

Insight



Before the BBB, There Was the BURP: Reviewing the U.S. Experiment with Book Taxes in the 1980s

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Executive Summary

- Congress is considering imposing a tax on the reported financial or “book” income of U.S. firms.
- In response to misleading reports about large corporations paying low effective tax rates, Congress experimented with this form of taxation in the late 1980s and wisely abandoned it.
- From 1987 to 1989, the United States imposed the Business Untaxed Reported Profits (BURP) adjustment that relief on book taxation, similar to the minimum book tax in the Build Back Better Act.
- The reliance on book income for the purposes of minimum taxes was criticized at the time – criticisms that were substantially documented in subsequent study.

Introduction

Congressional Democrats are assembling budgetary offsets for their domestic spending reconciliation bill, and, for the moment, have included a 15 percent minimum tax on major U.S. firms. The minimum tax is based not on taxable income, but rather another measure of income altogether—that reported in financial disclosures known as “book” income. The aim of the policy is to 1) raise revenue to pay for new spending, and 2) respond to headlines bemoaning U.S. firms that face low effective tax rates. What is old is indeed new again. While the policy in the Build Back Better (BBB) Act reflects a campaign proposal from Senator Warren, it has a more concrete historical antecedent: the Business Untaxed Reported Profits or BURP (yes, really) adjustment. The BURP tax was imposed from 1987-1989 before being supplanted by a more conventional corporate alternative minimum tax (AMT). A review of America’s brief experiment with conflating taxable and financial income suggests that rather than make the tax code better, it simply made financial reporting worse. Rather than repeat the mistakes of the past, this Congress should learn from them.

Book Taxation

The 1986 Tax Reform Act (TRA86) was a sweeping, bipartisan reform of the U.S. tax code characterized by reduced rates and a broadened tax base. As a consensus product, it did involve some compromises. Among the negotiated settlements between the parties and the House and Senate was a temporary experiment in taxing the difference between income reported for the purposes of financial statements, or book income, and income reported to tax authorities. Income as reported in financial filings such as annual reports or forms 10-K is determined by the application of Generally Accepted Accounting Principles (GAAP). For U.S. firms, these principles are determined by a private, independent board of accountants known as the Financial Accounting Standards Board (FASB).

Income subject to tax is determined by tax laws enacted by Congress. Elected officials regularly adjust the tax base and applicable levies. The charitable deduction, child tax credit, and home mortgage deduction are key examples of how Congress shrinks the tax base and tax liabilities for prescribed activities such as charitable giving, child rearing, and home ownership. It is no different for corporations, for which Congress has enacted over [\\$1 trillion](#) in such tax benefits over the next decade.

There is, however, an enduring tradition among some policy observers and analysts to lament the fact that in any given year, the combination of the business cycle, the deliberate policy choices of Congress, and individual circumstance will give rise to a small minority of the [several thousand firms](#) publicly traded in the United States having low, or even negative, effective tax rates. One progressive non-profit has made something of a cottage industry of these periodic lamentations for decades. “Corporations aren’t paying their fair share” is now a regular refrain among progressive policymakers to justify minimum taxes on financial statement income for certain publicly traded firms. But these arguments and the preferred policy solution – a minimum tax on book income – are old news. Indeed, the United States tried this policy before in 1987 in response to exactly the same critiques – and wisely abandoned it.

The 1986 BURP Adjustment

Minimum taxes seem to be a vice that Congress simply cannot shake. The U.S. imposed a corporate minimum tax prior to the enactment of TRA86, but, nevertheless, policymakers were confronted with the [very same reports](#) of corporations paying low tax rates that observers see today. A perusal of these studies from the 1980s is something of a time capsule. The remove of time alone might lead one to question the gravity of the ills of such corporate titans as Singer Sewing Machine Company and Piedmont Airlines facing low effective tax rates. House and Senate tax writers in 1986, however, were not afforded such perspective and decided to respond to concerns over, as the Joint Committee on Taxation (JCT) tactfully stated, “[both real and apparent fairness.](#)” The result was the Business Untaxed Reported Profits (BURP) adjustment, which was in place from 1987 through 1989. The rationale for this temporary policy was, according to JCT, that Congress concluded it would be “particularly appropriate to base minimum tax liability in part upon book income during the first three years after enactment of the Act, in order to ensure that the Act will succeed in restoring public confidence in the fairness of the tax system.” In short, conflating taxable income with book income was good public relations.^[1]

The BURP adjustment required that firms calculate an alternative minimum tax liability conceptually similar to conventional AMT regimes that limit otherwise available tax benefits. The novelty with the AMT that prevailed from 1987-1989 was the requirement to adjust that minimum taxable income measure by 50 percent of the amount by which a firm’s book income exceeded the alternative minimum taxable income measure. For example, a firm that earned \$100 million as calculated under the AMT rules but reported \$200 million in book income in its Security and Exchange Commission (SEC) form 10-K would have to plus-up its alternative minimum taxable income by 50 percent – or \$50 million in this example – to \$150 million against which the firm would pay tax.

