

**BETH CARR
TAX PARTNER
ERNST & YOUNG LLP
WRITTEN TESTIMONY FOR SENATE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
SEPTEMBER 20, 2012**

I. Introduction

My name is Beth Carr. I am submitting this statement on behalf of Ernst & Young LLP as a partner of the firm. I am a certified public accountant and an international tax services partner with Ernst & Young. I have been with Ernst & Young for 11 years, after beginning my career with another major accounting firm. At Ernst & Young, I am the tax partner responsible for the tax-related services that we provide to our audit client, Hewlett-Packard Company (HP). As such, I am actively involved in Ernst & Young's work with respect to HP's income tax provision.

Ernst & Young appreciates the opportunity to provide input in connection with the Subcommittee's review of certain international taxation matters and their corresponding financial reporting implications. We have worked closely with your Staff over the past months leading up to this hearing. Ernst & Young has provided to the Subcommittee documents you requested totaling approximately 150,000 pages, and I and other Ernst & Young partners have made ourselves available for many hours of discussions with your Staff. My firm is committed to cooperating with the Subcommittee as it explores these areas.

The Subcommittee has invited us to address a range of topics relating to HP's financial reporting and tax position. Specifically, you have asked us to answer questions relating to HP's application of an accounting concept generally referred to as the "indefinite reinvestment

assertion” under Accounting Principles Board Opinion No. 23 (APB 23),¹ HP’s repatriation of foreign earnings of its controlled foreign corporation subsidiaries (CFCs), and the company’s compliance with section 956 of the Internal Revenue Code (IRC) with respect to certain loans from its CFCs to HP itself.

Our testimony today is intended to provide a high-level overview of the topics you have asked us to address. The rules and regulations relating to international taxation are many, varied, and complex. The legal and regulatory framework has developed over an extended period of time through statutes, case law, notices, revenue rulings, and other administrative guidance. Addressing many of the topics raised by the Subcommittee is not easy to do with brevity, and accordingly we appreciate your patience.

Our primary role and responsibility as the independent auditor of HP’s financial statements is to provide our services within the established, current legal and regulatory framework, and to evaluate HP’s activity for consistency with applicable accounting rules. As the independent auditor, we provide reasonable assurance to the users of HP’s financial statements that those statements, taken as a whole, have been prepared on a basis consistent with generally accepted accounting principles (U.S. GAAP) and are free from material misstatement. Included in this responsibility is the testing, with independence, skepticism, and objectivity, of various assertions of HP to conclude, in the context of HP’s financial statements taken as a whole, whether HP has properly accounted for its foreign earnings under APB 23, among other accounting rules, and its income tax liabilities under section 956 of the IRC.

¹ The Subcommittee’s invitation to this hearing refers to “APB 23” and the majority of our discussions with your Staff have also generally used that term. For the sake of consistency, I too will use this term in this statement, although, as you are no doubt aware, in 2009 APB 23 was codified in Accounting Standards Codification (ASC) 740-30-05.

Ernst & Young has served as HP's independent auditor since 2000. At the completion of each of our audits, Ernst & Young has concluded that HP's financial statements fairly presented its financial position and results of operations under U.S. GAAP. Our opinions, issued annually on those financial statements, state our conclusions, and Ernst & Young stands firmly behind the audit opinions that it has issued for HP.

II. About Ernst & Young

The global Ernst & Young organization² is one of the largest professional services organizations in the world. With 167,000 partners and employees globally, we provide professional services to thousands of companies in approximately 150 countries each year. We are immensely proud of our role in providing independent and objective financial statement assurance services of benefit to the financial markets, investors, and other financial statement users. We are equally proud of our role in providing independent and objective tax, advisory, and transaction-related services.

Audit and tax are among the most highly-regulated of professions. In the United States, Ernst & Young's public company audit practice is principally overseen by the Public Company Accounting Oversight Board (PCAOB). We are also overseen in various capacities by the Securities and Exchange Commission (SEC), Internal Revenue Service (IRS), state boards of accountancy, and other regulators. The rules that govern and inform the performance of our services are established by these regulators, as well as accounting standard-setters such as the Financial Accounting Standards Board. Our services are further regulated around the globe by counterparts to our U.S. authorities. We have an open and ongoing dialogue with our regulators

² Ernst & Young LLP in the United States is a member firm of Ernst & Young Global Limited, a U.K. company limited by guarantee, which does not provide services to clients.

and accounting and tax standard-setters to enhance our understanding of the accounting and tax laws, rules, and regulations applicable to a company's financial reporting and tax position.

