Should U.S. and Global Regulators Take a Bigger Tax Bite Out of Technology Companies? A Case on Apple's International Tax Minimization and Reporting Strategies

Issues in Accounting Education, February, 2016

Accompanying Case Website: globalaccountingcases.com/home/taxation

Classroom PowerPoint Presentation:

Apple Taxation Case_classroom_presentation – Powerpoint (download time varies with internet speed)

Videos:

Tech Companies Take Advantage of Tax Code (PBS)

The New Tax Havens (CBS 60 Minutes)

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The Global Tax Reset (Deloitte)

UK and Others Urges G-20 to Make MNC's Pay Tax

OECD Aims to Rewrite Global Tax Rulebook (Euronews)

Attachment 3: Screenshots of the Accompanying Website

http://globalaccountingcases.com/home/taxation/

Apple Taxation Case Resources

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Exhibit 1 – 19 to May 21, 2013 Subcommittee memo on Offshore Profit Shifting – Part 2 (Apple, Inc.)

OECD/G20 BEPS Project

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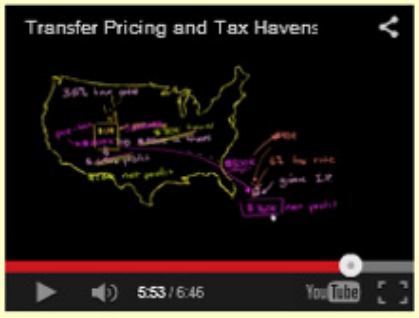

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Attachment 4: Multimedia PowerPoint presentation, with audio and video links, for instructor classroom use

Apple Taxation Case_classroom_presentation – Powerpoint

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A Case on Apple Inc.'s International Tax Minimization and Reporting Strategies

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1. Introduction
2. Senate Hearings, Offshore Profit Shifting
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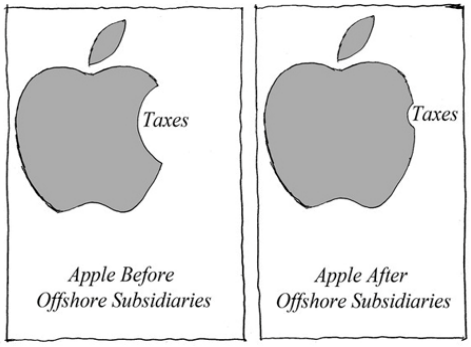
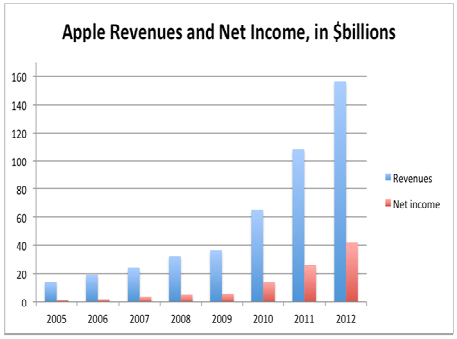
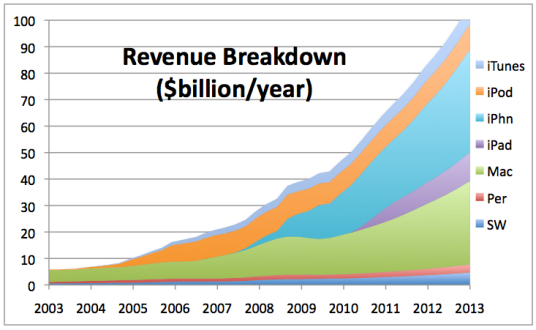


Rapid Growth in Apple's Revenue and Net Income



Apple's Revenue Breakdown by Product



While Apple's Profits increased, their Tax Payments rose more slowly

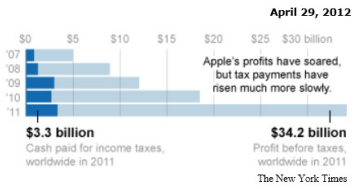
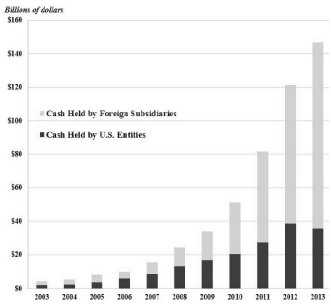


EXHIBIT 1
Growth of Apple's Cash Held by Foreign Subsidiaries (2003–2013)



Source: Apple 10-Ks for 2003 to 2013.

