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Real Effects of Accounting Rules: Evidence from Multinational Firms' Investment Location and Profit Repatriation Decisions

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Abstract:
We analyze survey responses from nearly 600 tax executives to better understand corporate decisions about real investment location and profit repatriation. Our evidence indicates that avoiding financial accounting income tax expense is as important as avoiding cash taxes when corporations decide where to locate operations and whether to repatriate foreign earnings. This result is important in light of the recent research about whether financial accounting affects investment and in light of the decades of research on foreign investment that examines cash tax implications but heretofore has not investigated the importance of financial reporting effects. Our analysis suggests that financial reporting is an important factor to be considered in the policy debates focused on bringing investment to the U.S.

Keywords: investment, reinvestment, repatriation, tax expense, multinational

JEL classification: M40, H20, H25

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Real Effects of Accounting Rules: Evidence from Multinational Firms' Investment Location and Profit Repatriation Decisions

1. Introduction

This paper addresses the broad research question of whether accounting affects corporate investment decisions. Specifically, we study whether the ability to avoid or defer the recording of income tax expense on financial statements is an important consideration in real corporate investment decisions regarding location of operations and, once foreign operations begin, whether to repatriate foreign earnings to the U.S. or reinvest the foreign earnings overseas. The question of whether statutory tax rates affect investment location has been studied extensively in prior research (see section 3 for a review). Our paper examines whether the U.S. financial accounting rules for recording the income tax expense also provide incentives for firms to move investment to and retain investment in foreign locations. We emphasize that although we study tax items reported on financial statements, our paper contributes to the broad research agenda that investigates whether financial reporting in general affects real corporate actions.

The key issue for our study is that U.S. multinationals can, by declaring their foreign source earnings "permanently reinvested" overseas, avoid reporting on their financial statements the deferred incremental U.S. income tax expense related to these foreign earnings. This avoidance results in lower reported GAAP effective tax rates and higher net incomes.[1] Traditional financial economics would argue that the "paper" income tax expense recognized on financial statements should not affect corporate decision-making. To the contrary, some research indicates that financial statement reporting considerations do in fact affect real corporate decisions (see Graham

[1] See Hanlon (2003) for a general discussion of the difference between cash taxes and the income tax expense for financial accounting purposes. In short, the income tax expense reported on financial statements is an accrual based expense measure and rarely equals the cash taxes paid to the government. Generally Accepted Accounting Principles define the effective tax rate as total worldwide income tax expense divided by worldwide pretax earnings. Throughout the rest of the study we refer to this measure as the GAAP ETR.

et al., 2005, and the references therein). In addition, anecdotal evidence indicates that accounting income tax expense effects are important in repatriation decisions. For example, James Tisch, CEO of Loews, wrote a letter to the editor of the *Wall Street Journal* stating that, "Unbeknownst to many (including legislators and Joint Committee on Taxation estimators), GAAP allows corporations to avoid the accrual of taxes on foreign earnings…The results of the interaction of our repatriation tax laws and the GAAP accounting rules is that very little in the way of foreign earnings are repatriated….The accounting penalty for repatriating even a penny of foreign profits is so great that those foreign funds will not come back to the U.S…." (July 5, 2008).

Little research to date has examined whether financial reporting consequences (i.e., the "accounting penalty" to which the CEO above refers) affect corporate location and reinvestment versus repatriation decisions. Shackelford et al. (2009) discuss the need for research that examines both the tax and accounting implications of real corporate investment decisions. The authors argue that because tax and accounting interact in important ways that affect real decisions, researchers should incorporate both tax and accounting choices when analyzing and interpreting corporate behavior. In addition, Hines (1999) calls for more research that examines the relation between tax and non-tax determinants of foreign direct investment. In this paper, we take a step towards filling these voids by surveying tax executives to obtain data about the importance of the financial accounting expense deferral in these real corporate decisions.

Specifically, we directly inquire about whether the financial accounting effects of being able to designate earnings as permanently reinvested under Accounting Principles Board Statement No. 23 (APB 23) affect real corporate decisions about operation location, and profit

reinvestment or repatriation.[2] In addition, we examine the relative importance of the deferral of actual cash income taxes versus the deferral of the income tax expense recognition for financial accounting purposes. The use of survey evidence is appropriate for our research questions because the cash and accounting effects are difficult, if not impossible, to separately identify using archival data. One reason for this difficulty is that there is no tradeoff in this setting between tax and financial reporting.[3] Thus, reliably identifying whether firms are responding to the accounting incentives or the tax incentives is hard to accomplish using archival data. In our survey, we directly ask tax directors about the cash tax effects and the financial accounting effects as separate factors in their decision-making process. Thus, using a survey of executives allows us to avoid the use of proxies in our main analysis where we investigate whether the financial accounting effects are important in the firms' decisions about investment location and profit repatriation.

Our evidence indicates that the ability to avoid or defer the recording of income tax expense on financial statements is an important consideration in real corporate investment decisions regarding location of operations and whether to repatriate foreign earnings to the U.S. or reinvest the foreign earnings overseas. For example, nearly one-third of the respondents rated income tax expense deferral under APB 23 as being important in their decision to locate operations outside of the U.S. Moreover, when we restrict the sample to firms we expect to be most concerned with financial reporting effects relative to all other factors (publicly traded, with foreign assets, and high intangibles), nearly 60 percent of these firms say financial accounting expense deferral is important in their real decision to invest in a foreign location. In addition, 44

[2] APB 23 provides an exception to deferred tax accounting where a deferred tax expense is not recorded on financial statements for foreign subsidiary earnings that are declared to be permanently reinvested overseas. We discuss this provision more below.

[3] We provide a detailed discussion of the tax and accounting rules in the next section. For a review and discussion of the book-tax tradeoff literature see Shackelford and Shevlin (2001). In many settings firms wanting to reduce cash taxes also have to report lower book income thus facing a book-tax tradeoff. In the setting here, reducing cash taxes by deferring repatriation also can increase (as opposed to reduce) book income if the firm designates at least some of the foreign earnings as permanently reinvested overseas.

percent of respondents state that deferral of the financial accounting tax expense is important in their decision of whether to repatriate foreign earnings to the U.S. or reinvest foreign earnings outside of the U.S. Again, after restricting the sample (to firms that are publicly traded, with foreign assets, and high intangibles), the data reveal that nearly two-thirds of respondents indicate that financial accounting expense deferral is important in their decision about whether to repatriate earnings or reinvest earnings outside of the U.S. For both decisions – where to locate operations and whether to reinvest or repatriate foreign earnings – the importance of the financial accounting expense deferral is as important statistically as the importance of cash tax deferral when making these decisions. These results are surprising in light of the decades of research on the location and repatriation decisions that tests the cash tax implications but has heretofore not examined the financial accounting effects.

The implications of our evidence are that the financial accounting effects lead to greater foreign direct investment by U.S. multinationals, all else constant. Moreover, in addition to the evidence in Foley et al. (2007) about repatriation taxes contributing to large corporate cash holdings, our results suggest that financial reporting expense deferral is very likely to be another contributing factor. Overall, our results suggest that financial accounting expense deferral impacts real decisions that could have macroeconomic effects.[4]

An underlying question is *why* firms care so much about the effective tax rate (GAAP ETR) and reported accounting earnings. We offer some conjectures and supporting evidence. First, a lower GAAP ETR increases after-tax accounting income, which previous research has shown affects stock price and thus shareholder returns. Second, compensation contracts could be affected by the GAAP ETR. For example, to the extent that stock option or other forms of equity

[4] These macroeconomic effects include increased investment in foreign locations, large cash balances, increased domestic debt levels, job creation overseas, and less tax revenue to the U.S. government.

based compensation are used, then the aforementioned relation between after tax earnings and stock prices will affect compensation. Furthermore, if bonus and other performance plans are based on after-tax earnings (e.g., in value added measurement plans in which the effective tax rate is used to adjust for taxes (see Young and O'Byrne, 2001)), then the reported GAAP ETR will be important. Third, in general, it is well documented that a lower GAAP ETR is important and that tax departments are profit centers for many firms (see Robinson et al., 2009).

Another potential reason for viewing the GAAP ETR as important is because both it and after-tax earnings are compared across firms, including firms in other tax jurisdictions. In interviews with several of our respondents, we find that their companies view the non-recognition of deferred tax expense on permanently reinvested earnings as an item that better aligns U.S. multinationals' effective tax rates with the rates of foreign competitors and as an item that increases comparability of firms' financial statements. For example, in the interviews we heard comments such as: "The designation of permanently reinvested earnings allows us to get our effective tax rate within striking distance of our international competitors' rates" and "… puts us on a more even playing field with [our competitor]" and "Our main competitor is in [another country] and their financial statements do not have this effect because there is no residual tax."[5] Indeed, in a letter to the International Accounting Standards Board, the Financial Executives Institute argued that effectively eliminating APB 23 would not "improve comparability of financial reports of U.S. preparers and non-U.S. preparers subject to IAS" and that in fact "comparability of financial reports will suffer…because many countries have a territorial tax system" and have no residual home country tax to record. The letter goes on to state that if taxes on permanently reinvested earnings were recorded for a U.S.-based company, "…earnings could

[5] Phrases in brackets replace phrases that may identify the respondent firms. By residual tax the individual is referring to the incremental (residual) U.S. tax on foreign earnings over and above the tax in the foreign jurisdiction.

be significantly affected relative to the foreign-based company when the companies are actually in essentially the same economic position…comparability would diverge rather than converge."[6] Thus, the GAAP ETR is potentially an important metric to firms because it affects stock prices, compensation contracts, and/or is an important benchmark.

We use survey data based on tax executive responses to conduct our analyses. Thus, we would be remiss not to mention that our data and results are subject to the general caveats associated with all survey data. When drafting the survey we attempted to word the questions carefully and worked with a survey consulting firm (discussed below) to employ best practices. In addition, we compare our firms' data to the data from the Compustat population and to the survey non-responders in an effort to test for non-response bias. However, despite these efforts if there is some unforeseen systematic tendency to obscure the truth or to be unconsciously biased on particular questions, our results could be affected.

The remainder of the paper proceeds as follows. Section 2 discusses the tax and accounting rules related to the foreign earnings of a U.S. multinational. Section 3 discusses the prior literature regarding accounting effects on investment, investment location decisions, and the reinvestment or repatriation decision. Section 4 discusses our survey approach, how we obtained our sample, and descriptive data on the respondents. Section 5 analyzes the survey responses. Section 6 examines whether the importance of financial accounting expense deferral provides some explanation for why firms hold so much cash. Section 7 concludes.

[6] Excerpted from the Financial Executives Institute letter to Sir David Tweedie, Chairman of the IASB dated June 14, 2004. Currently IAS12 effectively retains the APB 23 tax treatment (as does SFAS 109) of including an exception to deferred tax accounting for basis differences between book and tax for investments in foreign subsidiaries that are essentially permanent in nature (i.e., if the company designates the foreign earnings as permanently reinvested the company does not record the incremental repatriation tax in its home country).

2. Taxation and Accounting Rules for Foreign Earnings

2.1. Taxation of foreign earnings

The United States taxes corporate and individual income on a worldwide basis. This means that U.S. taxes are owed on income earned in the U.S. as well as on income earned abroad. However, an important feature of the U.S. tax system is what is known as deferral. In general, a U.S. parent is taxed on its subsidiaries' foreign income only when those foreign earnings are repatriated back to the parent corporation.[7] Until repatriation, foreign earnings reinvested in foreign operations are allowed to grow U.S.-tax free.

To avoid subjecting U.S. multinationals (and individuals) to double taxation, the U.S. allows a foreign tax credit (in recognition of income taxes paid to foreign governments) that reduces the U.S. tax owed on repatriated foreign earnings. In simple terms and ignoring limitations, if the U.S. tax rate (e.g., 35%) exceeds a given firm's average foreign tax rate (e.g., 30%), the company has to pay U.S. tax on repatriated foreign earnings at a rate equal to the difference between the U.S tax rate and the foreign tax rate (e.g., 5%). In contrast, if the firm's average foreign tax rate exceeds the U.S. tax rate, the company will not owe any incremental U.S. tax upon repatriation (nor will it receive an immediate rebate from the U.S. government, though it will accumulate a foreign tax credit).[8]

[7] Deferral is only available for U.S. taxes on earnings of foreign subsidiaries of U.S. parents; it is not available for the earnings of a foreign branch. The earnings of the foreign subsidiaries are not subject to U.S. tax when earned because foreign subsidiaries are not consolidated for U.S. tax purposes. If the foreign subsidiary had income effectively connected with a U.S. trade or business then that income would be immediately subject to U.S. tax; however, the foreign subsidiary still would not be part of the tax consolidation with the U.S. parent. There are provisions, such as the Subpart F rules, which aim to discourage U.S. firms from taking full advantage of deferral. Under these rules, certain foreign income of foreign subsidiaries is not eligible for deferral and is subject to immediate taxation in the U.S. Subpart F income includes, among other items, passive income of the foreign subsidiary.

[8] Foreign tax credits can be carried over (back one year, forward 10 years). There are limitations on the amount of foreign tax credit that can be utilized, a discussion of which is beyond the scope of this paper. See Scholes et al. (2009) for details.

