United States General Accounting Office

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Fact Sheet for the Honorable Byron L. Dorgan, U.S. Senate

June 1993

INTERNATIONAL TAXATION

Taxes of Foreign- and U.S.-Controlled Corporations

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June 11, 1993

The Honorable Byron L. Dorgan
United States Senate

Dear Senator Dorgan:

This fact sheet responds to your request for additional information on corporations that paid little taxes. Specifically, we determined how many taxpaying corporations in various asset categories paid a minimal amount of income tax in 1989. In addition, we identified the specific line items on the tax return that accounted for the differences in the cost of goods sold reported by foreign- and U.S.-controlled corporations. This information is presented in the attached tables and summarized below.

MANY VERY LARGE CORPORATIONS PAID LESS THAN $100,000 IN INCOME TAX

More than 40 percent of very large corporations doing business in the United States--those with assets of $250 million or more--either paid no income taxes or paid income taxes of less than $100,000.[1] In our recent testimony on transfer pricing issues, we reported that 207 (30 percent) of the 693 very large foreign-controlled corporations did not pay income taxes, as compared to 1,555 (33 percent) of the 4,650 very large U.S.-controlled corporations.[2] In the group of very large taxpaying corporations, we found that 102 (15 percent) foreign-

[1]We use $100,000 as our cutoff for minimal taxes paid here because the corporations of this size that did pay taxes paid an average of $19 million, and compared to that figure, we believe $100,000 is a relatively small amount. Similar reasoning lies behind the other minimal amounts we use although the gaps between average and minimal taxes are not nearly as large.

[2]International Taxation: Updated Information on Transfer Pricing (GAO/T-GGD-93-16, Mar. 25, 1993).

controlled corporations and 362 (8 percent) U.S.-controlled corporations paid less than $100,000 in income taxes (see table I.1 in appendix I). Combined, the corporations either paying no taxes or minimal taxes were about 45 percent of all very large foreign-controlled corporations and about 41 percent of all very large U.S.-controlled corporations. These corporations had about 27 and 11 percent, respectively, of the total receipts of all very large corporations (see table I.2) and owned about 36 and 19 percent, respectively, of the total assets owned by all very large corporations (see table I.3).

FEWER VERY LARGE FOREIGN-CONTROLLED CORPORATIONS PAID INCOME TAXES OF $1 MILLION OR MORE, BUT THEY ALSO ACCOUNTED FOR FEWER RECEIPTS

Proportionately, fewer very large foreign-controlled corporations than their U.S. counterparts paid income taxes of $1 million or more (see table I.1). About 36 percent of very large foreign-controlled corporations paid income taxes of $1 million or more, compared with 47 percent of very large U.S.-controlled corporations. However, these very large foreign-controlled corporations also accounted for fewer receipts. Table I.2 shows that these corporations accounted for 61 percent of the total receipts of very large foreign-controlled corporations, compared with 85 percent of the total receipts of very large U.S.-controlled corporations.

Taxes paid by this group of very large corporations--those that paid $1 million or more in taxes--averaged $16.7 million ($4,127.5 million divided by 247 corporations) among those foreign-controlled and $29.5 million ($64,141.3 million divided by 2,172 corporations) for those U.S.-controlled.

PROPORTIONATELY, SMALLER FOREIGN-CONTROLLED CORPORATIONS ACCOUNTED FOR MORE TAXES PAID

The pattern changes among corporations with less than $100 million in assets. In this group, 88 percent of foreign-controlled and 93 percent of U.S.-controlled corporations paid either no income tax or less than $10,000 in taxes. These corporations accounted for 49 percent and 56 percent of total receipts, respectively.

In addition, more foreign-controlled corporations of this size paid $1 million or more in income taxes--0.7 percent compared to 0.1 percent for U.S.-controlled corporations of this size. These foreign-controlled corporations accounted for 13 percent of the receipts of foreign-controlled corporations of this size, compared to 7 percent of receipts of U.S. controlled corporations in this group.

