

---

**GAO**

United States General Accounting Office

Report to the Joint Committee on  
Taxation  
Congress of the United States

---

October 1986

# IRS AUDIT COVERAGE

## Selection Procedures Same for Foreign- Owned and Other U.S. Corporations



037064

---

---



United States  
General Accounting Office  
Washington, D.C. 20548

---

## General Government Division

B-220847

October 14, 1986

The Honorable Bob Packwood  
Chairman, Joint Committee on  
Taxation

The Honorable Dan Rostenkowski  
Vice Chairman, Joint Committee on  
Taxation  
Congress of the United States

In a July 31, 1984, letter, the Joint Committee asked GAO to undertake a study of foreign-owned U.S. corporations and to develop information on effective tax rates and Internal Revenue Service (IRS) tax compliance activities with respect to such corporations. This report addresses IRS' tax compliance activities regarding foreign-owned U.S. corporations. We have briefed members of the Joint Committee staff on our work regarding effective tax rates.

This report contains no recommendations. Audit work performed during this study, however, was the basis for our report to your Committee entitled Tax Code Amendment: A Change in Foreign-Owned U.S. Corporations' Reporting Requirements (GAO/GGD-86-19, Nov. 1, 1985). In that report, we recommended that IRS' compliance activities could be improved by amending section 6038A of the Internal Revenue Code to require the reporting to IRS of certain transactions between foreign-owned U.S. corporations and their noncorporate foreign owners. The Conference Agreement signed on August 16, 1986, contains a provision requiring such expanded reporting.

During our audit, we also noted that IRS did not have a computerized data base identifying foreign-owned U.S. corporations. We discussed that matter with cognizant IRS officials and expressed our belief that such information would help IRS more efficiently conduct special compliance projects. IRS agreed with our suggestion and revised service center instructions to require transcription of foreign-ownership

---

# Executive Summary

---

## Purpose

Foreign direct investment in U.S. firms increased from about \$34.6 billion in 1977 to about \$150 billion in 1984, according to the U.S. Department of Commerce. As a consequence, both the Congress and the Internal Revenue Service (IRS) have paid increased attention to foreign based multinational corporations and other foreign investors doing business in the United States to assure equitable tax treatment.

GAO's objectives in making this review, undertaken at the request of the Joint Committee on Taxation, were to answer two questions:

- Do IRS' procedures for "classifying" (reviewing for audit potential) and selecting income tax returns to audit either single out or exclude foreign owned U.S. corporations?
- Do comparative statistics of IRS' audit coverage of foreign-owned and domestically owned U.S. corporations show any significant difference

---

## Background

A foreign-owned U.S. corporation is one whose voting stock is 50 percent or more owned by any foreign parent company or foreign person. This criterion is used by IRS on the U.S. Corporation Income Tax Return to denote foreign control. An IRS statistical analysis of corporate tax returns for tax year 1981, the most current ownership data at the time of GAO's review, projected that 27,096 U.S. corporations were foreign-owned, or about 1 percent of all U.S. corporations. (See p. 10.)

Specially trained revenue agents (international examiners) audit the more difficult and complex international issues. Such issues include transactions that involve foreign affiliates, such as U.S. parent corporations with foreign subsidiaries or U.S. corporations that are subsidiaries of foreign parent corporations. (See p. 12.)

---

## Results in Brief

IRS' standard procedures at service centers and district offices for classifying and selecting income tax returns neither single out nor exclude foreign-owned U.S. corporations. These procedures neither specify nor imply that the returns of foreign-owned U.S. corporations be given special treatment apart from other returns that have international issues such as those filed by U.S. parent corporations with foreign subsidiaries.

Statistics comparing IRS' audit coverage of foreign-owned and domestically owned U.S. corporations do not show any significant differences. That is, the statistics show that the foreign-ownership characteristic of

a U.S. corporation neither increases nor lessens the probability of an IRS audit.

---

## GAO's Analysis

---

### Classification and Selection Procedures

International examiners on detail from IRS district offices to service centers manually classify corporate income tax returns that have international issues. In this process, returns of both U.S. parent corporations with overseas affiliates and foreign-owned U.S. corporations are selected and sent to IRS districts for audit. According to IRS' procedures, the main criterion for selection is the potential for an IRS audit to significantly change the reported tax liability, for example, by correctly adjusting the taxpayer's income or denying certain deductions or credits. (See p. 21.)

Other returns having international issues might be selected for audit through special compliance projects. For example, IRS examination program guidelines have designated abusive tax havens as a priority area, which has resulted in selection of some foreign-owned U.S. corporations for audit. IRS officials told GAO, however, that U.S. parent corporations with tax haven subsidiaries are also given special emphasis. (See p. 26.)

### Comparative Audit Statistics

GAO's analysis showed that the differences in audit coverage percentages between foreign-owned and domestically owned U.S. corporations are not statistically significant. The differences in audit coverage percentages probably are more attributable to sampling error rather than bias in IRS' procedures for classifying or selecting tax returns to audit.

GAO developed audit coverage statistics in terms of three variables—size of total assets, category of industry, and country of foreign owner. At the higher asset levels, the audit coverage percentages generally are greater for domestically owned U.S. corporations. Audit coverage varied among major industry categories; IRS audited relatively more foreign-owned U.S. corporations in some industries and relatively fewer in others. Most IRS audits of foreign-owned U.S. corporations involved leading trade partner countries (Canada, Mexico, Japan, and Western European nations)—about 80 percent for fiscal year 1983 and about 51 percent for fiscal year 1984. (See p. 32.)

---

**Executive Summary**

---

**Recommendations**

GAO is making no recommendations.

---

**Agency Comments**

IRS reviewed the report and found it to be factually correct.



---

# Contents

---

<b>Executive Summary</b>		8
<hr/>		
<b>Chapter 1</b>		10
<b>Introduction</b>	Foreign-Owned Corporations in the United States	10
	IRS' International Enforcement Program	11
	Objectives, Scope, and Methodology	12
	Comments From IRS	10
<hr/>		
<b>Chapter 2</b>		18
<b>Standard Procedures Do Not Single Out Foreign-Owned Corporations</b>	Foreign Ownership Not a Procedural Criterion for Coordinated Examination Program	18
	Certain Returns Are Computer Analyzed for Audit Potential	20
	All International Feature Corporate Tax Returns Are Manually Reviewed for Audit Potential	21
	District Office Selections Are to Be Based on Potential for Changes in Tax Liability	21
	Conclusions	21
<hr/>		
<b>Chapter 3</b>		21
<b>Special Compliance Projects Result in Audits of Some Foreign-Owned Corporations</b>	Abusive Tax Haven Emphasis	21
	Electronic Components Industry Study	30
	Conclusions	31
<hr/>		
<b>Chapter 4</b>		31
<b>Comparative Audit Coverage Statistics for Fiscal Years 1983 and 1984</b>	Audit Coverage by Size of Total Assets	31
	Audit Coverage by Category of Industry	31
	Audit Coverage by Country of Foreign Owner	31
	Differences Not Statistically Significant	31
	Conclusions	31
<hr/>		
<b>Appendixes</b>	Appendix I: Request Letter	40



Appendix II: Flowcharts of IRS' Procedures for Selecting International Feature Corporate Income Tax Returns for Examination	42
Appendix III: IRS Form 1120, U.S. Corporation Income Tax Return	49
Appendix IV: Tables of Comparative Audit Statistics	53
Appendix V: Comments From the Internal Revenue Service	63

**Tables**

Table 1.1: Comparative Number of U.S. Corporations by Size of Total Assets	11
Table 1.2: Number of International Examiners, by Key District Office, in the International Enforcement Program (As of December 31, 1984)	13
Table 2.1: Line Items on Form 1120 (U.S. Corporation Income Tax Return) Screened by Service Center Personnel for the Presence of International Features	22
Table 2.2: International Feature Corporation Income Tax Returns: Number Surveyed, Referred, and Accepted for Inclusion in the International Enforcement Program During Fiscal Year 1984	25
Table 3.1: International Enforcement Program Examination Time on Tax Returns With Tax Haven Issues in Fiscal Year 1984	27
Table 4.1: Comparative Audit Coverage in Fiscal Year 1983 by Size of Total Assets	35
Table 4.2: Comparative Audit Coverage in Fiscal Year 1984 by Size of Total Assets	35
Table 4.3: Comparative Audit Coverage in Fiscal Year 1983 by Major Industry Categories	36
Table 4.4: Comparative Audit Coverage in Fiscal Year 1984 by Major Industry Categories	37
Table 4.5: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1983 by the Ten Countries Whose Residents Own the Largest Number of U.S. Corporations	38
Table 4.6: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1984 by the Ten Countries Whose Residents Own the Largest Number of U.S. Corporations	39
Table IV.1: Comparative Audit Coverage in Fiscal Year 1983 by Major and Minor Industry Categories	53

---

Contents

---

Table IV.2: Comparative Audit Coverage in Fiscal Year 1984 by Major and Minor Industry Categories	55
Table IV.3: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1983 by Country	57
Table IV.4: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1984 by Country	60

---

**Figures**

Figure II.1: Service Center Procedures	42
Figure II.2: District Office Procedures	46

---

**Abbreviations**

GAO	General Accounting Office
IRS	Internal Revenue Service

---

---

# Introduction

---

International tax administration has become more important in recent years as business transactions and operations increasingly have transcended domestic boundaries. This international economic trend—often expressed in terms of the growth of multinational corporations—is largely a post-World War II development. Although the United States remains the single largest overseas direct investor, Europe and Japan have increasingly expanded direct investments in the United States. According to the U.S. Department of Commerce, foreign direct investment in U.S. firms has more than quadrupled in the last 7 years, increasing from about \$34.6 billion in 1977 to about \$150 billion in 198

---

## Foreign-Owned Corporations in the United States

Most commonly, foreign direct investments in the United States are in the form of ownership of a part or all of the stock of a U.S. corporation. A U.S. corporation whose stock is either partially or wholly owned by a foreign corporation is subject to the same tax rules that are applicable to any other U.S. corporation, and accordingly, must file Form 1120, U.S. Corporation Income Tax Return.

IRS does not have a detailed computerized data base containing information about the universe of foreign-owned U.S. corporations.<sup>1</sup> However, each year IRS selects a random sample of corporate income tax returns in order to perform various statistical analyses. IRS' analyses of such returns for tax year 1981, which presented the most current ownership data available at the time of our review, projected that 27,096 U.S. corporations had voting stock that was 50 percent or more foreign owned. As shown in table 1.1, this represents about 1 percent of all U.S. corporations. As the table further shows, about 3 percent of all U.S. corporations with assets of \$1 million or more are foreign owned.

---

<sup>1</sup>As a result of our review, in October 1985, IRS agreed to revise service center returns processing instructions to require routine transcription of foreign-ownership data from corporate income tax returns for inclusion in the computerized Business Master File. This change was effective for the processing year beginning January 1, 1986, and will enable IRS to more efficiently conduct special compliance projects. Such projects, which generally focus on selected industries and tax haven countries, are likely to increase in frequency and significance as business transactions and operations continue to transcend domestic boundaries.

Table 1.1: Comparative Number of U.S. Corporations by Size of Total Assets

(M=million)

Size of total assets	Number of corporations <sup>a</sup>		Foreign-owned U.S. corporations as a percentage of all U.S. corporations
	All U.S. corporations	Foreign-owned U.S. corporations	
Zero assets	89,802	462	0.51
\$1 under \$100,000	1,452,270	9,744	0.67
\$100,000 under \$250,000	514,829	4,272	0.83
\$250,000 under \$500,000	295,260	3,080	1.04
\$500,000 under \$1M	192,068	2,355	1.23
<b>Total under \$1M</b>	<b>2,544,229</b>	<b>19,913</b>	<b>0.78</b>
\$1M under \$5M	177,129	4,335	2.45
\$5M under \$10M	23,702	975	4.11
\$10M under \$25M	17,430	845	4.85
\$25M under \$50M	8,380	369	4.40
\$50M under \$100M	5,183	238	4.59
\$100M under \$250M	3,423	202	5.90
\$250M or more	3,162	215	6.80
<b>Total \$1M or more</b>	<b>238,409</b>	<b>7,179</b>	<b>3.01</b>
<b>Total of all asset sizes</b>	<b>2,782,643</b>	<b>27,096<sup>b</sup></b>	<b>0.97</b>

<sup>a</sup>These figures were compiled by IRS' Detroit Data Center from an analysis of the Statistics of Income data base for corporate income tax returns filed for tax year 1981. According to IRS, the details do not add to totals due to weighting of data and to rounding.

<sup>b</sup>The 19,913 companies (each having total assets under \$1 million) comprise about 74 percent of all foreign-owned U.S. corporations, while the 7,179 companies (each having total assets of \$1 million or more) comprise about 26 percent.

## IRS' International Enforcement Program

The Assistant Commissioner (Examination) has overall responsibility for IRS' International Enforcement Program, which is directed nationally by the International Programs Section under the Office of National and International Programs. In turn, various regions and districts have designated managers to coordinate the program in the field. A typical district international group consists of 9 to 12 international examiners headed by an International Group Manager. In addition to regular audit training courses, each international examiner receives specialized training in areas such as U.S. taxation of foreign-sourced income.

The number of international examiners has grown from 150 in 1974 to 340 by 1985. IRS has established procedures intended to result in assigning international examiners only to those audits that present the

---

more difficult and complex international issues. Such issues may cover many areas, including foreign tax credit provisions and transfers of property outside the United States. As shown in table 1.2, international examiners are assigned to 20 districts designated by IRS as "key" districts. However, these examiners work on audits in all 63 IRS districts. International issues are handled by a regular IRS examiner (revenue agent) if an international examiner is not assigned to a particular audit. When assigned to an audit, the international examiner is responsible for preparing a report on the international tax issues audited. International issues include all transactions that involve foreign affiliates. Such affiliations may relate to U.S. entities with foreign subsidiaries or to U.S. corporations that are subsidiaries of foreign entities.

---

## Objectives, Scope, and Methodology

By letter dated July 31, 1984, the Joint Committee on Taxation, asked us to, among other things, study IRS enforcement activities with respect to foreign-owned U.S. corporations (see app. I). Our objectives were to

- identify and analyze IRS procedures for "classifying" (reviewing for audit potential) income tax returns filed by foreign-owned U.S. corporations and for selecting specific returns to audit (see chs. 2 and 3) and
- develop and analyze audit statistics, comparing foreign-owned and domestically owned U.S. corporations (see ch. 4).

**Chapter 1**  
**Introduction**

**Table 1.2: Number of International Examiners, by Key District Office, in the International Enforcement Program (As of December 31, 1984)**

Regions and key district offices	International examiners	
	Number	Region as percentage of total
North Atlantic region:		
Manhattan district	73	
Boston district	13	
Hartford district	10	
<b>Total</b>	<b>96</b>	<b>28.2</b>
Western region:		
Los Angeles district	28	
San Francisco district	26	
Laguna Niguel district	11	
<b>Total</b>	<b>65</b>	<b>19.1</b>
Southwest region:		
Houston district	19	
Dallas district	15	
Oklahoma City district	9	
<b>Total</b>	<b>43</b>	<b>12.6</b>
Midwest region:		
Chicago district	28	
St. Paul district	14	
<b>Total</b>	<b>42</b>	<b>12.4</b>
Mid-Atlantic region:		
Newark district	20	
Pittsburgh district	13	
Philadelphia district	6	
<b>Total</b>	<b>39</b>	<b>11.5</b>
Southeast region:		
Atlanta district	13	
Jacksonville district	10	
Greensboro district	6	
<b>Total</b>	<b>29</b>	<b>8.5</b>

**Chapter 1  
Introduction**

<b>Regions and key district offices</b>	<b>International examiners</b>	
	<b>Number</b>	<b>Region &amp; percentage of total</b>
North Atlantic region:		
Central region:		
Detroit district	10	
Cleveland district	10	
Cincinnati district	6	
<b>Total</b>	<b>26</b>	<b>7</b>
<b>U.S. total</b>	<b>340</b>	<b>99</b>

<sup>a</sup>Figure does not add to 100 percent due to rounding.