2.2. Accounting for foreign earnings and the U.S. taxation of those earnings

A firm's financial statements include the income or loss of foreign subsidiaries that are more than 50 percent owned, and the representative share of income or loss of foreign entities owned between 20 and 50 percent (under the equity method of accounting). A firm's tax return, however, does not include any of these earnings amounts. Instead, a firm's U.S. tax return only includes dividends (i.e., cash) received from these entities (while financial statement income excludes these dividend amounts because the accounting earnings were already included when earned under financial accounting principles).

As a result, for a U.S. multinational, the difference between current year foreign accounting earnings and current year cash dividends repatriated from the foreign jurisdiction is a temporary difference on which incremental U.S. deferred taxes would normally be accrued. Such an accrual would increase the GAAP effective tax rate and lower net income reported on financial statements. However, an exception is provided in Accounting Principles Board Opinion No. 23 (APB 23), which states that the accrual for taxes that would be due on future repatriations should not be recognized if the indefinite reversal exception applies. In other words, if a firm has foreign earnings in a foreign subsidiary that the company deems to be permanently reinvested (i.e., the company does not plan to repatriate the earnings), the firm's financial statement tax provision will not include an accrual of U.S. taxes that would be due on repatriation of those earnings, even though the earnings are included in book income. Thus, all else equal, if a company has earnings in a low tax country that it reinvests and designates as permanently reinvested, the company will have a lower GAAP effective tax rate and higher after-tax earnings relative to what earnings would be if the earnings were earned in the U.S. or earned in the foreign subsidiary but not designated as permanently reinvested. Hereafter, we refer to this accounting effect as APB 23 tax expense deferral.

An example of a firm's disclosure is included in Appendix B. This disclosure illustrates the effect of designating foreign earnings as permanently reinvested on the firm's GAAP ETR. Note for this company the effect of having $21 billion in earnings overseas and designated as permanently reinvested reduces their GAAP ETR by 6.6 percentage points (because there is no incremental U.S. tax expense accrued), which in turn increases the firm's income reported on its financial statements.

3. Prior Research

We briefly review two broad areas of related literature. The first includes research about financial accounting effects on investment decisions. In this subarea we include two types of research. First, the book-tax tradeoff literature which generally documents that pre-tax financial accounting concerns dominate tax concerns, consistent with financial accounting effects being important in firm investment decisions. Second, the recent literature centered on earnings quality or accounting method choices and investment. Our study is related to both of these types of studies but centers on the effect of financial accounting -- via the income tax expense -- on investment location decisions. Because we examine investment location, our study also relates to a second broad area of the literature that has examined the determinants of locating investment overseas. This area of the literature has potentially large macroeconomic and public policy implications but has heretofore not examined the importance of financial accounting with regard to investment location. Our study contributes to both of these broad areas of the literature.

3.1. Research about financial accounting effects on corporate decisions

There is a relatively long literature examining the tradeoffs firms make between tax reporting and financial accounting reporting that documents the importance of financial accounting effects. In sum, the evidence is generally consistent with firms leaving tax dollars "on

the table" in order to improve their financial reporting results. A portion of this literature is about corporate decisions about investment. For example, prior research examines whether the rules for LIFO accounting providing incentives for inventory purchases or liquidations near the end of accounting periods (Dhaliwal et al., 1994; and Hunt et al., 1995). Other studies examine the tax and accounting tradeoffs for asset divestitures (Bartov, 1993; Klassen, 1997; and Maydew et al., 1999), the payment of taxes on overstated accounting earnings (Erickson et al., 2004), and capital structure decisions (Engel et al., 1999). While some of these decisions are what some might label as "real" (e.g., asset divestitures), many of the decisions examined in the literature are more about timing or reporting (e.g., the timing of the divestiture decision (Bartov, 1993), the divestiture method (tax- free or taxable, e.g., Maydew et al., 1999), or the amount of gain recorded upon the divestiture (e.g., Klassen, 1997)). Other previously studied investment decisions may be considered "real" (e.g., inventory purchases), but in contrast to locating operations overseas, are the type that are easily reversed (e.g., R&D spending and inventory purchases can be increased in one period and decreased in a later period).[9]

A broad range of other studies also exemplify the interest and importance of financial accounting effects on corporate investment decisions, but from a somewhat different aspect. For example, Biddle et al. (2009) examine the effect of financial reporting quality on investment efficiency. The authors posit that higher financial reporting quality reduces the information asymmetry between firms and suppliers of capital, making it easier to attract capital, facilitating

[9] Prior research documents that tax incentives increase spending on research and development (e.g., Berger, 1993) but that financial accounting disincentives reduce research and development spending. For example, Bushee (1998) reports that firms reduce research and development spending when close to an earnings target (Bushee, 1998) and Dechow and Sloan (1991) report that when executives have short horizons research and development spending decreases. More recent work examines a condition under which these two incentives – book and tax – are traded off in the research and development spending decision, but only in the very specific case of the accounting for stock option compensation for R&D personnel (Brown and Krull, 2008).

better contracts that enhance efficient investing, and enabling stronger monitoring.[10] In other studies, McNichols and Stubben (2008) and Jackson et al. (2009) examine whether accounting earnings reported for external users influence managers' investment decisions. Specifically, McNichols and Stubben (2008) report firms that overstate their earnings also over-invest as if the managers themselves are "fooled" by the falsely reported earnings. More closely related to our current paper, Jackson et al. (2009) provide evidence that a firm's chosen depreciation method affects its capital investment. The authors hypothesize that managers' investment decisions are affected by depreciation method choices and one of the reasons they cite is financial reporting earnings consequences.

Our study also investigates the effect of accounting on investment. In our case, however, it is not an accounting method choice that is of interest, but rather the accounting rule that provides an exception to deferred tax accounting for foreign subsidiary earnings. In addition, the decision we examine is a real investment location decision that is not easily reversed and that has potentially important macroeconomic effects – the location of operations for U.S. multinationals.

3.2. Location decisions

In deciding where to locate operations, firms must consider many factors, such as local infrastructure, labor supply, culture, economy, political risk, distance to customers, financing opportunities, and the location's tax rates and policies. Single (1999) asked 66 experienced tax executives of major U.S.-based multinationals in the manufacturing industry to review a subsidiary plant location scenario and evaluate the relative importance of all the location-specific factors. Only five of the factors were tax-related: The corporate tax rate, tax holidays, the presence of a treaty with the U.S., withholding rates, and accelerated capital write-off provisions. Single (1999) reports that the five tax factors ranked among the lower half of importance of all factors in

[10] See also Biddle and Hilary (2006), Bushman and Smith (2001), Healy and Palepu (2001), and Lambert et al. (2007).

the location decision and concludes that non-tax factors often drive the decision. More detailed analysis of the extent to which taxes in the foreign country impact location decisions is conducted by Wilson (1993) who investigates the role of taxes in location decisions through interviews with nine companies. Wilson (1993) concludes that tax considerations largely dictate location decisions in business activities for which nontax costs are low, such as administrative centers. However, for manufacturing location decisions he reports that nontax considerations are very important, even when the final decision is to locate in a low tax country. Finally, Kemsley (1998) tests whether the ratio of exports to foreign production varies with export incentives and foreign country tax rates. Kemsley (1998) finds that greater export incentives are associated with higher exports and lower host country taxes are associated with a lower ratio of exports to foreign production. None of these studies examine the financial accounting implications of locating operations in a foreign jurisdiction, the subject of our paper.

Numerous studies in economics attempt to estimate the effect of host country taxation on foreign direct investment in a country. For example, Grubert and Mutti (2000) use tax returns of 500 U.S. multinationals and estimate that a lower tax rate, which increases the after-tax return to capital by one percent, is associated with roughly a three percent higher rate of capital investment. Indeed DeMooij and Ederveen (2003) compare the results of 25 empirical studies and conclude that the median response documented in the literature to a one percent reduction in the host country tax rate is slightly more than a three percent increase in foreign direct investment in that country.[11] Thus, there is substantial evidence suggesting that host country taxation affects location decisions. However, to our knowledge, no empirical study has examined the importance of financial accounting income tax expense deferral in location decisions.

[11] See Altshuler, Grubert and Newlon (2001), Devereux and Freeman (1995), Hines (1996, 1997, and 1999), and Slemrod (1990). In earlier work, Hines (1999) surveys the literature to date and finds an overall elasticity of -0.6.

Shackelford et al. (2009) hypothesize that the discretion in financial reporting that a firm gains via foreign operations gives companies an incentive to locate in low-tax countries, e.g., tax havens. This incentive occurs because generally the lower the foreign tax rate, the greater the U.S. tax due upon repatriation and thus the larger the financial accounting expense that can remain unrecognized by locating abroad, reinvesting foreign profits, and designating those profits as permanently reinvested. The model the authors develop implies that because the non-recognition of the expense is valued by managers, GAAP rules could have the effect of encouraging investment in low-tax countries or tax havens. We test this hypothesis in our paper.

3.3. Reinvestment or repatriation decisions

Previous research has investigated the corporate decision of whether to reinvest or repatriate foreign earnings. General considerations include relative domestic and foreign rates of return and local politics. For brevity, we review only the literature on the tax effects on reinvestment and repatriation.

There is some debate about the extent to which a home country repatriation tax is important. For example, Hartman (1985) demonstrates that, if the repatriation and U.S. taxation of foreign earnings is inevitable and tax rates are constant (and these are crucial assumptions), then U.S. repatriation taxes do not affect the choice by mature firms to reinvest funds abroad or repatriate the earnings.[12] Others argue that firms can (easily) tax plan around the repatriation tax (Altshuler and Grubert, 2003) and thus the tax is not an important factor. In addition, there is the empirical observation that little U.S. tax is actually collected on foreign earnings (Grubert and Mutti, 1995; Altshuler and Newlon, 1993; U.S. Treasury, 2007; U.S. Government Accountability Office, 2008; Dyreng and Lindsey, 2009). However, many empirical tests in a variety of settings

[12] See Hartman (1985) and Scholes et al. (2009) for the model (and a discussion) of a firm's decision to reinvest or repatriate earnings.

document that the repatriation tax affects profit repatriations (Desai et al., 2001; Altshuler and Newlon, 1993; Blouin and Krull, 2009; Brennan, 2008). Further, Foley et al. (2007) provide evidence consistent with the repatriation tax being a determinant of U.S. firms' large foreign cash balances. All of these studies examine the importance of the home country repatriation tax; none examine the importance of the financial accounting effects.

A contemporaneous paper by Blouin et al. (2009) examines capital market incentives on corporate repatriations using survey data from the Bureau of Economic Analysis (BEA). Their paper is similar to ours in that both papers investigate the same general question of whether financial accounting effects (APB 23 tax expense deferral) impact firms' decisions to repatriate earnings. Their paper uses BEA data and our paper uses our self-compiled survey data from corporate tax executives specifically designed to address our particular research question. Blouin et al. test only repatriations and how they vary with proxies for capital market pressures. We use our directed questions to examine whether accounting effects are important in a broader set of questions: investment and repatriation decisions (repatriation in general and under a recent temporary tax act). Blouin et al. (2009) interpret their results as being consistent with APB 23 tax expense deferral influencing the repatriation decision, consistent with and supporting our results. However, the use of the BEA archival data, and their tests in particular, require some maintained assumptions making it difficult to reliably separate the accounting effects from the tax effects.[13] While survey data bring their own set of concerns (see caveats below), one benefit of our survey approach is that we directly ask tax executives to separately identify the importance of the cash tax deferral and the accounting expense deferral. Overall, we view our paper and the Blouin et al.

[13] Specifically, the first set of tests in Blouin et al. (2009) relies on the public/private designation as the proxy for capital market pressures, thus requiring an assumption that public and private firms value cash tax savings equivalently in order to be able to identify the effects of capital market pressures. The data in our survey responses (as discussed below) are inconsistent with this assumption. The second set of tests in Blouin et al. (2009) regresses repatriations on the level of permanently reinvested earnings (PRE) which is somewhat circular in nature since the PRE designation means that the firm is not repatriating the earnings by definition.

paper as complementary, with both adding to the portfolio of knowledge about repatriation decisions.[14]

4. Survey Approach and Sample

We developed our survey instrument with the support of Tax Executives Institute and PriceWaterhouseCoopers. We solicited feedback from members of both groups as well as from academic researchers. Survey Sciences Group (SSG), a survey research consulting firm, assisted with the survey formatting and programmed an online version. SSG also professionally formatted a paper version of the survey that we distributed with our final reminder invitation (discussed below). We had two companies beta test the survey and we made revisions based on their suggestions. The final survey contained 64 questions, most with subparts. The paper version of the survey was 12 pages long. There were many branching questions and as a result many firms were directed to answer only a portion of the questions. See www.ssgresearch.com/taxsurvey for the online version of the survey. The paper version is available from the authors upon request.

An initial email invitation was sent on August 9, 2007 to the 2,794 member firms of Tax Executives Institute. We examined the list of Fortune 500 companies and identified 45 firms that were not members of Tax Executives Institute. For these firms, Price WaterhouseCoopers supplied the tax executive's name and email address. Three email invitations were returned as undeliverable. On August 15, 2007 we sent a letter via two-day express mail to fifteen companies for which we did not have email addresses. A total of 2,806 companies received invitations to complete the survey.