Tables I.3 and I.4 provide additional information on the assets owned and taxes paid by foreign- and U.S.-controlled corporations with assets of $100 million or more. Tables I.5 through I.8 show returns, receipts, assets owned, and taxes paid by corporations with assets of less than $100 million.

THE COST OF PURCHASES COMPRISES A LARGER PERCENTAGE OF TOTAL RECEIPTS FOR FOREIGN-CONTROLLED CORPORATIONS

We found in our 1992 transfer pricing report[3] that the ratio of cost of goods sold over sales for foreign-controlled corporations was 75 percent in 1987, which was 10 percent higher than the same ratio for U.S.-controlled corporations. Also, the ratio of cost of goods sold over sales for a group of Japanese-controlled firms in five wholesale industries was consistently higher than the same ratio for both European- and U.S.-controlled wholesale firms between 1983 and 1987.[4]

In our 1993 transfer pricing testimony, we reported that the ratios of cost of goods sold to receipts for all taxpaying and nontaxpaying foreign-controlled corporations were 12 and 14.7 percentage points higher, respectively, than the ratios for U.S.-controlled corporations of the same taxpaying status in 1989. Some have speculated that artificially high intercompany prices caused higher percentages like these on the part of foreign-controlled corporations.

Tables I.9 and I.10 present the various components that make up cost of goods sold. The largest component of cost of goods sold for both foreign- and U.S.-controlled corporations is purchases. However, the ratio of purchases to total receipts for foreign-controlled corporations was much greater than the ratio for U.S.-controlled corporations. Taxpaying foreign-controlled corporations had a ratio of nearly 54 percent, 20 percentage points higher than that for taxpaying U.S.-controlled corporations. For corporations that did not pay tax, the ratio of purchases to receipts was about 17 percentage points higher for foreign-controlled corporations than for U.S.-controlled corporations.

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[3]International Taxation: Problems Persist in Determining Tax Effects of Intercompany Prices (GAO/GGD-92-89), June 15, 1992).

[4]The five wholesale industries were machinery, equipment, and supplies; motor vehicles and automotive equipment; metals and minerals; electrical goods; and other durable goods. These industries accounted for 29 percent of all foreign-controlled corporations' sales in 1987 but only 4 percent of all U.S.-controlled corporations' sales.

METHODOLOGY

To obtain the information for this fact sheet, we analyzed 1989 data from the Internal Revenue Service's (IRS) Statistics of Income (SOI) Division. The database includes a weighted sample of both U.S.- and foreign-controlled corporate tax returns filed in the United States. In general, SOI included in its 1989 database almost all large firms with assets of $100 million or more. Hence, the estimates in tables I.1 to I.4 for large firms with assets of $100 million or more would have little sampling error.

However, the estimates in tables I.5 to I.10 are based on samples, and hence they are subject to sampling error. Differences between U.S.-controlled and foreign-controlled corporations in the tables I.5 to 1.10 may not be statistically significant. Data limitations are discussed in the SOI publication 1989 Corporation Income Tax Returns.

We did our work between March and May 1993 in accordance with generally accepted government auditing standards.

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As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this fact sheet until 30 days from the date of this letter. At that time, we will send copies to the Commissioner of the Internal Revenue Service, the Secretary of the Treasury, and other interested parties. The major contributors to this fact sheet are listed in appendix II. If you have any questions about the information provided, please contact me at (202) 272-7904.

