TAX SAVINGS ON REPATRIATIONS OF FOREIGN EARNINGS UNDER THE JOBS ACT

By Susan M. Albring, Ann C. Dzuranin, and Lillian F. Mills

Susan M. Albring is an assistant professor at the University of South Florida. Ann C. Dzuranin is a Ph.D. student at the University of South Florida, and Lillian F. Mills is an associate professor at the University of Arizona.

In this report the authors estimate the incremental tax savings from the 85 percent deduction for cash dividends from permanently reinvested earnings under the American Jobs Creation Act of 2004. Using 2,196 corporations that report foreign assets or foreign sales in 2002, they find that 282 corporations both report an amount of permanently reinvested earnings and have a foreign tax rate of less than 35 percent. Without the Jobs Act, those 282 firms would have paid an estimated incremental U.S. tax of $46 billion on repatriation. Under the Jobs Act, those firms would save $39 billion, resulting in incremental tax of $7 billion on immediate repatriation.

The authors appreciate helpful comments from Courtney Edwards, Linda Krull, Ernest Larkins, and Edmund Outslay, and discussions with Rosanne Altshuler, David Guenther, Edward Maydew, and Richard Sansing. Rohit Singh provided able research assistance, as did various master of accounting students at University of Arizona and MBA students at the University of South Florida.

Table of Contents

I. Introduction

As part of the American Jobs Creation Act of 2004 (Pub. L. 108-357), Congress provided U.S. multinational corporations with a temporary reduction in the U.S. tax imposed on certain dividends repatriated from their foreign subsidiaries.[1] The stated reason for the tax benefit was to stimulate the U.S. economy by triggering the repatriation of foreign earnings that would otherwise have remained abroad.[2] Since the beginning of 2005, U.S. multinational corporations have begun disclosing their plans to repatriate cash dividends from their foreign subsidiaries along with their estimated net U.S. tax liabilities from that repatriation. Unstated is the tax benefit (tax cost) to the U.S. corporation (U.S. Treasury) from taking advantage of the benefit. It is premature to

[1]New Internal Revenue Code section 965 allows a one-time deduction in 2004 or 2005 (for calendar-year companies) of 85 percent of foreign earnings repatriated to U.S. parent companies via extraordinary cash dividends. In effect, U.S. corporations will temporarily be taxed at a maximum effective rate of 5.25 percent on repatriations of foreign earnings compared to the top corporate statutory tax rate of 35 percent, for a savings of 29.75 percentage points or 85 percent. However, most corporations will receive a smaller net savings than 29.75 percent, because they would have received a foreign tax credit absent the 85 percent deduction.

[2]150 *Cong. Rec.* S11019, S11038 (Oct. 4, 2004). The Jobs Act reduces tax relative to the tax that would otherwise be collected on repatriations of foreign earnings. However, if those earnings would never be repatriated, any tax paid due to the Jobs Act deduction is a net increase to government revenues. Further, the tax collections in 2004 and 2005 may still represent a net present value increase to government revenues, if the Jobs Act generates more tax now (even at a lower effective tax rate) than the present value of future government revenues at a higher tax rate.

quantify the total amount of repatriations, let alone analyze whether the cash will be used to achieve Congress's intended effect. However, sufficient data exist to estimate the potential cost to U.S. taxpayers if U.S. multinational corporations repatriate their foreign earnings eligible for the benefit. We estimate that cost by examining 2,196 financial statements for all U.S. publicly traded corporations that report foreign sales or foreign assets in 2002.

Only 678 corporations report in their 2002 financial statements a dollar amount of permanently reinvested earnings, aggregating $426 billion. Of those corporations, only 282 have a current foreign tax rate of less than 35 percent, implying that they would have paid incremental U.S. tax on repatriation net of foreign tax credits. Absent the provisions of the Jobs Act, we estimate that those 282 firms would have paid an incremental U.S. tax of $46 billion if they immediately repatriated 100 percent of their permanently reinvested earnings of $318 billion.[3] After considering the provisions of the Jobs Act, those firms would likely pay $7 billion of tax.[4] Thus, we estimate a potential incremental $39 billion tax savings ($46 - $7) for the 282 corporations that both report an amount of permanently reinvested earnings and have a foreign tax rate of less than 35 percent.

We use disclosures in public financial statements (as originally issued, not as restated) for all U.S. corporations that report foreign assets or foreign sales to estimate the dollar amount of tax savings from repatriating permanently reinvested earnings. Dividends eligible for the 85 percent deduction may not exceed the greater of $500 million or the amount disclosed as permanently reinvested on the U.S. parent corporation's most recently audited financial statement certified on or before June 30, 2003.[5] As we discuss in Part VIII below, our estimate ignores two technical provisions that we expect have offsetting effects: the requirement that qualifying dividends exceed a base period amount and the ability for taxpayers to choose which dividends apply to the base period versus qualify for the 85 percent deduction.

In January 2005, Bear Stearns analyzed the S&P 500 firms and estimated they had $420 billion of unrepatriated earnings at the end of 2002.[6] Investigating another 1,500-plus firms increases the aggregate estimate only by another $6 billion, suggesting that the largest firms capture the vast majority of the economic benefit. We briefly review the political background, tax, and accounting rules before discussing our estimation method and results.

II. Background Preceding the Jobs Act

The lobbying for reduced tax on repatriating foreign earnings started several years ago. "For the past two years, a group of mostly tech and pharmaceutical multinationals with huge overseas stashes of profits, calling themselves the Homeland Investment Coalition, argued the law would create 'hundreds of billions of dollars in private investment . . . allowing U.S. companies to remake themselves and create new and better jobs within the United States.'"[7] Appendix A provides a list of companies and associations comprising the Homeland Investment Coalition as of November 13, 2003 and indicates which of those members are in our sample. Technology companies and pharmaceutical companies were expected to be the biggest benefactors from this new legislation, because companies with intangible products would have been more easily able to shift earnings to lower-tax jurisdictions in prior years.[8] Thus, they are more likely to have postponed repatriating those earnings to avoid the incremental U.S. tax.

Existing empirical research provides evidence consistent with the tax burden of repatriation trapping funds overseas. Hartzell, Titman, and Twite (2005) provide evidence that firms' cash holdings during 1984-2002 are related to having foreign tax rates less than U.S. rates. Relatedly, Albring (2005) finds that firms facing tax repatriation costs issue debt rather than repatriate foreign

---

[3]For each corporation contributing to the aggregate earnings of $426 billion, we estimate the incremental tax as the [amount of earnings ÷ (1 - foreign tax rate)] x [0.35 - foreign tax rate] for firms with foreign tax rate < 0.35. *See* the subsequent section on *Tax Savings Estimate* for more detail on our method.

[4]$39 billion = 0.85 x [aggregate of $P_R_E ÷ (1 - *Foreign_CurrentETR*)] x (0.35 - *Foreign_CurrentETR*).

[5]We examine 2002 financial statements for fiscal years April through December. We examine 2003 financial statements for fiscal years January through March.

As discussed in more detail below, section 965(b)(1)(C) provides an alternative limit for taxpayers that do not disclose the amount of permanently reinvested earnings but disclose the amount of tax due on repatriation of reinvested earnings. We consider that provision in constructing our estimates.

[6]We compare our estimates to those of Bear Stearns as follows: 296 of our sample firms are in the S&P 500 as of 2002. For those firms, the permanently reinvested earnings are $381

(Footnote continued in next column.)

billion. The Bear Stearns study (Exhibit 1) lists the 20 largest amounts of unrepatriated foreign earnings for 2002. We confirm those amounts in our sample with the exception of Chevron-Texaco, whose $10,108 billion of earnings is not included in our aggregate measure. Chevron-Texaco does not report either foreign assets or foreign sales so it is not included in our initial selection.

Other estimates have appeared in the business press. "Tax Break May Be Too Flexible: Law to Encourage Firms to Use Overseas Profits for U.S. Jobs Shows Cracks," *The Wall Street Journal*, Feb. 15, 2005, p. C3, cites a J.P. Morgan analysis from 2004 that estimates the unrepatriated earnings to be $550 billion in 2002. *The Wall Street Journal,* Jan. 14, 2005, p. A2, cites an analysis by Greg Kelly of Susquehanna Financial Group that suggests U.S. companies have earmarked about $320 billion for repatriation. *Business Week,* Nov. 8, 2004, p. 36, cites a survey conducted by J.P. Morgan Chase during 2003 that "over 50 percent of respondents said they would repatriate nearly all their foreign profits if the plan were enacted. The bank expects that nearly $300 billion of a potential $500 billion in eligible earnings will be repatriated in 2005."

[7]"Tax Windfall May Not Boost Hiring Despite Claims: Some Companies Plan to Use New Tax Break on Foreign Profits for Debt and Other Needs," *The Wall Street Journal*, Oct. 13, 2004, p. A12.

