STATISTICS OF INCOME STUDIES OF INTERNATIONAL INCOME AND TAXES: A BRIEF DESCRIPTION OF THE STUDIES

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The purpose of this paper is to briefly describe the foreign and international area studies conducted by the Statistics of Income Division of the Internal Revenue Service [1].

This paper includes statistics on foreign tax credit reported by corporations and individuals on their tax returns, Controlled Foreign Corporations, Domestic International Sales Corporations (DISC's), foreign corporations with income derived from U.S. sources, domestic corporations, which are more than 50 percent foreign owned, U.S. possessions corporations, foreign earned income of U.S. citizens, U.S. possessions excluded income, nonresident alien income and tax withheld, taxpayers who cooperate or participate in international boycotts, foreign trusts, and nonresident alien estates [2].

Most of the foreign area statistics prepared in these studies are for the Office of Tax Analysis in the Office of the Secretary of the Treasury, as well as for the staff of the Congressional Joint Committee on Taxation. Additionally, results from many of these studies are published in the Statistics of Income Bulletin, issued on a quarterly basis.

FOREIGN TAX CREDIT: CORPORATIONS

Until 1918, all foreign taxes paid by U.S. persons were treated as deductible expenses under U.S. income tax law. Foreign tax credit provisions were adopted that year in response to the sharp increases in tax rates at home and abroad during World War I. The United States was the first country to apply the foreign tax credit on a worldwide basis to relieve international double taxation of income [3]. The structure of the tax credit mechanism was established in the Revenue Act of 1921 followed by changes made through the years in various law changes [4].

The general philosophy of the foreign tax credit, despite its numerous changes has remained basically the same. It permits the corporation to carry approximately the same income tax burden operating throughout the world as that tax burden carried if it were operating only in the United States. In effect, the corporation pays the higher of the U.S. tax rate or the overall foreign country tax rate on its income.

The foreign tax credit takes into account only certain types of foreign taxes which the corporation paid or accrued. They include income, war profits, and excess profits taxes [5]. Other types of taxes, such as excise, sales, franchise, property taxes, etc., do not qualify for the tax credit. (However, these taxes may be taken as a deduction from income.) The qualifying taxes must be paid to a foreign country or a possession of the United States.

A U.S. corporation, upon the receipt of dividends from a foreign corporation in which the domestic corporation owns a certain amount of stock, is also allowed to credit the foreign income taxes paid by the foreign corporation (a "first-tier" corporation) that relates proportionately to the dividends. This credit allowed only to U.S. corporations is generally referred to as a "deemed-paid" tax credit (or indirect tax credit). The indirect credit also extends to taxes paid by second and third tier corporations. Provided that stock ownership criteria are met, the first-tier corporation is deemed to have paid a portion of the foreign taxes actually paid by the second-tier foreign corporation which it controls and from whom it receives dividends, and the second-tier foreign corporation in turn, is deemed to have paid a portion of the foreign taxes paid by the third-tier foreign corporation which it controls and from whom it receives dividends.

Under certain conditions, a U.S. corporation is required to include in income dividends that have been constructively distributed to them (i.e., undistributed earnings of Controlled Foreign Corporations). The U.S. corporation is also deemed to have paid its proportionate share of income taxes paid by the foreign corporation with respect to the earnings and profits that are required to be included in the domestic corporation's income. When the income is actually distributed, it is not included again as income of the U.S. corporation. Neither are the foreign taxes deemed paid allowed as a credit that year [6].

The foreign tax credit is not an unlimited credit. With the Tax Reform Act of 1976, the tax credit limitation could only be computed on an overall basis. The overall limitation required the domestic corporation to consolidate all foreign income received from all countries and the taxes applied to the income by the various countries. (At certain times prior to this Act, a per-country limitation could be used. Under this method, the tax credit limitation was computed on a country by country basis.)

U.S. corporations were also required to allocate their foreign income into separate categories or types of foreign income. For each type of foreign income reported, the foreign tax credit was limited to the smaller of the amount of foreign taxes available for credit or the portion of the U.S. tax imposed on that type of foreign source taxable income. For 1980, the types of foreign income were certain interest income, DISC dividends, foreign oil related income, and all other foreign source income. The total foreign tax credit claimed is the sum of these credits based on each type of income.

If a U.S. corporation earned certain interest income, the foreign tax credit limitation is calculated on that interest separately as if it were the only foreign income of the corporation. Similarly the U.S. corporation would also compute a separate limitation for certain qualifying DISC dividends. Those dividends are any dividends from a DISC which are treated as being from foreign sources. In addition, foreign taxes paid, accrued, and deemed paid on foreign oil related income were used to compute a separate foreign tax credit.

Under certain circumstances eligible foreign taxes which exceeded the credit limitation could be carried back 2 years and forward 5 years. The carryback or carryover, plus the actual taxes paid or accrued for a given year and the taxes deemed paid by foreign corporations, cannot exceed the tax credit limitation for the year to which it is carried back or forward.

Figure 1 shows the foreign tax credit claimed during the period 1955 through 1980 for corporate returns in addition to the foreign source taxable income and foreign taxes paid. Foreign tax credit claimed increased from nearly a billion dollars to over $25 billion in 1978 declining slightly in 1980. The increase during this period in foreign source taxable income and foreign tax credit provides the extent to which these U.S. corporations are involved in foreign operations.

The corporation foreign tax credit studies are processed in conjunction with the Controlled Foreign Corporation studies (described below). It is planned to conduct these studies in the future for Tax Years 1982, 1984, 1986, 1987, and 1990. The 1986 and 1987 studies should provide useful information on carryovers of foreign tax credit, which were briefly described above.

For each study, the SOI Division publishes two articles on corporate foreign tax credit in the SOI Bulletin. One article deals with industry data and the second article deals with country data. Additionally, tabulated data classified by industry and country are available.

CONTROLLED FOREIGN CORPORATIONS

Prior to 1960, U.S. corporations were not required to file information on their foreign subsidiary corporations. They were able to defer payment of U.S. income taxes on all foreign profits because the income earned by the foreign subsidiaries was not taxed by the U.S. Government until it was repatriated to the U.S. parents, usually in the form of dividends or liquidating distributions. If the earnings were reinvested abroad, repatriation could be postponed indefinitely.

Public Law 86-780 was passed in 1960 to obtain information on these foreign holdings. It required domestic corporations to provide certain financial and other information with respect to each foreign corporation controlled by them annually with their income tax return [7]. Control was defined as direct or indirect ownership of stock having more than 50 percent of the combined voting power of all classes of stock during its taxable year. These foreign corporations became known as Controlled Foreign Corporations (CFC's).

The 1960 law, although providing information on foreign subsidiaries, did not alter the accumulation of foreign earnings and profits abroad by CFC's. The first attempt to tax foreign corporations' income indirectly through their U.S. parent corporations led to enactment of the "Subpart F" provisions of the Tax Reform Act of 1962.

These provisions were intended to eliminate tax avoidance by U.S. corporations who used foreign corporations to accumulate certain types of income in jurisdictions with little or no tax on that income [8]. The rules in Subpart F attempt to distinguish between legitimate deferral and tax avoidance plans through the use of foreign subsidiaries in those countries that have a low or zero rate of tax on income [9].

