

# Tax Insights: Analysis of foreign-controlled domestic corporations

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## Robust growth in foreign business defies high U.S. corporate tax rate

IRS researchers have recently published new data on foreign-controlled domestic corporations. An analysis of the statistics by Grant Thornton's National Tax Office shows that the assets and earnings of U.S. corporations controlled by foreign entities has continued to grow robustly through 2005, the last year for which the IRS has data. This growth comes despite a U.S. corporate tax rate that has become less and less competitive over the last two decades. Yet these foreign-controlled domestic corporations are now responsible for a larger share of total U.S. corporate assets and earnings than ever before.

### FCDCs

IRS researchers define a foreign-controlled domestic corporation (FCDC) as any domestic corporation in which over 50 percent of the stock is owned by a foreign individual, corporation, partnership, estate or trust. There are some limitations to this definition. Domestic corporations could be "controlled" by a foreign entity that holds under 50 percent of the corporation's stock, but these corporations will not be captured in the data.

### Explosive growth

By almost any metric, FCDCs have become an increasingly important part of the U.S. corporate economy. (See figure 1.)

FCDC receipts reached \$3.5 trillion in 2005, an all-time high. This number is:

- \$450 billion more than in 2004,
- Twice the 1996 level, and
- Almost 90 times the level reported in 1971.

FCDC receipts in 2005 represented 13.7 percent of all U.S. corporate receipts, an all-time high. In the past:

- 13.5 percent of all corporate receipts came from FCDCs in 2004,
- Just 10.7 came from FCDCs in 1996, and
- Only 2.1 percent came from FCDCs in 1971.

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FCDCs assets reached over \$9.2 trillion in 2005, also an all-time high. This figure is:

- 15.7 percent higher than in 2004,
- More than three times the 1996 level, and
- Over 250 times the level in 1971.

FCDC assets represented 13.9 percent of all U.S. corporate assets in 2005, again an all-time high. In the past:

- FCDC assets made up 13.3 percent of all corporate assets in 1996,
- Just 10.6 percent of all corporate assets in 1996, and
- An even smaller 1.3 percent of total assets in 1971.

The IRS data also show that FCDCs are paying taxes. The income tax paid by FCDCs after tax credits jumped to \$42.4 billion in 2005, an increase of over 40 percent from 2004.

<b>Figure 1</b>							
<b>Foreign-controlled domestic corporation statistics 1971–2005</b>							
	<b>1971</b>	<b>1990</b>	<b>1996</b>	<b>2000</b>	<b>2002</b>	<b>2004</b>	<b>2005</b>
<b>FCDC receipts</b>	\$39 billion	\$1.1 trillion	\$1.7 trillion	\$2.6 trillion	\$2.5 trillion	\$3.1 trillion	\$3.5 trillion
<b>FCDC receipts as percentage of all corporate receipts</b>	2.1%	9.3%	10.7%	12.7%	12.7%	13.5%	13.7%
<b>FCDC assets</b>	\$37 billion	\$1.7 trillion	\$3.0 trillion	\$6.1 trillion	\$6.4 trillion	\$8.0 trillion	\$9.2 trillion
<b>FCDC assets as percentage of all corporate assets</b>	1.3%	9.1%	10.6%	12.9%	12.7%	13.3%	13.9%
<b>FCDC returns</b>	5,154	44,113	62,141	60,609	61,615	57,935	61,820
<b>FCDC returns as a percentage of all corporate returns</b>	0.2%	1.2%	1.3%	1.2%	1.2%	1.0%	1.1%
<b>FCDC income tax after tax credits</b>	\$ 0.6 billion	\$7.4 billion	\$15.4 billion	\$28.1 billion	\$17.8 billion	\$29.9 billion	\$42.4 billion

#### Industry and parents

Most of the FCDC receipts come from corporations in just a few industries and with parents in just a few countries. FCDCs with foreign owners from the United Kingdom, Japan, Germany, Netherlands, Canada and France were responsible for over ¾ of all FCDC receipts in 2005. (See figure 2.)

The countries controlling FCDCs have remained largely unchanged over the last decade. In 1996, the FCDCs with foreign owners in the same six countries were also responsible for over ¾ of all FCDC receipts.