III. Ernst & Young's Role as the Independent Auditor of HP

Before moving to the specific issues under review by the Subcommittee, it is appropriate to frame the discussion in the context of Ernst & Young's role as the independent auditor of HP.

With respect to public companies in the United States, such as HP, our financial statement audits are performed according to the standards established by the PCAOB, SEC regulations, and applicable laws such as the Sarbanes-Oxley Act of 2002. The objective of a financial statement audit is to provide reasonable assurance as to whether the financial statements prepared by a company are presented in a manner consistent with U.S. GAAP and are free from material misstatement. At the completion of our audits, we reach a conclusion and ultimately issue an audit report that expresses our opinion on the company's financial statements and, where applicable, its internal controls. We recognize and embrace the significant public objectives connected to and public trust placed in our performance of this work.

For each of the 12 years that Ernst & Young has served as HP's independent auditor, we have conducted our audits of HP in accordance with applicable auditing standards. At the conclusion of each audit we have issued our audit report on HP's financial statements and its compliance with U.S. GAAP. The procedures we perform to support our audit conclusions require the investment on an annual basis of tens of thousands of hours of time by our professionals here in the United States and around the world in the multitude of countries in which HP operates. With respect to our 2011 audit of the income tax provision alone, we spent more than 7,000 hours reviewing, questioning, challenging, and testing HP's accounting for income taxes.

The thoroughness of these efforts is a critical component of our ability to stand behind the audit opinions we have issued with respect to HP. Our work meets or exceeds all applicable professional standards governing our audits and provides a strong foundation for our conclusions. This includes our conclusions concerning our evaluation of HP's compliance with APB 23 and (as it relates to financial reporting) section 956 of the IRC.

IV. The APB 23 Indefinite Reinvestment Assertion

The concept of indefinitely reinvested foreign earnings was established in the early 1970s with APB 23 and presently is codified in Accounting Standards Codification (ASC) 740. To understand APB 23, it is necessary also to understand some basic tax accounting concepts.

The recognition (in terms of timing and amounts) of income, losses, assets, and liabilities is not always consistent between the accounting rules under U.S. GAAP and the relevant tax laws. For example, U.S. tax rules may permit an asset to be depreciated (and tax deductions generated) on an accelerated basis, whereas U.S. GAAP requires the asset to be depreciated over its estimated useful life. This results in a difference between the book (or accounting) and tax bases of this asset during its life. Accounting for income taxes requires that most differences in the accounting and tax bases of assets and liabilities be measured and recognized for accounting purposes. This method of accounting for income taxes is commonly referred to as the "asset and liability approach." In the example above, a company will report larger deductions on its tax return than the expense recognized on its financial statements in the early years of the asset's life, followed by larger expenses on its financial statements than deductions on its tax return as the asset ages. In the early years of the accounting for the asset, the benefit of this accelerated depreciation is reflected as a deferred tax liability under the asset and liability approach.

Turning to the matters the Subcommittee has inquired about, for financial reporting purposes, as with the example above, foreign earnings create a book and tax basis difference in a company's investment in a CFC. Foreign earnings are recognized when earned for book purposes. However, for tax purposes, such earnings generally are not recognized until they are brought into the United States in the form of a dividend or deemed dividend (often referred to as a repatriation of the earnings). As a result, a company generally records a future or deferred tax liability for those foreign earnings.

APB 23 contains a presumption that all foreign earnings of CFCs will ultimately be remitted to the U.S. parent through a taxable repatriation. But under this rule, there is an exception to providing for deferred taxes attributable to foreign earnings if a company has both the "intent" and "ability" to indefinitely reinvest the foreign earnings and not to bring such earnings into the United States through a dividend or deemed dividend.

With respect to HP, as disclosed in its financial statements for the year ended October 31, 2011, the company recognized an \$8.2 billion liability related to approximately \$25 billion of unremitted earnings of certain CFCs that HP expects to repatriate to the United States. HP has also disclosed that it intends indefinitely to reinvest outside of the United States approximately \$29.1 billion of foreign earnings. Accordingly, no deferred tax liability has been accrued with respect to such earnings.

