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Minimum Taxes on Business Income: Background and Policy Options

August 25, 2021

Congressional Research Service
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R46887

CRS REPORT
Prepared for Members and
Committees of Congress

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SUMMARY

R46887

August 25, 2021

Molly F. Sherlock
Specialist in Public Finance

Jane G. Gravelle
Senior Specialist in Economic Policy

Minimum Taxes on Business Income: Background and Policy Options

Some large corporations pay little or no U.S. tax as they report significant profits to shareholders. In an effort to curb tax avoidance among the largest corporations, the Biden Administration has proposed a 15% minimum tax on worldwide book income for corporations with pretax net income of more than $2 billion. Multilateral organizations have also proposed a worldwide minimum tax, also based on book income. There are several proposals in the 117th Congress to either impose a minimum tax or modify existing minimum tax laws.

One reason some entities pay little in corporate income tax is the deliberate design of the U.S. tax system, which includes specific provisions that reduce corporate taxes, referred to as *tax expenditures*. These provisions produce a substantial revenue loss relative to the yield of the corporate tax. U.S. corporate taxes relative to worldwide income may also be low because some income is earned abroad, and thus subject to foreign taxes. Various measures are in place to prevent double taxation of that income, including a credit for foreign taxes paid. Income for tax purposes as compared to income reported to shareholders (i.e., book income) can also differ due to limits on the deduction of net operating losses.

Corporate income can be measured in different ways. *Economic income* is the sum of dividends and distributions paid and changes in the market value of a firm adjusted for inflation. Corporate profits as measured by the National Income and Product Accounts (NIPA) are close to economic income but exclude all or a significant part of foreign-source income and do not include capital gains. The NIPA data also include income from entities that do not pay the corporate income tax. *Taxable income* is income subject to the corporate income tax as determined by the tax code. Broadly, taxable income is receipts minus deductions with additional adjustments. Taxable income (also referred to as income subject to tax) cannot fall below zero. *Book income* (also referred to as *financial income*) is income reported in financial statements, which includes income and deductions guided by accounting standards. Numerous factors affect differences between tax and book income, including the point in the business cycle at which income is measured and the different treatment of many aspects of income and deductions (e.g., foreign-source income, tax-exempt interest, and depreciation).

Corporate profits measured in NIPA are generally higher than income subject to tax. For large corporations, the differences between book income adjusted for tax consolidation rules and tax income (income before net operating losses and special deductions, or exclusions for nontaxed entities), referred to as *book-tax differences*, vary with the business cycle. Although tax income is generally smaller, financial income can be lower during downturns. Book income has been greater than tax income in recent years.

Over time, corporate profits based on financial measures (adjusted for different consolidation rules about which parts of related firms are included) and tax income before net operating losses track closely, although relationships vary over the business cycle. There has, however, been a general downward trend in the share of corporate income subject to tax.

Effective tax rates measured against a base that is similar to economic income (NIPA) are considerably lower than the statutory rate, even when confined to domestic income tax on domestic income. Taxes are also lower on financial income based on aggregate data provided by the Internal Revenue Service and for studies of certain subsets of large corporations. However, some data on worldwide tax rates show higher rates relative to the statutory rate for large corporations after the 2017 tax cut.

In the past, minimum taxes were adopted by policymakers seeking to ensure that corporations paid at least some amount in corporate income tax. The corporate alternative minimum tax (AMT), prior to its repeal in 2017, created a modified tax base by adding preferences back to the regular income tax base. A portion of the AMT relied on book income in the late 1980s. A future minimum tax might be considered for a similar purpose, and to address ongoing concerns that some have raised about tax avoidance. The Biden Administration has proposed a 15% minimum tax on financial income of large firms. Recently, the United States has enacted minimum taxes that apply to multinational firms in the international context. Current minimum taxes include the tax on foreign-source intangible income (the tax on global intangible low-taxed income, or GILTI) and the alternative minimum tax, which adds back certain payments to related foreign corporations (the base erosion and anti-abuse tax, or BEAT). Multinational proposals for a global minimum tax would base the tax on financial income, aimed at addressing base erosion (Global Anti-Base Erosion, or GloBE). A key concern about minimum taxes, some say, is that they

may reduce the effect of intended incentives in the tax code. Current minimum tax proposals would rely on financial income, raising concerns among some observers that such taxes could encourage the manipulation of book profits to avoid taxes.

Contents

Taxing Business Income 2
The Corporate Income Tax 2
Corporate Tax Expenditures 3
Net Operating Losses (NOLs) 4
Related Corporations 4
Taxing Multinationals 5
Pass-Through Businesses 6
Measuring Income 7
Economic Income 7
National Income and Product Accounts (NIPA) Earnings 8
Taxable Income 10
Book Income 12
Differences in Measures of Corporate Income over Time 15
NIPA Versus Taxable Income 15
Book-Tax Differences 16
Measuring Tax Burden: Effective Tax Rates 18
Effective Tax Rate Using Aggregate NIPA Data 18
Tax Rates from IRS Statistics of Income 22
Effective Corporate Tax Rates Using Financial Data 24
Damodaran Data: Worldwide Taxes Accrued and Cash Taxes on Worldwide Income 24
Institute for Taxation and Economic Policy: Current Taxes on Domestic Income 25
Martin Sullivan, *Tax Notes Federal* 25
Minimum Taxes on Business Income 26
Corporate AMT 26
Minimum Tax on Book Income 27
Corporate Surtax or Add-On Tax 29
GILTI, BEAT, and Proposed Changes 30
GloBE: An International Tax Proposal 30
Minimum Taxes on Noncorporate Business Income 31
Concluding Remarks 32

Figures

Figure 1. Corporate Profits and Corporate Income as a Share of GDP 16
Figure 2. Aggregate Book Income and Tax Income for Large Corporations 17
Figure 3. Aggregate Book-Tax Difference for Large Corporations 18

Tables

Table 1. Corporate Tax Expenditures 4
Table 2. Effective Corporate Tax Rates on Domestic Income, National Income, and Product Accounts 19

Table 3. Effective Corporate Tax Rates for 2016, Adjusting for Foreign-Source Income and Taxes 21
Table 4. Effective Corporate Tax Rates for 2017, Adjusting for Foreign-Source Income and Taxes 21
Table 5. Effective Corporate Tax Rates for 2018, Adjusting for Foreign-Source Income and Taxes 22
Table 6. Effective Tax Rates on Income, IRS Data 23
Table 7. Effective Total (Federal, State, and Foreign) Tax Rates on Large Corporations, Based on Financial Data 25

Table A-1. Glossary 33
Table B-1. Comparing Tax Income to NIPA's Profits Before Tax, 2018 35

Appendixes

Appendix A. Glossary 33
Appendix B. Comparing NIPA's Corporate Profits Before Tax and Corporate Taxable Income 34

Contacts

Author Information 37

Some large corporations that report profits to shareholders pay little to no federal corporate income tax.[1] For some, this raises questions of fairness. Is a tax system that allows large corporations with substantial assets, revenues, and financial profits to have a zero tax liability fair? Large, profitable corporations that pay little to no federal income tax are generally believed to be complying with federal tax law, which includes numerous provisions and preferences that result, in some cases, in zero tax liability.

Minimum taxes are a policy tool that could help ensure all taxpayers contribute a certain amount of tax revenue. Minimum taxes could be used in a range of policy contexts to address a variety of policy concerns. For example, minimum taxes are one policy option to limit multinational firms' ability to avoid taxes by shifting profits into low-tax jurisdictions. For both multinational and domestic firms, minimum taxes might be designed to serve as a backstop to the corporate tax system, ensuring that firms are not able to reduce tax liability to zero by claiming tax benefits or through tax planning. If a comprehensive reform of existing corporate tax law is not feasible, a more targeted minimum tax might be an option for policymakers seeking to make sure all firms pay some amount in tax.[2]

While minimum taxes might address some policy concerns, they could create others. One concern that has been raised regarding minimum taxes generally is that they could offset the tax system's automatic stabilizer effects, or limit the scope for using tax-related fiscal stimulus to respond to economic downturns. There are also concerns that a minimum tax that carves back investment incentives could weaken the effectiveness of such policies and negatively affect corporate investment.[3]

Minimum taxes of various forms appear in current policy debates. The Biden Administration has proposed a 15% minimum tax on worldwide book (financial statement) income for corporations with income above $2 billion.[4] Senator Elizabeth Warren has proposed a 7% minimum tax on large corporations with book income over $100 million.[5] The Group of Seven countries (G7) have also agreed to a tax policy framework that would establish a 15% global minimum tax on a country-by-country basis.[6] As of August 12, 2021, this framework had been agreed to by 133 countries and subnational jurisdictions.[7] While the 2017 tax revision (commonly referred to as the

[1] Media reports featuring profitable corporations believed to pay zero (or close to zero) in federal corporate taxes are common. See, for example, Patricia Cohen, "No Federal Taxes for Dozens of Big, Profitable Companies," *New York Times*, April 2, 2021, https://www.nytimes.com/2021/04/02/business/economy/zero-corporate-tax.html.

[2] For a further discussion of potential economic efficiency and equity implications of minimum taxes, see Aqib Aslam and Maria Coelho, *A Firm Lower Bound: Characteristics and Impact of Corporate Minimum Taxation*, IMF Working Paper, WP/21/161, June 2021, https://www.imf.org/en/Publications/WP/Issues/2021/06/08/A-Firm-Lower-Bound-Characteristics-and-Impact-of-Corporate-Minimum-Taxation-49886.

[3] Testimony of Michelle Hanlon, in U.S. Congress, Senate Finance Committee, *Made in America: Effect of the U.S. Tax Code on Domestic Manufacturing*, hearings, 117th Cong., 1st sess., March 16, 2021, at https://www.finance.senate.gov/imo/media/doc/Michelle%20Hanlon%20Testimony.pdf.

[4] See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, May 2021, at https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals, for a discussion of the budget proposals.

[5] See Sen. Elizabeth Warren, "Senators Warren and King, Representative Beyer Announce Legislation to Prevent The Biggest and Most Profitable Corporations From Paying Nothing in Federal Taxes," press release, August 9, 2021, at https://www.warren.senate.gov/newsroom/press-releases/senators-warren-and-king-representative-beyer-announce-legislation-to-prevent-the-biggest-and-most-profitable-corporations-from-paying-nothing-in-federal-taxes.

[6] Department of the Treasury, "G7 Finance Ministers & Central Bank Governors Communiqué," press release, June 5, 2021, https://home.treasury.gov/news/press-releases/jy0215.

[7] Organisation for Economic Co-operation and Development (OECD), "130 Countries and Jurisdictions Join Bold New Framework for International Tax Reform," press release, July 1, 2021, https://www.oecd.org/newsroom/130-countries-

"Tax Cuts and Jobs Act" [TCJA: P.L. 115-97]) repealed the corporate alternative minimum tax (AMT), it created two new minimum taxes. The base and anti-abuse tax (BEAT) is an alternative minimum tax that applies to large, multinational corporations making substantial payments to foreign affiliates. The 10.5% minimum tax on global intangible low tax income (GILTI) was enacted with a goal of taxing income from foreign intangible assets. There is active debate about whether these relatively new tax provisions should be modified.

This report provides an overview of minimum taxes on business income to help inform policy debates about a range of minimum tax policy options. The report begins with an overview of the tax system as it applies to U.S. corporations. A key challenge in designing a tax system is defining income. The next section discusses income concepts, followed by estimates of effective tax rates using various income concepts. The final sections discuss minimum taxes on business income that have previously been a part of the U.S. tax code, as well as current policy options and proposals.

Taxing Business Income

The Corporate Income Tax

The corporate income tax is largely designed as a tax on corporate profits (also known as *net income*). Broadly defined, corporate profit is total income minus the cost associated with generating that income. Business expenses that may be deducted from income include employee compensation; the decline in value of machines, equipment, and structures (i.e., depreciation); general supplies and materials; advertising; and interest payments. The corporate income tax also allows for a number of other special deductions, credits, and tax preferences. These provisions are often intended to promote specific policy goals.

A corporation's tax liability can be calculated as:

$$\text{Taxes} = [\text{Taxable Income} \times \text{Tax Rate}] - \text{Tax Credits}.$$

The corporate tax rate is currently a flat 21%. This rate is applied to taxable income, as determined for tax purposes.[8] Tax credits provide a dollar-for-dollar reduction in tax liability. The corporate tax system becomes increasingly complex as the details of specific provisions are examined. Various features of the corporate tax system contribute to average effective tax rates (i.e., taxes paid divided by income) that are less than the 21% statutory rate.

One alternative to taxing corporate or business profits is a cash-flow tax. This type of tax can be viewed as a consumption tax for business income.[9] With a cash-flow tax, businesses would expense, or immediately deduct, all capital investments. Interest deductions would be disallowed.[10] Certain changes enacted as part of the 2017 tax revision, including bonus depreciation and limitations on interest deductions, move the corporate tax away from a true

and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm. The list with the 133 joining countries and jurisdictions, as of August 12, 2021, is available at https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-july-2021.pdf.

[8] The term *tax income* is often used interchangeably with taxable income.

[9] Elena Patel and John McClelland, "What Would a Cash Flow Tax Look Like? Historical Panel Lessons," *Tax Notes*, February 7, 2017, pp. 439-450.

[10] Lily Batchelder, "The Shaky Case for a Business Cash-Flow Tax Over a Business Income Tax," *National Tax Journal*, vol. 70, no. 4 (December 2017), pp. 901-936.

income tax, shifting it toward a cash-flow tax.[11] In June 2016, House Speaker Paul Ryan proposed a destination-based cash flow tax (DBCFT) as part of the "A Better Way" tax reform blueprint.[12]

Corporate Tax Expenditures

The corporate tax system contains various provisions to support certain businesses and economic sectors and incentives designed to encourage certain behaviors. These provisions and incentives are known as *tax expenditures.* Corporate tax expenditures include special credits, deductions, exemptions, exclusions, and tax rates that reduce corporate income tax collections.