The 1962 Law considered as taxable income (generally as dividends), specific types of undistributed earnings and profits of CFC's. These provisions were also affected by additional legislative changes after 1962 [10]. At the present time, U.S. corporations are taxed if the CFC engages in certain transactions, or makes certain investments, on income earned by

Figure 1. --Returns with Foreign Tax Credit and Forms 1118 Filed for Selected Years, 1955-1980
(money amounts are in millions of dollars)

Tax Year	Returns with Foreign Tax Credit Claimed					
	All Returns		Returns with Forms 1118 Filed			
	Number of Returns	Foreign Tax Credit Claimed	Number of Returns	Taxable Income	Total Foreign Taxes*	Foreign Tax Credit Claimed
1955.......	3,688	959	3,084	2,130	951	862
1960.......	4,740	1,224	4,250	2,774	1,768	1,140
1965.......	6,186	2,616	5,684	6,455	4,242	2,596
1970.......	5,745	4,549	5,571	10,932	8,460	4,542
1972.......	6,412	6,315	5,497	16,486	10,681	6,306
1976.......	6,513	23,579	6,136	55,414	43,863	23,547
1978.......	6,039	26,357	5,219	65,150	59,912	26,345
1980.......	6,199	24,880	6,046	70,541	34,207	24,879

* Total foreign taxes available for credit before reduction for certain taxes. Includes foreign taxes paid or accrued, deemed paid, and carryover of prior year taxes.

these activities. Corporations are taxed on Subpart F income in the tax year the activities occurred, and therefore, are not taxed in a later year(s) on this income when it is actually distributed. The following outline shows the income components of Subpart F currently effective.

Subpart F income is the sum of:

1. Income from insuring U.S. risks,
2. Foreign base company income, which is composed of:
   a. foreign personal holding company income,
   b. foreign base company sales income,
   c. foreign base company services income,
   d. foreign base company shipping income, and
   e. foreign base company oil related income,
3. Income from boycott related activities,
4. Amounts of bribes, kickbacks and other illegal payments (the earnings and profits of CFC's cannot be reduced by the amount of these payments),
5. Previously excluded Subpart F income withdrawn from investments in less developed countries,
6. Previously excluded Subpart F income withdrawn from foreign base company shipping operations, and finally
7. The CFC's increase in earnings invested in U.S. property.

The "base company" referred to above, is usually holding, sales, or service corporations organized in a country (tax haven for example), other than the country where the goods are produced, sold, or services are performed. Foreign corporations that are organized in the same country in which their business activities are located are usually not affected.

The 1962 Act also redefined the term Controlled Foreign Corporation. Foreign corporations were now considered Controlled Foreign Corporations if more than 50 percent of the voting stock was owned by U.S. shareholders, each having at least a 10 percent or more interest. Also, control was extended to lower-tier foreign corporations through a chain of control, viz., the U.S. corporation owned more than 50 percent of a foreign corporation (first-tier) which, in turn, owned more than 50 percent of a second-tier foreign corporation which, in turn, owned more than 50 percent of a third-tier foreign corporation, and so forth. In this case, all three foreign corporations were classified as CFC's.

Figure 2 presents selected historical information on Controlled Foreign Corporations. As can be seen, while the number of CFC's nearly tripled between 1962 and 1980, their activity as measured by assets, receipts and earnings increased much faster indicating the increase of these corporations and the contribution of foreign income to total or worldwide income.

For each study, the SOI Division will publish two articles on Controlled Foreign Corporations in the SOI Bulletin. One article will deal with industry data and the second article will deal with country data. In addition, cross tabulations of CFC statistics classified by both industry and country will be available.

DOMESTIC INTERNATIONAL SALES CORPORATIONS (DISC'S)

A Domestic International Sales Corporation (DISC) is a special type of corporation established by passage of the Revenue Act of 1971. The purpose of this legislation is to provide a system of tax deferral and an inducement to increase U.S. exports [11].

To prevent unlimited tax deferral, at least one-half of the DISC's earnings and profits is taxed to its stockholders annually. This portion of the DISC's earnings and profits is fully taxable to the stockholders even if the earnings are not actually distributed. U.S. income taxation is deferred indefinitely, for the most part, on the remainder of the DISC's earnings.

To qualify as a DISC, a corporation has to elect to be treated as a DISC, have at least $2,500 of capital stock, and meet strict formal requirements each year, such as satisfying the tests that 95 percent of both its gross receipts and assets are "qualified." These requirements are designed to limit the DISC to export related activities. A DISC is allowed to export products that qualify as export property, which are manufactured, produced, grown, or extracted in the United States by someone other than the DISC [12].

A DISC usually acquires export property from its parent corporation or an affiliated corporation and then sells the property abroad. However, it can act simply as a commission

Figure 2. -- Growth of Controlled Foreign Corporations, 1962 - 1980
(money amounts are in millions of dollars)

Tax Year	Number of Controlled Foreign Corporations	Total Assets	Business Receipts	Current Earnings and Profits (Less Losses) Before Taxes
1962......	12,073	46,102*	49,859	4,181
1972......	29,221	167,830	172,407	16,943
1980......	35,471	508,032	699,003	47,622

* Estimated.

merchant on export sales of an affiliated corporation. The allocation of income between a DISC and its affiliated corporation is achieved through the use of special intercompany pricing rules which allow the DISC to maximize its allocation of the profits from export sales [13].

There have been three major modifications to the law in regards to DISC's since 1972. Each law change reduced the tax benefits allowed to stockholders of DISC's. The Tax Reduction Act of 1975 eliminated DISC benefits for profits arising from exports of products in short domestic supply, and from exports of natural resource products, such as oil, gas, and minerals, subject to percentage depletion allowance. The Tax Reform Act of 1976 limited DISC benefits to income attributable to export gross receipts in excess of 67 percent of average export gross receipts in a 4-year base period [14]. (In addition, DISC's were required to include in their computation of their deemed distributions taxable to their stockholders any amounts of international boycott income [15].) The third modification, enacted by the Tax Equity and Fiscal Responsibility Act of 1982, (whose provisions are not reflected in the data in this paper), increased the portion of DISC income considered deemed distributed to the DISC's corporate stockholders from 50 percent to 57.5 percent for taxable years beginning in 1983.

The DISC tax provisions have been a point of contention between the United States and other signatory countries of the General Agreement on Tariffs and Trade. As a result, the DISC provisions have been substantially modified by the Deficit Reduction Act of 1984. This Act will end the existence of large DISC exporters. U.S. corporations will replace these DISC's with foreign sales corporations (FSC's) abroad through which export sales will be made. A portion of the export income of eligible FSC's will be exempt from U.S. income tax, while the remainder of the earnings will be subject to taxation. Also exempted from taxation will be the accumulated tax-deferred profits of existing DISC's. Two alternatives have been provided by the Act, as relief for small exporters who may find the foreign economic activity requirements burdensome. These alternatives are the interest-charge DISC and the small FSC exception. Thus, there will be in existence both FSC's and DISC's.

The number of DISC returns, DISC taxable income, and amounts deemed distributed from 1972 to 1981 are presented in Figure 3. The difference between the amount of DISC taxable income and the amount deemed distributed for each year represents the amount of DISC income that can be deferred indefinitely from U.S. income taxation.

