

# Transactions Between Large Foreign-Owned Domestic Corporations and Related-Foreign Persons, 1994

*Data Release*

Statistics of Income studies of the transactions between large “foreign-owned” domestic corporations and related foreign persons, conducted annually beginning with Tax Year 1988, reflect the substantial and increasing interest in direct foreign investment in the United States. For Tax Year 1994, large “foreign-owned” domestic corporations reported amounts received of \$112.3 billion and payments of \$220.0 billion in transactions with 8,540 “related foreign persons.” These 444 large domestic corporations (in general, with total receipts of \$500 million or more) also reported outstanding balances at the end of the accounting periods of \$87.9 billion in loans received from, and \$28.4 billion in loans granted to, the same “related foreign persons.”

## Amounts Received From and Amounts Paid to Related Foreign Persons

Sales and purchases of stock in trade accounted for the majority of the total amounts received from, and total payments to, 8,540 related foreign persons (defined in the Explanation of Selected Terms) (Table 1). Large foreign-owned domestic corporations sold \$69.4 billion and purchased \$177.9 billion of stock in trade in Tax Year 1994, nearly 62 percent and 81 percent of the total amounts received and the total amounts paid, respectively. Foreign-owned domestic manufacturers reported transactions with the largest number of related persons (5,592 persons or 65.5 percent of the total) with \$18.5 billion (16.5 percent) in receipts and \$54.2 billion (24.6 percent) in payments. Corporations classified in the wholesale and retail trade industrial division, however, reported the largest dollar volume of transactions. Transactions reported by foreign-owned domestic wholesalers and retailers accounted for \$32.9 billion in receipts (29.3 percent) and \$109.2 billion in payments (49.6 percent). Foreign-owned domestic corporations classified in the finance, insurance, and real estate industrial division reported transactions of \$54.1 billion in receipts (48.2 percent) and \$52.0 billion in payments (23.6 percent) for 1994.

## Major Industrial Divisions of Foreign-Owned Domestic Corporations

The predominance of foreign-owned manufacturers, wholesalers, retailers, and financial entities on the statistics can be demonstrated in another way. Over 76

percent of these 444 large foreign-owned domestic corporations were classified in the manufacturing (43.5 percent) or wholesale and retail trade (32.7 percent) industrial divisions. Corporations in the finance, insurance, and real estate industrial division accounted for an additional 13.3 percent. The remaining returns by industrial division totaling 10.6 percent were divided, in order, among: services, mining, transportation and public utilities, and construction [1] (Figure A) (Table 1).

## Country of Residence of the Related Foreign Persons

Over 53 percent of the related foreign persons were “residents” (see the Explanation of Selected Terms) of one of the following eight countries: Australia, Canada, France, Germany, Japan, the Netherlands, Switzerland, and the United Kingdom. The transactions with related foreign persons in these eight countries of residence accounted for 81.5 percent of the total amount paid and 81.4 percent of the total amount received for Tax Year 1994 (Table 2). Transactions from related foreign persons resident in Japan, the largest single source of both amounts received and amounts paid, accounted for \$96.5 billion (43.8 percent) and \$40.8 billion (36.3 percent) of the totals, respectively.

Transactions with related foreign persons resident in Switzerland, the second largest single source of both amounts received and amounts paid, accounted for \$30.3 billion (13.8 percent) and \$25.8 billion (22.9 percent), respectively. Nearly all of these transactions were reported by companies classified in the finance, insurance, and real estate industrial division. Transactions with related foreign persons resident in the United Kingdom, Canada, Germany, France, the Netherlands, and Australia, in that order, accounted for an additional 21.8 percent of amounts received. Transactions with related foreign persons resident in the United Kingdom, Germany, Canada, France, the Netherlands, and Australia, in that order, accounted for an additional 23.6 percent of amounts paid (Table 3).