Sincerely yours,

Natwar M. Gandhi
Associate Director, Tax Policy and
Administration Issues

STATISTICS ON FOREIGN- AND U.S.-CONTROLLED CORPORATIONS

Table I.1: Number of Returns of Foreign- and U.S.-Controlled Corporations With $100 Million or More in Assets, by Income Taxes Paid, 1989

Distribution by asset size/taxes paid	Foreign-controlled corporations		U.S.-controlled corporations	
Companies with assets of $250 million or more	Number of returns	Percent of asset group	Number of returns	Percent of asset group
No tax paid	207	29.9	1,555	33.4
Less than $100,000	102	14.7	362	7.8
$100,000 under $1 million	137	19.8	561	12.1
$1 million or more	247	35.6	2,172	46.7
Total	693	100.0	4,650	100.0
Companies with assets of $100 million or more but less than $250 million				
No tax paid	238	39.4	1,614	34.0
Less than $100,000	88	14.6	467	9.8
$100,000 under $1 million	158	26.3	1,717	36.1
$1 million or more	119	19.8	954	20.1
Total	603	100.00	4,752	100.0

Note: Totals may not add due to rounding.

Source: IRS.

Table I.2: Receipts of Foreign- and U.S.-Controlled Corporations With $100 Million or More in Assets, by Income Taxes Paid, 1989

Dollars in millions

Distribution by asset size/taxes paid	Foreign-controlled corporations		U.S.-controlled corporations	
Companies with assets of $250 million or more	Receipts	Percent of asset group	Receipts	Percent of asset group
No tax paid	$94,956	14.0	$341,620	6.8
Less than $100,000	87,037	12.8	202,996	4.0
$100,000 under $1 million	80,056	11.8	213,939	4.2
$1 million or more	417,236	61.4	4,288,515	85.0
Total	$679,285	100.0	$5,047,070	100.0
Companies with assets of $100 million or more but less than $250 million				
No tax paid	$30,450	31.4	$85,101	20.3
Less than $100,000	14,354	14.8	41,030	9.8
$100,000 under $1 million	26,934	27.7	87,258	20.8
$1 million or more	25,365	26.1	206,756	49.2
Total	$97,103	100.0	$420,145	100.0

Note: Totals may not add due to rounding.

Source: IRS.

Table I.3: Assets of Foreign- and U.S.-Controlled Corporations With $100 Million or More in Assets, by Income Taxes Paid, 1989

Dollars in millions

Distribution by asset size/taxes paid	Foreign-controlled corporations		U.S.-controlled corporations	
Companies with assets of $250 million or more	Assets	Percent of asset group	Assets	Percent of asset group
No tax paid	$243,226	20.6	$1,904,803	14.9
Less than $100,000	176,543	15.0	525,914	4.1
$100,000 under $1 million	128,083	10.9	521,319	4.1
$1 million or more	631,022	53.5	9,844,794	76.9
Total	$1,178,874	100.0	$12,796,830	100.0
Companies with assets of $100 million or more but less than $250 million				
No tax paid	$36,530	38.7	$252,339	34.1
Less than $100,000	13,471	14.3	71,832	9.7
$100,000 under $1 million	25,041	26.5	259,779	35.1
$1 million or more	19,357	20.5	155,538	21.0
Total	$94,399	100.0	$739,488	100.0

Note: Totals may not add due to rounding.

Source: IRS.

Table I.4: Taxes Paid by Foreign- and U.S.-Controlled Corporations With $100 Million or More in Assets, by Income Taxes Paid, 1989

Dollars in millions

Distribution by asset size/ taxes paid	Foreign-controlled corporations		U.S.-controlled corporations	
Companies with assets of $250 million or more	Taxes paid	Percent of asset group	Taxes paid	Percent of asset group
No tax paid	$0.0	0.0	$0.0	0.0
Less than $100,000	2.6	0.1	9.3	0.0
$100,000 under $1 million	63.4	1.5	283.2	0.4
$1 million or more	4,127.5	98.4	64,141.3	99.6
Total	$4,193.5	100.0	$64,433.8	100.0
Companies with assets of $100 million or more but less than $250 million				
No tax paid	$0.0	0.0	$0.0	0.0
Less than $100,000	2.5	0.5	15.6	0.3
$100,000 under $1 million	60.8	11.5	768.4	15.2
$1 million or more	466.9	88.1	4,264.2	84.5
Total	$530.2	100.0	$5,048.2	100.0

Note: Totals may not add due to rounding.

