Automotive Tax Insights

September 4, 2012

2012 tax rate benchmarking study for industrial manufacturing and automotive companies

This article presents results of PwC's recent study[1] on tax rate benchmarking for 2012 in the industrial manufacturing (IM) and automotive industries.

Tax rate benchmarking can give valuable data and insight into companies' tax functions.

The study benchmarked the effective tax rate (ETR) and examined some of the key drivers of those rates. It provides you an overview of the ETRs, and insight on how your company's ETR compares to your peers. Knowing where you stand in comparison with those around you is an invaluable asset, especially during a time of rapid change.

Industry overview

The IM and automotive industries experienced a recovery this year, during a volatile business climate. There is cautious optimism that the recovery will continue, but with an expectation that it will be uneven. Emerging markets (principally, China, India, and Brazil) invested in infrastructure and increasing automation, driving much of the recovery, while the sovereign debt crisis in Europe and unemployment in mature markets created uncertainty in other parts of the world. A number of companies in the study had operations in or were based in Japan, and the earthquake in March

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[1] The study incorporates company data for 55 companies for accounting periods ending in 2011. Thirty-six companies in the study had calendar year-ends, 10 companies had March year-ends, and the remainder had year-ends at other times during the year. Data for 2011 were not available for one company at the time the study was completed; for 2010 and 2009 all data were available. The companies included in the study are listed at the end of this article.

See the full copy of *Assessing Tax: 2012 tax rate benchmarking study for industrial products and services companies* at www.pwc.com/us/industrialproducts/publications.

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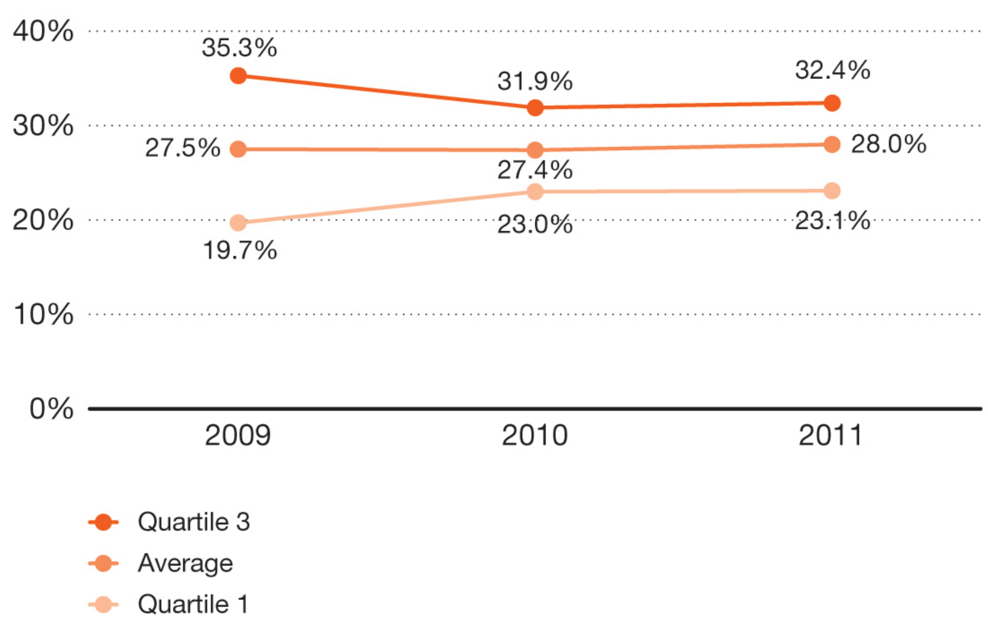
2011 and its aftermath had a significant impact on companies operating in that country.

Many companies reported a focus on innovation and development, seeing new products and processes as a way to differentiate and drive their business forward. New ideas led to the inception of new products and production methods, which improved firms' productivity. A focus on costs, although still present, was less marked than last year.

ETR for all companies

The average three-year ETR of the sector was 27.6%. As shown in the *Figure 1*, there has been a small increase in the 2011 ETR (28.0%) compared with 2009 (27.5%), but a decrease in the range between the quartiles, from 15.6 to 9.3 percentage points. As losses were used and profitability returned, ETRs were less distorted and the inter-quartile range narrowed. However, there was volatility in the ETRs that reflected external events, such as the earthquake in Japan; the maximum ETR in 2011 was 74.8% and the minimum was -81.8%. Four companies in the study saw a reduction in the ETR of more than 10 percentage points compared with 2010, and three companies saw an increase of more than 10 percentage points.

Figure 1—Effective tax rate for all companies

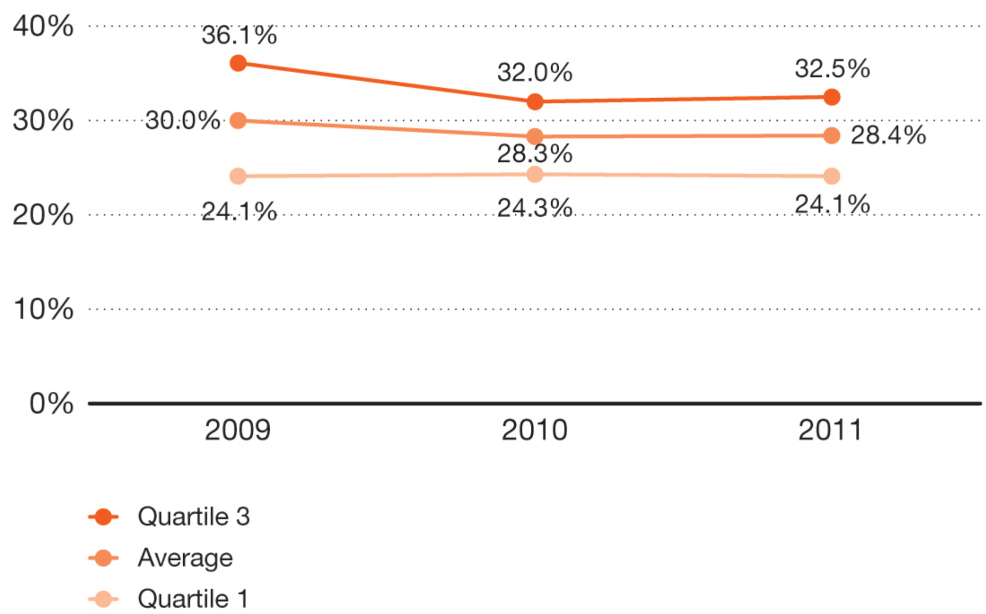


For companies in the study, profits increased on average by 24.0%, and all but two companies were profitable in 2011. One company was in a tax benefit position in 2011, compared with nine in a tax benefit position in 2009.

ETR for profitable companies

Figure 2 shows the ETR trend when all companies that have had losses or been in a tax benefit position in any of the last three years are removed. After this calculation, 41 companies remained in the analysis.

Figure 2—Effective tax rate for profitable companies



Both Quartile 1 and average ETR are consistent from 2010 to 2011. The range between the quartiles is 8.4% in 2011. Only one company had a movement in the ETR between 2010 and 2011 of more than 10 percentage points; the lowest ETR was 9.0% and the highest was 74.8%.

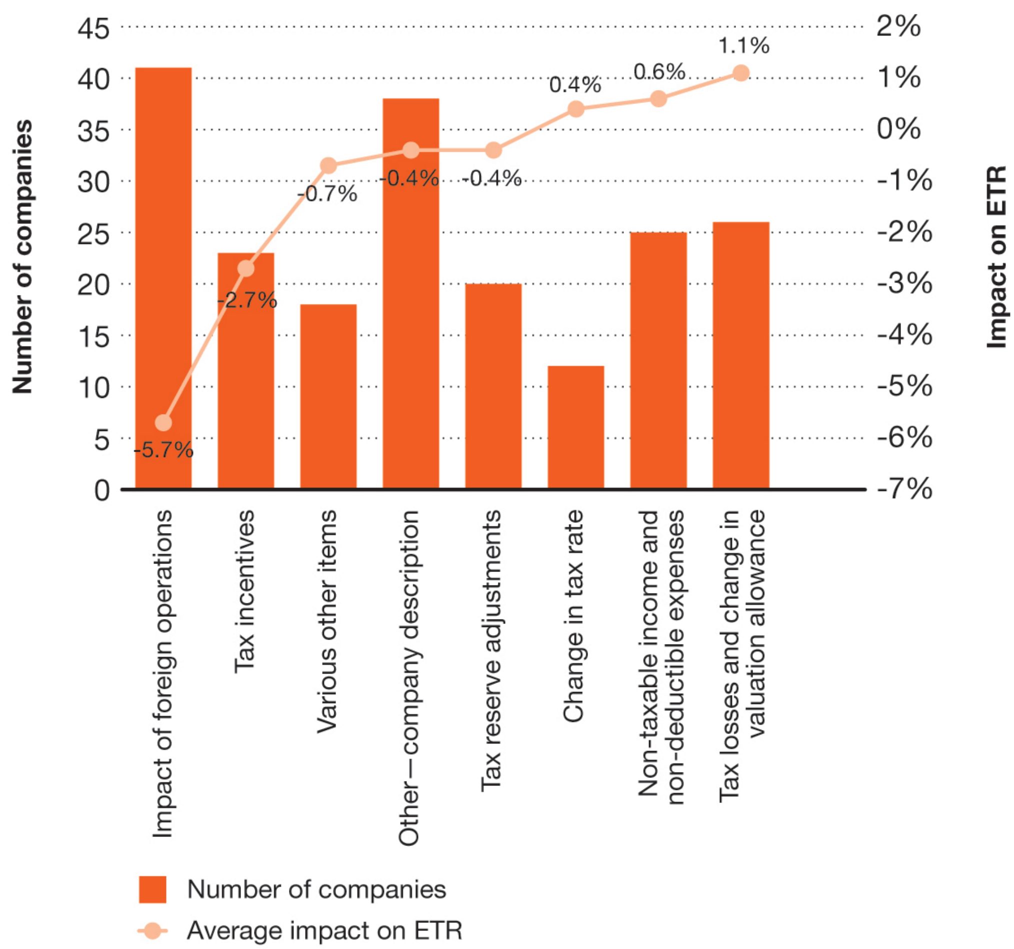
Drivers of the ETR

Forty-four companies in the study disclosed reconciliation between their statutory and effective rate in company accounts. It was possible to gain some insight into the drivers of the effective rate in the sector by reviewing this analysis.

The effective rate for 35 companies was below the statutory rate, and for nine companies it was above the statutory rate. The reconciling items as disclosed in the statutory/ effective rate reconciliation were analyzed, collated, and averaged over the sample.

Figure 3 shows how frequently the drivers appeared in statutory/ effective rate reconciliations and the impact they had on ETS. The bars showing the number of companies reporting the driver, and the lien shows the impact of that reconciling item averaged over all companies reporting it, excluding single outlying ratios in excess of +50% or -50%.

Figure 3—Drivers of the effective tax rate



The most common reconciling item, reported by 41 companies, was the impact of foreign operations, which reduced the ETR by 5.7%. This reflects increasing globalization in the sector, as highlighted in the special report, and the increasing significance of emerging markets. State taxes, where levied, fell into this category, and increased the ETR, but the tax differential on foreign earnings was favorable for the majority of companies in the study.

Tax incentives were a favorable driver for 23 of the companies in the study, and these companies benefited on average by 2.7%. Descriptions of the tax incentives varied from specific descriptions of "domestic manufacturing deduction" and "research and development credit" to the broader "general business credit."

The other item having an impact of greater than 1% was "tax losses and change in valuation allowance." Twenty-six companies reported this item, and it had an unfavorable impact of 1.1%. Change in valuation allowance, which can be both a positive and negative driver, was the most common description. It was a positive driver in seven instances and negative in nine instances.

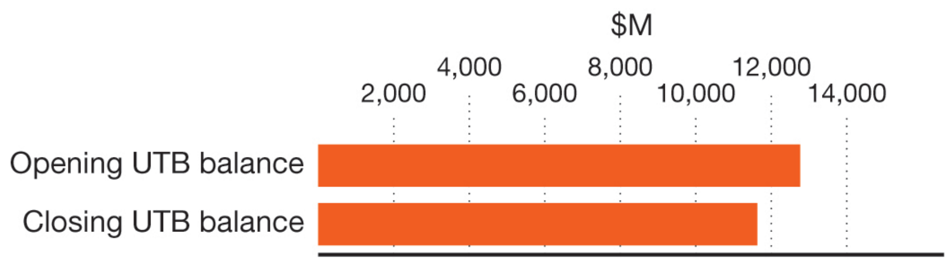
Unrecognized tax benefits

The accounting recognition and disclosure requirements in the US for uncertainty in a tax position taken or expected to be taken in a tax return involves a two-step approach of evaluating tax positions and determining if they should be recognized in the financial statements. This process involves recognizing any tax positions that are "more likely than not" to be sustained upon examination. If the tax position meets this threshold, the tax position must be measured using specified criteria.

Figure 4 shows that total unrecognized tax benefit (UTB) balances in the 24 US-based companies in this study decreased by 9.8% between 2010 and 2011. Total UTBs for all companies at the end of 2011 amounted to $11.6B. On an individual company basis, the average UTB was $465M, the average decrease was 2.7%, the maximum increase was 163%, and the maximum decrease was -75%.

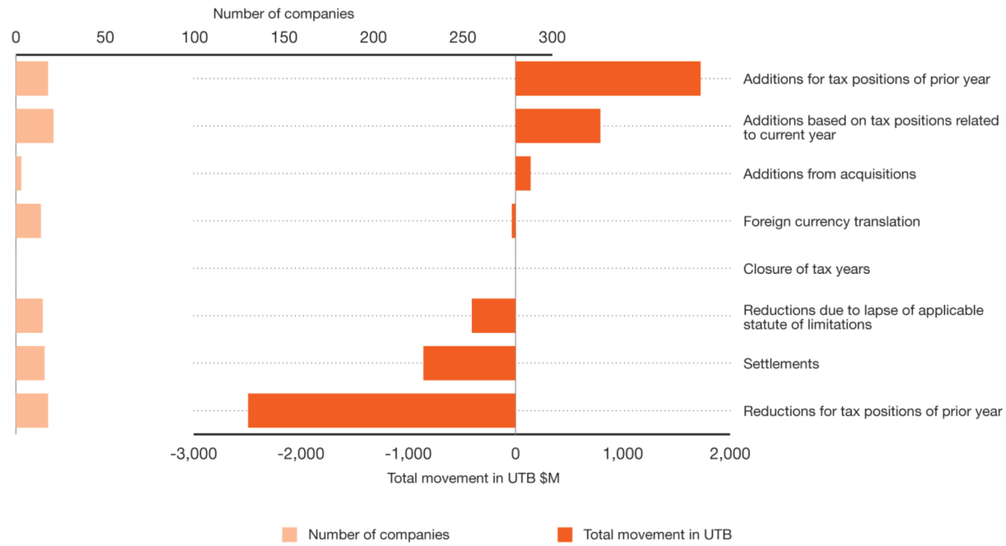
We reviewed how frequently the drivers of the UTBs were disclosed by companies.

Figure 4—Opening and closing UTB balances



The majority of companies (more than 80%) reported additions based on tax positions related to the current year as well as additions and reductions for tax positions of prior years. *Figure 5* illustrates that the overall reduction in UTBs was a result of prior years in which the reductions were larger than the additions in the current year.

Figure 5—Disclosures of the drivers of UTBs



Unrepatriated earnings

US-based multinationals are permitted to defer incremental taxes, which would be borne in the United States upon repatriation of foreign earnings. Without deferral, US multinationals would incur incremental US tax expense on their books, net of expected foreign tax credits, on non-repatriated earnings from foreign subsidiaries, when the subsidiary is operating in a jurisdiction with lower tax rates than in the United States.

All 23 US-based multinationals in the study disclosed the total cumulative amount of undistributed earnings from their foreign subsidiaries on which the US-based parent company had not recognized income taxes.

The average total cumulative amount of undistributed earnings from foreign subsidiaries equaled 318% (median 224%) of total income before income tax.

Companies included in the sector

3M Co.
ABB Ltd.
AB Volvo
Alstom S.A.
Alfa Mexico
Amcor Ltd.
Atlas Copco AB
Ball Corp.
Bharat Heavy Electricals Ltd.
Bridgestone Corp.
Canon Inc.
Compagnie De Saint-Gobain S.A.
Michelin S.c.a.
Continental AG
Cooper Industries plc
Corning Inc.
Cymer Inc.
Danaher Corp.
Deere & Co.
Dresser-Rand Inc.
E.ON AG
Eaton Corp.
Emerson Electric Co.
Energizer Holdings Inc.
Fanuc Ltd.
Flowserve Corp.
General Electric Co.
HeidelbergCement AG
Honeywell International Inc.
Hutchison Whampoa Ltd.
Hyundai Heavy Industries Co. Ltd.
Illinois Tool Works Inc.
Ingersoll-Rand plc
Itochu Corp.
ITT Corp.
Jardine Matheson Holdings Ltd.
Jardine Strategic Holdings Ltd.
Komatsu Ltd.
Larsen and Toubro Ltd.
MAN SE
Mitsubishi Corp.
Mitsubishi Electric Corp.
Mitsui & Co. Ltd.
PACCAR Inc.
Parker-Hannifin Corp.
Rockwell Automation Inc.
Sandvik AB
Schneider Electric S.A.
Siemens AG
SPX Corp.
Sumitomo Corp.
Te Connectivity Ltd.
The Timken Co.
Tyco International Ltd.
Xerox Corp.

How PwC can help

PwC's tax advisors can assist you in evaluating your company's effective tax rate opportunities, both domestic and international, to position you for the future.

For more information, please contact:

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Upcoming Automotive and Tax Events

September 26, 2012

Automotive News Europe EuroStars
Paris, France

October 4-7, 2012

SAE Global Leadership Conference
The Greenbrier, West Virginia

January 15-18, 2012

Automotive News World Congress
Detroit, Michigan

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