Source: Developed by GAO from data compiled by IRS' Office of National and International Programs.

For purposes of this study, we defined a foreign-owned U.S. corporation as one whose voting stock is directly or indirectly 50 percent or more owned by any foreign parent company or other foreign person. We used the 50 percent ownership figure because it is the criterion used by IRS on Form 1120 to denote foreign control.<sup>2</sup>

To identify and analyze IRS' procedures for classifying and selecting tax returns filed by foreign-owned U.S. corporations, we contacted International Enforcement Program officials at the national office and the North Atlantic, Southwest, and Western regional offices. Of IRS' seven regions, these three accounted for 58.6 percent of IRS' total examination time in the International Enforcement Program in fiscal year 1984. Also, these three regions cover U.S. areas active in foreign trade—the East, Gulf, and West Coasts. We also did work at one or more key district offices in each of the three regions—the Manhattan district office in the North Atlantic region, the Dallas and Houston district offices in the Southwest region, and the Los Angeles district office in the Western region.

Also, we visited two of IRS' 10 service centers—the Brookhaven Service Center in New York and the Austin Service Center in Texas—to discuss and observe the classification/selection process, particularly the involvement of international examiners on detail from key district offices. The Brookhaven Service Center supports the North Atlantic region, which has the largest number of international examiners (see table 1.2) in the International Enforcement Program. The Austin Service

<sup>2</sup>Appendix III presents a copy of Form 1120 (U.S. Corporation Income Tax Return). Line 1(2)(c) on page 3 of the Form 1120 asks the U.S. corporate taxpayer to specify whether the company was 50 percent or more foreign owned and, if so, to identify the owner's country.



Center supports the Southwest region, which conducted a study in 1982 to review and update classification criteria used to select tax returns for the International Enforcement Program nationwide.

During each of these contacts, we gathered applicable criteria (including information in the Internal Revenue Manual, the Law Enforcement Manual, and the International Examiners' Classification Handbook) and any pertinent reports, memoranda, statistics, etc. dealing with the classification/selection process. To facilitate our discussions and observations, we also developed flowcharts of service center and district office standard procedures for classifying/selecting international feature corporate income tax returns for examination. These flowcharts are presented in appendix II.

In addition to standard service center and district office procedures, we also determined whether IRS had any special compliance projects, such as those involving tax haven countries, focusing on foreign-owned U.S. corporations. By contacting International Enforcement Program managers and analysts at the national office, we identified potentially relevant projects and then interviewed the applicable regional and district office project officials.

To develop comparative audit statistics, we requested IRS' Data Center in Detroit, Michigan, to cross-match two computerized data bases. Of IRS' computerized data bases, only one, the Statistics of Income corporation data base, identifies U.S. firms that are 50 percent or more foreign owned. According to officials in IRS' Office of the Assistant Commissioner for Returns and Information Processing, the Statistics of Income data base is a statistically valid random sample of all U.S. corporation income tax returns. As we requested, the Detroit Data Center matched the Statistics of Income data base for tax year 1981 corporation returns with IRS' computerized audit history files for audits completed in fiscal years 1983 and 1984. We used these results to project IRS' audit coverage of domestically owned and foreign-owned U.S. corporations.<sup>3</sup> We analyzed differences in audit coverages using statistical tests. Because an IRS audit may cover more than 1 tax year, the computer cross-match was programmed to obtain a 5-year audit history—tax years 1979 through 1983.

<sup>3</sup>Data bases for these years were the ones currently available throughout most of our review. The 1982 Statistics of Income data base became available in March 1985, but IRS officials believed the 1981 data base was better for the cross-match with audit history files because a 1981 corporation tax return would not have been examined sooner than fiscal year 1983 or 1984, particularly if the corporation was a large company with a complex return.

---

We did not test the validity of this data. We did, however, provide the results of the cross-match to International Enforcement Program national office officials for their review and comment. They agreed with the data presented. Moreover, as discussed in chapter 4, we tested the statistical significance of the data.

We conducted our review from July 1984 to August 1985 in accordance with generally accepted government auditing standards.

---

## Comments From IRS

In commenting on a draft of this report, the Acting Commissioner of Internal Revenue noted that it was factually correct and that IRS had no specific comments to submit (see app. V).



# Standard Procedures Do Not Single Out Foreign-Owned Corporations

Generally, most IRS audits result from standard classification and selection procedures in place at service centers and district offices. These procedures neither single out nor exclude foreign-owned U.S. corporations. For example, as discussed in the following sections:

- The procedures do not include foreign ownership as a criterion for a tax return's inclusion in IRS' Coordinated Examination Program, which relies on team techniques to audit corporations with high asset levels and other characteristics of large companies.
- The mathematical formulas used to computer analyze the returns of smaller companies do not consider domestic or foreign ownership.
- The criteria for manually classifying "international feature" returns (i.e., corporate returns involving international issues) at IRS service centers neither specify nor imply selection of foreign-owned U.S. companies over U.S. parent multinational corporations.
- District office procedures for selecting cases and assigning international examiners to audits do not distinguish between domestic and foreign ownership.

## Foreign Ownership Not a Procedural Criterion for Coordinated Examination Program

Large corporations, such as those having assets of \$100 million or more and meeting other criteria, are included in the Coordinated Examination Program and are automatically selected for examination. This program is for examinations that require coordinated case management and team audit techniques because of the taxpayer's organizational structure, geographical dispersion, and financial strength and complexity. Returns in this program are examined by teams that include international examiners.

IRS has established a point system for identifying corporations to include in the Coordinated Examination Program. The listed criteria for giving points do not include ownership. Of the approximately 1,350 companies in the program as of July 1984, at least 102 (or about 8 percent) were foreign-owned U.S. corporations.<sup>1</sup>

<sup>1</sup>GAO calculated the number of foreign-owned U.S. corporations in the Coordinated Examination Program by using three source documents. All companies in the program are listed in IRS' Coordinated Examination Program Communications Index, Document 6033 (Rev. 7-84). To identify which of these are 50 percent or more owned by foreign parent companies or other foreign persons, we used two publicly available sources: (1) the 1983/1984 edition of the International Directory of Corporate Affiliations, published by the National Register Publishing Company; and (2) the 1984 edition of America's Corporate Families and International Affiliates, published by Dun's Marketing Services, a division of Dun and Bradstreet, Inc.

---

### Point System Used to Select Companies

In 1966 IRS established its Coordinated Examination Program after concluding that its traditional "one case/one agent" audit approach did not provide the necessary expertise and other requisites for properly examining large corporations. At one time, corporations were included in the program if they had \$250 million or more in gross assets or if the corporation was a utility or financial institution with \$1 billion or more in assets. However, effective October 1, 1979, IRS established a point system for identifying and including corporations in the program. Points are given for characteristics, such as total assets and gross receipts; number of operating entities and multiple industry status; and number of IRS team members and specialists needed for the examination, including revenue agents from support districts. Ownership, whether domestic or foreign, is not listed as a characteristic for consideration in assigning points.

Corporations that are assigned points above a fixed score are to be included in the Coordinated Examination Program. Most companies in the program have total assets of \$100 million or more. IRS generally audits all tax returns filed by corporations in the program. In contrast to the virtually 100 percent examination coverage of these large cases, less than 3 percent of all corporate income tax returns filed in calendar years 1982 and 1983 were examined.

---

### International Examiners Routinely Assigned to Large Case Teams

Under the Coordinated Examination Program, a corporation's income tax return is assigned to a case manager in the IRS district where the corporation's principal business headquarters is located. The case manager then controls the examination of all entities that are part of the business enterprise, regardless of location. The case manager reviews the operations of the total organization, determines the scope and depth of the examination, and assembles the audit team. The team is composed of revenue agents and other needed specialists, including economists and international examiners.

For each Coordinated Examination Program case, whether it involves a foreign-owned or a domestically owned corporation, the case manager must request the assistance of an international examiner. These requests are evaluated by International Enforcement Program managers in key district offices to determine whether an international examiner should be assigned to the audit. If assigned, these specialists are responsible for examining the international issues presented by the audit, such as related party transactions between the U.S. corporation and its foreign affiliates.

## Certain Returns Are Computer Analyzed for Audit Potential

For tax years before 1983, only those corporate income tax returns showing total assets of less than \$1 million were computer analyzed, during tax return processing, for examination potential. As shown earlier in table 1.1, IRS data indicated that 19,913 returns, or about 74 percent, of the tax year 1981 income tax returns filed by foreign-owned U.S. corporations were within this asset level. Beginning with tax year 1983, computer analysis was extended to all returns showing assets of less than \$10 million.

The computer analysis is done through mathematical formulas programmed into the computer to classify returns by assigning weights to certain basic return characteristics. These weights are added by the computer to generate a composite score for each return processed. These composite scores are used to rank the returns in numerical sequence from highest to lowest. Generally, the higher the score the greater the probability that an examination will produce a significant tax change. The mathematical formulas are confidential and are distributed to IRS personnel only on a need-to-know basis.

The mathematical formulas are developed based on data IRS obtains during surveys done as part of its Taxpayer Compliance Measurement Program, which is IRS' primary means of measuring taxpayers' voluntary compliance with the tax laws. The basic approach of a compliance measurement survey is to select for examination a probability stratified sample of all returns filed and then to thoroughly examine the sample returns, using controlled procedures and keeping detailed records. The examinations are performed by experienced revenue agents, and each line item on the returns is examined. The revenue agents record their results on checksheets designed to uniformly compare the amounts reported by the taxpayer and the amounts determined by the examiners. Completed checksheets are transcribed at IRS' Detroit Data Center, and output tables are produced that display the survey results in various combinations. IRS officials analyze the data for compliance trends and update the mathematical formulas, as appropriate.

According to International Enforcement Program officials, none of the mathematical formulas specifically consider or assign weights to the international feature characteristics of corporate returns. Further, none of the program officials we contacted at the national, regional, or district office levels believed it necessary that international feature aspects be included in the mathematical formulas. These officials said that they based their belief in large part on the fact that international feature corporate tax returns are manually reviewed for audit potential.

---

## All International Feature Corporate Tax Returns Are Manually Reviewed for Audit Potential

International examiners on detail from IRS key district offices to service centers manually classify corporate income tax returns that have international features. IRS' classification procedures do not differentiate between U.S. parent multinational corporations and foreign-owned U.S. corporations. Except for corporations selected for the Coordinated Examination Program, the manual classification process covers all international feature corporate returns, including those subjected to computer analysis.

---

## International Feature Returns Identified and Coded

When corporate income tax returns are received at IRS' 10 service centers, clerks in each center's Document Perfection Branch screen the returns for the presence of international features. As noted earlier, an international feature is any aspect of the return indicating the existence of a relationship between the filing U.S. corporate taxpayer and a foreign entity or activity (see table 2.1). For example, a tax return is to be identified as having "international features" if it has characteristics indicating that the corporation operates a branch, subsidiary, affiliate, or related entity in a foreign country. IRS procedures state that any of several forms that may be attached to the income tax return, such as Form 5735 (Computation of Possessions Corporation Tax Credit) or Form 3646 (Income from Controlled Foreign Corporation), is an indicator of international features.

**Chapter 2**  
**Standard Procedures Do Not Single Out**  
**Foreign-Owned Corporations**

**Table 2.1: Line Items on Form 1120**  
 (U.S. Corporation Income Tax Return)  
**Screened by Service Center Personnel**  
**for the Presence of International**  
**Features**

Line number on Form 1120 for tax year 1984 <sup>a</sup>	Subject <sup>b</sup>	Criteria applicable to prior tax years? <sup>c</sup>		
		1983	1982	19
C-4	Foreign corporations subject to 85 percent deduction	Yes	No	
C-5	Wholly-owned foreign subsidiaries subject to 100 percent deduction	Yes	Yes	\
C-8	Other dividends from foreign corporations not included in lines C-4 and C-5	Yes	No	
C-9	Income from controlled foreign corporations under subpart F of the Internal Revenue Code	Yes	Yes	\
C-10	Foreign dividend gross-up	Yes	No	
C-11	Domestic International Sales Corporation (DISC) or former DISC dividends not included in line C-1 and/or C-2	Yes	No	
J-4(a)	Foreign tax credit (above a certain amount)	Yes	Yes	\
J-4(b)	Possessions tax credit	Yes	Yes	\
I(2)(c)	Foreign ownership, directly or indirectly, of 50 percent or more of the U.S. corporation's voting stock	Yes	Yes	\
K	Responding "yes" to the question: "Was the corporation a U.S. shareholder of any controlled foreign corporation?"	Yes	Yes	\
M	Responding "yes" to the question: "Was the corporation the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not the corporation has any beneficial interest in it?"	No	No	

<sup>a</sup>See appendix III

<sup>b</sup>Even if the applicable line item on the Form 1120 contains no dollar amount or response, attached related forms will cause the Form 1120 to be identified as "international feature." For example, line J-4(b) inadvertently may be left blank, even though the taxpayer attached a Form 5735 (Computation of Possessions Corporation Tax Credit). IRS' guidelines to service center personnel cover these situations.

<sup>c</sup>The number of international feature criteria increased after 1982, following completion of a classificational study conducted by IRS' Southwest regional office.

Source: Developed by GAO from IRS code and edit guidelines in the Internal Revenue Manual.

If an international feature is present, service center clerks are to assign the income tax return a special code (code 2), which ensures that the return later will be classified by an international examiner. Of the approximately 3.1 million corporate tax returns processed by IRS' service centers during fiscal year 1984, about 1 percent (32,553) were identified at the service centers as having international features. We do not



know how many of these returns were filed by foreign-owned U.S. corporations because service center statistics for international feature returns are not recorded by category.

**Criteria Neither Single Out  
Nor Exclude Foreign-Owned  
U.S. Corporations**

When classifying international feature (code 2) returns, international examiners are to follow the mandatory and nonmandatory criteria specified in IRS' Law Enforcement Manual (which contains confidential information not releasable to the public) and the International Examiners' Classification Handbook. Our review of the manual and handbook showed that the criteria neither specify nor imply selection of foreign-owned U.S. companies over U.S. parent multinational corporations.

The procedures provide that if a return meets one of the mandatory criteria, the classifier must select it for examination. For example, returns of corporations that reflect activities with certain tax haven countries must be selected. However, if the return meets one of the nonmandatory criteria, the procedures encourage classifiers to use their own knowledge, experience, and judgment to identify significant issues warranting examination. For example, if it appears that payments made between related U.S. and foreign firms for royalty fees or managerial and technical services may not have been priced on an arm's-length basis, a classifier would have to judgmentally decide whether the potential for additional tax revenue from reallocating intercompany income or expenses under section 482 of the Internal Revenue Code is sufficiently significant to warrant selecting the return for examination.

Again, none of the classification criteria, whether mandatory or nonmandatory, single out foreign ownership. The IRS classifiers and managers we talked to further emphasized that they made no special distinctions for income tax returns filed by foreign-owned U.S. corporations in selecting returns for audit.

