Domestic Corporations Controlled by Foreign Persons, 1988

By James R. Hobbs*

For 1988, the 46,298 domestic corporations each "controlled" by a foreign "person" generated $0.8 trillion of worldwide receipts and reported total assets amounting to $1.2 trillion [1,2]. These corporations, 1.3 percent of the U.S. total, accounted for 8.0 and 7.2 percent of the receipts and assets, respectively, reported on U.S. corporation income tax returns. During the 1984-1988 period, foreign-controlled domestic corporations accounted for an increasingly higher percentage of the receipts and assets of all corporations (see Figure A).

The net income (less deficit) for foreign-controlled domestic corporations (FCDC's) was $11.2 billion for 1988, twice the $5.6 billion amount for 1987. Despite this increase, the 1988 amount was a relatively small percentage of FCDC total assets and receipts, when compared to amounts for other domestic corporations.

Manufacturing accounted for $8.5 billion, or over three-fourths, of the 1988 total net income (less deficit) for FCDC's. Profitable companies in all industries reported $19.8 billion of taxable income, a 37 percent increase for 1988. FCDC's also reported $5.8 billion of total U.S. income tax after credits for 1988, up from $4.6 billion for the previous year. Thus, while net income (less deficit) doubled for 1988, tax liability increased by 28 percent.

Domestic corporations controlled by persons from Japan had total receipts of $209 billion for 1988, an amount considerably larger than the receipts representing any other country. The receipts for U.S. companies controlled by persons in the United Kingdom remained in second place with $150 billion, followed by the Netherlands ($93 billion), Canada ($83 billion), and West Germany ($74 billion). Of these countries, Canada and the United Kingdom had the largest rates of increase (62 and 45 percent, respectively) in receipts over 1987.

DIRECT FOREIGN INVESTMENT IN THE UNITED STATES

Direct foreign investment in the United States can take several forms, including corporations, partnerships, and even joint ventures. Under these forms of direct investment, the foreign investor has sufficient equity in the enterprise so as to control and participate in managing its operations [3].

A foreign direct investor can either gain control of an existing U.S. corporation, or create a new company incorporated in the United States [4]. Another method of operating in the United States is through a branch of a foreign corporation. There are several factors involved in the decision of a foreign investor to operate in the United States through either a "domestic" or "foreign" corporation [5]. This article focuses on domestic corporations (i.e., companies incorporated in the United States) that are controlled (i.e., majority owned) by a foreign person (see the Explanation of Selected Terms section of this article for a description of foreign persons.) A separate article will be published in a future issue of the *Statistics of Income Bulletin* covering branch operations of foreign corporations with income "effectively connected" with a U.S. trade or business.

RAPID GROWTH

Foreign direct investment in the United States through foreign-controlled domestic corporations grew substantially during the 1984-1988 period. Worldwide receipts of

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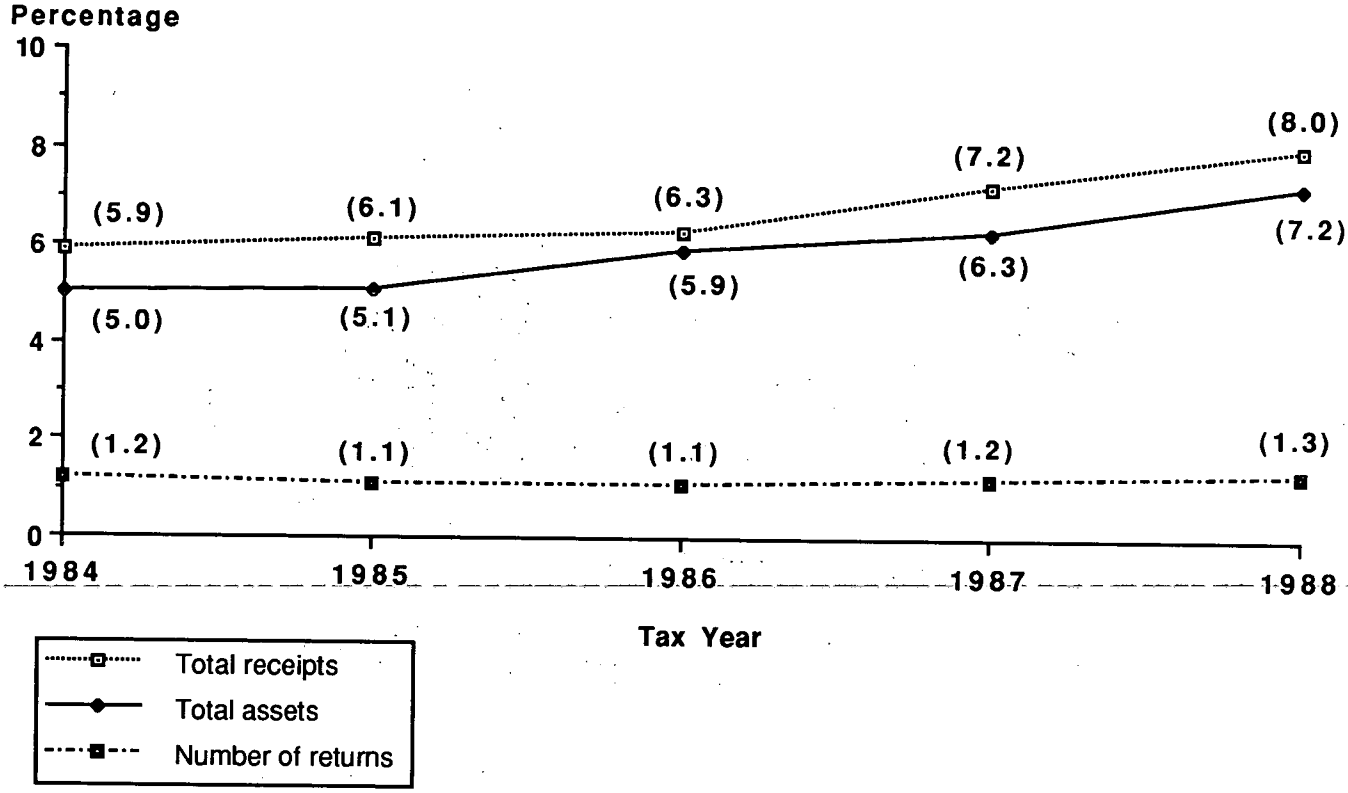
Figure A
Domestic Corporations Controlled by a Foreign Person as a Percentage of All Corporations, 1984-1988
[All figures are estimates based on samples]



FCDC's increased from $459 billion for 1984 to $826 billion for 1988, an 80 percent increase using current dollars. (Adjusting for inflation through the use of the Gross National Product Implicit Price Deflator, these receipts increased by 39 percent [6].) In comparison, worldwide receipts reported on all U.S. corporation income tax returns grew from $7.9 trillion for 1984 to $10.3 trillion for 1988, a 31 percent increase (in current dollars) over the same period [7]. As a result of the rapid growth rate of FCDC's, their share of the receipts reported on all corporate returns increased from 5.9 percent for 1984 to 8.0 percent for 1988.

The growth of FCDC's can also be measured from the early 1970's, when a question concerning foreign ownership of companies was first placed on Form 1120, U.S. Corporation Income Tax Return. For 1971, these companies had $39 billion of worldwide receipts, just 2.1 percent of the $1.9 trillion reported for all corporations. By 1988, this percentage had grown to 8.0 percent.

Total assets of domestic corporations controlled by a foreign person grew at an even faster rate than that for receipts. Between 1984 and 1988, their assets increased from $0.6 trillion to $1.2 trillion, a 117 percent increase. During this period, their share of the book value of total assets reported on all U.S. corporation income tax returns grew from 5.0 percent to 7.2 percent. For 1971, these companies had reported $37 billion of assets, just 1.3 percent of the total.