The Congressional Budget Office (CBO) projected the corporate income tax would generate $151.1 billion in revenues for the federal government in FY2020.[13] Using this baseline, the Joint Committee on Taxation (JCT) estimated that the two largest corporate tax expenditures—the reduced tax rate on active income of controlled foreign corporations (CFCs) and accelerated depreciation—would reduce federal tax by $45.4 billion and $43.2 billion, respectively, in FY2020 (**Table 1**). The amount of forgone revenue associated with these provisions is substantial, relative to total corporate tax revenues. These large tax expenditure provisions, as well as other tax expenditures listed in **Table 1**, are why corporate taxes paid are often less than 21% of income. Since actual corporate revenue in FY2020 was larger than projected ($212 billion), these tax expenditure amounts may also be larger.[14]

Tax expenditures might be designed to advance certain policy objectives. For example, the reduced tax rate on active income of CFCs and the deduction for foreign-derived intangible income are features of the U.S. international tax system (discussed below, at "Taxing Multinationals"). Bonus depreciation, captured in the tax expenditure for depreciation in excess of the alternative depreciation system, reduces effective tax rates on capital investment and, as noted above, is intended to encourage investment. Tax credits for research and development (R&D) are intended to support innovation, which in turn supports economic growth.[15] Other major corporate tax expenditures are designed to support policy objectives related to affordable housing (the credit for low-income housing) and renewable energy (the energy credit and the credit for electricity produced from renewable resources).

[11] Kyle Pomerleau, "Joe Biden's Alternative Minimum Book Tax," *Tax Notes*, October 5, 2020, pp. 109-116.

[12] See CRS Report R44823, *The "Better Way" House Tax Plan: An Economic Analysis*, by Jane G. Gravelle; and CRS Report R44821, *Border-Adjusted Consumption Taxes and Exchange Rate Movements: Theory and Evidence*, by Grant A. Driessen and Mark P. Keightley.

[13] This projection reflects the anticipated decline in corporate tax receipts due to the COVID-19 pandemic. In FY2019, corporate tax revenues were $230.2 billion. Congressional Budget Office, *An Update to the Budget Outlook: 2020 to 2030*, September 2, 2020, at https://www.cbo.gov/publication/56542.

[14] Congressional Budget Office, *Additional Information About the Budget Outlook: 2021 to 2031*, March 2021, https://www.cbo.gov/publication/57043.

[15] Congressional Budget Office, *Federal Policies and Innovation*, November 17, 2014, at https://www.cbo.gov/publication/49487.

Table 1. Corporate Tax Expenditures

10 Largest for FY2020

Tax Expenditure	FY2020 (billions)	Tax Expenditures as a Share of Taxes
Reduced tax rate on active income of controlled foreign corporations	$45.4	30.0%
Depreciation of equipment in excess of the alternative depreciation system	$43.2	28.6%
Credit for increasing research activities (Section 41)	$13.0	8.6%
Deduction for foreign-derived intangible income derived from trade or business within the United States	$12.6	8.3%
Credit for low-income housing	$9.9	6.6%
Energy credit (Section 48)	$6.1	4.0%
Exclusion of interest on public purpose state and local government bonds	$5.5	3.6%
Credit for electricity produced from renewable resources (Section 45)	$4.4	2.9%
Deferral of gain on nondealer installment sales	$4.0	2.6%
Work opportunity tax credit	$2.9	1.9%

Source: Joint Committee on Taxation, *Estimates Of Federal Tax Expenditures For Fiscal Years 2020-2024*, JCX-23-20, November 5, 2020.

Net Operating Losses (NOLs)

Another feature of business taxation is the treatment of net operating losses (NOLs).[16] When a business's taxable income is negative, the business has a NOL. Allowing losses to be carried forward (or carried back) and deducted from taxable income in a future (or past) tax year can help smooth taxable income over time and throughout the business cycle.

Current permanent law allows NOLs to be carried forward indefinitely. NOLs carried forward can reduce up to 80% of taxable income each year. Temporary changes, enacted in response to the Coronavirus Disease 2019 (COVID-19) pandemic, allow 2018, 2019, or 2020 losses to be carried back up to five years.[17] NOLs carried back can offset 100% of taxable income—an increase from the 80% offset under permanent law. Loss carrybacks can, and often do, result in an immediate tax refund for businesses.

Related Corporations

Large corporations often have subsidiaries (or tiers of subsidiaries). That is, they hold shares in these subsidiary corporations and receive dividends from them. Some subsidiaries are incorporated in the United States and some are incorporated abroad. Many subsidiaries are wholly owned by the parent corporation, and some are partially owned, in some cases with a majority (controlling) share and in some cases with a minority share.

[16] See CRS Report R46377, *The Tax Treatment and Economics of Net Operating Losses*, by Mark P. Keightley.

[17] See CRS Insight IN11296, *Tax Treatment of Net Operating Losses (NOLs) in the Coronavirus Aid, Relief, and Economic Security (CARES) Act*, by Jane G. Gravelle.

For tax purposes, corporate parents and their 80% owned *domestic* subsidiaries may elect to file a single consolidated tax return.[18] With this election, each subsidiary computes its own tax liability but tax and incomes are combined. Intercorporate dividends are eliminated and profit on intercompany sales is deferred until final goods are sold or depreciation occurs. Tax credits, NOLs, and deductions (including those for charitable contributions) are computed on a consolidated basis. Income is measured before foreign (largely, as there is an option to take a deduction rather than a credit for foreign taxes) and U.S. income taxes, but net of state and local taxes. Firms are allowed credits against foreign taxes paid. For example, if a firm has $100 million in income and pays taxes of 21%, but $10 million is subject to foreign taxes of 15% ($1.5 million), the $21 million tax is reduced by $1.5 million, so that combined taxes ($19.5 million on domestic income and $1.5 million on foreign income) sum to $21 million. However, if foreign taxes are 30% ($3 million), the credit on the $10 million is limited to the U.S. tax paid ($2.1 million), so there is a residual tax of $0.9 million, and foreign and domestic taxes combined are $21.9 million.

For firms not filing a consolidated tax return, dividends are subject to an intercorporate dividend deduction. Deduction amounts for domestic dividends are 100% of dividends from an 80% owned subsidiary, 65% from a 20% to 80% owned subsidiary, and 50% of other dividends. (The 65% and 50% amounts were 80% and 70%, respectively, before the 2017 tax revision [TCJA]).

Consolidation rules for financial reporting purposes differ depending on the level of control. Income of firms that are more than 50% controlled is consolidated worldwide, whereas shares of income from firms that are 20% to 50% owned is reported, and otherwise dividends are included.

Taxing Multinationals

The current U.S. international tax system, enacted in 2017 as part of the TCJA, is a hybrid between a territorial tax and worldwide tax system. With a territorial system, foreign profits of U.S. firms are not taxed. With a worldwide system, foreign profits are taxed, but a credit is allowed against U.S. tax for foreign taxes paid. Pre-TCJA, dividends paid by foreign firms were taxed but income retained abroad was not. Current law exempts dividends paid to corporations that hold 10% ownership, while imposing a minimum tax on income earned by CFCs, whether paid as dividends or retained abroad. CFCs are firms with 50% U.S. ownership by U.S. shareholders each owning at least 10%. Many CFCs are subsidiaries entirely owned by a U.S. parent corporation.[19]

Taxed income of CFCs includes Subpart F income that is easily shifted between businesses in different countries, including passive income (such as interest and royalties) and certain income earned in countries where goods and services are neither produced nor consumed. Since firms are related, they can easily, for example, have intercompany loans that shift deductions to a high-tax country and income to a low-taxed country. Or they can introduce intermediary subsidiaries in low-tax countries that capture some of the income of the combined firm in that jurisdiction.[20] Tax

[18] The treatment of multinational corporations and their foreign subsidiaries is discussed below. Firms do not file consolidated returns with their foreign subsidiaries; rather, they exempt dividends and income or their share of income in some cases.

[19] For a more detailed discussion of the international tax regime and how it changed in 2017, see CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

[20] Subpart F's effectiveness is limited by regulations called check-the-box, currently codified (called look-through rules) and expanded temporarily through 2025. See CRS In Focus IF11392, *H.R. 1865 and the Look-Through Treatment of Payments Between Related Controlled Foreign Corporations*, by Jane G. Gravelle.

on this type of income is common in most countries to prevent abuse, and was a feature of pre-TCJA U.S. tax law.

In addition, current law imposes a tax on some of the remaining profits of CFCs under the tax on global intangible low-taxed income (GILTI), which is imposed after exclusion of a deemed return on tangible assets and a deduction from the remainder. Foreign oil and gas extraction income is also excluded from GILTI. Foreign branch income of U.S. firms is also taxed. Foreign taxes are added back to this income (termed a gross up) to measure income before foreign taxes.

U.S. owners are allowed a credit for foreign taxes paid, although the credit for GILTI is limited to 80% of foreign taxes. Foreign tax credits are limited to U.S. taxes due, on an overall basis (so that higher taxes in one country can offset U.S. tax on income earned in low-tax jurisdictions). This overall limit is applied separately to passive income, active income outside of GILTI, and GILTI income.

The tax on GILTI is sometimes characterized as a minimum tax on foreign income; this might be appropriate from the baseline of a territorial tax. From the perspective of a worldwide tax, it would be characterized as a tax subsidy (because income is being taxed at less than the normal statutory rate). It is treated as a tax expenditure in the Joint Tax Committee's tax expenditure list.[21] Regardless of the perspective, the exemptions and deductions for GILTI income are a reason that many U.S. multinationals have low effective tax rates.

In transitioning from a tax on income from foreign corporations triggered by dividend payments (except for Subpart F) to a system that excluded dividends and imposed lower tax on GILTI regardless of dividends, the 2017 tax revision (TCJA) also included a tax on accumulated unrepatriated income, which can be paid in installments and will increase tax rates temporarily for the next several years.

There is a minimum tax embedded in the current international tax system—the Base Erosion and Anti-Abuse Tax (BEAT). To determine whether firms are required to pay BEAT, firms add back some payments to related parties abroad and make some other changes, then apply a lower rate. Firms pay the higher of the BEAT or regular tax.

Another feature of the international tax system that can affect effective tax rates is the deduction for foreign derived intangible income (FDII), which is designed to provide a similar benefit for the domestic holding of intangible assets as occurs for foreign-source income under GILTI.

Pass-Through Businesses

Pass-through businesses are not subject to the corporate tax; rather, income and expenses flow through to the owners to be taxed under the individual income tax.[22] Pass-throughs may be sole proprietors, with one owner; partnerships, with multiple owners; Subchapter S corporations, organized as corporations but electing to be taxed as a pass-through if the number of shareholders is 100 or less; or limited liability corporations, which are organized as corporations but have characteristics that allow them to be taxed as pass-throughs. Pass-through firms can be small or relatively large.

[21] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2020-2024*, JCX-20-23, November 5, 2020, https://www.jct.gov/CMSPages/GetFile.aspx?guid=ec4fb616-771b-4708-8d16-f774d5158469.

[22] See CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

Pass-through firms are eligible for many of the same subsidies and tax benefits as corporations, but some are also eligible for a pass-through deduction of 20% of taxable income.[23] This deduction is phased out for personal service firms and limited for some other businesses that do not meet certain conditions.

While the corporate AMT was repealed by the 2017 tax revision (TCJA), the individual AMT was retained, albeit with larger exemptions.[24] Some of the tax benefits, such as accelerated depreciation, are added back to the base, but not the pass-through deduction or most of the provisions listed in **Table 1**.

Measuring Income

Conceptually, income is computed by subtracting (deducting) the costs of doing business from gross receipts. In practice, it can be difficult to determine what expenses should be deducted as business costs, and the timing of those deductions. A similar timing issue can occur with respect to when receipts should be recorded.[25]

U.S. businesses report income differently for different purposes. One set of rules applies when companies report financial or "book" profits to the public, in compliance with financial securities laws. A primary purpose of these reports is to provide potential investors information about the risks associated with investing in a firm. Another set of rules applies when companies report taxable income to the Internal Revenue Service (IRS), in compliance with tax law. Tax accounting rules are intended to produce a verifiable tax base using rules that can be implemented and enforced.

Under this dual reporting system, businesses may have an incentive to maximize their reported financial (book) income and minimize their reported taxable income. Another complicating factor is that the reporting entity for the purposes of a financial statement is not necessarily the same as the entity filing a tax return. When this is the case, differences in consolidation rules make it so that income prepared for financial statements cannot be directly compared to income for tax purposes. The following sections discuss different measures of income and issues in reconciling the different measures.

Economic Income

A standard definition for *economic income* is consumption plus changes in net worth.[26] This definition is generally applied to individuals (where it can also be defined as consumption plus savings plus unrealized capital gains). Since corporations are a collection of individual shareholders, the concept can be applied to corporations as well. A corporation's income can be defined as dividends plus changes in net worth (or retained earnings). Individuals in the aggregate

[23] See CRS Report R46402, *The Section 199A Deduction: How It Works and Illustrative Examples*, by Gary Guenther.

[24] See CRS Report R44494, *The Alternative Minimum Tax for Individuals: In Brief*, by Donald J. Marples.

[25] For example, some businesses use cash accounting, where income and expenses are recorded when payment is received or made. This is in contrast to accrual basis accounting, where revenue is recorded when it is earned and expenses are reported when they are incurred. Cash basis accounting may be simpler, but it is not in accordance with Generally Accepted Accounting Principles (GAAP). For more, see CRS Report R43811, *Cash Versus Accrual Basis of Accounting: An Introduction*, by Raj Gnanarajah.

[26] This definition is referred to as "Haig-Simons income" after the economists who advanced this concept.

either consume or invest dividends and will realize increases in the value of stock due to retained earnings and any other gains in value through capital gains.

For businesses (including corporations), *profits* are receipts minus expenses, with both measured on a real (inflation-adjusted) accrual basis.[27] Measuring revenues and expenses on an accrual basis means that these items are recorded when they are earned or transactions occur, as opposed to when final payments are made.[28] For example, when an item from inventory is sold, income is accrued at the time of sale, even though payment may be deferred. The income of subsidiaries is also income of the parent corporations, whether it is received as dividends or increases in the value of shares. Economic income is a concept. In practice, it may be very difficult to measure true economic income.