The indefinite reinvestment assertion must be both affirmative and continuing in nature. In other words, the APB 23 assertion requires that a company continuously assert that the foreign earnings are indefinitely reinvested. If at any point the U.S. multinational is no longer prepared to make and support that assertion, the presumption under the standard (that such earnings will be remitted to the U.S. parent via a dividend or deemed dividend) would apply. At that point, the

foreign earnings would no longer be eligible for the APB 23 exception, and the company would be required to establish a deferred tax liability on the foreign earnings in the current period. Irrespective of the financial statement assertion and the establishment of a deferred tax liability, no U.S. taxes are due and payable unless and until the foreign earnings are repatriated to the United States through a dividend or deemed dividend.

In order to overcome the repatriation presumption inherent in APB 23, the U.S. parent must prepare and maintain sufficient evidence of plans for reinvestment of the CFC's foreign earnings for the foreseeable future. The standard states:

The presumption in paragraph 740-30-25-3 that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity, for entities and periods identified in the following paragraph if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation. A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely.³

In addition to meeting the "intent" portion of the standard, the U.S. multinational must also demonstrate its "ability" not to repatriate, in the form of a taxable dividend or deemed dividend, the foreign earnings. That is, the company must conclude and demonstrate that it has both the intention to indefinitely reinvest the CFC's foreign earnings as well as the ability to carry through on such intention. It is also important that the U.S. multinational's actions be consistent with its asserted plans of indefinite reinvestment.

The forward-looking and intent-based nature of the indefinite reinvestment assertion is, while not unique, somewhat unusual for an accounting standard; it presents special challenges to an auditor, who must assess a client's intent and ability regarding future actions. Our audit

³ ASC 740-30-25-17.

procedures include obtaining annual representations from the company's senior management, reviewing the company's history of maintaining its past assertions, considering past experience as to whether the company has operated in a manner consistent with previous representations, securing information regarding the company's plans for reinvestment, and considering the company's financial wherewithal or ability to maintain the assertion for the foreseeable future (for example, an assessment of a company's liquidity, credit facilities, and other sources of funding within the United States).⁴ We also carry out audit procedures to determine whether the U.S. multinational may have inadvertently triggered a tax due to a repatriation (or deemed repatriation) of what it has asserted are indefinitely reinvested earnings under the tax rules and regulations.

As auditors, we perform our work with independence, objectivity, and skepticism, which results in a healthy tension in our relationship with the companies we audit. We regularly request and push for more evidence, more specifics, or more documentation that support the company's assertions.

Specific to HP, Ernst & Young undertakes comprehensive audit procedures relating to HP's indefinite reinvestment assertion and has done so since we became the company's independent auditor. Each year, HP makes an assertion regarding the cumulative foreign earnings that it intends to indefinitely reinvest and each year we audit this assertion in accordance with professional standards.

⁴ ASC 740-30-25-17 provides: "Experience of the entities and definite future programs of operations and remittances are examples of the types of evidence required to substantiate the parent entity's representation of indefinite postponement of remittances from a subsidiary."

V. Alternating Loans and Section 956 of the Internal Revenue Code

Another topic on which the Subcommittee has solicited Ernst & Young’s input concerns our review of HP’s “alternating loan program” and our analysis of such loans under section 956 of the IRC. Ernst & Young’s review of HP’s CFC loans under section 956 is taken into account when we analyze the APB 23 indefinite reinvestment assertion, when relevant. For example, a factor germane to the determination of a U.S. multinational’s assertion of indefinite reinvestment is whether the foreign earnings that are the subject of the assertion are to be repatriated (in a taxable dividend or deemed dividend) to the United States in the foreseeable future. If a U.S. multinational does not follow the detailed framework set forth in section 956 and the associated case law, revenue rulings, notices, and other administrative guidance provided by the IRS, a tax liability could result. This would require the auditor to reconsider the sufficiency of the company’s deferred tax liabilities. Similarly, an auditor must evaluate whether the nature and extent of a loan program is consistent with a company’s assertion under APB 23 of the intent and ability to indefinitely reinvest foreign earnings. Therefore, we carefully consider HP’s loans from CFCs for compliance with section 956, as failure to comply could in turn have APB 23 ramifications.

Section 956 was enacted as part of the provisions of “Subpart F”⁵ added to the IRC by the Revenue Act of 1962. A principal purpose of the Subpart F provisions is to identify transactions by CFCs for which deferral of U.S. tax on their earnings is not permissible.⁶ Pertinent to the

⁵ I.R.C. §§ 951 – 64.