[14] Another related study is Krull (2004), who examines whether firms designate earnings as permanently reinvested in an attempt to manage earnings to meet analysts' forecasts. She reports evidence consistent with firms doing so.

SSG sent three email reminders throughout August and September. We then sent a paper version of the survey (along with a letter with instructions of how to complete the questionnaire online) during the last week of September and the first week of October. We closed the online survey on November 9, 2007.

A total of 804 firms accessed the survey. Sixty of these companies entered no more than two responses and thus we delete them from our sample leaving 744 usable responses. The response rate for our survey is 26.5 percent, higher than many prior survey studies. For example, Graham et al. (2005) obtain a response rate of 10.4 percent, Trahan and Gitman (1995) report a response rate of 12 percent, Graham and Harvey (2001) obtain a 9 percent response rate, and Brav et al. (2005) report a 16 percent response rate. In addition, Slemrod and Venkatesh (2002) survey tax preparers (12 percent response rate) and corporate taxpayers (9 percent response rate) about compliance costs, and Slemrod and Blumenthal (1996) obtain a 21.8 percent response rate in a survey of large corporate taxpayers about compliance costs. Thus, our response rate compares favorably with other recent surveys.[15]

We are most interested in U.S. multinationals' decisions with respect to the financial accounting treatment of the corporate income tax. Therefore, we eliminate eleven firms that indicate they are an S-corporation or other type of flow-through entity and are thus not subject to the U.S. corporate income tax. We also eliminate 29 companies that state they did not file a form 1120 (under the assumption that these companies are also not

[15] We believe the support of Tax Executives Institute was very helpful in increasing the response rate. In addition, there seemed to be genuine interest in the topics we asked about as evidenced by the respondents' comments. For example, one company wrote "Appreciate the survey. Interestingly, the survey touches on those tax management areas most important to our company at the moment…" Another commented "I rarely fill out surveys, but was impressed by your questions." Another respondent just wrote, "Good survey!"

C-corporations).[16] We restrict the sample further by eliminating observations for subsidiaries of foreign parents (105 firms) and for responses that state in their comments that their foreign operations were insignificant and thus they were not sure how to respond to the foreign earnings questions (4 firms). This leaves 595 remaining firms on which we conduct our analyses. The sample size varies across questions due to branching or incomplete responses for that particular question.

5. Descriptive Statistics, Research Questions, Results, and Inferences

5.1. Descriptive statistics

The survey was divided into four parts. The first section asked general descriptive questions about the companies. The second part of the survey asked questions about general location and reinvestment and repatriation decisions, the subject of the current paper. The third part focused on the 2004 American Jobs Creation Act and repatriation decisions in response to that Act (e.g., sources and uses of cash repatriated). The final part of the survey asked general questions about tax aggressiveness, tax rates, and tax planning. The data from the third and fourth parts of the survey are analyzed in separate papers.

The descriptive data for our sample firms are summarized in Table 1, Panel A. In terms of ownership, 75 percent of the respondents are publicly traded on the NYSE, NASDAQ or AMEX, 23 percent are privately held, and the remaining 2 percent responded that they were 'other' such as over the counter stocks. Our respondent firms represent a variety of industries, with roughly 30 percent being from manufacturing, 16 percent classified as holding companies, almost seven percent from professional, scientific, and technical services, and six percent from retail trade

[16] There were 24 companies that actually answered that they filed zero 1120s. There were 5 companies that did not answer the question and were deleted from the sample because by analyzing the other questions in the survey we determined that these companies were likely not C corporations either.

(industry classifications are derived from the companies' responses about their principal business activity code on Form 1120). In all, 19 different industry classifications are represented.

It is difficult using publicly available archival sources to obtain data on the location of a firm's assets. Using a survey, we are able to gather this information. In our sample, 53 percent of the respondents indicate that their companies have 10 percent or less of their assets in foreign locations. Slightly more than 8 percent of the firms have more than half of their assets in foreign locations.

Examining tax return filing characteristics reveals that our sample firms range from simple to complex in nature. For example, 94 percent of the respondents file a consolidated tax return. Of these consolidated returns, 58 percent include more than 10 entities in the tax filing. In addition, 80 percent of the sample file at least one Form 5471, indicating these companies have significant ownership interests in foreign subsidiaries.

We report firms' GAAP ETRs (total worldwide income tax expense/worldwide pretax book income) in Table 1 as well. We ask privately held companies to report their GAAP effective tax rate and we compute the ratio using financial statement data for the publicly traded firms in our sample (the data are for the most recent year prior to completing the survey). Consistent with archival GAAP ETR data (e.g., Dyreng et al., 2008), most of the firms report a GAAP effective tax rate in the 30 percent to 40 percent range, with the distribution being asymmetric -- more firms report a relatively lower rate than a relatively higher rate. The data in Table 1 also reveal that 46 percent of the respondents indicate their firm has a U.S. net operating loss (NOL) carryforward, 50 percent report that their firm has foreign NOLs, and 69 percent have state tax NOLs. Finally, three-fourths of the sample firms have foreign sourced earnings. Thus, collectively the descriptive data indicate that the majority of firms in our sample have complex tax structures and international activities.

One of the limitations of using survey data is the potential for non-response bias (e.g., perhaps only a certain type of firm answered our survey and/or some types of firms avoided our survey, which would make the results less generalizable). To address non-response bias, we use data from Compustat to compare the surveyed firms to all Compustat firms, and within the surveyed firms, we compare the responding firms to the non-responding firms.[17] We report these comparisons in Table 2. In columns (1) and (2), we find that our average sample firm is larger than the average Compustat firm in terms of assets (even though our sample includes private firms for the asset measure), market value, and sales. Our average sample firm has a larger debt-to-asset ratio, a smaller cash-to-asset ratio, and a smaller market-to-book ratio relative to the average Compustat firm. Further, our sample firms have on average a higher return-on-assets, a higher effective tax rate, and lower asset and sales growth rates. Thus, our sample firms are not small or poorly performing, and therefore our results might not generalize to such firms.

The comparison of respondent to non-respondent firms is shown in Table 2, columns (3) and (4). The average respondent firm is marginally smaller in terms of assets but similar in terms of market value and sales to the average non-respondent firm. In addition, the respondent firms have, on average, lower debt ratios, higher cash ratios, and a higher return-on-assets. While there are some differences we cannot think of any obvious biases that arise because of the differences. Finally, in terms of industry composition, it appears that the respondent and non-respondent samples are similar. It does appear that our survey population is overrepresented in manufacturing industries and underrepresented in terms of financial services, insurance, and real estate.

[17] We recognize that Compustat is limited to publicly traded firms and hence inferences based on this analysis are limited.

5.2. Research questions and survey responses

5.2.1. Location decision – unconditional analysis

We ask the following question to investigate the corporate decision of whether to locate operations in the U.S. or outside the U.S.: "Relative to all the factors your company considers when making a decision about whether to locate operations in the U.S. or outside the U.S., how important are the following?" The factors are 1) foreign tax rate, 2) U.S. cash tax deferral, and 3) financial accounting expense deferral under APB 23. The phrase "relative to all other factors" is intended to control for other factors such as the stability of the local government, regulation, work ethic of labor force, utilities, proximity to target market, import/export restrictions, transportation costs, etc.[18]

The respondents are asked to rate each of the factors on a 5 point scale ranging from "Not at all important" (given a numerical representation of 0) to "Very important" (a numerical representation of 4). In our analysis of the data we interpret these ratings in several ways. First, we classify ratings of three or four on the zero to four scale as being "important" to the firm and ratings of zero and one as being "not important." Second, we compute the average rating for each factor. Finally, we interpret the ratings as a ranking of the relative importance of the factors.

The easiest way to view the results is via the graphs in Figure 1. Panel A presents data for all respondent firms. The graph reveals that approximately 38 percent of firms indicate that the foreign tax rate is important in their decision to invest in a foreign location. Slightly more than 35 percent of the respondents say that the availability of U.S. cash deferral is important. In terms of the importance of financial accounting expense deferral under APB 23, a little more than 31

[18] We acknowledge that by focusing on a subset of relevant factors it is possible that salience gives rise to respondents ranking these factors as more important than they would if confronted by a more comprehensive list. However, to mitigate this problem, we compare the rankings across the named factors and conduct conditional analyses within the sample; such comparisons are less affected by concern about potential salience.

percent of firms say that this is an important factor in their decision making process when determining whether to make an investment overseas. While less than half the overall sample say the factor is important, for a factor not previously investigated in prior research and one that represents a "paper" deferral of one expense item, it is surprising to us that nearly one-third of companies indicate that financial statement expense deferral is important relative to all other factors when deciding whether to make a foreign investment.

Table 3 presents the data in table format. In Panel A, for each factor, we present the percent of respondents that answered that the factor was important (received a rating of 3 or 4) and the percent of firms that answered that the factor was not important (a rating of 0 or 1). The mean rating for foreign tax rate is 1.86, for U.S. cash tax deferral is 1.76 and for financial accounting expense deferral under APB 23 is 1.65. Although none of these ratings is greater than 2 (medium importance), we note that this question is about a decision to locate operations overseas. We would not expect tax and accounting factors to, on average, be very important for a diverse sample of firms because there are many other factors to consider when deciding where to locate operations (e.g., labor force, political stability of the country, etc.). Further, when the importance rating of the cash tax deferral factor is compared to the importance rating of the financial accounting expense deferral factor, they are not statistically distinguishable from each other (t-statistic of 1.32 on the difference in means). This implies a "paper" accounting expense is equally important as a factor that directly affects cash flows (cash tax deferral).

5.2.2. *Location decision – conditional analysis*

We next investigate ratings based on a variety of firm characteristics. For example, we explicitly test whether public firms are different from private firms in their rating of financial accounting effects because prior literature demonstrates that public firms are under greater financial reporting pressure than private firms and, as a result, are willing to incur costs to achieve

a desired financial accounting outcome (Cloyd et al., 1996; Beatty and Harris, 1999; Mikhail, 1999). Thus, we predict that publicly owned companies will rate financial accounting expense deferral as more important than private firms.

We also condition on the level of the effective tax rate the firm reports. We predict that firms with a lower reported effective tax will rank financial accounting concerns higher than firms with a high reported effective tax rate. We interpret the effective tax rate as a revelation of corporate preferences for low or high rates (similar to Hanlon and Slemrod, 2009). Thus, firms with a low rate engage in actions to achieve that low rate and, as a result, should rank financial accounting expense deferral more highly than firms with a high effective tax rate. Finally, we condition on the amount of research and development expense (R&D) as a proxy for the type of firm that can more easily locate in a foreign jurisdiction and ship product and more easily shift income through intangibles (Grubert and Slemrod, 1998) as compared to locating heavy manufacturing operations abroad (Wilson, 1993). We predict that firms with large R&D expenditures will rate financial accounting concerns as being more important in location (and repatriation) decisions because locating near customers is not as important in relative terms (i.e., shipping the product is easier for these firms). We use R&D spending as the underlying construct for the "firm type" that we condition on. One might group by industry, however, we note that pharmaceutical firms are classified as manufacturers in our sample (by tax form industry codes) and thus industry analysis would combine pharmaceutical firms in the same group with less intangible intensive manufacturers, whereas we predict differences across these two sets of firms. We do, however, include industry fixed effects in our regressions below in order to control for any remaining industry effects.

The results of the conditional analysis are provided in Panel B of Table 3. The numbers in the table are the percentage of respondents that answered that the factor was important. For

example, 41.3 percent of the public firms responded that the foreign tax rate was important among all the factors they consider when deciding to locate overseas.

Several interesting observations emerge from these data. Significantly more public firms rate the tax and financial accounting factors as being important than do private firms. Indeed, only 11 percent of the private firms in our sample rate financial accounting expense deferral as important compared to the 37 percent of public firms that rate the factor as important. This result is consistent with prior literature that concludes that because public firms are under greater financial reporting pressure they consider financial accounting effects as more important (Cloyd et al., 1996; Beatty and Harris, 1999; Mikhail, 1999).

Consistent with our stated prediction, significantly more firms with a low GAAP ETR rate cash tax deferral and accounting expense deferral as being important when deciding where to locate operations. This result may seem counter-intuitive at first but as discussed above, we interpret the GAAP ETR as a proxy for overall tax and financial reporting preferences with regard to the income tax expense. Firms that have a low GAAP ETR take actions to make it low and thus, it makes sense that these would be the same firms that are concerned about taxes and the financial accounting effects (in other words, firms with high ETRs reveal a preference of less concern about effective rates or they would have taken actions to reduce their GAAP ETR in the first place).

Consistent with our stated prediction, firms with relatively high R&D (scaled by sales) rate cash tax deferral and financial accounting expense deferral as being significantly more important than firms with low R&D. Firms with high R&D have proportionally more intangible assets which are easier to source to (and ship from) a foreign location. As a result, high R&D companies rate tax and accounting concerns as more important relative to all other concerns because they have

fewer (at least different) other concerns (Wilson, 1993).[19] For example, it would be more difficult for a heavy manufacturer of construction equipment to move to Ireland and ship the heavy equipment than it is for an intangible asset firm to locate in Ireland and ship their product.