To measure economic income, an adjustment must be made for the decline in the value of assets over time. For physical capital, depreciation reflects the decline in asset values as capital is used in the production process. For natural resource or mineral assets, depletion reflects the decline in the value of reserves as they are extracted and sold. The value of intangible assets (such as drug formulas, advertising, and human capital investment) declines as patents expire, new competition reduces the prices of goods produced with intangible assets, advertising's effects fade in consumers' minds, and trained workers retire. Economic income also should reflect the decline in value in current prices. Thus, depreciation, depletion, and deductions of investments resulting in intangible assets should reflect the increase in the nominal value of assets due to inflation as well as the economic decline in value that would occur in the absence of inflation.[29]

Two other assets where adjustments for inflation should be made in calculating economic income are inventories and net debt. When goods are sold out of inventory, the cost should be based on the original cost increased by inflation. Similarly, net debt acquired in the past becomes a smaller liability as inflation erodes its current value, so that debt is repaid in cheaper dollars.[30]

National Income and Product Accounts (NIPA) Earnings

The U.S. Bureau of Economic Analysis (BEA) produces measures of aggregate corporate profits (National Income and Product Accounts [NIPA] earnings).[31] NIPA's corporate profits measure "represents the portion of total income earned from current production that is accounted for by U.S. corporations."[32] NIPA earnings, by design, measure profits from current production.

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[27] Congressional Budget Office, *Corporate Income Tax Rates: International Comparisons*, November 2005, pp. 12-13, https://www.cbo.gov/sites/default/files/109th-congress-2005-2006/reports/11-28-corporatetax.pdf.

[28] See CRS Report R43811, *Cash Versus Accrual Basis of Accounting: An Introduction*, by Raj Gnanarajah; and CRS Report R44002, *Cash Versus Accrual Accounting: Tax Policy Considerations*, by Raj Gnanarajah and Mark P. Keightley.

[29] For example, assume an asset costs $1 million dollars and economic depreciation in the fifth year is $100 million. If the price of a replacement asset has now increased by 10% to $1.1 million, then depreciation should be increased to $110 million to reflect the current cost of replacing that portion of the asset.

[30] For example, suppose $100 million is borrowed and repaid five years later, and that prices have increased by 10% in this time frame. An equivalent debt today would be $110 million, but it is costing the firm only $100 million to repay the debt, so there is a gain in income of $10 million.

[31] NIPA earnings include earnings from organizations that do not file a tax return, such as certain mutual financial cooperatives, nonprofits that primarily serve businesses, Federal Reserve banks, and federally sponsored credit agencies. They also include earnings from Subchapter S corporations that do not pay corporate taxes and Real Estate Investment Trusts that do not pay corporate taxes.

[32] Bureau of Economic Analysis, *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts—Chapter 13: Corporate Profits*, December 2020, p. 13-1, https://www.bea.gov/resources/methodologies/

NIPA's profits from current production are computed as profits before tax, sometimes referred to as *book profits*, adjusted for (1) an inventory valuation adjustment; and (2) a capital consumption adjustment. BEA relies primarily on tax return information to determine profits before taxes.[33] The two adjustments are made to achieve the objective of measuring profits from *current* production.

The inventory valuation adjustment (IVA) is made to reflect changes in profits that arise from capital gain or capital loss, such as changes in the value of inventory holdings. Changes in prices of goods held in inventory can result in businesses having book profits or losses, but these changes are not from current production. The IVA adjustment is applied to inventory withdrawals such that these withdrawals are valued at current cost.[34]

The capital consumption adjustment (CCAdj) is made so that profits from current production reflect economic depreciation and have a value that reflects current replacement costs. When computing income, NIPA earnings allow for consumption of fixed capital using economic depreciation. Economic depreciation is the decline in the value of the stock of capital assets due to physical deterioration, normal obsolescence, and accidental damage that occurs in the routine course of use.[35]

The tax code specifies depreciation schedules that are generally more accelerated than economic depreciation. Further, since 2001, the tax code has generally allowed for some amount of bonus depreciation, with the bonus depreciation amount deducted in the first year.[36] With bonus depreciation or when tax depreciation is accelerated relative to economic depreciation, depreciation deductions are larger in the early years, offset by smaller deductions in the later years, over the lifetime of a particular capital asset. With bonus or accelerated depreciation, income or profits are understated initially, and later overstated. The CCAdj is made so that depreciation reflects economic depreciation in NIPA's measure of profits from current production. The CCAdj also adjusts measures of depreciation such that they are valued at current cost.[37]

nipa-handbook/pdf/chapter-13.pdf.

[33] The BEA uses tax data as its primary source for computing corporate profits. BEA supplements tax data with financial accounting data when measuring corporate profits. Financial accounting data are relied upon more heavily for the more recent time periods, as the information becomes available more quickly than tax data. Over time, the BEA adjusts and revises initial estimates. See Bureau of Economic Analysis, *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts—Chapter 13: Corporate Profits*, December 2020, p. 13-4, https://www.bea.gov/resources/methodologies/nipa-handbook/pdf/chapter-13.pdf.

[34] For example, suppose a good is purchased for $100 and could be sold for $120 dollars immediately, but is held for five years. Prices rise over five years by 10%, so the good is sold for $132 ($120 times 1.1). Under first-in, first-out (FIFO) inventory accounting, commonly used for tax purposes, the cost of the good sold is $100. With the IVA adjustment, the cost of the good sold is valued at $110 rather than $100. That adjustment reduces the profit from $32 to $22. This correction eliminates the treatment of inflation as part of the profit; that is, the $20 profit rises by 10% to $22, and the $10 increase due to inflation is excluded.

[35] Bureau of Economic Analysis, *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts—Chapter 2: Fundamental Concepts*, December 2020, p. 2-3, https://www.bea.gov/resources/methodologies/nipa-handbook/pdf/chapter-02.pdf.

[36] See CRS Report RL31852, *The Section 179 and Section 168(k) Expensing Allowances: Current Law and Economic Effects*, by Gary Guenther.

[37] Bureau of Economic Analysis, *NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts—Chapter 13: Corporate Profits*, December 2020, p. 13-4, https://www.bea.gov/resources/methodologies/nipa-handbook/pdf/chapter-13.pdf.

NIPA's profits from current production excludes dividend income, capital gains and losses, and certain other financial flows and adjustments, such as deductions for "bad debt."[38] NIPA's profits from current production comes close to measuring economic income, but is not a true measure of economic income because it does not account for unrealized capital gains or the ability to repay debt in cheaper dollars.

Other elements of NIPA's profits before tax make it an imperfect proxy for examining "book income" as a tax base. Specifically, NIPA's profits before tax include income from organizations that do not file corporate tax returns (e.g., Federal Reserve banks) or do not pay corporate taxes (e.g., Subchapter S Corporations).

NIPA's measures of corporate profits include domestic and national measures. Domestic corporate profits covers activities that take place within U.S. geographic borders. This measure excludes income from branches and subsidiaries earned from foreign sources. Because the U.S. tax system is not strictly territorial, focusing only on domestic earnings may not fully capture economic incomes that might potentially be part of the corporate tax base.

National corporate profits cover activities attributable to U.S. residents. This measure includes income of domestic corporations received from abroad as well as the income (dividends) received by individuals, net of payments. This definition does not correspond to worldwide income of U.S. corporations because it does not capture income retained abroad by foreign-incorporated firms and nets out payments.

In 2017, NIPA's domestic corporate profits (or profits from current production) were $1,630.0 billion.[39] For 2018, 2019, and 2020 these figures were $1,783.3 billion, $1,854.4 billion, and $1,789.0 billion, respectively. NIPA's corporate profits (or profits from current production) for all U.S. firms in 2017 were $2,194.8 billion.[40] For 2018 this figure was $2,259.0 billion; for 2019, $2,254.6 billion; and for 2020, $2,184.1 billion.

Taxable Income

For corporations, income subject to tax is generally total business receipts less total deductions, with adjustments.[41] One adjustment, for example, is to remove state and local government bond interest, which is not subject to tax, from income before determining income subject to tax. Deductions can include regular deductions for the cost of goods sold and ordinary and necessary business expenses, but can also include deductions that are tax expenditures, or special preference items. Net income (receipts minus deductions) includes NOLs, dividends received, and deductions for dividends paid—items that are also subtracted in determining taxable income.[42]

[38] See **Appendix B** for the difference in treatment of bad debts.

[39] Bureau of Economic Analysis, Table 1.14, "Gross Value Added of Domestic Corporate Business in Current Dollars and Gross Value Added of Nonfinancial Domestic Corporate Business in Current and Chained Dollars," at https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=2#reqid=19&step=2&isuri=1&1921=survey.

[40] Bureau of Economic Analysis, Table 7.16, "Relation of Corporate Profits, Taxes, and Dividends in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service," at https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=3&isuri=1&nipa_table_list=293&categories=survey.

[41] Total receipts include (1) business receipts; (2) interest; (3) interest on state and local government debts; (4) rents; (5) royalties; (6) net capital gains (excluding long-term gains from regulated investment companies); (7) net gain, noncapital assets; (8) dividends received from domestic corporations; (9) dividends received from foreign corporations (excluding certain taxable income from related foreign corporations only constructively received); and (10) other receipts. Total deductions include (1) the cost of goods sold; (2) ordinary and necessary business deductions from gross income; and (3) net loss from sales of noncapital assets.

[42] In IRS Statistics of Income data, net income differs from total receipts minus total deductions because net income

There are also limits on certain deductions for tax purposes, like limits on deductions for interest paid and executive compensation. These limits make taxable income higher than it would be otherwise.

Income as measured for tax purposes—taxable income—differs from economic income, and NIPA's measure of profits before tax, in several ways.[43] The tax code contains numerous provisions allowing for accelerated cost recovery through expensing, depreciation, or depletion. Accelerated cost recovery means that initially, in the early years of the lifetime of a capital asset, amounts deducted from income for tax purposes exceed the actual decline in the asset's value. The NIPA measure of profits before tax makes several adjustments to tax data, adding back amounts that were deducted for items that are more appropriately characterized as capital formation (e.g., expensing of intangible drilling costs and research and development).

In reconciling NIPA profits before tax and taxable income, not all adjustments, nor even all timing adjustments, add to taxable income. For example, the tax code does not allow certain deductions (e.g., fines) that are subtracted for the purposes of determining NIPA's profits before tax. NIPA profits before tax also treats the cost of trading or issuing securities as a current expense, whereas the tax code treats this as a reduction in future capital gains income.

In 2017, $1,002.3 billion in income was subject to the corporate tax. Total receipts less total deductions as reported on tax returns in 2017 were $1,577.8 billion. Income that is subject to the corporate tax is less than receipts less deductions for a number of reasons, including taxpayers' ability to deduct NOLs and part of dividends received, as well as certain forms of income and certain entities (primarily smaller Subchapter S corporations that elect to be taxed as pass-throughs under the individual income tax) not being subject to the corporate tax. As was noted above, in 2017, NIPA's corporate profits before tax (or profits from current production) were $2,194.8 billion.

The 2017 tax revision (TCJA) created incentives for taxpayers to reduce taxable income reported in the 2017 tax year (the statutory corporate tax rate was permanently reduced from a top rate of 35% in 2017 to a flat rate of 21% beginning in 2018). Taxpayer responses to the 2017 tax revision (TCJA) may have resulted in a higher than normal difference between financial (book) income and income for tax purposes, or *book-tax gap*, for 2017.

Income subject to tax in 2018 was $1,956.7 billion, which was substantially higher than the $1,002.3 billion in income subject to the corporate tax in 2017.[44] Total receipts less total deductions were also higher in 2018 at $2,329.3 billion compared to $1,577.8 billion, respectively.[45] NIPA's corporate profits in 2018 were $2,259.0 billion (compared to $2,194.8 billion for 2017). Thus, while measures of income for tax purposes differed substantially between 2017 and 2018, NIPA's measure of corporate profits was more stable. **Table B-1** reconciles total receipts less total deductions from IRS data with NIPA's measure of corporate profits for 2018.

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includes foreign deemed income and excludes interest on state and local government debt. See **Appendix B**.

[43] See **Appendix B** for a detailed reconciliation of NIPA's profits before tax and corporate income subject to tax for 2017.

[44] Internal Revenue Service, *Statistics of Income—2018: Corporation Income Tax Returns, Complete Report,* https://www.irs.gov/pub/irs-pdf/p16.pdf.

[45] Internal Revenue Service, *Statistics of Income—2018: Corporation Income Tax Returns, Complete Report,* https://www.irs.gov/pub/irs-pdf/p16.pdf.

Book Income

Book income is reported on a company's income statements. Public companies are required to disclose information on their financial performance on an ongoing basis.[46] Financial disclosures are filed with the Securities and Exchange Commission (SEC).[47] Public companies follow Generally Accepted Accounting Principles (GAAP), as set by the Financial Accounting Standards Board, when reporting financial information. Publicly disclosed Form 10-Ks are annual reports that describe a company's financial conditions and contain audited financial statements. The primary purpose of financial reporting is to provide information to investors and creditors.[48] Managers have some discretion when reporting earnings on financial statements. Flexibility in how certain expenses and assets are valued across industries is intended to allow managers to provide relevant information regarding their firms' economic position.[49]

Book income is generally determined by recognizing expenses in the period that revenue stemming from those expenses is received.[50] Book income includes certain revenues that are excluded from tax income, such as interest from municipal bonds and foreign-source income of U.S. corporations (tax income does not include all foreign-source income). Under GAAP, investments in capital assets are capitalized and generally depreciated over their useful life, consistent with the goal of recognizing expenses in the period in which those expenses result in revenue. For the purposes of financial statements, equity-based awards or stock options as compensation are recognized at fair value when granted. In contrast, for tax purposes, the deduction is taken when the stock option is exercised (that is, when the stock is purchased by the employee at the lower option price).

Large corporations—those with assets of at least $10 million—are required to file Schedule M-3 with their corporate tax returns. The Schedule M-3 collects information on firms' financial statement income and reconciles financial statement (book) income to tax income. Schedule M-3 reconciles book income to taxable income before net operating loss deduction and special deductions, which are then subtracted to determine taxable income (or the amount of income that is subject to the corporate tax). The first step in reconciling financial statement income to tax income is to address differences in consolidation rules.[51] Different consolidation rules under U.S. GAAP and the IRC make it such that the reporting entity for the purposes of a financial statement is not necessarily the same as the entity filing a tax return.

