Foreign Corporations with Income Effectively Connected with a U.S. Business, 1988

By James R. Hobbs*

For 1988, there were 9,921 "foreign" corporations (i.e., those incorporated abroad) that reported $77.1 billion of receipts generated from activities "effectively connected" with a U.S. trade or business. Overall, these companies reported net income (less deficit) of only $2.6 million from these activities. However, this was the first time in recent years that this amount was not a net loss. Only 3,557 of these companies reported a profit, totaling $2.7 billion. The remaining companies reported a combined deficit of also $2.7 billion.

The profitable companies reported taxable (net) income based on effectively connected activities of $2.0 billion. This resulted in $669 million of tax before the reduction by credits, which totaled $25 million.

FOREIGN OPERATIONS IN THE UNITED STATES

Foreign "persons" can establish business operations in the United States through several forms, including corporations, partnerships, and even joint ventures. In regard to corporations, foreigners can either gain control of an existing U.S. company, create a new U.S. company, or operate in the United States as a branch of a foreign company. This article focuses on the latter [1].

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 [2]. The U.S. tax structure is one of these factors and it is discussed next in this article for foreign corporations operating in the United States.

U.S. TAXATION

Foreign corporations are those that are incorporated abroad. Thus, they are not created or organized in the United States, or under the laws of the United States or any of its States. These corporations are, however, subject to U.S. income tax on income "effectively connected" with the conduct of a U.S. trade or business, as well as on income from U.S. sources that is not effectively connected. There are two methods of taxation that apply, depending on whether or not the income is considered to be effectively connected with a trade or business in the United States [3].

Foreign corporations are taxed on income effectively connected with a U.S. trade or business in a manner similar to that used to tax the income of domestic corporations. This tax is referred to as "Section II" tax on Form 1120F, *U.S. Income Tax Return of a Foreign Corporation.* To determine the taxable income, gross income that is effectively connected with a U.S. trade or business is reduced by allowable deductions to the extent that such deductions are related to this income [4]. The same tax method, tax rates, and credits used to reduce tax liability are available to both foreign and domestic corporations.

The Tax Reform Act of 1986 changed the regular corporate tax rates, effective July 1, 1987 [5]. For the period beginning on this date and continuing thereafter, the rates are shown below [6].

Taxable income	Tax rate
$50,000 or less	15%
$50,001 to $75,000	25%
Over $75,000	34%

If a corporation's taxable income exceeds $100,000, then the corporation is liable for an additional tax equal to the lesser of (a) 5 percent of the taxable income over $100,000, or (b) $11,750.

The 1986 Act also repealed the alternative tax on capital gains beginning July 1, 1987. Previously, companies with net long-term capital gains could use an alternative method of tax computation if it produced a lower amount of tax than under the regular method. Under the alternative method, net long-term capital gains were taxed separately at a rate of 28 percent (34 percent for the period January 1, 1987, to July 1, 1987). The remainder of taxable income was then taxed at the regular rates.

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Under the 1986 Act, corporate long-term capital gains are taxed as ordinary income; there is no alternative tax computation for capital gains.

The 1986 Act replaced the former minimum tax with an alternative minimum tax (AMT). While, in general, the AMT was imposed on a broader income tax base compared to the minimum tax, capital gains of corporations were not included in the base for the AMT, even though they had been for the previous minimum tax. The AMT became effective for tax years beginning after December 31, 1986. Statistics for this tax are shown in Tables 1 and 2.

Credits could be used to reduce the "Section II" tax. For Tax Year 1988, these credits totalled $25 million. The foreign tax credit accounted for 87 percent of this total. Foreign corporations could also claim a general business credit, an orphan drug credit, a credit for prior-year minimum tax and a credit for fuel produced from a nonconventional source.

Fixed or determinable annual or periodic income from U.S. sources, such as interest, dividends, rents, royalties, annuities and certain gains (such as from the sale or exchange of patents and copyrights) may or may not be effectively connected income [7]. This is determined on the basis of whether the income is from assets used in the conduct of a U.S. trade or business and whether the activities of the U.S. trade or business are a principal factor in producing the income.

A foreign corporation that disposes of U.S. real property interests must treat the gain or loss as effectively connected income, even if the corporation is not otherwise engaged in a U.S. trade or business. In addition, a foreign corporation can elect to treat certain income from U.S. real property as effectively connected income, even if it otherwise would not be considered as this type of income. Included are certain gross rents, royalties and gains. This election permits the corporation to apply deductions against this gross income. For 1988, 63 percent of foreign corporations with U.S. effectively connected income were classified as real estate companies. These are discussed in more detail later in this article.

Certain types of foreign-source income were also considered to be U.S. effectively connected income. For instance, interest received by a foreign bank from sources outside the United States was treated as effectively connected with the conduct of a U.S. trade or business if the bank had an office in the United States to which the income was attributable and if the interest was derived from banking activities in the United States. Because foreign income taxes were imposed on such interest, banks accounted for all of the total foreign tax credit claimed by foreign corporations with U.S. effectively connected income for 1988.

As mentioned previously, foreign corporations were also taxed on U.S.-source income that was not effectively connected with the conduct of a U.S. trade or business. (This tax is referred to as "Section I" tax on Form 1120F.) This income included certain amounts of investment income, such as interest, dividends, rents, royalties, annuities and gains from the sale or exchange of certain property (such as patents, copyrights, timber and coal). Gross income in these categories was taxed at a rate of 30 percent, unless the rate had been reduced as the result of a tax treaty between the United States and the foreign company's country of incorporation [8, 9].