Should U.S. and Global Regulators Take a Bigger Tax Bite Out of Technology Companies? A Case on Apple's International Tax Minimization and Reporting Strategies

Mark A. Holtzblatt
John Geekie
Cleveland State University

Norbert Tschakert
Salem State University

ABSTRACT: This case provides students with an opportunity to examine the international tax minimization and reporting strategies of Apple Inc. (Apple) and other technology companies, as well as the related U.S. congressional investigations into "Offshore Profit Shifting and the U.S. Tax Code." The case also addresses supranational and foreign governmental efforts that focus on these global tax issues. Apple has been able to minimize its overall tax bill by utilizing techniques to shift income to lower tax jurisdictions. Students are required to research and critically analyze tax and accounting issues related to Apple's tax minimization strategies, as well as the related U.S. and international regulatory investigations. The case learning objectives include understanding the importance of tax minimization and reporting strategies, increasing knowledge of congressional concerns about multinational tax strategies, and improving awareness of foreign governments' and supranational organizations' criticisms of multinational tax minimization. The case can be used in undergraduate and graduate level International Accounting, Corporate Taxation, and International Taxation classes.

Keywords: international taxation; transfer pricing; Subpart F; tax repatriation holiday; deferred taxes; offshore profit shifting.

INTRODUCTION

Several commentators believe that Apple Inc. (Apple) exemplifies how multinational technology companies have exploited tax codes that were written for an industrial age and are unsuitable for the modern world's digital economy (Dahiga and Kocieniewski 2012). Some earnings at corporations like Apple are not created from tangible products, but rather from intellectual property, such as the patents on the software that makes electronic equipment operate. In other cases, the merchandise items themselves are digital, such as downloadable music. It takes far less effort for companies with revenue earned primarily from royalties and digital merchandise to transfer earnings to tax haven nations than for companies in other industries, such as retail or automotive. Downloadable software or apps can be sold from any location in the world (Dahiga and Kocieniewski 2013).

The increase in digital business creates a problem for legislators worldwide in the regulation of the taxation of multinational corporations; despite the fact that technology is now one of the most important industries, numerous technology corporations are among the least taxed. Even in comparison to other technology firms, Apple's tax rates are relatively low. And even though Apple has helped to recreate industrial sectors, sparked business expansion, and has satisfied consumers, it has also designed corporate policies that exploit weaknesses in the tax regulations.

Many major companies try to lower taxes. For Apple, the potential tax savings are particularly attractive, as its earnings are so high. Apple has set up corporations in lower tax countries, such as Ireland and the British Virgin Islands, which has helped to reduce its worldwide taxes. These practices are drawing increasing scrutiny from members of the U.S. Senate, foreign

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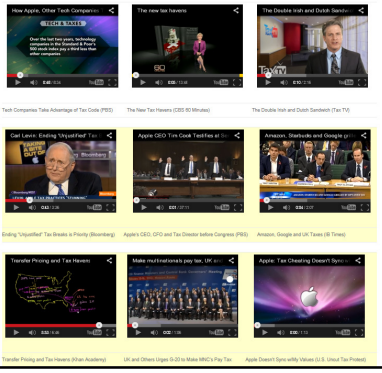

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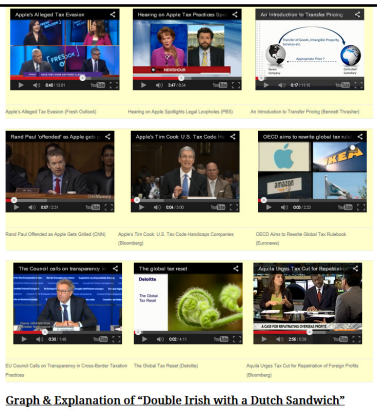

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September, 2012 Senate Hearings for HP & Microsoft

Forbes — New Posts +4 posts this hour | Most Popular First 3D-Printed Gun | Lists The Midas List