Schedule M-3s filed by corporations in 2017 reported $1,408.7 billion in worldwide consolidated financial statement net income. Financial statement net income for entities included on U.S. tax returns was $1,324.1 billion in 2017.[52] The tax income of these corporations in 2017 was $661.9 billion. In 2018, worldwide consolidated financial statement income reported on Schedule M-3s

[46] See CRS Report R44894, *Accounting and Auditing Regulatory Structure: U.S. and International*, by Raj Gnanarajah.

[47] See CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su.

[48] Joint Committee on Taxation, *Present Law and Background Relating to the Interaction of Federal Income Tax Rules and Financial Accounting Rules*, JCX-13-12, February 7, 2012, p. 2.

[49] Mindy Herzfeld, "Taxing Book Profits: New Proposals and 40 Years of Critiques," *National Tax Journal*, vol. 73, no. 4 (December 2020), pp. 1025-1046; and Ilia D. Dichev and Jingran Zhao, "Comparing GAAP With NIPA Earnings," *Journal of Accounting, Auditing, & Finance*, vol. 36, no. 3 (July 2021), pp. 517-539.

[50] For example, if a product is purchased for resale, the cost is not deducted until the sale is made.

[51] Caitlin Bokulic, Erin Henry, and George A. Plesko, "Reconciling Global Financial Reporting With Domestic Taxation," *National Tax Journal*, vol. 65, no. 4 (December 2012), pp. 933-959.

[52] Internal Revenue Service, *Statistics of Income—2017: Corporation Income Tax Returns, Line Item Estimates*, https://www.irs.gov/statistics/soi-tax-stats-corporation-income-tax-returns-line-item-estimates.

was $1,649.6 billion, financial statement net income for entities on U.S. tax returns was $2,265.5 billion, and tax income of these corporations was $2,220.1 billion.[53] Applying tax consolidation rules to all entities allows for an apples-to-apples (same entity) comparison of financial (book) and tax measures of income.

Although the relationship between book and tax income can change for a number of reasons, one possible explanation for the lower tax income in 2017 and the larger tax income in 2018 is that firms shifted tax income in response to changes in the 2017 tax revision (TCJA). Tax rates were lowered in 2018 and dividends received from foreign subsidiaries were no longer taxed.

Primary Causes of Book-Tax Differences

Differences between book and tax income reflect both differences in income items and differences in deductions. Income items can be larger or smaller for book and tax purposes, and can vary over time. For example, book foreign-source income reflects distributions out of current and previously taxed income, whereas, prior to 2018, tax foreign-source income reflected dividends not already taxed, as well as certain income, called Subpart F, that is taxed whether it is distributed or not because it is easily shifted between countries. In 2018 and later, tax income reflects inclusions such as GILTI, Subpart F, and (for 2018) accumulated untaxed income. As discussed above, interest income is larger for book income since interest on state and local bonds is included in book income, but excluded from taxable income (i.e., tax-exempt). Capital gains are often larger for tax purposes because capital losses are not fully deductible from taxable income.

Similarly, some deductions can be larger or smaller for book or tax purposes, and these differences can vary over time. Deductions for depreciation and for stock options and other forms of equity-based compensation are generally larger for tax purposes. Special rules that allow bonus depreciation or accelerated depreciation for tax purposes, which are often motivated by a desire to encourage investment, are a major factor in explaining book-tax differences.

Some book-tax differences, including those due to depreciation deductions, are temporary. The costs associated with capital investment will be recovered for both book and tax purposes, but there is a timing difference. With bonus depreciation for tax purposes, deductions are taken when investments are made. For book purposes, these costs will be recovered over time. Other differences are permanent. For example, tax-exempt interest payments are included in book income.

The 2017 tax revision (TCJA) may explain the significant book-tax difference in 2017, the year before many of the law's changes went into effect. Firms may have recognized commitments to larger dividend payments from foreign affiliates for book purposes but delayed paying those dividends until 2018, when dividends became exempt.

[53] Internal Revenue Service, *Statistics of Income—2018: Corporation Income Tax Returns, Line Item Estimates* https://www.irs.gov/statistics/soi-tax-stats-corporation-income-tax-returns-line-item-estimates.

Deriving Alternative Measures of Income for Tax Purposes

To the extent that a minimum tax aims to apply tax to economic income and address aggressive tax planning that leads to low effective tax rates, two basic options exist. One is the traditional alternative minimum tax (AMT), which adds back tax preferences to the taxable income base in order to more closely approximate economic income. The other would be a tax based on book income that adjusts for provisions that are appropriate to measuring economic income. Both approaches could be designed to retain desirable tax preferences. The traditional AMT approach, historically, has not prevented a key tax planning strategy—profit shifting by multinational firms—but it could potentially be designed to do so by including foreign-source income in full. Beginning with book income tends to capture tax planning items.

Neither approach captures profit shifting by U.S. subsidiaries of foreign parents through transfer pricing, which was the main target of BEAT, so there is still a role for that tax to apply if it exceeds the tax paid under the alternative minimum tax. BEAT might be modified to focus on that objective.

Adding Preference Items Back to Taxable Income: An AMT Approach

Book and economic income can be approximated by starting with taxable income and adjusting for the differences between taxable income and book income, as well as adjusting for some measures to move both to economic income. Although any specific set of adjustments might be made under this approach, the following is a list to consider:

- Add items included in the prior corporate AMT base, such as percentage depletion, intangible drilling costs, and other rapid amortization provisions (see Form 4626 and instructions for tax year 2017).
- Add and adjust for accelerated depreciation on equipment (eliminating the effects of expensing).
- Adjust the cost of goods sold by deducting inflation over the holding period for firms that use FIFO inventory accounting.
- Add real capital gains on like-kind exchanges and add to the basis for future sale.
- Add state and local income taxes.
- Capitalize and deduct over a period of time investments that earn future income and are currently expensed, such as research expenses, advertising expenses, investment in workforce training, film production, and losses from the search for oil and mineral deposits.
- Add back the value of repaying debt in cheaper dollars by multiplying average debt by the inflation rate. This amount should reduce interest deductions for purposes of the 30% cap in interest deductions, or the cap could be eliminated. (For net creditors, this adjustment would reduce income).
- Add the untaxed portion of income from controlled foreign corporations (the exemption of a deemed return on tangible assets, and the GILTI deduction).
- Add FDII deductions.
- Disallow interest deductions of U.S. subsidiaries of foreign parents to the extent they exceed a share consistent with the share of assets or profits of the parent and all of its subsidiaries; if such information is not provided, disallow all interest deductions.

These adjustments would produce a broader measure of income that begins from taxable income. With a minimum tax approach, the minimum tax would also be compared to ordinary tax after tax credits. Whether certain credits were allowed (R&D credit, low-income housing tax credit, and various energy credits) would be a policy choice.

There are multiple options to address foreign taxes. One option is to allow a full foreign tax credit of 100% for the GILTI basket, but subject it to the overall limits. A second option is to allow a full foreign tax credit of 100%, but allow the credit on a country-by-country basis within each basket. Alternatively, there could be a deduction for foreign taxes paid.

Adjusting Book Income to Approximate Economic Income

Book income could be used as a starting point for determining a broad taxable income base. With this approach, adjustments to book income could be made to better approximate economic income. These adjustments might include the following:

- Add federal, state and local, and foreign taxes to calculate a pretax income.
- Adjust the cost of goods sold by deducting inflation over the holding period for firms that use FIFO inventory accounting.

- Conform the treatment of stock options by adding back book expenses for options upon grant and allowing a deduction for the difference between price and payment (if any) on the exercise of stock options. Some argue this treatment would be appropriate because the recipients are taxed on exercise.
- Add back the value of repaying debt in cheaper dollars by multiplying outstanding debt at the beginning of the year by the inflation rate. (For net creditors, this adjustment would reduce income.)
- Capitalize and deduct over a period of time investments that earn future income and are currently expensed, such as research expenses, advertising expenses, investment in workforce training, film production, and losses from the search for oil and mineral deposits.
- Disallow interest deductions of U.S. subsidiaries of foreign parents to the extent they exceed a share consistent with the share of assets or profits of the parent and all of its subsidiaries; if such information is not provided, disallow all interest deductions.

Options related to tax credits, including the foreign tax credit, are similar to what was described above.

There are several challenges in creating a broad corporate tax base. First, conceptually, economic income should include real unrealized capital gains. It is not clear that this is appropriate for corporations. The gain on certain physical assets is likely attributable to inflation, with these assets depreciating in real terms (as addressed in depreciation deductions). Gains in the value of intangible assets will be captured in future profits. Financial assets that consist of stock holdings are usually related firms that are subject to corporate tax themselves. It would be possible to make a mark-to-market adjustment for other financial assets, such as bonds. Second, economic depreciation would require use of estimated real depreciation rates with the base adjusted for inflation as is done in NIPA. Using the lives and methods under the alternative depreciation system (for building up from the taxable base) or book treatment for beginning with book income might be a simpler approach because these measures may approximate the present value of economic depreciation. Third, there are conceptual challenges in how to treat charitable contributions. For corporations, charitable contributions may be a form of advertising or made to create goodwill, in which case they would most appropriately be considered an expense. However, to the extent they are indirect consumption for stockholders, they should be added back in computing a tax base.

Differences in Measures of Corporate Income over Time

The following sections compare NIPA's measure of corporate profits to aggregate measures of income subject to tax (taxable income), and, separately, book income to tax income, over time. As discussed further below, income subject to the corporate income tax tends to be smoother over time, as compared to other measures of corporate income. Smoothing income over time for tax purposes is a feature of the corporate income tax system.

NIPA Versus Taxable Income

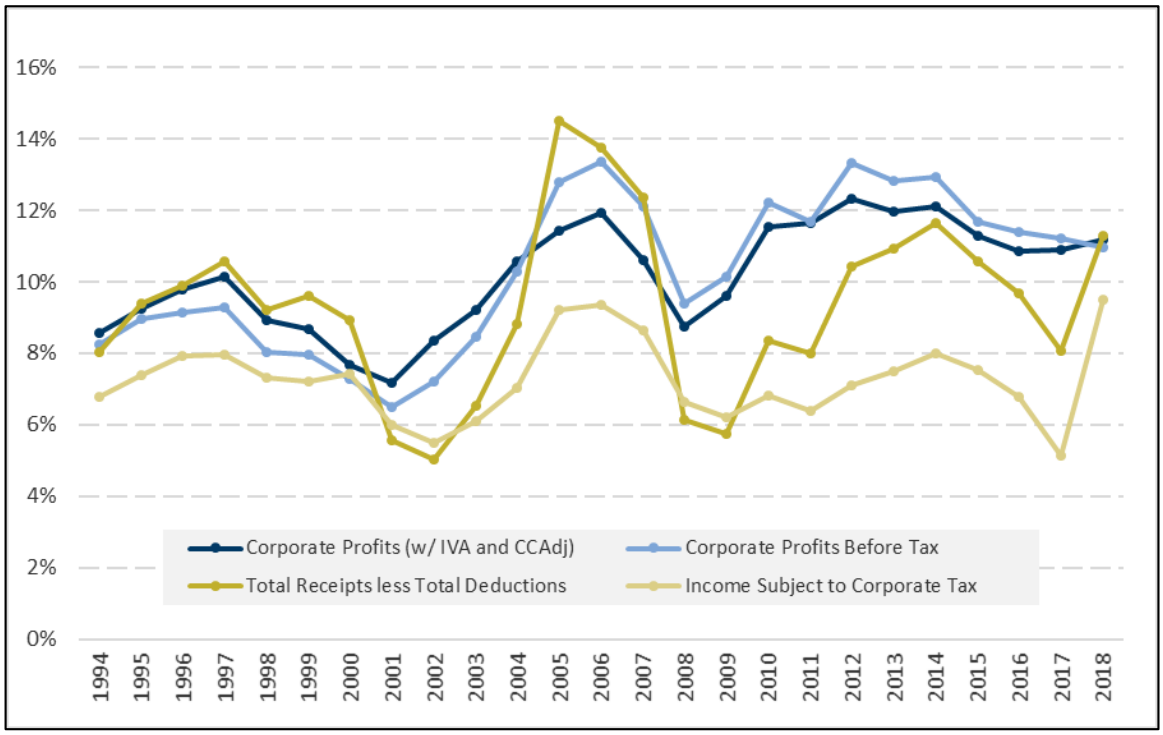
As discussed above, NIPA's corporate profits before tax (sometimes referred to as "book profits," although they differ from the book profit firms report on financial statements) are a broad measure of corporate income (but not a complete measure of corporate economic income). **Figure 1** compares NIPA's profits before tax and profits from current production to IRS data on net income (total receipts less total deductions) and income subject to the corporate tax (taxable income).

As illustrated in **Figure 1**, NIPA's corporate profits track fairly closely NIPA's corporate profits from current production (corporate profits with IVA and CCAdj). Since the 1990s, corporate profits in the NIPA data have generally exceeded the amount of income subject to the corporate tax. The size of the difference, however, has generally grown over time, relative to the size of the economy, with 2018 being an exception. Total receipts less total deductions are more variable over time than income subject to tax; NOLs, which smooth tax income over the business cycle, are one reason for this. Income subject to corporate tax is generally lower than receipts minus deductions because of entities (e.g., Subchapter S corporations) not subject to the tax. The trends in NIPA corporate profits and income subject to the corporate tax suggest that, over time, a

smaller share of corporate income has been subject to the corporate tax (although higher amounts of income being subject to tax in 2018 resulted in a deviation from this longer-term trend).

Figure 1. Corporate Profits and Corporate Income as a Share of GDP

1994-2018



Source: CRS figure using data from BEA and IRS.

Notes: Income subject to the corporate tax is the same as taxable income. Total receipts less total deductions a as reported in the IRS Statistics of Income.