Many international feature tax returns are not forwarded to district offices for examination because, during the service center classification process, the international examiners "survey" many of the returns, i.e., the classifiers see relatively little or no audit potential and, thus, accept the returns as filed. Additionally, some of the international feature tax returns sent to district offices are surveyed there—either because the district sees relatively little audit potential or because other examination work has a higher priority. As shown in table 2.2, 24,973 international feature returns were surveyed in fiscal year 1984—76.7 percent of the international feature returns classified that year.

IRS records do not show how many of the surveyed international feature tax returns involved foreign-owned U.S. corporations. The records do show, however, that returns with tax haven issues are less likely to be surveyed. Tax havens are countries with low tax rates and restrictive financial secrecy laws. As table 2.2 shows, 51.3 percent of the returns reflecting tax haven activities were surveyed, whereas 81 percent of all other international feature returns were surveyed. The International Enforcement Program places special emphasis on auditing returns with tax haven issues, as is discussed further in the next chapter.

---

### District Office Selections Are to Be Based on Potential for Changes in Tax Liability

International feature returns and other corporate income tax returns classified at the service centers and selected for examination are sent to the appropriate district offices where the returns are prioritized and held in the general program audit inventory. Then, as needed to balance workloads, the returns are distributed to general program examination groups. If a return has international issues, the case manager may need to refer the return to an international examiner. Referrals are mandatory if certain international issues, such as the corporate taxpayer having an affiliate in a tax haven country, are present. The mandatory referral criteria for international feature corporate returns do not distinguish between domestic and foreign ownership.

The International Enforcement Program manager in the applicable key district office evaluates each referral to determine if an international examiner should be assigned to assist the general program revenue agent with the case. The Internal Revenue Manual provides guidelines for managers to consider in making such determinations. Here again, those guidelines apply equally to all U.S. corporations, irrespective of domestic or foreign ownership. A primary consideration in deciding to assign an international examiner to the case is the potential for tax liability changes involving transactions that may not have been priced on an arm's-length basis between related corporations, particularly those situations wherein a related corporation is located in a tax haven country.

As shown in table 2.2, in fiscal year 1984, key district International Enforcement Program managers received 7,580 referrals. The managers accepted 4,191 returns (or 55.3 percent) for examination assistance by international examiners. IRS statistics do not indicate how many of these cases involved foreign-owned U.S. corporations. The managers did not assign international examiners to 3,389 cases because the managers

determined that the cases were not complex enough to require a specialist or because other International Enforcement Program work had a higher priority. In either situation, IRS' procedures require the key district program manager to give the general program revenue agent written guidance on how to proceed with the international issues.

## Conclusions

IRS treats the income tax returns of foreign-owned U.S. corporations as international feature tax returns. These returns are identified and classified at IRS service centers with other international feature returns to determine if potential exists for significant adjustments to reported tax liability. IRS procedures provide that if classifiers believe such potential exists, the returns are to be selected and sent with other selected international feature returns to IRS districts where they may be referred to specialists for examination. According to International Enforcement Program officials that we contacted at the national, regional, and district offices and published criteria that we reviewed, at no time during the classification and referral processes are the returns of foreign-owned U.S. corporations given special treatment apart from other international feature income tax returns, which includes U.S. parent corporations with foreign subsidiaries.

**Table 2.2: International Feature Corporation Income Tax Returns: Number Surveyed, Referred, and Accepted for Inclusion in the International Enforcement Program During Fiscal Year 1984**

	Forms 1120 (U.S. Corporation Income Tax Returns)					
	Tax haven returns		Non-tax haven returns		Total returns	
	Number	Percentage of total	Number	Percentage of total	Number	Percentage of total
Returns surveyed and accepted as filed by service centers	1,772	37.7	16,985	61.0	18,757	57.6
Returns surveyed and accepted as filed by district offices	641	13.6	5,575	20.0	6,216	19.1
<b>Total returns surveyed</b>	<b>2,413</b>	<b>51.3</b>	<b>22,560</b>	<b>81.0</b>	<b>24,973</b>	<b>76.7</b>
Returns referred but not accepted for inclusion in the International Enforcement Program	1,107	23.5	2,282	8.2	3,389	10.4
Returns referred and accepted for inclusion in the International Enforcement Program	1,186	25.2	3,005	10.8	4,191	12.9
<b>Total returns referred</b>	<b>2,293</b>	<b>48.7</b>	<b>5,287</b>	<b>19.0</b>	<b>7,580</b>	<b>23.3</b>
<b>Total returns surveyed and referred</b>	<b>4,706</b>	<b>100.0</b>	<b>27,847</b>	<b>100.0</b>	<b>32,553</b>	<b>100.0</b>

Source: Developed by GAO from data on IRS Form 3965 (International Enforcement Program—Report on Surveys, Referrals, and Inventory) for fiscal year ending September 30, 1984.

---

# Special Compliance Projects Result in Audits of Some Foreign-Owned Corporations

---

In addition to returns that might be selected for audit through the standard service center and district office procedures discussed in chapter 2, other returns filed by foreign-owned U.S. corporations might be selected for audit through special compliance projects. Occasionally, for instance, IRS has specifically selected for audit the income tax returns of some U.S. corporations with foreign owners located in tax haven countries; tax haven issues are given priority attention within IRS' International Enforcement Program. Another special compliance project involves the electronic components industry. That project, which was ongoing at the time of our review, began with a focus on foreign-owned U.S. corporations but later was expanded to include domestically owned U.S. corporations with overseas affiliates.

---

## Abusive Tax Haven Emphasis

IRS defines abusive tax haven activity as the unwarranted shifting of U.S. income to countries with low tax rates and restrictive financial secrecy laws in order to avoid or evade U.S. income taxes. In recent years, IRS' examination program guidelines have designated abusive tax havens as a priority area within the International Enforcement Program. As noted in table 3.1, International Enforcement Program examination time on tax returns with tax haven issues represented 62.4 percent of the program's total examination hours in fiscal year 1984. IRS national office and district offices in the International Enforcement Program have, at times, implemented special projects to identify and examine income tax returns with tax haven issues. Some of the U.S. corporations selected for examination have been ones with foreign owners located in tax haven countries. Program officials told us, however, that U.S. parent corporations with tax haven subsidiaries are also given special emphasis.

---

## National Office Tax Haven Efforts

We reviewed various national office initiatives regarding tax havens. None specifically singled out foreign-owned U.S. corporations.

**Chapter 3  
Special Compliance Projects Result in Audits  
of Some Foreign-Owned Corporations**

**Table 3.1: International Enforcement Program Examination Time on Tax Returns With Tax Haven Issues in Fiscal Year 1984**

Type of tax return examined	Fiscal year 1984 examination time	
	Hours	Percentage of total
<b>Corporate returns arrayed by asset size:</b>		
No balance sheet	345	0.2
Under \$50,000	1,664	0.8
\$50,000 under \$1M	786	0.4
\$1M under \$5M	2,931	1.5
\$5M under \$10M	2,208	1.1
\$10M under \$50M	8,007	4.0
\$50M under \$100M	2,948	1.5
\$100M under \$250M	13,443	6.8
\$250M and over	155,875	78.4
<b>Total<sup>a</sup></b>	<b>188,207</b>	<b>94.6</b>
Other corporate returns <sup>b</sup>	2,952	1.5
<b>Total corporate returns</b>	<b>191,159</b>	<b>96.1</b>
All other return types <sup>c</sup>	7,739	3.9
<b>Total tax haven returns</b>	<b>198,898<sup>d</sup></b>	<b>100.0</b>

<sup>a</sup>These are Forms 1120 (U.S. Corporation Income Tax Return).

<sup>b</sup>These include Forms 1120F (U.S. Income Tax Return of a Foreign Corporation) and other types.

<sup>c</sup>These include Forms 1040 (U.S. Individual Income Tax Return), Forms 1065 (U.S. Partnership Return of Income), and other types.

<sup>d</sup>This represents 62.4 percent of total International Enforcement Program examination time (318,805 hours) in fiscal year 1984.

Source: Developed by GAO from statistics compiled by IRS' Office of National and international Programs.

Efforts undertaken by IRS' national office primarily involve gathering and synthesizing information about tax haven activities and, in turn, distributing the information to assist district office examinations. Periodically, for example, a staff analyst in IRS' national office compiles a "Tax Haven Handbook" for distribution to regional and district offices. The August 1984 handbook, the most currently available at the time of our review, contained

- descriptions of information gathering projects directed at foreign transactions or tax havens being conducted within IRS' regions;
- overviews of different tax haven schemes, including examples exchanged or shared in meetings with tax treaty partner countries, such as the Federal Republic of Germany and the United Kingdom;

- discussions of district office examination techniques that have proven successful in various types of tax haven cases; and
- extracts of selected tax haven articles and promoter advertisements, as published in various periodicals.

At the time of our review, another national office initiative directed at tax haven activities involved use of Treasury Form 90-22.1 (Report of Foreign Bank and Financial Accounts). This form must be filed by any U.S. taxpayer, including any foreign-owned U.S. corporation, with a foreign bank account exceeding \$5,000 in value. IRS estimated that about 180,000 forms were filed in 1984. IRS is transcribing information from these forms onto computer tape at its Memphis Service Center to establish a computerized data base. The data base can be updated periodically in future years as additional forms are filed.

After a computerized data base is established, IRS will be able to use the foreign financial information to perform various compliance checks and research projects. For example, the data base can be programmed to permit printouts of filings arrayed by IRS district office, tax haven country, and value of the account. Also, by matching the data base with IRS' individual and business master files of tax information, IRS officials said it may be possible to develop profiles of taxpayers most likely to engage in abusive tax haven activities.

---

### District Office Tax Haven Efforts

As stated above, IRS district offices have, at times, implemented special projects to identify and examine tax returns with tax haven issues. The August 1984 Tax Haven Handbook, mentioned earlier, reported that key district offices in six of IRS' seven regions had a total of 16 tax haven information gathering projects ongoing at that time; the Southwest region, with 5 projects, had the largest number. Our review showed that none of these 16 projects focused specifically on foreign-owned U.S. corporations; however, we did identify 2 other projects, both initiated by the Southwest region's Dallas district office, that did specifically focus on such corporations.

### Dallas District Office Tax Haven Projects

The Dallas district initiated one project in 1982 by selecting for examination the income tax returns of seven U.S. corporations, each of which was owned by a foreign corporation located in a tax haven country, such as the Bahamas, the Channel Islands, Panama, and Vanuatu (formerly New Hebrides). One purpose of this project was to determine what types of tax liability issues arise in these situations.

In two of the seven examinations, IRS found that the foreign parent corporations located in two tax haven countries had loaned money to their U.S. subsidiaries. IRS determined that the subsidiaries had not withheld tax on interest payments to the respective foreign parent company, as required by section 1442 of the Internal Revenue Code. Accordingly, IRS secured the applicable withholding tax under code section 1442.

In another case, IRS found that the U.S. corporation had deducted certain "sales commissions," paid to related foreign corporations in Hong Kong and Liechtenstein. According to IRS' examination, the Liechtenstein corporation was only a shell and could not have performed any function to earn sales commissions. Under section 162 of the Internal Revenue Code, which permits a taxpayer to deduct only the ordinary and necessary expenses paid or incurred in carrying on any trade or business, IRS disallowed the U.S. corporate taxpayer's deduction for sales commissions.

Based in part on the results of this project, the Dallas district decided to establish a separate group of international examiners to focus on tax haven issues outside the Coordinated Examination Program. Historically, due to staffing restrictions and tax revenue yield, a large percentage of international examiner staff years nationwide has been applied to the Coordinated Examination Program. The objective of the recently formed Dallas group, which became operational on February 1, 1984, is to help ensure that the International Enforcement Program provides adequate coverage of individuals and smaller corporations with tax haven linkages. According to International Enforcement Program officials at the national office, the Dallas district office group is unique within IRS and, if successful, the concept may be expanded to other district offices.

One of the group's ongoing projects at the time of our review involved examination of the income tax returns of 14 U.S. corporations with foreign owners located in tax haven countries. An additional basis for selection was that each U.S. income tax return showed large amounts of debt (loan balances). According to district office officials, IRS was concerned that unreported income might have been transferred out of the U.S. to tax haven countries and then returned to domestic corporations in the form of loans. In this regard, IRS also hoped to determine whether U.S. citizens were, in fact, the beneficial owners of the entities located in the tax haven countries.

---

## Electronic Components Industry Study

In 1984, IRS initiated a nationwide study of the electronic components industry. The Service's Western region is leading the study because many of the major electronic component companies are located in California. The study, expected to be completed sometime in 1986, involves an analysis of both inbound and outbound transfer pricing among related companies in the industry—the pricing of items transferred from foreign companies to their U.S. subsidiaries and the pricing of items transferred from U.S. parent companies to their foreign affiliates. Although IRS' current focus on the electronic components industry includes both domestically owned and foreign-owned U.S. corporations, the study evolved from an earlier IRS data gathering effort concerning only foreign-owned U.S. companies, initiated in 1983.

One industry that stood out in IRS' 1983 study was the electronic components industry. According to International Enforcement Program officials, the study showed that foreign-owned U.S. corporations engaged in the wholesale trade of electronic goods had one of the lowest ratios of income tax to gross receipts. Further, the study group noted that

- foreign countries had made major inroads into the electronic components industry,
- many major domestically owned U.S. companies used overseas affiliates to manufacture electronic components and then shipped the components to related entities in the United States, and
- recent IRS audits of intercompany pricing in electronic component companies had resulted in proposals of substantial increases in taxes.

For these reasons, IRS initiated a comprehensive study of the electronic components industry, encompassing both domestically owned and foreign-owned U.S. corporations. The objective of this ongoing study is to determine if the electronic components industry should be included in IRS' Industry Specialization Program. Within a given industry, this program tries to ensure that examination issues raised in various districts are coordinated and resolved uniformly. To determine whether examinations of the electronic components industry should be included in this nationwide program, IRS is studying the scope, types, and significance of issues presented by the industry. If the industry is included in IRS' Industry Specialization Program, the larger electronic component companies may be given more examination emphasis, regardless of domestic or foreign ownership.



---

## Conclusions

IRS examination program guidelines have designated abusive tax havens as a priority area for the International Enforcement Program, with examination coverage to include all return types—individual, partnership, fiduciary, and corporation. Special compliance projects involving tax haven activity have resulted in selection of some foreign-owned U.S. corporations for audit. International Enforcement Program officials told us, however, that U.S. parent corporations with tax haven subsidiaries are also given special emphasis.

IRS began focusing some resources on the electronic components industry in 1984. IRS' study of this industry evolved from a data gathering survey initiated by the Service in 1983 regarding foreign-owned U.S. corporations. Survey results, according to International Enforcement Program officials, showed that the electronic components industry had an unusually low ratio of income tax to gross receipts. This industry involves many international affiliations, presenting IRS with both inbound and outbound transfer pricing issues. The Service's ongoing study of the industry, thus, is covering both domestically owned and foreign-owned U.S. corporations.

# Comparative Audit Coverage Statistics for Fiscal Years 1983 and 1984

Comparative audit coverage statistics confirm the observation presented earlier that IRS' standard classification and selection procedures neither single out nor exclude foreign-owned U.S. corporations. In fiscal year 1983, IRS audited 1.85 percent of all foreign-owned U.S. corporations and 1.36 percent of all domestically owned U.S. corporations. The comparative audit coverage statistics for fiscal year 1984 are 2.92 percent and 1.02 percent, respectively. Our analysis indicated that the differences in audit coverage percentages for foreign-owned and domestically owned U.S. corporations are not statistically significant. In other words, the statistics show that the foreign-ownership characteristic of a U.S. corporation neither increases nor lessens the probability of an audit.