9/20/2012 @ 12:00PM | 1,139 views

Senate Committee Says Multinationals Heading Offshore To Avoid Billions In Tax

+ Comment Now + Follow Comments

Senator Carl Levin's (D-Michigan) Permanent Subcommittee on Investigations will hear testimony today starting at 2:00 p.m. on the tax avoidance and possible tax evasion activities of multinational corporations. Microsoft, Hewlett Packard, IRS officials, accounting firm Ernst & Young and accounting standard setters will testify. Levin and the Committee believe many big corporations send profits offshore to avoid, and possibly evade, billions in tax by taking positions of "dubious validity". Auditors, tax accountants and lawyers are signing off on "egregious" abuses of tax loopholes for their clients, according to Levin.

Chairman Levin and the Committee are raising this issue now for one reason: The U.S. needs the money. "At a time when we face such difficult budget choices, and when American families are facing a tax increase and cuts in critical programs from education to health care to food inspections to national defense," say Levin, "these offshore schemes are unacceptable."

Senator Levin Quotes from the 2012 Senate Hearing on Offshore Profit Shifting and the U.S. Tax Code

"Some multinationals use our current tax system to engage in gimmicks to avoid paying taxes they owe," Sen. Carl Levin (D-Mich.), chairman of the Senate Permanent Subcommittee on Investigations, said in the hearing on September 20, 2012.

Levin described "a system used to shift billions of dollars of profit offshore and avoid billions in taxes" (Duke, 2012).

2012 Senate Hearing Findings:

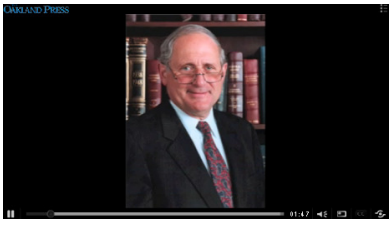
The Senate investigation explains that, to exploit the loophole, a company will "sell" their intellectual property rights to a foreign, controlled company in a tax shelter (Hickey, 2012).

The controlled foreign company gains the profits from domestic and international sales without the burden of American taxation. (Hickey, 2012).

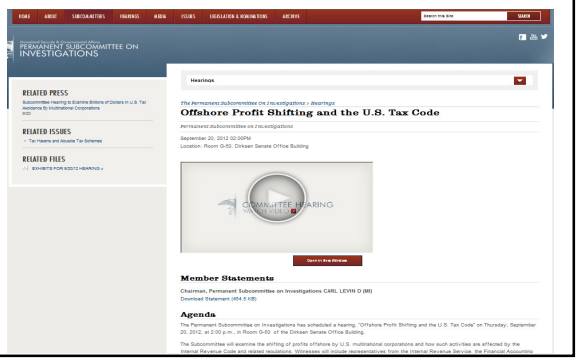
Audio: Senator Carl Levin Interview

http://www.theoaklandpress.com/general-news/20130404/us-sen-carl-levin-aims-at-closing-corporate-tax-loopholes-as-a-deficit-reduction-strategy-with-video

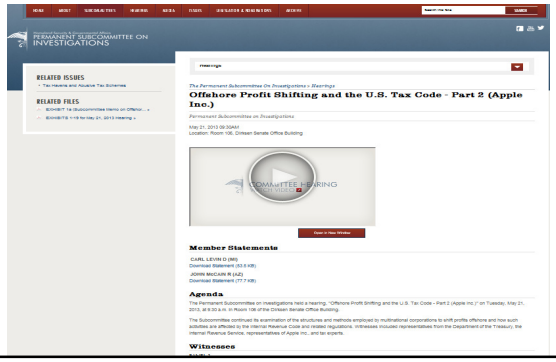
U.S. Sen. Carl Levin aims at closing corporate tax loopholes as a deficit reduction strategy



Website of 2012 Senate Investigation: HP & Microsoft
http://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code



Website of 2013 Senate Investigation: Apple Inc.
http://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code_-part-2



Video: Apple's Tim Cook at the 2013 Senate Hearing: "U.S. Tax Code Handicaps Companies"
https://youtu.be/FiJez6DtZWc

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Apple Inc.'s Strategies for Global Tax Minimization
(quotes from the New York Times article, April, 2012)