[8]*See, e.g.*, Grubert and Slemrod (1998), who show that firms with intangible assets are more successful at shifting income to Puerto Rico.

earnings as the level of estimated foreign internal funds increases. Appendix B uses excerpts from Schering-Plough's financial statements to illustrate the effect of this constraint on working capital needs.[9]

III. Application of Tax Rules

Section 965, a Jobs Act provision, allows a U.S. corporation to elect to deduct 85 percent of certain ''cash dividends'' it receives from controlled foreign corporations. See Blessing (2004) for a detailed and thorough technical analysis of section 965. With a top statutory rate of 35 percent, the 85 percent deduction results in a maximum effective rate of 5.25 percent (= 35 percent x (1 - 85 percent)). Dividends eligible for the 85 percent deduction cannot exceed the greater of 1) $500 million, 2) the dollar amount of permanently reinvested earnings disclosed in the taxpayer's financial statements, or 3) the disclosed potential tax liability on the disclosed permanently reinvested earnings divided by 0.35 (section 965(b)(1)).[10] Section 965(c)(1) references the taxpayer's most recent audited financial statement filed with the Securities and Exchange Commission on or before June 30, 2003 (or, if SEC filing is not required, certified on or before that date as prepared in accordance with generally accepted accounting principles and used as a statement or report to creditors, to shareholders, or for any other substantial nontax purpose).

One requirement of section 965 is that the repatriated funds must be invested by the company in the U.S. under a domestic reinvestment plan approved by company management before the funds are repatriated. Treasury (2005) provided technical guidance on reinvestment plans in Notice 2005-10. Eligible investments including worker hiring and training, infrastructure, research and development, capital investments, and the financial stabilization of the corporation, including debt repayment and acquisitions of U.S. companies, but not stock redemptions, executive compensation, or dividends. We provide examples of several firms' repatriation plans from their 2004 financial statements in Appendix C. Those disclosures vary. Eli Lilly discloses the expected repatriation amount, likely tax, and its reinvestment plan. In contrast, General Electric discloses that it does not expect to repatriate dividends because the foreign earnings are invested in active foreign business assets. The several firms we examined include disclaimers about waiting for the promised Technical Corrections Bill and additional guidance before they can refine (or even make) their estimates.

IV. Applicable Financial Accounting Rules

U.S. GAAP generally require corporations to record all incremental U.S. income tax and foreign withholding taxes on foreign earnings in the current period. Included in that amount are U.S. deferred taxes that will not be payable until foreign earnings are repatriated. However, Accounting Principals Board Opinion No. 23 (APB 23) offers an exception. If past experience or specific future plans of indefinite postponement provide evidence that the subsidiary intends to reinvest the undistributed earnings indefinitely (or that the earnings would be repatriated tax-free) deferred taxes need not be recorded. Consistent with most commentary concerning APB 23 and section 965, we refer to those earnings as ''permanently reinvested.''[11]

APB 23 allows managers considerable flexibility in designating earnings as permanently reinvested in foreign subsidiaries. As a result of not recording deferred tax expense, reported net income will be higher. However, Collins et al. (2001) find that the positive deferred tax liability associated with permanently reinvested earnings is capitalized in current stock prices. Consistent with the flexibility APB 23 provides, Krull (2004) finds that year-to-year changes in the amounts reported as permanently reinvested are related to the difference between analysts' forecasts and premanaged earnings.

Statement of Financial Accounting Standards No. 109 (FAS 109), ''Accounting for Income Taxes,'' provides for the comprehensive recognition of deferred taxes. FAS 109 requires corporations to disclose the amount of permanently reinvested earnings and taxes related to those earnings. The disclosure is cumulative over time and for all foreign subsidiaries. FAS 109 essentially ''grandfathered'' the provision of APB 23. FAS 109 requires that a corporation disclose the amount of tax related to permanently reinvested earnings if it is material and if ''determination of that liability is practicable or a statement that determination is not practicable.'' As a result of that latter clause, many corporations regularly disclose the amount of permanently reinvested earnings but do not disclose the associated deferred tax liability. Emerging Issue Task Force Bulletin 93-16 clarified that the deferral applied only to ''outside basis differences'' — that is, to unpaid dividends.

How does the Jobs Act affect financial reporting? We consider: 1) firms that fully repatriated earnings in prior years, 2) firms that reinvested some or all earnings and fully recorded deferred taxes, and 3) firms that reinvested some or all earnings and did not record deferred taxes because the earnings were permanently reinvested.

If a firm had fully repatriated earnings in prior years, that firm already paid any incremental U.S. tax and recorded it as a financial statement expense. Such a firm derives no benefit from the Jobs Act. Like in other ''tax amnesty'' programs, taxpayers that had previously paid taxes in full are disadvantaged compared to taxpayers

[9] Outslay (2005) provides this pointed example of the cash constraint in his discussion notes.

[10] Because the deferred tax liability would be recorded at the incremental U.S. tax rate (35 percent net of foreign tax credits), dividing by 35 percent would substantially understate the reinvested earnings. Sen. Chuck Grassley, R-Iowa, has since commented that this was a good point and encouraged Treasury to issue guidance that permits taxpayers to more accurately reflect the earnings permanently invested offshore. 150 Cong. Rec. S11019, S11036 (Oct. 4, 2004) and Peter H. Blessing, ''Bringing It All Back Home: Earnings Repatriations Under the U.S. Jobs Act,'' *Tax Notes,* Nov. 15, 2004, p. 965.

[11] Section 965(b) refers to the amount of ''permanently'' reinvested earnings. However, the original language of APB 23 refers to ''indefinitely'' reinvested earnings.

that wait for the tax benefit. Further, domestic companies without foreign operations obtain no similar benefit.[12]

If a firm had reinvested earnings and had fully recorded deferred taxes, it will enjoy both an incremental tax benefit and a financial reporting benefit. By paying tax at a lower rate than they had recorded the tax expense in prior years, those firms will recognize financial statement income. Those benefits help to offset the cash cost of accelerating the tax payment.

Finally, if a firm had reinvested earnings, but had not recorded any deferred tax expense, the firm must record tax expense (although at a reduced rate) when the earnings are repatriated. The financial statement cost, added to the cost of accelerating the U.S. incremental tax, may dissuade some firms from taking advantage of a one-time lower tax rate on repatriations.

The above descriptions have little application to firms who are paying taxes at rates higher than the United States. High-tax foreign earnings, whether repatriated or not, would not generate incremental U.S. income taxation due to foreign tax credits.

V. Tax Savings Estimate

We estimate tax savings for the 2,196 U.S. companies that report foreign assets or sales on the 2002 Compustat Geographic Segment database. Because Compustat generally includes only publicly traded companies, we are unable to estimate the tax savings for privately held corporations. We read tax footnotes, significant accounting policies, and other tax disclosures from financial statements filed on or before June 30, 2003. We record whether each firm discloses that it permanently reinvests earnings and whether it discloses the dollar amount of those earnings and/or the estimated tax liability associated with repatriating those earnings.

We estimate the potential tax savings taking into account estimated foreign tax credits (FTCs) that a U.S. taxpayer would otherwise claim. Specifically, we measure the savings as follows:

First, we gross-up the expected dividend to pretax amounts:[13]

$$Pretax\_Dividend = \$P\_R\_E \div (1 - Foreign\_Tax\_Rate) \quad (1)$$

Where $\$P\_R\_E$ is the amount of permanently reinvested earnings that will be repatriated.

We then estimate the incremental U.S. tax (for profitable companies) before the Jobs Act 85 percent deduction, assuming all permanently reinvested earnings is general limitation basket income:[14]

$$Pretax\_Dividend \times (35\% - Foreign\_Tax\_Rate) \quad (2)$$

If Congress passes the expected Technical Corrections provisions to make the section 78 gross-up eligible for the deduction, the 85 percent deduction equals:[15]

$$85\% \times Pretax\_Dividend \quad (3)$$

After the Jobs Act, the taxable dividend equals:

$$Pretax\_Dividend \times (1 - 85\%) = 15\% \times Pretax\_Dividend \quad (4)$$

The new incremental U.S. tax will be:

$$15\% \times Pretax\_Dividend \times (35\% - Foreign\_Tax\_Rate) \quad (5)$$

The tax savings from the Jobs Act equals:

$$85\% \times Pretax\_Dividend \times (35\% - Foreign\_Tax\_Rate) \quad (6)$$

In estimating the *Foreign_Tax_Rate*, we use *Foreign_CurrentETR*, defined as the sum of foreign current tax expense from year t-4 to t divided by the sum of foreign pretax income from year t-4 to t. We use a multiyear measure of foreign tax rate because the computation of deemed paid taxes under section 902(a) attaches to each dividend the amount of post-1986 foreign income taxes its foreign subsidiary actually pays in proportion to the percentage of the subsidiary's post-1986 earnings and profit it receives. We believe the five-year accumulation is a reasonable compromise between using the most recent year and attempting to include some or all of the tax and earnings since 1986, which would impose sample survival bias.[16] We consider an estimate of dividend withholding tax in a supplemental test, which would generally increase foreign tax credits and reduce the incremental tax benefit of the 85 percent deduction. In

[12]"[T]he Administration also has concerns regarding the fairness of the repatriation provision included in both bills. This provision would offer international corporations a partial 'tax holiday' for repatriating foreign income that is currently held overseas. U.S. companies that do not have foreign operations and have already paid their full and fair share of tax will not be able to benefit from this provision." 150 *Cong. Rec.* S11030 (Oct. 4, 2004). *See* Alm (1998) and Alm and Beck (1993) for discussions of tax amnesty.