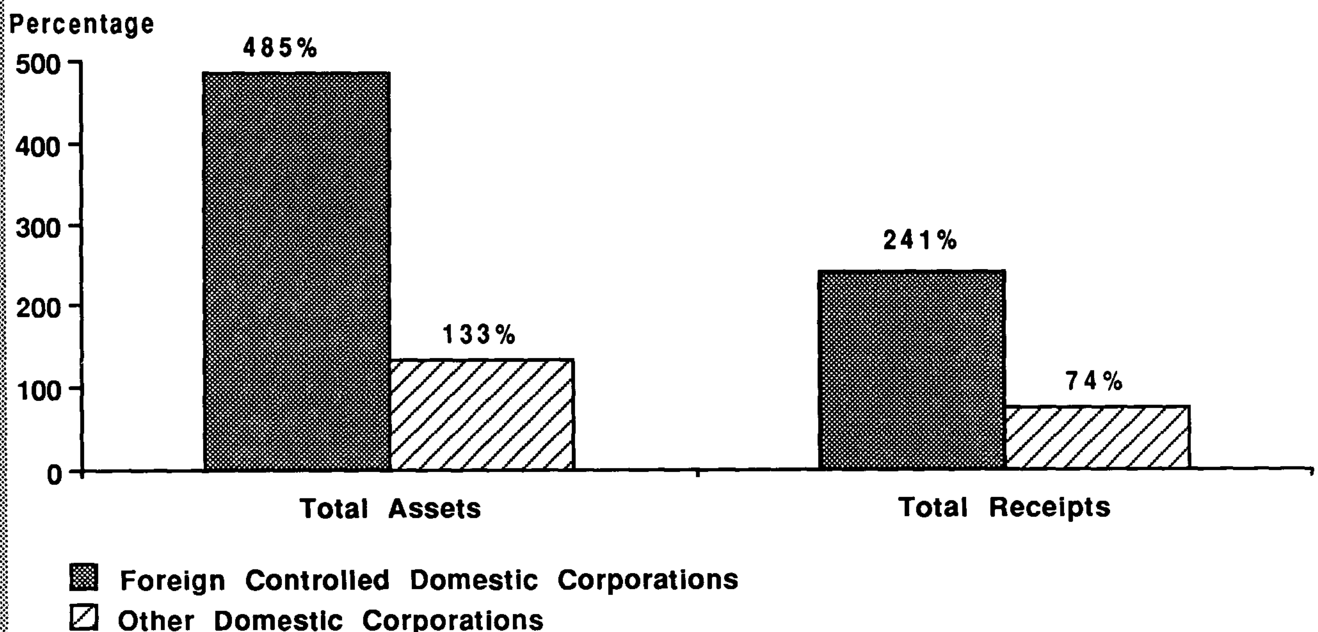
Figure B also shows the more rapid growth of FCDC's as compared to U.S.-controlled domestic companies. During the period 1979 to 1988, the assets and receipts of the FCDC's grew three to four times faster than those of other domestic corporations.

The number of returns of foreign-controlled domestic corporations rose to over 46,000 for 1988, a slight increase over the nearly 45,000 for the previous year. During the 1984-1986 period, there were approximately

Figure B

Growth of Domestic Corporations, 1979-1988

[All figures are estimates based on samples]



37,000 returns filed yearly by FCDC's [8]. Despite the increase between 1986 and 1987, returns of these companies comprised a rather constant percentage of all U.S. corporation income tax returns, between 1.1 and 1.3 percent for each year between 1984 and 1988.

It should be noted that foreign-controlled domestic corporations are considerably larger, on average, than other companies. While these companies accounted for only 1.3 percent of the total returns filed by corporations, for 1988 they comprised 8.0 and 7.2 percent of the total receipts and assets, respectively. Percentages for these three items had similar magnitudes for 1984 through 1987. Going back to 1971, the percentage for number of returns was similarly lower than the percentages for total receipts and assets (0.3, 2.1, and 1.3 percent, respectively).

INDUSTRY CHARACTERISTICS

Foreign-controlled domestic corporations were involved in every type of industrial activity, but were concentrated mainly in two industrial divisions: (1) wholesale and retail trade and (2) finance, insurance, and real estate (see Table 1) [9]. For 1988, these two divisions accounted for over two-thirds of all returns filed by domestic corporations owned by a foreign person. By comparison, these two divisions made up 44 percent of all the U.S. corporation income tax returns filed for that year. Two other industrial divisions contained significant numbers of returns filed by FCDC's. Returns classified in the services and manufacturing divisions together represented 25 percent of all FCDC returns.

Looking at assets, once again two industrial divisions comprised most of the total for FCDC's for 1988. Finance, insurance, and real estate and manufacturing had $0.5 and $0.4 trillion of total assets, respectively. (Within the finance, insurance, and real estate division, banks accounted for the largest portion, with $0.2 trillion of assets. In manufacturing, petroleum and chemical companies each accounted for $0.1 trillion of assets.) This was 78 percent of the $1.2 trillion of assets for all FCDC's. These same two divisions made up 77 percent of the total assets reported on all U.S. corporation income tax returns. In this respect, FCDC's closely reflected all companies.

Alternatively, using total receipts as the criterion, wholesale and retail trade and manufacturing were the two primary industrial divisions for FCDC's for 1988. Wholesalers and retailers reported $347 billion of receipts, while manufacturers had $338 billion. Together, these two divisions accounted for 83 percent of the $826 billion of total receipts for all FCDC's. This percentage was higher than the comparative one (62 percent) for all companies that filed U.S. corporation income tax returns.

The comparative levels of assets and receipts of foreign-owned domestic companies (as well as other corporations) primarily engaged in wholesale and retail trade and those engaged in finance, insurance, and real estate differed significantly. FCDC wholesalers and retailers produced large amounts of receipts with relatively small amounts of assets, amounting to $2.13 of receipts for each dollar of assets. On the other hand, companies classified in finance, insurance, and real estate had large amounts of assets, but relatively small amounts of receipts. (This was particularly true for banks and security and commodity brokers and services.) These companies produced only 16 cents of receipts for each dollar of assets. The difference between these industries is also reflected in the totals for all companies which filed U.S. corporation income tax returns.

Foreign-controlled domestic corporations accounted for 8.0 percent of the $10.3 trillion of worldwide receipts reported by all companies filing U.S. income tax returns for 1988. These companies played important roles in certain industries, as shown in Figure C. In particular, FCDC's in the wholesale trade, mining, and manufacturing industrial divisions accounted for 19.7, 16.1, and 10.1 percent, respectively, of the receipts of all companies classified in these divisions. Each of these percentages were increases over those for the previous year, which were: wholesale trade (18.9 percent), mining (12.3 percent), and manufacturing (8.5 percent) [10].

There were two major industries (miscellaneous wholesale trade, defined below, and the manufacture of leather and leather products) in which foreign-controlled domestic corporations produced over 20 percent of the U.S. totals for receipts for these industries. The percentage in the leather manufacturing industry jumped from only 2 percent for 1984 to about 21 percent for the 1986-1988 period. By comparison, the percentage for the miscellaneous wholesale trade industry was substantial (17.6 to 22.6 percent) during the entire 1984-1988 period. Many of the companies in this industry were U.S. distributors of products made in foreign countries by their parent corporations. This industry group includes the distribution of the following products [11]:

Alcoholic beverages
Apparel, piece goods, and notions
Chemicals and allied products
Drugs, drug proprietaries, and druggists' sundries
Electrical goods
Farm-product raw materials
Furniture and home furnishings
Hardware, plumbing, and heating equipment and supplies
Lumber and construction materials
Metals and minerals, except petroleum and scrap
Motor vehicles and automotive equipment
Paper and paper products
Petroleum and petroleum products
Sporting, recreational, photographic, and hobby goods, toys, and supplies
All other nondurable goods, except groceries and related products
All other durable goods, except machinery, equipment, and supplies

Domestic companies owned by a foreign person comprised significant portions of several other industries for 1988. These included wholesalers of machinery, equipment, and supplies (19.5 percent); coal mining companies (19.1 percent); stone, clay, and glass products manufacturers (18.4 percent); chemical manufacturers (18.3 percent); nonmetallic minerals, except fuels, mining companies (17.1 percent); tobacco manufacturers (17.0 percent); oil and gas extraction companies (15.7 percent); and manufacturers of petroleum and coal products (15.1 percent). With the exception of tobacco manufacturers, the 1988 percentages for all of these industries were increases over those for the previous year. Stone, clay, and glass product manufacturers and coal mining companies showed the largest increases over the 1987 percentages of 12.5 and 14.2, respectively.