In this chapter, audit coverage statistics are presented in terms of three variables—size of total assets, category of industry, and country of foreign owner. Our basic objective was to develop statistics comparing foreign-owned and domestically owned U.S. corporations. We did not undertake detailed analyses to explain differences in audit coverage percentages because our testing showed that the differences were not statistically significant.

## Audit Coverage by Size of Total Assets

Tables 4.1 and 4.2 present audit coverage statistics for fiscal years 1983 and 1984, respectively, comparing foreign-owned and domestically owned U.S. corporations by size of total assets. While the overall audit coverage percentage is higher for foreign-owned U.S. corporations, the data also show that the audit coverage percentage is lower for these corporations in the higher asset classes. For fiscal year 1983, for example, the audit percentages generally are greater for domestically owned U.S. corporations with total assets of \$500,000 or more. Similarly, for fiscal year 1984, the audit percentages at asset levels of \$5 million or more generally are greater for domestically owned U.S. corporations.

## Audit Coverage by Category of Industry

Tables 4.3 and 4.4 present audit coverage statistics by major industry categories for fiscal years 1983 and 1984. For fiscal year 1983, foreign-owned U.S. corporations show higher audit coverage percentages than domestically owned U.S. corporations in 5 of the 11 major industry categories—manufacturing; wholesale trade; retail trade; wholesale and retail trade not allocable; and finance, insurance, and real estate. Of these five categories, the widest spread in audit coverage percentages is

wholesale and retail trade not allocable (23.93 percent versus 1.38 percent), but the former percentage represents only four foreign-owned companies and one audit.

Three of the five categories each show over 100 audits of foreign-owned U.S. companies in fiscal year 1983—manufacturing, wholesale trade, and retail trade. Of these three categories, the widest spreads in audit coverage percentages are in the manufacturing (4.54 percent versus 2.85 percent) and retail trade (7.98 percent versus 1.01 percent) categories. More detailed analysis of these two and the other categories is presented in table IV.1 in appendix IV.

For fiscal year 1984 (see table 4.4), foreign-owned U.S. corporations show higher audit coverage percentages than domestically owned U.S. corporations in 4 of the 11 major industry categories—manufacturing; wholesale trade; finance, insurance, and real estate; and services. For the other seven major industry categories, the foreign-owned U.S. corporations had relatively less audit coverage than domestically owned U.S. corporations. Table IV.2 in appendix IV presents more detailed audit coverage statistics by industry.

## Audit Coverage by Country of Foreign Owner

Tables 4.5 and 4.6 present audit coverage statistics for foreign-owned U.S. corporations by the 10 countries whose residents own the largest number of U.S. corporations. Generally, these 10 countries are the nation's leading trade partner countries and account for about 67 percent of all foreign-owned U.S. corporations. For fiscal year 1983, audits of U.S. corporations owned by residents of these countries represented about 80 percent of IRS' total audits of foreign-owned U.S. companies, compared with about 51 percent for fiscal year 1984.

Table 4.5 shows that, for fiscal year 1983, IRS audited 6.8 percent of the U.S. corporations owned by residents of the Netherlands Antilles, the highest of the 10 percentages. The next highest percentage (5.35 percent) was for U.S. corporations owned by residents of the United Kingdom. Further, audits of U.S. companies owned by residents of the United Kingdom constituted over 20 percent of IRS' total audits of foreign-owned U.S. corporations in fiscal year 1983.

Table 4.6 shows that, for fiscal year 1984, IRS audited 9 percent of the U.S. corporations owned by residents of West Germany—the highest of the 10 percentages. The next highest percentage (5.52 percent) was for U.S. corporations owned by residents of Switzerland. In contrast to

---

1983, the audit coverage of U.S. corporations owned by residents of the Netherlands Antilles dropped to less than 1 percent. The table further shows that audits of U.S. companies owned by residents of West Germany constituted 18.42 percent of IRS' total audits of foreign-owned U.S. corporations in fiscal year 1984. Tables IV.3 and IV.4 in appendix IV present more detailed audit coverage statistics by country.

---

### Differences Not Statistically Significant

The differences in audit coverage percentages between foreign-owned and domestically owned U.S. corporations presented in the tables in this chapter are not statistically significant at a 95-percent level of confidence. Each projected percentage is subject to error due to sampling of subsets of all corporations. As a consequence, the differences in audit percentages probably are attributable to sampling error rather than bias in IRS' procedures for classifying or selecting tax returns to audit. The 95-percent level of confidence means that, if repeated samples were drawn, 95 percent of the time the results would show no statistically significant differences between the audit coverage percentages for foreign-owned and domestically owned U.S. corporations.

---

### Conclusions

Overall, IRS audited a higher percentage of foreign-owned U.S. corporations than domestically owned U.S. corporations in fiscal years 1983 and 1984. However, the differences in audit coverage percentages are not statistically significant. That is, the statistics show that a foreign-owned U.S. corporation has neither a higher nor a lower probability of being audited than a domestically owned U.S. corporation.

The statistical tables in this chapter present audit coverage comparisons in reference to three variables—size of total assets, category of industry, and country of foreign owner. Generally, the data show that IRS audited a comparatively higher percentage of domestically owned U.S. corporations in the larger total assets levels in the two fiscal years. Audit coverage varied among the 11 major industry categories presented. In some industries, IRS audited relatively more foreign-owned U.S. companies and relatively fewer in others. Not surprisingly, many IRS audits of foreign-owned U.S. corporations involved leading trade partner countries—Canada, Mexico, Japan, and Western European countries.

Chapter 4  
**Comparative Audit Coverage Statistics for  
 Fiscal Years 1983 and 1984**

**Table 4.1: Comparative Audit Coverage in Fiscal Year 1983 by Size of Total Assets<sup>a</sup>**

(M=million)

Size of total assets	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
\$0	462	1	0.22	89,339	153	0.17
\$1 under \$100,000	9,744	0	0.00	1,442,526	11,564	0.80
\$100,000 under \$250,000	4,272	105	2.48	510,556	7,409	1.45
\$250,000 under \$500,000	3,080	46	1.51	292,180	5,007	1.71
\$500,000 under \$1M	2,355	28	1.20	189,712	3,588	1.89
\$1M under \$5M	4,335	124	2.86	172,794	5,305	3.07
\$5M under \$10M	975	40	4.14	22,727	1,361	5.99
\$10M under \$25M	845	59	7.08	16,585	1,312	7.91
\$25M under \$50M	369	29	8.03	8,011	509	6.36
\$50M under \$100M	238	12	5.05	4,945	420	8.51
\$100M under \$250M	202	25	12.44	3,221	414	12.85
\$250M or more	215	28	13.02	2,947	565	19.17
<b>Total</b>	<b>27,096</b>	<b>500</b>	<b>1.85</b>	<b>2,755,547</b>	<b>37,611</b>	<b>1.36</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1983; see discussion of methodology in chapter 1.

**Table 4.2: Comparative Audit Coverage in Fiscal Year 1984 by Size of Total Assets<sup>a</sup>**

(M=million)

Size of total assets	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
\$0	462	1	0.38	89,339	729	0.82
\$1 under \$100,000	9,744	262	2.69	1,442,526	7,428	0.51
\$100,000 under \$250,000	4,272	98	2.31	510,556	5,039	0.99
\$250,000 under \$500,000	3,080	44	1.46	292,180	3,369	1.15
\$500,000 under \$1M	2,355	52	2.24	189,712	2,616	1.38
\$1M under \$5M	4,335	138	3.20	172,794	4,707	2.72
\$5M under \$10M	975	54	5.57	22,727	1,274	5.61
\$10M under \$25M	845	41	4.94	16,585	1,045	6.31
\$25M under \$50M	369	26	7.08	8,011	534	6.67
\$50M under \$100M	238	13	5.49	4,945	422	8.55
\$100M under \$250M	202	20	9.93	3,221	455	14.12
\$250M or more	215	37	17.21	2,947	569	19.31
<b>Total</b>	<b>27,096</b>	<b>791</b>	<b>2.92</b>	<b>2,755,547</b>	<b>28,193</b>	<b>1.02</b>

(Table note appears on following page.)

**Chapter 4**  
**Comparative Audit Coverage Statistics for**  
**Fiscal Years 1983 and 1984**

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1984; see discussion of methodology in chapter 1.

**Table 4.3: Comparative Audit Coverage in Fiscal Year 1983 by Major Industry Categories<sup>a</sup>**

Industry category	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
Agriculture, forestry, fishing	443	0	0.00	84,302	597	0.71
Mining	1,433	4	0.28	30,941	502	1.63
Construction	450	1	0.22	273,931	3,376	1.23
Manufacturing	3,095	140	4.54	246,320	7,015	2.85
Transportation and public utilities	448	3	0.69	107,350	1,802	1.68
Wholesale trade	7,154	108	1.52	269,930	3,910	1.45
Retail trade	1,743	139	7.98	529,012	5,358	1.01
Wholesale and retail not allocable	4	1	23.93	3,743	51	1.38
Finance, insurance, real estate	7,741	74	0.96	449,519	3,578	0.80
Services	4,570	29	0.64	743,110	11,326	1.52
Nature of business not allocable	12	0	0.00	17,384	92	0.53
<b>Total</b>	<b>27,096</b>	<b>500</b>	<b>1.85</b>	<b>2,755,547</b>	<b>37,611</b>	<b>1.36</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding. See table IV.1 in appendix IV for more detailed audit coverage statistics by industry.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1983; see discussion of methodology in chapter 1.

Chapter 4  
 Comparative Audit Coverage Statistics for  
 Fiscal Years 1983 and 1984

**Table 4.4: Comparative Audit Coverage in Fiscal Year 1984 by Major Industry Categories<sup>a</sup>**

Industry category	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
Agriculture, forestry, fishing	443	1	0.23	84,302	321	0.38
Mining	1,433	5	0.35	30,941	787	2.54
Construction	450	2	0.45	273,931	2,465	0.90
Manufacturing	3,095	120	3.90	246,320	4,978	2.02
Transportation and public utilities	448	2	0.46	107,350	1,158	1.08
Wholesale trade	7,154	441	6.17	269,930	3,413	1.26
Retail trade	1,743	7	0.42	529,012	4,967	0.94
Wholesale and retail not allocable	4	0	0.00	3,743	0	0.00
Finance, insurance, real estate	7,741	146	1.90	449,519	3,396	0.76
Services	4,570	65	1.42	743,110	6,675	0.90
Nature of business not allocable	12	0	0.00	17,384	28	0.16
<b>Total</b>	<b>27,096</b>	<b>791</b>	<b>2.92</b>	<b>2,755,547</b>	<b>28,193</b>	<b>1.02</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding. See table IV.2 in appendix IV for more detailed audit coverage statistics by industry.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1984; see discussion of methodology in chapter 1.

**Chapter 4**  
**Comparative Audit Coverage Statistics for**  
**Fiscal Years 1983 and 1984**

**Table 4.5: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1983 by the Ten Countries Whose Residents Own the Largest Number of U.S. Corporations<sup>a</sup>**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audited
Canada	6,769	24.99	69	1.02	13.
Japan	2,175	8.03	88	4.05	17.
United Kingdom	1,926	7.11	103	5.35	20.
West Germany	1,611	5.95	45	2.79	9.
Netherlands	1,262	4.66	19	1.51	3.
Switzerland	1,142	4.22	24	2.10	4.
France	1,071	3.96	8	0.75	1.
Mexico	806	2.98	0	0.00	0.
Australia	790	2.92	0	0.00	0.
Netherlands Antilles	603	2.23	41	6.80	8.
<b>Subtotal</b>	<b>18,155</b>	<b>67.05</b>	<b>397</b>	<b>2.19</b>	<b>80.</b>
All other countries	8,902	32.93	94	1.06	19.
<b>Total</b>	<b>27,096</b>	<b>100.00</b>	<b>500</b>	<b>1.85</b>	<b>100.</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding. See table IV.3 in appendix IV for more detailed audit coverage statistics by country.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1983; see discussion of methodology in chapter 1.



Chapter 4  
 Comparative Audit Coverage Statistics for  
 Fiscal Years 1983 and 1984

**Table 4.6: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1984 by the Ten Countries Whose Residents Own the Largest Number of U.S. Corporations<sup>a</sup>**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Canada	6,769	24.99	52	0.77	6.59
Japan	2,175	8.03	66	3.03	8.41
United Kingdom	1,926	7.11	19	0.99	2.41
West Germany	1,611	5.95	145	9.00	18.42
Netherlands	1,262	4.66	25	1.98	3.23
Switzerland	1,142	4.22	63	5.52	8.02
France	1,071	3.96	19	1.77	2.43
Mexico	806	2.98	8	0.99	1.09
Australia	790	2.92	0	0.00	0.00
Netherlands Antilles	603	2.23	5	0.83	0.65
<b>Subtotal</b>	<b>18,155</b>	<b>67.05</b>	<b>402</b>	<b>2.21</b>	<b>51.25</b>
All other countries	8,902	32.93	379	4.26	48.87
<b>Total</b>	<b>27,096</b>	<b>100.00</b>	<b>791</b>	<b>2.92</b>	<b>100.00</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding. See table IV.4 in appendix IV for more detailed audit coverage statistics by country.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1984; see discussion of methodology in chapter 1.

## Request Letter

98TH CONGRESS, 2ND SESSION

## MEMBERS

SENATE	HOUSE
ROBERT DOLE, KANS. CHAIRMAN	DAN ROSTENKOWSKI, ILL. VICE CHAIRMAN
BOB PACKWOOD, OREG.	SAM GIBBONS, FLA.
WILLIAM V. ROTH, JR., DEL.	J. J. PICKLE, TEX.
RUSSELL W. LONG, LA.	BARBER B. COHABLE, JR., N.Y.
LLOYD BENTSEN, TEX.	JOHN J. DUNCAN, TENN.

## Congress of the United States

JOINT COMMITTEE ON TAXATION  
1015 LONGWORTH HOUSE OFFICE BUILDING

Washington, D.C. 20515

JUL 31 1984

DAVID H. BROCKWAY  
CHIEF OF STAFF  
RICHARD A. GORDON  
DEPUTY CHIEF OF STAFF  
JAMES W. WETZLER  
DEPUTY CHIEF OF STAFF

Honorable Charles A. Bowsher  
Comptroller General of the United States  
U.S. General Accounting Office  
441 G Street, N.W.  
Washington, DC 20548

Dear Mr. Bowsher:

The Joint Committee on Taxation, pursuant to section 6103(f)(4)(A) of the Internal Revenue Code of 1954, as amended, requests the General Accounting Office to undertake a study of Federal taxation of United States subsidiaries of foreign corporations. As you know, foreign corporations increasingly have found it both desirable and beneficial to establish U.S.-based operations in recent years. It is important, therefore, to assure that these subsidiaries are being taxed in an equitable manner. Data on the effective tax rates for such companies is not now readily available. To the extent that the General Accounting Office could fill these data gaps, it would provide a considerable service to Congress.

