The Impact of the Tax Cuts and Jobs Act's Repatriation Tax on Financial Statements

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In Brief

The Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate, but not all of its provisions reduced the effective corporate tax burden. Under the new Internal Revenue Code section 965, U.S. multinational entities must pay a one-time mandatory repatriation tax on undistributed and deferred post-1986 foreign income. Companies were permitted to estimate provisional amounts of repatriation tax within 12 months of the new regulation, and have begun disclosing actual amounts with their 2018 financials. Using disclosures from selected multinationals, the authors examine the impact of the repatriation tax on 2017 and 2018 financial statements.

The Tax Cuts and Jobs Act of 2017 (TCJA) specifically affects multinational enterprises (MNE). Under the TCJA, U.S. corporations are subject to a one-time, mandatory deemed repatriation tax on undistributed and deferred post-1986 foreign income. This article investigates the impact of this tax on the 2017 and 2018 financial statements of select multinational companies.

Foreign Taxes of Multinationals before the TCJA

Before the TCJA, U.S. taxpayers who were shareholders in foreign corporations were generally not taxed on the earnings of said foreign corporations until the earnings were distributed (repatriated) to them. If the foreign corporation did not distribute earnings back to the United States, shareholders could postpone paying taxes on such foreign income indefinitely.

Upon repatriation of earnings from a foreign subsidiary, U.S. corporate shareholders' earnings were treated as dividends that were included in the parent corporation's income and were subject to U.S. taxation at a rate of up to 35%, with a foreign tax credit based on foreign taxes paid. As a result, U.S.–headquartered MNEs could incorporate in tax havens and allocate as much taxable income as possible to these low-tax jurisdictions in order to minimize corporate income tax. For example, in a recent high-profile tax case, the European Commission demanded that Apple pay Ireland 13.1 billion euros in underpaid taxes because Ireland granted

state aid to the company (Padraic Halpin, "Ireland Collects Disputed Apple Taxes in Full ahead of Appeal," Reuters, Sept. 18, 2018, https://reut.rs/38wQSLQ). Apple, a U.S.–headquartered MNE, had been offshoring its profits to Ireland, where the corporate tax rate is 12.5%. Thus, one of the primary goals of the TCJA was to remove potential tax benefits from offshoring income, thus deterring such activity.

IRC Section 965

In addition to the many domestic changes, the TCJA introduced major revisions to the taxation of international activities. In particular, the TCJA introduced Internal Revenue Code (IRC) section 951A on global intangible low-taxed income (GILTI), which reduces or eliminates U.S. shareholders' ability to defer recognizing post–December 31, 2017 earnings generated in certain foreign corporations. This required some mechanism to address the pre–January 1, 2018 earnings that had been deferred. The solution to this dilemma took the form of IRC section 965, which requires U.S. shareholders of deferred foreign income corporations (DFIC) to recognize a one-time deemed repatriation (also called a "transition tax") of post-1986 deferred income. The mandatory deemed repatriation applies to U.S. taxpayers who own, or were considered to own by applying the rules of ownership of IRC section 958(a), 10% or more of the voting power of a foreign corporation as of December 31, 2017, or the last day of the controlled foreign corporation's tax year.

IRC section 965 provides for a tax of 15.5%, to the extent the foreign corporation has cash and other liquid assets, and 8% for accumulated deferred earnings in excess of the cash and liquid assets. Corporations are allowed some credit for foreign tax paid on these deemed repatriated earnings.

IRC section 965 requires U.S. shareholders of deferred foreign income corporations (DFIC) to recognize a one-time deemed repatriation (also called a "transition tax") of post-1986 deferred income.

Furthermore, shareholders with interest in multiple foreign corporations that are subject to section 965 are allowed to offset accumulated earnings with accumulated losses.

Taxpayers can elect to pay their repatriation tax in installments over eight years (interest-free). Specifically, the tax is due as follows: 8% per year for the first five years, 15% in year six, 20% in year seven, and 25% in year eight (FASB, "Accounting for The Tax Cuts and Jobs Act," http://bit.ly/2PiNhcR).