Basically, then, a foreign corporation's total U.S. tax is the sum of (1) the tax on income effectively connected with the conduct of a U.S. trade or business ("Section II" tax) and (2) the tax on U.S.-source income that was not effectively connected ("Section I" tax). Both of these taxes are shown in Tables 1 and 2. Total tax could also include (1) branch profits and branch-level interest taxes (described below), (2) an alternative minimum tax, (3) an environmental tax, (4) a Personal Holding Company tax, (5) a tax from recapturing prior-year investment credits, and (6) a tax from recapturing prior-year low-income housing credits. Tables 1 and 2 also contain data for the first three of these taxes, for which the amounts for 1988 were significant.

For tax years beginning after 1986, the U.S. branch of a foreign corporation could be subject to a 30-percent tax on amounts considered to be a "dividend equivalent" and on certain "excess interest" deductions used in calculating effectively connected taxable income. Dividend equivalent is the branch's effectively connected earnings and profits for the year, reduced (or increased) by the amount of increase (or decrease) in the branch's U.S. net equity position during the tax year. Section 884 of the Internal Revenue Code specifies the branch profits and branch-level interest taxes. These taxes were subject to modification or elimination by tax treaties.

Under the Superfund Amendments and Reauthorization Act of 1986, corporations were subject to an environmental tax. This tax was based on a modified alternative minimum taxable income of the corporation in excess of $2 million. The amount of the excess income was subject to a 0.12 percent rate of tax. For 1988, foreign corporations reported $2.9 million for the environmental tax.

This article focuses only on data for the 9,921 foreign corporations which had income effectively connected with a U.S. trade or business for 1988. Foreign corporations with only U.S.-source investment income (i.e., income not effectively connected with a U.S. trade or business) are excluded.

GROWTH OF FOREIGN CORPORATIONS

The activity of foreign corporations in the United States has grown at a rapid pace. Total receipts of these corporations from activities effectively connected with a U.S. trade or business grew from $21 billion for 1983 to $77 billion for 1988, a 271 percent increase, using current dollars. This growth rate was notably higher than the 44 percent increase for all U.S. corporation income tax returns; 1983 and 1988 receipts were $7.1 and $10.3 trillion, respectively (see Figure A). It should be noted that total receipts for domestic corporations includes income from both domestic and foreign activities. Generally, it also includes investment-type income, such as interest and dividends not directly connected with a business activity. The amount of U.S. source, business-related income of domestic corporations for 1983 and 1988 was not separately reported on the corporation income tax return and, thus, not available for comparison to the U.S. effectively connected income of foreign corporations.

Figure A.--Foreign Corporations with Income Effectively Connected with a U.S. Business Compared with All Corporations, 1983-1988

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

Tax year and item	All corporation income tax returns	Returns of foreign corporations with U.S. effectively connected income
1988		
Number of returns	3,562,789	9,921
Total receipts	$10,264,867	$77,121
Net income (less deficit)	412,983	3
U.S. income subject to tax	383,202	1,995
Income tax after credits	91,428	644
1987		
Number of returns	3,612,133	10,478
Total receipts	$9,580,721	$61,004
Net income (less deficit)	328,224	-162
U.S. income subject to tax	311,841	1,647
Income tax after credits	83,577	589
1986		
Number of returns	3,428,515	11,342
Total receipts	$8,669,379	$43,626
Net income (less deficit)	269,530	-139
U.S. income subject to tax	276,173	1,818
Income tax after credits	71,509	557
1985		
Number of returns	3,277,219	11,693
Total receipts	$8,398,278	$50,909
Net income (less deficit)	240,119	-1,487
U.S. income subject to tax	266,061	1,025
Income tax after credits	61,114	339
1984		
Number of returns	3,170,743	10,905
Total receipts	$7,800,711	$43,656
Net income (less deficit)	232,901	-1,513
U.S. income subject to tax	257,054	902
Income tax after credits	62,035	301
1983		
Number of returns	2,999,071	8,001
Total receipts	$7,135,494	$20,794
Net income (less deficit)	188,314	-1,118
U.S. income subject to tax	218,686	469
Income tax after credits	50,106	136

As a result of the growth rate of foreign corporations with U.S. effectively connected income, their share of the receipts reported on all corporate returns increased from 0.29 percent for 1983 to 0.75 percent for 1988. While these aggregate percentages are small, foreign corporations accounted for substantially larger portions of the receipts reported for specific industries, particularly banking. This is discussed in the next section of this article.