Your initial efforts should be focused rather broadly to identify issues that warrant further development. Once you have identified these issues, we would like to discuss them with you and to reach agreement on the focus of future work. As part of your initial efforts, however, we ask specifically that you develop information on (1) effective tax rates of U.S.-based subsidiaries of foreign corporations and (2) Internal Revenue Service tax compliance activities with respect to such subsidiaries. To the extent feasible, your staff should compare, on an industry-by-industry basis, the effective U.S. income tax rates of domestic subsidiaries of foreign corporations to the tax rates on U.S. corporations. Your work should also develop information on the type of deductible payments (such as interest, rents, and royalties) made by domestic subsidiaries of foreign corporations. Finally, we are interested in obtaining comparative information about Internal Revenue Service compliance efforts, such as the enforcement of intercompany transfer pricing rules and the effectiveness of exchange of information agreements with tax treaty partner countries, for these entities.

**Congress of the United States**

JOINT COMMITTEE ON TAXATION

Washington, D.C. 20515

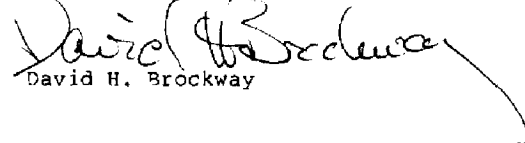
**MAR 31 1984**

Honorable Charles A. Bowsher  
Comptroller General of the United States  
Page two

We expect that your designated representatives will have access to the IRS files, records, and returns necessary to conduct this study for the Joint Committee. The Joint Committee staff will work closely with your representatives and will assist as needed. We would like to be kept informed of the progress of the work.

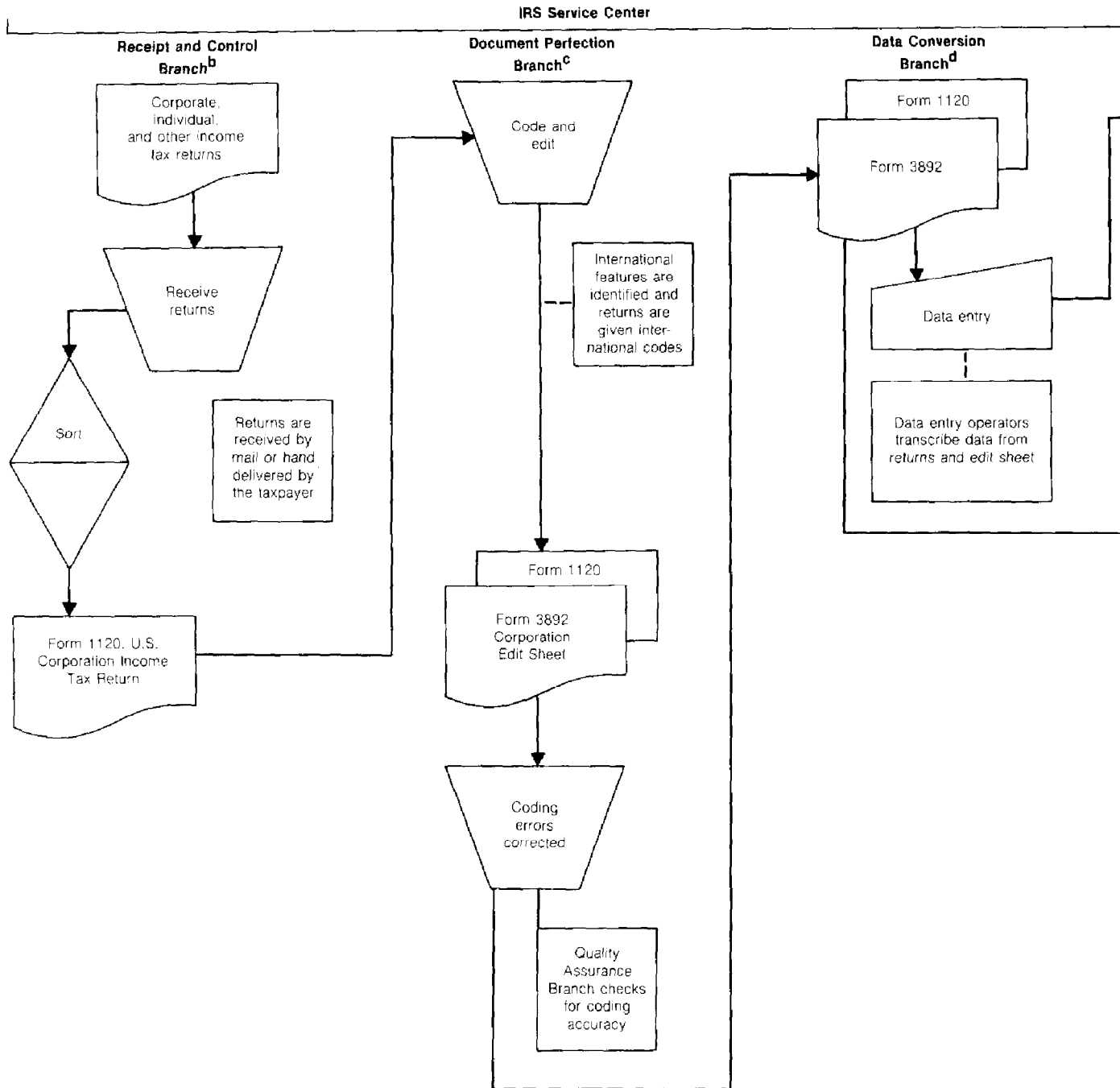
Because of the possible interest of other Congressional committees in this subject, the Joint Committee does not object to your discussing the progress of your work with them. (Of course, these discussions could not involve any disclosure of tax returns or return information.) The Joint Committee staff would like to be notified in advance of all such discussions and be given the opportunity to attend any meetings on the subject.

Sincerely,

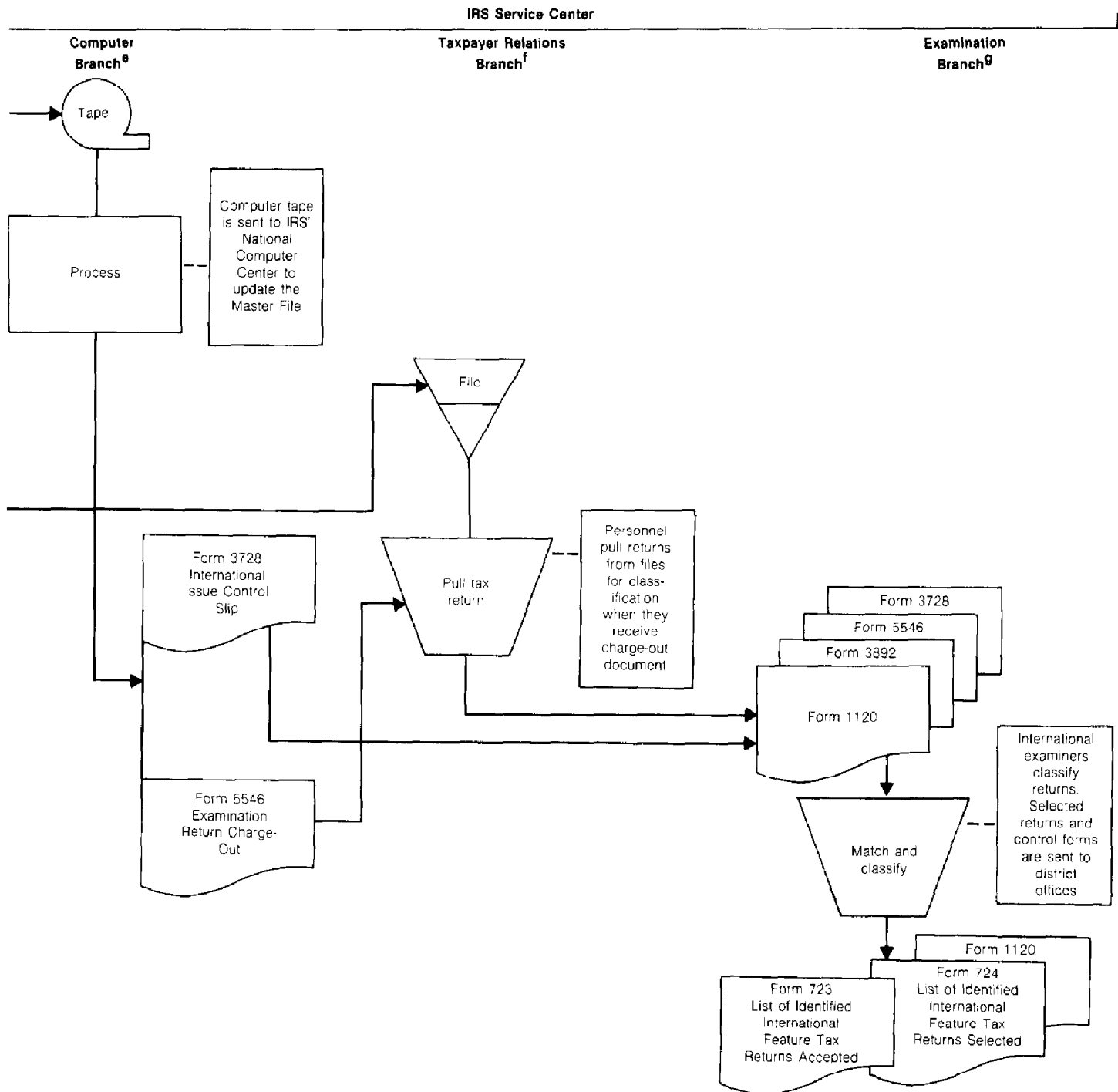
  
David H. Brockway

# Flowcharts of IRS' Procedures for Selecting International Feature Corporate Income Tax Returns for Examination

Figure II.1: Service Center Procedures<sup>a</sup>



**Appendix II**  
**Flowcharts of IRS' Procedures for Selecting**  
**International Feature Corporate Income Tax**  
**Returns for Examination**



---

**Appendix II  
Flowcharts of IRS' Procedures for Selecting  
International Feature Corporate Income Tax  
Returns for Examination**

---

Notes:

<sup>a</sup>IRS has 10 service centers. The procedures presented here are those used at the Austin Service Center as of October 1984. According to IRS national office officials responsible for the International Enforcement Program, the other service centers use similar procedures.

<sup>b</sup>Corporate, individual, and other income tax returns generally are delivered by mail (occasionally in person) to the service center's Receipt and Control Branch. The returns are mechanically and manually sorted by type, and those of corporations (Forms 1120) are sent in batches to the Document Perfection Branch.

<sup>c</sup>In the Document Perfection Branch, tax examiners review the corporate income tax returns to determine if international features are present. The tax examiners use an IRS code and edit handbook for guidance in identifying international features. The examiners attach corporation edit sheets (Forms 3892) to the returns and place international codes on the sheets if the returns have international features. The same international code (code 2) is used regardless of the nature of the international feature identified, except that a code 6 is used to identify a foreign bank account.

Samples of corporate returns that have been coded and edited by tax examiners in the Document Perfection Branch are selected for review by the Quality Assurance Branch. Senior examiners review the sample returns and the corporation edit sheets to ensure that the returns have been coded accurately and completely. Errors are corrected by the tax examiners, and the returns are sent to the Data Conversion Branch.

<sup>d</sup>In the Data Conversion Branch, selected data entry operators, i.e., those with better transcription records, transcribe information from the corporate income tax returns and the corporation edit sheets to computer tape. An IRS code and edit handbook shows the line items the data entry operators must transcribe from the tax returns and the edit sheets. One of these line items is the audit code for international features. After the data has been transcribed to tape, the returns and the edit sheets are sent to the Taxpayer Relations Branch where they are held temporarily, pending classification.

<sup>e</sup>The Computer Branch sends the computer tape of tax return data to the National Computer Center in Martinsburg, West Virginia, where the tape is used to update the Business Master File. Then the National Computer Center generates a new tape, which is sent to the service center's Computer Branch. The service center uses this tape to generate international issue control slips (Forms 3728) and examination return charge-out documents (Forms 5546).

These forms are generated for every corporate income tax return that was given an international code (codes 2 and 6). The applicable code appears on the charge-out documents. The charge-out documents are sent to the Taxpayer Relations Branch where they are used to pull tax returns for classification. The international issue control slips are sent to the Examination Branch where they are used to control the receipt of the corporate income tax returns having international features.

<sup>f</sup>Personnel in the Taxpayer Relations Branch pull corporate income tax returns from their files for classification when they receive the charge-out documents from the Computer Branch. Document locator numbers on the charge-out documents are used to locate specific tax returns. After the tax returns are pulled, they are sent with the charge-out documents and corporation edit sheets to the Examination Branch to be classified.

<sup>g</sup>Examination Branch staff match the international issue control slips received from the Computer Branch with the charge-out documents and the corporate income tax returns by using the document locator numbers on the documents. If a control slip cannot be matched, Examination Branch staff secure the applicable charge-out document and the tax return from the Taxpayer Relations Branch.

When the Examination Branch has received a sufficient number of international feature returns, the Classification Section Chief notifies the Regional Program Manager. In the Southwest region, a sufficient number is approximately 500, which includes some individual and partnership income tax returns with international issues, as well as the corporate returns. The Regional Program Manager then contacts the key district international group managers, who assign experienced international examiners to the service center to classify the returns. The assigned international examiners use classification criteria specified in the International Examiners' Classification Handbook and the Law Enforcement Manual to select returns that appear to have high potential for tax liability adjustments. The Examination Branch sends the tax returns that are selected for examination to the Planning and Special Projects Branch in the applicable district office.

---

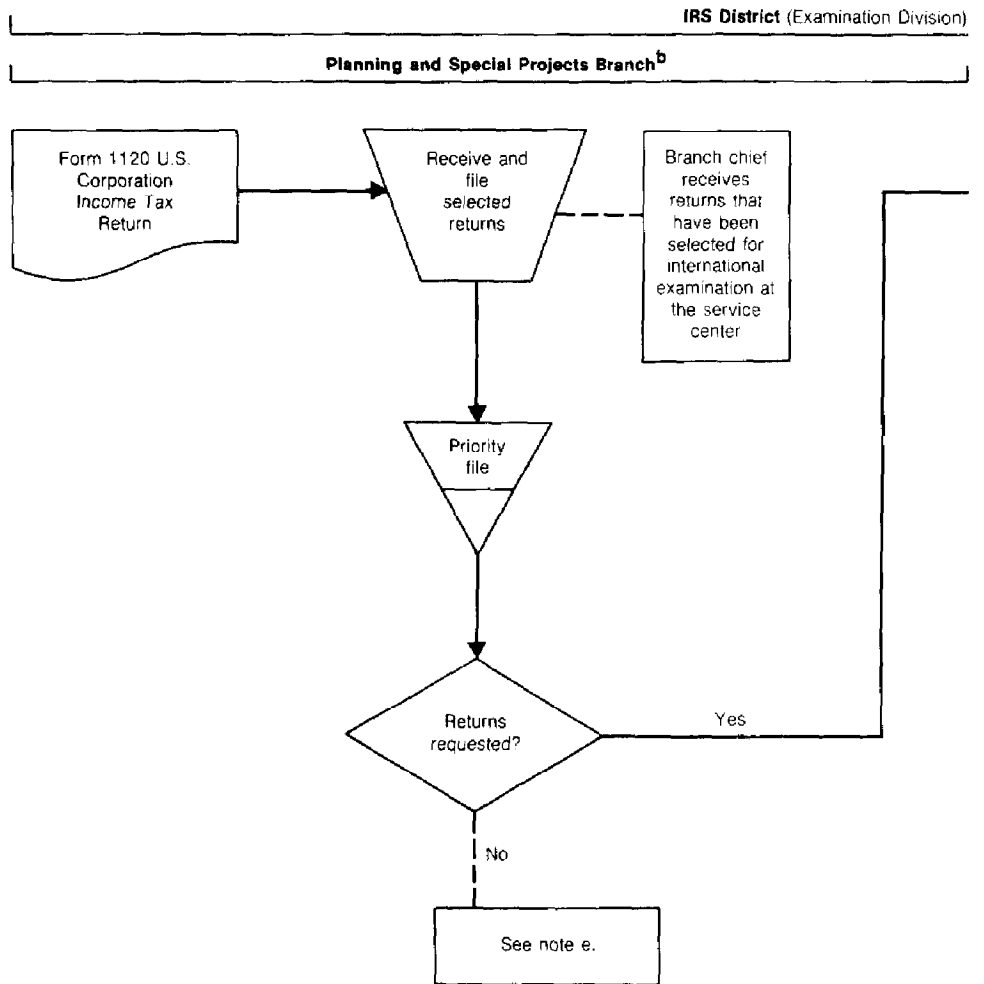
**Appendix II**  
**Flowcharts of IRS' Procedures for Selecting**  
**International Feature Corporate Income Tax**  
**Returns for Examination**

---

The examiners prepare two reports to account for all the tax returns that are classified. One report, Form 723, lists the international feature tax returns that are accepted as filed by the taxpayer ("surveyed"). The other report, Form 724, lists the international feature returns that are selected for examination. These reports are sent to District Program Managers who use them to monitor the receipt of income tax returns in their respective districts. (See figure II.2 for district office processing of international feature tax returns.)