COUNTRY CHARACTERISTICS

Domestic corporations are owned by persons throughout the world. However, for 1988, owners from seven countries controlled nearly 58 percent of the 46,298 domestic corporations controlled by a foreign person (see Figure D). (The countries represent the geographic location of the direct foreign owner's country of residence,

Figure C.--Total Receipts of Domestic Corporations Controlled by a Foreign Person as a Percentage of All Corporations, by Selected Major Industry, 1988

[All figures are estimates based on samples–money amounts are in millions of dollars]

Selected major industry	All U.S. corporation income tax returns	Returns of domestic corporations controlled by a foreign person	Percentage of all returns
	(1)	(2)	(3)
All industries 1/	$10,264,867	$825,557	8.0%
Agriculture, forestry and fishing	86,258	987	1.1
Mining, total	100,427	16,136	16.1
Metal mining	11,361	1,291	11.4
Coal mining	20,696	3,947	19.1
Oil and gas extraction	57,010	8,955	15.7
Nonmetallic minerals, except fuels	11,361	1,943	17.1
Construction	499,690	6,087	1.2
Manufacturing, total	3,348,966	338,320	10.1
Food and kindred products	358,647	31,100	8.7
Tobacco manufactures	63,691	10,827	17.0
Textile mill products	54,559	2,482	4.5
Apparel and other textile products	67,849	1,367	2.0
Lumber and wood products	80,903	2,866	3.5
Furniture and fixtures	40,185	1,349	3.4
Paper and allied products	115,603	8,368	7.2
Printing and publishing	156,200	15,234	9.8
Chemicals and allied products	338,728	62,019	18.3
Petroleum (including integrated) and coal products	409,450	61,682	15.1
Rubber and miscellaneous plastics products	76,157	9,943	13.1
Leather and leather products	15,316	3,206	20.9
Stone, clay, and glass products	66,462	12,254	18.4
Primary metal industries	137,547	19,536	14.2
Fabricated metal products	177,950	14,367	8.1
Machinery, except electrical	288,773	17,840	6.2
Electrical and electronic equipment	296,245	36,752	12.4
Motor vehicles and equipment	306,211	9,160	3.0
Transportation equipment, except motor vehicles	144,754	1,379	1.0
Instruments and related products	84,848	8,979	10.6
Miscellaneous manufacturing and manufacturing not allocable	68,887	7,609	11.0
Transportation and public utilities	838,753	11,056	1.3
Wholesale and retail trade, total	2,977,983	346,628	11.6
Wholesale trade, total	1,432,705	282,558	19.7
Groceries and related products	210,926	11,019	5.2
Machinery, equipment, and supplies	131,262	25,541	19.5
Miscellaneous wholesale trade	1,090,517	245,998	22.6
Retail trade	1,541,442	64,015	4.2
Wholesale and retail trade not allocable	3,835	*54	1.4
Finance, insurance, and real estate	1,714,352	80,928	4.7
Services	695,265	25,379	3.7

1/ Includes "Nature of business not allocable," which is not shown separately.
* Estimate should be used with caution because of the small number of sample returns on which it is based.
NOTE: This figure includes all major industries of those industrial divisions in which foreign-controlled domestic corporations accounted for 5 percent or more of the corporate totals. Only the totals for the other industrial divisions are shown. Detail may not add to totals because of rounding.

Figure D.--Domestic Corporations Controlled by a Foreign Person: Selected Items, by Selected Countries, 1988

[All figures are estimates based on samples – money amounts are in thousands of dollars]

Country	Number of returns	Total assets	Total receipts	Total U.S. income tax after credits
	(1)	(2)	(3)	(4)
All countries	46,298	$1,199,346,487	$825,557,383	$5,823,758
Selected countries, total	26,780	991,990,897	690,812,236	5,086,817
Percentage of all countries 1/	57.8%	82.7%	83.7%	87.3%
Japan	5,345	$247,520,600	$209,042,500	$1,111,870
United Kingdom	5,043	301,459,799	149,651,067	1,782,810
Netherlands	1,877	148,482,615	93,089,636	668,155
Canada	7,545	115,726,878	83,437,240	485,092
West Germany	3,291	74,016,322	74,336,712	438,641
France	1,876	61,898,322	42,589,646	362,694
Switzerland	1,803	42,886,361	38,665,435	237,555

1/ This figure includes only those countries which had $25 billion or more of total receipts for 1988. Country information is based on the location of the owner's country of residence, incorporation, organization, creation, or administration.

incorporation, organization, creation, or administration. Because holding companies located in a country different from that of the ultimate owner may directly own the stock of U.S. affiliates, the country reported on the tax return may not necessarily reflect the country of the ultimate owner. Unfortunately, no data on the extent of this potential limitation are available.) The 26,780 corporations owned by persons from these seven countries accounted for 83, 84, and 87 percent of the total assets, total receipts, and total U.S. income tax after credits, respectively, of all foreign-controlled domestic corporations.

Domestic corporations controlled by Japanese persons had worldwide receipts of $209 billion for 1988, an amount far larger than the receipts representing any other country. (Japanese persons also accounted for the largest amount of receipts for the 1983-1987 period.) Over $140 billion of this amount was produced by miscellaneous wholesale trade companies. The products they distributed have previously been listed in this article. This one country-industry combination accounted for over 17 percent of the 1988 total receipts of all FCDC's.

Domestic corporations controlled by persons in the United Kingdom had the second largest amount ($150 billion) of receipts for 1988, as well as the second largest for the 1983-1987 period. Unlike Japan, most of these receipts, totalling $94.2 billion, were produced by manufacturers (see Table 1). Some of the more predominant manufacturing industries were petroleum and coal products ($23.8 billion), chemicals and allied products ($17.9 billion), tobacco ($10.7 billion), and food and kindred products ($9.7 billion). Apart from manufacturing, an additional $24.0 and $18.9 billion of receipts were produced by wholesale and retail trade companies and companies in finance, insurance, and real estate, respectively, owned by U.K. persons. Insurance companies accounted for $6.2 billion of receipts for 1988.

The worldwide receipts of domestic corporations controlled by a foreign person increased by 20.2 percent between 1987 and 1988. For corporations with owners from the seven countries shown in Figure D, the growth rates varied widely. Corporations owned by persons in Switzerland, Canada, United Kingdom, and France showed increases of 63.4, 61.9, 45.3, and 42.9 percent, respectively, well above the average for all countries. Percentage increases for the Netherlands (20.6 percent) and West Germany (18.4 percent) were close to the average. Corporations owned by persons in Japan (13.1 percent) had smaller-than-average increases in receipts between 1987 and 1988.

It should be noted that percentage increases in total receipts for countries over a 1-year period can be very different from year to year, as well as from those for a longer period of time. For instance, between 1984 and 1987, receipts increased by 50 percent for all countries. Over this same time period, corporations owned by persons in Japan and the United Kingdom showed increases in receipts of 64 and 34 percent, respectively. These results were quite different from those for the 1987 to 1988 period.

INCOME STATEMENT AND TAX ITEMS

Over 91 percent of the $826 billion in total receipts reported by domestic corporations controlled by a foreign person consisted of "business receipts" (i.e., receipts from sales and operations). Taxable interest income of $38.6 billion accounted for an additional 5 percent of the total, with banks producing the largest part ($15.8 billion) [12]. (Briefly, banking items such as fees, commissions, trust department earnings, exchange collections, discounts, and service charges were included in business receipts. Interest, the principal operating income of banks, is excluded from business receipts.)

