Insight

Misleading on the State of Business Taxation

GORDON GRAY | MARCH 14, 2017

The Institute for Taxation and Economic Policy (ITEP) recently released a report that bemoans the state of business taxation, arguing that many large firms pay little to no corporation tax. Unfortunately, the ITEP report mixes tax opinion with sound tax analysis.

Calculating a firm's tax rate should be fairly straightforward: tax paid divided by taxable income. But as any taxpayer knows, it's not so simple. Taxable income isn't simply one's salary but rather is net of deductions and other tax items that can make it look very different from how much money someone made in a given year. Similarly, how much one pays in tax reflects the rate of tax paid on the adjusted taxable income, plus the effects of tax credits or other tax items that alter someone's tax liability in any given year. By the time this calculation is complete, a person's tax rate can look very different from what one might anticipate from their income. If someone made $250,00, but turned around and donated it all to charity, their tax rate would be 0, but no one would fault them as a tax cheat. Similarly, if a business turns around and invests its profits in a new investment, those investments can (under certain circumstances) be expensed, and wipe out a tax liability in a given year.

These benign examples underpin how the ITEP report can paint a sensationalist picture from selective use of data over a highly selective time period. The ITEP report is based on corporate filings over the period 2008-2015, which was dominated by the worst recession in modern history. ITEP pares down the Fortune 500 list to 258 companies that reported profits over that period. During this time and since Congress enacted several provisions that have altered investment incentives, including accelerated depreciated (partial, and in some instances full, expensing) and extension of the R&D tax credit. ITEP dismisses these elements in their analysis by excluding the effects of these elements in their denominator. Essentially, what ITEP is trying to calculate is an effective tax rate – what a firm really paid in tax net of all tax provisions, but then ignoring those provisions by reporting the tax paid as a share of overall net income, rather than taxable income.

The ITEP report misleads observers that the current tax code is allowing U.S. firms to escape tax. It is well understood that the U.S. pays the highest corporate tax rate in the world, what the ITEP report argues is that this fact is meaningless if *effective* rates are low or zero. But on this front, the ITEP report fails to tell the whole story – the U.S. remains a high global *effective tax* nation as well.[1] . The misleading analytical approach taken by the ITEP report may allow for sensational headlines, but it fails to illuminate a debate on federal tax policy.

[1] https://www.aei.org/publication/report-card-on-effective-corporate-tax-rates/