taxnotes® international

Volume 98, Number 4 ■ April 27, 2020

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Reprinted from *Tax Notes International*, April 27, 2020, p. 427

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The authors are grateful for constructive comments on earlier drafts from Kimberly A. Clausing, Tim Dowd, Marty Sullivan, and David Rosenbloom.

In this article, the authors estimate the double-counted pretax profit of U.S. corporations and partnerships using country-by-country reporting data gathered by the IRS.

Since 2016, U.S. corporations and partnerships have been required to attach to their federal income tax returns Form 8975, which provides a country-by-country allocation of the company's profit (loss) before income tax. The IRS has published summaries of the aggregate pretax profit allocated to various countries reported on Forms 8975 for tax years 2016 and 2017. The IRS and foreign tax authorities use the CbC data in their examinations of the tax returns of U.S. multinational enterprises. International tax policy analysts in and outside the U.S. government use the summaries to assess the extent to which U.S. MNEs shift profits to tax havens, as well as the revenue consequences of proposed changes to the U.S. international tax rules.[1]

The reliability of the IRS CbC data has been questioned because some portion of the aggregate revenue and pretax profit reported in the summary tables was double counted.[2] That is, in some instances, some portion of the revenues or the pretax profit that a U.S. MNE attributes to an entity that is a tax resident in one jurisdiction is also attributed to a second entity resident in some other jurisdiction.

This article estimates how much the aggregate pretax profit reported in the IRS CbC data for tax year 2017 exceeds the consolidated pretax profit that U.S. MNEs reported on their financial statements for fiscal years ending in 2017,[3] which is our measure of the double-counted pretax profit.

I. Why the Double Counting?

To properly interpret the IRS CbC summary statistics, it is important to understand how and why a U.S. MNE group's revenue and pretax profit may be double counted. The best place to start is the IRS instructions for Form 8975 and Schedule A, which have several key points:

- a separate Schedule A must be provided for each tax jurisdiction of an MNE group;

[1] *See* Kimberly A. Clausing, "How Big Is Profit Shifting?" SSRN (Jan. 20, 2020); and "Profit Shifting Before and After the Tax Cuts and Jobs Act," SSRN (Jan. 20, 2020).

[2] *See, e.g.*, Martin A. Sullivan, "Are Country-by-Country Reports Worthless?" *Tax Notes Int'l*, Jan. 13, 2020, p. 140.

[3] Part II of the IRS instructions for Form 8975 provide that the financial amounts furnished should be based on the MNE's applicable financial statements. Accordingly, we concluded that the pretax profit (or loss) an MNE group reported on Form 8975 was comparable to the consolidated profit before tax (or similarly labeled amount) that the group reported to its investors and included in its SEC Form 10-K.

- Part I of Schedule A provides the aggregate values of revenue, pretax profit, and various other amounts for all constituent entities of an MNE that are resident in a jurisdiction;
- a constituent entity generally includes any business entity of an MNE that is recognized for federal tax purposes, including any entity with a single owner that may be treated as a disregarded entity under the U.S. check-the-box regulations and any permanent establishment that prepares financial statements separate from its owner's;
- a constituent entity is generally considered resident in a tax jurisdiction if, under the laws of that jurisdiction, it is liable for tax there based on its place of management or organization, or similar basis; and
- a constituent entity's revenue from unrelated and related parties is reported separately.

The Form 8975 instructions also define the term "revenue," saying it includes revenue from inventory and property sales, services, royalties, interest, and premiums. It does not include:

> payments received from other constituent entities in your group that are treated as dividends in the payor's tax jurisdiction of residence. Distributions and remittances from your constituent entities that are partnerships, other fiscally transparent entities, or permanent establishments are not considered revenue of the recipient-owner.
>
> Revenue also does not include imputed earnings or deemed dividends from other constituent entities in your group that are taken into account solely for tax purposes and that otherwise would be included as revenue by a constituent entity.

The first reason the aggregate pretax profit a U.S. MNE reports on Form 8975 will be double counted results from the treatment of stateless entities. A U.S. MNE group must:

- include the revenue and pretax profit of its stateless entities on a separate Schedule A; and
- allocate the revenue and profit of the stateless entity to the specific countries where the entity owners are resident.