INDUSTRY CHARACTERISTICS

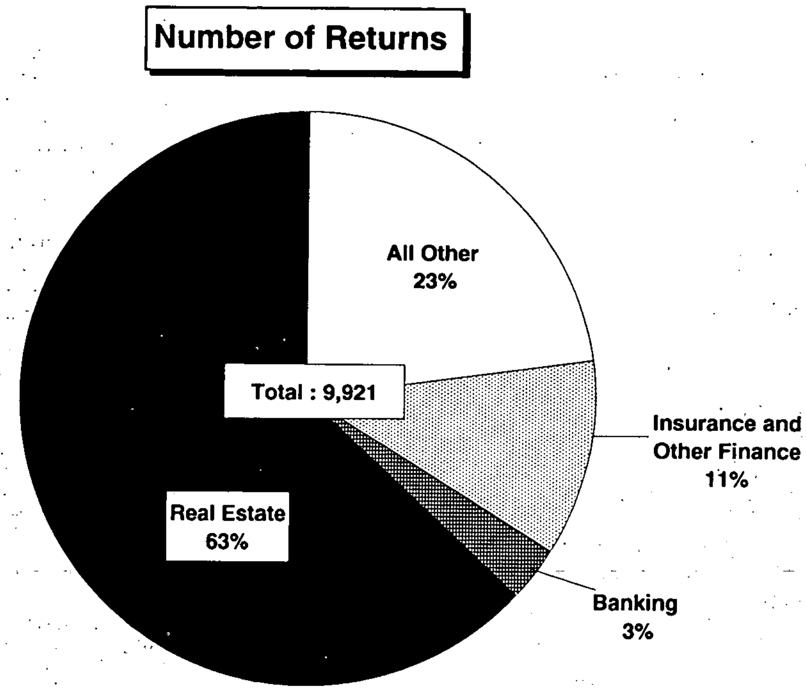
As can be seen in Figure B, the finance, insurance and real estate industrial division accounted for most of the business activity in the United States by foreign corporations. In fact, for 1988, this division accounted for 77 percent of the returns filed and 83 percent of the total receipts resulting from trade or business effectively connected with a U.S. activity.

The 6,245 foreign corporations involved in real estate (63 percent of the total) generated only $1.9 billion (or 2 percent) of total receipts. This was an average of just $308,000 per company. As a group, foreign real estate companies reported a net deficit of $274 million for 1988. For every company that reported a profit (i.e., net income for tax purposes), two others reported a loss (see Figure C).

Foreign banks in the United States reported receipts of $51.2 billion, or 66 percent of the total U.S. effectively connected income. Foreign countries with the most U.S. effectively connected banking income were: Japan ($25.8 billion), West Germany ($5.9 billion), Canada ($4.2 billion), Italy ($2.7 billion), France ($2.4 billion), United Kingdom ($2.1 billion) and Switzerland ($1.6 billion). Nearly all ($46.8 billion) of the banking income was interest. Only 272 banks, 3 percent of all the foreign companies, generated these receipts for 1988.

Figure B

Foreign Corporations with Income Effectively Connected with a U.S. Business, by Industry, 1988



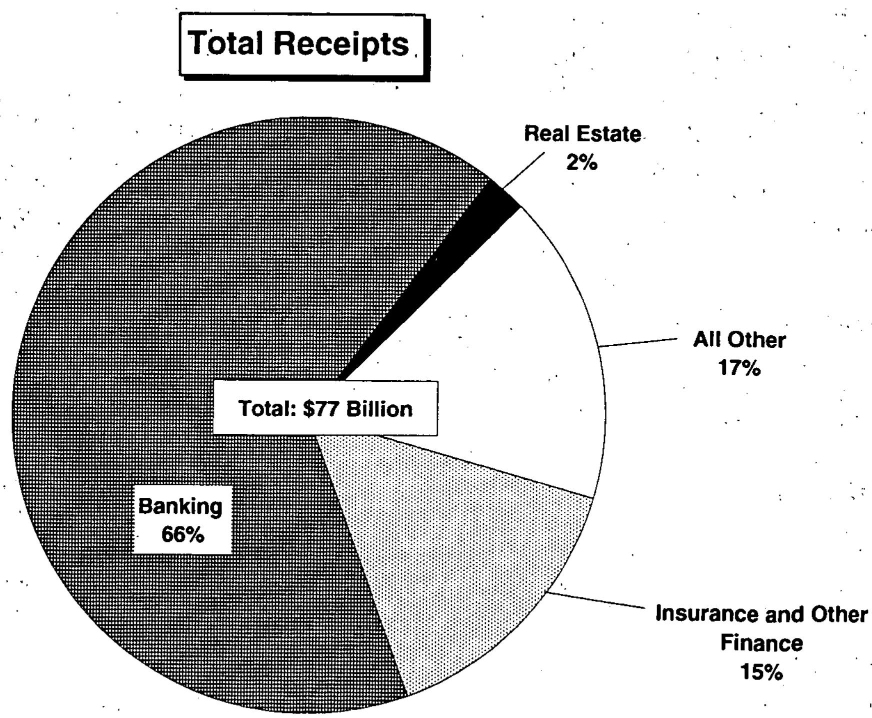


Figure C.--Foreign Real Estate Companies with Income Effectively Connected with a U.S. Business, 1987 and 1988

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

Item	1988	1987
Number of returns, total	6,245	6,367
With net income	2,072	1,862
Percentage	33.2%	29.2%
Total receipts	$1,925	$1,534
Total deductions	2,193	1,856
Net income (less deficit)	-274	-332
Net income	351	238
Deficit	626	570
U.S. income subject to tax	183	124
Income tax:		
Before credits	56	42
After credits	56	41
Income tax after credits as a percentage of total receipts	2.9%	2.7%

The $51.2 billion in receipts resulting from U.S. effectively connected business operations represented 12 percent of the worldwide receipts ($442.2 billion) reported on all U.S. corporation income tax returns with banking as the principal business activity. (Refer back to the U.S. Taxation section of this article for a discussion of foreign-source interest received by foreign banks which is considered to be U.S. effectively connected income.)