## Amounts Borrowed from and Loaned to Related Foreign Persons

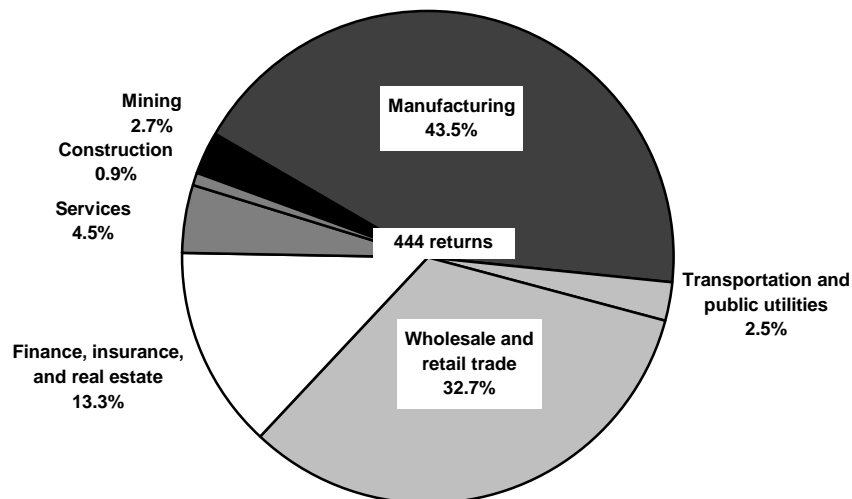
Based on their year-end balances, foreign-owned domestic corporations reported they owed \$87.9 billion in loans from related foreign persons, compared with \$70.9 billion at the beginning of the year. The increase between the opening and closing balances does not include short-term loans borrowed after the year began and paid off before the year ended, which would, therefore, not be reflected in

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Figure A

### Foreign-Owned Domestic Corporations with Total Receipts of \$500 Million or More and with Form 5472 Attached: Number of Returns, by Industrial Division, Tax Year 1994



NOTES: Detail may not add to total because of rounding.

either the beginning or ending balance (transactions *during* the year did not have to be reported). Several companies were also included in Tax Year 1994 statistics for the first time, thus contributing to differences between closing amount statistics presented for 1993 and opening amounts reported for 1994. Moreover, discrepancies in beginning and ending balances may also be due to specific companies varying their reported transactions from year to year.

In comparison to the beginning and ending balances for loans paid, \$28.4 billion and \$26.4 billion at the beginning of the year, loans received were nearly three times higher, although, here again, “new” loans made and paid off *during* the year are not reflected in the data. Transactions reflected in the interest received and interest paid balances reflect the same difference in the magnitude of loans borrowed versus loans paid, with the year-end balance for interest paid to related foreign persons (\$6.2 billion) far exceeding the year-end balance for interest received (\$1.1 billion). The number of domestic corporations and foreign persons associated with these transactions was not tabulated. In theory, a comparison can be made between the difference between the opening and closing interest transaction balances and the interest income and expenses of the domestic corporation. However, the income and expense data of the foreign-owned domestic corporation

would also include interest received or paid on transactions with entities other than related foreign persons. Moreover, other foreign-owned domestic corporations had no interest transactions with related foreign persons.

Transactions with related foreign persons resident in the United Kingdom accounted for the largest single amount of outstanding borrowing activity by foreign-controlled domestic corporations as of the end of their 1994 accounting periods, \$23.6 billion in amounts borrowed, 26.8 percent of the total. Amounts borrowed from persons resident in the Netherlands ranked a distant second, with \$14.9 billion or 16.9 percent of the total, followed by large but lesser amounts reported as loaned from persons resident in Germany, France, and Switzerland, in that order. Together, persons resident in these three countries accounted for \$24.8 billion or 56.3 percent of the total. On the lending side, of the total amount domestic corporations loaned to related foreign persons, persons resident in the United Kingdom also borrowed the most, as indicated by their year-end balances, with \$6.5 billion or 22.9 percent of the total. Foreign persons resident in Switzerland, France, and Japan, in that order, also accounted for large proportions of the residual \$28.4 billion year-end balance. The combined total for persons resident in these three countries was \$22.8 billion, 41.6 percent of the total.