⁶ The general deferral of U.S. tax on CFC earnings results from two fundamental principles of U.S. tax policy: (1) taxing U.S. residents, including U.S. corporations, on both U.S.- and foreign-source earnings; and (2) respecting the separate existence for tax purposes of corporations, including related corporations. Pursuant to those principles, a U.S. corporation is generally subject to U.S. tax on its CFCs’ earnings, but only when those earnings are repatriated to the United States, generally in the form of a dividend (that is, U.S. tax is “deferred”

Subcommittee's present review, section 956 provides that certain types of investments in U.S. property (U.S. Investments) by a CFC, including loans to its U.S. shareholder(s), may result in immediate U.S. tax if those U.S. Investments are substantially equivalent to dividends from the CFC to its U.S. shareholder(s).⁷

The rules under section 956 are highly complex and have evolved over the last several decades. The original section 956 rule was an annual "snapshot" test – any CFC that had U.S. Investments on its balance sheet at the end of its tax year would be considered to have paid a taxable dividend to its U.S. shareholder(s) in the amount of the lesser of (a) its increase in the amount of such investments for the year, or (b) the amount of its previously untaxed earnings at the end of the year.⁸ In 1993, Congress amended section 956 to require testing for U.S. Investments at the end of each financial quarter, with the average of the quarter-end investments being used as the base for determining the deemed dividend amount for the year.⁹ Hence, the IRS and Treasury Department have long recognized that many CFC-to-U.S. shareholder loans are not and should not be deemed equivalent to dividends and specifically have concluded that short-term loans do not constitute U.S. Investments.¹⁰

until such repatriation). Subpart F generally and section 956 in particular essentially deem dividends from CFCs to their U.S. shareholder(s) upon the occurrence of certain events or transactions.

⁷ S. Rep. No. 87-1881, at 66 (1962), stated: "Generally, earnings brought back to the United States are taxed to the shareholders on the grounds that this is substantially the equivalent of a dividend being paid to them."

⁸ I.R.C. § 956(a) (1962) (current version at I.R.C. § 956(a) (2012)).

⁹ H.R. 2264, 103rd Cong. (1993).

¹⁰ As mentioned previously, the section 956 deemed dividend originally was calculated based upon the U.S. Investments held by a CFC as of the end of its taxable year. Treasury regulations, however, provided that related party loans that were collected within one year were excluded from the computation, even if they were outstanding at the end of the CFC's year. Former Treas. Reg. § 1.956-2(d)(2)(ii) (prior to amendment by T.D. 8209, 1988-2 C.B. 174). In 1988, the IRS and Treasury modified the regulations to delete the one-year rule, T.D. 8209, 1988-2 C.B. 174, but in I.R.S. Notice 88-108, 1988-2 C.B. 445, the IRS permitted a more limited exception with respect to short-term loans, providing that U.S. Investments could exclude obligations held at the end of a CFC's year if the obligations were collected within 30 days from the time they were incurred and the

In Revenue Ruling 89-73, 1989-1 C.B. 258, the IRS provided specific guidance regarding its approach for determining whether a recurring loan by a CFC would be treated as a U.S. Investment. In making its determination on assumed facts, the IRS stated:

The application of section 956 is concerned with the substance of the transaction, not its form.... [T]he facts and circumstances of each case must be reviewed to determine if, *in substance*, there has been a repatriation of the earnings of the controlled foreign corporation. If a controlled foreign corporation lends earnings to its U.S. shareholder interrupted only by brief periods of repayment which include the last day of the controlled foreign corporation's taxable year [NOTE: As discussed above, under current law, since 1993, testing is required not only at year-end but at quarter-end as well¹¹], there exists, *in substance*, a repatriation of the earnings to the U.S. shareholder within the objectives of section 956. Because *the substance* of such a transaction must control the tax consequences, the lending of the controlled foreign corporation's earnings to the U.S. shareholder is a repatriation of a type which constitutes an investment in U.S. property under section 956.¹²

Under the differing facts of two examples in the revenue ruling, the IRS determined that although an “off” period of investment constituting two months out of 12 months was insufficient to avoid deemed dividend treatment, an off period of six months out of 12 months did break the continuous loan treatment, when compared to the periods that the loans were outstanding. Practitioners have interpreted Revenue Ruling 89-73 to require that the “off” period of investment should be approximately as long as the “on” period that the loan was outstanding.¹³

CFC did not hold obligations for 60 days or more during that calendar year that, without regard to the 30-day rule, would constitute U.S. Investments if held at the end of the CFC's year.

¹¹ I.R.C. § 956(a)(1) (2012).

¹² Rev. Rul. 89-73, 1989-1 C.B. 258 (emphases added).