Figure D compares foreign banks to all banks that filed U.S. income tax returns for 1988. The receipts reported by foreign banks are those effectively connected with a U.S. business, while receipts reported on all U.S. income tax returns of banks represent worldwide activities. Despite this difference, foreign banks tended to be larger, as measured by total receipts, than U.S. banks. The 272 foreign banks averaged $188 million of receipts from U.S. effectively connected activities, while the 11,398 U.S. banks averaged just $34 million of receipts from worldwide activities.

Substantially fewer foreign banks reported profits than did all of the banks, 40 percent compared to 73 percent. However, the 110 profitable foreign banks averaged $15.1 million of net income, while the 8,512 total profitable banks averaged only $2.9 million of net income. The ratios of U.S. income tax before credits to total receipts were 1.0 percent for foreign banks, compared to 1.7 percent for all of the banks. After credits, the difference in the ratios of tax to receipts narrowed to 1.0 percent versus 1.3 percent. The foreign tax credit was the largest credit claimed by banks.

The wholesale and retail trade industrial division was second to finance, insurance and real estate in total receipts, although it accounted for only 10 percent (or

Figure D.--Foreign Banks with Income Effectively Connected with a U.S. Business Compared with All Banks that Filed U.S. Income Tax Returns, 1988

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

Item	All corporation income tax returns of banks	Returns of foreign banks with U.S. effectively connected income
Number of returns, total	11,670	272
With net income	8,512	110
Percentage	72.9%	40.4%
Total receipts	$442,156	$51,173
Interest	346,465	46,778
Total deductions	419,652	50,402
Interest paid	249,826	41,896
Net income (less deficit)	15,007	764
Net income	24,697	1,656
Deficit	9,690	891
U.S. income subject to tax	22,249	1,509
Income tax before credits	7,538	513
Total credits	1,685	22
Foreign tax credit	1,318	21
Income tax after credits	5,853	491
Income tax before credits as a percentage of total receipts	1.7%	1.0%
Income tax after credits as a percentage of total receipts	1.3	1.0

$7.8 billion) of the total receipts of all foreign corporations (see Table 1). The corresponding percentage for the finance, insurance and real estate group was 83.

COUNTRY CHARACTERISTICS

Over 71 percent of the 9,921 foreign corporations which reported income effectively connected with a U.S. trade or business for 1988 were incorporated in the following seven countries: Canada, Japan, Netherlands, Netherlands Antilles, Switzerland, United Kingdom and West Germany (see Table 2). These 7,074 companies also accounted for 82 percent of the effectively connected receipts of all foreign corporations operating a U.S. trade or business.

The Netherlands Antilles had the largest number of foreign-incorporated U.S. businesses, 3,451, or nearly 35 percent of the total for 1988. However, this was a substantial decrease from the 4,375 Antilles corporations for 1987. This decrease may be related to the partial termination of the United States-Netherlands Antilles treaty which began in January 1988.

The 3,451 Antilles corporations accounted for only 2 percent of the 1988 effectively connected receipts of all foreign corporations. This coincided with the fact that 2,811 of these corporations were principally involved in real estate activities and produced only $774 million of receipts. (Once again, these numbers represent decreases from 1987; for that year, 3,422 real estate corporations produced $870 million of receipts.) As previously noted, foreign corporations involved in U.S. real estate activities tended to report relatively small amounts of receipts, as compared to those engaged in other business activities.

Japanese corporations reported the largest amount ($26.9 billion) of U.S. effectively connected receipts for 1988. This was an increase of more than 26 percent from 1987. The majority of the receipts were produced by banks. In fact, U.S. branches of 36 Japanese banks produced $25.8 billion of U.S. effectively connected receipts, one-third of the total for 1988. In addition, these receipts accounted for 96 percent of the receipts of the 598 Japanese-incorporated businesses operating in the United States.

Twenty-one of these 36 Japanese banks produced $764 million of taxable (net) income (i.e., "U.S. income subject to tax" in the statistics) as a result of their U.S. effectively connected business activities. (The other 15 banks reported deficits and, as a result, had no taxable income.) This U.S. taxable income resulted in $260 million of income tax prior to credits. This amount was then reduced by $21 million of foreign tax credits, which represented over 96 percent of the total foreign tax credits claimed by all foreign corporations with income effectively connected with a U.S. trade or business. The United States allowed a foreign tax credit against income tax for certain taxes paid or accrued to foreign countries. These taxes were based on the corporation's foreign-source taxable income, certain types of which were also considered to be U.S. effectively connected income (see the section entitled U.S. Taxation).

Canadian corporations produced the second largest amount ($15.8 billion) of U.S. effectively connected receipts for 1988, a 26 percent increase over 1987. Over 90 percent of these receipts were from companies classified in the finance, insurance and real estate industrial division. Insurance companies and banks accounted for most of these receipts, with $9.5 and $4.2 billion, respectively.

INCOME STATEMENT AND TAX ITEMS

For 1988, the 9,921 foreign corporations reported receipts totalling $77 billion from activities effectively connected with a trade or business in the United States. Business receipts, i.e., gross receipts from sales and operations, amounted to $23 billion, while $49 billion was interest income. Most of the interest income was reported by banks, which reported this income separately from other operating income, even though it was their principal source of receipts.