The data also reveal that firms with foreign source earnings and with a high percentage of foreign assets rate the tax and accounting effects as important more often than firms without much foreign activity. Thus, firms concerned with cash taxes and financial reporting effects more actively move operations overseas to minimize taxes and tax expense.

We present some conditional graphical analysis in Panel B of Figure 1. We include data in this panel from a subsample of firms for which we would expect the accounting implications of foreign earnings to be important – publicly traded firms that have positive foreign assets (N = 284). We further subdivide these publicly traded firms into those with high research and development spending (lighter shaded, top bar) and those with low research development spending (darker shaded bottom bar) to proxy for the level of intangibles.[20] The data here are even starker (see Panel B of Figure 1). For example, nearly 60 percent of publicly traded firms with foreign assets and high research and development spending rate the accounting expense deferral under APB 23 as an important factor in their decision to locate investment in a foreign jurisdiction.

In Panel C of Table 3, we present results from the estimation of multivariate regressions including the variables used in the conditional univariate analysis in Panel B. We estimate separate regressions, one using the rating of cash tax deferral as the dependent variable and another with

[19] Indeed, in discussions with respondent companies, one heavy manufacturer with low R&D spending said their decision is driven by the need to reach the local customer and nothing else. The respondent went on to say that he disagreed with the view expressed by policy-makers often that the decision for operation location for U.S. multinationals is U.S. or China (or elsewhere). This respondent indicated that if a company is trying to reach customers in China, the decision is China or not building at all.

[20] We assign a high R&D indicator for those firms with greater than the median research and development (scaled by sales) spending of those firms in our sample that had positive research and development spending.

the rating of financial accounting expense deferral as the dependent variable.[21] The results indicate that being publicly held, having foreign source earnings, having a high percentage of foreign assets, and having high research and development spending are significant predictors of the rated importance of delaying expense recognition on financial statements. This corroborates the implications from the univariate analysis. Note that we present the regressions both with and without industry fixed effects where we include nine industry fixed effects, one for each of the industry classifications in Table 1 that comprise at least two percent of the sample. The effect of industry for the remaining firms (those from industries which make up less than two percent of the sample and those that did not provide an industry code) is captured in the intercept. The inferences are the same with or without industry fixed effects.

Overall, we document that the availability of accounting expense deferral under APB 23 is an important factor in determining where to locate operations and its importance is statistically indistinguishable from the importance of the availability of cash tax deferral. Furthermore, our data indicate that firm characteristics (e.g., public versus private ownership, having high or low R&D spending, etc.) are related to the importance assigned to both the tax and financial accounting factors that affect the decision of where to locate operations around the world.

5.2.3. Reinvestment vs. repatriation decision – unconditional analysis

Figure 2 summarizes results regarding the importance of factors considered when firms decide between reinvesting foreign earnings overseas versus repatriating the foreign earnings to the U.S. Panel A presents the data for the all respondents who answered the question.[22] The

[21] Note that we do not have the amount of research and developmental spending for private firms. Thus, to include both R&D and an indicator for being publicly held, we create an indicator variable for having nonmissing R&D in Compustat (some public firms have a missing value) and then interact this indicator variable with the spending on R&D. In addition, we convert the high/low variables in Panel B into continuous variables to mitigate the effects of multicollinearity.

[22] We include two additional factors for the repatriation decision relative to the location decision question discussed above. We include a factor for the relative rates of return because Hartman (1985) is very explicit that this is the most

unconditionally most important repatriation factor is the "rate of return outside the U.S. is higher than that in the U.S." with nearly 60 percent of respondents indicating the rate of return is important. U.S. cash tax deferral is the second most important factor, with approximately half of the respondents rating cash deferral as important. Interestingly, nearly 45 percent of the respondents rate the financial accounting expense deferral under APB 23 as important, making it the third most important factor.

Table 4 presents the responses in table format. In Panel A, for each factor, we present the percent of respondents that answered that the factor was important (received a rating of 3 or 4) and the percent of firms that answered that the factor was not important (a rating of 0 or 1). The mean ratings are 2.58 for higher rates of return outside the U.S., 2.29 for U.S. cash tax deferral, 2.18 for financial accounting expense deferral under APB 23, and 2.15 for the foreign tax rate. We note that the average ratings for the tax and accounting factors for the repatriation question are higher than the ratings in the location of foreign operations question (1.76 and 1.65 for the location decision, respectively). This result is consistent with expectations because there are fewer operational, non-tax, non-accounting factors to consider once the decision to operate overseas has been made and thus, the importance of the accounting and tax factors rises.

Of note is that financial accounting expense deferral has an average importance rating that is not significantly different than the importance rating for U.S. cash tax deferral (t-statistic of the difference is 1.13). As before, a "paper" accounting consideration is statistically as important as a "real" cash deferral. This result is quite surprising to us given that the prior literature scarcely mentions financial accounting considerations as a driver affecting the decision of whether to

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important consideration for the repatriation decision (in fact the only consideration under certain conditions). We include a factor "the need for foreign cash to service debt" because one of our beta test companies suggested that we include it.

reinvest or repatriate foreign earnings (with the exception of concurrent papers Shackelford et al. (2009) and Blouin et al. (2009)).

5.2.4. Reinvestment vs. repatriation decision – conditional analysis

Panel B of Table 4 analyzes the data for various sub-samples of firms for the repatriation versus reinvestment decision (based on the same conditioning variables as in Table 3). The patterns for the repatriation responses are very similar to those for the location decision (Table 3). For example, when deciding whether to repatriate earnings, publicly traded firms are more likely than private firms to rate both cash tax deferral and financial accounting expense deferral as being important.[23] The most striking difference is the rating of the financial accounting expense deferral: 51.4 percent of public firms rate this factor as important while only 14.7 percent of private firms do so. Again, this result is consistent with public firms being under more pressure to report higher financial accounting returns.[24]

In addition to the private/public contrast, we find that larger firms, firms with a higher foreign asset percentage, firms that have a lower GAAP effective tax rate, and firms with relatively high R&D spending all rate the importance of cash tax deferral and the importance of financial accounting expense deferral more highly than their counterparts. We examine the effect of having a U.S. NOL on this decision because it could be that firms with an NOL are not concerned with the tax and accounting effects because the U.S. NOL would offset any incremental tax upon repatriation (and thus perhaps the inclusion of these firms would cause our results to be

[23] One possible explanation as to why public firms rate cash tax deferral more highly than private firms is that the survey question is phrased "relative to all other" considerations the firms have. Private firms likely have fewer opportunities to raise capital than public firms thus, quite likely need to use internal funds more often, even when subject to a costly repatriation tax. As a result, among private firms tax and accounting effects are less important in a relative rating of all other factors (given that the need for domestic financing may rate more highly).

[24] While the financial accounting result is consistent with Blouin et al.'s (2009) assumption for public firms and capital market pressures, the fact that public firms rate *cash tax* deferral significantly higher than private firms confounds Blouin et al. analysis because their research design requires the assumption that public and private firms value cash tax deferral equally (for tax purposes). They require this assumption so that they can interpret any difference in public firm repatriations on a tax cost variable as being evidence of public firms being concerned with the financial accounting tax expense deferral.

understated). However, running counter to this reasoning is the possibility that a U.S. taxpayer would not use the U.S. NOL to offset fully taxable dividends that could be left offshore (because the firm might rather use the net operating loss to offset other earnings). In our data, we find no difference in the rankings for firms with a U.S. NOL.

Panel B of Figure 2 presents the data from the sub-sample of firms that are publicly traded and that have foreign assets. Again the lighter shaded bar on top for each factor represents firms that have high research and development spending and the lower, darker bars represent firms with relatively little research and development spending. The responses for the importance of the cash tax and financial accounting expense deferral factors are greater for R&D intensive companies. Nearly 64 percent of these firms rate the financial accounting expense deferral as being important.

We again estimate multivariate regressions using the above conditioning variables and present these results in Panel C of Table 4. The variables that statistically explain the importance of financial accounting expense deferral in the repatriation decision are 1) being publicly traded, 2) having a high foreign asset percentage, and 3) having high research and development expenses.[25]

5.2.5. How much unremitted foreign earnings are designated as permanently reinvested?

To get a sense of the importance of the APB 23 permanently reinvested earnings (PRE) designation, we ask our sample firms how much unremitted foreign earnings (URE) their companies had and how much of those earnings were designated as permanently reinvested under APB 23.[26]

[25] We again estimate the regressions both with and without industry fixed effects.

[26] We obtain these data as of the date June 30, 2003. That is the date required to be used when firms computed qualifying dividends when they repatriated foreign source earnings under the American Jobs Creation Act of 2004 (the Act). See below for a discussion of the American Jobs Creation Act of 2004. Note this question was only answered by firms who took advantage of the Act to repatriate foreign earnings. The answers relate to account balances just prior to the enactment of the Act.

These data are presented in Table 5. The average ratio of PRE to URE is 0.76, indicating that three-fourths of all accumulated foreign earnings are declared permanently reinvested. Table 5 also indicates that the median firm classifies all unremitted foreign earnings as permanently reinvested and that 75 percent of companies classify at least 57 percent of unremitted earnings as permanently reinvested. That more than half the sample designates 100 percent of their unremitted earnings as permanently reinvested indicates that the APB 23 tax expense deferral is an important accounting rule.[27]

5.2.6. What if APB 23 were repealed (i.e., the recognition of tax expense was required)?

To further investigate the importance of financial accounting expense, we asked the following question "If the rule allowing the deferral of U.S. tax expense under APB 23 were repealed but the deferral of cash tax until repatriation was still allowed, would your company repatriate more foreign earnings as dividends (in other words, if your company had to immediately accrue the tax expense for financial accounting would your company repatriate more dividends?)?" As summarized in Figure 3, approximately 17 percent of the respondents said yes, they would repatriate more foreign earnings if APB 23 were repealed. In addition, 43 percent of the respondents responded "maybe" they would repatriate more if APB 23 were repealed, and we interpret maybe to indicate that the option would be considered. Thus, 60 percent of the respondents indicate that they would consider bringing more cash back to the U.S. even if it meant incurring the U.S. cash taxes upon repatriation, if their company had to record financial accounting tax expense on those earnings regardless of whether they repatriate. In other words, if

[27] In our sample, the percentage of unremitted foreign earnings designated as PRE might be overstated relative to all firms in the Compustat universe. The percentage PRE might be overstated because the firms for which we have these data are firms that repatriated earnings under the American Jobs Creation Act which allowed a lower tax price upon repatriations (5.25% versus 35%, before credits). These repatriating firms may be different than the average Compustat company. One specific way in which they may be different is that they may have anticipated the 2004 rate reduction and surrounding rules and increased the amount of permanently reinvested earnings to maximize their low-tax repatriations. We cannot calibrate the amount of unremitted foreign earnings, however, because such data are not disclosed by firms and thus not in Compustat.

the exception to deferred tax accounting were discontinued for foreign earnings permanently reinvested, many of the respondents would at least consider repatriating the earnings and incurring the cash tax cost. This result suggests that in addition to cash tax costs contributing to the large balance sheet cash balances observed in Foley et al. (2007), financial reporting considerations could be another cause of "trapped" equity or high cash holdings observed at many firms. We investigate this issue more fully in Section 6.

5.2.7. Discussion of the one time dividend received deduction on repatriations after 2004

The survey questions discussed above and the main emphasis of the paper addresses financial accounting effects on general investment and repatriation decisions. We also asked the executives several questions about the importance of accounting effects when their firm faced the decision to repatriate earnings under a special "one-time" reduction of the tax on repatriated earnings. This section briefly discusses the responses to those questions.

The American Jobs Creation Act (the Act) was enacted into law on October 22, 2004 and a portion of the Act was codified in Internal Revenue Code (IRC) Section 965. The Act provided that a corporation that is a U.S. shareholder of a controlled foreign corporation may elect, for one taxable year, an 85 percent dividend received deduction (i.e., not have to pay tax on 85 percent of received dividends) with respect to certain cash dividends it receives from its foreign subsidiaries.[28] This deduction provision effectively reduced the applicable U.S. tax rate on qualified repatriations from the U.S. statutory corporate tax rate of 35 percent (less applicable credits) to 5.25 percent (less applicable credits) (5.25 = 15 percent times 35 percent).[29] In this

[28] See IRS Notice 2005-10 for the definition of cash dividends. The election could only be made for one of the following years 1) the last tax year that began after October 22, 2004 or 2) the first tax year that began during the one year period beginning on October 22, 2004.

[29] Part of our survey instrument gathered information about non-financial accounting issues related to the Act (e.g., the sources and uses of funds repatriated under the Act, tax policy questions, etc.): we present the results from these questions in a companion paper (Graham et al., 2009). The current paper and Graham et al. (2009) use the same survey instrument to gather data but the two papers examine different research questions. More specifically, Graham

paper, we discuss only the questions that address the financial accounting effects firms might have considered when deciding whether to repatriate earnings under the Act.