Recognition and Disclosure Requirements

Although the TCJA was enacted on December 22, 2017, companies were required to apply provisions related to the repatriation tax in the current year's financial statements and their 2017 fiscal year tax returns. SEC Staff Accounting Bulletin (SAB) 118 was released on December 22, 2017, and was updated on February 27, 2018, in response to the demand for additional information. In addition, FASB released Accounting Standards Update (ASC) 2018-05, *Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118,* in March 2018 to address the income tax accounting implications of the TCJA. These disclosure guidelines had implications for the type and level of disclosure required for the repatriation tax.

In the original SAB 118, the SEC recognized that companies may be unable to provide a complete assessment of the tax effects of the TCJA and allowed them to report the provisional effects based on reasonable estimates. In the absence of reasonable estimates, provisional amounts were not required (Catherine Clarkin, Robert Downes, and Brian Farber, "SEC Guidance on Tax Reform Reporting," Harvard Law School Forum on Corporate Governance and Financial Regulation, Jan. 11, 2018, http://bit.ly/2RITikm). As such, companies were required to disclose any incomplete tax effects related to the TCJA in the first reporting period that reasonable estimates were established. The required disclosures include qualitative disclosures of the TCJA's income tax effects, details of items reported as provisional amounts, disclosures of existing current or deferred tax amounts affected by the TCJA, the reason for the incomplete initial accounting, and any additional information needed to complete the accounting. Furthermore, companies could adjust their provisional amounts for up to one year after the enactment of the TCJA.

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Exhibit
Selected First Disclosures of Repatriation Tax
(dollars in billions)

Disclosures of sample companies	Repatriation tax (provisional amount)	Ratio of repatriation tax to sales	Deferred tax assets (liabilities)	Net tax benefit (expense)	Net income	% change in net income	Effective tax rate	Effective tax rate pre-TCJA
Alphabet, Inc. 2017	$10.2	9.2%	$0.376	($9.9)	$12.66	–34.99%	53.4%	19.3%
Apple 2018*	$37.3	13.6%	$35.8*	($1.5)*	$59.53	23.1%	18.3%	24.6%
Cisco 2018	$8.09	22%	($0.787)	($8.88)	$0.11	–98.9%	99.2%	21.8%
ExxonMobil 2017	Unknown	Unknown	Unknown	$5.94	$19.71	151.4%	5.0%	13.0%
Home Depot 2017	$0.4	0.4%	$0.147	($0.127)	$8.63	8.46%	37.0%	36.3%
Medtronic 2018	$2.6	8.68%	$0.114	($2.4)	$3.095	–23.09%	45.5%	12.6%
Nike 2018	$1.87	5.15%	($0.158)	($2.03)	$1.93	–54.41%	55.3%	13.2%
Procter & Gamble 2018	$3.8	5.7%	$3.2	($0.602)	$9.75	–36.4%	26.0%	23.1%
Walmart 2017	$1.9	0.4%	$2.1	$0.2	$9.86	–27.7%	30.4%	30.3%

*Apple's 2018 disclosure includes the adjustments to the 2017 disclosure.
TCJA=Tax Cuts and Jobs Act of 2017

Financial Statement Disclosure Impacts and Implications

The authors reviewed the 2017 and 2018 financial statements of a select group of U.S.–based MNEs to assess the impact of the TCJA on their performance and disclosures. The *Exhibit* shows the earliest provisional amounts disclosed in selected companies' financial reports after the enactment of the TCJA. Almost all companies in the sample noted that the reported amounts were provisional estimates in accordance with SEC guidelines. The companies facing the highest repatriation tax bills are from the technology industry, such as Alphabet, Apple, and Cisco. The repatriation tax had a much smaller impact, or even a net tax benefit, on the other companies in the sample due to the relatively small amounts of repatriation tax being offset by other tax benefits from the TCJA. The disclosed tax effects are discussed in greater detail below.