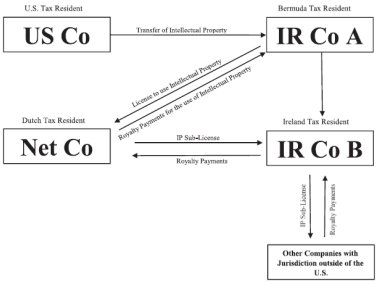
"Although Apple Inc. is based in the United States, its profits - on paper, at least - are largely foreign. While Apple contracts out much of the manufacturing and assembly of its products to other companies overseas, the majority of Apple's executives, product designers, marketers, employees, research and development, and retail stores are in the United States" (Duhigg & Kocieniewski, 2012).

"Furthermore, even though 54 percent of Apple's long-term assets, 69 percent of its retail stores, and 39 percent of its sales are in the United States, Apple's accountants have found legal ways to allocate about 70 percent of its profits overseas, where tax rates are often much lower" (Duhigg & Kocieniewski, 2012).

APPLE'S TAX MINIMIZATION STRATEGY

"Double Irish With a Dutch Sandwich"

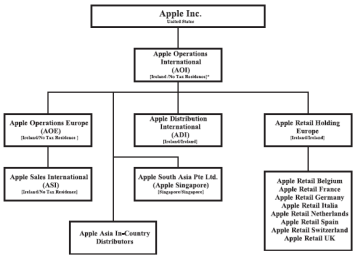
EXHIBIT 2
General Overview of the "Double Irish with a Dutch Sandwich"



American Accounting Association — *Issues in Accounting Education*

8 *Holtzblatt, Geekie, and Tschakert*

EXHIBIT 1
Apple's Offshore Organizational Structure



*Listed countries indicate country of incorporation and country of tax residence, respectively.
Source: Levin and McCain (2013).

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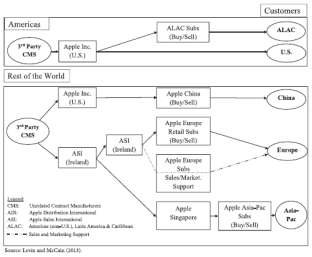
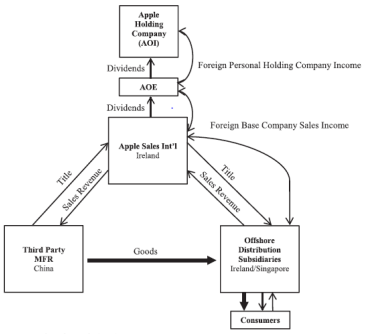
EXHIBIT 2
Distribution Plan for Apple Sales International



Source: Levin and McCain (2013).

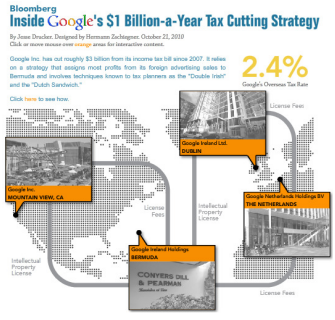
10 *Holtzblatt, Geekie, and Tschakert*

EXHIBIT 3
Apple's Offshore Distribution Structure



Source: Levin and McCain (2013).

Google also uses the Double Irish Strategy



Video: How Apple, Other Tech Companies Take Advantage of the U.S. Tax Code
https://www.youtube.com/watch?v=IsWHCl3HgDk

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On November 4, 2012, the following headline appeared in the British newspaper, The Telegraph.

The Telegraph

Apple pays less than 2pc tax on overseas profits

Apple is paying less than 2pc tax on its overseas profits, as it moves money through offshoots in low-tax countries and secretive tax havens, such as the British Virgin Islands.

The Sunday Times reports that new documents have revealed that the world's biggest company paid $713m (£445m) in corporation tax abroad in the year to September 30, as profits grew to a $36.8bn outside America, according to regulatory filings lodged last week.

The technology giant's overseas tax rate fell to 1.9pc from 2.5pc the year before, significantly below the corporate tax rate of 35pc in the US and 24pc in Britain.