The dividends received deduction in the Act was subject to several limitations. For the purposes of our paper, the only relevant limitation was that the amount of dividends eligible for the deduction was limited to the greater of the following 1) $500 million, 2) the amount shown on the taxpayer's applicable financial statement as being permanently reinvested outside of the U.S. (the applicable financial statement is the most recently audited financial statement which is certified on or before June 30, 2003 as being prepared in accordance with GAAP, and if the taxpayer is required to file with the SEC is so filed on or before June 30, 2003). [30]

This limitation (to PRE or $500M) provided a maximum in terms of *amount* repatriated that would qualify for the deduction but the Act did not require funds to be repatriated *from* permanently reinvested earnings (i.e., the cash could have been repatriated from unremitted foreign earnings that were not designated as permanently reinvested). Thus, the outcome for financial accounting purposes in terms of the effect on income could vary across firms. For example, if a company repatriated permanently reinvested earnings for which no U.S. tax had been previously accrued, the repatriation would increase the firm's U.S. tax expense by the 5.25 percent tax on the repatriated earnings (less any available foreign tax credits). On the other hand, if a firm repatriated earnings that were not designated as permanently reinvested, the repatriation of the funds and the associated 5.25 percent tax could decrease the firm's tax expense (and increase earnings) because those earnings would probably have had a higher rate of tax accrued than the

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et al. (2009) focus on the Act and the sources and uses of funds that companies repatriated under the Act. Graham et al. (2009) also examine the costs firms incur to avoid the repatriation tax in general. Graham et al. (2009) do not investigate financial accounting issues or effects.

[30] For more details on the Act and the dividend received deduction see IRC Section 965, IRS Notice 2005-10, Blouin and Krull (2009), Brennan (2008), Graham et al. (2009), and others.

5.25 percent (less credits). Thus, in the latter case, the repatriation of dividends and payment of the 5.25 percent tax under the Act could have increased earnings.

A firm specific example highlights this effect. General Electric repatriated $1.2 billion of foreign earnings, which had the effect of reducing their GAAP ETR by approximately 0.5 percent.[31] In an investor relations conference call where a question was asked about how repatriating earnings could *reduce* the GAAP ETR, the GE representative explained that the "…majority of them (foreign reinvested earnings) are continually permanently reinvested in productive assets overseas…but that they had $1.2 billion overseas that we thought we could repatriate which had been provided at rates above the repatriation rate of 5%." Thus, GE repatriated non-PRE earnings but in an *amount* less than their PRE. The reversal of the previously recorded deferred tax liability down to the tax owed at the lower rate under the Act resulted in a decrease in GE's GAAP ETR and an increase in earnings (of roughly $107 million).

We discussed this GAAP ETR effect with one of the beta test companies. The tax executive said that there were two reasons that his company repatriated funds from non-PRE: 1) it avoided any hassles with their auditor over the company bringing back earnings that were previously designated as permanently reinvested, and 2) it avoided an income statement hit. In our sample, when we directly ask companies whether they brought earnings back from a non-PRE pool, 26 percent of the respondents (that answered this question) said that they did (untabulated).[32]

To evaluate the overall importance of the financial accounting expense deferral for firms that repatriated under the Act, we listed "Additional financial accounting expense that could result

[31] Data are from GE's 2005 10-K.

[32] There are 31 firms in our sample that had non-PRE but did not repatriate those non-PRE earnings. The average (and median) firm that could have repatriated non-PRE but did not is smaller (in terms of assets, sales, and market value) and has much lower growth metrics (sales and asset growth and market-to-book ratios) than firms that repatriated non-PRE. Thus, on average these firms appear to be under less capital market scrutiny, which may provide one explanation for their decision not to repatriate non-PRE earnings. However, we asked one of the larger companies that had non-PRE, why they repatriated only PRE. Their response was that they still planned future repatriations and thus needed to retain the tax accrual on the books for those future repatriations.

if earnings previously designated as permanently reinvested were repatriated" as a factor when we asked firms the following question "When considering whether and to what extent your company would repatriate earnings utilizing the Act's one-time dividends received deduction, which of the following were of most concern/importance to your company (e.g., which items received the most attention in planning all aspects of the repatriation)?" In our sample, 43.2 percent of the firms reported that the additional financial accounting tax expense that would be reported upon repatriation of permanently reinvested earnings was important in their decision of whether to, and the extent to, repatriate earnings under the Act (see Figure 4). For a factor not investigated previously in the literature, 43 percent is a surprisingly large proportion of firms to view this factor as important. In addition, the importance of the repatriation's effect on the financial accounting expense is statistically indistinguishable from the importance of the effect on the cash taxes (untabulated t-statistic of 1.19 for the difference in the average rating).[33] In addition, it is important to remember that the importance of the financial accounting effects may be understated because some firms were able to decrease their tax expense through the rules of the Act, thus increasing earnings (by repatriating earnings not designated as PRE) and because firms could clearly disclose why the effective tax rate increased (i.e., the Act allowing a lower cash tax rate on repatriations).

[33] In addition, several companies wrote in responses in the "Other" category. Such responses for this question about the factors important when repatriating earnings under the Act included those that indicated that it was very important to their company to repatriate earnings in a way that decreased the firm's effective tax rate and increased earnings. One such comment was "…5.25% tax applied to earnings on which a 35% deferred tax had been accrued." Another similar response was "All foreign earnings are expected to be repatriated so primary consideration was reducing the U.S. tax that had been provided and decreasing the effective tax rate." Another comment was that the main consideration was "Anticipated future effective tax rate benefits related to a reduction in future repatriations of low-tax foreign earnings." Thus, some of the "other" comments include financial accounting concerns as well. The fact that respondents took the time to write these comments in underscores the importance of financial accounting considerations.

6. Is There an Accounting Based Explanation for Why Firms Hold So Much Cash?

Foley et al. (2007) examine whether cash (repatriation) tax costs help explain the large cash balances observed on multinational firms' balance sheets. Using confidential BEA survey data for approximately 1,600 observations they document a positive relation between cash tax costs and foreign cash holdings and a negative but insignificant relation between cash tax costs and domestic cash holdings. The authors conclude that the cash tax costs of repatriation are a significant cause of firms holding so much cash on their balance sheet. They highlight that much of this cash is held overseas (but they cannot definitively show that there is substitution of foreign cash for U.S. cash).

Our evidence above suggests financial accounting tax expense deferral could be another explanation for the large observed cash balances. To further examine this research question we attempt to replicate the Foley et al. (2007) results in our sample using the financial accounting importance rating as our main test variable. If the accounting implications are important, we would expect that the relation between cash balances and our APB 23 tax expense deferral rating would be significantly positive. However, our tests are subject to several limitations. First, because the expense deferral depends on the cash tax deferral, the two effects are somewhat difficult to disentangle in a regression setting (the correlation between the two ratings in our survey responses is around 0.80). Second, we have a much smaller sample size (N=267 for our largest regression) and an ordinal rating between 0 and 4 for our independent variable. Finally, while we would like to use the ratio of foreign cash/total assets we cannot because we do not have foreign cash holdings, only total worldwide cash for the subset of sample firms on Compustat. Thus, we use two proxies for foreign cash holdings, neither of which are perfect. The proxies we use are total worldwide cash holdings multiplied by the percentage of foreign assets the firm discloses in the survey (scaled by assets excluding the estimate of foreign cash) and the amount of permanently

reinvested earnings (scaled by assets excluding cash). We estimate two different regressions using the two different proxies for foreign cash and we include industry fixed effects.

Our results are presented in Panel A of Table 6. First, we regress the log of our estimate of foreign cash scaled by net assets on each of the ratings – the importance of cash tax deferral and the importance of financial accounting expense deferral – separately and then together. The coefficient on each of the ratings is positive and significant when each is in the regression alone. When both ratings are included in the same regression, both have a positive coefficient but the financial accounting rating is insignificant. We also estimate a regression including all the control variables used in Foley et al. (2007) but requiring these variables reduces the sample size significantly. Neither of our test variables is significant at conventional levels in these expanded specifications.[34]

The results of the regression using our second proxy for foreign cash holdings, the amount of permanently reinvested earnings scaled by total assets (PRE/TA) (where assets again are defined as assets less cash), as the dependent variable are in Panel B of Table 6.[35] When the importance rating of APB 23 deferral is included on its own (second column of results) or with cash tax deferral (third column of results), it is significant in explaining the PRE/TA dependent variable consistent with financial accounting effects increasing the amount of foreign cash holdings (as proxied by PRE/TA). When we add the additional control variables, the importance of APB 23 tax expense deferral retains significance. We also note that the coefficient on foreign income is positive and significant and the coefficient on domestic income is negative and

[34] The cash tax rating is marginally significant at a one-tailed p-value of 0.07.

[35] We caveat that a firm could have a large amount of earnings designated as permanently reinvested but have little cash if the earnings are reinvested in operating assets. On the other hand, while some firms did have to borrow significant sums of cash to repatriate under the Act, Graham et al. (2009) document that 62 percent of all funds repatriated from their sample of firms repatriated from cash holdings and 13 percent of the funds were repatriated from foreign financial assets. Thus, there is likely a significant positive correlation between PRE and foreign cash holdings.

significant, similar to the Foley et al. (2007) tests using foreign cash holdings as the dependent variable. Given the constraints of the data and sample, these results provide some evidence that APB 23 deferral of recording tax expense on financial statements contributes to trapped foreign earnings and high cash balances.[36] However, due to the limitations of our regressions and the proxies we use for foreign cash holdings, these results must be interpreted with some reserve.

7. Conclusions

Our main objective in this paper is to examine whether the ability to avoid or defer the recording of income tax expense for financial accounting is an important consideration in real corporate investment decisions regarding location of operations and whether to repatriate foreign earnings to the U.S. or reinvest the foreign earnings overseas. Shackelford et al. (2009) predict and model that both cash tax deferral and financial accounting expense deferral may be important factors for firms as they decide where to locate operations. Our results support their location predictions. We extend our tests to investigate the repatriation versus reinvestment decision and find that financial reporting effects are important in this decision as well.

We examine survey responses from nearly 600 executives and find evidence consistent with the deferral of income tax expense for financial accounting being important in corporate decisions regarding location of operations and whether to repatriate or reinvest earnings. For example, 31 percent of the respondents rated deferral under APB 23 as being important in their decision to locate operations outside of the U.S. In addition, 44 percent of respondents stated that deferral of the financial accounting tax expense is important in their decision of whether to reinvest foreign earnings outside of the U.S. These percentages are markedly higher for firms that

[36] Recall that firms provided importance ratings for both the investment location decision and the reinvestment versus repatriation decision. We use the ratings from the investment decision in the regressions above in order to maximize the number of observations. We also estimate the same regressions described above but with importance ratings from the reinvestment versus repatriation decision. Few factors are significant in explaining Cash/TA but in the PRE/TA regressions the results are similar to those described above except when all the control variables are included the importance of cash tax deferral and accounting expense deferral become insignificant.

are publicly traded, have foreign assets, and have high research and development spending – companies for which one might expect the financial accounting incentives to be highest.

For both decisions – where to locate operations and whether to reinvest or repatriate – the importance of the financial accounting tax expense deferral is not statistically different than the importance of cash tax deferral when making these decisions. This result is important in light of the decades of research on the location and repatriation decisions that considers the cash tax implications but heretofore has not examined the financial accounting implications. Our results show that the accounting expense deferral is important to firms and appears to provide an incentive, along with the relatively high corporate tax rates in the U.S., to move operations and investments overseas and to reinvest more of the foreign earnings overseas as well. In addition, if the determinants of corporations making investments in the U.S. or elsewhere are important to U.S. policymakers, then our results should be informative in that the determinants include not only the effects of tax policies but the financial accounting rules as well.

Appendix A
Variable Descriptions

Public/Private = Company responses to a question that asks if the firm is public and traded on NYSE or on NASDAQ/AMEX or if the firm is private.

Size = Total assets of the firm in the most recent fiscal year prior to completion of the survey, self-reported by the respondents. Firms above the median are considered large firms and those below the median are considered small firms.

Foreign Asset Percentage = Company responses to a question that asked the respondent for the percentage of foreign assets in foreign locations. Firms with a percentage greater (lower) than the sample median are considered to have a high (low) ratio.

Foreign Source Earnings = Indicator variable representing responses to a question that asked the respondent whether their company has had foreign source earnings in the last ten years. The variable is set to one if the respondent answered their company did have foreign source earnings and zero otherwise.

GAAP ETR = The companies' effective tax rate (total worldwide tax expense/worldwide pre-tax book income) for the last fiscal year prior to completion of the survey. Obtained from reported survey answers for the private companies and from Compustat data for the public firms. A high (low) GAAP ETR is defined as being above (below) the sample median.

U.S. NOL = Company responses about whether the firm had a U.S. net operating loss (U.S. NOL) for tax purposes in the latest fiscal year-end before the completion of the survey.

R&D = The level of research and development spending scaled by sales. These data are from Compustat. We do not have data for the private firms for this item. Firms with an R&D spending amount above (below) the sample median are considered high (low). If R&D expense is missing on Compustat we replace with zero.

Appendix B
Example of Firm Disclosure of Foreign Earnings Tax Effects

Note 10: Income Taxes

Under SFAS 109, "Accounting for Income Taxes," income taxes are recognized for the amount of taxes payable for the current year and for the impact of deferred tax liabilities and assets, which represent future tax consequences of events that have been recognized differently in the financial statements than for tax purposes. Deferred tax assets and liabilities are established using the enacted statutory tax rates and are adjusted for any changes in such rates in the period of change.