FOREIGN CORPORATIONS WITH INCOME DERIVED FROM U.S. SOURCES

A foreign corporation is any corporation which is not "created or organized" in the United States or under the laws of the United States or any State [16]. Foreign corporations referred to in this section of the paper have income derived from U.S. investments, such as dividends, interest, rents, and royalties, and/or income derived from business operations conducted in the United States.

Income that a foreign corporation receives that is derived from its U.S. investments is subject to U.S. tax generally at the rate of 30 percent on that income, unless a lower tax rate has been set by a tax treaty. Generally, most investments in the United States are made by foreign corporations located in treaty countries [17]. Income derived by a foreign corporation from U.S. business operations is considered to be "effectively connected" income and is subject to tax in the same manner as a domestic corporation is taxed [18]. Income derived by the foreign corporation outside the U.S. is not included as income subject to U.S. taxation [19].

Figure 4 presents selected data from Form 1120F returns filed for Tax Year 1981 compared to the data for 1972 and 1977. As described in the previous paper, foreign corporations with "effectively connected" income from U.S. sources increased during the nine year period dramatically, and these were primarily engaged in banking and real estate [20].

Figure 3. -- Number of DISC Returns, DISC Taxable Income, and Amounts Deemed Distributed, 1972 - 1981*
(money amounts are in millions of dollars)

Tax Year	Number of Returns	DISC Taxable Income	Amount Deemed Distributed
1972*.........	2,826	1,566	776
1973..........	4,162	3,149	1,579
1974..........	5,498	4,783	2,416
1975..........	6,431	4,772	2,420
1976..........	6,911	5,071	3,499
1977..........	6,665	5,234	3,715
1978..........	7,208	6,427	4,360
1979..........	7,933	8,461	5,397
1980..........	8,665	9,875	6,270
1981..........	9,408	10,952	7,187

*Tax year refers to taxable periods ended between July 1 of the year and June 30th of the following year. However, for 1972, the effective date began January 1, 1972.

Figure 4. -- Number of Active Foreign Corporations (Forms 1120F) with U.S. Business Operations and Selected Financial Data, 1972 - 1981

Item	1972	1977	1981
Number of active foreign corporations with U.S. business operations, total....	796	3,093	9,350
	(millions of dollars)		
Total receipts..........................	3,567	10,398	37,281
Business receipts...................	2,490	7,157	10,143
Interest............................	886	2,454	25,480
Dividends received from domestic corporations.......................	85	53	74
Total deductions........................	3,379	10,572	38,857
Cost of sales and operations.........	1,687	4,476	7,268
Taxes paid..........................	57	219	469
Interest paid.......................	584	2,501	25,125
Depreciation........................	37	257	416
Net income (less deficit)...............	161	(188)	(1,596)
Total income tax........................	77	124	260
Foreign tax credit......................	4	9	12

NOTE: Data excludes Forms 1120F filed with only income derived from U.S. investments subject to withholding tax.

DOMESTIC CORPORATIONS WITH 50 PERCENT OR MORE OWNERSHIP BY A FOREIGN ENTITY

In addition to foreign corporations with income from sources in the United States described above, there are domestic corporations whose voting stock is 50 percent or more directly or indirectly owned by at least one foreign entity, such as a corporation. These foreign-owned domestic corporations could result from stock acquisitions by foreign entities, be newly formed subsidiary corporations, or result from joint ventures between two or more corporations, at least one of which is a foreign corporation, to mention a few of the possibilities [21].

Each domestic corporation regardless of ownership is required to indicate on its income tax return whether any person, domestic or foreign, owned 50 percent or more of its voting stock. If there was a 50-percent-or-more foreign owner, the country of the owner and percentage of stock directly or indirectly owned was used for the SOI statistics.

These data are tabulated generally by the industry of the domestic corporation and by the country of the foreign owner and are furnished annually to the Office of Tax Analysis, Department of the Treasury. The data include income statements, balance sheets, tax items, and distributions to stockholders.

Figure 5 shows the number of domestic corporations that indicated they were 50 percent or more owned by a foreign entity and selected financial data. From 1972 to 1981, the number of these corporations rose from 6,198 to 27,626. Their assets similarily rose from $46.9 billion to $383.7 billion, and the receipts they generated increased from $50.8 billion to $371.3 billion.

More than half of these domestic corporations were engaged in either trade activities or involved in finance, insurance, or real estate. This was true in 1972 as well as in 1981. Trade corporations accounted for 40 percent of the total in 1972, and 33 percent in 1981. Domestic financial corporations accounted for 24 percent of the total in 1972 and 28 percent in 1981. Data for these corporations will continue to be tabulated for the Office of Tax Analysis, and may be produced upon request on a reimbursable basis.

U.S. POSSESSIONS CORPORATIONS

A U.S. possessions corporation is a domestic corporation that has elected to be treated as a possessions corporation by filing a Form 5712, Election to be Treated as a Possessions Corporation. To qualify the corporation must derive 80 percent or more of its gross income from sources within a U.S. possession and 50 percent or more of its gross income from the active conduct of a trade or business within a U.S. possession. Corporations which meet these requirements for a period of three years (the current taxable year and two preceding years) are allowed a credit against their U.S. income tax liability.

Prior to 1976, provisions for possessions corporations entitled their U.S. parent corporations a unique form of domestic tax treatment. In profitable years, the possessions income was excluded from taxation, while in loss years, the parent corporations were allowed to offset their profits with the subsidiaries' losses by joining the subsidiary in the filing of a consolidated return [22].

In addition, dividends distributed to the U.S. parent corporation were fully taxable to

Figure 5. -- Domestic Corporations Indicating 50 Percent or More Ownership by a Foreign Entity, Selected Items, 1972 and 1981 (money amounts are in millions of dollars)

Item	1972	1981
Returns indicating 50% or more ownership by a foreign entity		
Number of returns	6,198	27,626
Total assets	46,868	383,702
Total receipts	50,814	371,344
Business receipts	48,932	342,958
Interest received	752	19,018
Total deductions	49,496	365,938
Cost of sales and operations	37,613	265,998
Interest paid	1,071	23,615
Net income (less deficit)	1,295	5,270
Total income tax before credits	741	5,731
Foreign tax credit	28	794
Total income tax after credits	658	4,125
Distributions to stockholders	593	2,778

the U.S. parent corporation when received. However, the dividends received deduction allowed on other domestic dividends received were not applicable to dividends received from possessions corporations. Amounts received by U.S. parent corporations upon liquidation of a possessions corporation were exempt from U.S. income tax. As a result, income accumulated over the years by possessions corporations tended to be invested abroad in anticipation of a tax-free liquidation.

The tax benefits for possessions corporations were substantially revised by the Tax Reform Act of 1976. Although the 80 and 50 percent tests were not changed, possessions corporations were no longer permitted to be included in consolidated returns, thus, eliminating the benefit to parent corporations in both profit and loss years. In addition, the possessions corporations' dividends now qualified for the dividends received deduction, thus removing the incentive to liquidate. The allowance of the deduction caused the acceleration of the remittance of dividends to U.S. parent corporations. According to the U.S. Treasury Department, dividends distributed by manufacturing possessions corporations increased from virtually none prior to 1977 to $1.2 billion in 1980 [23]. The exemption of income was replaced with a credit against U.S. income tax equal to that portion of the tax attributable to possessions business income and qualified possessions source investment income. It was also necessary for the corporation to make an election to be treated as a possessions corporation. The election was irrevocable for 10 years unless the Secretary of the Treasury consented to the revocation of the election.

