SHOULD APPLE REPATRIATE ITS INTERNATIONAL EARNINGS?

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CASE DESCRIPTION

The primary subject matter of this case involves international taxation of U.S. multinational corporations. Secondary issues include tax policy, corporate responsibility, macroeconomics, and public policy. The case has a difficulty level of two or higher. Business students at the sophomore, junior, or senior level can successfully complete this case. The case is appropriate for undergraduate courses in macroeconomics, microeconomics, international economics, tax, corporate tax, or corporate finance. The case is designed to be taught in 1-2 class hours and is expected to require up to 2 hours of outside preparation by students.

CASE SYNOPSIS

The case focuses on the strategic decision made by Apple and many other U.S.-based multinational firms to hold large cash balances offshore. In April 2017, Apple held approximately $230 billion cash offshore (90% of its $256 billion cash balance). Many other large, U.S.-based multinational firms also held tens of billions of dollars offshore, with some estimates putting the total cash held internationally by U.S. firms at approximately $2.5 trillion. The case explores the potential reasons for this strategic decision, focusing on the worldwide tax system used by the U.S., wherein corporations are taxed on income wherever it occurs in the world. This tax, however, is not triggered until U.S. firms bring foreign earnings back home, thus creating a perverse incentive not to repatriate foreign earnings.

The case presents the idea that Apple (and other firms pursuing similar strategies) are "unpatriotic" for taking advantage of the legal tax strategy of avoiding U.S. income taxes on foreign earnings by leaving those earnings overseas. The case also presents the idea that Apple is making prudent business decisions, consistent with its fiduciary responsibility to its shareholders, by delaying repatriation until tax rates are more favorable. Students are left to assess the arguments and form a conclusion.

INSTRUCTORS' NOTE

LEARNING OUTCOMES

The information contained in the case came solely from secondary public sources. Nothing in the case has been disguised. In completing this assignment, students should be able to:

1. Describe and evaluate U.S. corporations' legal and ethical tax requirements.
2. Describe and evaluate the fiduciary relationship between a corporation and its shareholders.
3. Evaluate and assess the pros and cons of repatriating earnings, given the 2017 U.S. tax environment.
4. Evaluate and assess how tax policy affects economic activity and growth within a tax jurisdiction.
5. Describe and evaluate the concepts of tax avoidance and tax evasion.

DISCUSSION QUESTIONS

1. Does Apple have a moral, legal, or patriotic duty to repatriate its earnings given the 2017 tax environment in the U.S.? (LO1)
2. How does Apple's decision to repatriate its foreign earnings relate to its fiduciary responsibility to its shareholders? (LO2)
3. Does holding cash overseas mean that cash loses its "usefulness" for Apple? To what extent does holding cash overseas rather than domestically hamper Apple's business operations or strategy? What options does Apple have? (LO3)
4. Evaluate and assess the effect of tax policies (worldwide vs. territorial) and tax rates have on economic activity and economic growth? (LO4)
5. Describe and evaluate the differences between tax avoidance and tax evasion. What are the ethical and legal issues? (LO5)

ANSWERS TO DISCUSSION QUESTIONS

1. Does Apple have a moral, legal, or patriotic duty to repatriate its earnings given the 2017 tax environment in the U.S.? (LO1)

Apple clearly does not have a legal obligation to repatriate its earnings. The tax law in this regard is very clear, and Apple is in full compliance with the tax law. This is not in dispute. The better question is why the U.S. tax code creates an incentive for firms not to repatriate their foreign earnings. This will be addressed in a later question.

It is also well established in U.S. case law that firms have no duty, patriotic or otherwise, to pay more than the legally required minimum tax bill. Judge Learned Hand had two well-known quotes that relate to legal and moral tax obligations:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. ("Gregory v. Helvering" 1934)
>
> *Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant. ("Commissioner v. Newman," 1947)*

The question of whether Apple has a moral obligation to repatriate its earnings will probably create some debate among students. Our position is that this is not a moral question. It is the duty of Congress to write the tax code, which can reflect whatever morality that Congress and its constituents deem appropriate. It is the duty of corporations to then comply with the relevant tax code.

2. How does Apple's decision to repatriate its foreign earnings relate to its fiduciary responsibility to its shareholders? (LO2)

Public corporations have a legal obligation to act as fiduciaries for their shareholders. One of the primary elements of this fiduciary responsibility is the "duty of care", which requires the firm and its directors to exercise good business judgment when making decisions. The standard of care requires that the directors of the firm exercise the same degree of prudence and care that a reasonably prudent person would in the same situation. Thus, if a reasonable person would not pay an additional voluntary tax of 40% to move money from one country to another, then the firm also should not pay.