Earnings before income taxes consisted of the following:

Years ended June 30	**2008**	**2007**	**2006**
United States	$ 9,142	$ 9,138	$ 7,410
International	6,936	5,572	5,003
Total	16,078	14,710	12,413

The income tax provision consisted of the following:

Years ended June 30	**2008**	**2007**	**2006**
Current Tax Expense			
U.S. federal	$1,016	$2,667	$1,961
International	1,546	1,325	1,702
U.S. state and local	227	125	178
	2,789	4,117	3,841
Deferred Tax Expense			
U.S. federal	1,267	231	226
International and other	(53)	22	(338)
	1,214	253	(112)
Total Tax Expense	4,003	4,370	3,729

A reconciliation of the U.S. federal statutory income tax rate to our actual income tax rate is provided below:

Years ended June 30	**2008**	**2007**	**2006**
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
Country mix impacts of foreign operations	-6.6%	-4.3%	-3.6%
Income tax reserve adjustments	-3.1%	-0.3%	-1.5%
Other	-0.4%	-0.7%	0.1%
Effective Income Tax Rate	24.9%	29.7%	30.0%

We have undistributed earnings of foreign subsidiaries of approximately $21 billion at June 30, 2008, for which deferred taxes have not been provided. Such earnings are considered indefinitely invested in the foreign subsidiaries. If such earnings were repatriated, additional tax expense may result, although the calculation of such additional taxes is not practicable.

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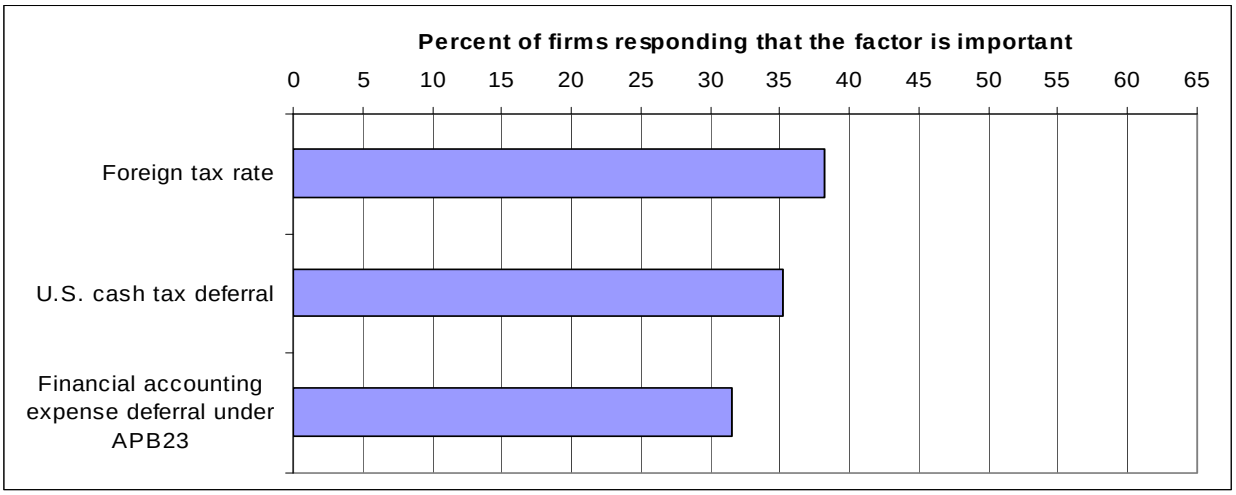
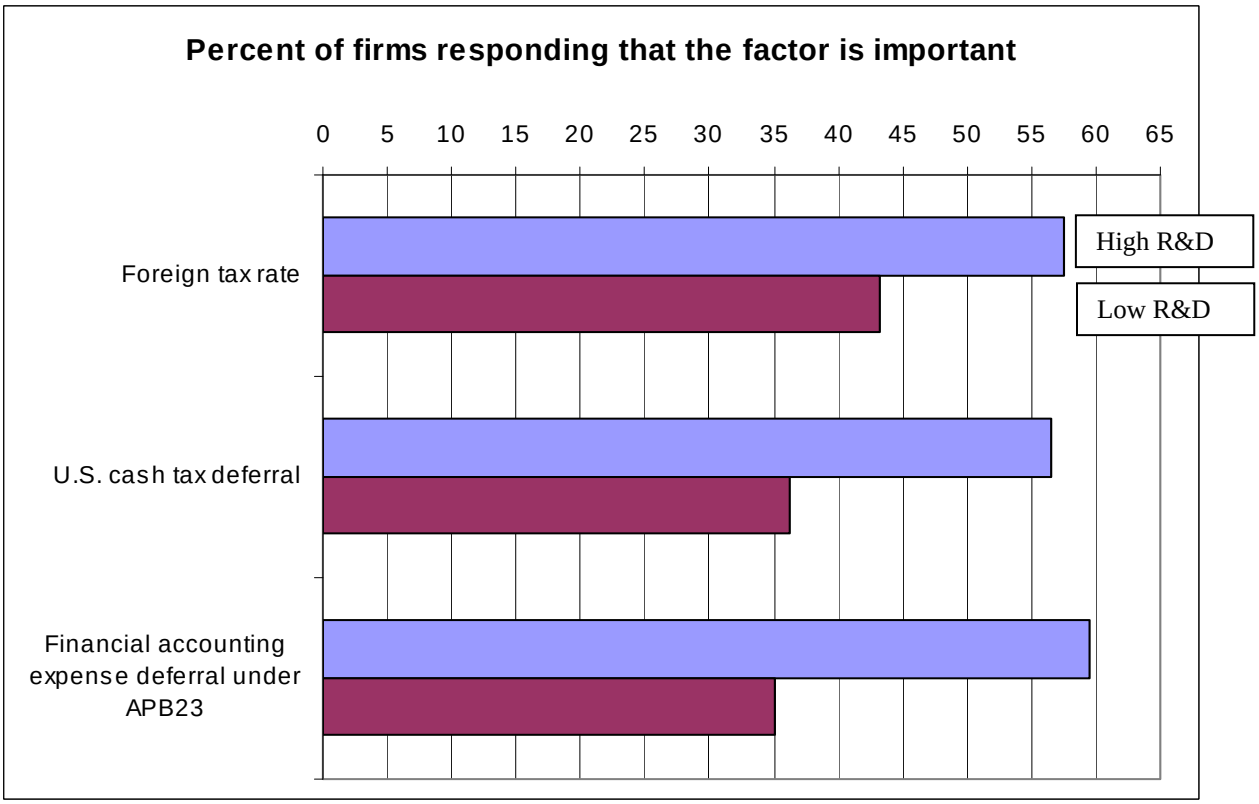
Figure 1
Factors Important in the Decision of where to Locate Operations

Panel A: All firms



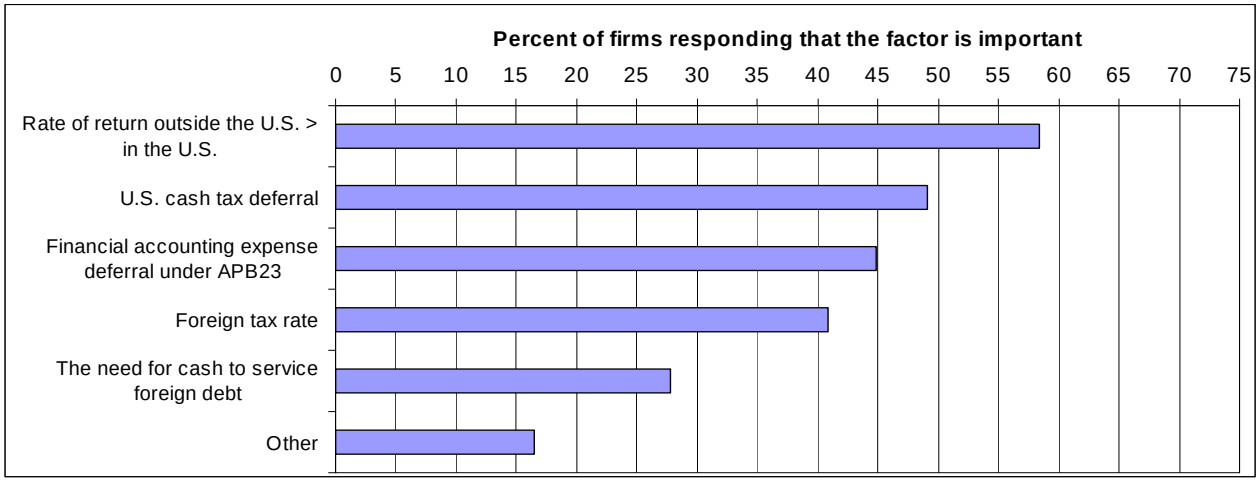
Panel B: Public Firms with Assets in a Foreign Location



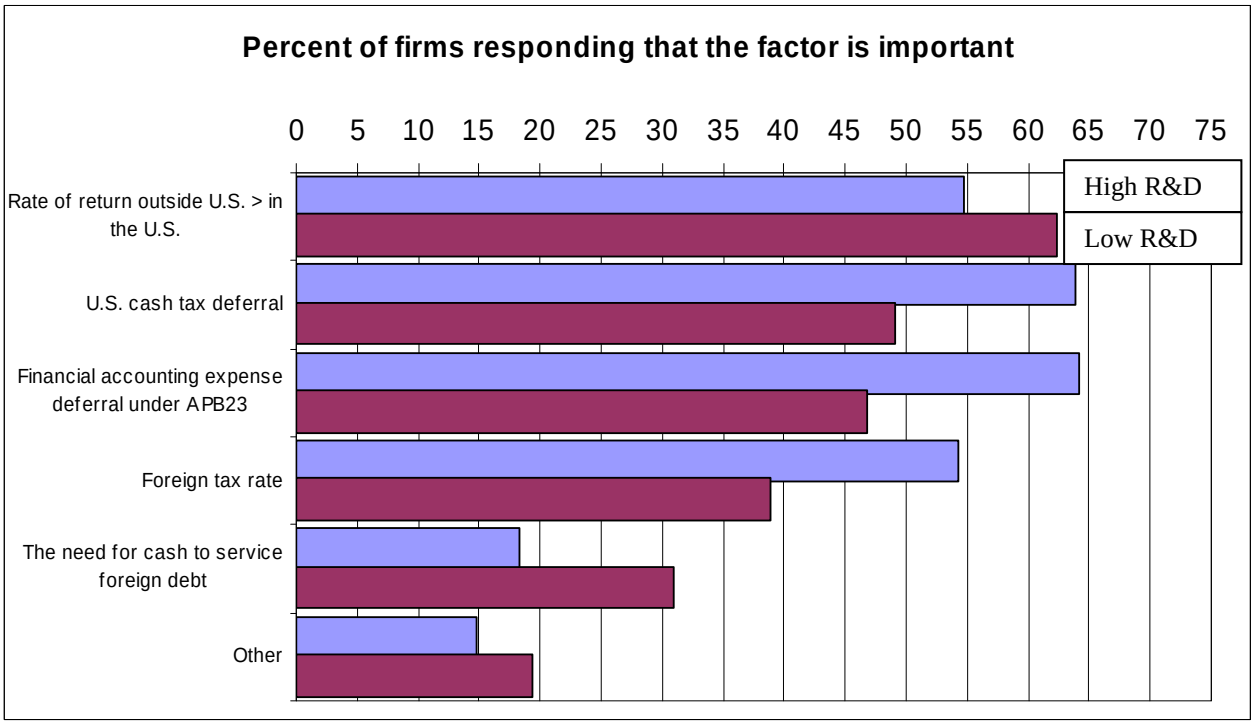
Notes: Survey responses to the question: Relative to all the factors your company considers when making a decision about whether to **locate operations in the U.S. or outside the U.S**., how important are the following? All data are obtained from a survey of corporate tax executives. The survey provides a 5 point rating scale ranging from 0 to 4. The zero rating is labeled "Not at all important" and the rating of 4 is labeled "very important." The data above are the percentage of firms that answered that the listed factor was important at either the 3 or 4 rating. In Panel B the top series are public firms with high R&D spending and the bottom series are public firms with low R&D spending.

Figure 2
Factors Important in the Decision of Whether to Reinvest or Repatriate Foreign Earnings Outside the U.S.