[13]Section 78 requires that dividends be grossed-up to pretax earnings and profits that generated the dividend. Unfortunately, section 965 does not reduce the section 78 gross-up by 85 percent. However, the chairs of the Senate Finance and House Ways and Means Committees have pledged that Congress would pass a technical corrections bill to achieve that result. For purposes of our estimates, we assume that the entire pretax dividend, including gross-up, will be eligible for the 85 percent deduction.

[14]Seven firms with *Foreign_Pretax* less than zero are included in our tax savings estimates. We include those firms because *Foreign_Pretax* is the sum of five years foreign pretax income. Although the sum may be negative, the firm may not be in a loss position when the earnings are actually repatriated.

[15]We consider the provision that only cash dividends in excess of "base period dividends" qualify for the deduction in supplemental tests. Thus, in our formulaic simplification, we assume that the taxpayer had paid no dividends in the prior five years. We also ignore allocation and apportionment of U.S. expenses (such as interest expense or research and development expense) that would decrease the foreign tax credit limitation. A decreased foreign tax credit limitation is most likely to affect firms whose foreign tax rate is only slightly below the U.S. statutory rate.

[16]We appreciate Edward Maydew's suggestion to Hartsell et al. (2005) at the 2005 University of North Carolina Tax Symposium to use a five-year average for this estimate. Also, our five-year average also accounts for the effect of the five-year carryforward of foreign tax credits, and we thank Linda Krull for this insight. Foreign tax credits may be carried back two years and carried forward for five years, although there are limitations on the amount of creditable foreign taxes. The FTC limitation is calculated on an aggregate basis, rather than a country-by-country basis. In addition, the FTC limitation rules categorize income into various baskets. Each basket of income has a separate FTC limitation.

Table 1. Sample Selection	
Firms reporting foreign assets or foreign sales on 2002 Compustat Geographic Segment database	2,230
Firms with financial statements not available[a]	(34)
Final Sample	2,196
[a]Financial statements were obtained using Lexis/Nexis and the Edgar database.	

supplemental tests, we also use the foreign total tax expense, including both current and deferred taxes, to estimate *Foreign_Tax_Rate*.

For example, assume permanently reinvested pretax earnings in a foreign subsidiary equal $800, *Foreign_CurrentETR* equals 20 percent, and the U.S. parent is subject to the top U.S. statutory tax rate of 35 percent. Before the Jobs Act, if the subsidiary repatriates the $800 net earnings to the United States, grossed-up to a $1,000 taxable dividend, the gross U.S. tax would be $350 ($1,000 x 0.35 percent). The U.S. tax is decreased by $200 of deemed paid foreign tax credits ($1,000 x 20 percent). Hence the firm would owe $150 net U.S. tax ($350-$200). The incremental U.S. effective tax rate in this example is 15 percent ($150 ÷ $1,000).

During the tax holiday, if the firm repatriates the $800 of foreign earnings (grossed-up to $1,000) the firm receives a deduction of $850 (85 percent of the cash dividend, assuming a technical corrections bill qualifies the gross-up for deduction) and so is only taxable on $150. It computes gross U.S. tax on $150 x 35 percent = $52.50, which is the 5.25 percent maximum tax rate mentioned earlier. The U.S. tax is reduced by an FTC of $30 ($150 x 20 percent). Thus, the net U.S. tax is $22.50 ($52.50 - $30.00). The incremental U.S. effective tax rate under the new tax law, given a 20 percent foreign rate, is thus 2.25 percent ($22.50 ÷ $1,000). Hence the U.S. parent's tax savings from the new tax law is 12.75 percentage points (15 percent - 2.25 percent) [or 85 percent x (35 percent - 20 percent)].

In an example from our data, *Foreign_CurrentETR* for Pfizer Inc. equals 19 percent. Using equations (1)-(6), above the tax savings equals 13.6 percent [85 percent x (35 percent - 19 percent)]. Pfizer reports permanently reinvested earnings of $29 billion. Pfizer's grossed-up pretax dividend is $35.80 billion [$29 billion ÷ (1 - 19 percent)]. Its estimated tax savings is $4.87 billion [$35.80 billion taxable dividend x 13.6 percent tax rate savings].

In computing the net tax savings using equations (1) through (6) above, we limit *Foreign_CurrentETR* to the top U.S. statutory tax rate of 35 percent. We assume that a corporation with *Foreign_CurrentETR* > 35 percent does not pay incremental U.S. tax on its foreign dividends because it receives a full foreign tax credit and is in an excess credit position. Thus, we drop all firms with *Foreign_CurrentETR* > 35 percent from our sample when estimating the aggregate tax savings. We acknowledge that some of those firms might still enjoy a tax benefit from section 965 if they repatriate earnings only from low-tax countries. On the other hand, the Treasury could gain if some of those taxpayers forsake excess credits to use the repatriation deduction.

VI. Results

Table 1 indicates that we located 2,196 financial statements for firms reporting foreign assets or foreign sales in their 2002 Compustat Geographic Segment data. Table 2 presents a frequency distribution for our sample by industry, using one-digit standard industrial classification (SIC) codes. A total of 1,317 firms in our sample represent the manufacturing industry; 432 firms in the sample represent the hotel and services industries. We classify 674 firms as technology firms according to Bushee et al. (2003). There are 100 firms in the pharmaceutical subindustry.

Table 3 provides descriptive statistics on the variables in the sample. Average foreign assets, *FORAST*, for the 2,196 companies in our sample are $2,784.60 million. Of the 973 firms that disclose in the financial statement footnotes whether or not they permanently reinvest earnings, 31 do not permanently reinvest earnings in foreign subsidiaries while 942 permanently reinvest earnings.

Of the 942 firms that disclose that they permanently reinvest earnings, only 680 firms disclose the dollar amount of permanently reinvested earnings. The 680 firms that disclose the dollar amount of permanently reinvested earnings comprise approximately 31 percent of our total sample of 2,196 firms. Our sample differs from Krull (2004) where 280 firms out of 417 firms in the sample disclose the dollar amount of permanently reinvested earnings, representing 67 percent of the sample.[17] While we examine one year of financial statement data and select firms based on disclosure of foreign assets or foreign sales, Krull (2004) examines a longer time period, 1993-1999, and selects firms based on disclosure of foreign assets only.

Collins et al. (2001) examine publicly traded companies in 1993 and find that 8.9 percent, 340 out of the 3,800 companies reported on the National Automated Accounting Retrieval System (NAARS), disclose permanently reinvested earnings. Our sample has a higher percentage of firms that disclose the dollar amount of permanently reinvested earnings because we limit our sample to only firms that disclose foreign assets or foreign sales. Collins et al. (2001) find that 18 percent[18] of the companies that disclose permanently reinvested earnings also disclose the potential tax liability on permanently reinvested earnings. That is comparative to our sample in which 15 percent (105 firms divided by 678 firms) of the firms that disclose permanently reinvested earnings also disclose the potential tax liability on permanently reinvested earnings.

Advanced Medical Optics Inc. is an example of one of the 264 firms that did not disclose the dollar amount of

---

[17]Included in the 280 firms are 256 firms that always disclose *$P_R_E*, 12 firms that begin disclosing *$P_R_E* during the sample period, 11 firms that stop disclosing during the sample period, and 1 firm that discloses *$P_R_E* intermittently.

[18]Sixty companies in the sample disclose the potential tax liability on permanently reinvested earnings out of the 340 companies that disclose permanently reinvested earnings.

Table 2. Industry Distribution of 2,196 Companies That Report Foreign Assets or Foreign Sales on Compustat Geographic Segment Database for 2002

SIC Code	Industry Type	Number of Companies
1-999	Agriculture, Forestry, Fishing	8
1000-1999	Mining, Building	74
2000-2999	Manufacturing	346
3000-3999	Manufacturing	971[a]
4000-4999	Transportation, Communication, Electric, Gas	103
5000-5999	Wholesale, Retail	117
6000-6999	Financial Services	71
7000-7999	Hotels, Services	432
8000-8999	Services	67
9000-9999	International, Nonoperating	7
Total		2,196

[a]A total of 674 firms are in the Technology or Pharmaceutical industry. Specifically, 100 firms are in Pharmaceuticals (SIC code 2833-2836), 333 firms are in Computer or computer-related industries (SIC code 7370-7377) and 241 firms are in other Technology including; Electric Distribution Equipment (3612-3613), Electrical Industrial Apparatus (3621-3629), Household Audio & Video Equipment (3651-3652), Communications Equipment (3661-3669), Electron Tubes (3671), Printed Circuit Boards (3672), Semiconductors & Related Devices (3674), Magnetic & Optical Recording Media (3695), Telephone Communications (4812-4822), Radio & TV Broadcasting (4832-4899). Above coding of Technology and Pharmaceutical firms is consistent with Bushee *et al.*, (2003).

permanently reinvested earnings. Advanced Medical Optics Inc. (December 31, 2002 financial statements) discloses that "Deferred taxes have been provided for U.S. federal and state income taxes and foreign withholding taxes on the portion of undistributed earnings of non-U.S. subsidiaries expected to be remitted. Applicable foreign income taxes have also been provided." By not disclosing the amount of permanently reinvested earnings, firms like Advanced Medical Optics Inc. would have lost some tax benefit under the provisions of the Jobs Act if their reinvested earnings exceeded $500 million in 2002.