Collectively, foreign corporations claimed $77 billion in deductions for 1988. Cost of sales and operations was $16 billion. In conjunction with foreign banks producing large amounts of receipts in the form of interest income, they reported deductions for interest paid totaling $42 billion. Bearing in mind the predominant effect of banking on these statistics, this amount was 97 percent of the total interest paid by all of the foreign corporations.

Foreign corporations realized an overall net profit of $3 million from their effectively connected activities. This was the result of 3,557 corporations having $2.7 billion of profits and 6,364 companies that were without profits, totaling $2.7 billion of deficits. (A small number of these 6,364 companies were actually "breakeven" companies with equal amounts of receipts and deductions.) Thus, only 36 percent of the foreign corporations reported profits for 1988, as compared to 54 percent of all corporations filing U.S. tax returns. The percentages for 1987 were similar to those for 1988, with only 32 percent of the foreign corporations reporting profits, compared to 55 percent for all corporations. Figure E presents a comparison of the percentages of profitable companies for the period 1984 to 1988. As can be seen in this figure, the percentage of profitable foreign corporations increased somewhat over the 5-year period, particularly for 1988.

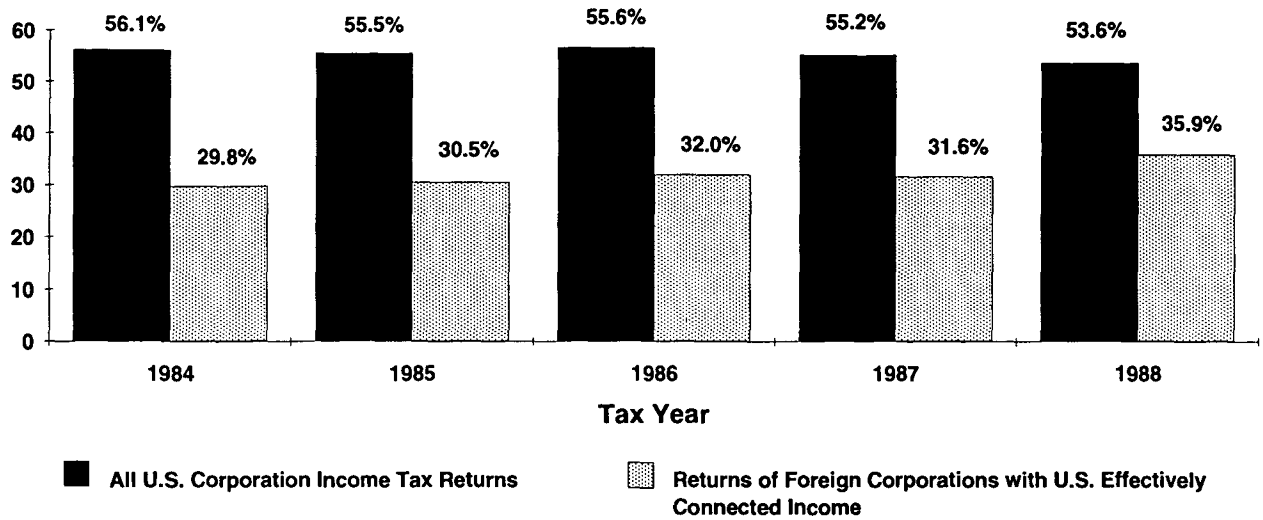
The $3 million of net profits (i.e., net income (less deficit) in the statistics) for 1988 was an improvement over the $162 million of net losses for 1987. Several industrial groupings had either larger net profits or smaller net losses for 1988, including the following: construction; manufacturing; wholesale and retail trade; transportation and public utilities; and agriculture, forestry and fishing. Only the overall performance of companies in finance, insurance and real estate was significantly worse for 1988 (with $387 million of net profits) as compared to 1987 ($526 million of net profits). However, the percentage of companies in finance, insurance and real estate which reported profits (i.e., net income) increased for 1988, as well as their associated profits, from $2.1 billion to $2.4 billion.

For 1988, the profitable foreign corporations had $2.0 billion of income subject to U.S. tax from their effectively connected activities in a U.S. trade or business. This

Figure E

Percentage of Corporation Returns Reporting Net Income, 1984-1988

[All figures are estimates based on samples]



amount was after net operating loss deductions and special deductions, and resulted in a U.S. income tax of $669 million before credits. Tax credits of $25 million reduced this U.S. tax liability. As previously mentioned, foreign tax credits of $21 million accounted for most of the credits. The $644 million of tax after credits represents 0.8 percent of the $77 billion of effectively connected total receipts generated by foreign corporations. In comparing this percentage to the 0.9 percent of tax after credits for all corporations that filed U.S. income tax returns, it should be noted that the receipts of most companies could be from worldwide sources and could include investment-type income as well as receipts from a trade or business activity.

Foreign corporations with effectively connected U.S. trade and business income also incurred another $43 million of income tax, on U.S.-source income that was not effectively connected with their U.S. operations (i.e., "Section I" tax), as well as $14 million of taxes on branch profits and branch-level interest, $10 million of alternative minimum tax, and $3 million of environmental tax. (While "Section I" tax is shown separately in the statistics, the income on which it was based was not tabulated.) These companies also had small amounts of the tax from recapturing prior-year investment credits and the Personal Holding Company tax. However, none of the foreign corporations sampled for 1988 had any tax from recapturing prior-year low-income housing credits.