Panel A: All firms



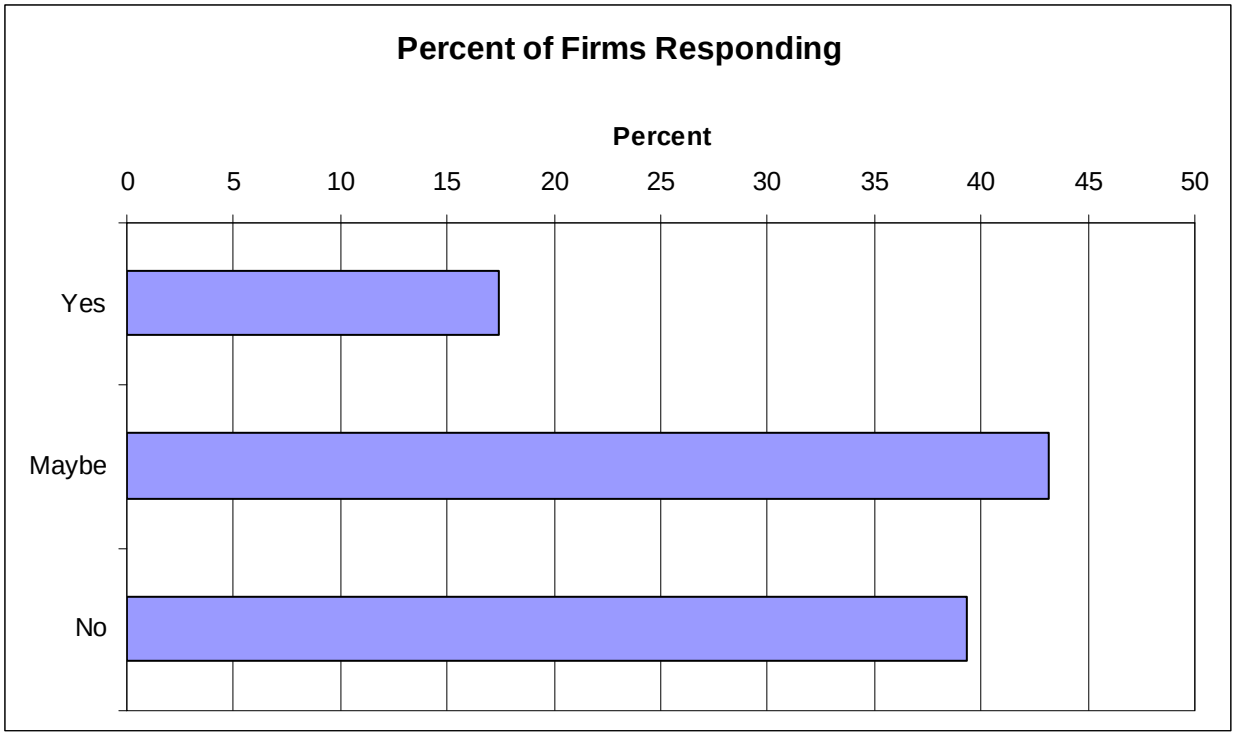
Panel B: Public Firms with Assets in a Foreign Location



Notes: Survey responses to the question: In general, what factors are important in your company's decision to **reinvest foreign earnings outside of the U.S**.? All data are obtained from a survey of corporate tax executives. The survey provides a 5 point rating scale ranging from 0 to 4. The zero rating is labeled "Not at all important" and the rating of 4 is labeled "very important." The data above are the percentage of firms that answered that the listed factor was important at either the 3 or 4 rating. In Panel B the top series are public firms with high R&D spending and the bottom series are public firms with low R&D spending.

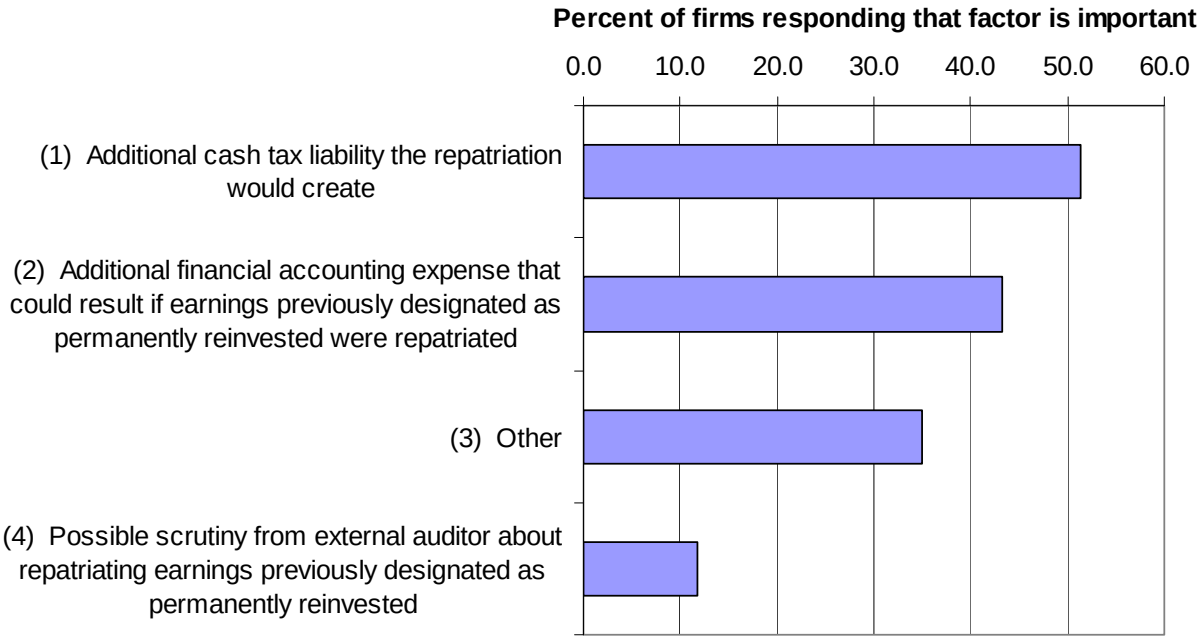
Figure 3
Response to a Hypothetical Repeal of Deferral under APB 23

(N=315)



Survey responses to the question "If the rule allowing the deferral of U.S. tax expense under APB 23 were repealed but the deferral of cash tax until repatriation was still allowed, would your company repatriate more foreign earnings as dividends (in other words, if your company had to immediately accrue the tax expense for financial accounting would your company repatriate more dividends)? "

Figure 4
Factors Important for Firms Taking Advantage of the One-Time Dividends Received Deduction in the 2004 Tax Act



Notes: Survey responses to the question: When considering whether and to what extent your company would repatriate earnings utilizing the Act's one-time dividend received deduction, which of the following were of most concern/importance to your company (e.g., which items received the most attention in planning all aspects of the repatriation)? All data are obtained from a survey of corporate tax executives. The survey provides a 5 point rating scale ranging from 0 to 4. The zero rating is labeled "Not at all important" and the rating of 4 is labeled "very important." The data above are the percentage of firms that answered that the listed factor was important at either the 3 or 4 rating.

Table 1
Descriptive Statistics

	Percent
Ownership (N=594)	
Public - NYSE	47
Public - Nasdaq/Amex	28
Private	23
Other (e.g., OTC)	2
Industry (N=595)	
Agriculture, Forestry, Fishing, and Hunting	0.17
Mining	1.85
Utilities	1.01
Construction	1.51
Manufacturing	29.92
Wholesale Trade	5.04
Retail Trade	6.22
Transportation and Warehousing	2.02
Information	4.54
Finance and Insurance	5.04
Real Estate, Rental and Leasing	2.18
Professional, Scientific, and Technical Services	6.72
Management of Companies (Holding Companies)	15.80
Admin., Support, Waste Mgt. and Remediation Services	1.51
Educational Services	0.50
Health Care and Social Assistance	1.18
Arts, Entertainment, and Recreation	1.01
Accomodation and Food Services	1.68
Other services	0.67
No code reported	11.43
File a consolidated Form 1120 (N=590)	
Yes	93.9
No	6.1
Percent of firms with foreign source income in last 10 years (N=551)	
Yes	75.0
No	25.0

	Percent
Assets (N=535)	
<$500 million	26.9
$500 - $999 million	16.3
$1 - $4.9 billion	32.7
$5 - 10 billion	7.5
> $10 billion	16.6
Percent of Assets in Foreign Location (N=538)	
0%	25.46
0-10%	26.77
11%-20%	11.52
21%-30%	10.97
31%-40%	9.29
41%-50%	7.62
51%-60%	2.42
61%-70%	2.60
71%-80%	1.67
81%-90%	0.74
91%-100%	0.93
Prior year GAAP ETR (N=439)	
<10%	10.9
10%-20%	4.8
20%-30%	18.5
30%-40%	55.6
40%-50%	6.2
>50%	4.1
Percent of firms with NOLs	
U.S.	46.3
Foreign	49.8
State	68.7

	Percent
Entities included in 1120 group (N=554)	
1	0.54
2 - 10	41.52
11 - 50	42.24
51 - 100	8.48
> 100	7.22
Number of Forms 1120 filed (N=582)	
1	60.48
2 - 10	28.35
11 - 50	8.76
51 - 100	0.52
101 - 1,000	1.55
> 1,000	0.34
Number of Forms 5471 filed (N=580)	
Zero	19.48
1	7.59
2 - 10	28.79
11 - 50	29.83
51 - 100	8.45
> 100	5.86
Number of flow-through entities in which firm has some ownership (N=588)	
Zero	19.39
1	9.52
2 - 10	45.24
11 - 50	18.54
51 - 100	4.59
> 100	2.72

Notes: The above data are all obtained through survey questions, with the exception of the GAAP effective tax rate (total tax expense divided by pre-tax book income) for the publicly traded firms which is obtained from Compustat. Form 1120 is the U.S. Corporate Income Tax form. Form 5471 is an informational return filed in the U.S. about the activities of a foreign controlled corporation owned more than 10 percent by a U.S. person (the definition of which includes a U.S. corporation).

Table 2
Descriptive Statistics of Compustat Firms, Nonresponders, and Responders
(Non-response bias tests)

	All Compustat (1)		All firms we contacted with available data (2)		Survey Non - Responders with available data (3)		Survey Responders with available data (4)		P-value			
	N	Mean	N	Mean	N	Mean	N	Mean	1 vs 2	1 vs 4	2 vs 4	3 vs 4
Assets	4,996	4,066.26	1,398	8,891.22	863	9,617.72	535	7,547.93	0.000	0.000	0.202	0.085
MVE	4,654	2,709.19	1,183	7,977.02	813	7,831.80	370	8,304.84	0.000	0.000	0.777	0.692
Sales	4,977	1,991.09	1,235	5,527.34	863	5,499.10	372	5,625.37	0.000	0.000	0.881	0.855
Debt	4,980	0.19	1,233	0.22	861	0.22	372	0.20	0.000	0.754	0.083	0.019
Cash	4,994	0.20	1,234	0.14	862	0.13	372	0.15	0.000	0.000	0.086	0.019
MB	4,653	3.75	1,183	3.28	813	3.26	370	3.29	0.000	0.005	0.946	0.891
ROA	4,976	-0.03	1,235	0.05	863	0.05	372	0.06	0.000	0.000	0.033	0.006
GAAP ETR	3,723	0.26	1,195	0.30	756	0.30	439	0.30	0.000	0.000	0.690	0.640
Asset growth	4,795	0.20	1,211	0.14	845	0.14	366	0.14	0.000	0.000	0.921	0.918
Sales growth	4,687	0.21	1,210	0.14	845	0.13	365	0.14	0.000	0.000	0.632	0.451
Industry												
0	12	0.2%	3	0.2%	3	0.4%	0	0.0%				
1	241	4.8%	58	4.7%	44	5.1%	14	3.6%				
2&3	1,802	36.1%	549	44.0%	376	43.6%	173	45.1%				
4	484	9.7%	141	11.3%	102	11.8%	39	10.2%				
5	404	8.1%	152	12.2%	102	11.8%	50	13.0%				
6	1,237	24.8%	142	11.4%	104	12.1%	38	9.9%				
7	563	11.3%	155	12.4%	103	11.9%	52	13.5%				
8	196	3.9%	43	3.4%	26	3.0%	17	4.4%				
9	57	1.1%	4	0.3%	3	0.4%	1	0.3%				

All dollar amounts are in millions. All Compustat variables are measured in the year 2006 and are winsorized at 1% and 99% of the distribution. Column (1) consists of all the firms on Compustat except for firms with a negative book value, firms whose name ends with LP, and firms incorporated outside of the U.S. Column (2) includes all the firms that were sent a survey (described earlier in the manuscript), that we could match to and retrieve the data on Compustat. Column (3) consists of the group of firms that are on Compustat and that we sent a survey to but did not receive a response. Column (4) includes the survey responders with data available on Compustat. *Assets* is defined as world-wide assets (Compustat data item AT). *MVE* is the market value of equity (data PRCC_F times data CSHO). *Sales* are total sales (data SALE) divided by total assets (data AT). *Debt* is the ratio of long-term debt (data DLTT) plus the debt included in current liabilities (data DLC) to total assets (data AT). Cash is cash and marketable securities (dataCHE) scaled by total assets (data AT). *MB* is the market-to-book ratio (MVE/data CEQ). *ROA* is return-on-assets defined as net income (data NI) divided by total assets (data AT). *GAAP ETR* is the GAAP effective tax rate defined as total tax expense (data TXT) divided by pre-tax accounting income (data PI). Industries are determined by SIC codes because these are all Compustat firms (for which we do not have the tax code for industry). The industry groups are as follows: 0 = Agriculture, Forestry, and Fishing; 1 = Mining and Construction; 2 = Manufacturing (Food, Tobacco, Lumber, Furniture, Paper, Chemicals); 3 = Manufacturing (Rubber, Leather, Stone, Metal, Electronics); 4 = Transportation, Communication, Electric, Gas and Sanitary; 5 = Wholesale and retail trade; 6 = Finance, Insurance, and Real Estate; 7 = Hotel and Business Services; 8 = Health, Legal, and Educational Services; and 9 = Public Administration.