- **The regulatory document that The Telegraph is referring to is Apple's 10-K. The relevant information is in the note on income taxes. The note from the 2013 10 –K discloses that Apple's effective tax rates were approximately 26.2%, 25.2%, and 24.2% for 2013, 2012, and 2011.**
- **The Company's effective rates for these periods differ from the statutory federal income tax rate of 35% due primarily to certain <u>undistributed foreign earnings</u> for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.**

Apples Note 5: Income taxes for 2013, 2012, 2011

Note 5 – Income Taxes

The provision for income taxes for 2013, 2012 and 2011, consisted of the following (in millions):

	2013	2012	2011
Federal:			
Current	$ 9,334	$ 7,240	$ 3,884
Deferred	1,878	5,018	2,998
	11,212	12,258	6,882
State:			
Current	1,084	1,182	762
Deferred	(311)	(123)	37
	773	1,059	799
Foreign:			
Current	1,559	1,203	769
Deferred	(426)	(490)	(167)
	1,133	713	602
Provision for income taxes	$13,118	$14,030	$ 8,283

The foreign provision for income taxes is based on foreign pre-tax earnings of $30.5 billion, $36.8 billion and $24.0 billion in 2013, 2012 and 2011, respectively. The Company's consolidated financial statements provide for any related tax liability on undistributed earnings that the Company does not intend to be indefinitely reinvested outside the U.S. Substantially all of the Company's undistributed international earnings intended to be indefinitely reinvested in operations outside the U.S. were generated by subsidiaries organized in Ireland, which has a statutory tax rate of 12.5%. As of September 28, 2013, U.S. income taxes have not been provided on a cumulative total of $54.4 billion of such earnings. The amount of unrecognized deferred tax liability related to these temporary differences is estimated to be approximately $18.4 billion.

As of September 28, 2013 and September 29, 2012, $111.3 billion and $82.6 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2013, 2012 and 2011) to income before provision for income taxes for 2013, 2012 and 2011, is as follows (in millions):

	2013	2012	2011
Computed expected tax	$17,554	$19,517	$11,973
State taxes, net of federal effect	508	677	552
Indefinitely invested earnings of foreign subsidiaries	(4,614)	(5,895)	(3,898)
Research and development credit, net	(287)	(103)	(167)
Domestic production activities deduction	(308)	(328)	(168)
Other	265	162	(9)
Provision for income taxes	$13,118	$14,030	$ 8,283
Effective tax rate	26.2%	25.2%	24.2%

Accounting Standards Codification 740-30-25 (Formerly - APB 23)

APB 23: Accounting for Income Taxes—Special Areas

APB 23 STATUS

Issued: April 1972

Effective Date: For fiscal periods beginning after December 31, 1971

Affects: Deletes ARB 51, paragraph 16
Deletes APB 11, paragraphs 38, 39, and 41
Deletes APB 18, paragraph 19(j) and footnote 11

Affected by: Paragraph 2 amended by FAS 9, paragraph 16
Paragraph 4 deleted by FAS 71, paragraph 26(i)
Paragraph 9 and footnote 9 amended by FAS 96, paragraph 205(e), and FAS 109, paragraph 288(f)
Paragraph 10 amended by FAS 96, paragraph 205(e)
Paragraph 10 replaced by FAS 109, paragraph 288(f)
Paragraphs 11, 14, and 24 replaced by FAS 96, paragraph 205(e), and FAS 109, paragraph 288(f)
Paragraph 13 amended by FAS 96, paragraphs 204 and 205(e), and FAS 109, paragraphs 287 and 288(f)
Paragraphs 21 and 23 amended by FAS 109, paragraph 288(f)

APB 23 contains one important presumption. Consider it to be the normal route for reporting undistributed earnings of a subsidiary:

"It shall be presumed that all undistributed earnings of a subsidiary will be transferred to the parent entity. Accordingly, the undistributed earnings of a subsidiary included in consolidated income shall be accounted for as a temporary difference unless the tax law provides a means by which the investment in a domestic subsidiary can be recovered tax free." (From Accounting Standards Codification 740-30-25-3)

The APB 23 exception as currently framed in the Accounting Standards Codification: "The presumption in paragraph 740-30-25-3 that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity ... if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation. A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely. These criteria required to overcome the presumption are sometimes referred to as the indefinite reversal criteria." (From Accounting Standards Codification 740-30-25-17)

- Apple does not maximize reported profit like most other companies.
- Perhaps because it is breaking all records for profitability now, it is saving some profits for less fortunate times in the future. Another possible reason is to avoid negative publicity. **(Martin Sullivan, Chief Economist for Tax Analysts)**

Martin Sullivan's Calculations

Apple's Financial Information
(For fiscal year ending September 2011, unless otherwise indicated; dollar amounts in billions.)