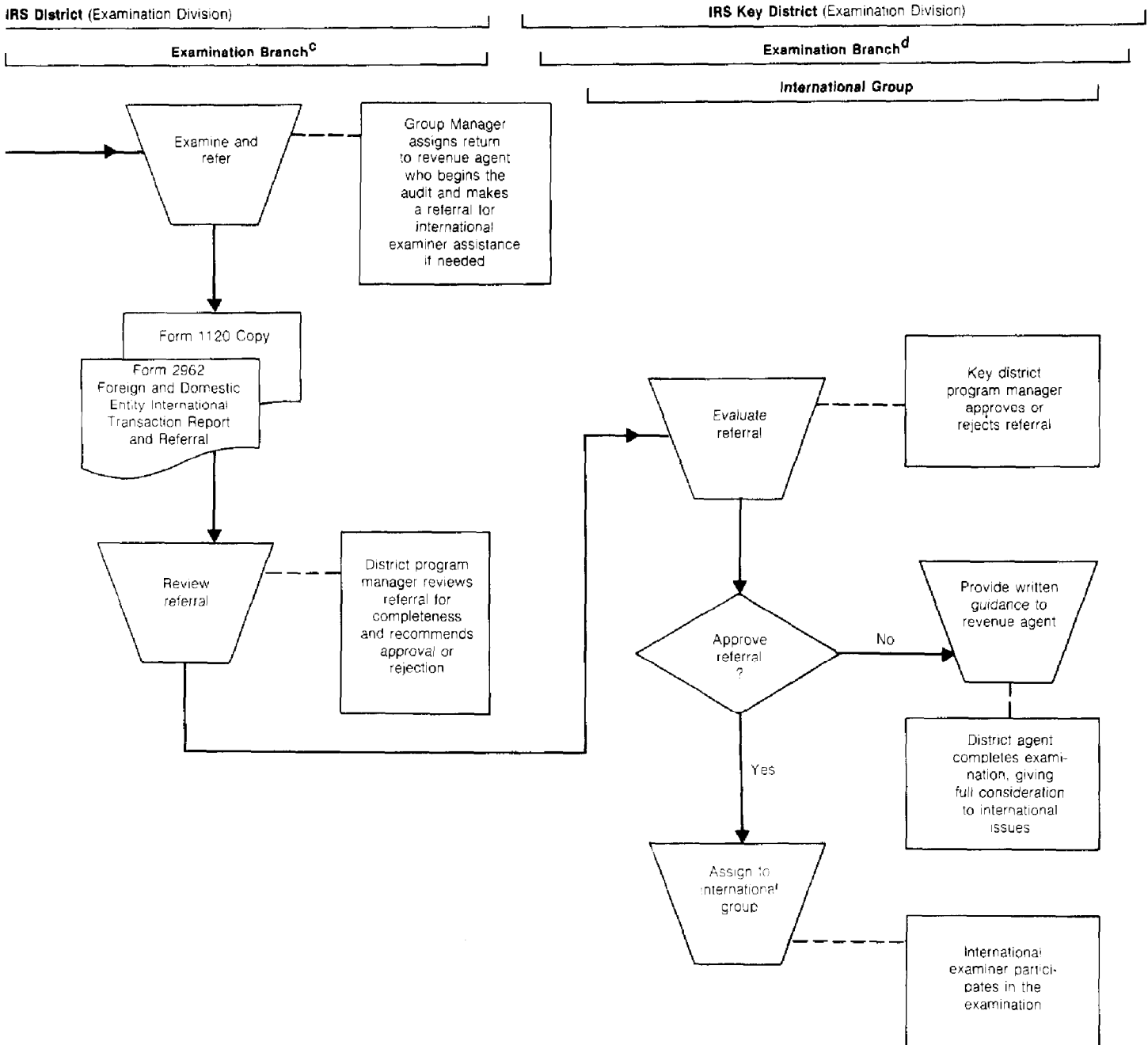
Appendix II  
Flowcharts of IRS' Procedures for Selecting  
International Feature Corporate Income Tax  
Returns for Examination

Figure II.2: District Office Procedures<sup>a</sup>





**Appendix II  
Flowcharts of IRS' Procedures for Selecting  
International Feature Corporate Income Tax  
Returns for Examination**



---

**Appendix II**  
**Flowcharts of IRS' Procedures for Selecting**  
**International Feature Corporate Income Tax**  
**Returns for Examination**

---

Notes:

<sup>a</sup>IRS has 63 district offices. The district office procedures presented here were being used, as of January 1985, in the four districts we visited during our review—Dallas, Houston, Los Angeles, and Manhattan. According to IRS national office officials responsible for the International Enforcement Program, the other districts use similar procedures.

<sup>b</sup>The district office Planning and Special Projects Branch receives the international feature tax returns that have been selected for examination by classifiers at the service center. The branch files the returns by priorities established in the district office's examination plan. Our review of IRS' procedural guidance showed that foreign ownership is neither a separate nor a priority criterion in examination plans. Upon request, the returns are distributed to general program examination groups as needed to maintain workload levels.

<sup>c</sup>International feature tax returns that are distributed by the Planning and Special Projects Branch to general program groups in the Examination Branch are assigned to district revenue agents by group managers. The returns have been stamped "international selected" during classification at the service center and, accordingly, the district revenue agents prepare a Form 2962 referral for each stamped return. The agents forward the international referrals to the district program manager for review and continue to examine the returns for domestic issues. The district program manager reviews the referral for completeness, makes a recommendation as to whether an international examiner should participate in the examination, and then forwards the return to the applicable key district International Enforcement Program manager.

<sup>d</sup>The key district International Enforcement Program manager approves or rejects international referrals based on potential for a change in tax liability and/or the size of the workload of the international examiners in the district. If the referral is approved, the return is assigned to an international group supervisor who assigns an international examiner to participate in the examination. If the key district program manager rejects the referral, the manager will give the general program revenue agent written guidance on how to proceed with the international issues. The general program revenue agent will then undertake a complete examination, giving full consideration to the international issues involved. If the revenue agent subsequently develops information that indicates a need for an international examiner to participate in the examination, the agent will again refer the case to an international examination group.

Due to workload demands or to determinations that little potential exists for proposing audit adjustments to tax liability, international feature tax returns may be surveyed (not shown on flowchart), i.e., accepted as filed by the taxpayer, by district offices before or after assignment to revenue agents. Surveyed returns are not examined; however, a survey decision must be approved by the district program manager. In cases involving tax haven countries, survey decisions must also be approved by the key district International Enforcement Program manager.

<sup>e</sup>At times, the general program examination groups may not be in a position to request additional international feature tax returns because of the need to work higher priority tax returns, such as those involving abusive tax shelters. In these situations, if the international group needs more workload, international group managers from key districts or district program managers review the international feature returns in the priority files and select some for examination. The managers prepare a Form 2962 (Foreign and Domestic Entity International Transaction Report and Referral) for each return that is selected and directly assign the return to an international examiner, i.e., the return is not first routed through a general program revenue agent. Nevertheless, general program case managers still screen these cases for domestic issues and make examination assignments to revenue agents as warranted. Even if no domestic issues are examined, a general program revenue agent is responsible for controlling the case, i.e., monitoring the statute of limitations, preparing the final report, and closing the case.

# IRS Form 1120: U.S. Corporation Income Tax Return

<b>1120</b>	<b>U.S. Corporation Income Tax Return</b>		OMB No. 1545-0123
Form Department of the Treasury Internal Revenue Service	For calendar 1984 or tax year beginning _____, 1984, ending _____, 1984		1984
▶ For Paperwork Reduction Act Notice, see page 1 of the instructions.			
Check if a— A. Consolidated return <input type="checkbox"/> B. Personal Holding Co. <input type="checkbox"/> C. Business Code No. (See the list in the instructions)	Use IRS label. Otherwise please print or type.	Name Number and street City or town, State, and ZIP code	D. Employer identification number E. Date incorporated F. Total assets (see Specific Instructions) \$
6. Check box if there has been a change in address from the previous year <input type="checkbox"/>			
<b>Gross Income</b>	1 (a) Gross receipts or sales	(b) Less returns and allowances	Balance ▶ 1(c)
	2 Cost of goods sold and/or operations (Schedule A)		2
	3 Gross profit (line 1(c) less line 2)		3
	4 Dividends (Schedule C)		4
	5 Interest		5
	6 Gross rents		6
	7 Gross royalties		7
	8 Capital gain net income (attach separate Schedule D)		8
	9 Net gain or (loss) from Form 4797, line 14(a), Part II (attach Form 4797)		9
	10 Other income (see instructions—attach schedule)		10
	11 TOTAL income—Add lines 3 through 10 and enter here		▶ 11
<b>Deductions</b>	12 Compensation of officers (Schedule E)		12
	13 (a) Salaries and wages	(b) Less jobs credit	Balance ▶ 13(c)
	14 Repairs		14
	15 Bad debts (Schedule F if reserve method is used)		15
	16 Rents		16
	17 Taxes		17
	18 Interest		18
	19 Contributions (see instructions for 10% limitation)		19
	20 Depreciation (attach Form 4562)	20	
	21 Less depreciation claimed in Schedule A and elsewhere on return	21(a)	21(b)
	22 Depletion		22
23 Advertising		23	
24 Pension, profit-sharing, etc. plans		24	
25 Employee benefit programs		25	
26 Other deductions (attach schedule)		26	
27 TOTAL deductions—Add lines 12 through 26 and enter here		▶ 27	
28 Taxable income before net operating loss deduction and special deductions (line 11 less line 27)		28	
29 Less: (a) Net operating loss deduction (see instructions)	29(a)		
(b) Special deductions (Schedule C)	29(b)	29(c)	
30 Taxable income (line 28 less line 29(c))		30	
<b>Tax</b>	31 TOTAL TAX (Schedule J)		31
	32 Payments:		
	(a) 1983 overpayment allowed as a credit		
	(b) 1984 estimated tax payments		
	(c) Less 1984 refund applied for on Form 4466		
	(d) Tax deposited with Form 7004		
	(e) Credit from regulated investment companies (attach Form 2439)		
(f) Credit for Federal tax on gasoline and special fuels (attach Form 4136)		32	
33 Enter any PENALTY for underpayment of estimated tax—check <input type="checkbox"/> if Form 2220 is attached		33	
34 TAX DUE—If the total of lines 31 and 33 is larger than line 32, enter AMOUNT OWED		34	
35 OVERPAYMENT—If line 32 is larger than the total of lines 31 and 33, enter AMOUNT OVERPAID		35	
36 Enter amount of line 35 you want: Credited to 1985 estimated tax ▶		Refunded ▶ 36	
<b>Please Sign Here</b>	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.		
	Signature of officer	Date	Title
<b>Paid Preparer's Use Only</b>	Preparer's signature	Date	Check if self-employed <input type="checkbox"/> Preparer's social security number
	Firm's name (or yours, if self-employed) and address	E.I. No.	ZIP code

**Appendix III  
IRS Form 1120: U.S. Corporation Income  
Tax Return**

Form 1120 (1984)

Page **2**

**Schedule A Cost of Goods Sold and/or Operations**  
(See instructions for line 2, page 1)

<b>1</b> Inventory at beginning of year . . . . .	<b>1</b>	
<b>2</b> Purchases . . . . .	<b>2</b>	
<b>3</b> Cost of labor . . . . .	<b>3</b>	
<b>4</b> Other costs (attach schedule) . . . . .	<b>4</b>	
<b>5</b> Total—Add lines 1 through 4 . . . . .	<b>5</b>	
<b>6</b> Inventory at end of year . . . . .	<b>6</b>	
<b>7</b> Cost of goods sold and/or operations—Line 5 less line 6. Enter here and on line 2, page 1 . . . . .	<b>7</b>	

**8 (a)** Check all methods used for valuing closing inventory:

- (i)  Cost
- (ii)  Lower of cost or market as described in Regulations section 1.471-4 (see instructions)
- (iii)  Writedown of "subnormal" goods as described in Regulations section 1.471-2(c) (see instructions)
- (iv)  Other (Specify method used and attach explanation) ▶

**(b)** Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) . . . . .

**(c)** If the LIFO inventory method was used for this tax year, enter percentage (or amounts) of closing inventory computed under LIFO . . . . . **8(c)**

**(d)** If you are engaged in manufacturing, did you value your inventory using the full absorption method (Regulations section 1.471-11)? . . . . .  Yes  No

**(e)** Was there any change in determining quantities, cost, or valuations between opening and closing inventory? . . . . .  Yes  No  
If "Yes," attach explanation.

**Schedule C Dividends and Special Deductions**  
(See instructions for Schedule C)

	(A) Dividends received	(B) %	(C) Special deductions: multiply (A) X (B)
<b>1</b> Domestic corporations subject to 85% deduction (other than debt-financed stock) . . . . .		85	
<b>2</b> Debt-financed stock of domestic corporations (section 246A) . . . . .		see instructions	
<b>3</b> Certain preferred stock of public utilities . . . . .		59.13	
<b>4</b> Foreign corporations subject to 85% deduction . . . . .		85	
<b>5</b> Wholly-owned foreign subsidiaries subject to 100% deduction (section 245(b)) . . . . .		100	
<b>6</b> Total—Add lines 1 through 5. See instructions for limitation . . . . .			
<b>7</b> Affiliated groups subject to the 100% deduction (section 243(a)(3)) . . . . .		100	
<b>8</b> Other dividends from foreign corporations not included in lines 4 and 5 . . . . .			
<b>9</b> Income from controlled foreign corporations under subpart F (attach Forms 5471) . . . . .			
<b>10</b> Foreign dividend gross-up (section 78) . . . . .			
<b>11</b> DISC or former DISC dividends not included in line 1 and/or 2 (section 246(d)) . . . . .			
<b>12</b> Other dividends . . . . .			
<b>13</b> Deduction for dividends paid on certain preferred stock of public utilities (see instructions) . . . . .			
<b>14</b> Total dividends—Add lines 1 through 12. Enter here and on line 4, page 1 . . . . . ▶			
<b>15</b> Total deductions—Add lines 6, 7 and 13. Enter here and on line 29(b), page 1 . . . . . ▶			

**Schedule E Compensation of Officers** (See instructions for line 12, page 1)

Complete Schedule E only if total receipts (line 1(a), plus lines 4 through 10, of page 1, Form 1120) are \$150,000 or more.