Assuming 100 percent of the ownership interests in the stateless entity are owned by group affiliates, 100 percent of that entity's revenue and pretax profit will be double counted in the total amounts reported in the IRS statistical tables.[4]

Pretax profit might also be double counted because of the way dividends received from subsidiary corporations are treated. As noted, the IRS instructions for Form 8975 provide that those dividends should be excluded from the parent's revenue, but do not say that those dividends should also be excluded from the parent's pretax profit. The OECD recently concluded that its earlier guidance[5] did not address the exclusion of dividends from subsidiaries from a parent company's pretax profit, and that various jurisdictions and MNEs have thus adopted different approaches.[6] In other words, the OECD is concerned that some MNE groups (including MNEs resident in the United States) have filed CbC reports that double count pretax profit by including dividends received from subsidiaries in the parent's pretax profit.

A related double count involves a PE's revenue and pretax profit. The IRS instructions provide that a constituent entity includes a PE and that the PE's revenue and pretax profit are to be included on Schedule A for the tax jurisdiction where the PE is situated. The OECD's 2015 final action 13 report states:

> The permanent establishment data should be reported by reference to the tax jurisdiction in which it is situated and not by reference to the tax jurisdiction of residence of the business unit of which the permanent establishment is a part.

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[4] In a recent publication, the OECD acknowledged that some pretax profits attributed to stateless entities will be double counted. *See* OECD, "Public Consultation Document: Review of Country-by-Country Reporting (BEPS Action 13)" (Feb. 6, 2020). The OECD says that based on submissions from stakeholders, many MNEs, including entities that are not subject to tax in the country where they would otherwise be tax resident and are held directly or indirectly by constituent entities that are tax resident in that same country, have filed CbC reports. For example, the pretax profit of a U.S. partnership would be included first in the stateless category, and then again in pretax profit attributed to U.S. tax residents.

[5] OECD, "Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 — 2015 Final Report" (2015), and subsequent OECD action 13 updates.

[6] OECD, "Guidance on the Implementation of Country-by-Country Reporting (BEPS Action 13)" (Dec. 2019).

> Residence tax jurisdiction reporting for the business unit of which the permanent establishment is a part should exclude financial data related to the permanent establishment.[7]

Unfortunately, the second sentence of that excerpt is not clearly reflected in the IRS instructions for Form 8975, which instead provide that distributions and remittances from constituent entities that are PEs are not considered revenue of the recipient-owner. But what if a PE had revenue and pretax profit but made no distributions or remittances of that profit to its parent company? If some U.S. MNEs were confused about whether a parent's reported pretax profit should include dividends received from a subsidiary, they may also have been confused about whether that profit should include the profits of its PEs in other countries.

II. Estimates of Double-Counted Profit

Our estimate of double-counted profit is based on a comparison of the aggregate pretax profit reported by the IRS with consolidated pretax company profit reported in S&P Capital IQ's Compustat database. Our calculations are summarized in the appendix.

Our analysis involved five important steps. We first downloaded and tabulated S&P Compustat pretax profit data for fiscal 2017 for the 189 large U.S. companies in a database we compiled from the financial statements attached to those companies' SEC Forms 10-K for 2017.[8] The sole purpose of that exercise was to confirm that the consolidated pretax profit data from Compustat agreed with the results we extracted from the Forms 10-K and thus provided a reliable source for assessing the data in the IRS CbC reports.

Our second step was to download and tabulate all available S&P Compustat pretax profit data for fiscal 2017 for U.S. companies with annual revenue of at least $850 million to see how closely the number of Compustat companies and their aggregate pretax profit matched the comparable statistics from the IRS CbC summary.[9] We also tabulated the subtotals for the 47 private companies in that group[10] so we could apply their average earnings before taxes (EBT) to adjust our results for the other companies in the IRS CbC database.

Third, we summarized the aggregate pretax profit for the 1,575 U.S. MNE groups that filed CbC reports with the IRS for fiscal 2017. Table 3 includes not only the overall total reported pretax profit, but also the subtotals for the constituent entities that were stateless, in the United States, or in a foreign country. We subdivided all foreign countries into two categories based on whether a country's average effective tax rate (ETR) for entities was greater or less than 5 percent. More than 70 percent of the total reported pretax profit attributed to foreign countries was attributed to countries with an ETR under 5 percent.

