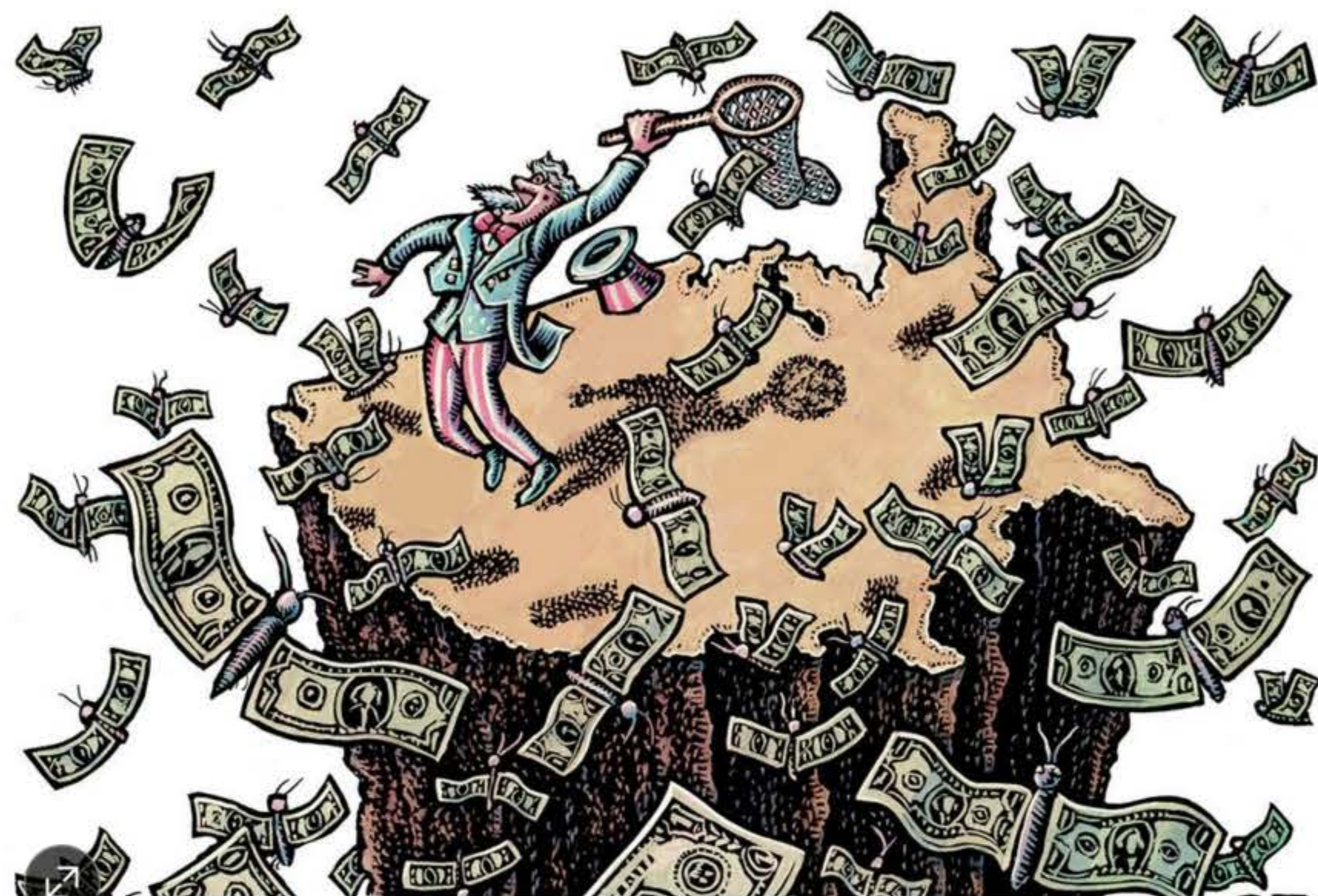


BUSINESS | CFO JOURNAL

Sheltering Foreign Profits From U.S. Taxes Is No Big Feat

Accounting regulations and auditing standards pave the way for American companies



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By VIPAL MONGA
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The U.S. government chalked up a big victory this month when it stopped pharmaceutical giant [Pfizer Inc.](#) from merging with [Allergan PLC](#) and shifting its address overseas to avoid U.S. taxes.

But there is at least one thing the Treasury Department still can't do: force Pfizer to book taxes on \$80 billion in foreign profits the New York-based company has socked away overseas.

While most countries tax only the money companies earn inside their borders, the U.S. taxes profits that American companies make world-wide at 35%, minus any foreign taxes paid.

Still, accounting regulations and auditing standards make it relatively easy for U.S.-based businesses to avoid taxes on their overseas profits.

All those companies have to do is say the money is “indefinitely reinvested” abroad. Using that phrase allows them to avoid deducting U.S. taxes on those funds from their overall earnings. That can save them billions of dollars, fattening their bottom line.