Source: IRS.

Table I.5: Number of Returns of Foreign- and U.S.-Controlled Corporations With Less Than $100 Million in Assets, by Income Taxes Paid, 1989

	Foreign-controlled corporations		U.S.-controlled corporations	
Distribution by taxes paid of companies with assets of less than $100 million	Number of returns	Percent of asset group	Number of returns	Percent of asset group
No tax paid	31,690	72.8	1,262,801	59.0
Less than $10,000	6,792	15.6	721,269	33.7
$10,000 under $100,000	3,039	7.0	124,646	5.8
$100,000 under $1 million	1,719	4.0	29,126	1.4
$1 million or more	303	0.7	2,381	0.1
Total	43,543	100.0	2,140,223	100.0

Note 1: Totals may not add due to rounding.

Note 2: Figures were obtained from weighted estimates based on samples. The weights were provided by IRS, and the estimates are subject to sampling error. Sampling error may vary widely from one estimate to another. Data limitations are discussed in SOI publication, 1989 Corporation Income Tax Returns.

Source: IRS.

Table I.6: Receipts of Foreign- and U.S.-Controlled Corporations With Less Than $100 Million in Assets, by Income Taxes Paid, 1989

Dollars in millions

	Foreign-controlled corporations		U.S.-controlled corporations	
Distribution by taxes paid of companies with assets of less than $100 million	Receipts	Percent of asset group	Receipts	Percent of asset group
No tax paid	$77,553	40.7	$975,842	34.5
Less than $10,000	15,922	8.4	592,702	21.0
$10,000 under $100,000	30,505	16.0	543,540	19.2
$100,000 under $1 million	42,262	22.2	512,437	18.1
$1 million or more	24,491	12.8	203,736	7.2
Total	$190,733	100.0	$2,828,257	100.0

Note 1: Totals may not add due to rounding

Note 2: Figures were obtained from weighted estimates based on samples. The weights were provided by IRS, and the estimates are subject to sampling error. Sampling error may vary widely from one estimate to another. Data limitations are discussed in SOI publication, 1989 Corporation Income Tax Returns.

Source: IRS.

Table I.7: Assets of Foreign- and U.S.-Controlled Corporations With Less Than $100 Million in Assets, by Income Taxes Paid, 1989

Dollars in millions

	Foreign-controlled corporations		U.S.-controlled corporations	
Distribution by taxes paid of companies with assets of less than $100 million	Assets	Percent of asset group	Assets	Percent of asset group
No tax paid	$83,121	53.3	$674,634	38.7
Less than $10,000	12,824	8.2	252,476	14.5
$10,000 under $100,000	20,237	13.0	318,014	18.2
$100,000 under $1 million	28,111	18.0	406,749	23.3
$1 million or more	11,583	7.4	93,749	5.4
Total	$155,876	100.0	$1,745,622	100.0

Note 1: Totals may not add due to rounding.

Note 2: Figures were obtained from weighted estimates based on samples. The weights were provided by IRS, and the estimates are subject to sampling error. Sampling error may vary widely from one estimate to another. Data limitations are discussed in SOI publication, 1989 Corporation Income Tax Returns.

Source: IRS.

Table I.8: Taxes Paid by Foreign- and U.S.-Controlled Corporations With Less Than $100 Million in Assets, by Income Taxes Paid, 1989

Dollars in millions

	Foreign-controlled corporations		U.S.-controlled corporations	
Distribution by taxes paid of companies with assets of less than $100 million	Taxes paid	Percent of asset group	Taxes paid	Percent of asset group
No tax paid	$0.0	0.0	$0.0	0.0
Less than $10,000	13.9	1.0	1,584.9	8.6
$10,000 under $100,000	113.4	7.9	3,698.8	20.1
$100,000 under $1 million	553.7	38.5	7,465.8	40.5
$1 million or more	756.4	52.6	5,699.9	30.9
Total	$1,437.4	100.0	$18,449.4	100.0

Note 1: Totals may not add due to rounding.