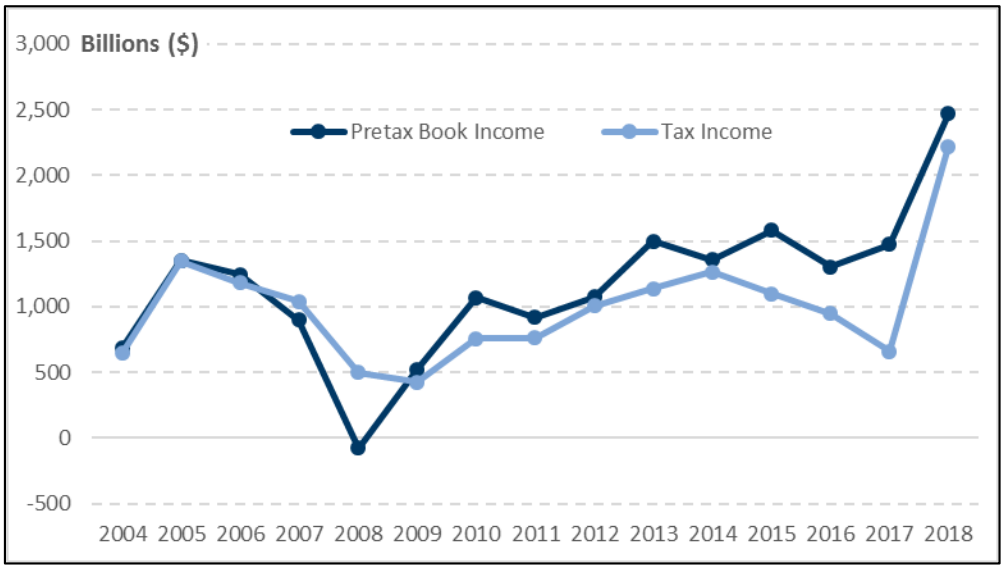
Book-Tax Differences

As stated previously, large corporations—those with assets of at least $10 million—are required to file Schedule M-3 with their corporate tax returns. Schedule M-3 reconciles book income to tax income *before* adjusting for NOLs and other special deductions. When deductions exceed receipts, income is negative, and the negative amount is a NOL. Income subject to tax—the measure of income to which tax rates are applied—cannot be less than zero, and includes NOLs. In economic downturns, income subject to tax tends to be higher than tax income (the tax income measure reported on Schedule M-3s), because weak economic conditions limit taxpayers' ability to claim losses in the current tax year. At full employment, income subject to tax is often lower than reported tax income as NOL carryforwards reduce income subject to tax. Ultimately, because of NOLs, income subject to tax is smoother over time than tax income.

Figure 2 compares aggregate pretax financial (book) income to tax income for corporations filing Schedule M-3, after differences due to consolidation have been removed (other analysis of book-

tax differences also uses pretax book income).[54] Since 2009, corporations filing Schedule M-3, in aggregate, have reported more in financial (book) income than tax income.

Figure 2. Aggregate Book Income and Tax Income for Large Corporations
2004-2018



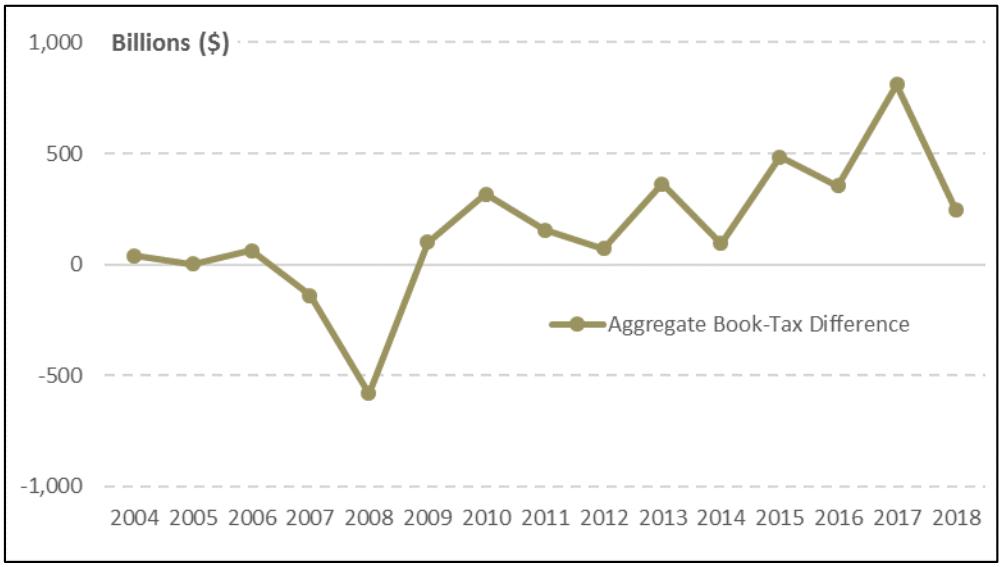
Source: CRS calculations using data from IRS Schedule M-3.

Notes: Pretax book income is financial statement income of corporations filing tax returns that were required to file Schedule M-3 plus U.S. tax expenses. Large corporations are those with assets of $10 million or more filing Form 1120 U.S. corporate income tax returns. Schedule M-3 reconciles book income to taxable income before net operating loss deduction and special deductions ("tax income" in the figure).

Figure 3 plots aggregate book-tax differences from 2004 through 2018. The relationship between book and tax income is affected by the business cycle (including the COVID-19 recession and recovery) and the government's fiscal policy response. During the Great Recession, in 2007 and 2008, aggregate tax income was larger than aggregate book income, leading to negative book-tax differences (**Figure 2** and **Figure 3**). One factor that may partially explain why book-tax differences decline during economic downturns is the treatment of bad debt, which may be recorded on financial statements before being claimed for tax purposes. As noted above, changes made in the 2017 tax revision (TCJA) created incentives to minimize taxable income in 2017, because the statutory corporate tax rate was reduced starting in 2018. This, and other elements of TCJA, might explain the larger book-tax difference in 2017.

[54] Danielle H. Green and George A. Plesko, "The Relationship Between Book and Tax Income Since the Introduction of the Schedule M-3," *National Tax Journal*, vol. 69, no. 4 (December 2016), https://www.journals.uchicago.edu/doi/10.17310/ntj.2016.4.02#. Pretax book income can be found on Part II of the Schedule M-3, while federal taxes are reported on Part III.

Figure 3. Aggregate Book-Tax Difference for Large Corporations
2004-2018



Source: CRS calculations using data from IRS Schedule M-3.

Notes: Aggregate book-tax difference is aggregate pretax book income less aggregate tax income. Large corporations are those with assets of $10 million or more filing Form 1120 U.S. corporate income tax returns.

Measuring Tax Burden: Effective Tax Rates

Effective tax rates and how they are affected by different features of income or tax measurement can be estimated from several data sources. The first section below estimates average tax rates based on NIPA data, adjusting for certain inclusions and exclusions to bring the measure closer to both tax income and economic income. The effect of other modifications to the income and tax base are also estimated, including adjustments for foreign taxes and foreign-source income. The second section uses IRS data in the M-1 and M-3 reconciliation schedules to show effective tax rates as successive adjustments are made, showing the source of differences between the effective and statutory tax rates. The final section reviews studies of effective tax rates using financial data.

Effective Tax Rate Using Aggregate NIPA Data

One source of an aggregate and current estimate of the effective tax rate on corporate profits is the National Income and Product Accounts (NIPA), a measure that, as discussed above, largely reflects economic income.

Table 2 shows effective corporate tax rates based on measures of corporate profits from the NIPA, which measures output (based on sales of goods and services) net of costs.[55] This measure is for domestic profits and does not include profits of U.S. firms earned abroad. Profits are adjusted, excluding payments from the Federal Reserve banks and other government credit agencies that do not file corporate tax returns. There are two additional adjustments needed to measure profits. The first is that the corporate profits include profits from Subchapter S

[55] Corporate profits are from Bureau of Economic Analysis, Table 1.10, "National Income and Product Accounts." Federal taxes are from Table 3.2, "Federal Government Current Receipts and Expenditures," https://apps.bea.gov/itable/index.cfm.

corporations and a less important amount from real estate investment trusts (REITs) that are treated as pass-throughs and not subject to corporate tax. The second is that the NIPA measure does not include capital gains. The effective tax rates in **Table 2** adjust for these Subchapter S corporations and capital gains. Based on tax data from the IRS Statistics line counts (discussed subsequently), the share of profits attributable to Subchapter S corporations was 30% of the total in each year available (2016-2017).[56] This adjustment reduced profits. Capital gains reported on C corporation returns (firms subject to the corporate tax) increased corporate profits by 18%, 23%, and 22% for 2016-2018.[57] The first row of **Table 2** shows corporate federal taxes as a percentage of domestic profits for 2016 through 2020, covering tax rates before the 2017 tax revision (TCJA) (i.e., 2016 and 2017), when the corporate statutory rate was 35%, and after (2018, 2019, and 2020), when the statutory rate was 21%. Since there may have been incentives to shift income from 2017 to 2018, the rates for 2016 and 2019 and 2020 might more accurately reflect these effective tax rates. In both cases, they were about 70% of the statutory rate.

Table 2. Effective Corporate Tax Rates on Domestic Income, National Income, and Product Accounts

Type of Measure	2016	2017	2018	2019	2020
Profits (with Subchapter S and Capital Gains Adjustment)	22%	17%	13%	14%	13%
Plus Adjustment for State and Local Taxes	23%	18%	15%	15%	14%

Sources: CRS calculations using NIPA and IRS data; see text. Initial data for profits are as follows: $1,603.8 billion (2016), $1,617.3 billion (2017), $1,730.4 billion (2018), $1,745.0 billion (2019), and $1,688.9 billion (2020). Federal taxes are as follows: $311.9 billion (2016), $245.4 billion (2017), $210.6 billion (2018), $217.3 billion (2019), and $199.0 billion (2020). The two adjustments plus excluding payments of the Federal Reserve and other agencies reduce NIPA profits by 10% in 2016, 12% in 2017, and 9% in 2018. Projecting based on the three-year average for the two adjustments, profits are reduced by 8% in 2019 and 10% in 2020.

An adjustment that might be considered is to measure the effective tax rate with a deduction for state and local taxes. It raises the effective tax rate by up to two percentage points. The decline in rates between 2016 and 2018 appears to largely reflect the reduction in the statutory corporate tax from a top rate of 35% to a flat rate of 21%, a 40% reduction.

As discussed above, the NIPA data make adjustments for depreciation and inventories to measure economic profits more closely, and these measures include an adjustment for inflation (measuring the basis of assets and inventories in current dollars).[58]

The remaining issue with the NIPA data is the treatment of foreign-source income. All of the measures in **Table 2** include total U.S. tax, including the residual U.S. tax on foreign-source

[56] Data from line 21, Form 1120S, Internal Revenue Service, Statistics of Income, Corporation Income Tax Returns Line Item Estimates, 2016-2018, https://www.irs.gov/statistics/soi-tax-stats-corporation-income-tax-returns-line-item-estimates.

[57] Data from Internal Revenue Service, Statistics of Income, Corporate Complete Report, Table 2.3 Returns of Active Corporations, other than Forms 1120S, 1120-REIT, and 1120-RIC, 2016-2018, https://www.irs.gov/statistics/soi-tax-stats-corporation-complete-report.

[58] While the NIPA base is close to a measure of economic income, it does not make some other adjustments, including the gain from repaying debt in cheaper dollars, that would increase profits. In addition, when including capital gains, only real capital gains (and not the gain due to inflation) should be included. Eliminating the inflation portion of capital gains would reduce profits. Economic income would also include real unrealized capital gains that would increase profits.

income, but do not include foreign-source income. Thus, the effective tax rates reported are higher than they would be if foreign-source income were included.

Data to make adjustments for foreign-source income and taxes are only available for 2016 and 2017. **Table 3**, for 2016, reports three different ways to address this issue. The first column repeats the tax rates from **Table 2** (the first column of numbers). The second column eliminates the U.S. residual tax paid on foreign-source income, yielding a measure of domestic effective rates on domestic income.[59] This adjustment lowers the tax rate by a small amount, typically a percentage point or less, reflecting the small size of the U.S. residual tax on foreign-source income. The third column retains the full U.S. tax but includes foreign-source income (by adding back income from U.S. controlled foreign corporations and branch income). It provides a rough estimate of the U.S. tax on worldwide income; this adjustment increases profits prior to debt and state and local adjustments (by 95% in 2016 and 114% in 2017).[60] This measure is similar in concept to the type of measure that might be found from financial statements, suggesting an effective tax rate of approximately 12%.[61] The final column adds foreign taxes to the total; because this measure does not capture all foreign taxes paid, it likely understates the true effective tax rate.[62] The adjustments for foreign taxes are imperfect because not all firms have a tax year corresponding to the calendar year, so some of the foreign income and tax reflects 2017 levels.

[59] The U.S. tax on foreign-source income data are from Internal Revenue Service, Statistics of Income, Corporate Foreign Tax Credit, https://www.irs.gov/statistics/soi-tax-stats-corporate-foreign-tax-credit-statistics. The residual tax is measured as the difference between the foreign tax credit limit and foreign tax credits claimed.

[60] Foreign-source income is estimated as the earnings of U.S. foreign affiliates from Bureau of Economic Analysis International Data, Direct Investment of Multinationals, Data on Activities of Multinational Enterprises, Net Income. Branch income is reported at IRS Statistics of Income Corporate Foreign Tax Credits Statistics, Table 1, https://www.irs.gov/statistics/soi-tax-stats-corporate-foreign-tax-credit-statisticsform. Two elements make this measure of income either too large or too small compared to true foreign-source income: branch income is before deductions, and before income of shares of noncontrolled foreign corporations is excluded. Branch income is so small that the difference is less than a percentage point if it is excluded. The bulk of foreign-source income is in foreign affiliates.

[61] How close worldwide profits as measured from NIPA data on domestic earnings are to tax data on foreign-source earnings is also affected by depreciation measures. Financial data reflect slower depreciation rates than allowed under the tax rules, but no inflation adjustments for depreciation. Inventories are not adjusted for inflation, as is the case with NIPA data.