Negative Effect

Among the selected companies, Apple had the largest amounts of cash and marketable securities held overseas, and it faced the largest repatriation tax bill as a result (Laurie Meisler, "The 50 Largest Stashes of Cash Companies Keep Overseas," *Bloomberg,* June 13, 2017, https://bloom.bg/2kUQiU1; Allyson Versprille and Alison Bennett, "Early Numbers Show Repatriation Tax Haul Likely to Miss Estimates," *Bloomberg Tax,* May 31, 2018, http://bit.ly/2YRP6AF). Apple's 2018 Form 10-K did not specifically disclose the net impact of the TCJA; instead, it said that the company's repatriation tax payable of $37.3 billion was a provisional estimate that may change as the company continues to analyze the impact of additional implementation guidance. In its 2017 disclosure, Apple estimated a deferred tax liability of $36.4 billion based on the cumulative post-1986 deferred foreign income, and it replaced $36.1 billion of its deferred tax liability with a deemed repatriation tax payable of $37.3 billion in 2018. The figures in the *Exhibit* were adjusted accordingly to reflect the impact of the repatriation tax.

Apple disclosed that it elected to pay the repatriation tax in installments. The company's effective tax rate decreased significantly from 24.6% in 2017 to 18.3% in 2018, primarily due to the lower TCJA tax rates and $1.7 billion of unrecognized tax benefits resulting from the repatriation tax.

Cisco, which has the third largest amount of overseas cash and marketable securities, recorded a provisional amount of $8.094 billion for the repatriation tax on accumulated earnings of foreign subsidiaries in 2018 (Meisler 2017). This amount included adjustments to provisional amounts reported in prior quarters, made in

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accordance with the TCJA. The adjustments included an $863 million benefit related to U.S. taxation of foreign dividends. In accordance with the TCJA, Cisco plans to pay the repatriation tax in installments over eight years; as a result, it recorded a $787 million repatriation tax payable within one year.

Despite the adjustment, Cisco's effective tax rate increased from 21.8% in 2017 to 99.2% in 2018 as a result of the repatriation tax. Consequently, net income decreased from $9.61 billion in 2017 to just $110 million in 2018, a 99% decrease.

impact its provision for income taxes and effective tax rate in the period in which the adjustments are made; however, it also pledged to have the process concluded by the end of FY 2018.

Similarly, Nike had a nearly $2 billion adjusted net tax charge as a result of the TCJA, including the transition tax and increase in deferred tax liability. Nike elected to pay the tax under an eight-year installment plan. Nike stated that it had $12.2 billion worth of previously untaxed foreign earnings subject to the TCJA transition tax; this caused its effective tax rate to increase

Companies were required to disclose any incomplete tax effects related to the TCJA in the first reporting period that reasonable estimates were established.

Alphabet Inc. also reported a large repatriation tax charge in its 2017 financial statements disclosures. This tax charge contributed to a 176% increase in its effective tax rate and a 35% decrease in net income. Alphabet noted in its financial statements that it was subject to a one-time transition tax on accumulated foreign subsidiary earnings not previously subject to U.S. income tax, specifically mentioning the timing of the enactment and the complexity involved in applying the provisions of the TCJA, which requires the use of reasonable estimates of the effects. The company also noted that it may make adjustments to the provisional amounts, and the adjustments may materially

by 42.1% in the year of application, to 55.3%. Furthermore, its earnings declined by 54% from 2017 to 2018, in major part due to the tax effects. This is not surprising, given that the majority of Nike's total revenue (nearly 58%) comes from overseas operations.

Medtronic also suffered adverse effects resulting from the transition tax under the TCJA. Its estimated tax bill was $2.6 billion (nearly 8.7% of revenues in FY 2018). As a result, its net income decreased by 22%, and its effective tax rate increased from 12.6% in 2017 to 45.5% in 2018. Medtronic reported that "a significant portion" of its earnings is generated in Switzerland and Ireland.

Procter & Gamble also had a negative net tax effect resulting from the TCJA, including a significant repatriation tax charge (5.7% of sales). In addition, the company reported a 36% decrease in net income, mainly due to earnings from discontinued operations in 2017; the repatriation tax charge only partially contributed to this decrease. Compared to Apple, Alphabet, Cisco, Nike, and Medtronic, its repatriation tax expense was minimal. Procter & Gamble noted that prior to the TCJA, it had a strategy of indefinitely investing undistributed foreign earnings, and thus had no associated deferred taxes. Its provisional tax included the U.S. income tax and related foreign withholding taxes for the portion of earnings no longer invested.