These same domestic companies claimed $815 billion in deductions for 1988. Cost of sales and operations was $572 billion, or 70 percent of the total. Interest paid ($47 billion, including nearly $11 billion paid mostly to depositors by banks), depreciation ($22 billion), and advertising ($14 billion) accounted for 6, 3, and 2 percent, respectively, of total deductions.

For 1988, the percentage of cost of sales and operations to business receipts was considerably higher for foreign-controlled domestic corporations whose principal business activity was trade than it was for other corporations in the trade industry; 85.6 percent versus 76.0 percent (see Figure E). (For manufacturers, the percentage for FCDC's and other companies was closer.) The difference may reflect certain transfer pricing practices of FCDC's that buy goods and services from related persons outside the United States. These practices help determine the amounts of their expenses and, as a result, their net income [13].

The net income (less deficit), as computed under the Internal Revenue Code, for foreign-controlled domestic

Figure E.--Cost of Sales and Operations as a Percentage of Business Receipts, 1988

[All figures are estimates based on samples--money amounts are in millions of dollars]

Foreign-controlled domestic corporations:	
Manufacturing:	
Number of returns	5,874
Business receipts	$317,342
Cost of sales and operations	222,393
Percentage	70.1%
Wholesale and retail trade:	
Number of returns	15,900
Business receipts	$336,934
Cost of sales and operations	288,495
Percentage	85.6%
All other corporations:	
Manufacturing:	
Number of returns	293,664
Business receipts	$2,800,717
Cost of sales and operations	1,895,435
Percentage	67.7%
Wholesale and retail trade:	
Number of returns	968,653
Business receipts	$2,554,402
Cost of sales and operations	1,942,441
Percentage	76.0%

corporations was $11.2 billion for 1988, the highest amount reported for recent years and about twice the 1987 amount of $5.6 billion. For statistical purposes, net income (less deficit) was the difference between "modified" total receipts and total deductions. The $826 billion of total receipts for 1988 was modified as follows: (1) tax-exempt interest from State and local Government obligations was subtracted and (2) "constructive" receipts were added. Constructive receipts were the sum of the following types of taxable income from related foreign corporations: (1) includable income from Controlled Foreign Corporations, and (2) foreign dividend income resulting from foreign taxes deemed paid. Net income (less deficit) should also be distinguished from taxable income (i.e., "U.S. income subject to tax" in the statistics). Because certain statutory special deductions, including the net operating loss deduction, were allowed most companies in computing their taxable income, the statistics for net income are generally larger than the amounts shown for taxable income.

Manufacturing companies accounted for $8.5 billion of the total 1988 profits of FCDC's. This was a 43 percent increase over the 1987 profits. Manufacturers of chemicals and allied products reported $3.2 billion of 1988 profits. In addition, manufacturers of tobacco products, paper and allied products, petroleum and coal products, and primary metals showed higher profits for 1988. Manufacturers of motor vehicles and equipment, however, reported a net deficit of $455 million for 1988, somewhat larger than the net deficit of $380 million for 1987.

For 1988, wholesale and retail trade companies produced $1.7 billion of profits, an 85 percent increase over the 1987 amount of $0.9 billion. Finance, insurance, and real estate companies reported $0.9 billion of 1988 profits, as compared to the net loss of $0.4 billion for the previous year.

The $11.2 billion of net income (less deficit) was the result of 18,867 corporations reporting $26.5 billion of profits and 27,431 companies reporting $15.3 billion of deficits [14]. Thus, only 41 percent of the domestic corporations with foreign owners reported a profit for 1988. By comparison, 54 percent of all corporations filing U.S. income tax returns for 1988 reported profits which totalled $556 billion. The deficits for all corporations were $143 billion, resulting in a net income (less deficit) amount of $413 billion. The percentages of corporations reporting a profit for 1988 were similar to those for the 1984-1987 period (see Figure F).

It is instructive to compare amounts of net income (less deficit) and total income tax after credits to total assets and receipts, for both foreign-controlled domestic corporations and other domestic corporations. The four ratios shown in Figure G are all lower for FCDC's than the comparable ratios for other domestic companies. Using total income tax after credits as the numerator, as opposed to net income (less deficit), produces a smaller difference between the ratios for the two groups of companies. This reflects the fact that while only 41 percent of FCDC's reported net income, these companies had significant amounts of profits, which resulted in considerable amounts of tax after credits. On the other hand, 59 percent of FCDC's reported significant amounts of deficits, which could be carried back or forward, under prescribed rules, to reduce taxable income for other years.

The percentage of before-tax net income (less deficit) compared to total assets is commonly referred to as the rate of return on assets. For 1988, foreign-controlled domestic corporations had a 0.9 percent rate of return as compared to a 2.2 percent rate for other domestic companies. A similar difference has occurred for every year since 1981 (see Figure H).

The percentages shown in Figure G for domestic corporations controlled by a foreign person varied among different industries. (Comparable percentages by industry for other domestic corporations are not available.) Net income (less deficit) as a percentage of total receipts was only 0.5 percent for wholesale and retail trade, as