Market value (Feb. 8, 2012)	$444.4	Reported effective tax rate*	24.2%
Before-tax profits*	$34.2	Foreign effective tax rate	4.7%
Before-tax foreign profits*	$24	Accumulated foreign earnings*	$54.3
U.S. share of before-tax profits	29.8%	Permanently invested foreign earnings*	$23.4
U.S. share of sales	38.6%	Accumulated foreign earnings not permanently invested	$30.9
U.S. share of long-lived assets	54.2%	Deferred tax liability of not permanently invested foreign earnings, end of 2011*	$8.9
U.S. share of retail stores	68.6%	Deferred tax liability of not permanently invested foreign earnings, end of 2010*	$5
U.S. sales margin	24.4%	Estimated book U.S. tax expense on foreign profit	$3.9
Foreign sales margin	36.1%	Estimated foreign profit with booked U.S. tax expense	$12.4
Additional U.S. tax if 50% profits in U.S.	$2.4	Estimated U.S. tax rate on repatriated foreign earnings	28.8%
Additional U.S. tax if 70% profits in U.S.	$4.8	Adjusted effective tax rate	12.8%

Notes:
Asterisk (*) means information is directly from 2011 annual report.
Market value. From Yahoo Finance. Second in market capitalization is Exxon Mobil at $403.9 billion.
U.S. share of before-tax profits. Calculated from 2011 reported total before-tax profits ($34.2 billion) and 2011 reported before-tax foreign profits ($24 billion).
Additional U.S. tax if 50% profits in U.S. The difference between 50 percent and 29.8 percent multiplied by $34.2 billion (before-tax profits) and 35 percent (the marginal U.S. federal corporate tax rate).
Foreign effective tax rate. Total foreign tax liability ($602 million) divided by total before-tax foreign profits ($24.0 billion).
Accumulated foreign earnings not permanently invested. The difference between accumulated foreign earnings at the end of 2011 ($54.3 billion) and permanently invested foreign earnings at the end of 2011 ($23.4 billion).
Estimated foreign profit with booked U.S. tax expense. Increase from 2010 to 2011 (from $18.5 to $30.9 billion) in accumulated foreign profit not permanently reinvested.
Estimated book U.S. tax expense on foreign profit. Increase from 2010 to 2011 (from $5 to $8.9 billion) in deferred tax liability related to foreign earnings not permanently invested.
Estimated U.S. tax rate on repatriated foreign earnings. Booked U.S. tax expense on foreign profits as a percentage of estimated booked foreign profit with U.S. tax expense.
Adjusted effective tax rate. The difference between booked tax expense ($8.238 billion) and estimated book tax expense on foreign profits ($3.9 billion) divided by before-tax profits ($34.2 billion).

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7. Case Questions

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Apple Holds Billions of Dollars in Foreign Tax Havens

May 20, 2013 11:53 AM | Permalink | SHARE

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Virtually None of Its $102 Billion Offshore Stash Has Been Taxed By Any Government

An analysis of Apple Inc.'s financial reports makes clear that Apple has paid almost no income taxes to any country on its $102 billion in offshore cash holdings. That means that this cash hoard reflects profits that were shifted, on paper, out of countries where the profits were actually earned into foreign tax havens.

How We Know Apple's Offshore Cash is Largely in Tax Havens

Under current law, corporations can indefinitely defer paying U.S. income taxes on their offshore profits. Multinational corporations with offshore profits sometimes disclose in their financial reports the amount of tax they would pay if there were no "deferral" and their offshore profits were taxable in the United States. But this potential tax rarely amounts to the full 35 percent U.S. corporate tax rate, since these companies typically have already paid some foreign income taxes on these foreign profits when they were earned. Companies are allowed a "foreign tax credit" against their U.S. tax when and if the profits are subject to U.S. tax. So a company that has already paid (for example) a 25 percent tax rate on its unrepatriated offshore income would only pay the difference between that amount and the U.S. corporate tax rate of 35 percent (in this example, 10 percent) when that income is repatriated to the U.S.