[62] This measure adds foreign taxes paid on branch income from Internal Revenue Service, "Statistics of Income Tax Stats—Corporate Foreign Tax Credit Table 1," https://www.irs.gov/statistics/soi-tax-stats-corporate-foreign-tax-credit-table-1, and taxes paid by controlled foreign corporations from Internal Revenue Service, "Statistics of Income Tax Stats—Controlled Foreign Corporations," https://www.irs.gov/statistics/soi-tax-stats-controlled-foreign-corporations, to domestic taxes paid (i.e., net of the residual tax). This number may overstate foreign-source income because branch income is not offset by deductions, but branch income is so small that the difference in effective tax rate is less than a percentage point. This number may understate the effective tax rate since it does not include taxes on income of interests in noncontrolled foreign corporations. The measure of foreign taxes for 2017 is taken from Internal Revenue Service, Statistics of Income—Country by Country Report," at https://www.irs.gov/statistics/soi-tax-stats-country-by-country-report. It reflects only larger firms, and the number was increased by 24%, the ratio by which taxes in the statistics on the foreign tax credit data and the controlled foreign corporation data exceed the country-by-country measure for 2016.

Table 3. Effective Corporate Tax Rates for 2016, Adjusting for Foreign-Source Income and Taxes

Type of Measure	U.S. Tax on Domestic Income	U.S. Domestic Tax on U.S. Domestic Income	U.S. Tax on Worldwide Income	U.S. and Foreign Taxes on Worldwide Income
Profits (with Subchapter S and Capital Gains Adjustment)	22%	20%	12%	15%
Plus Adjustment for State and Local Taxes	23%	20%	12%	16%

Sources: CRS calculations using NIPA and IRS data; see text.

Table 4 provides the same estimates for 2017. As noted, these rates may be affected by incentives to shift taxable income between 2017 and 2018.

Table 4. Effective Corporate Tax Rates for 2017, Adjusting for Foreign-Source Income and Taxes

Type of Measure	U.S. Tax on Domestic Income	U.S. Domestic Tax on U.S. Domestic Income	U.S. Tax on Worldwide Income	U.S. and Foreign Taxes on Worldwide Income
Profits (with Subchapter S and Capital Gains Adjustment)	17%	15%	8%	13%
Plus Adjustment for State and Local Taxes	18%	16%	9%	13%

Sources: CRS calculations using NIPA and IRS data; see text.

It is difficult to know how these measures are affected in future years by the 2017 tax revision (TCJA) changes—which lowered the U.S. effective tax rate by any measure and changed the international system—because not all data sources are available. Data are not available to estimate the U.S. domestic tax on domestic income. For the remaining measures, a rough projection can be made by assuming branch income (which is small) bears the same proportion to foreign income of affiliates as in 2017 and that taxes on foreign-source income (without considering the effects of the 2017 changes) would be about the same as in 2017.[63]

[63] Income of branches was similar but slightly lower in 2017: 12% in 2016 and 9% in 2017.

Table 5. Effective Corporate Tax Rates for 2018, Adjusting for Foreign-Source Income and Taxes

Type of Measure	U.S. Tax on Domestic Income	U.S. Domestic Tax on U.S. Domestic Income	U.S. Tax on Worldwide Income	U.S. and Foreign Taxes on Worldwide Income
Profits (with Subchapter S and Capital Gains Adjustment)	13%	NA	7%	11%
Plus Adjustment for State and Local Taxes	15%	NA	7%	11%

Sources: CRS calculations using NIPA and IRS data; see text.

Tax Rates from IRS Statistics of Income

IRS data include reconciliation of tax and book income, although these data are subject to a lag and are currently only available through 2019.[64] Tax returns and book income are not on a calendar-year basis, so the rates cannot be easily compared to tax rates using the NIPA data. In the IRS data, for example, some of the data for 2016 come from calendar year 2017, and some of the data for 2017 include income from calendar year 2018. In concept, however, these rates are similar to the rates for NIPA-based profits in **Table 2**.

Table 6 reports several measures of income from the IRS data. The first measure is worldwide financial income (row 1), which most closely corresponds to income on financial reports. Since financial income is measured after taxes, federal income taxes must be added back to the base to provide a pretax measure comparable to income measured for tax purposes. This measure is reported on Schedule M-3 only for firms with $10 million or more in assets and differs from a related measure, book income, to reflect different consolidation rules. For example, financial reports include income of majority-owned foreign affiliates, whereas the book income measure includes dividends of foreign affiliates as well as certain other minority-owned foreign income shares. Schedule M-1, reflecting smaller firms with less than $10 million of assets, only reports book income; however, these smaller firms presumably do not have major differences due to consolidation, so the same value is reported in **Table 6** for these firms as financial income in reporting totals in the second row. Corporations with less than $250,000 of income and assets are not required to complete Schedule M-1.

Worldwide financial income before taxes (row 1) is similar to book income in 2016 and 2017 (row 2). The large increase in book income in 2018 appears to be due to the inclusion of the deemed repatriation of income from abroad. The fourth row is larger than the third because it includes taxable income of corporations not filing the M-1 or M-3.

Comparing book income with taxable income for firms filing M-1 and M-3 forms shows the book-tax difference after controlling for consolidation. Some of the major differences include foreign income, the degree to which intercorporate domestic dividends are captured, and capital gains. Differences in expenses reflect differences in depreciation, travel and entertainment, and compensation (including stock options). Both measures are before federal income tax to achieve a pretax measure of income. Comparing these two measures provides a direct comparison of income measured on a book versus tax basis. Note that the tax rates for these measures do not

[64] The data can be found in the individual line accounts on the IRS Statistics of Income website, https://www.irs.gov/statistics/soi-tax-stats-corporation-income-tax-returns-line-item-estimates.

capture all income (although most of that income is probably associated with nontaxed entities that are more likely to be small, such as Subchapter S firms). Also, measuring tax rates in row 1 using income tax expenses as reported on financial statements rather than actual tax paid does not result in very much change in rates, leading to a 10% rate in 2016, and 8% in 2017 and 2018. This measure would be U.S. tax on worldwide income based on financial reports. These rates are not very different from the rates using the same concept based on NIPA data (13% in 2016 and 2017 and 9% in 2018).

Table 6. Effective Tax Rates on Income, IRS Data

Income Measure	Income 2016, $billions	Income 2017, $billions	Income 2018, $billions	Effective Tax Rate, 2016	Effective Tax Rate, 2017	Effective Tax Rate, 2018
Worldwide Financial Income plus Federal Income Tax	$2,872	$4,094	$3,008	11%	6%	11%
Book Income + Federal Income Tax	$2,803	$4,004	$3,584	11%	7%	9%
Taxable Income Before NOLS and Other Adjustments, M-1 & M-3	$1,285	$1,010	$2,595	24%	26%	12%
Taxable Income Before NOLS and Other Adjustments	$1,913	$1,656	$3,391	17%	16%	9%
Taxable Income After Special Deductions, Before NOLs	$1,894	$1,633	$2,800	17%	16%	11%
Taxable Income After NOLs	$1,643	$1,384	$2,587	19%	19%	12%
Income Subject to Tax	$1,271	$1,002	$1,957	25%	26%	16%

Source: CRS calculations using IRS data. All data taken from the IRS Statistics of Income Line Item Estimates for Form 1120.

Notes: Taxable income before NOLs was from line 28 of Form 1120, income subject to tax from line 30 of Form 1120. Worldwide financial income is from line 1 of the M-1 schedule, plus line 4 of the M-3, Part I schedule. Book income was from line 1 of the M-1 schedule, plus line 11 of the M-3 Part I schedule. Both added back federal taxable income before NOLs, and special deductions for M-1 and M-3 filers were from the M-1 form line 10 plus the M-3 Part 11, line 30(d). Federal income tax was reduced by $127 billion in deferred taxes on unrepatriated accumulated income in 2017. Taxes were $313 billion in 2016, $261 billion in 2017, and $319 billion in 2018. The net deferred tax on unrepatriated income was $14 billion in 2017 and $4 billion in 2018.

The fourth measure is taxable income as reported on the corporate tax form before net operating losses and special deductions. The fifth measure deducts special deductions (which generally relate to domestic intercorporate dividend deductions), and the sixth measure also deducts net operating losses. In general, the special deductions are small, but they were much larger for 2018 because they captured the deduction for deemed unrepatriated income abroad. This measure (row 5) is a rough measure of current taxable income measured on a tax basis. It is likely to be smaller when the economy is at full employment because of carryovers of net operating losses from previous years (including the recession that began in 2008, which was characterized by a slow recovery). The final measure, income subject to tax, eliminates nontaxable firms that are reported in the 1120 series, most notably Subchapter S corporations.

The difference between the statutory tax rate (a top rate of 35% in 2016 and 2017 and a flat 21% in 2018) and the tax on income subject to tax is due to tax credits and is significant (10 percentage points in 2016, 9 in 2017, and 5 in 2018). However, most of that lower rate is due to the foreign tax credit, which offsets income taxes paid by foreign entities. Adding back foreign tax credits ($89 billion in 2016 and $60 billion in 2017) would increase the effective rate to 32% (data are not available for 2018). The remaining difference is due to other business credits—especially the research credit, although other credits, such as energy credits and the low-income housing credits, are significant as well.

Effective Corporate Tax Rates Using Financial Data

Financial (SEC 10-K) data are frequently used by researchers to estimate tax rates because of their public availability for individual companies, whereas tax data are only available in the aggregate due to confidentiality rules. The following sections present selected research that has drawn on financial data, which is constructed under financial accounting rules (as opposed to tax accounting rules).

Financial data include three measures of taxes: taxes accrued, current taxes, and cash taxes. Accrued taxes reflect tax effects that are triggered by current-year events (such as depreciation deductions reflecting write-off periods, losses, or, in prior law, earnings abroad that were expected to be repatriated and create a future liability). Current taxes are taxes paid on current income, which reflect tax depreciation rules, loss carryovers, and limitations on losses and taxes currently due on foreign-source income. Cash taxes are similar to current taxes and reflect the actual tax paid in a period, which may not reflect tax liabilities associated with current income because of filing delays. Cash taxes are not generally divided into federal, state and local, and foreign taxes.

Financial data can also differ from NIPA data because not all firms have calendar reporting years.

Damodaran Data: Worldwide Taxes Accrued and Cash Taxes on Worldwide Income

Professor Aswath Damodaran of the Stern School at New York University reports a range of data, including measures of effective tax rates.[65] Damodaran's data do not cover the total corporate population but do cover 7,000 large firms. These data measure total income taxes on total income and therefore reflect worldwide taxes on worldwide income, similar in concept to the first row, last column, of **Table 4** and **Table 5**, but they also include state and local income taxes, which are not included in this row. Damodaran reports both an aggregate tax rate (aggregate taxes paid divided by aggregate income) and the average of the firms' effective tax rates, the latter for both all firms and profitable firms. Damodaran reports both taxes accrued and cash taxes. Data for the aggregate measure and for average tax rates for firms with profit, for cash and accrual taxes, are shown in **Table 7**. The cash measure is not reported for 2016.

State and local taxes only explain part of the difference between the cash tax rates in **Table 7** and in **Table 4** and **Table 5**. For 2017, the cash flow rate is 22%, but if state and local taxes are added to the rate in **Table 4**, the comparable tax rate is 16%; for 2018, the cash flow rate is 19% and the

[65] Current-year data can be found at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/taxrate.htm and archived data at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/dataarchived.html. A discussion of the rates is at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/valquestions/taxrate.htm. The home page is at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/data.html.

comparable tax rate (with state and local taxes added) is 14%. These higher rates may reflect a subset that includes more profitable companies that are less likely to experience losses. The 2020 cash rates may have been especially affected by losses.

Table 7. Effective Total (Federal, State, and Foreign) Tax Rates on Large Corporations, Based on Financial Data

Type of Measure	2016	2017	2018	2019	2020
Aggregate Tax Rate					
Cash		22.26%	18.81%	21.32%	32.73%
Accrual	28.49%	26.06%	27.38%	19.01%	20.43%
Average Rate on Moneymaking Firms					
Cash		20.28%	25.16%	18.37%	21.35%
Accrual	26.22%	25.58%	31.34%	18.57%	17.76%

Source: Damodaran Online, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/biomission.html.

These data show tax rates below the statutory rate for 2017 but in some cases above that rate in 2018, which may reflect the influence of foreign and state and local taxes. Industries with the lowest cash tax rates for 2019 were air transport, broadcasting, power, shoe manufacturing, and utilities (both general and water). Utilities and power companies have particularly large benefits from accelerated depreciation. The aggregate tax rate in 2020 on all firms presumably reflects the effects of the COVID-19 recession (which led to more firms with losses) and the limitation of taxes rates to zero. The losses offset the incomes of moneymaking firms, but their taxes are not reduced because taxes cannot be negative, leading to a higher aggregate tax rate. These conditions are less representative of normal times.

Institute for Taxation and Economic Policy: Current Taxes on Domestic Income

The Institute on Taxation and Economic Policy (ITEP) estimates federal income taxes as a percentage of domestic income, and thus corresponds, in concept, to the numbers in **Table 2**.[66] This study estimates the effective tax rate for 2018 at 11%, which is similar to those measures. It covers the Fortune 500 and identifies 379 firms that are profitable and have sufficient data to calculate tax rates. The study reports 91 companies that paid no taxes; the firms with the largest profits among the 91 were Amazon, Delta, Starbucks, Chevron, and General Motors.

Martin Sullivan, *Tax Notes Federal*

Economist Martin Sullivan has examined the largest 100 corporations, based on an average of data in 2018 and 2019 (i.e., after the 2017 tax revision [TCJA]), and estimated that 33 of the firms would pay the minimum tax proposed by President Biden (imposed at a 15% rate and allowing NOLs and foreign tax credits).[67] Sullivan estimated four firms would pay more than $1 billion under the Biden proposal: AT&T, Berkshire Hathaway, Bank of America, and JPMorgan Chase. Eight additional firms were estimated to pay more than $500 million each: Duke Energy, NextEra Energy, T-Mobile, Lockheed Martin, United Parcel Service, U.S. Bancorp, Amazon, and Intel.