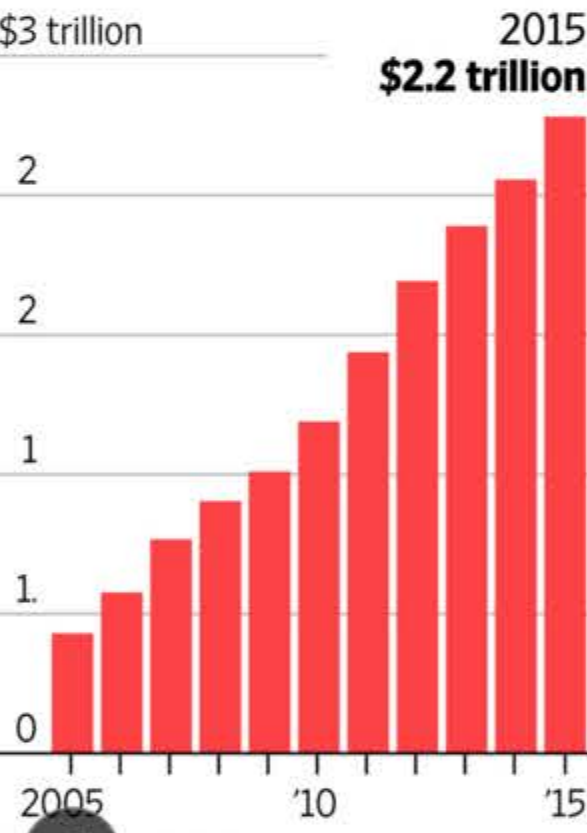
What counts as reinvestment? “It’s fair to say the bar is very low,” said Michael Minihan, a principal at Dallas-based tax consulting firm Ryan LLC.

S&P 500 companies including Pfizer, [Apple Inc.](#) and [Microsoft Corp.](#) indefinitely put away a record \$2.3 trillion of cumulative foreign earnings by the end of 2015, according to [Credit Suisse Group AG](#), up 11% from 2014 and more than the gross domestic product of Italy.

Under U.S. accounting rules, companies have to persuade their auditors that they are justified in designating foreign earnings as permanently reinvested. But the evidence doesn't have to be ironclad. It can include plans for new overseas factories, prospective acquisition sprees, or restrictions in loan agreements that prevent them from transferring money to the U.S.

Trapped Cash

Foreign earnings for companies in the S&P 500



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“It’s a very big loophole, and I think companies use it liberally,” said Tony Sondhi, a financial consultant and member of the Emerging Issues Task Force of the Financial Accounting Standards Board, which sets U.S. accounting rules.

The companies and their auditors also can take into account the “tax consequences” of any decision to bring money back to the U.S. or reinvest overseas, according to an accounting guide published by accounting firm PricewaterhouseCoopers. They can justify parking the money overseas to avoid paying U.S. taxes by arguing that taxes are too high, said Ryan’s Mr. Minihan.

A PwC spokeswoman declined to comment.

Pfizer said most of its earnings already have been reinvested. “Cumulative foreign earnings do not equate to cash because much of these earnings have been reinvested in our foreign operations, such as property, plant and equipment, working capital and other investments to support our growing business outside the United States,” said a company spokeswoman.

Microsoft’s regulatory filings show that it had \$108.3 billion of foreign earnings indefinitely reinvested overseas as of last June. The software maker said in the filings that it hadn’t booked any U.S. income taxes on that money, and that the unrecognized deferred tax liability on the earnings equaled \$34.5 billion. That sum has lifted Microsoft’s profits.

Microsoft declined to comment beyond its filings.

Companies complain that they can’t use money sequestered abroad to fund dividends, buy back shares or invest in new projects in the U.S. But they still have an easy time borrowing for such purposes in the U.S. Apple has sold \$71 billion of bonds since 2013 to help it fund more than \$150 billion in dividend payments and share repurchases. The rest came from the company’s U.S. cash flow.

Investors took into account the company’s strong financial profile, said Dave Novosel, a senior analyst at research firm Gimme Credit LLC. He said they didn’t penalize the company for having money trapped offshore.

Companies with reinvested earnings don’t actually have to use the money on new projects right away. They need only have a plan for the money, which they can hold in deposit accounts or invest it in securities, said tax consultant Robert Willens.

Apple’s foreign subsidiaries held \$186.9 billion of cash and marketable securities when its fiscal year ended last Sept. 26. Of that sum, Apple had set aside \$91.5 billion as indefinitely reinvested.

In fiscal 2015 Apple reported \$22 billion in operating expenses for the past fiscal year, but it isn’t clear how much of that it spent overseas. Meanwhile, Apple collects interest on its foreign cash and investments, and pays U.S. tax only on its gains.

The Obama administration has resisted calls to bring the U.S. corporate tax system more in line with that of the rest of the world. The White House is proposing a one-time 14% tax on all unrepatriated foreign earnings.

The administration also proposes taxing all future foreign earnings at 19%, but the plan eliminates companies’ ability to defer those taxes. If enacted, the plan would bring in almost \$500 billion of tax revenue over 10 years, according to the Joint Committee on Taxation. Few expect the plan to pass, at least until after the presidential election.

Companies like Apple say they are waiting for a tax overhaul that would let them bring their money back to the U.S. cheaply. In calling for a “dramatic simplification of the corporate tax system,” before Congress in 2013, Apple Chief Executive Officer Tim Cook said the company supports “a reasonable tax” on foreign earnings that allows them to flow back to the U.S.

“Apple supports this plan even though it would likely result in Apple paying more U.S. corporate tax,” he said.

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