1. Name of officer	2. Social security number	3. Percent of time devoted to business	Percent of corporation stock owned		6. Amount of compensation
			4. Common	5. Preferred	
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	

Total compensation of officers—Enter here and on line 12, page 1 . . . . .

**Schedule F Bad Debts—Reserve Method** (See instructions for line 15, page 1)

1. Year	2. Trade notes and accounts receivable outstanding at end of year	3. Sales on account	Amount added to reserve		6. Amount charged against reserve	7. Reserve for bad debts at end of year
			4. Current year's provision	5. Recoveries		
1979						
1980						
1981						
1982						
1983						
1984						

**Appendix III  
IRS Form 1120: U.S. Corporation Income  
Tax Return**

Form 1120 (1984)

Page **3**

**Schedule J Tax Computation**

(See instructions)

<b>1</b> Check if you are a member of a controlled group (see sections 1561 and 1563) . . . . .	<input type="checkbox"/>		
<b>2</b> If line 1 is checked, see instructions and enter your portion of the \$25,000 amount in each taxable income bracket:			
	(i) \$	(ii) \$	(iii) \$
<b>3</b> Income tax (see instructions to figure the tax; enter this tax or alternative tax from Schedule D, whichever is less). Check if from Schedule D <input type="checkbox"/> . . . . .			<b>3</b>
<b>4 (a)</b> Foreign tax credit (attach Form 1118) . . . . .	<b>4(a)</b>		
<b>(b)</b> Possessions tax credit (attach Form 5735) . . . . .	<b>(b)</b>		
<b>(c)</b> Orphan drug credit (attach Form 6765) . . . . .	<b>(c)</b>		
<b>(d)</b> Credit for fuel produced from a nonconventional source (see instructions) . . . . .	<b>(d)</b>		
<b>(e)</b> Research credit (attach Form 6765) . . . . .	<b>(e)</b>		
<b>(f)</b> General business credit. Enter here and check which forms are attached <input type="checkbox"/> Form 3800 <input type="checkbox"/> Form 3468 <input type="checkbox"/> Form 5884 <input type="checkbox"/> Form 6478 <input type="checkbox"/> Form 8007 . . . . .	<b>(f)</b>		
<b>5</b> Total—Add lines 4(a) through 4(f) . . . . .			<b>5</b>
<b>6</b> Line 3 less line 5 . . . . .			<b>6</b>
<b>7</b> Personal holding company tax (attach Schedule PH (Form 1120)) . . . . .			<b>7</b>
<b>8</b> Tax from recomputing prior-year investment credit (attach Form 4255) . . . . .			<b>8</b>
<b>9</b> Minimum tax on tax preference items (see instructions—attach Form 4626) . . . . .			<b>9</b>
<b>10</b> Total tax—Add lines 6 through 9. Enter here and on line 31, page 1 . . . . .			<b>10</b>

**Additional Information (See instruction F)**

	Yes	No		Yes	No
<b>H</b> Did the corporation claim a deduction for expenses connected with:					
<b>(1)</b> Entertainment facility (boat, resort, ranch, etc.)? . . . . .					
<b>(2)</b> Living accommodations (except employees on business)? . . . . .					
<b>(3)</b> Employees attending conventions or meetings outside the North American area? (See section 274(h).) . . . . .					
<b>(4)</b> Employees' families at conventions or meetings? . . . . . If "Yes," were any of these conventions or meetings outside the North American area? (See section 274(h).) . . . . .					
<b>(5)</b> Employee or family vacations not reported on Form W-2? . . . . .					
<b>I (1)</b> Did the corporation at the end of the tax year own, directly or indirectly, 50% or more of the voting stock of a domestic corporation? (For rules of attribution, see section 267(c).) . . . . . If "Yes," attach a schedule showing: (a) name, address, and identifying number; (b) percentage owned; (c) taxable income or (loss) before NOL and special deductions (e.g., if a Form 1120: from Form 1120, line 28, page 1) of such corporation for the tax year ending with or within your tax year; (d) highest amount owed by the corporation to such corporation during the year; and (e) highest amount owed to the corporation by such corporation during the year.					
<b>(2)</b> Did any individual, partnership, corporation, estate or trust at the end of the tax year own, directly or indirectly, 50% or more of the corporation's voting stock? (For rules of attribution, see section 267(c).) If "Yes," complete (a) through (e) . . . . .					
<b>(a)</b> Attach a schedule showing name, address, and identifying number.					
<b>(b)</b> Enter percentage owned <input type="checkbox"/> . . . . .					
<b>(c)</b> Was the owner of such voting stock a person other than a U.S. person? (See instructions) (Note: If "Yes," the corporation may have to file Form 5472.) . . . . . If "Yes," enter owner's country <input type="checkbox"/> . . . . .					
<b>(d)</b> Enter highest amount owed by the corporation to such owner during the year <input type="checkbox"/> . . . . .					
<b>(e)</b> Enter highest amount owed to the corporation by such owner during the year <input type="checkbox"/> . . . . .					
			<b>(Note:</b> For purposes of (1) and (2), "highest amount owed" includes loans and accounts receivable/payable.)		
			<b>J</b> Refer to the list in the instructions and state the principal:		
			Business activity <input type="checkbox"/> . . . . .		
			Product or service <input type="checkbox"/> . . . . .		
			<b>K</b> Was the corporation a U.S. shareholder of any controlled foreign corporation? (See sections 951 and 957.) . . . . .		
			If "Yes," attach Form 5471 for each such corporation.		
			<b>L</b> At any time during the tax year, did the corporation have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country? . . . . . (See instruction F for exceptions and filing requirements for form TD F 90-22.1.) If "Yes," write the name of the foreign country <input type="checkbox"/> . . . . .		
			<b>M</b> Was the corporation the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not the corporation has any beneficial interest in it? . . . . . If "Yes," the corporation may have to file Forms 3520, 3520-A or 926.		
			<b>N</b> During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sections 301 and 316.) . . . . . If "Yes," file Form 5452. If this is a consolidated return, answer here for parent corporation and on Form 851, Affiliations Schedule, for each subsidiary.		
			<b>O</b> During this tax year did the corporation maintain any part of its accounting/ tax records on a computerized system? . . . . .		
			<b>P</b> Check method of accounting:		
			<b>(1)</b> <input type="checkbox"/> Cash		
			<b>(2)</b> <input type="checkbox"/> Accrual		
			<b>(3)</b> <input type="checkbox"/> Other (specify) <input type="checkbox"/> . . . . .		

**Appendix III  
IRS Form 1120: U.S. Corporation Income  
Tax Return**

Form 1120 (1984)

Page **4**

Schedule L	Balance Sheets	Beginning of tax year		End of tax year	
		(A)	(B)	(C)	(D)
<b>Assets</b>					
1	Cash				
2	Trade notes and accounts receivable				
	(a) Less allowance for bad debts				
3	Inventories				
4	Federal and State government obligations				
5	Other current assets (attach schedule)				
6	Loans to stockholders				
7	Mortgage and real estate loans				
8	Other investments (attach schedule)				
9	Buildings and other depreciable assets				
	(a) Less accumulated depreciation				
10	Depletable assets				
	(a) Less accumulated depletion				
11	Land (net of any amortization)				
12	Intangible assets (amortizable only)				
	(a) Less accumulated amortization				
13	Other assets (attach schedule)				
14	<b>Total assets</b>				
<b>Liabilities and Stockholders' Equity</b>					
15	Accounts payable				
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach schedule)				
18	Loans from stockholders				
19	Mortgages, notes, bonds payable in 1 year or more				
20	Other liabilities (attach schedule)				
21	Capital stock: (a) Preferred stock				
	(b) Common stock				
22	Paid-in or capital surplus				
23	Retained earnings—Appropriated (attach schedule)				
24	Retained earnings—Unappropriated				
25	Less cost of treasury stock				
26	<b>Total liabilities and stockholders' equity</b>				

**Schedule M-1 Reconciliation of Income Per Books With Income Per Return**

Do not complete this schedule if the total assets on line 14, column (D), of Schedule L are less than \$25,000.

1	Net income per books		7	Income recorded on books this year not included in this return (itemize)	
2	Federal income tax			(a) Tax-exempt interest \$	
3	Excess of capital losses over capital gains				
4	Income subject to tax not recorded on books this year (itemize)				
5	Expenses recorded on books this year not deducted in this return (itemize)		8	Deductions in this tax return not charged against book income this year (itemize)	
	(a) Depreciation \$			(a) Depreciation \$	
	(b) Contributions carryover \$			(b) Contributions carryover \$	
6	Total of lines 1 through 5		9	Total of lines 7 and 8	
			10	Income (line 28, page 1)—line 6 less line 9	

**Schedule M-2 Analysis of Unappropriated Retained Earnings Per Books (line 24, Schedule L)**

Do not complete this schedule if the total assets on line 14, column (D), of Schedule L are less than \$25,000.

1	Balance at beginning of year		5	Distributions: (a) Cash	
2	Net income per books			(b) Stock	
3	Other increases (itemize)			(c) Property	
			6	Other decreases (itemize)	
			7	Total of lines 5 and 6	
4	Total of lines 1, 2, and 3		8	Balance at end of year (line 4 less line 7)	

U.S. GOVERNMENT PRINTING OFFICE: 1984-O-423-174

13-134-8150

# Tables of Comparative Audit Statistics

**Table IV. 1: Comparative Audit Coverage in Fiscal Year 1983 by Major and Minor Industry Categories<sup>a</sup>**

Industry category	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
Agriculture, forestry, fishing	443	0	0.00	84,302	597	0.71
Mining	1,433	4	0.28	30,941	502	1.63
Metal mining	158	0	0.00	1,017	3	0.31
Coal mining	62	0	0.00	3,363	96	2.86
Oil, gas extraction	1,206	4	0.33	22,594	310	1.37
Non-metallic minerals	6	0	0.00	3,965	93	2.35
Construction	450	1	0.22	273,931	3,376	1.23
General contractors & operative builders	363	1	0.28	114,338	842	0.74
Heavy construction contractors	9	0	0.00	18,205	351	1.93
Special trade contractors	77	0	0.00	141,387	2,183	1.54
Manufacturing	3,095	140	4.54	246,320	7,015	2.85
Food & kindred products	119	2	1.74	16,044	737	4.60
Tobacco manufacturing	2	1	50.00	107	1	0.93
Textile mill products	56	1	1.83	4,932	260	5.29
Apparel & other textile products	61	11	18.68	16,887	743	4.40
Lumber & wood products	160	8	5.15	15,146	198	1.31
Furniture & fixtures	19	0	0.00	6,299	104	1.66
Paper & allied products	245	13	5.41	3,199	132	4.14
Printing & publishing	462	3	0.66	35,827	1,233	3.44
Chemicals & allied products	114	10	8.88	10,002	348	3.49
Petroleum & coal products	23	2	8.56	2,341	241	10.32
Rubber & misc. plastics	221	2	0.92	9,700	142	1.47
Leather & leather products	12	0	0.00	1,837	39	2.16
Stone, clay, glass products	66	8	12.23	9,530	227	2.39
Primary metal industries	63	7	11.22	4,759	176	3.71
Fabrications metal products	263	1	0.38	39,709	754	1.90
Machinery except electrical	527	36	6.89	24,908	751	3.02
Electrical equipment	333	7	2.14	14,323	269	1.88
Motor vehicles & equipment	25	6	26.03	3,135	60	1.92
Transportation equipment except motor vehicles	26	0	0.00	4,403	67	1.53
Instruments & reporting products	104	14	13.39	5,781	97	1.69
Miscellaneous	183	5	3.13	17,441	426	2.44
Transportation & public utilities	448	3	0.69	107,350	1,802	1.68
Transportation	426	3	0.72	85,386	1,486	1.74
Communication	18	0	0.00	10,738	80	0.75
Electric, gas, sanitary service	3	0	0.00	11,225	235	2.10
Wholesale & retail trade	8,901	248	2.80	802,686	9,320	1.16

**Appendix IV  
Tables of Comparative Audit Statistics**

Industry category	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
Wholesale trade	7,154	108	1.52	269,930	3,910	1.45
Groceries	187	16	9.04	22,462	445	1.98
Machinery	596	18	3.14	48,314	792	1.64
Miscellaneous	6,369	73	1.15	199,153	2,672	1.34
Retail trade	1,743	139	7.98	529,012	5,358	1.01
Building materials & garden supplies	40	0	0.00	41,969	328	0.78
General merchandise stores	26	0	0.00	11,220	293	2.62
Food stores	72	1	1.47	42,989	523	1.22
Auto dealers & service	72	1	1.38	81,025	1,018	1.26
Apparel & accessory stores	40	0	0.00	43,379	382	0.88
Furniture stores	167	1	0.60	33,961	143	0.42
Eating & drinking places	499	47	9.53	106,758	1,174	1.10
Miscellaneous retail	824	88	10.72	167,707	1,494	0.89
Wholesale & retail not allocable	4	1	23.93	3,743	51	1.38
Finance, insurance, real estate	7,741	74	0.96	449,519	3,578	0.80
Banking	71	4	5.60	14,280	483	3.38
Credit agencies or nonbanks	447	28	6.45	34,909	568	1.63
Security, commodity banks	54	5	9.53	10,590	223	2.11
Insurance	195	6	3.30	9,553	269	2.82
Insurance agents, brokers & services	105	2	1.90	49,186	393	0.80
Real estate	5,118	15	0.30	288,808	1,198	0.41
Holding & other invest co.	1,748	12	0.69	42,191	442	1.05
Services	4,570	29	0.64	743,110	11,326	1.52
Hotel & other lodging	451	1	0.23	17,480	327	1.87
Personal services	48	0	0.00	47,767	497	1.04
Business services	2,049	16	0.83	192,411	2,842	1.48
Auto & misc. repair	383	1	0.26	71,386	566	0.79
Amusement & recreation	323	1	0.32	56,010	1,062	1.90
Other services	1,313	9	0.69	358,053	6,029	1.68
Nature of business not allocable	12	0	0.00	17,384	92	0.53
<b>Total</b>	<b>27,096</b>	<b>500</b>	<b>1.85</b>	<b>2,755,547</b>	<b>37,611</b>	<b>1.36</b>

<sup>3</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1983, see discussion of methodology in chapter 1.



