INSTITUTE ON TAXATION AND ECONOMIC POLICY

Informing the debate over tax policy nationwide

September 30, 2016

Technical Director
File Reference No. 2016-270,
FASB, 401 Merritt 7,
PO Box 5116,
Norwalk, CT 06856-5116

Re: File Reference No. 2016-270: Comments on the Exposure Draft for the Proposed Accounting Standards Update to Income Taxes (Topic 740)

Dear Director Cosper,

We appreciate the Financial Accounting Standards Board's (FASB) ongoing review of its accounting standards to ensure that financial statements are "facilitating clear communication of information that is important to financial statement users." An overhaul of income tax disclosure standards is critically needed as the current standards have not kept pace with the rapid growth of corporations' foreign operations and changes in their tax accounting over the past few decades. The current standards allow companies to be opaque in their income tax disclosures and to obscure important details of their operations.

Overall, the changes to disclosure requirements proposed by FASB in the exposure draft would represent a significant step forward toward providing users of financial statements the clarity that they need. We believe, however, that the exposure draft does not go far enough in providing the clarity needed and sought by investors and the public alike. The ideal standard would be a requirement that companies disclose core financial data (such as their pre-tax income, income taxes paid, income tax expense, revenues, etc) on a country-by-country basis. Enacting such a standard would finally provide the clear and complete picture of companies' operations needed in the modern world of international business.

ITEP's Work and Financial Statements

The Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization that works on international, federal, state and local tax issues. Our goal is to provide lawmakers, the media and the public accurate and timely information about our country's tax system. To accomplish this goal, we rely heavily on the information publicly disclosed in financial statements.

One of the areas of particular focus for ITEP has been the corporate tax code and its impact on U.S. corporations. The core insights of our many articles and reports looking at the impact of corporate taxes come from data that we collect and analyze from the information disclosed in public financial statements. For example, our most recent comprehensive analysis of Fortune 500 companies' federal effective tax rates, titled *"The Sorry State of Corporate Taxes,"* was based entirely on the income and tax expense information that can be gleaned from companies' 10-K filings to the Securities and Exchange Commission (SEC).[i] Similarly, we use 10-K filings as the core source of information in our major report, titled *"Offshore Shell Games."* looking at companies' offshore earnings and the taxes they may owe on those earnings. [ii]

Our work provides critical information to the public and lawmakers alike on the effective tax rates paid by large companies, how much they owe in taxes on foreign earnings and the different strategies that companies use to lower their tax rates. Time and again, however, we have found that the data provided in public disclosures, even when combed through in exacting detail and with expertise, are wholly inadequate in providing a complete picture of how companies interact with the corporate tax code.

Inadequate financial statement disclosure is a huge barrier to creating a fair, efficient and sustainable tax code because those making decisions about the tax code are forced to do so in a context where much of the corporate tax code's impact is unknown. For example, without knowing the effective tax rates that U.S. companies pay, it is difficult to determine if the U.S. tax rate is competitive with the tax rates paid by companies to other countries. In addition, without adequate information on a company's offshore operations, it is difficult to determine the extent to which companies' income is being taxed in those jurisdictions where it does significant business or whether the company is taking advantage of mismatches between various countries' tax codes to shift its income into low tax jurisdiction. With lawmakers from across the political spectrum looking to reform the business tax code in the coming years, improving public disclosure of corporate tax and financial information will prove critical in allowing lawmakers and the public to have a better understanding of the tax code and how it might be improved going forward.[iii]

Improving Disclosure

The Benefits of Country-by-Country Disclosure

The best way to provide the media, lawmakers and the public the information they need to make informed decisions about our nation's tax code would be to require companies to publicly disclose key financial data on a country-by-country basis. Ideally, this would include the disclosure of total revenues, profit, income tax paid, tax cash expense, stated capital, accumulated earnings, number of employees on a full-time basis, and book value of tangible assets on a country-by-country basis. For many companies that will already have to file country-by-country reports to the Internal Revenue Service (IRS) in the coming years, providing this information in financial statements would represent little to no additional cost.[iv]

With this information, it would be possible to determine the level of tax that individual companies and the corporate sector as a whole are paying. From a public policy perspective, a good starting point for determining whether corporate taxes should be increased or decreased is knowing exactly how much companies are truly paying under the current code. Similarly, breaking out such effective tax rate information by economic sector could allow for a deeper understanding of how various tax breaks in the code affect the rates that companies pay and thus for a better evaluation of whether to reform or repeal these breaks.