The Tax Equity and Fiscal Responsibility Act of 1982, made two additional changes related to possessions corporations. First, it cut back the amount of passive investment income that a corporation could earn and still qualify for the possessions tax credit. The 50 percent active trade or business test is increased by 5 percentage points to 55, 60, and 65 percent for taxable years beginning in 1983, 1984, and 1985, respectively. Secondly, the Act provided new rules for the allocation of income attributable to intangible property between a possessions corporation and its U.S. affiliate.

The most recent data obtained by the SOI Division are for Tax Year 1981 and are summarized in Figure 6. There were 565 returns in 1981 with nearly $2.0 billion of possessions tax credit (compared to 384 returns in 1976 with $700 million of credit) [24]. The 23 return difference in Figure 6 represents those corporations that claimed the credit but did not file the supporting information on Forms 5735.

U.S. possessions corporation studies have been conducted on an annual basis, and data are presented in the SOI Bulletin covering two years on a biennial basis. The most recent SOI Bulletin article for Tax Year 1980 points out that most possessions corporations are located in Puerto Rico. It was estimated that 9 percent of the total employment in Puerto Rico was accounted for by all possessions corporations in manufacturing and one-half of all employees in the manufacturing sector of Puerto Rico. The employment data are based on the Federal unemployment insurance tax returns (Forms 940) available for 282 possessions corporations engaged in manufacturing activities in 1980 and are provided to the Office of Tax Analysis each year [25].

FOREIGN TAX CREDIT: INDIVIDUALS

U.S. taxpayers (defined to include both U.S. citizens and alien residents in the United States) who paid or accrued foreign taxes on their foreign source income were eligible to use those taxes either as an itemized deduction or as a tax credit, provided that the foreign source income was subject to U.S. taxation. The United States imposes its income tax on the

Figure 6. -- Selected Financial Data for U.S. Possessions Corporations, 1981
(money amounts are in millions of dollars)

Item	All Possessions Corporations	Possessions Corporations with Forms 5735 Attached
Number of returns	565	542
Total assets	17,442	16,988
Total retained earnings	12,542	12,344
Total receipts	14,379	13,387
Business receipts	13,235	12,258
Net income (less deficit)	4,327	4,254
Total income tax	1,971	1,938
Possessions tax credit	1,942	1,914
Income tax after credits	28	23
Gross income from trade or business: *		
Total	*	7,395
Within U.S. possessions	*	6,597

* Data obtained from Form 5735 not filed by 23 U.S. possessions corporations with $28 million tax credit.

worldwide income of individual citizens and residents without regard to the geographic source of that income.

The choice of taking the deduction or claiming the credit is up to the taxpayer. In the majority of cases it was advantageous to claim the foreign taxes as a credit since, after computing the credit limitation, the allowable foreign tax credit resulted in a dollar-for-dollar reduction of U.S. tax liability. The foreign tax credit is allowed either against the basic income tax or by using a special computation, the alternative minimum tax. However, the credit cannot be applied against any of the other taxes reported on Form 1040 such as minumum tax preferences, tax from recomputing prior-year investment credit, and other taxes making up part of the total tax liability.

The foreign tax credit was not allowed to: (1) U.S. citizens entitled to an exemption from U.S. tax on income from sources within U.S. possessions (see the U.S. Possessions Excluded Income section of this paper), (2) U.S. citizens who were inhabitants of the U.S. Virgin Islands, and (3) citizens of U.S. possessions (except Puerto Rico) who were not otherwise U.S. citizens or residents. Additionally, nonresident aliens were not allowed a foreign tax credit except for income taxes paid to a foreign country on foreign source income that was "effectively connected" with a trade or business in the United States. In computing total foreign taxable income and total U.S. taxable income, taxpayers could not take into account any foreign income excluded from U.S. tax. Also, the amount of taxes paid or accrued on this excluded income was not allowed in the foreign tax credit computation.

The Tax Reform Act of 1976 changed the method of computing the foreign tax credit for individual taxpayers. Generally, for taxable years beginning in 1976 only the overall limitation method of computing the foreign tax credit was allowed. Another part of the Act changed the method of reporting foreign source capital gains. They were now required to be offset by U.S. source capital losses for purposes of computing the foreign tax credit. The Act also introduced the requirement that the foreign tax credit be reduced if the individual agreed to participate in or cooperate with an international boycott. Finally, the Act allowed individuals claiming a foreign tax credit to take the standard deduction rather than requiring taxpayers to itemize their deductions in computing their total taxable income from all sources.

In general, the foreign tax credit may be taken only by the individuals upon whom the foreign tax is imposed [26]. These individuals, unlike domestic corporations, are not usually eligible to take the deemed paid credit on distributions received from foreign corporations that domestic corporations are allowed to claim [27].

However, an individual that meets the minimum stock ownership requirement for a Controlled Foreign Corporation can elect to be taxed at the corporate taxes rates on the individual's share of certain undistributed income of the CFC (Subpart F income). Under these circumstances the individual is also eligible for a deemed paid credit. As with corporations, the amount of foreign income taxes which exceeds the allowable credit can be carried back two years and forward five years.

Figure 7 compares the number of returns and foreign tax credit claimed for each year of the 10 year period, 1972-1981. Also, it indicates that the majority of the credit is claimed by individuals in the upper income bracket (adjusted gross income of $100,000 or more), especially in more recent years. The last detailed study of foreign tax credit claimed by individuals for Tax Year 1979 indicates that ten countries accounted for $823 million of the

Figure 7. -- Amount of Foreign Tax Credit Claimed on Individual Income Tax Returns and for Returns with Adjusted Gross Income (AGI) of $100,000 or More, 1972-1981
(money amounts are in thousands of dollars)

Year	All Returns		Returns with AGI of $100,000 or More		
	Number	Foreign Tax Credit	Number	Foreign Tax Credit	Percent of Total Credit
1972...	202,440	221,387	48,875	137,312	62.0
1973...	223,127	255,286	48,861	135,265	53.0
1974...	233,191	291,730	57,698	153,816	52.7
1975...	231,078	345,928	60,043	168,926	48.8
1976...	255,749	427,627	70,728	255,368	59.7
1977...	240,874	451,033	70,529	248,766	55.2
1978...	278,267	901,030	95,257	585,801	65.0
1979...	287,508	842,176	107,778	627,128	74.5
1980...	393,074	1,341,675	153,227	996,957	74.3
1981...	387,680	1,233,564	169,887	1,019,780	82.7

NOTE: Data includes nontaxable returns with foreign tax credit and foreign tax credit claimed by U.S. citizens living abroad.

total $842 million of foreign tax credit claimed by individuals [28]. Compared to the corporate foreign tax credit described earlier the credit claimed by individuals generally makes up only about 5 percent of the combined total for both individual and corporation foreign tax credits.

The next study of individual tax returns with foreign tax credit is scheduled for Tax Year 1983. It will contain data for each type of foreign source income by country to which foreign taxes were paid or accrued.

