A recent report released by the Institute on Taxation and Economic Policy (ITEP) concluded that 55 large companies paid no federal income taxes last year despite being profitable. President Biden cited this report in his April 28 address to a joint session of Congress.

The ITEP report bases its estimate of federal income tax payments on a figure reported in annual company financial statements: “current federal income tax expense.” This is only an *approximate* estimate of the federal income taxes a company actually pays in the current year for a variety of reasons. Actual corporate tax return information filed with the Internal Revenue Service (IRS) is confidential.

**ITEP’s methodology is a misleading measure of companies’ tax burden:**

The ITEP report methodology determines a company’s “effective” tax rate by dividing “current federal income tax expense” by “U.S. income” from its financial statement. Due to this methodology, the resulting rate is almost always less than the 21% federal corporate statutory tax rate and can be zero or negative in some cases.

Financial analysts generally regard the sum of “current federal income tax expense” and “deferred federal income tax expense” as the best measure of federal income tax liability on financial statement income because it accounts for differences in when income and loss are reported for tax and financial statement purposes.

**IRS and financial accounting rules differ in how income should be reported:**

Taxable income reported to the IRS differs from U.S. income reported to the Securities and Exchange Commission (SEC) on financial statements due to different measures of income and deductions. Key differences include:

- **Accelerated depreciation.** The ITEP report notes that at least 16 companies had lower taxable income than reported for financial statement purposes as a result of investments in plants and equipment. Supported by economists across the political spectrum, tax deductions for these types of investments are accelerated relative to financial statements to incentivize investment activity. As accelerated depreciation applies to nearly all investments in plants and equipment, it is likely all companies had lower taxable income from this provision, not just the 16 noted by ITEP.

- **Stock option expense.** The ITEP report notes that at least 12 companies had lower taxable income than reported for financial statement purposes as a result of an accounting difference for stock options. For financial statement purposes, companies account for the cost of stock options at the time they are granted based on an estimate of their value. However, for tax purposes, companies cannot deduct the cost of stock options as an expense in the year granted. Instead, the cost is spread over the vesting period and tax benefits are realized as the employee exercises the option.
options until they are exercised, when their actual value is determined. At that time, the value is deducted by the company and a corresponding amount of taxable income is recognized by the employee exercising the option. The current tax treatment of stock option expense ensures that the deduction is not claimed by employers until the income is realized and taxed to the employee; it is widely viewed as the correct treatment for tax purposes. The federal government raises tax revenue on stock options because the expense is generally deducted at a 21% federal corporate income tax rate and is taxable to the employee at a higher federal individual income tax rate, up to 40.8%.

- **Operating losses.** For financial statement purposes, an operating loss is fully recognized in the year of the loss and not in any other year. For tax purposes, companies can only use net operating losses to offset taxable income in other years. As a result, a company can be profitable in 2020, but reduce its 2020 tax liability by using a loss incurred in a prior year. The bipartisan CARES Act also provided a limited opportunity to use losses incurred in 2018 or 2019 in prior years, the benefit of which would be shown as a reduction in 2020 current federal income tax expense.

- **Tax credits.** The ITEP report notes that research credits or renewable energy credits reduced income tax for at least 10 companies in 2020. Tens of thousands of companies claim these tax credits, far more than the 10 identified by ITEP. Federal tax law provides tax credits to incentivize a range of activities, including incentives for innovation, clean energy, disadvantaged workers, affordable housing and distressed communities (e.g., the research credit, production tax credit and investment tax credit, work opportunity tax credit, low-income housing tax credit and new markets tax credit). In the absence of these tax credits, companies would less frequently engage in these activities. Because of the social value of these activities, President Biden has proposed that the financial statement minimum tax allow all tax credits.

**Many of these existing provisions have bipartisan support and, without them, our nation's companies would less frequently engage in these important economic activities.**

**The bottom line:** Even with the use of these common provisions and under the current tax system, large U.S. companies are responsible for the vast majority of corporate income tax payments.

In 2017, the latest year of available data, the 2,000 largest U.S. corporate taxpayers, representing 0.1% of all corporations, paid 85% of all corporate income taxes.³

---