¹³ See, e.g., Lowell D. Yoder, *Notice 2008-91 Exception to § 956: Guidance on Particular Issues*, 39 Tax Mgm't Int'l J. 96 (2010). Notice 88-108 and Revenue Ruling 89-73 were written at a time when only loans held by a CFC on the last day of its tax year mattered under section 956. As noted, in 1993 Congress modified section 956 so that investments in U.S. property were measured based upon the average of amounts held by a CFC at the four quarter-ends of the CFC's year. In doing so, Congress specifically acknowledged that the short-term loan exception was important and should be continued under the amended law (while at the same time noting the continued viability of Revenue Ruling 89-73, just discussed), stating:

Also relevant in this regard is *Jacobs Engineering Group v. United States*, 1997 WL 314167 (C.D. Cal. 1997), *aff'd without published opinion*, 168 F.3d 499 (9th Cir. 1999), in which the court held that the IRS properly determined that funds received by a U.S. corporation from a single CFC in the form of 12 short-term loans over a more than two-year period were in fact a single investment in U.S. property resulting in deemed dividends under section 956. The court applied the step transaction and substance over form doctrines in reaching its conclusion and treated the advances as a single loan on the basis that the loans were interdependent, that the U.S. corporation was in possession of the funds for almost all of the period, and that the U.S. corporation did not need to raise capital 12 separate times for separate reasons. The court agreed with the IRS that the economic reality of the series of transactions was that the taxpayer repatriated foreign capital from its CFC for a period of over one year.

It is important to note that the *Jacobs Engineering* case involved loans from a single CFC. The IRS has issued guidance for situations in which a series of loans originate from more than one CFC. In Generic Legal Advice Memorandum (GLAM) 2009-13, the IRS stated that in the case where multiple CFCs make loans to the same U.S. parent company, the loans of each CFC should be considered separately, provided that each CFC complies with the on/off periods in effect, each CFC funds its own loans, and the U.S. parent separately executes and repays each

The committee intends that the measurement of assets as of the close of each quarter of the taxable year shall disregard short-term loans or other temporary arrangements with regard to the [CFC's] assets, where one of the principal purposes of such arrangement was to avoid taking assets into account for purposes of this provision. Examples of what the IRS views as such arrangements are discussed in Rev. Rul. 89-73..., interpreting present law.

The bill is not intended to change the measurement of U.S. property that may apply, for example, in the case of certain short-term obligations, as provided in IRS Notice 88-108 ... interpreting present law.

H.R. Rep. No. 103-111, at 700 (1993), reprinted in 1993 U.S.C.C.A.N. 2-1, 931-2.

obligation as a separate transaction.¹⁴ This is consistent with the statute, which tests each CFC separately, and consistent with the general approach of U.S. tax law to treat separately incorporated entities as separate even if related.

GLAM 2009-13 further specifies that each CFC of a U.S. person may separately qualify and choose to apply Notice 2008-91.¹⁵ In other words, each CFC lender is reviewed separately in testing the application of section 956 and the short-term loan exceptions. Thus, there is no general rule combining or considering together for purposes of section 956 various CFCs making complementary or overlapping loans to one or more U.S. affiliates as long as each loan is repaid in the required fashion. As noted above, *Jacobs Engineering* addresses only multiple loans from a single CFC. Moreover, the so-called section 956 “anti-abuse” rule of Temporary Treasury Regulations Section 1.956-1T(b)(4), first issued in 1988, similarly does not apply to combine loans from different CFCs. That regulation addresses instead the situation in which an obligation held by one CFC may be treated as held by another. The regulation provides that at the discretion of the IRS Commissioner, a CFC (the first CFC) will be considered to own indirectly an obligation of a related U.S. person acquired by a related CFC (the second CFC) if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) the second CFC is to avoid the application of section 956 with respect to the first CFC. This narrow rule is effectively a tracing provision, looking to the true source of the funds; it does not require

¹⁴ I.R.S. Generic Legal Advice Memorandum 2009-13 (Oct. 19, 2009). GLAM 2009-13 was issued concerning the application of I.R.S. Notice 2008-91, 2008-43 I.R.B. 1001, which temporarily expanded the 30- and 60-day rules of Notice 88-108 to 60 and 180 days, respectively. Its analysis is equally applicable to loans subject to the provisions of Notice 88-108.

¹⁵ “Notice 2008-91 may apply to exclude, from the definition of ‘obligation’ under section 956, obligations of a related United States person held by one of more controlled foreign corporations” provided that the conditions noted in the text are satisfied. *Id.*

aggregation of short-term loans by various CFCs or a combination or aggregation of related CFCs.