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Figure B

## Foreign-Owned Domestic Corporations with Total Receipts of \$500 Million or More and with Form 5472 Attached: Selected Items for Tax Years 1991 through 1994 <sup>1</sup>

[Money amounts are in billions of dollars]

Item	1991	1992	1993	1994
	(1)	(2)	(3)	(4)
<b>Foreign-owned domestic corporations with total receipts of \$500 million or more and with Form 5472 attached <sup>1</sup></b>				
Number of returns.....	344	366	437	444
Total assets.....	1,181.3	1,317.3	1,540.5	1,681.6
Total receipts.....	761.0	808.0	871.4	944.6
Income subject to U.S. tax.....	13.7	14.5	15.7	18.5
Total U.S. income tax after credits.....	3.7	4.1	4.9	5.8
<b>Transactions between foreign-owned domestic corporations and related foreign persons <sup>1</sup></b>				
Number of related foreign persons.....	5,807	6,708	7,662	8,540
Amounts received from related foreign persons:				
Total (excluding loan balances) <sup>2</sup> .....	60.5	63.1	77.1	112.3
Sales of stock in trade.....	46.9	49.0	53.1	69.4
Sales of other tangible property.....	0.8	0.7	0.5	1.1
Consideration received for services.....	3.1	3.0	3.1	3.6
Interest received.....	1.6	1.1	1.1	1.1
Premiums received for insurance or reinsurance.....	1.3	2.8	1.4	0.7
Amounts borrowed, ending balance.....	63.5	67.9	88.6	87.9
Amounts paid to related foreign persons:				
Total (excluding loan balances) <sup>2</sup> .....	134.0	139.2	185.3	220.0
Purchases of stock in trade.....	114.4	120.8	153.4	177.9
Purchases of other tangible property.....	4.8	2.6	3.9	2.7
Consideration paid for services.....	2.1	2.1	2.5	3.4
Interest paid.....	6.5	5.4	5.7	6.2
Premiums paid for insurance or reinsurance.....	2.7	3.1	1.7	1.8
Amounts loaned, ending balance.....	18.8	19.2	24.0	28.4

<sup>1</sup> Includes data for a few foreign life insurance companies filing Form 1120L. See footnote 7 at the end of this data release.

<sup>2</sup> Includes items not shown separately.

NOTE: Detail may not add to totals because of rounding.

### A Comparison of Tax Year 1991, 1992, 1993, and 1994 Statistics

Figure B presents selected data for large foreign-owned domestic corporations filing Forms 5472 for Tax Years 1991 through 1994 [2]. The number of related foreign persons reported increased by 15.5 percent from 1991 to 1992, by 14.2 percent from 1992 to 1993, and by 11.5 percent from 1993 to 1994. Other trends in the data are not as uniform, however. For example, the number of large domestic corporations reporting transactions with related foreign persons increased by 6.4 percent from 1991 to 1992, by 19.4 percent from 1992 to 1993, and by 1.6 percent from 1993 to 1994. (See the Data Sources and Limitations section of this data release for additional

information.)

Total amounts foreign-owned domestic corporations received from, and total amounts paid to, related foreign persons increased by 4.3 and 3.9 percents, respectively, from 1991 to 1992. However, from 1992 to 1993, total amounts received from, and total payments made to, related foreign persons increased by 22.2 and 33.1 percents, respectively. From 1993 to 1994, total amounts received from, and payments made to, related foreign persons increased by 45.6 and 18.7 percents, respectively.