**Appendix IV  
Tables of Comparative Audit Statistics**

**Table IV.2: Comparative Audit Coverage in Fiscal Year 1984 by Major and Minor Industry Categories<sup>a</sup>**

Industry category	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
Agriculture, forestry, fishing	443	1	0.23	84,302	321	0.38
Mining	1,433	5	0.35	30,941	787	2.54
Metal mining	158	0	0.00	1,017	12	1.27
Coal mining	62	1	1.66	3,363	66	1.98
Oil, gas extraction	1,206	4	0.33	22,594	595	2.64
Non-metallic minerals	6	0	0.00	3,965	112	2.83
Construction	450	2	0.45	273,931	2,465	0.90
General contractors & operative builders	363	2	0.55	114,338	910	0.80
Heavy construction contractors	9	0	0.00	18,205	297	1.63
Special trade contractors	77	0	0.00	141,387	1,257	0.89
Manufacturing	3,095	120	3.90	246,320	4,978	2.02
Food & kindred products	119	7	5.86	16,044	407	2.54
Tobacco manufacturing	2	1	50.00	107	3	2.79
Textile mill products	56	1	1.83	4,932	397	8.07
Apparel & other textile products	61	2	3.38	16,887	465	2.75
Lumber & wood products	160	11	7.40	15,146	156	1.03
Furniture & fixtures	19	0	0.00	6,299	41	0.66
Paper & allied products	245	2	0.83	3,199	106	3.32
Printing & publishing	462	1	0.22	35,827	522	1.46
Chemicals & allied products	114	18	15.91	10,002	193	1.94
Petroleum & coal products	23	3	12.84	2,341	51	2.20
Rubber & misc. plastics	221	4	2.13	9,700	111	1.15
Leather & leather products	12	0	0.00	1,837	63	3.48
Stone, clay, glass products	66	3	4.61	9,530	101	1.07
Primary metal industries	63	6	9.55	4,759	103	2.18
Fabrications metal products	263	3	1.46	39,709	848	2.14
Machinery except electrical	527	16	3.06	24,908	497	2.00
Electrical equipment	333	16	5.06	14,323	527	3.68
Motor vehicles & equipment	25	0	0.00	3,135	44	1.43
Transportation equipment except motor vehicles	26	2	7.49	4,403	59	1.36
Instruments & reporting products	104	18	17.78	5,781	110	1.91
Miscellaneous	183	2	1.11	17,441	163	0.94
Transportation & public utilities	448	2	0.46	107,350	1,158	1.08
Transportation	426	2	0.48	85,386	975	1.14
Communication	18	0	0.00	10,738	73	0.68
Electric, gas, sanitary service	3	0	0.00	11,225	110	0.98
Wholesale & retail trade	8,901	449	5.04	802,686	8,380	1.04

**Appendix IV  
Tables of Comparative Audit Statistics**

Industry category	Foreign-owned U.S. corporations			Domestically owned U.S. corporations		
	Number of companies	Number audited	Percent audited	Number of companies	Number audited	Percent audited
Wholesale trade	7,154	441	6.17	269,930	3,413	1.26
Groceries	187	23	12.68	22,462	290	1.29
Machinery	596	19	3.27	48,314	794	1.64
Miscellaneous	6,369	398	6.25	199,153	2,328	1.17
Retail trade	1,743	7	0.42	529,012	4,967	0.94
Building materials & garden supplies	40	0	0.00	41,969	147	0.35
General merchandise stores	26	0	0.00	11,220	247	2.20
Food stores	72	4	5.59	42,989	336	0.78
Auto dealers & service	72	0	0.00	81,025	770	0.95
Apparel & accessory stores	40	0	0.00	43,379	273	0.63
Furniture stores	167	0	0.00	33,961	333	0.98
Eating & drinking places	499	1	0.20	106,758	1,683	1.58
Miscellaneous retail	824	2	0.28	167,707	1,175	0.70
Wholesale & retail not allocable	4	0	0.00	3,743	0	0.00
Finance, insurance, real estate	7,741	146	1.90	449,519	3,396	0.76
Banking	71	6	8.39	14,280	487	3.41
Credit agencies or nonbanks	447	121	27.22	34,909	423	1.21
Security, commodity banks	54	0	0.00	10,590	39	0.37
Insurance	195	5	2.99	9,553	254	2.67
Insurance agents, brokers & services	105	0	0.00	49,186	617	1.25
Real estate	5,118	11	0.22	288,808	1,440	0.50
Holding & other invest. co.	1,748	2	0.11	42,191	134	0.32
Services	4,570	65	1.42	743,110	6,675	0.90
Hotel & other lodging	451	46	10.42	17,480	258	1.48
Personal services	48	0	0.00	47,767	647	1.36
Business services	2,049	1	0.05	192,411	1,881	0.98
Auto & misc. repair	383	0	0.00	71,386	425	0.60
Amusement & recreation	323	14	4.35	56,010	85	0.15
Other services	1,313	3	0.23	358,053	3,376	0.94
Nature of business not allocable	12	0	0.00	17,384	28	0.16
<b>Total</b>	<b>27,096</b>	<b>791</b>	<b>2.92</b>	<b>2,755,547</b>	<b>28,193</b>	<b>1.02</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1984; see discussion of methodology in chapter 1.

Appendix IV  
Tables of Comparative Audit Statistics

Table IV.3: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1983 by Country<sup>a</sup>

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Canada	6,769	24.99	69	1.02	13.98
Japan	2,175	8.03	88	4.05	17.71
United Kingdom	1,926	7.11	103	5.35	20.73
West Germany	1,611	5.95	45	2.79	9.18
Netherlands	1,262	4.66	19	1.51	3.91
Switzerland	1,142	4.22	24	2.10	4.88
France	1,071	3.96	8	0.75	1.73
Mexico	806	2.98	0	0.00	0.00
Australia	790	2.92	0	0.00	0.00
Netherlands Antilles	603	2.23	41	6.80	8.38
Panama	598	2.21	1	0.17	0.21
Colombia	563	2.08	0	0.00	0.00
Phillippines	542	2.00	0	0.00	0.00
Hong Kong	430	1.59	0	0.00	0.00
Iran	417	1.54	0	0.00	0.00
Sweden	388	1.43	6	1.55	1.21
South Africa	338	1.25	0	0.00	0.00
Trinidad and Tobago	305	1.13	0	0.00	0.00
China	264	0.98	0	0.00	0.00
Barbados	263	0.97	0	0.00	0.00
Jamaica	262	0.97	0	0.00	0.00
Taiwan	243	0.90	2	0.82	0.41
Liechtenstein	230	0.85	2	0.87	0.41
Lebanon	225	0.83	0	0.00	0.00
Sri Lanka	216	0.80	0	0.00	0.00
Denmark	182	0.67	1	0.55	0.21
Norway	137	0.51	0	0.00	0.00
Venezuela	133	0.49	0	0.00	0.00
Bermuda	122	0.45	12	9.84	2.41
Spain	119	0.44	0	0.00	0.00
Bahamas	118	0.44	1	0.65	0.21
Belgium	116	0.43	18	15.52	3.69
Luxemburg	98	0.36	4	4.08	0.98
Puerto Rico	94	0.35	1	1.06	0.20
Italy	82	0.30	3	3.66	0.62
Ireland	80	0.30	0	0.00	0.00

**Appendix IV  
Tables of Comparative Audit Statistics**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Kuwait	68	0.25	0	0.00	0.00
Portugal	56	0.21	0	0.00	0.00
Israel	48	0.18	1	2.08	0.21
Austria	46	0.17	12	26.09	2.55
South Korea	40	0.15	2	5.00	0.40
Liberia	38	0.14	1	2.63	0.21
India	37	0.14	0	0.00	0.00
Swaziland	33	0.12	0	0.00	0.00
Pakistan	25	0.09	0	0.00	0.00
Virgin Islands	22	0.08	0	0.00	0.00
Greece	21	0.08	0	0.00	0.00
Cayman Islands	18	0.07	0	0.00	0.00
Brazil	15	0.06	0	0.00	0.00
Poland	13	0.05	0	0.00	0.00
New Zealand	10	0.04	0	0.00	0.00
Saudi Arabia	9	0.03	0	0.00	0.00
United Arab Emirates	9	0.03	0	0.00	0.00
Libya	9	0.04	0	0.00	0.00
Finland	8	0.03	0	0.00	0.00
North Korea	8	0.03	0	0.00	0.00
Leeward Islands	6	0.02	1	16.67	0.20
Uruguay	6	0.02	0	0.00	0.00
Yugoslavia	5	0.02	0	0.00	0.00
Turkey	3	0.01	0	0.00	0.00
Argentina	2	0.01	0	0.00	0.00
Monaco	2	0.01	0	0.00	0.00
Soviet Union	2	0.01	0	0.00	0.00
Indonesia	2	0.01	0	0.00	0.00
Singapore	2	0.01	0	0.00	0.00
Other south and south-east Asia	2	0.01	0	0.00	0.00
Costa Rica	1	0.00	0	0.00	0.00
Iceland	1	0.00	0	0.00	0.00

**Appendix IV**  
**Tables of Comparative Audit Statistics**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Thailand	1	0.00	0	0.00	0.00
Guam	1	0.00	0	0.00	0.00
Other Oceania	1	0.00	0	0.00	0.00
Country not stated or not allocable	1,530	5.65	26	1.70	5.38
U.S. possessions not allocable	115	0.43	0	0.00	0.00
Caribbean not allocable	69	0.26	0	0.00	0.00
Common market not allocable	26	0.10	0	0.00	0.00
Other western Europe not allocable	11	0.04	0	0.00	0.00
Europe not allocable	8	0.03	0	0.00	0.00
Eastern Asia not allocable	8	0.03	0	0.00	0.00
<b>Total</b>	<b>27,096</b>	<b>100.00</b>	<b>500</b>	<b>1.85</b>	<b>100.00</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1983; see discussion of methodology in chapter 1.

**Appendix IV**  
**Tables of Comparative Audit Statistics**

**Table IV.4: Audit Coverage of Foreign-Owned U.S. Corporations in Fiscal Year 1984 by Country<sup>a</sup>**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Canada	6,769	24.99	52	0.77	6.59
Japan	2,175	8.03	66	3.03	8.41
United Kingdom	1,926	7.11	19	0.99	2.41
West Germany	1,611	5.95	145	9.00	18.42
Netherlands	1,262	4.66	25	1.98	3.23
Switzerland	1,142	4.22	63	5.52	8.02
France	1,071	3.96	19	1.77	2.43
Mexico	806	2.98	8	0.99	1.09
Australia	790	2.92	0	0.00	0.00
Netherlands Antilles	603	2.23	5	0.83	0.65
Panama	598	2.21	8	1.34	1.12
Colombia	563	2.08	0	0.00	0.00
Phillippines	542	2.00	0	0.00	0.00
Hong Kong	430	1.59	0	0.00	0.00
Iran	417	1.54	0	0.00	0.00
Sweden	388	1.43	7	1.80	0.93
South Africa	338	1.25	0	0.00	0.00
Trinidad and Tobago	305	1.13	0	0.00	0.00
China	264	0.98	0	0.00	0.00
Barbados	263	0.97	0	0.00	0.00
Jamaica	262	0.97	262 <sup>b</sup>	100.00	33.15
Taiwan	243	0.90	44	18.11	5.68
Liechtenstein	230	0.85	4	1.74	0.60
Lebanon	225	0.83	0	0.00	0.00
Sri Lanka	216	0.80	0	0.00	0.00
Denmark	182	0.67	0	0.00	0.00
Norway	137	0.51	0	0.00	0.00
Venezuela	133	0.49	0	0.00	0.00
Bermuda	122	0.45	10	8.20	1.37
Spain	119	0.44	0	0.00	0.00
Bahamas	118	0.44	0	0.00	0.00
Belgium	116	0.43	15	12.93	1.97
Luxemburg	98	0.36	2	2.04	0.26
Puerto Rico	94	0.35	0	0.00	0.00
Italy	82	0.30	1	1.22	0.15

**Appendix IV  
Tables of Comparative Audit Statistics**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Ireland	80	0.30	2	2.50	0.25
Kuwait	68	0.25	0	0.00	0.00
Portugal	56	0.21	0	0.00	0.00
Israel	48	0.18	0	0.00	0.00
Austria	46	0.17	0	0.00	0.00
South Korea	40	0.15	1	2.50	0.13
Liberia	38	0.14	3	7.89	0.44
India	37	.14	0	0.00	0.00
Swaziland	33	0.12	1	3.03	0.13
Pakistan	25	0.09	0	0.00	0.00
Virgin Islands	22	0.08	0	0.00	0.00
Greece	21	0.08	1	4.76	0.13
Cayman Islands	18	0.07	0	0.00	0.00
Brazil	15	0.06	0	0.00	0.00
Poland	13	0.05	0	0.00	0.00
New Zealand	10	0.04	0	0.00	0.00
Saudi Arabia	9	0.03	0	0.00	0.00
United Arab Emirates	9	0.03	0	0.00	0.00
Libya	9	0.04	0	0.00	0.00
Finland	8	0.03	0	0.00	0.00
North Korea	8	0.03	0	0.00	0.00
Leeward islands	6	0.02	2	33.33	0.26
Uruguay	6	0.02	0	0.00	0.00
Yugoslavia	5	0.02	0	0.00	0.00
Turkey	3	0.01	0	0.00	0.00
Argentina	2	0.01	0	0.00	0.00
Monaco	2	0.01	0	0.00	0.00
Soviet Union	2	0.01	0	0.00	0.00
Indonesia	2	0.01	0	0.00	0.00
Singapore	2	0.01	0	0.00	0.00
Other south and south-east Asia	2	0.01	0	0.00	0.00
Costa Rica	1	0.00	0	0.00	0.00
Iceland	1	0.00	0	0.00	0.00

**Appendix IV**  
**Tables of Comparative Audit Statistics**

Country	Foreign-owned U.S. corporations		Audit coverage		
	Number	Percentage of total	Number audited	Percentage audited by country	Percentage of total audits
Thailand	1	0.00	0	0.00	0.00
Guam	1	0.00	1	100.00	0.13
Other Oceania	1	0.00	0	0.00	0.00
Country not stated or not allocable	1,530	5.65	6	0.39	0.82
U.S. possessions not allocable	115	0.43	0	0.00	0.00
Caribbean not allocable	69	0.26	1	1.45	0.23
Common market not allocable	26	0.10	0	0.00	0.00
Other western Europe not allocable	11	0.04	0	0.00	0.00
Europe not allocable	8	0.03	0	0.00	0.00
Eastern Asia not allocable	8	0.03	8	100.00	1.14
<b>Total</b>	<b>27,096</b>	<b>100.00</b>	<b>791</b>	<b>2.92</b>	<b>100.00</b>

<sup>a</sup>Details do not add to totals, and percentages are not simple arithmetic computations due to weighting of sample data and to rounding.

<sup>b</sup>According to IRS Detroit Data Center officials, only one corporation was audited, but the weighting of the case resulted in a projected 100 percent audit coverage of Jamaican-owned U.S. corporations.

Source: Cross-match, programmed at GAO's request by IRS' Detroit Data Center, of the Statistics of Income data base for tax year 1981 corporation returns with IRS Audit Information Management System files for examination cases completed in fiscal year 1984; see discussion of methodology in chapter 1.



# Comments From the Internal Revenue Service

COMMISSIONER OF INTERNAL REVENUE

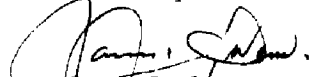
Washington, DC 20224

Mr. William J. Anderson  
Director, General Government Division  
United States General Accounting Office  
Washington, DC 20548

Dear Mr. Anderson:

We appreciate the opportunity to comment on your draft report entitled "IRS Audit Coverage: Selection Procedures Same for Foreign-Owned and Other U.S. Corporations." We have reviewed the report and find it to be factually correct and, therefore, we do not have any specific comments to submit.

Sincerely,



James I. Owens  
Acting Commissioner

Department of the Treasury Internal Revenue Service

10

---

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office  
Post Office Box 6015  
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are \$2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

---

United States  
General Accounting Office  
Washington, D.C. 20548

First-Class Mail  
Postage & Fees Paid  
GAO  
Permit No. G100

Official Business  
Penalty for Private Use \$300

Address Correction Requested

---