It is important to note that this standard of care is not just a business theory. The fiduciary responsibility to shareholders is the law in all 50 states, though some states do allow the responsibility to shareholders to be tempered by responsibilities to other stakeholders as well. If shareholders have a good reason to believe that a firm is not acting in the best interest of its shareholders, then they may file a lawsuit against the firm seeking financial damages.

3. Does holding cash overseas mean that cash loses its "usefulness" for Apple? To what extent does holding cash overseas rather than domestically hamper Apple's business operations or strategy? What options does Apple have? (LO3)

Cash held overseas can be used overseas with no penalties or additional taxes. So, Apple could use its overseas cash to pay foreign employees, repay debt borrowed from foreign lenders, build foreign factories, acquire foreign firms, etc. However, foreign cash is not as useful in some ways as domestic cash since it cannot be used to repurchase shares, pay dividends to shareholders, pay domestic employees, or invest in domestic operations.

So, failing to repatriate the earnings may hamper domestic operations in some ways, but for large well-funded firms those inconveniences are probably minor and easily overcome. For

example, if Apple wanted to fund a major U.S. operation and did not have enough domestic cash, it could borrow domestically at very low rates using the foreign cash as collateral. Since the interest rate on this borrowing would be far below the 40% tax rate on repatriating, borrowing would probably be a good business decision in this situation.

Firms choosing to delay repatriation have essentially made the decision that giving up some of the "usefulness" of cash is a fair price to pay to avoid the incremental taxation.

4. Evaluate and assess the effect of tax policies (worldwide vs. territorial) and tax rates have on economic activity and economic growth? (LO4)

The most important effect of the worldwide tax system is that it encourages a domestic company to hold cash outside the country, called the "lockout effect." Thus, the United States is discouraging the repatriation of assets because of the 40% income tax rate. The U.S. has one of the highest tax rates in the world, but many corporations choose not to pay U.S. tax on foreign income. So, this reduces the revenues of the U.S. and it reduces the assets that are moved to the U.S. If a country uses the territorial system, there is no lockout effect and the assets may freely flow back to the home country.

Taxpayers, both individual and corporate, have an incentive to legally reduce their tax burden. So, money and investments flow to countries with lower tax rates and smaller tax bases. Ireland is more competitive because of a low tax rate and a smaller tax base (the territorial system) than the U.S. with its higher tax rate and larger tax base (worldwide system). Ireland has effectively lowered the cost of doing business in Ireland versus other countries, especially compared to the U.S.

5. Describe and evaluate the differences between tax avoidance and tax evasion. What are the ethical and legal issues? (LO5)

Tax evasion is the illegal underpayment of taxes. It is illegal and unethical. It can carry stiff penalties and imprisonment.

Tax avoidance is the use of legal measures to reduce tax. It is legal and ethical to avoid paying tax or to delay tax by legal means. There is no requirement to pay more than legally obligated. Tax avoidance is following the available tax rules and laws. Critics sometimes call these legal rules "loopholes" but they are available to all taxpayers.

One of the basic tenets of taxation is that everyone wants to pay less on their own taxes but they want everyone else to pay more. So, a legal deduction for one company is a loophole for its critics. A company can arrange its tax affairs legally to reduce its tax liability and that is within the rules. It is both ethical and legal and is acceptable.

EPILOGUE

In December 2017, the Tax Cuts and Jobs Act was passed by Congress and signed by the president. This law included a tax holiday that reduced the repatriation tax to 15.5% on cash and cash equivalents. The bill also reduced corporate tax rate from a maximum of 35% to a flat 21%

beginning in 2018. The new law also converted the U.S. income tax to a territorial system from the worldwide system (Ren, Sankara & Trimble, 2020).

Apple announced plans to pay a one-time $38 billion tax on its overseas cash. This would be the single largest tax payment in history (Mickle, 2018).

Apple reported total cash and marketable securities of $195 billion in the first quarter of 2021 (Apple, 2021).

ADDITIONAL READING

The Facts about Apple's Tax Payments. January 17, 2017. apple.com

What is the TCJA Repatriation Tax and How Does it Work? May 2020. taxpolicycenter.org

The 50 Largest Stashes of Cash Companies Keep Overseas. June 13, 2017. bloomberg.com

The Impact of the Tax Cuts and Jobs Act's Repatriation Tax on Financial Statements. January 2020. cpajournal.com

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