Total amounts borrowed by, and total amounts loaned to, foreign-owned domestic corporations from related foreign persons increased by 6.9 percent and 2.1 percent, respectively, from 1991 to 1992, and by 30.5 percent and 25.0 percent, respectively, from 1992 to 1993. However, from 1993 to 1994, while amounts loaned by foreign-owned domestic corporations to related foreign persons increased 18.3 percent, the year-end balance for total amounts borrowed by these corporations declined by .8 percent. From 1991 to 1992, the interest paid balance by foreign-owned domestic corporations to related foreign persons decreased by 16.9 percent, despite an increase in borrowing activity for the period. From 1992 to 1993, the interest paid balance increased by 5.6 percent. However, from 1993 to 1994, despite a slight decrease in borrowing activity from the previous period, interest paid amounts increased by 8.8 percent.

Caveats to these year-to-year data are necessary. Patterns of transactions between a foreign-owned domestic corporation and related persons may or may not recur on an annual (or even longer) basis. Consequently, a 4-year comparison of these data may not show changes that might be evident if a longer time series were available. Additional information about the year-to-year comparability of the data is presented below under Data Sources and Limitations.

### Legislative History

Even before the Tax Equity and Fiscal Responsibility Act of 1992 (TEFRA), U.S. parent corporations were required to report transactions with and between their foreign affiliates [3]. However, no similar reporting requirements existed for transactions between domestic subsidiaries (i.e., those incorporated in the United States) of foreign corporations, or between foreign corporations (i.e., those incorporated abroad) engaged in a U.S. trade or business and their related foreign affiliates. Concerned that these related party transactions could be manipulated to avoid U.S. taxation, Congress added new reporting requirements as part of TEFRA to provide the Internal Revenue Service

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with more information about the nature and amount of these transactions. Under Internal Revenue Code section 6038A, domestic corporations that are 25-percent or more owned by a foreign person, as well as foreign corporations engaged in a U.S. trade or business, have to report transactions with related foreign persons. The transactions are reported on Form 5472, *Information Return of a 25 Percent Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*. Form 5472 had to be filed with corporation income tax returns for tax years beginning after December 31, 1983.

## Data Sources and Limitations

The foreign-owned domestic corporation statistics have been collected annually starting with 1988. The 1994 statistics include data from Forms 5472, in general, for all U.S. corporations with total receipts of \$500 million or more that were owned (25 percent or more) by a foreign person and reported transactions with related foreign persons, which were included in the Statistics of Income sample of U.S. corporation income tax returns with accounting periods ending July 1994 through June 1995 [4].

Once a corporation is selected for inclusion, its income tax return is included in all future Form 5472 studies, even if its total receipts drop in subsequent years below \$500 million [5]. For the 1994 statistics, 33 corporate returns included in the statistics had total receipts of less than \$500 million.

The corporation Statistics of Income sample included over 95,000 income tax returns chosen from over 4.7 million returns filed for Tax Year 1994, i.e., accounting periods ending July 1994 through June 1995. These returns were selected after administrative processing was complete, but before any audit examinations [6]. The domestic corporations with total receipts of \$500 million or more that were part of the Statistics of Income sample were used for the statistics presented in this data release. Foreign corporations (filing Form 1120F) engaged in a U.S. trade or business were, for the most part, not included, even though they may have filed Forms 5472 for transactions with related foreign persons [7].

The corporation income tax returns with total receipts of \$500 million or more for which statistics are presented were included among the returns prescribed for sampling at the 100-percent rate. However, because not all of the returns could be located in time to be included in the sample, some of the returns that *were* included were given a sampling weight of more than “1” to compensate for those missing. This leads to small rounding differences in

the frequency statistics; the sum of the detail for “number of returns” does not equal the totals shown. (The sum of the detail for dollar amounts may not equal the totals, but this is because amounts were rounded to thousands of dollars during statistical processing.)

The statistics in this data release augment the data for some of the companies included in Statistics of Income data for foreign-controlled domestic corporations [8]. These data show that for 1994, the 444 large foreign-owned domestic corporations filing Forms 5472 accounted for less than 1 percent of the returns filed, but 68.5 percent of the \$2.5 trillion in total assets, and 65.8 percent of the \$1.4 trillion in total receipts reported by all domestic corporations that were 25 percent or more foreign-owned. (Figure C).