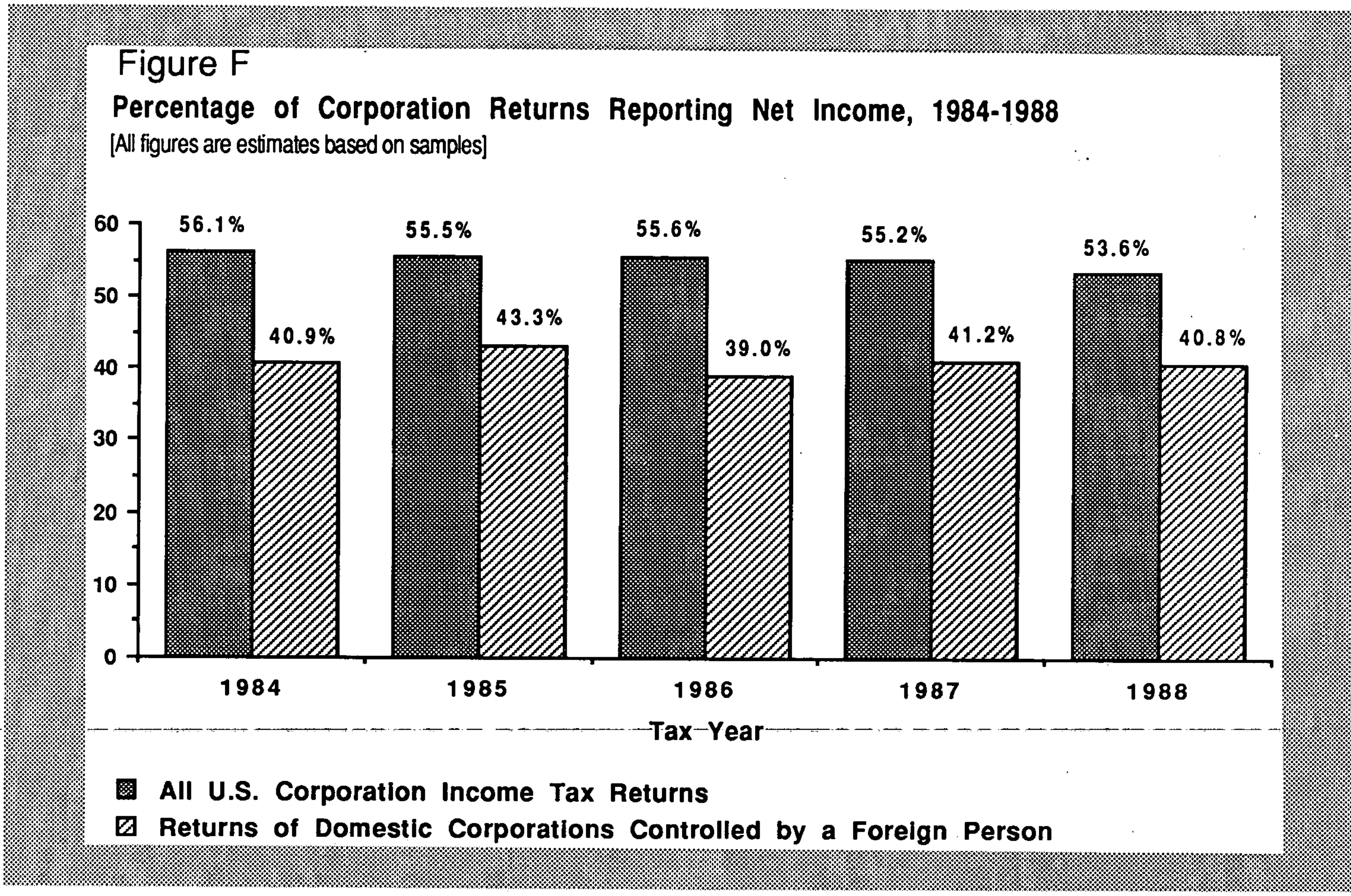


Figure G.--Comparative Rates of Net Income (Less Deficit) and Taxes to Total Assets and Receipts, for Foreign-Controlled and Other Domestic Corporations, 1988
[All figures are estimates based on samples--money amounts are in billions of dollars]

Item	Domestic corporations controlled by a foreign person	Other domestic corporations
Number of returns	46,298	2,289,014
With net income	18,867	1,266,572
Percentage	40.8%	55.3%
Total assets	$1,199.3	$14,805.8
Total receipts	825.6	8,770.1
Net income (less deficit)	11.2	324.4
Net income	26.5	437.5
Deficit	15.3	113.1
Total income tax after credits	5.8	93.9
Net income (less deficit) to total receipts	1.4%	3.7%
Net income (less deficit) to total assets	0.9	2.2
Total income tax after credits to total receipts	0.7	1.1
Total income tax after credits to total assets	0.5	0.6

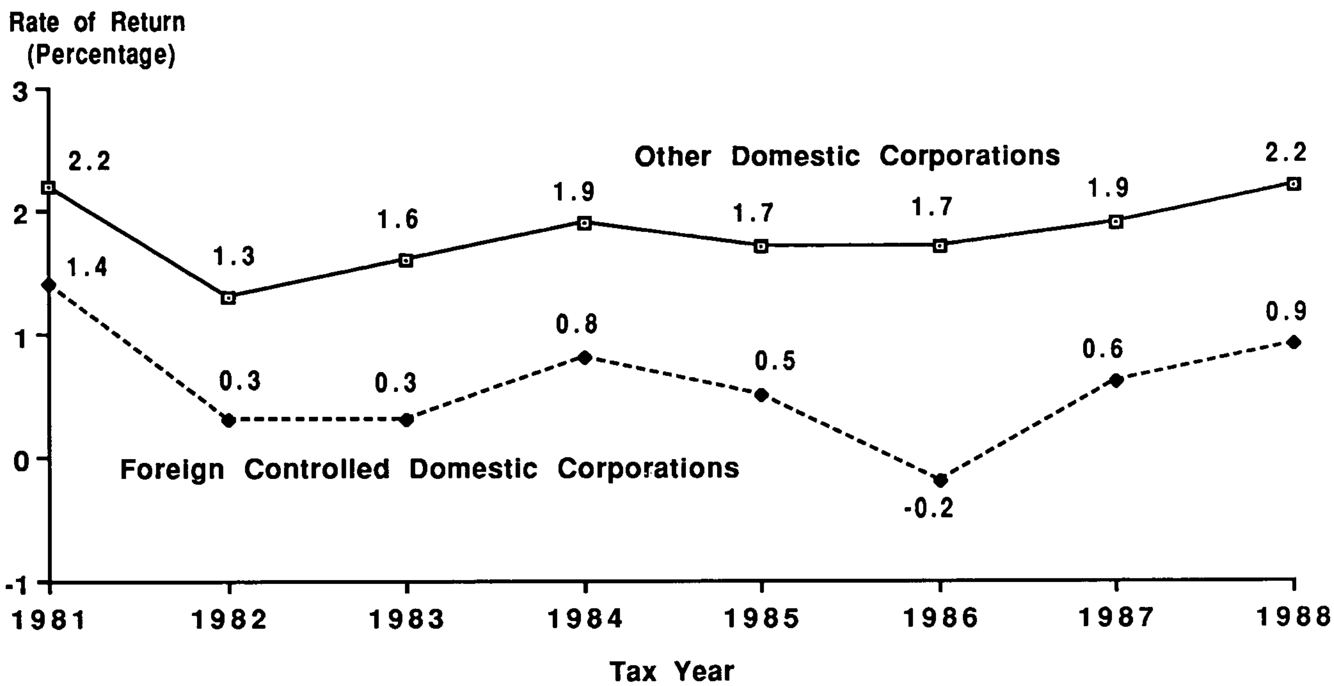
compared to 1.1 percent and 2.5 percent for finance, insurance and real estate and manufacturing, respectively. Net income (less deficit) was 0.2, 1.1, and 2.0 percent of total assets for finance, trade and manufacturing, respectively. Comparing total income tax after credits to total receipts, the percentages were 0.4, 0.9, and 1.2 for trade, manufacturing and finance, respectively. This same tax liability was 0.2, 0.7, and 0.8 percent of total assets for finance, manufacturing, and trade, respectively. It should be noted that many of the percentages shown above are reflections, in part, on the relative levels of assets and receipts typically shown between different industries.

For 1988, profitable foreign-controlled domestic corporations had $19.8 billion of "U.S. income subject to tax" (or taxable income, i.e., the base on which tax was computed for the statistics), resulting in tax before credits of $7.1 billion [15]. The difference between the $26.5 billion of profit (or net income) and $19.8 billion of income subject to tax was the result of statutory special deductions. These deductions were allowed most corporations in computing their taxable income and were for "net operating losses" from other years and deductions for both intercorporate dividends received and for dividends on certain preferred stock of public utilities. (See the Explanation of Selected Terms section of this article for a discussion of the net operating loss deduction.) Beginning with 1987, there were two additional statutory special

Figure H

Rate of Return on Assets, 1981-1988

[All figures are estimates based on samples]



deductions, which were: (1) a deduction for dividends paid on Forms 1120-RIC and 1120-REIT, and (2) an IRC Section 857(b)(2)(E) deduction on Form 1120-REIT. Because FCDC's can file returns on these forms (see the Data Sources and Limitations section of this article), these deductions apply to the 1987 and 1988 data shown in this article.

Tax credits totalling $1.2 billion reduced the U.S. tax liability of foreign-owned domestic corporations to $5.8 billion for 1988. The largest credits claimed were $763 million of foreign tax credits and $399 million of general business credits. The other credits were the U.S. possessions tax credit ($63 million), prior-year minimum tax credit ($21 million), and small amounts of orphan drug and nonconventional source fuel credits. The $5.8 billion of total U.S. income tax after credits represents the tax liability as reported by taxpayers. However, it does not include any changes made by taxpayers through amended returns or by the IRS as a result of audit examination.

SUMMARY

Direct foreign investment in the United States through corporations continued to grow at a relatively fast rate for 1988. While worldwide receipts reported on all U.S. corporation income tax returns increased by 7 percent (using current dollars) for 1988, receipts of domestic corporations controlled by foreign persons increased by 20 percent.

Foreign-controlled domestic corporations generated approximately 83 percent of their total receipts from two industrial divisions: manufacturing and trade. From a single country perspective, domestic corporations controlled by persons in Japan had worldwide receipts of $209 billion, 25 percent of the total. The United Kingdom accounted for another 18 percent.

