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Highlights

Highlights of GAO-08-950, a report to the Committee on Finance, U.S. Senate

U.S. MULTINATIONAL CORPORATIONS

Effective Tax Rates Are Correlated with Where Income Is Reported

Why GAO Did This Study

U.S. and foreign tax regimes influence decisions of U.S. multinational corporations (MNC) regarding how much to invest and how many workers to employ in particular activities and in particular locations. Tax rules also influence where corporations report earning income for tax purposes.

The average effective tax rate, which equals the amount of income taxes a business pays divided by its pretax net income (measured according to accounting rules, not tax rules), is a useful measure of actual tax burdens.

In response to a request from U.S. Senate Committee on Finance, this report provides information on the average effective tax rates that U.S.-based businesses pay on their domestic and foreign-source income and trends in the location of worldwide activity of U.S.-based businesses.

GAO analyzed Internal Revenue Service (IRS) data on corporate taxpayers, including new data for 2004 and Bureau of Economic Analysis data on the domestic and foreign operations of U.S. MNCs. Data limitations are noted where relevant.

GAO is not making any recommendations in this report.

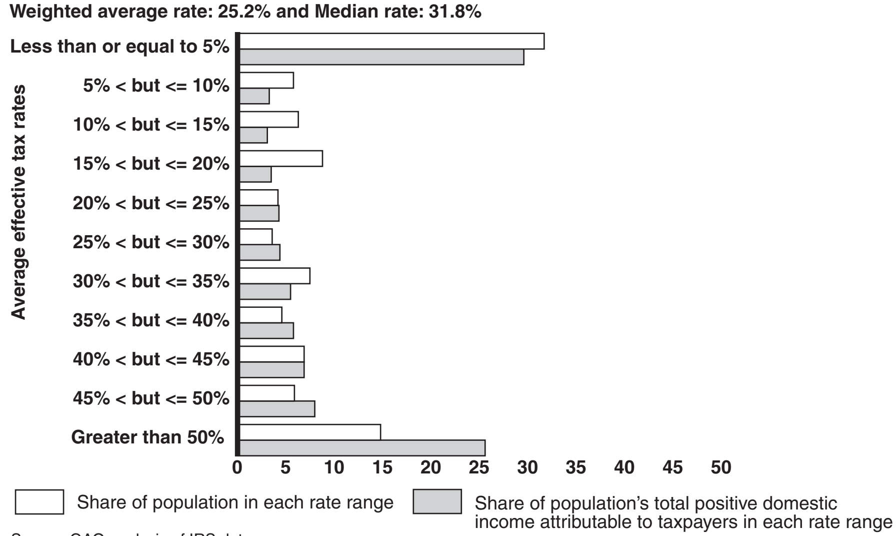
To view the full product, including the scope and methodology, click on GAO-08-950. For more information, contact James White at (202) 512-9110 or whitej@gao.gov.

What GAO Found

The average U.S. effective tax rate on the domestic income of large corporations with positive domestic income in 2004 was an estimated 25.2 percent. There was considerable variation in tax rates across these taxpayers, as shown in the figure below. The average U.S. effective tax rate on the foreign-source income of these large corporations was around 4 percent, reflecting the effects of both the foreign tax credit and tax deferral on this type of income. Effective tax rates on the foreign operations of U.S. MNCs vary considerably by country. According to estimates for 2004, Bermuda, Ireland, Singapore, Switzerland, the United Kingdom (UK) Caribbean Islands, and China had relatively low rates among countries that hosted significant shares of U.S. business activity, while Italy, Japan, Germany, Brazil, and Mexico had relatively high rates.

U.S. business activity (measured by sales, value added, employment, compensation, physical assets, and net income) increased in absolute terms both domestically and abroad from 1989 through 2004, but the relative share of activity that was based in foreign affiliates increased. Nevertheless, as of 2004, over 60 percent of the activity (by all six measures) of U.S. MNCs remained located in the United States. The U.K., Canada, and Germany are the leading foreign locations of U.S. businesses by all measures except income. Reporting of the geographic sources of income is susceptible to manipulation for tax planning purposes and appears to be influenced by differences in tax rates across countries. Most of the countries studied with relatively low effective tax rates have income shares significantly larger than their shares of the business measures least likely to be affected by income shifting practices: physical assets, compensation, and employment. The opposite relationship holds for most of the high tax countries studied.

U.S. Average Effective Tax Rates on U.S. Corporations' Domestic Income, 2004
Weighted average rate: 25.2% and Median rate: 31.8%



Source: GAO analysis of IRS data.