[66] Institute on Taxation and Economic Policy, *Corporate Tax Avoidance in the First Year of the Trump Tax Law*, December 16, 2019, https://itep.org/corporate-tax-avoidance-in-the-first-year-of-the-trump-tax-law/.

[67] Martin Sullivan, "Which Large U.S. Corporations Would Pay Biden's 15% Minimum Tax?" *Tax Notes Federal*, December 22, 2020, pp. 1868-1872.

According to Sullivan, the overall effective tax rate would be 16.7%. Because foreign taxes would be creditable against the minimum tax under the Biden proposal, Sullivan reports federal and foreign income taxes on worldwide income, similar in concept to the last column of **Table 5**. His estimates indicate that the effective tax rate would rise by two percentage points, to 18.7% with application of the Biden minimum tax.

Minimum Taxes on Business Income

The tax code has, at various points in time, included different types of minimum taxes on business income. The corporate AMT was in place from 1987 through 2017. Current minimum taxes include GILTI and BEAT. The following sections discuss these taxes, as well as other policy options for imposing minimum taxes on business income.

Corporate AMT

A corporate minimum tax was first introduced into the U.S. tax code in 1969. The original minimum tax was an add-on tax imposed on preference items in excess of an exemption amount and tax liability.[68] The tax was significantly modified as part of the Tax Reform Act of 1986 (P.L. 99-514).[69] At that time, the policy goal was "to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits."[70] The corporate AMT was repealed as part of the 2017 tax revision (TCJA). At that time, repeal of the corporate AMT was estimated to reduce federal tax revenues by $40.3 billion from 2018 through 2027.[71] The corporate AMT was complex, a factor that led to its repeal in TCJA.[72] It had also become much less effective in raising corporate taxes as AMT depreciation—originally a major factor in the increase in the AMT tax base compared to the regular base—was conformed more closely to regular depreciation.

The corporate AMT required corporations to calculate their tax liability under two sets of rules, those of the regular tax system and tax that would be owed under the alternative system.[73] Taxpayers would then pay the higher amount. The AMT also served to smooth tax liability over time. Taxpayers with AMT liability would receive a credit for the amount that AMT exceeded regular tax liability. That amount could be claimed against future regular tax liability.

Taxpayers were required to compute alternative minimum taxable income (AMTI) to determine whether they owed tax under the AMT. AMTI was taxable income, increased by certain

[68] Tax preference items included in the corporate add-on tax base were excess accelerated depreciation on real property; amortization of certain rehabilitation expenditures, certified pollution control facilities, and railroad rolling stock; excess bad debt reserves for financial institutions; excess depletion; certain capital gains; and the excess of the fair market value over the option price of certain stock options.

[69] Andrew B. Lyon, "Alternative minimum tax, corporate," in *The Encyclopedia of Taxation and Tax Policy*, ed. Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle (Washington, DC: The Urban Institute, 1999).

[70] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514)*, JCS-10-87, May 4, 1987, p. 432. For a history of the corporate AMT, see Curtis P. Carlson, The Corporate Alternative Minimum Tax: Aggregate Historical Trends, Department of the Treasury, Office of Tax Analysis, OTA Paper 93, June 2005, https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-93.pdf (cited hereinafter as "Carlson, The Corporate Alternative Minimum Tax").

[71] Joint Committee on Taxation, *General Explanation of* P.L. 115-97, December 20, 2018, p. 436.

[72] Eric Zwick, "The Costs of Corporate Tax Complexity," *American Economic Journal: Economic Policy*, vol. 13, no. 2 (May 2021), pp. 467-500.

[73] Carlson, *The Corporate Alternative Minimum Tax*.

preference items (effectively disallowing deductions for those items), and adjusted according to different rules related to timing and deferrals. Adjustment items modified cost recovery under the AMT.[74] One preference item was tax-exempt interest income, meaning the amount of tax-exempt interest income was added to taxable income as part of determining AMTI. Another limit provided that a NOL carryover could not reduce AMT liability by more than 90% of AMTI (as determined without the NOL deduction).

A corporation's tentative minimum tax was computed as 20% of AMTI in excess of a $40,000 exemption amount. The exemption amount phased out once AMTI exceeded $150,000. Many nonrefundable business credits, including the tax credit for research and experimentation (R&E), could not be claimed against the AMT.

Minimum Tax on Book Income

A minimum tax on financial statement or book income was included as part of the corporate AMT modifications in the Tax Reform Act of 1986 (P.L. 99-514). This policy was pursued in an effort to "achieve both real and apparent fairness," by adopting a system that generally required that "whenever a company publicly reports significant earnings, that company will pay some tax for the year."[75] When enacted, the minimum tax on book income was intended to be temporary. For years after 1989, a broad-based tax system defined by the Internal Revenue Code, one that relied on "income tax principles," was to replace the book income tax.[76]

The book-income AMT adjustment was a catch-all adjustment designed to ensure that any items not captured in the AMT base but reported as income would be subject to tax. Specifically, the book-income adjustment required taxpayers to include in taxable income one-half of any positive difference between book income and taxable income included in the AMT.

The book-income adjustment only applied to the 1987, 1988, and 1989 tax years.[77] One concern about using book income to compute tax liability is that book income is defined outside of the tax code. There was concern that corporations would act to reduce book income in response to the book-income adjustment.[78] Empirical research has found that taxpayers did manage their earnings, adjusting book income to reduce taxes owed.[79]

The Biden Administration has proposed a 15% minimum tax, based on the book income of certain large corporations. Only corporations with worldwide book income in excess of $2 billion

[74] Recovery periods under the AMT were shortened over time, a factor that contributed to fewer firms being affected by the corporate AMT. See Carlson, *The Corporate Alternative Minimum Tax*. Other adjustment items made changes related to the treatment of inside build-up of life insurance contracts; the use of first-in, first-out inventory accounting methods; and the installment sales method.

[75] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514)*, JCS-10-87, May 4, 1987, p. 434.

[76] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514)*, JCS-10-87, May 4, 1987, p. 435.

[77] The book-income adjustment was replaced with Adjusted Current Earnings (ACE) after 1989.

[78] See CRS Report 89-619, *The Corporate Minimum Tax and Adjusted Current Earnings (ACE)*, by David L. Brumbaugh (November 3, 1989) (out of print; available to congressional clients upon request).

[79] For a summary of the research, see Mindy Herzfeld, "Taxing Book Profits: New Proposals and 40 Years of Critiques," *National Tax Journal*, vol. 73, no. 4 (December 2020), pp. 1025-1046. More recent work also suggests that financial statement income might be modified if a book income tax were to be imposed. See Dhammika Dharmapala, "The Tax Elasticity of Financial Statement Income: Implications for Current Reform Proposals," *National Tax Journal*, vol. 73, no. 4 (December 2020), pp. 1047-1064; and Jordan Richmond, *Firm Responses to Book Income Alternative Minimum Taxes*, February 12, 2021, https://jordan-richmond.github.io/research/book_inc_AMT.pdf.

would be subject to the minimum. In support of this proposal, the Administration claims that in a typical year there are approximately 120 companies that report at least $2 billion in earnings on financial statements, with a "significant share" of these companies paying no income tax.[80] The policy seeks "to ensure that the most aggressive corporate tax avoiders bear meaningful federal income tax liabilities" and make it so that "highly profitable multinational corporations would no longer be able to report significant profits to shareholders while avoiding federal income taxation entirely."[81]

The tentative minimum tax would be computed as 15% of worldwide pretax book income, calculated after subtracting book net operating losses. General business credits—such as credits for R&D, clean energy, and housing—and foreign tax credits would be allowed. Taxpayers would owe additional taxes under this provision if the tentative minimum tax amount exceeded taxes paid under the regular income tax. Taxpayers owing taxes under the provision would be allowed a book tax credit, which could offset regular income tax liability in future years (but not below the minimum tax amount). The Department of the Treasury has estimated this tax would generate $148.3 billion in additional revenue between FY2022 and FY2031.[82]

Senator Elizabeth Warren has proposed a minimum tax of 7% on the book income of corporations above $100 million.[83] Since the tax would apply only to book income in excess of the $100 million amount, there is effectively a deduction so that firms just above the threshold would be subject to a small tax that would rise as book profits increased. Firms would be allowed a credit against the tax for one-third of corporate taxes paid. The credit against the tax of one-third of corporate taxes would offset the tax for some firms that pay the regular income tax. Since the corporate rate is 21%, the credit allows an offset at a rate of 7% of taxable income, reduced by one-third of credits. Thus, the tax base is increased by a third of the foreign tax credit (and other credits). The credit also makes this tax an alternative minimum tax rather than an add-on surtax.[84]

Concerns about current proposals to impose a minimum tax on book income are similar to those expressed about the policy in the late 1980s. In a public finance context, researchers continue to question how much taxpayers will change their behavior to avoid the tax. If a tax on book income causes taxpayers to engage in profit shifting or other forms or tax avoidance, or if the tax reduces real economic activity, then there is an efficiency cost associated with imposing the tax.[85] From an accounting perspective, there are concerns that manipulation of book income in response to a

[80] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, May 2021, p. 21, https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf.

[81] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, May 2021, p. 21, https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf.

[82] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, May 2021, p. 104, https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf.

[83] See Sen. Elizabeth Warren, "Senators Warren and King, Representative Beyer Announce Legislation to Prevent The Biggest and Most Profitable Corporations From Paying Nothing in Federal Taxes," press release, August 9, 2021, at https://www.warren.senate.gov/newsroom/press-releases/senators-warren-and-king-representative-beyer-announce-legislation-to-prevent-the-biggest-and-most-profitable-corporations-from-paying-nothing-in-federal-taxes.

[84] In 2019, economists Emmanuel Saez and Gabriel Zucman estimated that an earlier version of the real corporate profits tax as outlined by Senator Warren might generate $1.05 trillion in additional corporate tax revenue over the 10-year budget window. This version did not include the credit for corporate taxes paid. See Letter from Emmanuel Saez and Gabriel Zucman to Senator Warren, April 9, 2019, https://elizabethwarren.com/wp-content/uploads/2019/04/Saez-and-Zucman-Letter-on-Real-Corporate-Profits-Tax-4.10.19-2.pdf.

[85] Dhammika Dharmapala, "The Tax Elasticity of Financial Statement Income: Implications for Current Reform Proposals," *National Tax Journal*, vol. 73, no. 4 (December 2020), pp. 1047-1064.

book income tax could reduce the quality of information in financial reporting statements.[86] There are also concerns that a tax on book income could subject the Financial Accounting Standards Board to political pressure or weaken its ability to independently establish financial accounting rules.[87]

As discussed above, many of the factors that create differences between book income and tax income are intentional policy choices. Congress chose to provide accelerated depreciation allowances, for example. While a corporate minimum tax based on book income could serve as a backstop, by increasing tax liability for certain corporations, it could also offset or diminish the effects of tax incentives intended to encourage investment or economic activities if the incentives are recaptured by a minimum tax.

The Administration's proposal to impose a minimum tax on firms with worldwide book income in excess of $2 billion also could raise some policy questions. The size threshold could raise horizontal equity concerns (where taxpayers in similar economic circumstances are treated differently for tax purposes). Some may ask whether there is a reason that a firm with $1.9 billion in worldwide book income is less likely to engage in tax avoidance strategies than a firm with $2.1 billion in worldwide book income. Providing a firm size threshold, however, could limit the tax's administrative burden, as relatively few firms would be subject to the tax. If "the most aggressive corporate tax avoiders" are firms with more than $2 billion in worldwide book income, as opposed to firms outside this group, then there may be a rationale for imposing the tax on this group.

Corporate Surtax or Add-On Tax

Another option is to impose a surtax or an add-on tax. From 1987 through 1995, an "environmental tax" of 0.12% was imposed on modified alternative minimum taxable income (modified AMTI) of corporations above $2 million.[88] This tax was imposed to raise revenue for the Superfund Trust Fund. For the purposes of this tax, modified AMTI was a corporation's AMTI determined without regard to NOL deductions and without a deduction for the corporate environmental tax itself. The corporate environmental tax was a flat tax, applied on the corporation's modified AMTI, regardless of whether the corporation was otherwise subject to AMT. This tax was criticized for creating complexity. Many taxpayers subject to the tax did not pay the corporate AMT, but were required to compute AMTI to determine the amount of corporate environmental tax owed.[89]

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[86] Michelle Hanlon and Terry Shevlin, "Book-Tax Conformity for Corporate Income: An Introduction to the Issues," *Tax Policy and the Economy*, vol. 19 (September 2005), pp. 101-134.

[87] Daniel Shaviro, *What Are Minimum Taxes, And Why Might One Favor or Disfavor Them?* (Working Paper, New York University School of Law: 2020). Jeffrey Hoopes also has expressed concern that a tax on book income would "distort the financial accounting process and politicize the FASB." Testimony of Jeffrey L. Hoopes, in U.S. Congress, Senate Finance Subcommittee on Fiscal Responsibility and Economic Growth, *Creating Opportunity Through a Fairer Tax System*, hearings, 117th Cong., 1st sess., April 27, 2021, at https://www.finance.senate.gov/imo/media/doc/Hoopes%20Testimony.pdf.

[88] Section 516(a) of the Superfund Amendments and Reauthorization Act of 1986 (P.L. 99-499) established the special tax on corporate income to provide an additional revenue stream for the Superfund Trust Fund. S corporations, regulated investment companies, and REITs were not subject to the tax.

[89] Don Fullerton, "Why Have Separate Environmental Taxes?" in *Tax Policy and the Economy*, ed. James M. Poterba, vol. 10 (National Bureau of Economic Research, 1996), pp. 33-70, https://www.nber.org/system/files/chapters/c10898/c10898.pdf.

An add-on or surtax approach could avoid some of the complexity that might be associated with a minimum tax based on book income. For example, presumably an add-on tax would not allow for amounts paid to be credited against regular tax liability in future years, which is a typical but complicating feature of the AMT. Additionally, an add-on tax might also be imposed without allowing a foreign tax credit (foreign tax credits would still be allowed against the regular corporate income tax). For example, the base erosion and anti-abuse tax (BEAT) does not allow a foreign tax credit. General concerns similar to those discussed above (in "Minimum Tax on Book Income") with regard to using book or financial income as a base for tax purposes would still apply in the add-on tax context.