SUMMARY

Foreign operations in the United States through corporations continued to grow at a relatively fast rate for 1988. While total receipts reported on all U.S. corporation income tax returns increased from 1987 to 1988 by 7 percent (using current dollars), receipts of foreign corporations with U.S. effectively connected income grew by 26 percent.

Foreign corporations with U.S. effectively connected income were largely involved in finance, insurance and real estate activities. For 1988, this division alone accounted for 83 percent of the total receipts, with only 272 banks actually generating 66 percent of the $77 billion of total receipts reported by all 9,921 foreign corporations. In fact, U.S. branches of 36 Japanese banks, alone, accounted for $26 billion, or one-third, of the total receipts.

Tax Year 1988 was the first time in recent years that foreign corporations with income effectively connected with a U.S. trade or business reported net profits ($3 million). By comparison, these companies had net losses of $139 million to $1,513 million for each year between 1983 and 1987.

Japanese corporations accounted for $27 billion of the total receipts for all foreign corporations with U.S. effectively connected income. This was the largest amount of any country. Canadian companies were second with nearly $16 billion. The receipts of Japanese and Canadian companies rose 26 percent, for each group, between 1987 and 1988.

DATA SOURCES AND LIMITATIONS

Sample

For foreign corporations with income effectively connected with a U.S. trade or business, the statistics are based primarily on samples of Forms 1120F, *U.S. Income Tax Return of a Foreign Corporation.* In addition to this form, the statistics may include data from Form 1120L, *U.S. Life Insurance Company Income Tax Return,* and Form 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return.* Forms 1120L and 1120-PC were filed by foreign companies that carried on an insurance business in the United States.

Form 1120F samples were stratified based on the size of total assets and the business activity, even though balance sheet information was not actually tabulated from Forms 1120F. The sampling rates specified for these forms were either 20 percent or 100 percent, depending on the size of total assets and the business activity. Forms 1120L and 1120-PC were stratified based solely on the size of total assets. The sample rates specified for Forms 1120L were either 50 percent or 100 percent, depending on the size of total assets. The sample rates specified for Forms 1120-PC ranged from 0.35 percent to 100 percent, also depending on the size of total assets.

Because the data presented in this article are estimates based on samples, they are subject to sampling error. To properly use the 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 of corporation statistics in general, see *Statistics of Income — 1988, Corporation Income Tax Returns.*

Nonsampling Limitations

Most of the data in this article relate to 1988. However, for each tax year, 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, the span covered dates ending 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 statistics was given an industry code during processing. This code was then used as a classifier of the returns by industry. 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. (In general, foreign corporations could not be members of affiliated groups eligible to be included in consolidated returns.) To the extent that some 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.

The income statement data for foreign corporations shown in this article are only for those corporations which had income effectively connected with a U.S. trade or business. U.S.-source investment income (including interest, dividends, rents, royalties, annuities, and other fixed or determinable annual or periodic income) that was not effectively connected with the conduct of a U.S. trade or business is thus excluded. The tax liability on this U.S. source investment income is, however, shown separately under the heading of "Section I" tax.

EXPLANATION OF SELECTED TERMS

Income Tax.—For foreign corporations, this was the tax on income effectively connected with the conduct of a U.S. trade or business. (For other corporations which filed U.S. income tax returns, this was the "regular" tax; see *Statistics of Income—1988, Corporation Income Tax Returns,* for a description of this term.) This article contains statistics for this tax, both before and after credits. Because this article focuses on income effectively connected with U.S. business activities, the following additional taxes, which a foreign corporation may also have had, were excluded: (1) the tax on U.S.-source income that was not effectively connected ("Section I" tax), (2) branch profits and branch-level interest taxes, (3) an alternative minimum tax, (4) an environmental tax, (5) a Personal Holding Company tax, (6) a tax from recapturing prior-year investment credits, and (7) a tax from recapturing prior-year low-income housing credits. Table 1 contains separate statistics for the first four of these items, which had significant amounts for 1988.

Net Income (or Deficit).—For foreign corporations, this is the difference between gross receipts from activities that are effectively connected with a U.S. trade or business and the ordinary and necessary business deductions that are related to these receipts and allowed by the Internal Revenue Code. It is also referred to as "profits" in this article. Because certain statutory special deductions, including the net operating loss deduction, were allowed 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.

Person.—This term includes an individual, a trust, estate, partnership, association, company or corporation, under section 7701 of the Internal Revenue Code.

NOTES AND REFERENCES

[1] For a separate article on domestic corporations that were controlled by foreign persons, see Hobbs, James R., "Domestic Corporations Controlled by Foreign Persons, 1988," *Statistics of Income Bulletin*, Fall 1991, Volume 11, Number 2.

[2] 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 thus one which is not domestic.

[3] Section 864(c) of the Internal Revenue Code and the related Internal Revenue Regulations describe tests to be used in determining whether income is effectively connected with a U.S. trade or business.

[4] Charitable contributions are deductible, subject to a limitation, whether or not they are related to effectively connected income.

