United States General Accounting Office

GAO

Report to the Honorable William J. Coyne, House of Representatives

March 1988

TAX POLICY

Information on Interest Deducted for Financing Mergers Is Not Available

135437
041717

GAO/GGD-88-58

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

General Government Division

B-230473

March 29, 1988

The Honorable William J. Coyne
House of Representatives

Dear Mr. Coyne:

In your November 25, 1987, letter, you asked us to identify the amount of interest deducted on 1981 through 1986 tax returns by corporations that borrowed funds to finance mergers which required Federal Trade Commission (FTC) notification under section 7A of the Clayton Act. This section requires that the FTC be notified and make an antitrust review when firms meeting specific size criteria plan to merge. On February 5, 1988, we briefed your office on our findings, and we were asked to present our results in a report. These results are summarized below.

Results in Brief

We found that information on interest deductions deriving from corporate mergers is not readily available. The Internal Revenue Service (IRS), the FTC, and the Securities and Exchange Commission (SEC) have no current need to assemble this data on a systematic basis. Therefore, an answer to your question is not possible using existing public data sources.

Scope and Methodology

To respond to your request, we reviewed existing data sources which might link merger and acquisition expenditures with the source of financing. We contacted officials from FTC, IRS, and SEC; reviewed forms and instructions relating to section 7A notification; reviewed IRS' corporate tax forms and related instructions; and reviewed SEC studies and documents related to the financing of corporate mergers. A more detailed description of the work done at each agency appears below. We did our work in January and February 1988.

FTC Information

The number of mergers requiring section 7A notification has increased substantially from 1981 through 1987. In fiscal year 1981, FTC received 996 notifications. This number rose to 2,533 in fiscal year 1987. Over the 7-year period, the FTC received 10,717 notifications. Our inspection of the form required under section 7A indicated that information regarding how mergers are financed is not required. FTC officials confirmed this and said FTC does not collect financing information because FTC does not view information regarding the financing of these mergers

mergers, we did not obtain official agency comments. However, we discussed its contents with representatives of FTC, IRS, and SEC, and we incorporated their suggested clarifying language in preparing the final report. With these changes having been made, they agreed with the factual presentation.

As arranged with your office, we will make this report available upon issuance to any interested parties. If you have questions regarding our work, please contact Charles Vehorn of my staff on 272-7904.

Sincerely yours,

Jennie S. Stathis
Associate Director

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

Official Business
Penalty for Private Use $300

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

to be directly relevant to monitoring antitrust provisions of the Clayton Act, and because FTC must attempt to minimize the reporting burden.

IRS Information

Our inspection of U.S. Corporation Income Tax Return, IRS Form 1120, indicated that corporations are required to identify the total amount of interest expense incurred in the tax period on line 18. However, IRS does not require corporations to link this interest expense to the use of the borrowed funds that created the expense. Unlike the case of the home mortgage deduction, where a form specifically identifies the interest deducted in association with the purchase of a particular type of asset, interest expense associated with mergers and acquisitions is not specifically identified but rather lumped together with other instances of interest expense. Consequently, IRS does not have information linking specific interest expense deductions to the financing of mergers.

We also attempted to determine if any other IRS forms or audits identified mergers and contained financing information. We found that some taxable mergers could be identified through Form 8023, which shows whether firms merging through qualified stock purchases elect to treat the acquisition of stock as an acquisition of assets under Internal Revenue Code section 338. This form requires the acquiring firm to identify whether the stock was purchased with cash or debt but does not identify the amount of interest eligible for deduction. IRS may also obtain financing information related to mergers through audits. However, this information would be available for only those firms that were audited and would not reveal subsequent debt refinancing, which might alter the amount of interest deducted.

SEC Information

We also reviewed SEC information to determine whether SEC maintains records which could link mergers to interest expenses. Our review indicated that SEC collects some information relating to the financing of corporate mergers. The Department of the Treasury used this data to identify the financing behind 10 large mergers in 1984. However, this data will not reveal subsequent debt refinancing using instruments not registered with SEC (e.g., bank loans) and therefore will not provide an accurate indication of the total amount of interest eligible for deduction for mergers in a given year.

Because this report contains only factual information about our efforts to obtain information on the amount of interest deducted for financing