The average dollar amount of permanently reinvested earnings, *$P_R_E*, is $672.60 million for the 678 firms that disclose an amount. A total of 105 firms disclose the potential tax liability associated with permanently reinvested earnings, *P_R_ETAX*. Of these 105 firms, 88 firms also disclosed *$P_R_E*. The remaining 17 firms did not disclose *$P_R_E*.[19] Average *P_R_ETAX* for those 103 firms is $76.68 million.

We describe other tax attributes for those firms that disclose them, although not all 2,196 firms make each disclosure. Average foreign pretax income, *Foreign_PreTax*, is $266.99 million. Average current foreign tax, *Foreign_CurTax*, is $102.94 million and median current foreign ETR, *Foreign_CurrentETR*, is 28 percent. Average total foreign tax, *Foreign_TotalTax*, is $100.06 million and median total foreign ETR, *Foreign_TotalETR*, is 29 percent.

We estimate the potential tax savings in several steps. First, we estimate tax savings based on unrepatriated earnings disclosed in financial statements, again ignoring foreign tax credits. Next, we estimate tax savings based on disclosed unrepatriated earnings, assuming that each taxpayer claims a foreign tax credit at a rate equal to its 2002 foreign current effective tax rate.

Table 3 further shows that the median disclosed amount of *$P_R_E* is only $61.75 million, far less than $500 million. Only 117 firms disclose *$P_R_E* in excess of $500 million. *Foreign_CurrentETR*, *Foreign_TotalETR*, and *$P_R_E* are listed in Table 4 for those firms. For those 117 firms, the incremental tax benefit of the disclosure is substantial.

We calculate tax savings for each of the firms in our sample with *$P_R_E* greater than zero and *Foreign_CurrentETR* less than 35 percent. 282 out of the 678 firms that report *$P_R_E* fit this criteria. In contrast 396 firms that report *$P_R_E* show a foreign current effective tax rate equal to or greater than 35 percent, less than zero, or do not report sufficient data to compute the foreign tax rate. For the 282 firms that report foreign tax rates lower than 35 percent (but not less than zero), we estimate an aggregate potential incremental tax savings of $38.84 billion using Equation (1) and each firm's *$P_R_E* and *Foreign_CurrentETR*.

Omitting 114 firms with a missing foreign tax rate understates the incremental tax savings. To address missing values, we reestimate the tax savings by assuming those firms that report *$P_R_E* but no foreign tax rates have *Foreign_CurrentETR*= 0. This assumption generates a full 35 percent savings on the 85 percent deduction, which may overstate the incremental tax savings. For the 385[20] firms that report foreign tax rates lower than 35 percent, where missing foreign taxes are assigned a zero rate, we estimate an aggregate potential incremental tax

[19]The tax savings estimates to follow incorporate a grossed-up estimate of *$P_R_E* based on *P_R_ETAX* for these 17 firms. We divide *P_R_ETAX* by 0.35 for those 17 firms per section 965(b)(1)(c).

[20]We exclude Exxon from this analysis because per Table 4, note a, Exxon's tax rate is greater than 35 percent.

Table 3. Descriptive Statistics

Variable	N	Mean	Std. Dev.	Min.	Median	Max.	Sum
FORAST	556	2,784.60	28,884.51	0.001	53.39	575,244.00	1,548,240.18
FORSALE	1,640	803.85	4,616.42	0.004	63.58	141,274.00	1,318,314.23
P_R_E	973	0.97	0.18	0.00	1.00	1.00	942.00
$P_R_E	678	672.60	2,279.20	-61.40	61.75	29,000.00	426,021.10
P_R_ETAX	105	76.68	155.38	0.00	20.00	930.00	8,051.90
Foreign_CurrentTax	2,183	102.94	725.67	-68.00	2.39	25,279.00	224,715.80
Foreign_TotalTax	2,183	100.06	688.95	-221.04	2.21	23,421.00	218,440.44
Foreign_Pretax	2,183	266.99	1,627.83	-3,664.60	0.00	26,861.00	582,832.61
Foreign_CurrentETR	1,327	-0.00	11.82	-398.82	0.28	91.86	-5.69
Foreign_TotalETR	1,327	-0.14	13.87	-398.82	0.29	176.76	-180.28
Tax_Savings	282	139.90	446.89	0.00	15.95	4,930.43	38,835.25

The variables are defined as follows ($ amounts in millions): FORAST = total foreign assets. FORSALE = total foreign sales. P_R_E = dummy variable coded 1 if firm permanently reinvests earnings, 0 otherwise. $P_R_E = dollar level of permanently reinvested earnings. The $P_R_E measure includes permanently reinvested earnings for all foreign subsidiaries and is cumulative over time. P_R_ETAX = potential tax liability on permanently reinvested earnings. Foreign_CurrentTax = sum of current foreign taxes from year t-4 to t. Foreign_TotalTax = sum of current and deferred foreign taxes from year t-4 to t, where deferred tax is zero if missing. Foreign_Pretax = sum of foreign pretax income from year t-4 to t. Foreign_CurrentETR = Foreign_CurrentTax/Foreign_Pretax. Foreign_TotalTax = Foreign_TotalTax / Foreign_Pretax. Tax_Savings estimate for firms in our sample with $P_R_E greater than zero and Foreign_CurrentETR less than 35 percent using Equation (1) and each firm's $P_R_E and Foreign_CurrentETR. The sample of 2,196 firms comprises all firms that report foreign assets or foreign sales for the 2002 tape year on the Compustat geographic segment tape. The financial data are reported on hand-collected financial statement tax footnotes for fiscal years from Apr. 30, 2002 through Mar. 31, 2003.

savings of $46.55 billion using Equation (1) and each firm's *$P_R_E* and *Foreign_CurrentETR*.

Technology and pharmaceutical companies were expected to be the biggest benefactors from this new legislation. Of the 674 technology and pharmaceutical firms that comprise 30.7 percent of our sample that report either foreign assets or foreign sales, only 239 disclose that they have permanently reinvested earnings, and 152 of those disclose the amount. The aggregate permanently reinvested earnings for those technology and pharmaceutical firms are $159 billion (37.4 percent of the earnings in our sample). Thus, although technology and pharmaceutical firms clearly benefited, they do not dominate the sample or the reinvested earnings.

However, technology and pharmaceutical companies do capture a relatively higher proportion of the tax benefit. Eighty-five of the 152 firms that report *$P_R_E* have *Foreign_CurrentETR* equal to or greater than 35 percent or do not report sufficient data to compute the foreign tax rate. For the remaining 67 firms whose *Foreign_CurrentETR* is below 35 percent, we estimate an aggregate potential incremental tax savings of $19.38 billion. That tax savings represents 50 percent ($19.38 billion divided by $38.84 billion) of the tax savings for our sample, although technology and pharmaceutical firms used in this estimate represent only 24 percent (67 firms divided by 282 firms) of the firms used in the calculation.

We next consider whether we can make any reasonable speculations about the 1,223 firms that report foreign assets or foreign sales on Compustat, but made no disclosure concerning permanently reinvested earnings in their financial statements. The fact that some firms disclose that they recorded incremental U.S. deferred taxes on unrepatriated earnings (even if they do not disclose the amount) suggests that firms that choose this conservative approach will disclose it to their shareholders. Thus, we speculate that few firms would record material deferred taxes on unrepatriated earnings but not disclose their policy. If so, the amount of net tax savings related to firms that do not disclose the presence of permanently reinvested earnings would be small.

In summary, we estimate zero tax savings for 1,518 firms that did not disclose *$P_R_E* and for 396 firms with $P_R_E greater than zero and *Foreign_CurrentETR* greater than 35 percent. We estimate $39 billion tax savings for the 282 firms with *$P_R_E* greater than zero and *Foreign_CurrentETR* less than 35 percent.