Minimal or No Effect

Conversely, the repatriation tax was immaterial for some companies, with the TCJA having little effect on their tax liability. For example, Walmart's repatriation tax charge was only 0.4% of sales. Although it also reported a significant reduction in net income, the reduced income was not tax related, but mainly due to the loss on extinguishment of debt and a decrease in operating income. In addition, its minimal tax expense was offset by a $2.1 billion deferred tax benefit as a result of the TCJA's reduced U.S. tax rate and the related remeasurement of deferred taxes. As a result, its effective tax rate remained nearly the same.

Walmart stated that adjustments to the provisional amounts could have a material impact on its financial results, specifically the provision for income taxes, effective tax rate, net income, earnings per share, consolidated cash flows, and liquidity. In FY 2018, Walmart finalized the calculations of the transition tax liability and increased

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the provisional amount by $413 million, with the increase included as a component of provision for income taxes. Furthermore, it reported its effective tax rate as 37.4%, compared to 30.4% previously reported in FY 2017.

Home Depot disclosed a relatively small transition tax of $400 million, which included the transition tax, foreign withholding taxes, and state taxes owed. In total, the TCJA increased its effective tax rate by less than 1%. It also noted that due to the complexity of the change in tax law and expected further guidance from the Treasury Department and the IRS, there may be material adjustments to the provisional estimates in the subsequent period. The minimal effect of the transition tax on Home Depot's financials is not entirely unexpected, given that it operates exclusively in North America. (Its 182 stores in Canada and 122 stores in Mexico account for only 13.3% of its total locations.) The foreign income tax burden is further diminished by foreign tax credits due to higher tax rates abroad.

ExxonMobil reported a net positive benefit from the tax reform. The company stated that it paid a tax rate of more than 35% on its non-U.S. earnings and was, therefore, largely unaffected by the repatriation tax. ExxonMobil included a net $5.94 billion credit in its 2017 results, representing a reasonable estimate of the income tax effects of the changes in tax law and rate.

Its disclosures included disaggregating the effect of the TCJA across years, upstream sales, downstream sales, and select industries such as chemicals. In its management discussion and analysis (MD&A) section, it noted that the benefits from the reduction in corporate tax rate from 35% to 21% were somewhat offset by other provisions related to the company's future tax liability.

In 2018, ExxonMobil included a $291 million tax credit, mainly in the non-U.S. upstream segment, reflecting an updated estimate of the impact of U.S. tax changes, including clarifications provided in proposed transition tax regulations issued by the U.S. Treasury. Its effective income tax rate dropped to 5% in 2017, mainly due to the TCJA; however, the effective tax rate increased again in 2018 (the year after the initial repatriation tax charge) to 37%. ExxonMobil explained that this increase reflected the absence of the impact (i.e., benefit) of the TCJA.

Mixed Results

It is evident that the TCJA, and specifically the repatriation tax, affected MNEs' financial statements in 2017 and 2018. The effects do not, however, seem to be uniform across companies and industries. For some companies, such as Cisco and Nike, the repatriation tax resulted in a material cost in the first year of remittance (to 99.2% and 55.3% effective tax rates, respectively). For others, the TCJA had a lesser or even positive effect, such as with Walmart and ExxonMobil. Overall, it appears that the cost of the repatriation tax to MNEs may not be as high as expected, and the variation of its effects could be related to the extent of the companies' international business and their ability to offset this tax expense with related tax benefits (Versprille and Bennett 2018).

> Overall, it appears that the cost of the repatriation tax to MNEs may not be as high as expected.

The repatriation tax was implemented quickly amid much uncertainty. The regulations allowed companies to make reasonable estimates and complete their accounting of the repatriation tax's effect within 12 months. For the most part, the MNEs discussed above were able to make reasonable estimates and complete the accounting within the 12-month deadline. Companies generally disclosed the amount and effect of the tax as required, and highlighted the risks associated with their reporting of the tax even when the tax did not represent a material cost to the company. ❑

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