial statement purposes. The decision to accrue a U.S. tax liability on foreign earnings does not indicate that earnings will be repatriated in the current year. Some firms may not assert indefinite reinvestment of any foreign earnings and therefore accrue a U.S. tax liability with respect to all these earnings irrespective of the amount of their actual repatriations. Because U.S. GAAP rules related to recognition of income and tax amounts in relation to undistributed foreign earnings are

---

[1] Accounting Standards Codification ("ASC") 740-30-25-3.

[2] ASC 740-30-25-17.

not based on whether a firm actually repatriates these earnings, financial statements may not allow clear inferences about the amount of a firm's actual repatriations.

The decision to assert indefinite reinvestment with respect to foreign earnings does not necessarily mean that the firm has not used the earnings in the United States. Specifically, it is believed that some firms have made an indefinite reinvestment assertion for financial statement purposes, even while using the earnings in the United States, whether on a temporary basis or otherwise, so long as the use of the earnings does not give rise to a current taxable inclusion for U.S. tax purposes. One example is a position taken by taxpayers that certain short-term CFC loans to the U.S. parent do not give rise to a current taxable inclusion under relevant IRS guidance, and therefore this use of earnings does not conflict with their assertion regarding indefinite reinvestment.

If a parent entity has asserted indefinite reinvestment of foreign earnings, it must record in its financial statements a tax liability in respect of undistributed earnings if it subsequently plans to or actually repatriates these earnings. To the extent that a firm's managers are concerned with increases in the firm's reported U.S. tax expense, and the corresponding decrease in the firm's earnings per share, managers may delay the repatriation of foreign earnings. Some commentators therefore have observed that the financial accounting rules provide an incentive to delay repatriations. On the other hand, the residual U.S. tax on earnings repatriations may also discourage firms from paying dividends from foreign subsidiaries to U.S. parent companies. The extent to which these tax and financial accounting rules distort decisions whether to reinvest or repatriate earnings may vary from one firm to another. The most recent year for which we have tax return data reporting the amount of undistributed post-1986 not previously taxed earnings and profits is 2012. The Statistics of Income Division of the Internal Revenue Service has reported that the end of year accumulated amount of undistributed earnings and profits for CFCs was $2.3 trillion. Given ordinary growth of the world economies and corporate earnings and profits, we estimate that undistributed post-1986 not previously taxed earnings for 2015 were approximately $2.6 trillion.

There are a couple important caveats to the estimated $2.3 trillion. First, the undistributed earnings may include more than just cash holdings as corporations may have reinvested their earnings in their business operations, such as by building or improving a factory, by purchasing equipment, or by making expenditures on research and experimentation. Second, the $2.3 trillion only includes controlled foreign corporations and only the amount attributable to

any 10 percent or greater shareholder. It does not include the undistributed earnings of non-controlled section 902 corporations (so-called ("10-50 companies")). Due to differing filing requirements, data do not exist on the untaxed earnings and profits attributable to U.S. 10-percent shareholders of 10-50 companies, but we believe that the amount of these earnings is significantly smaller than the amount of untaxed earnings of CFCs, maybe less than one percent of that latter amount

Media reports of the amount of overseas earnings often rely on the amount of earnings designated on public financial statements as being indefinitely reinvested abroad. We have described above the ways in which indefinitely reinvested earnings amounts do and do not overlap with the amounts of untaxed foreign earnings. Audit Analytics estimates that publicly traded corporations in the Russell 1000 had $1.8 trillion in indefinitely reinvested earnings in 2012 and $2.4 trillion in 2015.[3]

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

---

[3] http://www.auditanalytics.com/blog/indefinitely-reinvested-foreign-earnings-still-on-the-rise/.