The combined effect of section 956 and the related regulations and guidance is to provide U.S. taxpayers with extensive and specific IRS guidance that, absent failures in their implementation of such intercompany loan arrangements, they may follow and be assured that their CFC-to-U.S. shareholder loans will not be treated as a repatriation triggering taxable deemed dividends. This framework provides great certainty to U.S. multinationals in their cash flow planning.

It is also important to recognize the policy considerations implicit in the framework provided by Treasury and IRS guidance relating to CFC loans. The IRS's various pronouncements reference the important role that CFC loans may serve as a short-term, alternative source of liquidity for a U.S. multinational.¹⁶ Indeed, during the recent credit crisis, when corporate liquidity was suffering greatly, the IRS temporarily relaxed the short-term loan requirements to 60/180 days in an attempt to encourage more intercompany lending to help "facilitate liquidity."¹⁷ This demonstrates both that the U.S. Government is well aware that recurring short-term loans from CFCs can be an important source of funds for U.S. companies and that such loans do not result in U.S. taxation provided the rules promulgated by the Treasury and IRS in this area are followed.

In recognition of the complexity of this area of the tax law, IRS regulations require disclosure of the fact of loans to a U.S. taxpayer by its CFCs.¹⁸ Specifically, the IRS requires

¹⁶ See, e.g., I.R.S. Notice 2008-91, 2008-43 I.R.B. 1001. See also I.R.S. Notice 2010-12, 2010-4 I.R.B. 326 (extending the application of the relief provided in Notice 2008-91).

¹⁷ *Id.*

¹⁸ Treas. Reg. § 1.6038-2(f)(11)(i)(G) (as amended in 2008).

that inter-company loan balance information between a CFC and its U.S. parent or a domestic corporation controlled by the parent be included on the taxpayer's Form 5471 or Form 8858.¹⁹

In summary, a CFC's short-term loan to its U.S. parent does not constitute a taxable dividend if either: (1) the loan is not outstanding at the CFC's quarter-end and, in the case of a recurring loan that is "off" at quarter-ends, such loan was "off" for a period of time that was approximately equivalent to or greater than the time such loan was "on" or outstanding during the year; or (2) the loan is paid off within 30 days from the time it is incurred and the CFC's total loans that would otherwise be considered U.S. Investments are not outstanding for 60 days or more during the calendar year.

In Ernst & Young's role as an independent auditor, we are required to understand and evaluate loans from CFCs to their U.S. shareholder(s) as part of our financial statement audit. If a company triggers a section 956 income inclusion, the result may be a deemed dividend with potentially material impact to the company's financial statements. Further, with respect to the company's APB 23 indefinite reinvestment assertions, if the CFC-to-U.S. shareholder loans consist of indefinitely reinvested earnings, even an inadvertent deemed dividend inclusion under section 956 may impair the company's ability to assert that those earnings are indefinitely reinvested. Finally, the nature and extent of CFC loans must be evaluated for long-term consistency with the indefinite reinvestment assertion. Similarly, the independent auditor must carefully and thoroughly assess all of these matters to be confident that the company's financial statements properly reflect both incurred and deferred tax liabilities.

HP has an intercompany loan program that utilizes more than one CFC to engage in alternating "off/on" loans to the U.S. parent company. In the context of our audit work relating

¹⁹ *Id.*

to HP's income tax expense and income tax provision, Ernst & Young regularly reviews HP's loan programs to be satisfied both that the company is appropriately applying section 956 and its related guidance and (to the extent applicable) that the loans are consistent with HP's indefinite reinvestment assertion. As with the other aspects of Ernst & Young's work, we bring skepticism, objectivity, and independence to our audit procedures and require that HP provide us with substantial support evidencing its compliance with these requirements each year. Only after a review of all of the available information relevant to these issues are we in a position to complete our audit and issue our audit report.

VI. Conclusion

As the independent auditor of HP, Ernst & Young's responsibility is to perform an audit in conformity with applicable professional standards. As a part of our audit, we evaluate HP's compliance with relevant accounting principles, income tax laws, and other laws and regulations to the extent they could affect HP's financial statements. At the end of our audit, we form a conclusion with respect to HP's financial statements and issue an audit report setting forth our opinion as to whether HP's financial statements are fairly stated under U.S. GAAP. We stand by the audit reports our firm has issued.

Again, we appreciate the opportunity to provide input in connection with this Subcommittee's review.