GILTI, BEAT, and Proposed Changes

GILTI is often referred to as a minimum tax, although under a worldwide tax system with full taxation of foreign-source income (with a foreign tax credit) GILTI deductions may be viewed as tax subsidies.[90] The GILTI tax, even if considered a minimum tax, is different from the prior corporate AMT because it is added to tax liability. There is no difficulty in integrating GILTI with a typical minimum tax because it is part of the regular tax system. The Biden Administration has proposed modifying GILTI and increasing revenues by disallowing the deduction for tangible assets, applying a 21% rate, and imposing the foreign tax credit limit on a country-by-country basis.[91] (The proposal would raise the ordinary corporate tax rate to 28%, so the GILTI rate would still be below the ordinary rate.) Congress has also considered proposals to modify GILTI in a similar way.[92]

In contrast, BEAT is an alternative minimum tax that adds back certain payments between U.S. firms and their related affiliates and disallows some credits, notably the foreign tax credit. The likely method of integrating a new minimum tax with the BEAT minimum tax is to have the firms pay the highest of the three taxes: regular, BEAT, and the minimum tax. The Administration has proposed replacing BEAT with a provision to disallow deductions for payments to tax havens, which it terms Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD).[93]

GloBE: An International Tax Proposal

The Organisation for Economic Co-operation and Development (OECD) and the G20 have been developing a proposal for a Global Anti-Base Erosion (GloBE) minimum tax that has an income inclusion rule similar to GILTI that all member nations would adopt.[94] This proposal was endorsed by the G7 on June 5, 2021, at a 15% rate; by the G20 on July 9-10, 2021; and by 133

[90] The Joint Committee on Taxation lists the lower tax rates imposed by GILTI as a tax expenditure or a departure from a normal tax system. See Joint Committee of Taxation, *Estimates Of Federal Tax Expenditures For Fiscal Years 2020-2024*, JCX-23-20, November 5, 2020, https://www.jct.gov/publications/2020/jcx-23-20/.

[91] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, May 2021, p. 4, https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf,

[92] See CRS In Focus IF11809, *Trends and Proposals for Corporate Tax Revenue*, by Donald J. Marples and Jane G. Gravelle.

[93] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, May 2021, p. 12, https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf.

[94] See OECD/G20 Base Erosion and Profit Shifting Project, *Tax Challenges Arising from Digitilisation: Report on Pillar Two Blueprint*, 2020, https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint.pdf.

countries and subnational jurisdictions as of August 12, 2021.[95] It would require broad agreement on details among countries.

GloBE would be based on financial income using the International Financial Reporting Standards (IFRS, used by many foreign countries) or other acceptable accounting methods (presumably including GAAP). A deduction would be allowed for a percentage of payroll and of assets (as yet unspecified), and then the residual would be subject to taxation to bring the effective tax rate up to 15%. GloBE also has an undertaxed payments rule, fulfilling a function somewhat similar to BEAT. (This undertaxed payments rule is also similar to the SHIELD proposal made by the Administration, which would replace the BEAT alternative minimum tax with the disallowance of deductions for payments to tax havens.) The undertaxed payments rule would impose a tax on payments to low-tax countries that are not subject to the income inclusion rule.

The proposal also addresses the coordination of GloBE with GILTI and BEAT. Although the preexisting GILTI rules could be maintained as a substitute in the United States (barring measures that substantially weaken GILTI), there would be issues when the U.S.-parented subsidiary is in turn in a country that applies the minimum tax to its own subsidiaries. The proposal also suggests that BEAT not apply to payments for entities subject to the undertaxed payments rule.

Minimum Taxes on Noncorporate Business Income

Imposing a minimum tax on noncorporate (pass-through) income could prove difficult for several reasons if the base is financial income. First, noncorporate firms' book income is not subject to the rules applicable to public corporations that must report their financial income to shareholders. Additionally, there is flexibility in book income measures, and some firms may not keep a full set of financial books. (A similar problem would arise with private corporations, many of which are small and owned by one person; even large corporations can be owned by one family.) If the minimum tax were limited to large firms, most pass-throughs would be excluded. Some limited partnerships and limited liability corporations can be very large, however. A minimum tax would also need to be coordinated with the existing individual alternative minimum tax, which includes pass-through businesses. One option is to require all firms of a certain size, however organized, to be taxed under the corporate tax.

A minimum tax based on adding back items to the tax base would be feasible for firms of any size, but it might be easier to add any additional preference items to the existing individual minimum tax for pass-throughs. Policymakers would have to consider treatment of the 20% pass-through deduction.

A third option is to exclude pass-through businesses from a minimum tax and limit the change to corporations of a certain size. This could encourage some firms, on the margin, not to incorporate to avoid the minimum tax.

[95] U.S. Department of the Treasury, "G7 Finance Ministers & Central Bank Governors Communiqué," press release, June 5, 2021, https://home.treasury.gov/news/press-releases/jy0215; OECD, "Members of the OECD/G20 Inclusive Framework on BEPS joining the *Statement on a Two–Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* as of 12 August 2021," https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-july-2021.pdf; and Italian G20 Presidency, "Third Finance Ministers and Central Bank Governors Meeting," Communiqué, July 9-10 2021, https://www.g20.org/wp-content/uploads/2021/07/Communique-Third-G20-FMCBG-meeting-9-10-July-2021.pdf.

Concluding Remarks

There is evidence that corporations pay taxes on profits at lower rates, on average, than the statutory rates. Some firms may pay little or no corporate income tax. In part, effective corporate tax rates are lower than statutory rates due to policy choices where the tax code is used to create various incentives. Firms can also reduce their taxable income through tax planning, including shifting income abroad, given the current rules for taxing foreign-source income. A minimum tax is one policy option for ensuring that all corporations or businesses pay some amount in taxes. An alternative to imposing a minimum tax is to reconsider the tax preferences and rules that allow taxes to fall below the statutory rate (such as lower taxes on foreign-source income and accelerated depreciation). If some tax preferences are deemed desirable to encourage an activity, then lower taxes are in part a consequence of heavy usage of those tax preferences.

In the past, an AMT was used in an attempt to ensure that all taxpayers with income contributed to tax revenues. The AMT system was complex. That complexity, combined with questions about its efficacy (although its effectiveness was reduced by policies that scaled back depreciation preferences) and the concern that minimum taxes may reduce the effectiveness of tax policy incentives or limit tax policy options for responding to economic downturns, led to its repeal after 2017. One option for imposing a minimum tax could be to reinstate some form of an AMT.

Corporations reporting high profits to shareholders while sometimes paying very little in corporate income taxes has led to interest in taxing book income. A minimum tax based on worldwide financial income could ensure that firms pay at least some minimum level of tax. Given current tax reporting requirements, large firms are already reporting data on their book-tax differences that could ease complying with a minimum tax.

Minimum taxes based on financial profits present a number of issues. In addition to the general policy concerns potentially associated with an AMT, an AMT that relies on book income could encourage firms to manipulate their financial accounts to reduce taxes, reducing the quality of information reported to shareholders. Structuring a book tax as an add-on minimum tax could avoid some of the traditional AMT complexities, namely those created when credits for AMT payments are carried over to offset future regular income tax liability. However, in the case of an add-on tax, general concerns that some have raised about using book income as a base for determining tax liability would remain.

As debates about minimum taxes continue, policymakers may consider a number of issues. For example, how will pass-through businesses be treated? What about multinational businesses? Is the tax consistent with the GloBE framework? These types of questions, and others, could present a number of conceptual and administrative challenges.

Appendix A. Glossary

Table A-1. Glossary

BEAT	The base and anti-abuse tax (BEAT) is an alternative minimum tax that applies to large, multinational corporations making substantial payments to foreign affiliates.
Book Income	Book income is reported on a company's financial or income statements. Public companies are required to disclose information on their financial performance on an ongoing basis.
Book-Tax Difference	The difference between financial (or book) income and income for tax purposes (also referred to as the book-tax gap).
Economic Income	Economic income is the sum of dividends and distributions paid and changes in the market value of a firm adjusted for inflation.
Financial Income	Financial income is synonymous with book income. Book income is reported on a company's financial statements.
GILTI	The current tax system imposes a 10.5% minimum tax on global intangible low-tax income (GILTI).
NIPA	The U.S. Bureau of Economic Analysis (BEA) produces measures of aggregate corporate profits (National Income and Product Accounts [NIPA] earnings). NIPA's corporate profits measure "represents the portion of total income earned from current production that is accounted for by U.S. corporations." NIPA earnings, by design, measure profits from current production.
Profits from Current Production	Profits before tax, sometimes referred to as book profits, adjusted for (1) an inventory valuation adjustment; and (2) a capital consumption adjustment.
Tax Expenditure	Tax expenditures include special credits, deductions, exemptions, exclusions, and tax rates that reduce corporate income tax collections. These provisions can support certain businesses and economic sectors and be incentives designed to encourage certain behaviors.
Tax Income	On the Schedule M-3, tax income is taxable income before any net operating loss deduction and special deductions.
Taxable Income	Income that is subject to the corporate income tax (also referred to as income subject to tax).

Appendix B. Comparing NIPA's Corporate Profits Before Tax and Corporate Taxable Income

Table B-1 uses information from the IRS and BEA to compare income subject to the corporate income tax to NIPA's profits before tax. This comparison highlights some items that are excluded from taxable income that appear in the NIPA income measure, which is sometimes referred to as "book profits."

Table B-1. Comparing Tax Income to NIPA's Profits Before Tax, 2018

Measure of Income	Amount ($billions)	Notes
Income Measures from Tax Returns		
Income Subject to Tax (Taxable Income)	$1,956.7	Income that is subject to the corporate income tax.
Net Income (Less Deficit)	$3,391.4	Net income includes statutory special deductions that are subtracted in determining taxable income. Statutory special deductions include deductions for net operating losses (NOLs), dividends received, and deductions for dividends paid. Net income also includes profits of certain pass-through entities (RICs and S corporations) whose profits are generally passed through to shareholders and taxed on individual income tax returns.
Total Receipts less Total Deductions	$2,329.3	Total receipts less total deductions differs from net income (less deficit) in that (1) it includes tax-exempt interest; and (2) it excludes constructive taxable income from related foreign corporations. Constructive taxable income from related foreign corporations is the sum of (a) income from controlled foreign corporations (CFCs) under Subpart F; and (b) a foreign dividend gross-up, or the foreign tax deemed paid by the foreign corporation that U.S. shareholders could claim as a foreign tax credit. This amount for total receipts less total deductions includes C corporations and entities legally organized as corporations whose income is not subject to the corporate income tax.
NIPA Profits Before Tax Computation		
Total Receipts less Total Deductions	$2,329.3	
Plus Income received from equities in foreign corporations and branches by all U.S. residents, net of corresponding payments	$521.7	To compute profits before tax on a national basis, an adjustment is made to include profits from the rest of the world.
Plus Adjustments for Misreporting on Income Taxes	$411.8	Adjustment made to account for underreported income and nonfiling of tax returns.
Plus Post-tabulation adjustments and revisions	-$145.0	Adjustments for various items, including adjustments (1) for tax treatment of intangible drilling costs (IDCs); (2) to expense all meals and entertainment; (3) for small business corporations for income that is passed through to shareholders; (4) to reflect a deduction for fines; and (5) for various other items.[a] The adjustment for IDCs is positive, while items listed in (2), (3), and (4) are negative adjustments. Other items are both positive and negative.
Plus interest payments of regulated investment companies (RICs)	-$239.7	RIC payments to shareholders obtained from interest receipts are treated as dividends, rather than interest, in the IRS data.

Measure of Income	Amount ($billions)	Notes
Plus bad debt expense	$120.7	Bad debt expenses are treated as a change in corporate assets, and not a reduction in profits from current production, in NIPA data. Thus, corporate financial accounting profits can differ from NIPA corporate profits, tending to be lower than NIPA corporate profits during periods when corporations report large bad debt expenses.
Plus adjustment to depreciate expenditures for intellectual property products	$160.7	Tax law allows for expensing of certain expenditures for intellectual property products (which consists of software; research and development; and entertainment, literary, and artistic originals). This adjustment treats these expenses as capital formation.
Plus income of organizations not filing corporate income tax returns	$84.9	Organizations not filing a tax return, whose income is included in NIPA's measure of corporate profits, include Federal Reserve banks, federally sponsored credit agencies, certain mutual financial institutions and cooperatives, and nonprofits that primarily serve business.
Plus other adjustments to receipts less total deductions	$99.3	Other adjustments add amounts paid in state and local corporate income taxes; add amounts to reflect for depletion on domestic minerals; make an adjustment to depreciate expenditures for mining exploration, shafts, and wells; and make an adjustment for disaster losses (NIPA treats disaster losses as a loss in capital; not a reduction in current income).
Less gains (net of losses) from the sale of property	$412.3	Net gains from the sale of fixed assets and securities are not income from current production.
Less dividends received from domestic corporations	$355.8	Dividends received by corporations are included in corporate receipts but are not part of current production.
Less income on equities in foreign corporations and branches (to U.S. corporations)	$251.7	Removes the income earned abroad by U.S. corporations such that income from current production is measured on a domestic basis.
Less cost of trading or issuing securities	$55.4	Tax accounting treats expenses for brokers' commissions as a reduction in future capital gains income, whereas NIPA income treats these expenses as a reduction in income in the current period.
Less excess of employer expenses over actual employer contributions for defined benefit pension plans	$9.5	Employer expenses for defined benefit employee pension plans include actual employer contributions, imputed employer contributions, and imputed interest for unfunded (or overfunded) actuarial liability.
Profits Before Tax	$2,259.0	NIPA's profits before tax

Source: NIPA Handbook, Chapter 13: Corporate Profits, updated December 2020; Table 7.16. Relation of Corporate Profits, Taxes, and Dividends in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service, revised July 30, 2021.

a. Through 2017, the adjustment to remove the Section 199 production activities deduction was another large (positive) item in the post-tabulation amendments and revisions. This provision was repealed effective 2018.

Author Information

Molly F. Sherlock
Specialist in Public Finance

Jane G. Gravelle
Senior Specialist in Economic Policy

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