The data in Apple's latest annual report show that the company would pay almost the full 35 percent U.S. tax rate on its offshore income if repatriated. That means that virtually no tax has been paid on those profits to any government.

At the end of March 2013, Apple's foreign subsidiaries had accumulated $102.3 billion in cash, cash equivalents and marketable securities. Based on more

Apple's Untaxed Offshore Cash Stash

At the end of Sept. 2012:	Amount ($-millions)	US tax without "deferral"	US tax rate w/o "deferral"
"Permanently Reinvested"	$ 40,400	$ 13,800	34.2%
Other Offshore Cash	42,200	14,712	34.9%
Total Offshore, Sept. 2012	$ 82,600	$ 28,512	34.5%

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Video: *U.S. Uncut* criticizing Apple's Tax Avoidance
https://youtu.be/gbJLq5skvNg

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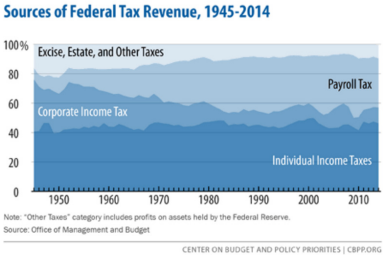
U.S. and Global Regulatory Efforts

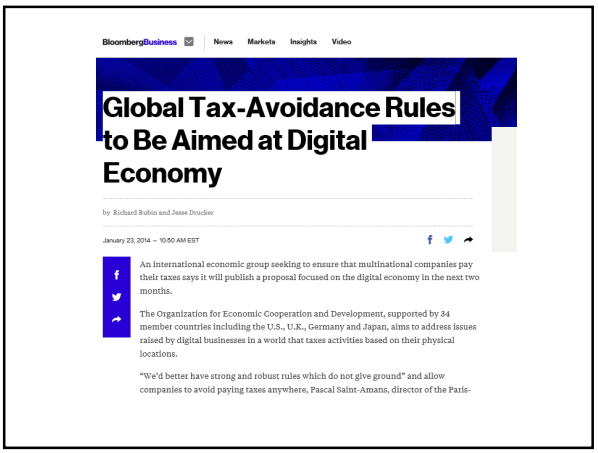
(1) U.S. Senate Investigation
(2) OECD BEPS Study (supported by G-20)
(3) European Union (EU)
(4) U.S. Tax Repatriation Holiday

U.S. Senate investigation on "Offshore Profit Shifting and the U.S. Tax Code"

Tens of billions of dollars of revenue that could and should be going toward reducing the federal deficit and keeping the budget afloat are being hoarded offshore, according to the Senate subcommittee report (O'Donnell, 2012).

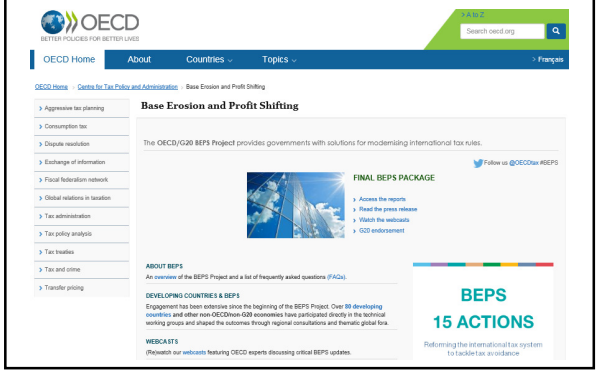
In 1952, corporate tax generated 32.1% of all federal tax revenue and individual tax generated 42.2%. Individual tax has remained nearly the same, accounting for 41.5% today, while corporate tax has dropped to a meager 8.9%. The subcommittee report attributes this drop largely to the tax loopholes and offshore shelters (O'Donnell, 2012).