Figure C

## Foreign-Owned and Other Domestic Corporations, Tax Year 1994 <sup>1</sup>

[Money amounts are in billions of dollars]

Item	25 percent or more foreign-owned domestic corporations		All other domestic corporations
	Total	With total receipts of \$500 million or more and with Form 5472 attached	
	(1)	(2)	(3)
Number of returns.....	58,694	444	4,283,674
Total assets.....	2,455.5	1,681.6	20,990.7
Total receipts.....	1,434.6	944.6	11,925.4
Income subject to			
U.S. tax.....	36.4	18.5	457.6
Total U.S. income tax after credits.....	10.6	5.8	124.9

<sup>1</sup> Includes data for a few foreign life insurance corporations filing Form 1120L. See footnote 7 at the end of this data release.

The industry code used as a classifier of the returns for Figure A and Table 1 represents the principal activity (i.e., the activity that accounted for the largest portion of total receipts as reported in the tax return income statement) 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 that conducted different business activities. To the extent that some consolidated and (non-consolidated) returns were engaged in more than one type of business activity, transaction data in

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this data release are not entirely related to the industrial activity under which they are shown. For example, foreign-owned domestic corporations classified in the manufacturing industrial division often engaged in loan or other financial transactions with related foreign persons.

### Explanation of Selected Terms

*Amounts Borrowed and Loaned.*--Because the beginning and ending balances, in general, reflect only the amounts outstanding at the beginning and end of the year, respectively, these amounts do not equal the actual amounts borrowed and loaned during Tax Year 1994.

*Country of Residence of a Related Person.*--The income tax regulations related to Internal Revenue Code section 6038A require that each country in which each 25-percent shareholder files an income tax return as a resident under the tax laws of that country be reported on Form 5472 for each related foreign person. The statistics in Tables 2 and 3 are based upon this reported residence and, within this meaning, the related foreign person is a "resident" of a particular foreign country.

*Foreign-Owned Domestic Corporations.*--For purposes of these statistics, a domestic corporation was considered foreign-owned if at least 25 percent of the total voting power of all classes of stock permitted to vote, or 25 percent of the total value of all classes of stock of the corporation, was owned, directly or indirectly, at any time in the tax year, by a single foreign shareholder (generally a foreign parent corporation). This is in contrast to the other Statistics of Income data on "foreign-controlled" domestic corporations, which are based on 50-percent or more ownership by a foreign person [9].

*Foreign Person.*--The term "foreign person" generally includes: (1) any partnership, association, company, or corporation that was not created or organized under the laws of the United States or laws of any State; (2) any individual who is not a citizen or resident of the United States; (3) any individual who is a citizen of a U.S. possession, but is not otherwise a U.S. citizen or resident; and (4) any foreign trust, estate, or government. For the most part, the foreign persons referred to in this data release are corporations. See also "Related Foreign Persons" below.

*Number of Foreign Persons.*--The data shown in the tables, in general, represent the number of foreign persons reported on the Forms 5472 appended to the 444 income tax returns filed by domestic corporations with \$500 million or more in total receipts (defined below) that were 25-percent-or-more owned by a foreign person. Domestic member corporations of an affiliated group that filed a consolidated income tax return could also join in filing a

consolidated Form 5472 for transactions with a given related foreign person. However, some affiliated domestic corporations that could have filed consolidated Forms 5472 filed separate forms instead. When these forms were identified during statistical processing, the information on them was combined, and the result treated as a single Form 5472 for consistency. To this extent, the "number of persons" understates the actual number of Forms 5472 attached to the 444 income tax returns included in the statistics.

*OPEC Countries.*--Summary statistics are provided (Table 2) for the following Middle Eastern countries that were members of the Organization of Petroleum Exporting Countries (OPEC) for 1994: Iran, Iraq, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates. Data for non-Middle Eastern OPEC members are not shown by country.