VII. Supplemental Tests

A. Alternative Measure of Foreign Tax Rate

Foreign current tax expense provides a reasonable proxy for foreign taxes paid, but foreign pretax income could differ from foreign pretax earnings and profits. As an alternative measure that ignores the effect of temporary differences, we also use foreign total tax expense including both current and deferred taxes, to estimate the gross-up and foreign tax credit.[21]

We estimate the tax savings for each of the firms in our sample with *$P_R_E* greater than zero and *Foreign_TotalETR* less than 35 percent. Omitting firms with missing data understates the incremental tax savings. For the 271 firms that report foreign tax rates lower than 35 percent, we estimate an aggregate potential incremental tax savings of $39.36 billion. Our prior estimate using

[21]We appreciate conversations with David Guenther on this point.

Foreign_CurrentETR was $38.84 billion. Thus, the measurement of tax savings is not sensitive to our foreign tax rate assumptions.

We reestimate the tax savings when *Foreign_TotalETR* is less than 35 percent as if the firms with missing foreign tax rates have a zero foreign tax rate, thus obtaining a full 35 percent savings on the 85 percent repatriation. For the 374[22] firms that report foreign tax rates lower than 35 percent, when missing foreign taxes are assigned a zero rate, we estimate an aggregate potential incremental tax savings of $42.98 billion.

B. Foreign Withholding Taxes

The foreign tax rate we estimate using Compustat data ignores potential withholding taxes. If we assume that the average withholding tax rate on dividends is 5 percent, the available foreign tax credit rate increases from *Foreign Tax Rate* to *Foreign Tax Rate* + 5 percent (1 - *Foreign Tax Rate)*, or 95 percent *Foreign Tax Rate* + 5 percent, because the dividend withholding tax applies to the cash dividend, not to the pretax earnings and profits. Based on this higher *Foreign Tax Rate w/WH*, only 247 corporations have a foreign rate less than 35 percent. For those corporations, we estimate the tax benefit under the Jobs Act at $29 billion.

C. Absence of Technical Correction

We also estimate the tax savings assuming Congress does not pass the expected Technical Corrections provision to make the section 78 gross-up eligible for the deduction (150 *Cong. Rec.* S11036, Oct. 4, 2004). Thus, we do not gross-up the expected dividend to pretax amounts. Under that assumption, the tax savings from the Jobs Act equals:

85% x $*P_R_E* x (35% - *Foreign_Tax_Rate*) (7)

We estimate the tax savings for each of the firms in our sample with *$P_R_E* greater than zero and *Foreign_CurrentETR* less than 35 percent. Omitting firms with missing data understates the incremental tax savings. For the 282 firms that report foreign tax rates lower than 35 percent, we estimate an aggregate potential incremental tax savings of $31.54 billion.

D. Alternative Gross-Up of Disclosed Tax

The Jobs Act provides that if corporations disclosed the expected tax on permanently reinvested earnings rather than the amount of earnings, the eligible dividends would be limited to the disclosed tax divided by 35 percent (or $500 million if greater). However, the incremental tax burden is likely less than 35 percent, so this computation understates permanently reinvested earnings. Corporations have asked for a technical corrections bill to correct this underestimate. Thus, we reestimate the tax savings incorporating a grossed-up estimate of *$P_R_E* based on *P_R_ETAX* by dividing *P_R_ETAX* by (35 percent - *Foreign_CurrentETR)* for the 17 firms that do not disclose *$P_R_E* but disclose *P_R_ETAX.* We estimate the tax savings for each of the firms in our sample with *$P_R_E* greater than zero and *Foreign_CurrentETR* less than 35 percent. Omitting firms with missing data understates the incremental tax savings. For the 282 firms that report foreign tax rates lower than 35 percent, we estimate an aggregate potential incremental tax savings of $39.38 billion.

VIII. Limitations

A. Sample

Our initial sample selection is based on a firm reporting either foreign assets or foreign sales on the Compustat geographic segment file. We selected the sample to identify public corporations with material foreign subsidiaries. However, the omission of Chevron-Texaco from our sample, which is in the Bear-Stearns list of top-20 foreign earnings, indicates that our selection method, while generating 2,196 financial statements for review, is not 100 percent comprehensive.

B. Foreign Tax Rate Estimates

Compustat data necessarily generate a blended tax rate across all foreign subsidiaries. A parent corporation might choose to repatriate only low-tax earnings during the tax holiday and wait to repatriate its high-tax earnings until after the holiday. Our estimate understates tax savings if a corporation has reinvested earnings in subsidiaries in both high-tax and low-tax countries.

For example, suppose a U.S. parent has permanently reinvested earnings in both a low-tax (20 percent) country ($100 pretax less $20 tax equals $80 after-tax) and a high-tax (40 percent) country ($100 pretax less $40 tax equals $60 after-tax). The financial statements would show an average tax rate of 30 percent and *$P_R_E* of $140. We would compute an incremental tax savings based on the difference between the U.S. rate of 35 percent and the average foreign tax rate of 30 percent. However, the taxpayer could choose to repatriate only the earnings from the 20 percent rate subsidiary as a dividend eligible for the 85 percent deduction. In future years, the taxpayer could repatriate the earnings from the 40 percent rate subsidiary and have no incremental U.S. tax because it would be fully shielded by foreign tax credits.

C. Extraordinary Dividends

Another limitation in estimating the amount of tax savings from repatriation is the requirement that the dividend be extraordinary. To promote extraordinary dividends, the dividend eligible for the 85 percent deduction is limited to the excess (if any) of the cash dividend over an historical average. The taxpayer computes the historical average using three of the last five years' dividend payments, disregarding the highest and lowest year. For this purpose, the base period dividends include qualifying and nonqualifying dividends received from CFCs, amounts includable under section 951(a)(1)(B) regarding investments in U.S. property, and amounts includable in income under subpart F rules. Because financial statement data do not disclose intercompany dividends, we are unable to determine the base period dividends that would reduce the amount of repatriation that qualifies for the 85 percent deduction.

(Text continued on p. 665.)

[22] We exclude Exxon from this analysis because per Table 4, note a, Exxon's tax rate is greater than 35 percent.

Table 4. Characteristics of 117 Firms That Disclose $P_R_E > 500 Million

Company Name	FYE	Foreign_ CurrentETR	Foreign_ TotalETR	$P_R_E
3M Co.	12	.3630	.3566	3,900.00
Abbott Laboratories	12	.2521	.2462	4,304.40
AES Corp.	12	-.6349	-.6377	1,200.00
Agilent Technologies Inc.	10	.3101	.2977	970.00
Air Products & Chemicals Inc.	9	.2070	.2978	1,003.00
Alcoa Inc.	12	.2695	.2771	5,893.00
Altria Inc.	12	.3190	.3377	7,100.00
Amerada Hess Corp.	12	.5360	.5110	1,900.00
American Express	12	.4220	.4220	2,400.00
American International Group	12	.4955	.7284	5,100.00
Analog Devices	10	.1794	.1745	1,055.00
Apache Corp.	12	.2669	.2669	2,100.00
Apple Computer	9	.0505	.0544	755.00
Archer-Daniels-Midland Co.	6	.2681	.2681	758.00
Autoliv Inc.	12	.3430	.3809	810.00
Avaya Inc.	9	1.8108	1.7387	632.00
Avery Dennison Corp.	12	.2764	.3005	800.00
Bard (C.R.) Inc.	12	.3231	.3264	792.23
Bausch & Lomb Inc.	12	.2769	.2816	804.80
Bell South Corp.	12	N/A	N/A	884.00
Black & Decker Co.	12	.1599	.1187	1,200.00
Boston Scientific Corp.	12	.1912	.1501	1,046.00
Bristol Myers Squibb	12	.1882	.1965	9,000.00
Cadence Design System Inc.	12	.3469	.3475	550.00
Campbell Soup Co.	7	.3790	.3399	578.00
Cendant Corp	12	.2627	.2702	539.00
Chiquita Brands International	12	-.0455	-.0489	600.00
Cisco Systems Inc.	7	.2340	.2187	1,200.00
Citigroup Global Markets Holdings	12	N/A	N/A	1,300.00
Coca-Cola Co.	12	.3449	.3373	6,100.00
Conoco Phillips	12	.6335	.7318	569.00
Corning Inc.	12	-.0317	.0052	1,000.00
Crown Holdings Inc.	12	.0000	.0000	719.00
Dana Corp.	12	N/A	N/A	673.00
Deere & Co.	10	.4626	.4439	574.00
Dell Inc.	1	.1409	.1409	4,100.00
Dole Food Co. Inc.	12	.1882	.1826	1,400.00
Dow Chemical	12	.3291	.3694	6,056.00
DuPont (EI) De Nemours	12	.3425	.4027	10,320.00
Eastman Kodak Co.	12	.2780	.3214	1,817.00
Eaton Corp.	12	.3199	.3810	873.00
Edison Mission Energy	12	.1229	.1942	515.00
El Paso CGP Co.	12	.0854	-.2005	964.00
EMC Corp.	12	.1705	.1678	2,729.40
Emerson Electric Co.	9	.3130	.3092	1,531.00
Engelhard Corp.	12	.2558	.2491	510.00
Exxon Mobil Corp.	12	>.35[a]	>.35[a]	17,000.00
Ford Motor Co.	12	-4.7645	-1.2620	860.00
Forest Laboratories	12	.1364	.1115	1,238.90
Franklin Resources Inc.	9	.1260	.1260	1,894.00
Gap Inc.	1	N/A	N/A	676.00
General Electric Capital Corp.	12	.1275	.1275	8,300.00