Website: OECD Base Erosion and Profit Shifting

http://www.oecd.org/ctp/beps.htm



Video: G20 vows to crack down on corporate tax evasion

https://youtu.be/fEbNXwn9H-8

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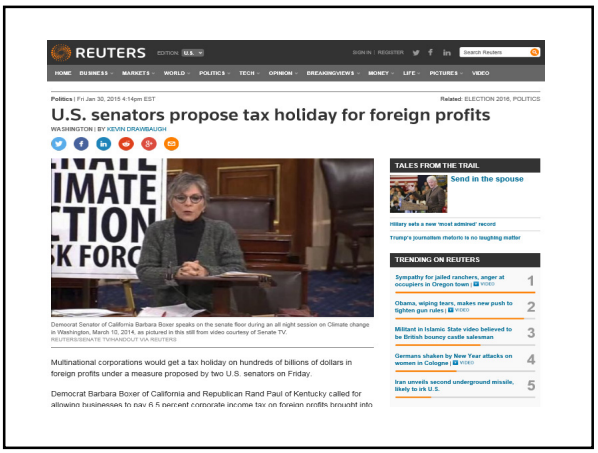
Apple's Irish tax deal faces further scrutiny by Brussels

European Commission extends its probe Ireland's alleged sweetheart tax deal with Apple

Mon, Dec 14, 2015, 12:03

The European Commission has extended its investigation into whether Dublin has offered illegal preferential tax terms to Apple. (Photograph: Kimihiro HOSHINO / AFP/Getty Images)

Brussels has extended its probe into Ireland's alleged sweetheart tax deal with Apple, the US technology company, reducing the risk that a tough verdict in



REUTERS

Politics | Fri Jan 30, 2015 4:14pm EST

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U.S. senators propose tax holiday for foreign profits

WASHINGTON | BY KEVIN DRAWBAUGH

Democrat Senator of California Barbara Boxer speaks on the senate floor during an all night session on Climate change in Washington, March 10, 2014, as pictured in this still from video courtesy of Senate TV.

Multinational corporations would get a tax holiday on hundreds of billions of dollars in foreign profits under a measure proposed by two U.S. senators on Friday.

Democrat Barbara Boxer of California and Republican Rand Paul of Kentucky called for

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REQUIREMENTS

1. In your own words, describe: (a) What is Apple attempting to achieve? (b) How is it possible that Apple, as a U.S. company, does not pay the regular corporate tax rate?
2. In your opinion, to what extent should the design and creation of intellectual property in the U.S. influence and trigger U.S. taxation? What are the possible consequences for Apple if these events would be the criteria for taxation?
3. Provide examples and comments in which Apple has been criticized for not paying appropriate taxes in other foreign countries in which it conducts business.
4. Why does General Motors Company not use the same "Double Irish with a Dutch Sandwich" technique of tax minimization as Apple?
5. The case and Senate Subcommittee hearings mention that other technology companies are using tax minimization techniques similar to Apple. Identify one other global company that engages in similar tax minimization strategies. Provide: (a) article citations; (b) a description of techniques used; and (c) a description of criticism the company may receive from foreign governments.
6. Research the concept of the "Tax Repatriation Holiday" that Apple and other technology companies support. What is the recent history of this proposal? Do you support the implementation of a tax holiday to help bring foreign earnings back to the U.S.? Why or why not?
7. ASC 740-30-25 covers the topic of undistributed earnings of subsidiaries and corporate joint ventures. (a) In your opinion, how does ASC 740-30-25 provide incentive to U.S. multinational corporations to shift or keep profits offshore? (b) How can this financial accounting standard be used as a tool for earnings management? (c) What evidence exists that corporate tax executives favor the Indefinite Reversal Exemption?
8. Several organizations, including the Organisation for Economic Co-operation and Development (OECD), the Group of Twenty (G20) Finance Ministers and Central Bank Governors, the European Union (EU), and the Global Forum on Transparency and Exchange of Information for Tax Purposes, concern themselves with tax avoidance. (a) What specific activities related to addressing multinational corporate tax minimization are each of these organizations involved in? Prepare a brief report of your findings. (b) What is the current status of each organization's progress in achieving its goals? (c) Based upon your research, what is your opinion of the potential for success of global regulatory efforts in curbing multinational corporate tax avoidance?