Our fourth step was to estimate the aggregate consolidated EBT for the 1,575 U.S. MNEs that filed CbC reports for fiscal 2017. The consolidated EBT for a U.S. company is generally less than the aggregate pretax profit in the IRS CbC reports because duplicative profit (loss) is eliminated in the company's consolidated income statement. We combined the aggregate consolidated EBT for the 1,349 U.S. companies in the S&P Compustat database with an estimate of the aggregate consolidated EBT for the 226 additional U.S. companies in the IRS database.[11] Assuming the Compustat database included all public companies, the average consolidated EBT for the 226 additional companies was based on the $460 million average pretax profit for private companies calculated in Table 2.

Finally, we calculated the amounts of double-counted pretax profit by comparing the IRS-reported total amounts for the 1,575 companies (step 3) with our estimate of those companies' consolidated EBT (step 4). If no adjustment is made for the pretax profit assigned to stateless entities in the IRS tabulations, our estimate of the double-counted pretax profit represents 23 percent of the aggregate pretax profit for all

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[7] OECD, *supra* note 5.

[8] Table 2, lines 1-2.

[9] *Id.* at lines 3-4.

[10] *Id.* at lines 5-7.

[11] Table 4, lines 1-7.

companies and all jurisdictions (including stateless).[12]

Further, on the assumption that 100 percent of the interests in stateless entities are owned by U.S. or foreign affiliates of a U.S. group, 100 percent of the pretax profit of the stateless entities would be double counted. If the aggregate pretax profit of the stateless entities is excluded, our estimate of the double-counted pretax profit in the IRS CbC data is $0.26 trillion, which represents 14.4 percent of the total reported pretax profit for all companies and tax jurisdictions (excluding stateless).[13] That good-faith estimate reflects the several underlying assumptions we made in estimating the consolidated pretax profit that U.S. MNE groups reported on their audited consolidated financial statements.

III. Allocating Double-Counted Profit

As noted above, IRS CbC summary data is used by international tax policy analysts and others to assess the extent to which U.S. corporations and partnerships shift profits to tax havens. Table 1 shows how the IRS-reported total pretax profit (excluding stateless entities) is divided among entities in the United States, in foreign countries with an average ETR of at least 5 percent, and in foreign countries with an average ETR of less than 5 percent.

Table 1. IRS-Reported Pretax Profit (Excluding Stateless Entities)

	Amount (Trillions)	Share of Total
Total Pretax Profit (Excluding Stateless)	$1.82	100%
United States	$1.18	64.9%
Foreign Countries — Total	$0.64	35.1%
Foreign Countries With Current ETR > 5%	$0.19	10.4%
Foreign Countries With Current ETR < 5%	$0.45	24.7%
Source: Table 3, *infra*, lines 4-8.		

[12] *Id.* at lines 8-10.

[13] *Id.* at lines 11-13.

We do not have a reliable way of allocating the estimated total double count of pretax profit ($0.26 trillion) among the subtotals of pretax profit for the country categories listed above. Perhaps the most reasonable procedure would be to reduce each category of total pretax profit by 14.4 percent. A pro rata 14.4 percent reduction in the pretax profit attributed to foreign jurisdictions having an ETR under 5 percent ($0.45 trillion) may overstate the actual (but unknown) double count for that category because U.S. MNEs had a clear incentive to avoid overstating the pretax profit allocated to tax havens on a required tax form the IRS would share with foreign tax authorities.

IV. Conclusions and Recommendations

There are four principal conclusions to draw from this analysis:

- The pretax profit attributed to stateless entities in the IRS CbC data appears to be double counted.
- If the total pretax profit attributed to stateless entities is disregarded to adjust for the double count, we estimate that the remaining double-counted pretax profit represents 14.4 percent of the remaining pretax profit attributed to the United States and all foreign countries in the IRS summary table.
- Over 70 percent of the total pretax profit that is attributed to foreign countries is attributed to countries with an ETR of less than 5 percent.
- A pro rata 14.4 percent reduction in the pretax profit ($0.45 trillion in fiscal 2017) attributed to foreign jurisdictions having an ETR below 5 percent may overstate the actual (but unknown) double count for that category because of the incentives U.S. MNEs had to avoid overstating the pretax profit they attributed to tax havens.