[5] For a complete discussion of this Act, see U.S. Department of the Treasury, Internal Revenue Service, *Explanation of the Tax Reform Act of 1986 for Business*, Publication 921. This Act is also discussed in *Statistics of Income—Corporation Income Tax Returns*, for 1986 and 1987.

[6] These rates do not strictly apply to members of "controlled groups" of corporations or to "qualified personal service corporations." A controlled group of corporations is defined by Internal Revenue Code section 1563. In general, there are two types of controlled groups: parent-subsidiary groups and brother-sister groups. A personal service corporation is a corporation whose principal business activity is the performance of personal services that are substantially performed by employee-owners who own more than 10 percent of the corporation's outstanding stock. Personal services are those in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.

[7] While capital gains that were considered to be effectively connected with a U.S. trade or business were taxable income, other U.S.-source capital gains were exempt from the U.S. income tax.

[8] For a list of tax treaties, see U.S. Department of the Treasury, Internal Revenue Service, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*, Publication 515.

[9] Foreign corporations are also subject to a 4 percent tax on one-half of their "gross transportation income." This income is derived from the transportation of people or property that begins or ends in the United States, or from leasing or renting vessels or aircraft in such transportation. The tax is included in "Section I" tax.

Table 1.--Selected Income and Tax Items, by Selected Industry

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

Selected industry	Number of returns: Total	Number of returns: With net income	Total receipts	Business receipts	Interest	Total deductions	Cost of sales and operations	Interest paid	Net income (less deficit)	Net income
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
All industries	**9,921**	**3,557**	**77,121,339**	**23,486,892**	**49,039,094**	**77,062,467**	**16,303,506**	**43,259,479**	**2,627**	**2,673,878**
Agriculture, forestry and fishing	316	111	140,541	93,671	4,315	146,611	38,704	20,546	-7,356	27,082
Mining	458	163	536,882	512,894	4,893	593,409	273,243	26,562	-56,636	31,796
Construction	57	*13	766,154	*714,484	*7,978	722,585	*681,999	*11,583	43,569	*50,683
Manufacturing	217	81	1,549,229	1,511,147	8,150	1,574,630	1,253,754	38,869	-25,400	23,965
Transportation and public utilities	162	*40	1,714,747	1,695,334	*123	2,043,770	1,228,758	94,687	-329,023	*22,037
Wholesale and retail trade	392	185	7,765,896	7,721,982	5,671	7,721,713	7,368,217	28,342	44,173	90,848
Wholesale trade	297	140	7,497,844	7,464,859	5,630	7,445,871	7,184,499	25,052	51,973	85,584
Finance, insurance and real estate	7,646	2,696	63,888,123	10,773,512	48,995,110	63,445,858	5,294,246	43,004,397	387,428	2,380,341
Banking	272	110	51,173,474	2,996,091	46,778,119	50,402,145	--	41,896,255	764,328	1,655,629
Insurance	158	85	10,454,208	6,863,793	2,110,521	10,560,387	4,894,041	483,121	-125,613	242,611
Real estate	6,245	2,072	1,924,553	834,716	74,375	2,192,988	304,767	575,473	-274,047	351,479
Services	551	202	755,912	463,845	12,612	808,848	164,564	34,318	-52,936	44,127
Nature of business not allocable	122	66	3,854	*23	*242	5,044	*22	*173	-1,191	3,001

Selected industry	U.S. income subject to tax	Income tax before credits	Total credits	Income tax after credits	Selected other taxes: Section I tax	Selected other taxes: Branch taxes [1]	Selected other taxes: Alternative minimum tax	Selected other taxes: Environmental tax	Distributions to stockholders except in own stock: Total	Distributions to stockholders except in own stock: Returns with net income
	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
All industries	**1,994,577**	**669,008**	**24,778**	**644,230**	**42,584**	**13,935**	**10,116**	**2,869**	***94,535**	***6,401**
Agriculture, forestry and fishing	14,734	4,820	*74	*4,746	--	--	--	--	--	--
Mining	*22,584	*7,638	--	*7,638	*4,157	*231	*(2)	26	--	--
Construction	*5,579	*1,897	*143	*1,754	*524	*5	365	*53	--	--
Manufacturing	21,090	6,880	*61	*6,819	--	*85	*79	--	--	--
Transportation and public utilities	*21,820	*7,409	--	*7,409	*1,119	312	--	*(2)	*1,987	*1,987
Wholesale and retail trade	49,739	16,459	1,988	14,471	*771	*1,320	*416	390	--	--
Wholesale trade	45,454	15,148	1,988	13,160	--	*1,320	*416	390	--	--
Finance, insurance and real estate	1,823,177	612,420	*22,512	*589,908	21,216	11,796	9,128	2,400	*92,548	*4,414
Banking	1,509,001	513,027	*22,015	*491,012	15,947	2,386	2,694	1,915	--	--
Insurance	95,640	32,241	--	32,241	3,312	568	3,210	*260	*89,722	*1,589
Real estate	183,491	56,067	*286	*55,781	1,482	8,374	2,302	*142	*2,826	*2,825
Services	32,859	10,620	--	10,620	*149	*133	*128	--	--	--
Nature of business not allocable	2,995	864	*(2)	*864	*14,648	*54	--	--	--	--

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

[1] Includes the branch profits and branch-level interest taxes.

[2] Less than $500.