The profits of foreign-controlled domestic corporations increased for 1988. The net income (less deficit) amount for these companies was $11.2 billion for that year, the highest amount reported for recent years, as compared to $5.6 billion of profits for 1987 and a net negative amount

of $1.5 billion reported for 1986. Despite these increases, the 1988 amount was a relatively small percentage of FCDC assets and receipts, when compared to similar items for other domestic corporations.

EXPLANATION OF SELECTED TERMS

Attribution rules.--In regard to domestic corporations that are 50 percent or more owned by a foreign "person," these rules provide that an individual shall be considered as owning the stock of a corporation that is owned, directly or indirectly, by or for his or her family. The family of an individual includes his or her spouse, brothers and sisters, ancestors, and lineal descendants. For more information on these rules, see section 267(c) of the Internal Revenue Code. However, if a corporation is owned by two or more unrelated persons, neither of whom owned 50 percent or more of the corporation, then that corporation was excluded from the statistics even though, together, the persons may have met the 50 percent ownership criterion.

Foreign person.--A foreign person (or entity) is defined as a person other than a U.S. person. A U.S. person includes: (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, and (4) any estate or trust (other than a foreign estate or trust). Section 7701 of the Internal Revenue Code further defines the term U.S. person.

Net income (or deficit).--This is the difference between gross receipts and the ordinary and necessary business deductions allowed by the Internal Revenue Code. It is also referred to as "profits" in this text. It reflects not only actual receipts but "constructive" receipts as well. Interest from State and local Government obligations is excluded. Because certain statutory special deductions, including the net operating loss deduction, were allowed most corporations in computing their income subject to tax, the statistics for net income are generally larger than the amounts shown for "U.S. income subject to tax," i.e., the base on which tax was computed. See also the discussion of the "Net Operating Loss Deduction" in this section of the article.

Net operating loss deduction.--A statutory "net operating loss" (NOL) for a given tax year can be carried back over a 3-year period to reduce the taxable income of those years, and any amount of the NOL not offset against income during that time can be carried forward against income for a period not exceeding 15 years. The amount of NOLD included in this study, however, consists only of losses from prior years carried forward and actually used to reduce taxable income for the current (1988) tax year. Losses incurred after the 1988 Tax Year and carried back to that year at a later date could not be reported on the tax returns used for this article. Net operating losses on which the 1988 deduction was based include: (1) the excess of ordinary and necessary business expenses over income in previous loss years, and (2) statutory special deductions claimed in a loss year for dividends received and for dividends paid on certain preferred stock of public utilities (or any excess of such deductions over net income).

Other corporations.--Data shown in this article for these companies represents all U.S. corporation income tax returns, except those for domestic companies controlled by a foreign person. Thus, the data include Forms 1120, 1120A, 1120L, 1120S, 1120F, 1120-RIC, 1120-REIT, and 1120PC (stock and mutual companies). For tax years before 1988, the data also include Forms 1120-IC-DISC and 1120-FSC (see footnote 7). When available, data for "other domestic corporations" (see below) were compared to the FCDC's. However, when these data were not available, data for "other corporations" were used.

Other domestic corporations.--Data shown in this article for these companies come from Forms 1120, 1120A, 1120L, and 1120PC (stock companies). The following forms were excluded: 1120S, 1120F, 1120-IC-DISC, 1120-FSC, 1120-RIC, 1120-REIT, and 1120PC (mutual companies).

Rate of return on assets.--For domestic corporations, this is the amount of before-tax net income (less deficit) calculated for U.S. tax purposes expressed as a percentage of total assets.

DATA SOURCES AND LIMITATIONS

Sample

The statistics for domestic corporations controlled by a foreign person shown herein are based primarily on samples of Forms 1120 (U.S. Corporation Income Tax Return). In addition, the 1988 statistics include data from small numbers of Forms 1120L (U.S. Life Insurance Company Income Tax Return), Forms 1120-RIC (U.S. Income Tax Return for Regulated Investment Companies), and Forms 1120-REIT (U.S. Income Tax Return for Real Estate Investment Trusts). For tax years before 1988, small numbers of Forms 1120-IC-DISC (Interest Charge Domestic

International Sales Corporation Return) were also included in the FCDC statistics.

Forms 1120, 1120-RIC, and 1120-REIT sampled returns were stratified based on the year a return was sampled for the study, business activity, size of total assets and size of "proceeds," which was the larger of the absolute value of net income (or deficit) or the absolute value of "cash flow" (i.e., net income plus depreciation plus depletion). Form 1120L returns were sampled on the size of total assets.

For 1988, the Form 1120 achieved sampling rates ranged from 0.26 percent to 100 percent. In general, 1120 return forms with assets of $25 million or more, or with "proceeds" of $5 million or more, were selected for the study at the 100 percent rate. For additional information of the sampling rates, see *Statistics of Income--1988, Corporation Income Tax Returns.*

Because the data presented are estimates based on samples, they are subject to sampling error. To properly use these data, the magnitude of the sampling error should be known. Coefficients of variation (CV's) are used to measure that magnitude. For a general discussion of CV's, see the Appendix to this publication. For a more detailed discussion of CV's, see *Statistics of Income--1988, Corporation Income Tax Returns.*

Nonsampling Limitations

Most of the data in this article relate to Tax Year 1988. However, the estimates cover returns with accounting periods that ended in a 12 month span beginning in July and ending in June. Thus, for Tax Year 1988, this span was between July 1988 and June 1989. As a result of the 12 month span for ending accounting periods, the statistics for each year shown in this article include income received or expenses incurred during a 23 month span. For Tax Year 1988, that span was from August 1987 through June 1989.

Each return used for the studies described in this article had an industry code reported or assigned during statistical processing. This code was used as a classifier of the returns, as shown in Table 1 of this article. The industry code represented the principal business activity (i.e., the activity which accounted for the largest portion of total receipts) of the corporation filing the return. However, a given return may have been for a company engaged in several business activities or may have been a consolidated return filed for an affiliated group of corporations which conducted different business activities. To the extent that some consolidated (and nonconsolidated) corporations were engaged in many types of business activities, the data in this article are not entirely related to the industrial activity under which they are shown.

Each return used for the statistics described in this article also had a foreign country code assigned during statistical processing, which identified the owner's country. For individuals, it was the owner's country of residence. For all others, it was the country where the foreign entity was incorporated, organized, created, or administered. The code was used as a classifier of the returns (see Figure D and Table 1). To the extent that a holding company or other affiliated entity was part of a chain between a U.S. subsidiary company and the ultimate parent, the data are not entirely related to the foreign country under which they are shown.

Returns were selected for this study based on taxpayers' responses to a question on the various types of Form 1120 which asks whether "a person other than a U.S. person" owned, directly or indirectly, 50 percent or more of the filing corporation's voting stock. Certain taxpayers incorrectly answered this question "yes" when a U.S. person other than an individual (such as a U.S. corporation) was the owner. (See the definition of a foreign person in the Explanation of Selected Terms section of this article.) These reporting errors were primarily made by corporations with small amounts of assets and income. As a result of these errors, it is estimated that the number of returns may be overstated by 5 to 10 percent. However, money amounts for balance sheet, income statement and tax items are only minimally overstated. Additional research on the frequency of these incorrect responses will be conducted in the future. In addition, the question on Form 1120 will be changed to ask specifically if any "foreign person" owned, directly or indirectly, 50 percent or more of the filing corporation's voting stock.

NOTES AND REFERENCES

[1] For purposes of this article, "control" is defined as ownership by any foreign person (i.e., an individual, partnership, corporation, estate or trust), directly or indirectly, of 50 percent or more of a U.S. corporation's voting stock at the end of the tax year. For rules of attribution, see the Explanation of Selected Terms section of this article and section 267(c) of the Internal Revenue Code.