Table 4. Characteristics of 117 Firms That Disclose $P_R_E > 500 Million (continued)

Company Name	FYE	Foreign_ CurrentETR	Foreign_ TotalETR	$P_R_E
General Electric Capital Services	12	.1042	.1232	8,500.00
General Electric Co.	12	.2383	.2383	15,000.00
General Motors Acceptance CP	12	.3203	.3437	1,256.00
General Motors Corp.	12	.4227	.3248	11,900.00
Georgia-Pacific Corp.	12	.2874	.3107	811.00
Gillette Co.	12	.3297	.3406	2,600.00
Goodyear Tire & Rubber Co.	12	.4622	.4481	1,640.00
Guidant Corp.	12	.1787	.1691	1,485.60
Heinz (HJ) Co.	4	.2237	.2581	2,410.00
Hewlett-Packard Co.	10	.3151	.3200	14,500.00
Honeywell International Inc.	12	.3832	.4164	2,200.00
Illinois Tool Works	12	.3839	.3428	4,500.00
IMS Health Inc.	12	.1869	.1278	682.60
Intel Corp.	12	.1244	.1062	6,300.00
International Business Machines	12	.4223	.4084	16,631.00
International Paper Co.	12	.2537	.2279	2,500.00
Interpublic Group of Cos.	12	.8001	.5985	794.70
Johnson & Johnson	12	.2629	.2214	12,300.00
Johnson Controls Inc.	9	.4970	.4189	612.00
Kellogg Co.	12	.3458	.3797	857.00
Kimberly Clark Corp.	12	.3545	.3244	3,400.00
Kraft Foods Inc.	12	.3984	.4268	2,400.00
Lafarge North America Inc.	12	.3284	.3496	1,088.10
Lexmark International Inc.	12	.1886	.1915	683.90
Lilly (Eli) & Co.	12	.2191[b]	.2128[b]	8,000.00
Lucent Technologies	9	1.2376	1.2871	3,374.00
Marsh & McLennan Cos.	12	.1943	.3372	1,200.00
Masco Co.	12	.3078	.3691	530.00
Mattel Inc.	12	.2000	.1841	2,300.00
McDonalds Corp.	12	.2849	.2640	3,200.00
Medtronic Inc.	4	.2539	.2454	933.70
Merck & Co.	12	.1488[c]	.1496[c]	15,000.00
Merrill Lynch & Co.	12	.3901	.3350	4,300.00
Microsoft Corp.	6	.2267	.2267	780.00
Morgan Stanley	11	.2799[d]	.2742[d]	4,000.00
Motorola Inc.	12	.3533	.3533	7,600.00
Office Depot Inc.	12	1.1303	1.1303	778.70
OM Group Inc.	12	.1647	.1917	553.20
Oracle Corp.	5	.3005	.2970	2,300.00
Owens-Illinois Inc.	12	.3624	.2892	865.90
PACCAR Inc.	12	.3409	.3318	1,551.00
Pepsi Co. Inc.	12	.2394	.2365	7,500.00
Pfizer Inc.	12	.1875	.1875	29,000.00
Pharmacia Corp.	12	.1948	.1763	8,600.00
Phelps Dodge Corp.	12	.9901	1.3218	638.00
PPG Industries Inc.	12	.3919	.3715	922.00
Praxair Inc.	12	.1650	.1619	1,145.00
Procter & Gamble Inc.	6	.3358	.3358	14,021.00
Safeway Inc.	12	.3920	.4274	901.20
Schering-Plough	12	.2377	.2309	9,400.00
Solectron Corp.	8	.1490	.1265	592.80
Stryker Corp.	12	.2910	.2910	660.70

Table 4. Characteristics of 117 Firms That Disclose $P_R_E > 500 Million (continued)

Company Name	FYE	Foreign_ CurrentETR	Foreign_ TotalETR	$P_R_E
Sun Microsystems Inc.	6	.2740	.2547	1,463.00
Tellabs Inc.	12	.3137	.3137	769.40
Texas Instruments Inc.	12	.5087	.5032	1,293.00
Textron Inc.	12	.4637	.4637	618.00
Thermo Electron Corp.	12	.4346	.4248	576.00
Tootsie Roll Industries Inc.	12	.4854	.4404	6,506.00
Unisys Corp.	12	.5856	.6216	830.00
Unocal Corp.	12	.4641	.5339	1,900.00
Verizon Communications	12	.1818[e]	.1273[e]	4,500.00
Viacom Inc.	12	.2055	.2055	1,900.00
Vishay Intertechnology	12	.0636	.0998	897.55
Weyerhaeuser Co.	12	.5312	.4303	1,100.00
Xerox Co.	12	.9039	.9039	5,000.00

See Table 3 for variable definitions. N/A indicates that the firm does not report *Foreign_Pretax* in Compustat. Thus, *Foreign-_CurrentETR* and *Foreign_TotalETR* cannot be calculated.
[a]The Effective Tax Rate reconciliations in the Financial Statement Footnotes for Exxon Mobil Corp. for 1998-2002 indicate that Exxon is in a fully creditable position. For example, the December 31, 2002, Effective Tax Rate Reconciliation indicates that "Non-U.S. taxes in excess of theoretical U.S. tax" is $1.355 million. Therefore, we conclude that the *Foreign_CurrentETR* and *Foreign_TotalETR* are greater than 35 percent.
[b]*Foreign_Pretax* is not available on Compustat. We estimate *Foreign_Pretax* by multiplying the ratio of foreign sales to total sales by consolidated total pretax income for fiscal year 1998 through fiscal 2002 and then sum the results. We obtain foreign and total sales information from the geographic segment financial statement footnote for the applicable year in the Form 10-K.
[c]*Foreign_Pretax* is not available on Compustat. We estimate foreign pretax income by subtracting the percentage of consolidated pretax income contributed by domestic companies from 1. We multiply that percentage by consolidated total pretax income for fiscal year 1998 through fiscal 2002 and sum the results to determine *Foreign_Pretax*. Consolidated pretax income contributed by domestic subsidiaries is obtained from the income tax financial statement footnote.
[d]*Foreign_Pretax* is not available on Compustat. We sum pretax income for each foreign geographic area for fiscal year 1998 through fiscal 2002. We sum the results for each of the five years to calculate *Foreign_Pretax*. Foreign pretax income by geographic area is obtained in the geographic segment financial statement footnote for the applicable year in the Form 10-K.
[e]*Foreign_Pretax* is not available on Compustat. We multiply the ratio of foreign operating revenues to total operating revenues by consolidated total pretax income for fiscal year 1998 through fiscal 2002. We sum the results to obtain *Foreign_Pretax*. We obtain foreign and total operating revenue information from the geographic segment financial statement footnote in the applicable year Form 10-K.

We examine the firms listed in Exhibit 1 of the Bear Stearns study to perform a small-sample estimate of the base period dividend. The 20 firms listed in Exhibit 1 have the largest amounts of unrepatriated foreign earnings for 2002. We estimate the earnings repatriated in 1998, 1999, 2000, 2001, and 2002 as the sum of foreign pretax income less foreign current tax expense from 1998-2002 plus *$P_R_E* in 1997 less *$P_R_E* in 2002. We divide the five-year sum of repatriated earnings by five to obtain an average base period dividend.[23] For 10 firms, our estimate of the average dividend is a positive amount. Three firms do not disclose *$P_R_E* in 1997, one firm was not in existence in 1997, and one firm does not have footnote data available on Lexis-Nexis or the Edgar database for 1997. Thus, we are not able to estimate the average dividend for those five firms.[24] Surprisingly, our estimate of the average dividend for the remaining 5 firms is a negative amount, and we discuss this further below.

On average for the 10 firms with a positive estimate of the average dividend, the average base period dividend is 9 percent of the 2002 *$P_R_E.* That estimate of base period dividends would shrink the tax benefit somewhat if 9 percent of dividends would not be eligible for the 85 percent deduction for the sample as a whole. However, other provisions of the law work to increase the tax benefit above our estimate. Blessing (2004) comments that taxpayers can designate dividends from high-taxed pools of earnings and profits to apply against the base period amount, leaving low-taxed earnings to reap the benefits of the 85 percent dividend deduction. That "cherry-picking" would increase the tax savings above our estimate because as the amount of low-taxed earnings eligible for the 85 percent deduction increases, tax

[23]We appreciate Richard Sansing's suggestion regarding how to compute this estimate.

[24]The three firms that do not disclose *$P_R_E* include General Electric Co., Procter & Gamble Co., and Pepsico Inc. Altria Group Inc. was not in existence in 1997. Financial

(Footnote continued in next column.)

statement footnote data are not available on Lexis-Nexis or the Edgar database for Motorola Inc.

