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INTERNATIONAL TAXATION

Tax Haven Companies Were More Likely to Have a Tax Cost Advantage in Federal Contracting

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Highlights

Highlights of GAO-04-856, a report to the Chairman, Committee on Governmental Affairs, U.S. Senate

Why GAO Did This Study

The federal government was involved in about 8.6 million contract actions, including new contract awards, worth over $250 billion in fiscal year 2002. Some of these contracts were awarded to tax haven contractors, that is, U.S. subsidiaries of corporate parents located in tax haven countries. Concerns have been raised that these contractors may have an unfair cost advantage when competing for federal contracts because they are better able to lower their U.S. tax liability by shifting income to the tax haven parent.

GAO's objectives in this study were to (1) determine the conditions under which companies with tax haven parents have a tax cost advantage when competing for federal contracts and (2) estimate the number of companies that could have such an advantage. GAO matched federal contractor data with tax and location data for all large corporations, those with at least $10 million in assets, in 2000 and 2001, in order to identify those companies that could have an advantage.

www.gao.gov/cgi-bin/getrpt?GAO-04-856.

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

What GAO Found

There are conditions under which a tax haven contractor may have a tax cost advantage (lower tax on additional income from a contract) when competing for a federal contract. The extent of the advantage depends on the relative tax liabilities of the tax haven contractor and its competitors. One way for a contractor to gain a tax cost advantage is by reducing its U.S. taxable income from other sources to less than zero and by using its losses to offset some or all of the additional income from a contract, resulting in less tax on the contract income. A company would thereby gain an advantage relative to those competitors with positive income from other sources and may be able to offer a lower price or cost for the contract. While some domestic corporations may also have a tax cost advantage, tax haven contractors may be better able to reduce U.S. taxable income to less than zero because of opportunities to shift income to their tax haven parents. Whether a contractor has a tax cost advantage in competing for a particular contract depends on the tax liabilities of other competitors. Also, the contractors with a tax cost advantage are not necessarily the successful competitors because the tax cost savings may not be reflected in actual prices, and prices may be only one of several factors involved in awarding contracts.

Using tax liability as an indicator of ability to offset contract income, GAO found that large tax haven contractors in both 2000 and 2001 were more likely to have a tax cost advantage than large domestic contractors. In 2000, 56 percent of the 39 large tax haven contractors reported no tax liability, while 34 percent of the 3,253 large domestic contractors reported no tax liability. In 2001, 66 percent of large tax haven contractors and 46 percent of large domestic contractors reported no tax liability.

Tax Status of Large Tax Haven and Domestic Contractors in 2000 and 2001

	Contractors with tax liability		Contractors without tax liability	
U.S. federal contractors	Number of companies	Percentage of companies	Number of companies	Percentage of companies
2000				
Tax haven	17	44	22	56
Domestic	2,132	66	1,121	34
2001				
Tax haven	17	34	33	66
Domestic	1,888	54	1,636	46

Source: GAO analysis of IRS data.