[2] For 1988, there were 46,298 U.S. corporation income tax returns filed by foreign-controlled domestic corporations. These corporations could file consolidated returns for affiliated groups of corporations. To the extent that this happened, the data included in this article actually represent more than 46,298 companies.

[3] Portfolio investment is different from direct investment in that there is no control of the management of the enterprise, except to the extent, for example, of rights to vote periodically in stockholder meetings of corporations. The portfolio investor has a minimal interest in a company, and is primarily seeking dividend payments or an increase in the value of the shares of stock.

[4] The Bureau of Economic Analysis, U.S. Department of Commerce, periodically publishes data on foreign direct investment in the United States in the *Survey of Current Business.*

[5] Sections 7701(a)(4) and (5) of the Internal Revenue Code define a domestic corporation as one created or organized in the United States or under the laws of the United States or any State. A foreign corporation is "one which is not domestic."

[6] The source of the GNP Implicit Price Deflator is the *Survey of Current Business,* Bureau of Economic Analysis, U.S. Department of Commerce.

[7] Beginning with 1988, returns of Foreign Sales Corporations and Interest Charge Domestic International Sales Corporations were not included in the totals for all U.S. corporation income tax returns. Previously, they were included in the totals. Because these returns accounted for such a small portion of the total for most financial items, this change is not considered to be significant in the year-to-year comparison of statistics.

[8] The increase in the number of returns for 1987 may be a reflection of additional incentives for foreigners to purchase U.S. companies, provided by the Tax Reform Act of 1986. For information about these incentives, see, for example, Scholes, Myron and Wolfson, Mark, "The Effects of Changes in Tax Laws on Corporate Reorganization Activity," *NBER Working Paper No. 3095,* National Bureau of Economic Research.

[9] See the Data Sources and Limitations section of this article for a discussion of how returns are industry coded during statistical processing.

[10] For percentages comparable to those shown in Figure C for Tax Years 1984-1987, see Hobbs, James R., "Domestic Corporations Controlled by Foreign Persons, 1987," *Statistics of Income Bulletin,* Summer 1990, Volume 10, Number 1.

[11] In addition, the miscellaneous wholesale trade industry includes wholesale companies for which the products they distributed could not be identified. For the 1989 FCDC's study, it is planned to produce statistics which will classify the miscellaneous wholesale trade industry into smaller, more specific, industry segments. Such information is not available for Tax Year 1988.

[12] For all industries, total receipts include $531 million of tax-exempt interest income from State and local Government obligations, most of which ($305 million) was received by banks. This amount, however, is not included in net income (less deficit).

[13] See Dworin, Lowell, "Transfer Pricing Issues," *National Tax Journal,* Volume 43, September 1990, pp. 285-291. Also see, Goldberg, Fred T., Commissioner of Internal Revenue, "International Tax Administration Issues," statement before the Subcommittee on Oversight, House Committee on Ways and Means, July 1990.

[14] The 27,431 companies reporting a deficit include a small number of "breakeven" companies, i.e., those whose receipts and deductions were equal.

[15] The $7.1 billion of total income tax before credits as it appears in the statistics includes the alternative minimum tax ($310 million), tax from recapture of investment credits ($41 million), environmental tax ($29 million), and Personal Holding Company tax ($644 thousand).

Table 1.--Selected Items, by Selected Industry and Selected Geographic Area

[All figures are estimates based on samples – money amounts are in thousands of dollars]

Selected industry and selected geographic area 1/	Number of returns		Total assets	Total receipts	Net income (less deficit)	Net income	U.S. income subject to tax	Total U.S. income tax	
	Total	With net income						Before credits	After credits
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
ALL INDUSTRIES									
All geographic areas	46,298	18,867	1,199,346,487	825,557,383	11,201,230	26,494,565	19,799,582	7,071,485	5,823,758
Canada	7,545	3,391	115,726,878	83,437,240	934,523	2,738,322	1,539,017	562,326	485,092
Latin America, total	7,170	2,142	38,592,451	36,644,482	6,935	1,149,983	790,363	272,474	208,942
Mexico	1,908	370	2,572,366	3,545,347	67,506	198,665	165,022	55,820	37,247
Central America	1,108	380	7,304,199	6,050,569	-86,608	77,685	53,406	19,545	18,151
Caribbean, total	2,955	686	25,583,460	23,258,739	33,427	801,806	542,442	188,056	145,585
Netherlands Antilles	1,863	287	21,723,121	21,897,289	148,532	750,661	520,522	181,051	138,879
South America	1,199	707	3,132,426	3,789,826	-7,390	71,827	29,493	9,054	7,961
Other Western Hemisphere	459	328	11,431,510	9,229,001	-6,436	239,652	162,086	58,177	50,349
Europe, total	16,454	7,049	682,348,032	441,903,850	9,638,549	16,669,863	13,248,313	4,756,585	3,805,612
European Economic Community, total	13,693	5,844	612,404,273	381,860,640	8,595,125	14,748,640	11,830,672	4,255,920	3,430,264
France	1,876	811	61,898,322	42,589,646	711,008	1,462,522	1,230,706	428,860	362,694
Netherlands	1,877	807	148,482,615	93,089,636	1,853,560	3,249,965	2,264,303	791,785	668,155
United Kingdom	5,043	2,171	301,459,799	149,651,067	4,672,637	6,916,288	5,969,691	2,193,249	1,782,810
West Germany	3,291	1,193	74,016,322	74,336,712	674,537	1,979,372	1,508,118	539,594	438,641
Sweden	265	141	15,027,309	14,073,239	410,211	557,548	450,945	159,989	106,552
Switzerland	1,803	813	42,886,361	38,665,435	719,355	1,177,071	873,666	307,371	237,555
Africa	659	*114	601,807	610,626	-13,522	*6,238	*2,126	*637	*637
Asia, total	8,527	3,730	315,389,611	231,904,893	388,986	4,734,030	3,591,483	1,253,725	1,190,011
Japan	5,345	2,304	247,520,600	209,042,500	956,098	4,353,350	3,324,227	1,159,940	1,111,870
Oceania, total	653	107	28,623,893	14,038,501	86,708	564,368	148,639	63,940	31,588
Australia	605	79	27,173,176	12,370,137	111,356	551,866	144,228	62,318	30,160
Puerto Rico and U.S. Possessions	*179	*4	*2,201,456	*1,491,004	*180,358	*207,991	*196,942	*67,039	*15,232
Country not stated	4,651	2,002	4,430,849	6,297,785	-14,871	184,117	120,614	36,581	36,295
MANUFACTURING									
All geographic areas	5,874	2,261	425,967,232	338,319,932	8,491,496	13,403,928	10,378,044	3,754,823	3,046,144
Canada	785	544	30,384,561	32,080,996	748,527	1,177,087	669,754	239,081	202,391
Latin America, total	580	30	12,060,543	13,636,630	502,329	615,884	489,516	170,336	138,742
Mexico	*454	2/	*432,278	*612,385	*120,027	*144,176	*143,765	*49,057	*30,864
Central America	*10	2/	*4,292,992	*3,751,624	*2,965	*10,458	*7,970	*4,824	*3,569
Caribbean, total	108	16	7,262,394	9,085,836	373,702	455,615	*333,070	114,853	102,739
Netherlands Antilles	52	12	6,870,529	8,519,237	370,777	447,691	*329,499	113,591	101,741
South America	*9	*9	*72,878	*186,785	*5,635	*5,635	*4,710	*1,602	*1,572
Other Western Hemisphere	*23	*7	*3,014,483	*3,833,421	*123,611	*154,929	*117,295	*40,676	*36,911
Europe, total	2,343	898	333,681,763	246,569,130	7,588,262	10,247,958	8,409,643	3,054,531	2,443,285
European Economic Community, total	1,901	742	302,330,306	213,544,632	6,795,259	9,149,185	7,490,647	2,728,229	2,231,025
France	158	68	25,548,862	19,443,641	557,418	858,440	708,370	249,578	209,175
Netherlands	323	61	93,540,403	59,767,173	1,690,936	2,247,148	1,577,501	557,315	490,181
United Kingdom	462	302	143,141,277	94,201,933	3,460,243	4,321,661	3,817,796	1,432,222	1,163,064
West Germany	652	267	36,646,278	34,410,647	877,786	1,357,707	1,146,615	405,261	313,739
Sweden	112	56	6,464,092	7,835,556	294,274	346,384	303,620	109,013	59,537
Switzerland	197	82	22,247,172	22,286,410	523,576	689,497	568,978	201,118	137,445
Africa	*23	–	*130,489	*159,377	*-7,712	–	–	*19	*19
Asia, total	1,159	590	32,487,486	32,865,867	-412,934	912,410	588,522	208,281	190,129
Japan	1,037	503	28,156,760	29,480,353	-363,421	818,328	534,812	189,454	172,341
Oceania, total	37	*15	11,979,533	6,606,153	-86,975	*202,491	*30,263	*16,816	*12,043
Australia	31	*13	11,941,341	6,556,388	-86,999	*202,044	*30,263	*16,816	*12,043
Puerto Rico and U.S. Possessions	*4	2/	*821,901	*891,576	*35,864	*52,247	*49,173	*16,796	*14,409
Country not stated	919	175	1,406,473	1,676,782	524	40,921	*23,878	*8,286	*8,215