NOTE: Detail may not add to totals because of rounding. Table excludes foreign corporation returns with only income from U.S. sources that was not effectively connected with a U.S. trade or business. Income statement items shown in this table pertain only to the effectively connected income of foreign corporations.

Table 2.--Selected Income and Tax Items, by Selected Country of Incorporation

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

Selected country	Number of returns: Total	Number of returns: With net income	Total receipts	Business receipts	Interest	Total deductions	Cost of sales and operations	Interest paid	Net income (less deficit)	Net income
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
All countries	**9,921**	**3,557**	**77,121,339**	**23,486,892**	**49,039,094**	**77,062,467**	**16,303,506**	**43,259,479**	**2,627**	**2,673,878**
Canada	1,863	857	15,817,770	8,215,232	N/A	15,726,593	5,505,194	N/A	81,399	768,751
Latin America, total	5,011	1,522	2,971,110	1,775,012	N/A	3,360,476	1,175,421	N/A	-417,187	306,842
Netherlands Antilles	3,451	995	1,358,611	727,657	N/A	1,678,282	263,294	N/A	-346,984	204,651
Other Western Hemisphere	127	60	263,136	210,112	N/A	202,060	53,490	N/A	59,912	78,879
Europe, total	1,645	659	26,991,186	9,672,154	N/A	27,258,534	8,128,014	N/A	-272,949	454,238
France	51	*26	2,386,865	133,506	N/A	2,467,104	--	N/A	-80,266	*18,111
Italy	23	3	2,738,122	32,444	N/A	2,855,895	*5,822	N/A	-117,773	5,201
Netherlands	299	77	1,020,483	175,896	N/A	1,049,351	49,539	N/A	-30,430	50,806
United Kingdom	375	150	3,047,961	1,032,374	N/A	3,103,299	812,317	N/A	-52,995	42,407
West Germany	262	156	7,491,530	1,712,375	N/A	7,392,725	1,299,414	N/A	92,993	196,927
Switzerland	226	70	7,736,412	6,180,386	N/A	7,642,904	5,825,169	N/A	93,508	117,320
Africa	207	78	231,571	82,058	N/A	235,362	49,987	N/A	-3,845	5,784
Asia, total	869	304	29,353,750	3,057,834	N/A	28,920,714	1,108,877	N/A	432,996	893,407
Japan	598	191	26,894,047	2,484,027	N/A	26,177,704	775,871	N/A	715,493	850,006
Oceania	89	*31	852,413	93,770	N/A	809,574	*26,402	N/A	42,839	*67,361
Puerto Rico and U.S. possessions	46	*28	116,530	*7,616	N/A	131,249	*1,671	N/A	-14,720	*280
Country not stated	65	*19	523,874	*373,103	N/A	417,905	*254,449	N/A	94,181	*98,336

Selected country	U.S. income subject to tax	Income tax before credits	Total credits	Income tax after credits	Selected other taxes: Section I tax	Selected other taxes: Branch taxes [1]	Selected other taxes: Alternative minimum tax	Selected other taxes: Environmental tax	Distributions to stockholders except in own stock: Total	Distributions to stockholders except in own stock: Returns with net income
	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
All countries	**1,994,577**	**669,008**	**24,778**	**644,230**	**42,584**	**13,935**	**10,116**	**2,869**	***94,535**	***6,401**
Canada	592,586	197,621	59	197,562	6,838	*792	N/A	N/A	*88,370	*237
Latin America, total	156,687	50,307	*1,001	49,306	2,968	3,941	N/A	N/A	*888	*886
Netherlands Antilles	119,921	38,940	*362	38,578	2,886	2,033	N/A	N/A	--	--
Other Western Hemisphere	19,517	6,364	--	6,364	*666	*449	N/A	N/A	*2,452	*2,452
Europe, total	296,645	99,782	2,339	97,443	18,494	1,428	N/A	N/A	*2,825	*2,825
France	*3,376	*1,125	*35	*1,090	2	176	N/A	N/A	--	--
Italy	501	170	15	155	2	146	N/A	N/A	--	--
Netherlands	14,701	4,843	138	4,705	*15,003	--	N/A	N/A	--	--
United Kingdom	23,105	7,477	--	7,477	*2,142	*139	N/A	N/A	--	--
West Germany	181,057	61,339	*63	61,276	*(2)	--	N/A	N/A	*2,825	*2,825
Switzerland	59,884	20,212	1,988	18,224	*237	*698	N/A	N/A	--	--
Africa	*4,931	*1,455	--	*1,455	*133	*216	N/A	N/A	--	--
Asia, total	802,564	272,159	21,098	251,061	13,479	6,993	N/A	N/A	--	--
Japan	780,633	264,918	20,843	244,075	13,479	5,763	N/A	N/A	--	--
Oceania	*28,358	*9,641	*168	*9,473	*(2)	115	N/A	N/A	--	--
Puerto Rico and U.S. possessions	*214	*32	--	*32	--	--	N/A	N/A	--	--
Country not stated	*93,075	*31,646	*114	*31,532	7	--	N/A	N/A	--	--

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

[1] Includes the branch profits and branch-level interest taxes.

[2] Less than $500.

N/A - Not available.

NOTE: Detail may not add to totals because of rounding. Table excludes foreign corporation returns with only income from U.S. sources that was not effectively connected with a U.S. trade or business. Income statement items shown in this table pertain only to the effectively connected income of foreign corporations.