Table 3
Factors Important in Where to Locate Operations

Survey responses to the question: Relative to all the factors your company considers when making a decision about whether to **locate operations in the U.S. or outside the U.S**., how important are the following?

Panel A: Unconditional Results

Factor	% important	% not important	Average rating
(1) Foreign tax rate	38.17	42.83	1.86
(2) U.S. cash tax deferral	35.21	45.32	1.76
(3) Financial accounting expense deferral under APB23	31.53	51.12	1.65

Statistical Test of Differences in the Average Rating of the Factors

Comparison Factors	t-statistic
(1) = (2)	1.13
(2) = (3)	1.32
(1) = (3)	2.45

Panel B: Conditional Results

			Ownership		Size		Foreign Source Earnings		Foreign Asset Percentage		GAAP ETR		R & D	
Factor	**% important**	**Obs**	**Public**	**Private**	**Large**	**Small**	**Yes**	**No**	**High**	**Low**	**High**	**Low**	**High**	**Low**
(1)	38.2	537	41.3	26.7***	42.9	33.6*	45.2	15.1***	55.9	20.9***	27.6	48.1***	52.4	37.4***
(2)	35.2	534	38.5	23.3***	42.5	28.2***	41.9	14.3***	48.0	22.8***	25.2	44.3***	50.5	33.7***
(3)	31.5	536	37.1	11.2***	34.9	28.9	37.5	11.9***	46.5	17.9***	24.3	40.7***	51.9	31.0***

Table 3 (continued): Factors Important in Where to Locate Operations

Panel C: Regression Results

		Dependent variable							
		Rating of APB23 expense deferral		Rating of APB23 expense deferral		Rating of cash tax deferral		Rating of cash tax deferral	
		coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat
Intercept		1.850	6.20	1.638	4.81	2.452	8.41	2.339	7.02
Public	+	0.725	4.19	0.700	3.92	0.430	2.54	0.391	2.24
Assets		0.000	-0.23	0.000	0.41	0.000	0.51	0.000	0.97
Foreign source earnings	+	0.921	5.62	0.886	5.32	1.078	6.73	1.019	6.25
Foreign asset percentage	+	1.537	4.83	1.325	3.94	1.281	4.12	1.076	3.27
GAAP ETR	-	0.038	0.10	-0.060	-0.15	-0.325	-0.84	-0.429	-1.09
Nonmissing R&D		-0.041	-0.26	-0.560	-0.33	0.092	0.59	0.096	0.57
*Nonmissing R&D *R&D*	+	3.892	3.51	3.132	2.70	2.932	2.70	2.196	1.93
Industry fixed effects		no		yes		no		yes	
R-squared		0.276		0.307		0.273		0.304	
N		416		416		415		415	

Notes: The survey provides a 5 point rating scale ranging from 0 to 4 with a rating of zero labeled "Not at all important" and a rating of 4 labeled "very important." The percentages listed in Panel A of the table under "% important" are the percentages of respondents that gave a rating of 3 or 4 for that particular factor. The percentages listed in Panel A of the table under the column "% not important" are the percentages of respondents that gave a rating of 0 or 1 for that particular factor. The percentages listed in Panel B are only the percentages of firms that gave a rating of 3 or 4 for the factor (i.e., the company rates the factor as important). Statistical significance is based on tests of the average rating being different between factors in Panel A and tests of the average rating for the sub-samples being statistically different from each other in Panel B. ***, **, and * mark significance of .01, .05, and .10 respectively. See Appendix A for definitions of the conditioning variables. Note that in the regression above we use the continuous version of the *GAAP ETR* and *Foreign asset percentage*. In addition, in order to be able to include public and private firms in the regression and test for the effect of *R&D* we establish an indicator variable set equal to 1 for observations that have nonmissing *R&D* and zero otherwise.

Table 4
Reinvestment vs. Repatriation

Panel A: Unconditional Results

Survey responses to the question: In general, what factors are important in your company's decision to **reinvest foreign earnings outside of the U.S**.?

Factor	% important	% not important	Average rating
(1) Rate of return outside the U.S. > in the U.S.	58.4	19.9	2.58
(2) U.S. cash tax deferral	49.1	28.6	2.29
(3) Financial accounting expense deferral under APB23	44.9	31.9	2.18
(4) Foreign tax rate	40.8	26.7	2.15
(5) The need for cash to service foreign debt	27.8	54.9	1.48
(6) Other	16.5	70.0	0.95

Statistical Test of Differences in the Average Rating of the Factors

Comparison Factors	t-statistic
(1) = (2)	3.12
(2) = (3)	1.13
(3) = (4)	0.30

Panel B: Conditional Results

			Ownership		Size		Foreign Asset Percentage		GAAP ETR		U.S. NOL		R & D	
Factor	**% important**	**Obs**	**Public**	**Private**	**Large**	**Small**	**High**	**Low**	**High**	**Low**	**Yes**	**No**	**High**	**Low**
(1)	58.4	387	59.8	52.1*	62.9	53.1**	65.1	47.5***	52.3	64.7*	56.2	59.0	53.5	63.0
(2)	49.1	385	52.7	32.9***	55.1	44.4***	56.4	38.1***	37.4	61.1***	48.4	51.1	64.3	45.8***
(3)	44.9	383	51.4	14.7***	49.5	41.2**	53.8	30.4***	32.8	58.1***	45.7	44.8	65.7	43.5***
(4)	40.8	382	44.9	22.9***	44.1	37.1	49.6	25.9***	29.0	50.6***	41.2	39.8	58.6	37.8***
(5)	27.8	381	28.5	24.6	32.1	24.1	32.8	20.6***	28.5	27.1	30.2	25.4	19.4	30.7**
(6)	16.5	237	17.3	13.0	14.4	18.6	19.7	11.6***	13.3	19.4	18.5	13.2	14.3	19.0

Table 4 (continued)
Reinvestment vs. Repatriation

Panel C: Multivariate Analysis

		Dependent variable							
		Rating of APB23 expense deferral		Rating of APB23 expense deferral		Rating of cash tax deferral		Rating of cash tax deferral	
		coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat
Intercept		0.957	3.95	1.054	3.18	1.370	5.71	1.629	5.00
Public	+	1.055	4.73	1.038	4.43	0.532	2.41	0.497	2.15
Assets		0.000	0.04	0.000	0.17	0.000	0.59	0.000	0.47
NOL		-0.054	-0.36	-0.073	-0.46	0.013	0.09	-0.035	-0.23
Foreign asset percentage	+	1.168	3.40	1.112	2.99	1.132	3.33	1.009	2.76
GAAP ETR	-	-0.313	-0.68	-0.374	-0.78	-0.237	-0.52	-0.339	-0.72
Nonmissing R&D		0.209	1.12	0.212	1.02	0.379	2.06	0.443	2.18
*Nonmissing R&D *R&D*	+	3.770	3.06	3.452	2.60	0.379	2.20	1.891	1.45
Industry fixed effects		no		yes		no		yes	
R-squared		0.211		0.239		0.148		0.120	
N		287		287		286		286	

Notes: The survey provides a 5 point rating scale ranging from 0 to 4 with a zero rating labeled "Not at all important" and a rating of 4 labeled "very important." The percentages listed in Panel A of the table under "% important" are the percentages of respondents that gave a rating of 3 or 4 for that particular factor. The percentages listed in Panel A of the table under the column "% not important" are the percentages of respondents that gave a rating of 0 or 1 for that particular factor. The percentages listed in Panel B are only the percentages of firms that gave a rating of 3 or 4 for the factor (i.e., the company ranks the factor as important). Statistical significance is based on tests of the average rating being different between factors in Panel A and tests of the average rating for the sub-samples being statistically different from each other in Panel B. ***, **, and * mark significance of .01, .05, and .10 respectively. See Appendix A for definitions of the conditioning variables. The sample is smaller than in Table 3 because only firms with foreign source earnings were directed to answer this question. See Table 3 for the adjustments made to the conditioning variables for use in the regression.

Table 5
Information on Unremitted Foreign Earnings and Permanently Reinvested Earnings

Variable	N	Mean	Std Dev	25th Pctl	50th Pctl	75th Pctl	Sum
Unremitted foreign earnings	196	1,043	3,768	21	97	542	204,515
Permanently reinvested earnings	196	897	3,431	8	53	358	175,749
Ratio of PRE/URE	196	0.76	0.36	0.57	1.00	1.00	149.01

Notes: Unremitted foreign earnings (URE) are earnings in foreign subsidiaries that have not been repatriated to the U.S. parent company. Permanently reinvested earnings (PRE) is the portion of URE the firm designates as permanently reinvested and on which there is no U.S. income tax accrual provided. Both amounts are from the survey data. There are a smaller number of observations in this table because the data are provided based on respondents to a question about a tax form filed to elect to take advantage of the one-time-dividends received deduction under the American Jobs Creation Act of 2004. (See manuscript for a discussion of the American Jobs Creation Act).

Table 6
Tests of Association Between Survey Ratings and Proxies for Foreign Cash Balances

Panel A: Estimated foreign cash balance as a proxy for foreign cash balance

Dependent Variable = ln(Estimate of Foreign Cash/Net Assets)

Variable		coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat
Intercept		-6.408	-17.57	-6.059	-17.09	-6.412	-17.54	-5.261	-7.54	-4.780	-7.48
Importance rating of cash tax deferral	+	0.449	5.36			0.415	3.18	0.203	1.51	0.156	1.18
Importance rating of APB23 expense deferral	+			0.341	4.22	0.431	0.35	-0.167	-1.30	-0.107	-0.86
Domestic income	-							-1.984	-1.31	-2.136	-1.41
Foreign income	+							12.586	4.02	13.881	4.60
Log assets								0.109	1.37	0.094	1.22
Dividend dummy	-							-0.329	-1.39	-0.299	-1.28
Book to market								0.086	0.41	0.049	0.24
St dev operating income								1.448	0.97	1.202	0.81
R&D	+							7.271	2.69	8.755	3.42
Capex	-							5.118	1.36	2.098	0.59
Market Leverage	-							-4.215	-4.98	-4.095	-5.13
Industry fixed effects			yes		yes		yes		yes		no
N			266		267		267		177		177
R^2			0.214		0.182		0.214		0.468		0.393

Table 6 (continued)
Tests of Association Between Survey Ratings and Proxies for Foreign Cash Balances

Panel B: Amount of permanently reinvested earnings as proxy for foreign cash balance

Dependent Variable = ln(PRE/Net Assets)

Variable		coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat
Intercept		0.034	1.34	0.023	0.98	0.030	1.21	0.218	0.34	0.039	0.69
Importance rating of cash tax deferral	+	0.007	1.14			-0.009	-0.89	-0.277	-2.13	-0.031	-2.53
Importance rating of APB23 expense deferral	+			0.013	2.22	0.020	2.06	0.021	1.70	0.025	2.15
Domestic income	-							-0.531	-3.43	-0.525	-3.55
Foreign income	+							1.070	3.71	1.109	4.02
Log assets								0.007	0.91	0.005	0.70
Dividend dummy	-							0.008	0.35	0.006	0.26
Book to market								0.019	1.11	0.020	1.20
St dev operating income								-0.075	-0.38	-0.082	-0.43
R&D	+							-0.136	-0.46	-0.104	-0.39
Capex	-							0.648	1.65	0.541	1.54
Market Leverage	-							-0.121	-1.31	-0.112	-1.36
Industry fixed effects			yes		yes		yes		yes		no
N			195		197		195		118		118
R^2			0.072		0.090		0.093		0.325		0.307

Notes: This table uses two proxies for foreign cash holdings and tests whether respondents' answers for the importance of tax and accounting factors are determinants of the (proxies for) foreign cash holdings. Panel A presents estimated coefficients and t-statistics from regressions of a ratio of an estimate of foreign cash holdings to the net assets (assets less the estimate of foreign cash) of the firm on the importance ratings of cash tax and accounting expense deferral (and control variables). The estimate of the foreign cash holdings is computed by multiplying each company's foreign asset percentage by their total worldwide cash on the balance sheet (we only have for public firms). Panel B uses a different proxy for foreign cash holdings - natural logarithm of the ratio of permanently reinvested earnings to assets (where assets are measured as total assets less cash). Importance rating of cash tax deferral and APB23 expense deferral are the ratings from Table 3. Following Foley et al. (2007) *Domestic income* and *Foreign income* are scaled by total assets. *Domestic income* is from Compustat and is pre-tax income and *Foreign income* is from Compustat and is also pre-tax. *Log assets* is the natural logarithm of total firm assets. *Dividend dummy* is a dummy equal to one if the firm pays cash dividends and zero otherwise. *Book-to-market* is the ratio of book value of common equity to market value of common equity. *Standard deviation of operating income* is the standard deviation of the ratio of operating income before depreciation to total assets measured over the five years prior to 2006. *R&D* is the ratio of research and development expenditures to total assets. Research and development is set to zero when missing. *Capex* is the ratio of capital expenditures to total assets. *Market leverage* is the ratio of long and short term debt to the sum of long and short term debt and the market value of equity.