Footnotes at end of table.

Table 1.--Selected Items, by Selected Industry and Selected Geographic Area--Continued

[All figures are estimates based on samples – money amounts are in thousands of dollars]

Selected industry and selected geographic area 1/	Number of returns		Total assets	Total receipts	Net income (less deficit)	Net income	U.S. income subject to tax	Total U.S. income tax	
	Total	With net income						Before credits	After credits
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
WHOLESALE AND RETAIL TRADE									
All geographic areas	15,900	8,010	162,574,006	346,628,174	1,737,060	5,089,260	3,982,649	1,387,498	1,337,905
Canada	1,861	971	25,847,248	34,122,925	-22,775	268,064	168,001	74,807	71,930
Latin America, total	2,696	1,046	6,279,184	16,920,549	76,853	204,725	106,156	35,746	34,422
Mexico	720	350	687,821	2,593,954	30,452	42,300	*20,199	*6,351	*5,971
Central America	385	*74	677,759	1,338,322	-13,020	*24,356	*20,684	*6,808	*6,808
Caribbean, total	902	*42	4,155,648	9,848,051	20,816	*87,614	*51,061	*18,204	*17,500
Netherlands Antilles	509	*37	3,935,737	9,605,405	27,947	*84,953	*48,403	*17,301	*16,624
South America	690	579	757,956	3,140,221	38,604	50,454	14,212	4,382	4,142
Other Western Hemisphere	*299	*281	*2,187,282	*3,392,881	*-82,207	*29,262	*2,054	*1,398	*1,398
Europe, total	5,142	2,783	56,298,195	116,417,253	454,031	2,022,207	1,625,416	562,764	534,070
European Economic Community, total	4,184	2,372	48,457,195	102,881,069	245,983	1,648,005	1,313,729	457,111	432,846
France	783	247	7,454,370	17,587,262	177,096	364,022	333,041	113,346	111,903
Netherlands	274	238	6,672,990	18,179,145	-48,390	249,776	191,131	65,022	48,863
United Kingdom	1,079	665	14,840,683	23,952,340	56,177	346,352	269,905	93,167	91,378
West Germany	1,410	770	15,019,484	30,729,196	-137,579	357,688	251,420	94,775	93,176
Sweden	45	28	2,165,788	4,478,968	107,812	122,493	91,175	31,357	28,818
Switzerland	720	241	4,061,399	6,212,296	136,415	211,622	190,561	64,464	63,129
Africa	*96	*50	*184,838	*434,716	*3,647	*3,650	*1,359	*402	*402
Asia, total	4,086	1,893	69,874,742	170,822,130	1,270,202	2,480,941	2,009,117	692,954	676,414
Japan	2,645	1,177	63,479,748	157,998,769	1,350,928	2,380,896	1,946,733	673,233	656,978
Oceania, total	87	*59	963,124	1,554,099	1,284	*12,947	*7,089	*2,030	*1,967
Australia	*63	*38	*593,422	*1,002,925	*-2,713	*5,939	*5,287	*1,544	*1,481
Puerto Rico and U.S. Possessions	*173	–	*15,154	*37,254	*11,250	–	–	–	–
Country not stated	1,459	927	924,240	2,926,367	47,274	67,464	63,458	17,398	17,304
FINANCE, INSURANCE, AND REAL ESTATE									
All geographic areas	15,401	5,095	507,971,764	80,928,267	925,616	4,670,428	3,217,325	1,108,138	975,290
Canada	3,317	1,045	45,772,280	8,666,498	313,327	713,859	405,876	141,437	117,202
Latin America, total	3,321	982	15,636,193	2,666,555	-272,712	294,101	186,559	63,125	32,901
Mexico	532	*17	1,129,905	116,723	-53,116	*10,086	*1,058	*377	*377
Central America	672	288	1,649,497	260,301	-37,046	33,707	*18,341	*5,797	*5,730
Caribbean, total	1,660	600	10,725,365	2,033,697	-130,353	237,274	158,310	54,246	24,593
Netherlands Antilles	1,067	217	7,759,444	1,640,208	-57,687	196,942	142,620	49,413	19,768
South America	457	78	2,131,427	255,834	-52,197	13,034	8,851	2,705	2,201
Other Western Hemisphere	125	33	2,820,518	1,070,083	-41,362	28,656	*22,281	*7,588	*7,426
Europe, total	4,674	1,728	244,339,361	45,433,125	967,825	2,539,910	1,805,019	618,073	554,748
European Economic Community, total	3,852	1,307	217,547,814	39,316,174	983,510	2,288,383	1,683,636	575,139	517,600
France	178	112	24,816,698	3,086,002	85,716	147,287	117,965	41,165	21,990
Netherlands	1,045	488	40,484,691	10,930,884	175,581	503,262	342,620	109,909	108,480
United Kingdom	1,872	475	118,210,402	18,929,221	641,446	1,346,413	1,071,157	370,062	341,400
West Germany	442	56	19,525,527	4,998,339	59,590	220,694	97,154	34,158	26,455
Sweden	74	28	5,900,008	1,222,993	-29,608	49,970	24,887	8,543	7,946
Switzerland	543	319	14,169,994	3,920,793	28,325	181,933	79,813	28,469	23,895
Africa	*532	*63	*248,906	*16,418	*-3,651	*2,587	*767	*216	*216
Asia, total	2,367	1,014	191,968,355	20,474,645	-7,528	990,255	755,229	262,336	247,685
Japan	1,099	408	145,690,173	15,365,598	179,127	872,692	649,285	226,201	215,408
Oceania, total	326	23	5,701,657	1,750,294	-9,273	34,093	19,014	7,225	6,975
Australia	308	20	4,908,016	682,935	8,555	29,046	*16,405	6,089	6,033
Puerto Rico and U.S. Possessions	2/	2/	2/	2/	2/	2/	2/	2/	2/
Country not stated	737	*206	1,386,995	840,257	-31,402	*56,575	*20,163	7,315	7,315

* Estimate should be used with caution because of the small number of sample returns on which it is based.

1/ Selected industries include manufacturing; wholesale and retail trade; and finance, insurance, and real estate; which together accounted for 91 and 93 percent of total assets and receipts, respectively, for domestic corporations controlled by foreign persons. Industries comprising the remainder include: agriculture, forestry, and fishing; mining; construction; transportation and public utilities; services; and nature of business not allocable. These are not shown separately. Selected geographic areas are based on the location of the owner's country of residence, incorporation, organization, creation, or administration.

2/ Data suppressed to avoid disclosure of information for specific corporations.