In addition, breaking out the information on a country-by-country basis would provide a clear picture of any disconnections between the economic activities of companies and where they are declaring their income for tax purposes. For example, this information could show if a company is reporting a suspiciously large amount of its income in a jurisdiction where it has little to no activity and faces no taxation, while at the same time declaring a low amount of income in a jurisdiction where it faces a higher tax rate but performs a substantial amount of its business. This information would be invaluable to lawmakers in the U.S. and countries across the world in determining whether or not they should be taking action to tax income that is being shifted to low- or zero-tax jurisdictions.

Addressing Changes in the Exposure Draft

Taken as it is, the FASB exposure draft on income tax disclosure would communicate more clearly the tax and financial position of disclosing corporations. Perhaps the most crucial improvement is that the new rules require that companies disaggregate income tax paid between domestic and foreign rather than reporting one worldwide figure. Breaking income taxes paid out between foreign and domestic will allow research organizations like ITEP to better estimate the effective tax rates that companies pay to the United States versus foreign countries as a whole. Building on this, the exposure draft would require companies to disaggregate their foreign taxes paid by any countries that are significant. Such information would be valuable in determining the tax rates that each company is paying where it does a significant amount of business.

While disaggregating income taxes as proposed would be valuable, the potential value of these additional disclosures is undermined by the failure to require companies to disclose pre-tax income by significant country as well. Without knowing the company's pre-tax income, it is impossible to determine the tax rate being paid by companies in the significant countries in which they do business. To fix this issue, FASB should require companies to disaggregate both pre-tax income and taxes paid for countries in which they have either significant income or significant taxes. Without such a requirement, companies would only be required under the rules to report their income tax paid information for those countries for which they have significant income taxes, meaning that this requirement would exclude precisely those countries where the company is paying an insignificant amount in taxes because they are shifting profits into low- or no-tax jurisdictions.

In addition, it would be extremely valuable for FASB to require companies to further disaggregate domestic taxes paid and domestic tax expense, into federal and state taxes paid and expense. This would allow for better understanding of the relative levels of federal and state income taxes that companies pay, an important piece of information in understanding our multi-level corporate tax system. Such information would also allow researchers of state tax policy as well as state lawmakers to get a better understanding of the amount that companies are paying on the state level and whether they may be engaged in interstate profit shifting.

Another pair of positive changes proposed in the draft are the disclosure of the aggregate amount of cash, cash equivalents and marketable securities held by foreign subsidiaries and an explanation for any change in assertion about indefinite reinvestment of undistributed foreign earnings. Taken together these rules will provide a clearer picture of any tax risks faced on offshore earnings and provide clarity on the currently opaque process by which companies determine what portion of their offshore earnings are indefinitely reinvested.

While helpful, these changes do not provide the needed clarity required to understand the tax risks involved with permanently reinvested offshore earnings. The key problem facing users of financial statements is the fact that they cannot determine the full potential tax exposure that permanently reinvested earnings may face if they were subject to some form of repatriation. Given that many companies indicate having significant amounts of permanently reinvested earnings, the tax risk facing these earnings could be significant as well. To provide clarity to users of financial statements, FASB should require all companies with permanently reinvested earnings to estimate the amount they would owe on these earnings if they were to be repatriated. In practice, this would mean removing the ability of many companies to avoid disclosing this information under the current rules if they determine that making this calculation is not practicable. While companies have expressed concerns that removing the “not practicable” exception could cause some additional accounting cost, this cost is well worth it considering that without this information users of financial statements may be getting an incomplete understanding of a company’s financial situation.

Good public policy requires good information. In the world of tax policy, this means that decision makers need access to data on where and how much companies are paying in taxes. With its review of income tax disclosures, FASB has a real opportunity to expand access to critical tax information and ensure a better informed debate as lawmakers consider ways to improve our country’s tax code.

Sincerely,

Richard Phillips
Senior Policy Analyst at the Institute on Taxation and Economic Policy

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[i] Institute on Taxation and Economic Policy, “Sorry State of Corporate Taxes,” February 25, 2014 http://itep.org/itep_reports/2014/02/the-sorry-state-of-corporate-taxes.php
[ii] US PIRG and Citizens for Tax Justice, “Offshore Shell Games 2015,” October 5, 2015. http://ctj.org/ctjreports/2015/10/offshore_shell_games_2015.php
[iii] Jonathan Nicholson, “Ryan's 2017 Agenda: Tax, Regulatory, Entitlement Overhauls,” Bloomberg BNA, September 29, 2016. http://www.bna.com/ryans-2017-agendatax-n57982077735/
[iv] Internal Revenue Service, “Country-by-Country Reporting,” June 30, 2016. https://www.federalregister.gov/articles/2016/06/30/2016-15482/country-by-country-reporting