The BURP Tax Reviewed

When Congress enacted the TRA86, and the BURP along with it, it included a requirement for the Department of the Treasury to conduct a study on the operation of the BURP adjustment in practice. While Congress repealed the requirement before the study was published, Treasury substantially previewed the report in [testimony](#) before the Ways and Means Committee. Acting Assistant Secretary for Tax Policy John Wilkins observed that the “book income adjustment may be having a detrimental effect on the quality of financial reporting.” Further, the Treasury official observed that the book income adjustment was effectively a “one-way street,” overtaxing firms due to timing differences and the operation of the book adjustment was only a positive adjustment. A firm could have to mark down book income in one year for an expense that it would be able to deduct for tax purposes the following year. But that subsequent deduction would create a book-tax difference that would then be taxed under this system. Last, the assistant secretary observed that the determination of financial statement is not without controversy, citing footnotes and supplemental corporate disclosures that may be material to the financial statement as being complicating factors in drafting the regulatory regime governing the BURP adjustment. For those reasons, Treasury, “would generally be opposed to making the book income adjustment permanent.”

The concern that the tax would harm financial reporting was held by other contemporary critics. A 1988 [law review](#) article noted that GAAP accounting can involve multiple accounting methods and subjective judgment by accountants. The article also echoes the concern that the tax would degrade the quality of financial reporting given the new incentive to under-report book income to minimize tax, a view that was shared by other accounting institutions. Indeed, the SEC similarly expressed concern and nearly drafted a letter to this effect to the Congress, but the commissioners decided to avoid a jurisdictional squabble with Treasury.[2]

The brief experiment in book taxation did not escape the scrutiny of academics. In recent [testimony](#) before the Senate Finance Committee, Professor Michelle Hanlon of the Sloan School of Business examined the research literature examining the BURP experiment and observed that, “the evidence from the studies of outcomes around the Tax Reform Act

of 1986 suggest that companies responded to such a policy by altering how they report financial accounting income – companies deferred more income into future years.”[3] Other reviews have found similar responses, with one study noting that conforming book and tax-income measures would lead to a loss of information to investors that would be “quite dramatic.”[4] Dhammika Dharmapala of the University of Chicago surveyed the literature examining the BURP and similarly observed “a high degree of responsiveness” of book income to taxation.[5] While the brevity of the BURP’s existence may suggest some reason not to lean too heavily on the conclusions in the literature, the degree to which contemporaneous concerns with the tax were borne out in the research literature is remarkable.

Conclusion

What is old is indeed new again. The House of Representatives is poised to vote to enact a book tax as part of the BBB, reviving a concept of taxation from the late 1980s. Like New Wave music and shoulder pads, however, this tax should remain in the past. The tax was inspired by misleading characterizations of the financial and taxable corporate income measures, mischaracterizations that continue today. At the time, informed critique of conflating book and taxable income suggested a number of flaws in the policy that were substantially documented in subsequent study, not least of which was the degree to which financial income could be manipulated to avoid tax, notionally the very activity book taxation is supposed to mitigate. Instead of “fixing” tax avoidance, the tax policy made financial reporting worse. Congress abandoned the experiment after 1989. It should remain a relic of the past.

[1] See also <https://www.law360.com/tax-authority/articles/1377405/corporate-amt-plan-revives-specter-of-earnings-distortion>

[2] See footnote 47: <https://lawcommons.luc.edu/cgi/viewcontent.cgi?article=1777&context=lucj>

[3] See: Gramlich, J. D. 1991. The effect of the alternative minimum tax book income adjustment on accrual decisions. *Journal of the American Taxation Association* 12 (1): 36-56; Dhaliwal, D. and S. Wang. 1992. The effect of book income adjustment in the 1986 alternative minimum tax on corporate financial reporting. *The*

Journal of Accounting and Economics 15(1): 7-26; Boynton, C., P. Dobbins, and G. Plesko. 1992. Earnings management and the corporate alternative minimum tax. *Journal of Accounting Research* 30 (Supplement): 131-53; Manzon, G. B. 1992. Earnings management of firms subject to the alternative minimum tax. *Journal of the American Taxation Association* 14(2): 88-111; Wang, S. 1994. The relationship between financial reporting practices and the 1986 alternative minimum tax. *The Accounting Review* 69(3): 495-506; Dharmapala, D. 2020. The tax elasticity of financial statement income: implications for current reform proposals. *National Tax Journal* 73: 1047-1064.

[4] See Herzfeld, M. 2020. Taxing Book Profits: New Proposals And 40 Years Of Critiques. *National Tax Journal* 73: 1025-1046; Hanlon, Michelle, Stacie Kelley Laplante, and Terry Shevlin, 2005. "Evidence for the Possible Information Loss of Conforming Book Income and Taxable Income." *Journal of Law & Economics* 48 (2), 407-442, doi:10.1086/497525.

[5] Dharmapala, 1059