The Daily Dish

Much Ado About Nothing

DOUGLAS HOLTZ-EAKIN | APRIL 6, 2021

Eakinomics: Much Ado About Nothing

As Ronald Reagan used to say, "There they go again." Every year the Institute on Taxation and Economic Policy (ITEP) publishes a report with a banner headline "55 Corporations Paid $0 in Federal Taxes on 2020 Profits" (the year and number of firms vary, obviously). It opens with "At least 55 of the largest corporations in America paid no federal corporate income taxes in their most recent fiscal year despite enjoying substantial pretax profits in the United States."

Every year the *Washington Post* and *New York Times* run articles featuring this report. This year, those articles run right next to calls to raise corporate taxes to pay for the "infrastructure" known as the American Jobs Plan.

And every year the impression is conveyed that corporate America is an unprincipled cheater and/or the Tax Cuts and Jobs Act was a giveaway purchased by corporate lobbyists. None of this stands up to any serious scrutiny.

The ITEP report is not based on tax returns. Instead, it is an attempt to analyze the Securities and Exchange Commission filings of public U.S. firms and pretend to do their taxes. That's a tricky thing as financial reports adhere to Generally Accepted Accounting Principles (GAAP) as set forth by the Financial Accounting Standards Board. GAAP or "book" income departs substantially from taxable income on returns. There are two big reasons (and myriad small ones).

First, the timing differs in important ways. Firms' financial statements are reported on an accrual basis, where tax returns are based on firm cash flows. Moreover, firms have some degree of flexibility in determining their own fiscal years – the Internal Revenue Service has a rather more rigid schedule for tax payments. These distinctions are principally about timing. Accrual accounting is based on present values, which includes a time value. Financial reports may not cover the same period of time as a tax return.

In addition, the tax code allows companies to smooth out income by allowing losses to be carried forward (or backward) for a number of years. This provision makes practical sense for several reasons but lends itself to exploitation by critics. A firm may be profitable in a given year, but only after years of losses. After the Great Recession, this scenario was common for many firms. A snapshot of the company in its single year of profitability is a necessarily distorted view, but one that some tax critics tend to highlight.

Second, there is a big difference in the treatment of investment. Under GAAP accounting, firms can only deduct or expense a portion of a given capital investment (unlike labor costs, which are fully deductible except for some limitations on executive compensation), but under federal tax law firms could deduct a greater share of their capital investments for tax purposes than was allowable under GAAP accounting.

All else equal, for a firm making an investment, reported profit will be higher under GAAP accounting than for tax purposes. Some critics exploit this distinction, suggesting firms that expense investment are engaging in tax “avoidance,” where they are simply following the law.

Finally, there are a number of deliberate policy choices to subsidize activities through the corporate tax code, most notably the Research & Experimentation tax credit and tax credits for clean energy. One could debate the policy merits of those, but I don’t think that is what people have in mind when they think of tax cheats.

So, that’s the deal. You can believe the people who use the wrong data to guarantee a misleading answer and make a PR push out of it every year. Or not.