Table 5. Pfizer Buildup of Permanently Reinvested Earnings ($P_R_E)[a]

Year	Foreign_Pretax	Foreign_ CurrentTax	Foreign After-Tax	Ending $P_R_E	(Implied Dividend) Unexplained Increase
1997				4,500	
1998	1,410	550	860	6,500	1,140
1999	1,891	606	1,285	8,200	415
2000	4,764	684	4,080	14,000	1,720
2001	6,056	906	5,150	18,000	-1,150
2002	7,273	1,265	6,008	29,000	4,992

See Table 3 for variable definitions. *Foreign After-tax* is *Foreign_Pretax* less *Foreign_CurrentTax*. The (Implied Dividend) or *Unexplained Increase* is the *Ending $P_R_E*, less the *Foreign After-tax* and prior year *Ending $P_R_E*. Amounts are in millions of dollars.
[a]As originally stated. Pfizer restated 1998, 1999, 2000, and 2001, resulting in (Implied Dividend) or Unexplained Increase of $145, $(1,127), $1,910 and ($981).

savings increase. On balance, we assume that the provisions surrounding the base period dividend limitations net to a minor effect.

As noted above, in attempting to estimate the average base period dividends, we observe a curious anomaly. For five firms, our estimate of the average dividend is a negative amount, which represents an unexplained increase in *$P_R_E*. These five firms include four pharmaceutical firms — Lilly Eli & Co., Merck & Co. Inc., Pfizer, and Schering Plough Corp. — as well as Exxon Mobil Corp. Table 5 provides an example for Pfizer, using 1997 through 2002 financial statement data. The largest unexplained increase in *$P_R_E* occurs in 2002. *$P_R_E* increases by nearly $5 billion more than the after-tax foreign earnings. Perhaps the after-tax earnings of Pfizer includes both foreign gains and losses, but the *$P_R_E* represents only the foreign profits. However, given that Pfizer was part of the Homeland Investment Coalition that lobbied for the new provision, perhaps Pfizer increased its *$P_R_E* in anticipation of the requirements of the new law.

D. Reinvestment Plans

The dividend equivalent amount must be invested in the United States under a domestic reinvestment plan approved by the taxpayer's top officer before the dividend is paid, and approved subsequently by the board of directors. Nonexclusive permitted domestic reinvestment can include funding worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for purposes of job retention or creation. In addition, the dividend is reduced to the extent the CFC increases its debt to U.S.-related parties. We ignore both the related-party debt and domestic reinvestment plan limitations in estimating the potential tax savings from dividend repatriations. We await further company disclosures to provide evidence on the effect of those limitations, but it appears to us that the law provides sufficient flexibility to permit taxpayers to plan to meet the requirements.

E. Currency Effects

We do not address whether the Jobs Act repatriation deduction affects U.S.-foreign currency translation rates. However, if currency markets are efficient, any effects would have occurred when the law was passed based on the market's expectation of additional demand for dollars based on planned dividends.

IX. Conclusion

The American Jobs Creation Act of 2004 permits a short-lived deduction for corporations to repatriate foreign earnings at a lower tax cost. The law provides that the deduction is limited to the greater of $500 million or the amount of permanently reinvested earnings disclosed in or estimated from the 2002 financial statements. That direct reference to financial statement disclosure creates a new link between financial reporting and tax reporting, and we were curious to learn how many large publicly traded companies this provision affects.

Of 2,196 corporations that report foreign assets or foreign sales on the Compustat geographic segment database for 2002, only 678 report an amount of permanently reinvested earnings. Absent the new tax law, firms would still obtain some foreign tax credit relief against double taxation on repatriated earnings. The new provision only generates a net tax benefit where foreign earnings are not already fully shielded by foreign tax credits. There are 282 corporations that report permanently reinvested earnings and report average current foreign tax rates less than the 35 percent U.S. statutory rate. Ignoring requirements for the qualifying dividend to exceed a base period amount, the potential $38.84 billion tax savings for those 282 corporations is still substantial for a small number of taxpayers.

This tax law appears to strengthen links between financial reporting and tax policy, although this single-year deduction does not have ongoing effects. Treasury analysts with tax return access could determine the extent of tax benefits claimed by corporations that made no prior disclosure of permanently reinvested earnings in their financial statements. If the tax benefits claimed by nondisclosing firms are material, it could shed light on the extent to which corporations do or do not provide full disclosure in areas involving management discretion, such as APB 23. As we continue ongoing work to gather disclosures of repatriation plans, future work can address the extent to which financial reporting incentives constrain firms from taking advantage of the partial tax holiday on foreign repatriations.

References

Accounting Principles Board (APB). "Accounting for Income Taxes — Special Areas." APB Opinion No. 23. New York, NY: APB. (April 1972): 271-277.

Albring, Susan."The Effects of the Cost of Foreign Internal Funds on Firms' Financing Choice of Domestic Debt vs. Internal Funding." University of South Florida working paper (2005).

Alm, James. "Some Considerations on the Introduction of a Russian Tax Amnesty." United States Agency for International Development, October 1998, http://www.isp-aysps.gsu.edu/papers/ispwp9806.pdf.

Alm, J. and W. Beck. "Tax Amnesties and Compliance in the Long Run: A Time Series Analysis." *National Tax Journal* (March 1993) 46, 53-60.

Bear Stearns and Company. "The JOBS Act: Repatriation Guidance Issued." Equity Research Report, Jan. 13, 2005.

Blessing, Peter. "Bringing It All Back Home: Earnings Repatriations Under the U.S. Jobs Act." *Tax Notes*, Nov. 15, 2004, p. 965.

Bushee, Brian J., Dawn Matsumoto, and Gregory Miller, 2002. "Open Versus Closed Conference Calls: The Determinants and Effects of Broadening Access to Disclosure." *Journal of Accounting and Economics* 34 (January): 149-180.

Collins, Julie H., John R.M. Hand, and Douglas A. Shackelford. 2001. "Valuing Deferral: The Effect of Permanently Reinvested Foreign Earnings on Stock Prices." In *International Taxation and Multinational Activity*, edited by J. Hines. Chicago, IL: University of Chicago Press: 143-166.

Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Norwalk, CT: FASB (February 1992).

Financial Accounting Standards Board, Emerging Issues Task Force Bulletin No. 93-16, "Application of FASB Statement 109 to Basis Differences Within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion 23."

Grubert, Harry and Joel Slemrod. "The Effect of Taxes on Investment and Income Shifting to Puerto Rico." *The Review of Economics and Statistics* 80 No. 3 (August 1998): 365-373.

Hartzell, Jay C., Sheridan Titman, and Garry Twite, 2005. "Why Do Firms Hold So Much Cash? A Tax-Based Explanation." University of Texas at Austin working paper (March, 2005). http://ssrn.com/abstract=654881.

Krull, Linda. "Permanently Reinvested Foreign Earnings, Taxes and Earnings Management." *The Accounting Review* 79 No. 3 (July 2004): 745-767.

Mehring, James. "Afterglow of a Tax Holiday." *Business Week* (Nov. 18, 2004): p. 36.

Outslay, Edmund."Discussion of: Why Do Firms Hold So Much Cash? A Tax-Based Explanation." Discussion Comments at University of North Carolina Tax Symposium (April 2005), http://public.kenan-flagler.unc.edu/2005taxsym/index.html.

Rapoport, Michael, and Steven D. Jones. "Tax Break May Be Too Flexible: Law to Encourage Firms to Use Overseas Profits for U.S. Jobs Shows Cracks." *The Wall Street Journal* (Feb. 15, 2005): page C3.

Schroeder, Michael. "Treasury Gives Corporations Latitude on Overseas Profits." *The Wall Street Journal* (Jan. 14, 2005): page A2.

Simpson, Glenn R., and Gregory Zuckerman. "Tax Windfall May Not Boost Hiring Despite Claims; Some Companies Plan to Use New Tax Break on Foreign Profits for Debt and Other Needs." *The Wall Street Journal* (Oct. 13, 2004): page A12.

U.S. Department of the Treasury. "Treasury and IRS Announce Guidance on Repatriation of Foreign Earnings Under the American Jobs Creation Act." Notice 2005-10, 2005-6 IRB 474, *Doc 2005-887, 2005 TNT 10-6* (Jan. 13, 2005).