FOREIGN EARNED INCOME OF INDIVIDUALS

U.S. citizens are generally taxed on their worldwide income and receive a foreign tax credit for foreign taxes paid or accrued on their foreign source income. However, U.S. citizens working abroad are allowed to exclude from their gross income a specified amount of income earned for services performed abroad [29]. In order to qualify for the foreign earned income exclusion, the taxpayer must be a bona fide resident of a foreign country for a period which includes a full taxable year, or be physically present in a foreign country for 11 out of 12 consecutive months [30].

Prior to 1976, a U.S. citizen working abroad could exclude up to $20,000 of foreign earned income which increased to $25,000 after three years of bona fide foreign residence. A U.S. citizen who was not a bona fide resident of a foreign country but remained abroad for a period of 510 days out of an 18-month period could also exclude up to $20,000 of foreign earned income. U.S. citizens who paid taxes to a foreign country were not only allowed to exempt foreign earned income but also could claim a foreign tax credit for foreign taxes paid on the excluded amounts against any U.S. tax liability on income over and above the excluded amounts, thereby, increasing the tax-exempt amount.

The Tax Reform Act of 1976 made several changes in the taxation of U.S. citizens working abroad. The principal changes were: (1) reducing the exclusion to $15,000 annually, (2) applying higher tax rates on any remaining portion of income subject to U.S. income taxation, and (3) eliminating a foreign tax credit for foreign taxes attributable to the excluded income. The provisions of the 1976 Act were effective for taxable years beginning in 1976. However, the Tax Reduction and Simplification Act of 1977 postponed the effective date of the 1976 provisions until taxable years beginning in 1977.

The Foreign Earned Income Act of 1978 further postponed the effective date of the Tax Reform Act of 1976 provisions affecting Americans working abroad to taxable years beginning in 1978. Therefore, qualifying individuals had to follow the pre-1977 rules for Tax Year 1977 returns. These returns were allowed to be filed without penalty on or before February 15, 1979. The effects of these postponements are presented in Figure 8. The number of returns declined from 1976 to 1977 because many 1977 tax returns were filed in early 1979 and thus were included in figures for 1978.

The Foreign Earned Income Act of 1978 contained other provisions affecting U.S. citizens working abroad. For Tax Year 1978 returns, the Act permitted taxpayers to choose between the $15,000 earned income exclusion (as specified in the Tax Reform Act of 1976) or the provisions of two new rules. One of these new rules allowed a taxpayer, who resided in an employer camp in a foreign hardship area, an annual exclusion from gross income of up to $20,000 of foreign income [31]. The second rule provided qualified individuals a deduction for excess qualified foreign living expenses for such items as cost-of-living differentials, housing costs, school expenses, home leave

Figure 8. -- Number of Returns, Income Earned Abroad and Tax-exempt Amount, 1976-1979 (money amounts are in millions of dollars)

Items	1976	1977	1978	1979 *
Number of returns............	140,438	123,045	169,951	91,966
Income earned abroad..........	3,472	3,068	5,773	3,710
Tax-exempt or excluded amount.	2,131	1,486	2,053	288
Percent of tax-exempt amount to income earned abroad......	61.4	48.4	35.6	7.8

* Data for 1979 does not include 6,904 returns filed for 1977 and prior tax years, and 20,560 returns filed for Tax Year 1978.

travel expenses, and hardship area expenses. The 1978 Act also repealed for taxable years beginning in 1979 the $15,000 earned income exclusion.

The Economic Recovery Tax Act of 1981 simplified the foreign earned income provisions by eliminating most of the special deductions available to taxpayers under the 1978 Act and reintroduced an election to exclude earned income attributable to services performed overseas [32]. For Tax Year 1982, qualifying taxpayers were allowed to exclude up to $75,000 in foreign earned income. The maximum annual exclusion increases $5,000 per year until 1986, when the maximum exclusion will be $95,000. Qualified taxpayers also can elect separately an exclusion for reasonable housing costs in excess of 16 percent of the salary of a U.S. Government employee at grade level GS-14, step 1 (currently approximately $43,000). The 1981 Act also reduced the foreign presence residence requirement to a period of 11 out of 12 months.

The last study was for Tax Year 1979 and the next study (which will reflect the legislative changes in the Economic Recovery Tax Act of 1981), is scheduled for Tax Year 1983.

U.S. POSSESSIONS EXCLUDED INCOME

A citizen of the United States who works as an employee or operates a business in certain possessions of the United States may qualify for an exclusion from gross income, the amount of which is that received from sources outside the United States. The exclusion is allowed if in a 3 year or other applicable period [33] immediately before the end of the tax year, 80 percent of gross income was derived from sources within a U.S. possession and 50 percent or more of the gross income was from salaries and wages or the active conduct of a trade or business within the U.S. possession. The 80 percent requirement includes all income (salaries, wages, interest, dividends, rent, etc.) received. If the individual qualifies for the possession exclusion, then only U.S. source income (including foreign and possession source income received in the United States) is taxable, plus any income received during the part of the tax year that is not part of the applicable period [34]. In addition, wages, salaries, and other kinds of pay from the U.S. Government to civilian and military employees in U.S. possessions are also subject to U.S. taxation. These individuals generally do not qualify for the possessions exclusion.

Regarding possessions exclusion income, it is important to note that the term, "possession of the United States" only includes the following: (1) Midway Islands, (2) Palmyra, (3) Johnston Island, (4) Kingman Reef, (5) Wake Island, (6) Howland Island, (7) Baker Island, (8) Jarvis Island, (9) American Samoa, and (10) other U.S. islands, cays, and reefs that are not part of the 50 states. It does not include Guam, the Northern Mariana Islands, the U.S. Virgin Islands, and Puerto Rico. Each of these areas has its own separate and independent tax system, generally modelled after that of the United States. U.S. citizens residing in them are liable for payment of taxes imposed on them by the possession.

The last study was for Tax Year 1974. Shown in Figure 9 are selected statistics resulting from that study. Plans are to conduct the next study in 1983 and then studies every four years thereafter. These studies will tabulate data described previously with selected data from related Forms 1040, U.S. Individual Income Tax Returns, and Forms W-2, Wage and Tax Statements. The information obtained will be presented in future publications.

NONRESIDENT ALIEN INCOME AND TAX WITHHELD

The Internal Revenue Code requires that certain income paid by U.S. persons to nonresident aliens be taxed by withholding. A nonresident alien is defined as an individual whose residence is not within the United States and who is not a U.S. citizen. Corporations, estates, trusts, and other organizations created outside the United States are also considered nonresident aliens.

A U.S. individual or organization that pays income to a nonresident alien reports information on the gross income paid and the tax withheld at the source on such income [35]. Also, information on the type of income paid, the applicable withholding rate, type of recipient and the legal residence of the recipient is provided.

The basic tax rate on the income, which is primarily "fixed or determinable" income (i.e., interest, dividends, rents, and the like), is 30 percent. However, tax treaties with particular countries may provide for lower tax rates or exemptions for specific types of otherwise taxable income [36]. Past studies indicate that the amount of income paid to nonresident aliens residing in "treaty" countries was substantially

Figure 9. -- Total Gross Income and Its Components, by U.S. Possessions, 1974
(money amounts are in thousands of dollars)

U.S Possessions	Number of Forms 4563 Filed	Total Gross Income	Gross Income Exempt from U.S. Taxation		Gross Income Earned Within U.S.
			Income from Possessions	Income Outside U.S. and Possessions	
U.S. possessions, total....	604	9,554	9,136	15	403
American Samoa...........	150	2,244	2,185	3	56
Johnston Island..........	302	3,729	3,514	6	109
Midway Island............	12	112	107	-	5
Panama Canal Zone *......	88	2,831	2,722	6	103
Wake Island..............	52	639	608	**	31

* Panama Canal Zone is no longer a U.S. possession.
** Amount less than $500.
NOTE: Detail may not add to total due to rounding.

greater than that paid to nonresident aliens residing in "nontreaty" countries [37].

Most payments went to individuals, although the size of the payments were less than those made to corporations. As one would probably expect, dividends and interest represented the majority of income paid. Figure 10 shows gross income paid and tax withheld classified by country of recipient.

INTERNATIONAL BOYCOTT REPORTS

The Tax Reform Act of 1976 added provisions to the Internal Revenue Code (IRC) denying certain benefits to taxpayers who participated in or cooperated with an international boycott. In addition, these provisions contained reporting requirements for any U.S. person that had operations in, or related to, a boycotting

Figure 10. -- Number of Forms 1042S Filed, Gross Income Paid and Tax Withheld, by Selected Country of Recipient, 1981
(money amounts are in millions of dollars)

Country	Number of Forms 1042S Filed	Income Tax Withheld	Gross Income Paid		
			Total	Interest	Dividends
All countries...	575,207	727	9,561	3,365	4,269
Bahamas...........	1,886	7	39	3	18
Belgium...........	11,870	15	118	24	62
Bermuda...........	1,522	13	52	19	19
Canada............	258,241	115	1,238	487	365
France............	13,091	51	650	180	307
Germany, Federal Republic.	47,355	26	622	192	109
Hong Kong.........	9,605	9	34	5	27
Italy.............	6,936	7	48	14	13
Japan.............	5,630	39	520	158	103
Luxembourg........	2,588	5	58	20	27
Mexico............	8,576	8	31	6	12
Netherlands.......	9,706	88	1,340	200	1,059
Netherlands Antilles.........	1,857	27	1,400	1,037	329
Panama............	2,531	11	46	11	27
Saudi Arabia......	1,593	1	211	207	3
Sweden............	4,867	3	46	8	13
Switzerland.......	19,845	126	1,204	349	710
United Arab Emirates.........	530	*	48	2	25
United Kingdom....	65,524	99	1,357	326	798
Other countries...	101,450	77	499	117	243

*Less than $500,000.
NOTE: All Forms 1042S are included in these statistics.

country either directly, or indirectly such as through ownership of a foreign corporation that had operations in a boycotting country [38].

Boycott participation and cooperation can apply to a particular country, nationality, race, or religion, and includes most business activity and transactions. (Most boycotts are related to the boycott of Israel.) The boycott provisions of the IRC require the Secretary of the Treasury to publish a list of those countries, (first published on November 3, 1976), which may require participation in, or cooperation with, an international boycott [39]. The taxpayer may also request the Secretary to issue a determination whether a particular operation constitutes participation in, or cooperation with, an international boycott.

A U.S. taxpayer who actually participates in a boycott will lose certain foreign tax credit benefits, the deferral of tax on the earnings of foreign subsidiaries, and certain DISC tax benefits. Of course, if a taxpayer does not have any foreign tax credits, an interest in a Controlled Foreign Corporation, or an interest in a DISC, there is no tax impact by the participation in an international boycott [40].

In general, the boycott provisions allow the taxpayer to choose between two methods for computing the amount of tax benefits lost. These methods are the "specifically attributable income and taxes" method and the "international boycott factor" method. Under the former, the foreign tax credit benefits are denied by reducing the amount of taxes eligible for foreign tax credit. Under the latter, the allowable foreign tax credit itself is reduced. The DISC benefits and the deferral of the earnings and profits of a Controlled Foreign Corporation are denied under both methods by requiring a deemed distribution of earnings to the shareholders of the DISC or Controlled Foreign Corporation.

The number of persons filing Boycott Reports and the tax effect of international boycott participation for 1979 and 1980 are presented in Figure 11. These data are provided to the Office of Tax Analysis, Treasury Department, for their report, "The Operation and Effect of the International Boycott Provisions of the Internal Revenue Code."

Most of the boycott information will be tabulated for Tax Years 1982, 1986, and 1990 (a 4-year cycle). For the years in between, information will be obtained from returns that showed a denial of tax benefits (approximately 100 returns). For all other returns, only a count will be made. Articles for the SOI Bulletin on boycott participation are planned beginning with Tax Year 1982.

Figure 11. -- Number of Boycott Reports, and Tax Effect of International Boycott Participation, 1979-1980
(money amounts are in thousands of dollars)

Item	1979	1980
All persons, total:		
Number of boycott reports.................	3,197	3,413
Number of returns indicating a tax effect.	101	88
Reduction in foreign taxes eligible for a foreign tax credit *...............	6,563	3,850
Reduction of foreign tax credit **........	656	2,128
Subpart F boycott income..................	11,688	7,943
DISC boycott income.......................	1,496	830
Corporations (including DISC's):		
Number of boycott reports.................	2,892	3,090
Number of returns indicating a tax effect.	101	88
Reduction in foreign taxes eligible for a foreign tax credit *..............	6,563	3,850
Reduction of foreign tax credit **.......	656	2,128
Subpart F boycott income..................	11,688	7,943
DISC boycott income.......................	1,496	830
Number of boycott reports for other types of persons:		
Individuals...............................	153	142
Partnerships..............................	120	142
Trusts and others.........................	32	39

* Represents the reduction in foreign taxes eligible for a foreign tax credit computed under the "specifically attributable taxes and income" method.

** Represents the reduction in foreign tax credit computed using the "international boycott factor" method.

FOREIGN TRUSTS

U.S. persons are required to furnish information on the creation of a foreign trust or transfers of property to existing foreign trusts [41]. A trust generally is real or personal property administered by a person for the benefit of someone else. Whether a trust is classified as a foreign trust for U.S. tax purposes depends on various factors, such as the residence of the trustee, the location of the trust assets, the country under whose laws the trust is created, and the nationality of the grantor (creator or owner of the trust), and the nationality of the beneficiaries (persons receiving the income and corpus, i.e., assets, from the trusts).

For tax purposes, a foreign trust is taxable only on its U.S. source income (unless such income is effectively connected with a U.S. trade or business) and its beneficiaries only on distributed or distributable income. Distributions of income (i.e., dividends and interest), received by U.S. taxpayers from the foreign trust, are taxed basically in the same manner as distributions from domestic sources.

Prior to 1976, foreign trusts, which had only foreign source income, could allow income (if not distributed) to accumulate free of U.S. tax; and, if funds were accumulated in countries that did not tax interest or dividends paid to foreign investors, these trusts were generally able to avoid payment of any income tax. U.S. source passive income such as dividends and interest was subject to U.S. tax at a flat withholding rate of 30 percent, unless a tax treaty set a lower rate.

The Tax Reform Act of 1976 provided new rules to tax the income of foreign trusts. This income is now taxed to the U.S. grantor (owner) in the year it is earned if the funds are accumulated for U.S. beneficiaries. These new rules were effective for taxable years beginning in 1976 and applied to foreign trusts created, and to property transfered to such trusts, after May 21, 1974.

In those instances where the income of a foreign trust was not taxed to the grantor (if the grantor is a foreign person), the 1976 Act provided for an interest charge of 6 percent on the U.S. beneficiaries receiving taxable accumulated distributions from a foreign trust. The tax is based upon the length of time during which that tax was deferred because of the trust's accumulation of income. This interest charge applied to distributions made in taxable years of beneficiaries beginning in 1977. In addition, the excise tax imposed on transfers of appreciated property to foreign trusts was increased from 27.5 percent to 35 percent on property transfers made after October 2, 1975.

Figure 12 shows that for the years 1979 - 1982, most of the trusts created were by individuals and the dollar value of the transfer of assets to the trusts fluctuated substantially.

NONRESIDENT ALIEN ESTATES

A nonresident alien decedent was an individual who was neither a resident in nor a citizen of the United States at the time of death, but who owned property in the United States and whose estate is liable for tax [42].

The gross estate of a nonresident alien may include property located both inside and outside the United States. However, for U.S. estate tax purposes, the tax liability is based only on property situated in the United States [43]. Further, the tax liability is placed upon the estate itself, and not the beneficiaries of the estate.

In general, the personal representative, such as an executor, must file an estate tax return if the decedent's gross U.S. estate value exceeds $60,000 at the date of death. (This filing limit of $60,000 is lowered in certain instances.) This form is filed usually within 9

Figure 12. -- Number of Forms 3520 Filed by Individuals and Value of Assets Transferred, 1979-1982

Item	1979	1980	1981	1982
Total number of Forms 3520	298	328	351	338
Individuals filing, total	297	322	342	324
Grantor	194	242	253	216
Transferor	72	69	70	63
Grantor/transferor *	29	12	17	35
	(thousands of dollars)			
Value of assets transferred	3,489	15,631	5,118	9,756

* Number of Forms 3520 with both grantor and transferor indicated as type of person filing returns.

Figure 13. -- Future Studies Planned for the Foreign Area in the Statistics of Income Division, Internal Revenue Service, 1982-1990

Foreign Area Studies	Tax Year								
	1982	1983	1984	1985	1986	1987	1988	1989	1990
Corporation Foreign Tax Credit	x	-	x	-	x	x	-	-	x
Controlled Foreign Corporations	x	-	x	-	x	x	-	-	x
U.S. Possessions Tax Credit	x	x	-	x	-	x	-	x	-
Excluded Income from U.S. Possessions	-	x	-	-	-	x	-	-	-
Foreign Trusts	x	-	-	-	x	-	-	-	x
Nonresident Alien Estates	x	-	-	-	x	-	-	-	x
International Boycott Participation	x	1/	1/	1/	x	1/	1/	1/	x
Nonresident Alien Income and Tax Withheld	x	x	x	x	x	x	x	x	x
Domestic International Sales Corporations	x	x	x	x	x	x	x	x	x
Individual Foreign Tax Credit	-	x	-	-	-	x	-	-	-
Foreign Corporations (Form 1120F) 2/	x	x	x	x	x	x	x	x	x
Domestic Corporations 50% or More Foreign Owned 2/	x	x	x	x	x	x	x	x	x
Foreign Earned Income (Form 2555)	-	x	-	-	-	x	-	-	-

1/ Limited to approximately 100 returns which show a denial of tax benefits.
2/ Tabular data are prepared for transmittal to the Office of Tax Analysis, Department of the Treasury.

SOURCE: Office of Assistant Commissioner, Returns and Information Processing, "Proposed Multi-year Operating Plan, Statistics of Income Division, FY 1984-1990," March 1984.

months after the date of death, with the IRS Philadelphia Service Center. The 9-month filing period may be extended for certain reasons (in particular, due to the deliberate nature of estate settlement procedures).

A study of all estate tax returns filed for nonresident aliens who became deceased during calendar year 1982 is in progress. The data (which will include value and types of estate property, expenses, and estate tax) will be classified by country of residence at the time of death and by size of gross estate both within and outside the United States [44].

PLANS FOR FUTURE STUDIES

This paper has provided a description of the current SOI foreign statistics at some length and presented statistics based on prior and current year studies.

Additionally, Figure 13 below shows the present plans of the SOI Division to continue on a cyclical basis various studies in the area of international income and taxes. Additional research may also be made in the future into certain new foreign activities reported on tax returns. For example, IR Code Section 6038A added by the Tax Equity and Fiscal Responsibility Act of 1982 requires that information be filed by certain foreign-based corporations beginning in 1983. Both domestic corporations and foreign corporations, except banks and certain financial companies, doing business in the United States which are controlled by foreign persons and have certain "reportable" transactions will generally have to provide financial data on annual returns on such foreign persons that is similar to the data required for domestic corporations controlling foreign corporations.

Areas for other studies are also planned. The SOI Division will compare its different data bases to develop greater insight into the international area. Further, the Division plans to commit certain resources to research other government (and perhaps private) sources of foreign area data. The purpose of this research would be to compare the various data sets with SOI data for similarities, differences and other relationships. It may allow both data sets to be joined together providing additional data and information not presently available. The results may be published in future ASA papers.

ACKNOWLEDGMENTS

The authors would like to thank Antoinette Dade for her typing assistance, and other members of the Foreign Returns Analysis Section of the Statistics of Income Division for their review and comments to this paper.

NOTES AND REFERENCES

[1] See Gianelos, Arthur, and Hobbs, James, "Statistics of Income Studies of International Income and Taxes: An Overview," 1984 American Statistical Association Proceedings, Section on Survey Research Methods for an overview of the international operations of U.S. corporations abroad and operation of foreign corporations and interests in the United States.

[2] Details on the various programs including information regarding such processing steps as the sample selection of returns, editing of returns (or data entry), transcription, programming and systems analysis and testing of the data and correction procedures used, are briefly described in the SOI Division's, Proposed Multi-Year Operating Plan, FY 1984 - 1990, volume 1.

[3] Owens, Elisabeth A., The Foreign Tax Credit, The Law School of Harvard University, Cambridge, Massachussetts, 1961, page 20.

[4] For example, The Revenue Act of 1932 required the taxpayer to elect to take the credit rather than a deduction for foreign tax.

[5] Form 1118, Computation of Foreign Tax Credit, is filed in support of the credit claimed and provides the source of the data on foreign income and taxes. For additional detail on the foreign tax credit study, see States, William, "Corporate Foreign Tax Credit, 1980: An Industry Focus," SOI Bulletin, volume 4, number 1, Summer 1984, pp. 63-84.

[6] A third-tier foreign tax credit was added to dividends constructively received for deemed paid foreign tax credit in 1977. Prior to this, only first and second-tier foreign corporations were used for constructive dividend distributions.

[7] Form 2952, Information Return with Respect to a Controlled Foreign Corporation, is required to be filed for each foreign corporation a U.S. person controls. Also, beginning in 1982 a new Form 5471 will substitute for Form 2952 providing additional data.

[8] Gifford, W.E. and Owens, E.A., International Aspects of U.S. Income Taxation - Part III; Taxation of U.S. Citizens and Residents and Domestic Corporations on Foreign Source Income, International Tax Program, Harvard Law School, Cambridge, Massachusetts, 1982, page 118.

[9] Ibid., page 362.

[10] Gianelos, Arthur, and Sutton, William, "Controlled Foreign Corporations, 1980," SOI Bulletin, volume 3, number 4, Spring 1984, pp 37-57.

[11] See Gianelos, Arthur, and Hobbs, James, "Statistics of Income Studies of International Income and Taxes: An Overview," in this volume for a discussion of DISC and U.S. exports.

[12] The property is usually acquired from its parent corporation or an affiliated corporation unless the DISC acts as a commission agent.

[13] For a discussion of intercompany pricing methods, see Hartzok, Jeffrey, "Domestic International Sales Corporation - 1980," SOI Bulletin, volume 3, number 2, Fall 1983, pages 12-14. For definitions of terms applicable to DISC, also see Internal Revenue Service, Statistics of Income - 1972-74, International Income and Taxes, Domestic International Sales Corporation Returns, Washington, D.C., 1980, pages 145-161.

[14] U.S. Department of the Treasury, The Operation and Effect of The Domestic International Sales Corporation Legislation, 1981 Annual Report, page 5.

[15] See International Boycott Participation in this paper.

[16] Certain foreign corporations incorporated in Mexico or Canada that are wholly owned by U.S. corporations may under certain circumstances and options of the U.S. corporation, be treated as domestic corporations. Also, under the Foreign Investment in Real Property Act of 1980, relating to taxation of gains from the disposition of real estate, a foreign corporation can elect to be taxed as a domestic corporation. See Zimmerman, Neal W., and Hickey, G.P., "Foreign Investment in U.S. Real Estate Reporting Requirements," The Tax Advisor, April 1983.

[17] Howenstein, Ned, and Fouch, Gregory, "Foreign Direct Investment in the United States in 1981," Survey of Current Business, volume 62, number 8, August 1982, pp. 30-42.

[18] These foreign corporations with income derived from foreign sources must file Form 1120F, U.S. Income Tax Return of a Foreign Corporation. This form contains information for income types derived from U.S. sources that are not "effectively connected" with the conduct of trade or business within the U.S., and income and deductions from U.S. sources that are "effectively connected" from conduct of a trade or business within the U.S.

[19] However, if a foreign corporation generates foreign source income that is effectively connected with its U.S. business then that foreign source income will also be subject to U.S. tax.

[20] See Gianelos, Arthur, and Hobbs, James, "Statistics of Income Studies of International Income and Taxes: An Overview," 1984 American Statistical Association Proceedings, Section on Survey Research Methods.

[21] Ibid.

[22] Szeflinski, Kenneth, "U.S. Possessions Corporation Tax Credit, 1980," SOI Bulletin, volume 2, number 4, Spring 1983, pp. 41-45.

[23] Department of Treasury, The Operation and Effect of the Possessions Corporation System of Taxation, Fourth Report, February 1983, page 130. Most possessions corporations are engaged in manufacturing operations.

[24] These corporations represent those having a U.S. possessions tax credit. It does not include U.S. possessions corporations that were either inactive or reported a loss from their operations. The basis of the data are Forms 5735, Computation of Possessions Corporations Tax Credit.

[25] Szeflinski op. cit., page 43, and Department of the Treasury, The Operation and Effect of the Possessions Corporation System of Taxation, First Annual Report, June 1978, for a discussion of the impact upon Puerto Rico and other U.S. possessions.

[26] A U.S. citizen who is a partner in a partnership can take as a foreign tax credit the proportionate share of the foreign taxes of the partnership. Foreign tax credits are also allowed to shareholders of regulated investment companies as if the shareholders were the direct owners of foreign corporations in the investment company portfolio. Finally, shareholders of registered foreign investment companies that elect to distribute income currently may claim foreign tax credits under certain cases.

[27] Form 1116, Computation of Foreign Tax Credit, is filed by individuals claiming a foreign tax credit as part of their individual income tax returns.

[28] The ten countries are Canada, South Africa (including South West Africa), United Kingdom, Puerto Rico, Netherlands, Israel, Switzerland, Japan, Saudi Arabia, and West Germany.

[29] Data for this study are based on Forms 2555, Foreign Earned Income, attached to individual income tax returns. The data are generally classified by size of adjusted gross income (AGI) and by country where the income is earned. See also, Statistics of Income - 1976-1979, Foreign Income and Taxes Reported on U.S. Income Tax Returns, U.S. Government Printing Office, Washington, D.C., 1982, pp. 13-15 for a description of the sample and limitations of the data.

[30] For taxable years beginning before 1982, a U.S. citizen working abroad, who was not a bona fide resident, had to be physically present in a foreign country for 17 out of 18 months in order to qualify for the foreign earned income provisions.

[31] See Internal Revenue Service, Statistics of Income - 1977, 1978, Individual Income Tax Returns, for a summary of the law changes for those years.

[32] Hoff, Citizens and Resident Aliens Employed Abroad, 13-3rd Tax Management.

[33] The applicable period only includes those periods during the 3-year period immediately preceding the end of the tax year that the individual was employed or engaged in a trade or business in the U.S. possession.

[34] U.S. citizens, who qualify for the possessions exclusion income must file Forms 4563, Exclusion of Income from Sources in United States Possession, attached to their U.S. individual income tax returns (Forms 1040).

[35] This information is reported on Form 1042S, Income Subject to Withholding under Chapter 3, Internal Revenue Code. These forms are filed with Forms 1042, U.S. Annual Return of Income Tax to be Paid at Source, which identifies the tax liability of the withholding agent.

[36] It should be noted that if income is paid to a foreign nominee or fiduciary, additional withholding is often required and is held by the government in the country of the nominee or fiduciary.

[37] For statistics on the number of Forms 1042S filed, income paid and tax withheld by tax treaty and nontreaty countries, see Carson, Chris, "Nonresident Alien Income and Tax Withheld, 1980 and 1981, " SOI Bulletins, vol. 2, number 1, and vol. 3, number 1.

[38] All U.S. persons who know, or believe, that they have conducted business in, or related to, a boycotting country, or with a national of a boycotting country, must report those operations. The information required is reported on Forms 5713, International Boycott Reports, which is the source of the data.

[39] Since April 1, 1980, the listed countries have been Bahrain, Iraq, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syria, the United Emirates, Yemen Arab Republic, and the Peoples Democratic Republic of Yemen. Prior to this, the list contained Egypt in addition to the countries above.

[40] However, he may be subject to a fine under provisions of the Export Administration Act.

[41] Forms 3520, Creation of, or Transfers to, Certain Foreign Trusts, provides the basis for the statistics presented. These forms must be filed by any U.S. person creating a foreign trust or transfering property to a foreign trust. Forms 3520A, Annual Return of a Foreign Trust with U.S. Beneficiaries, provides balance sheet and profit and loss statement information of foreign trusts with one or more U.S. beneficiaries and the countries under whose law the trusts were formed.

[42] Forms 706NA, United States Estate Tax Returns, are used to compute estate tax liability for nonresident alien decedents.

[43] Also included in the estate is certain property transferred by the decedent before death. However, excluded from the estate are life insurance contracts,

certain bank accounts in the United States, and deposits with foreign branches of U.S. banks.

[44] Preliminary estimates based on approximately 180 Forms 706NA indicate that the average taxable estate for a nonresident alien who died in 1982 is $222,395, and the average estate tax is $20,782. The SOI Division is continuing to receive additional Forms 706NA for this 1982 study.

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