Note 2: Figures were obtained from weighted estimates based on samples. The weights were provided by IRS, and the estimates are subject to sampling error. Sampling error may vary widely from one estimate to another. Data limitations are discussed in SOI publication, 1989 Corporation Income Tax Returns.

Source: IRS.

Table I.9: Individual Components of Cost of Goods Sold as a Percentage of Total Receipts, Corporations That Paid Income Tax, 1989

Dollars in millions

	Foreign-controlled corporations		U.S.-controlled corporations	
Tax return item	Dollars	Percent of total receipts	Dollars	Percent of total receipts
Inventory, beginning of year	$67,076	8.8	$438,345	6.4
Purchases	411,087	53.8	2,330,816	33.8
Cost of labor	24,742	3.2	331,336	4.8
Additional section 263A costs[a]	3,225	0.4	21,319	0.3
Other costs[b]	67,466	8.8	821,170	11.9
Inventory, end of year[c]	71,798	9.4	450,086	6.5
Total cost of goods sold[d]	$515,291	67.4	$3,819,244	55.4
Total receipts	$764,162		$6,892,907	

Note: Figures were obtained from weighted estimates based on samples. The weights were provided by IRS, and the estimates are subject to sampling error. Sampling error may vary widely from one estimate to another. Data limitations are discussed in SOI publication, 1989 Corporation Income Tax Returns.

[a]Section 263A costs are costs associated with items that must be capitalized under the uniform capitalization rules enacted by Congress in 1986.

[b]Other costs represent any costs paid or incurred during the tax year and not already included in the line items above it.

[c]End-of-year inventory is subtracted from the other components to arrive at the cost of goods sold.

[d]The total cost of goods sold figure does not equal the sum of its components because IRS uses the cost of goods sold figure reported by the taxpayer on the return, instead of computing it based on the components. IRS personnel told us that the discrepancy may be due to taxpayer errors and the failure of some taxpayers to submit the Schedule A, which breaks out the individual components.

Table I.10: Individual Components of Costs of Goods Sold as a Percentage of Total Receipts, Corporations That Did Not Pay Income Tax, 1989

Dollars in millions

	Foreign-controlled corporations		U.S.-controlled corporations	
Tax return item	Dollars	Percent of Total Receipts	Dollars	Percent of Total Receipts
Inventory, beginning of year	$24,631	12.1	$110,754	7.9
Purchases	108,391	53.4	515,787	36.8
Cost of labor	7,441	3.7	68,566	4.9
Additional section 263A costs[a]	911	0.5	4,018	0.3
Other costs[b]	25,629	12.6	168,131	12.0
Inventory, end of year[c]	25,794	12.7	107,286	7.7
Total cost of goods sold[d]	$141,952	69.9	$774,893	55.2
Total Receipts	$202,959		$1,402,563	

Note: Figures were obtained from weighted estimates based on samples. The weights were provided by IRS, and the estimates are subject to sampling error. Sampling error may vary widely from one estimate to another. Data limitations are discussed in SOI publication, 1989 Corporation Income Tax Returns.

[a]Section 263A costs are costs associated with items that must be capitalized under the uniform capitalization rules enacted by Congress in 1986.

[b]Other costs represent any costs paid or incurred during the tax year and not already included in the line items above it.

[c]End-of-year inventory is subtracted from the other components to arrive at the cost of goods sold.

[d]The total cost of goods sold figure does not equal the sum of its components because IRS uses the cost of goods sold figure reported by the taxpayer on the return, instead of computing it based on the components. IRS personnel told us that the discrepancy may be due to taxpayer errors and the failure of some taxpayers to submit the Schedule A, which breaks out the individual components.

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