Appendix A
Homeland Investment Coalition

The Homeland Investment Coalition, as of Nov. 13, 2003, consisted of the following companies and associations:

3M
Advanced Energy Industries
Advanced Micro Devices
Alpharma
Alvaka Networks[c]
American Electronics Association[a]
Apple Computer
Autodesk
BEA Systems
BioMEMS Technologies[c]
Boston Scientific
BMC Software
Cadence Design Systems
Computer & Communications Industry Association[a]
Corning
Cummins
Dell
DuPont Photomasks
EDS
Eeparts[c]
Eli Lilly
EFJ[b]
EMS Technologies
Frequency Electronics[b]
GM Nameplate[c]
Guidant
Hewlett-Packard
Honeywell
Information Technology Association of America[a]
Information Technology Industry Council[a]
Intel
Johnson & Johnson
Kerr McGee

MAPICS
Masimo[c]
Medical Device Manufacturers Association[a]
National Association of Manufacturers[a]
National Semiconductor
Nuera Communications[c]
Nike
Oracle
Pacific Northwest International Trade Association[a]
Pharmacia
PhRMA[c]
Plantronics
Printronix
Qsent[c]
QUALCOMM
Sara Lee
Schering-Plough
Scientific Technologies[b]
Semiconductor Industry Association[a]
SGI[b]
Software Finance and Tax Executives Council[a]
Solectron
Sun Microsystems
TechNet[c]
Technitrol
Texas Instruments
United Technologies
Veritas Software
Wyeth
Xilinx

All companies above are in our sample except as noted:
[a]Associations, not corporations.
[b]These corporations had neither foreign assets nor foreign sales in 2002 on the Compustat segment tape.
[c]These corporations were neither listed in Compustat nor were their financial statements available on the Edgar database or Lexis-Nexis.

Appendix B
Excerpts From Schering-Plough Corporation and Subsidiaries' Financial Statements December 31, 2002, 2003, and 2004

Excerpt From Dec. 31, 2002:

Cash and cash equivalents totaled $3,521 million . . . at December 31, 2002. . . . In addition, the Company had short-term investments of $481 million at December 31, 2002. . . . Short-term borrowings and current portion of long-term debt totaled $1,423 million at year-end 2002. . . . Approximately 90 percent of short-term borrowings is owed by wholly owned U.S.-based subsidiaries of the Company. Substantially all cash and cash equivalents and short-term investments are held by wholly owned foreign-based subsidiaries. If the funds of these foreign-based subsidiaries were to be used for U.S. cash flow needs, additional U.S. income taxes would likely be owed.

Excerpt From Dec. 31, 2003:

In previous filings the Company had reported that, for 2003 and possibly beyond, cash provided by operating activities would not be sufficient to fund working capital, capital expenditures and dividends, if these items remained at the then-current levels. In response to the decline in sales and earnings in 2003 as well as the likelihood of further declines in 2004, the Company announced on August 21, 2003, a reduction in the quarterly dividend from 17 cents to 5.5 cents per common share. This action saves approximately $170 million per quarter beginning with the fourth quarter of 2003. On the same day, the Company also announced accelerated and intensified cost-cutting actions, including a global workforce reduction effort.

As shown in the Statement of Consolidated Cash Flows for 2003, cash needs for working capital, capital expenditures and dividends exceed cash from operations. This excess of cash needs over cash generation occurred entirely within the U.S. operations where the deficit was approximately $1,400 million. Foreign operations generated cash in excess of cash needs. In 2003, the Company borrowed additional funds in the United States to finance the U.S. operations while continuing to accumulate cash with the foreign-based subsidiaries.

Excerpt From Dec. 31, 2004:

The American Jobs Creation Act of 2004 (the Act was enacted on October 22, 2004). A provision of the Act effectively reduces the tax rate on qualifying repatriation of earnings held by foreign-based subsidiaries to 5.25 percent. Normally, such repatriation would be taxed at a rate up to 35 percent. In the fourth quarter of 2004, the Company made the decision that it intends to repatriate approximately $9.4 billion under the Act, which is the maximum amount of foreign earnings qualifying for the reduced rate.[25] This intended repatriation of earnings will trigger a U.S. federal tax payment in 2005 of approximately $417 (tax charge of $494 less $77 in foreign tax credits) and a state tax payment of approximately $6. These amounts have been reflected in current income tax expense. Prior to the Act, the Company did not provide deferred taxes on undistributed earnings of foreign subsidiaries as the Company had intended to indefinitely reinvest all these undistributed earnings in foreign subsidiaries.

The Company has the intent to indefinitely reinvest any undistributed earnings of foreign subsidiaries that are not repatriated under the Act and therefore has not provided deferred taxes on approximately $2,200 of undistributed foreign earnings. Determining the tax liability that would arise if these earnings were remitted is not practicable. The amount would depend on a number of factors, including the amount of the earnings distributed and whether the U.S. operations were generating taxable profits or losses.

---

[25]Table 4 indicates that the permanently reinvested earnings at Dec. 31, 2002 is $9.4 billion.

Appendix C
Selected Excerpts of 2004 Financial Statements Disclosing Repatriation Plans

Eli Lilly, Dec. 31, 2004:

Although the deduction is subject to a number of limitations and uncertainty remains as to how to interpret certain provisions of the [American Jobs Creation Act] AJCA, we believe we have the information necessary to make an informed decision on the impact of the Jobs Act on our repatriation plans. Based on that decision, we plan to repatriate $8.00 billion in incentive dividends, as defined in the Jobs Act, during 2005 and accordingly have recorded a related tax liability of $465.0 million as of December 31, 2004. Potential uses of proceeds from the incentive dividends include research and development activities, capital asset expenditures, and other permitted activities. As noted above, in anticipation of the repatriation of overseas earnings into the U.S. in 2005, we began to liquidate our long-term investments held internationally during the latter part of 2004 into cash, cash equivalents and short-term investments.

Pfizer, Dec. 31, 2004:

As of December 31, 2004, we had not decided whether, and to what extent, we might repatriate foreign earnings under the Act, and accordingly, the financial statements do not reflect any provision for taxes on unremitted foreign earnings. Since that time, however, the U.S. Treasury has issued some guidance, which appears to clarify some of the Act's provisions, and management continues to investigate whether the Company might repatriate up to $29 billion in extraordinary dividends, as defined in the Act. This amount could increase by $8.6 billion, the amount of Pharmacia's historical accumulated earnings, but is subject to further U.S. Treasury guidance. It is expected that the analysis and evaluation of the provision will be completed during the first quarter of 2005 and recommendations will be made to senior management and the Board of Directors for their approval to repatriate a portion of the total available as an extraordinary dividend. We expect to complete our analysis as to the total amount available for repatriation once the U.S. Treasury issues all of its guidance, including the expected passage of a Technical Corrections Bill by Congress. Since the U.S. Treasury has not completed the issuance of all its guidance on the Act, the company can only make a good-faith estimate of the tax liability that would have to be recorded if these extraordinary dividends are paid. Accordingly, the Company expects, based on the information presently available, that it would record a tax liability based on the 5.25 percent statutory rate in the Act. However, the actual cost to the Company is dependent on a number of factors that are currently being analyzed, including the amount of repatriation, the passage of the pending Technical Corrections Bill and further guidance from the Treasury. Therefore, the range of income tax effects of such repatriation cannot be reasonably estimated at this time.

General Electric:

While GE continues to evaluate the Act, because the vast majority of our permanently reinvested non-U.S. earnings have been deployed in active business operations, and it is therefore unlikely that we will repatriate any material portion of our permanently reinvested non-U.S. earnings, no incremental tax provision effect has been recorded through December 31, 2004. If we were to repatriate up to $3,000 million of indefinitely reinvested earnings in 2005, incremental taxes would be provided at less than a 5 percent rate.

Hewlett Packard, Oct. 31, 2004:

The maximum amount of HP's foreign earnings that qualify for the temporary deduction is $14.5 billion. For HP, the one-year period during which the qualifying distributions can be made is fiscal 2005 [10/31/2005]. HP is in the process of evaluating whether it will repatriate any foreign earnings under the repatriation provisions of the Jobs Act and, if so, the amount that it will repatriate. The range of reasonably possible amounts that HP is considering for repatriation, which would be eligible for the temporary deduction, is zero to $14.5 billion. HP is awaiting the issuance of further regulatory guidance and passage of statutory technical corrections with respect to certain provisions in the Jobs Act prior to determining the amounts it will repatriate. If such regulatory guidance or technical corrections are favorable, HP is likely to repatriate amounts in the high end of our range. HP expects to determine the amounts and sources of foreign earnings to be repatriated, if any, during the third quarter of fiscal 2005. Use of the funds will be governed by a domestic reinvestment plan, as required by the Jobs Act.

Repatriation of the maximum amount eligible for the temporary deduction, which is $14.5 billion, could result in additional United States federal income tax expense, which HP currently estimates to be between $850 million and $925 million, in fiscal 2005. Repatriation also would substantially increase liquidity in the United States, although use of the additional liquidity would be restricted by the domestic reinvestment plan. There would be a corresponding reduction in liquidity at HP's foreign subsidiaries. Some foreign subsidiaries would be required to borrow in order to repatriate their earnings to the U.S. We expect HP's significant positive foreign cash flows would be sufficient to repay any foreign debt and replenish foreign cash balances over time. Should HP decide not to repatriate foreign earnings under the Jobs Act, we would meet United States liquidity needs through ongoing cash flows, external borrowing, or both. We utilize a variety of tax planning and financing strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed.