Insights from the Investment Community

Disclosing cash held offshore

March 2014

Background

In recent years, the cash (and equivalents) balances of US multinational companies have increased significantly. From 2006 through mid-2013, total cash of US non-financial companies increased 81% to nearly $1.5 trillion.[1] A numbers of factors may be contributing to the increase in these balances, but the growing significance of companies with foreign operations and the resulting accumulation of earnings from foreign subsidiaries may be a significant contributor. Why? Companies may have an incentive to leave earnings of foreign subsidiaries in the countries in which they operate if those countries have a lower corporate tax rate than that of the US. Disclosing the amount of cash affected by this tax strategy can help investors understand how much of a company's total cash is not available to fund domestic operations.

What's the accounting?

Under US accounting standards, there is no requirement for a company to disclose the amount of cash of its foreign subsidiaries that is not available for use by the US parent. The standards focus instead on the accounting for undistributed earnings of foreign subsidiaries, for which there is a general presumption that the amount will be transferred to the parent company for its own use, thus requiring deferred taxes on those earnings to be recorded. A company is not required to record a tax liability, however, if it can assert that it will indefinitely reinvest the foreign earnings and has the intent and ability to do so. In those cases, it can indefinitely defer the tax liability associated with those earnings.

A decision to indefinitely reinvest foreign earnings requires careful consideration of financial and operational factors. A company that asserts it will indefinitely reinvest foreign earnings must compile evidence and have a specific plan to support such a position. For instance companies need to consider the financing requirements of the parent and subsidiary as a result of current operations, anticipated transactions, and debt, lease, or other capital arrangements.

[1] Moody's Investor Service, Global Credit Research, September 30, 2013.

Disclosures—indefinite reinvestment assertion

When a company makes an indefinite reinvestment assertion, it is required to disclose in the financial statement footnotes the amount of the unrecognized tax liability on the undistributed earnings of foreign subsidiaries or a statement that it is impractical to determine such amount.[2] When an estimate cannot be made, the SEC staff has sometimes sought to understand why as part of reviewing the company's filing.

Information in a company's footnote disclosure about its indefinite reinvestment assertion should be consistent with information in the liquidity section of its MD&A. Additionally, companies should consider disclosing in MD&A the amount of cash and short term investments held by the foreign subsidiary. This is consistent with an SEC staff suggestion made a few years ago. Companies also should consider disclosing the potential tax consequence of repatriating those amounts and a description of events that may cause such foreign earnings to become taxable. These disclosures would highlight the portion of a company's total cash and short term investments reported on its balance sheet that are not currently available to fund domestic operations or obligations without paying a significant amount of taxes upon repatriation.

Why it matters?

In our discussions with members of the investment community,[3] they noted that income tax issues are very important to their analyses and they desire more transparency into the impact of income tax related decisions on companies' financial reporting.

In addition, understanding a company's liquidity and therefore its ability to pay down debt, pay dividends, and fund capital expenditures or expansion is important. Certain investment professionals we spoke with recommended that companies that assert indefinite reinvestment of foreign earnings disclose the cash balances held by the parent and its foreign subsidiaries. This information is important in evaluating sources and uses of cash, and can be a factor that impacts a company's credit or debt rating. In the absence of this transparency, investors would be left to make their own assumptions about these significant matters.

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[2] Accounting Standards Codification 740-30-50

[3] The U.S. investment professionals' views aggregated and described generally herein are based on meetings we held with buy-side, sell-side, and credit analysts. None of these discussions involved company-specific matters or fact-patterns, nor did we discuss any of PwC's specific audits or the work we perform on them. This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors. PwC is not providing investment advice, recommending investment strategies or recommending anyone or anything for the purpose of effecting or influencing securities transactions.

Questions or comments?

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