<b>Figure 2</b>		
<b>Qualifying dividends repatriated by country of controlled foreign corporation (CFC)</b>		
	<b>% of total receipts in 2005</b>	<b>% of total receipts in 1996</b>
<b>United Kingdom</b>	20.5%	13.7%
<b>Japan</b>	16.2	26.5
<b>Germany</b>	12.7	9.6
<b>Netherlands</b>	12.3	11.3
<b>Canada</b>	8.7	9.9
<b>France</b>	6.5	6.2

Switzerland	4.5	5.5
Total for top 4 countries	61.7	61.4
Total for top 6 countries	76.9	77.2
All other countries	18.6%	17.3%

Most of the FCDC receipts also came from FCDCs operating in just a few industries. Over 80 percent of all FCDC receipts came from the manufacturing, wholesale trade and the finance and insurance industries alone. (See figure 3.)

**Figure 3**  
**Repatriated dividend figures by industry of parent corporation**

	Number of returns	Total receipts (billions)	Percentage of total FCDC receipts	Receipts per return (millions)
Manufacturing	7,128	\$1,659	47.3%	\$233
Wholesale trade	15,789	713	20.4	45
Retail trade	3,599	175	5.0	49
Finance and insurance	2,540	436	12.5	171
Holding companies	2,567	85	2.4	33
All other industries	30,197	436	12.4	14
<b>Total</b>	<b>61,820</b>	<b>\$3,505</b>	<b>100.0%</b>	<b>\$57</b>

**What the numbers mean**

The explosion in foreign investment defies the deterrent effect of high U.S. corporate tax rates, which have become less and less competitive over the last two decades. There is some evidence in the IRS data of a reluctance to enter the U.S. market. FCDC assets and earnings may have grown even more robustly if the U.S. had more competitive rates. The number of FCDCs operating and filing returns in the U.S. has remained largely stagnant for over 10 years, even as total assets and receipts have gone up. (See figure 1.) With total corporate filings continuing to increase every year, FCDCs now represent a smaller percentage of total domestic corporations than they did in 1996.

The U.S. corporate tax rate has changed little since the late 1980s while countries all over the world have been cutting rates to compete for investment and spur economic growth. The U.S. now has an average combined state and federal corporate rate of almost 40 percent, the second highest to Japan among OECD countries. There is a growing consensus across the ideological spectrum that the U.S. needs to cut its corporate rate to remain competitive in a global economy. The idea has been long championed by conservatives, but many Democrats have recently supported lowering rates.

Both of the top Senate taxwriters — Senate Finance Committee Chair Max Baucus, D-Mont., and ranking minority member Chuck Grassley, R-Iowa — have stated publicly that high corporate rates are hampering competitiveness. House Ways and Means Committee Chair Charles B. Rangel, D-N.Y., included a corporate rate cut to 30.5 percent as part of his sweeping tax reform proposal. Presidential candidate Sen. John McCain, R-Ariz., proposes to cut the top corporate rate to 25 percent, while his opponent, Sen. Barack

A real, meaningful reduction in the U.S. corporate tax rate would likely stimulate even greater investment by foreign-based multinationals into U.S. corporations. Several other countries in recent years have reduced corporate tax rates in an attempt to attract such investment and, for the most part, such measures have been successful.

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Obama, D.-Ill., has hinted that a corporate rate cut could be considered if loopholes are closed.

A meaningful reduction in the U.S. corporate tax rate would likely stimulate more U.S. investment by foreign-based multinationals. A rate reduction would also help U.S.-based multinational groups (a multinational group with a U.S. parent at the top of the chain), as long as there is not a corresponding tax cost that essentially wipes out the benefit. Many proposals to cut corporate tax rates impose other restrictions that limit the benefits of the proposed rate cut.

U.S.-based multinational groups may be at a disadvantage compared to certain foreign-based multinational groups because of high U.S. corporate tax rates, a U.S. tax system that taxes U.S. corporations on their worldwide income, and the application of certain anti-deferral regimes, such as the subpart F regime. Anti-deferral rules such as subpart F often require U.S. companies to include certain types of income earned by their foreign subsidiaries into income even though such income has not been repatriated.

All numbers are based on the most recently released IRS data in a study on FCDCs in the latest IRS Statistics of Income Bulletin. IRS researchers say all the data is based on random sampling of returns. To view the latest IRS statistics of income bulletin and other IRS statistical tables, see their website: [www.irs.gov/taxstats/article/0,,id=185883,00.html](http://www.irs.gov/taxstats/article/0,,id=185883,00.html).

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