The IRS should quickly revise its instructions for Form 8975 and Schedule A to provide that, consistent with the latest OECD guidance, pretax profit (not just revenue) of a constituent entity excludes its subsidiaries' dividends, deemed dividends, or imputed earnings, as well as its PEs' distributions, remittances, or pretax profits. MNE groups should also be required to:

- report their consolidated pretax profit per their audited financial statements on Form 8975; and
- attach a schedule to Form 8975 reconciling the aggregate pretax profit reported on Schedule A with the consolidated pretax profit reported on Form 8975.

Appendix

Table 2. Consolidated Pretax Profit Per S&P Compustat Database, Fiscal 2017

1	Number of U.S. Companies in Horst-Frisch SEC-10-K Database With Non-Zero Pretax Profit (Loss)	189	Per Compustat
2	Total Pretax Profit of All U.S. Companies in Horst Frisch SEC-10-K Database (in trillions)	$1.04	Per Compustat
3	Number of U.S. Public & Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million	1,349	Per Compustat
4	Total Pretax Profit of U.S. Public & Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million (in trillions)	$1.45	Per Compustat
5	Number of U.S. Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million	47	Per Compustat
6	Total Pretax Profit of U.S. Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million (in billions)	$21.64	Per Compustat
7	Average Pretax Profit of U.S. Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million (in millions)	$460	#6 / #5

Table 3. Total Reported Pretax Profit (Loss) Per IRS CbC Summary, Fiscal 2017

1	Total Number of Reporting Companies	1,575	Per IRS Statistical Report
	Pretax Profit (in trillions)		
2	IRS Reported Total	$2.02	Per IRS Statistical Report
3	Subtotal for Stateless Entities	$0.20	Per IRS Statistical Report
4	IRS Reported Total Excluding Subtotal for Stateless Entities	$1.82	#2 - #3
5	United States	$1.18	Per IRS Statistical Report
6	Foreign Countries — Total	$0.64	Per IRS Statistical Report
7	Foreign Countries With ETR > 5%	$0.19	Per IRS Statistical Report
8	Foreign Countries With ETR < 5%	$0.45	Per IRS Statistical Report

Note: ETR is IRS reported income tax accrued, current year as percentage of pretax profit (loss) for a country.

Table 4. Estimated Double Count of Pretax Profit in IRS CbC Summary Table

	Estimate of Consolidated Pretax Profit for Companies Providing IRS CbC Reports		
1	Total Number of Reporting Companies per IRS CbC Summary Table	1,575	Table 3, #1
2	Number of U.S. Public & Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million	1,349	Table 2, #3
3	Additional Companies Providing IRS CbC Reports	226	#1 - #2
4	Average Pretax Profit of Private Companies With Revenues > $850 million (in millions)	$460	Table 2, #7
5	Estimate of Total Pretax Profit of Additional Companies Providing IRS CbC Reports (in trillions)	$0.10	#3 x #4
6	Total Pretax Profit of U.S. Public & Private Operating Companies With Non-Zero Compustat Pretax Income, Revenues > $850 million (in trillions)	$1.45	Table 2, #4
7	Estimate of Consolidated Pretax Profit for Companies Providing IRS CbC Reports (in trillions)	$1.56	#5 + #6
	Estimated Double Count if Pretax Profit of Stateless Entities Is Included		
8	IRS Reported Pretax Profit — IRS Reported Total (in trillions)	$2.02	Table 3, #2
9	Estimated Double-Counted Profit (Loss) (in trillions)	$0.47	#8 - #7
10	Estimated Double-Counted Profit (Loss) — %	23%	#9 / #8
	Estimated Double Count if Pretax Profit of Statelesss Entities Is Excluded		
11	IRS Reported Pretax Profit — IRS Reported Total Excluding Subtotal for Stateless Entities (in trillions)	$1.82	Table 3, #4
12	Estimated Double-Counted Profit (Loss) Excluding Stateless (in trillions)	$0.26	#11 - #7
13	Estimated Double-Counted Profit (Loss) Excluding Stateless — %	14.4%	#12 / #11

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