*Related Foreign Person.*--Persons related to the domestic corporation that filed a Form 5472 include the 25-percent-or-more foreign shareholder, any person who was related to the reporting corporation or the 25-percent-or-more shareholder (as described in Internal Revenue Code sections 267(b) or 707(b)), or any other person who was related to the reporting corporation within the meaning of Internal Revenue Code section 482 (covering the allocation of income and deductions among related taxpayers) and the associated income tax regulations. See also "Number of Foreign Persons," above, for the definition of "person."

*Total Receipts.*--Total receipts is the total income of the domestic corporation as reported in the U.S. corporation income tax return. It is derived from the tax return as follows: (1) gross taxable receipts (before deduction of cost of sales and operations, and ordinary and necessary business expenses), plus (2) tax-exempt interest received from State and local Government obligations, less: (1) net losses from sales of property other than capital assets and (2) certain taxable income from related foreign corporations only constructively received.

### Notes and References

- [1] In prior years, data for returns classified in the agriculture, forestry, and fishing industrial division filed were shown separately in the statistics. These returns were generally few in number and were sometimes grouped in a residual "all other" category to avoid disclosure of information about specific taxpayers. For Tax Year 1994, however, there were no returns classified in this industrial division with Forms 5472 attached.

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- [2] The Form 5472 study, beginning with Tax Year 1994, has been conducted biennially. Statistics on foreign-owned domestic corporations for Tax Years 1988 through 1990 covered all foreign-owned corporations with total receipts of \$1 billion or more. Statistics for Tax Years 1991, 1992, 1993, and 1994 covered all foreign-owned U.S. corporations with total receipts of \$500 million or more. Consequently, data for all years are not comparable.
- [3] See also Nutter, Sarah E., "Controlled Foreign Corporations, 1990," *Statistics of Income Bulletin*, Summer 1994, Volume 14, Number 1, and Green, Kathryn A., "Controlled Foreign Corporations, 1993," *Statistics of Income Bulletin*, Winter 1995-1996, Volume 15, Number 3.
- [4] Additional information about SOI Form 5472 studies for Tax Years 1988 through 1993 may be found in the following *Statistics of Income Bulletin* issues: Tax Year 1988, Summer 1992, Volume 12, Number 1; Tax Year 1989, Spring 1993, Volume 12, Number 4; Tax Year 1990, Summer 1994, Volume 14, Number 1; Tax Year 1991, Summer 1995, Volume 15, Number 1; Tax Year 1992, Fall 1996, Volume 16, Number 2; and Tax Year 1993, Fall 1997, Volume 17, Number 2.
- [5] The use of total receipts as a size criterion for including U.S. corporation income tax returns in the statistics may offer a different picture than the use of total assets, for example. This difference may occur because classification of returns by total receipts, rather than by total assets, might lead to the selection of a somewhat different set of large corporations. For example, corporation returns classified in the finance, insurance, and real estate industrial division may not have shown large amounts of total receipts in their income statements, but may have shown large amounts of total assets, when compared with corporation returns classified in the wholesale and retail trade industrial division, which shows just the opposite.
- [6] For more information on the corporate sample and statistics on corporation income tax returns for 1994, see *Statistics of Income--1994, Corporation Income Tax Returns*.
- [7] Foreign corporations (except life insurance companies) engaged in a U.S. trade or business file Form 1120-F. Data reported by a few foreign life insurance companies filing Form 1120-L are also included in the statistics to ensure completeness of the industrial division statistics for domestic corporations.
- [8] Statistics on domestic corporations controlled by foreign persons for 1994 are reported in Hobbs, James R., "Foreign-Controlled Corporations, 1994," *Statistics of Income Bulletin*, Summer 1997, Volume 17, Number 1.
- [9] Hobbs, James R., *op cit*.