Study finds largest US corporations avoiding billions in taxes

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27 October 2000

A study carried out by the Institute on Taxation and Economic Policy (ITEP), a liberal think tank based in Washington DC, reveals that large US companies are paying billions of dollars less in corporate taxes than federal law supposedly requires. The figures are quite staggering.

The report's authors observe that if the 250 corporations studied—whose income tax payments represent about 30 percent of the total amount of federal corporate tax receipts collected annually—had paid the full 35 percent corporate tax rate on their combined $735 billion in pretax profits from 1996-98, the government would have received $98 billion more than it actually did. How many hospitals, schools and roads could be built with $98 billion?

The three-year period studied by the ITEP was a heady time for US corporations and those who run them. They were making money hand over fist. Pretax corporate profits rose by a total of 23.5 percent over the three years. Federal corporate income tax receipts, however, grew only by one-third that pace—7.7 percent from fiscal 1996 to fiscal 1999.

The overwhelming majority of the companies examined by the study's authors paid far less than the statutory 35 percent corporate tax rate, the average rate for the 250 companies being only 21.7 percent. In fact, this average rate declined over the three years, from 22.9 percent in 1996 to only 20.1 percent in 1998.

Forty-one of the companies paid *less than zero* in federal income taxes in at least one year from 1996 to 1998. In the years they paid no income tax, the firms—most of them giants—made a combined $25.8 billion in pretax profits. “These companies generated so many tax breaks that they received outright rebate checks from the U.S. Treasury, totaling $3.2 billion,” write the study's authors. Eleven companies—Goodyear, Texaco, Ryder, El Paso Energy, MedPartners, Tenneco, Colgate-Palmolive, MCI Worldcom, Corporate Express, WestPoint Stevens and Kmart—enjoyed “negative tax rates over the entire three-year period.” Their after-tax income, thanks to the generosity of the US government, was actually *greater* than their pre-tax income! Almost half of the tax-break dollars went to just 25 companies, with General Electric leading the way. GE received nearly $7 billion in tax breaks over three years.

As an industry, oil companies enjoyed the lowest effective tax rate over the 1996-98 period, paying only 12.3 percent of their profits in federal income taxes. In fact, that figure is misleading, as their tax rates are sharply declining. By 1998 US oil companies, including some of the largest and most powerful corporations in the world, were paying only 5.7 percent of profits, one-sixth the statutory amount.

The revelation about the oil companies' particularly low tax payment came only days before the press was flooded with announcements of the massive third-quarter profits earned by the energy giants. The newly merged Exxon Mobil, for example, earned $4.49 billion in the three months ending September 30, more than double what Exxon and Mobil made in the same period a year ago as two separate companies. Texaco also more than doubled its profit of a year ago. Chevron “hit a grand-slam” in the third quarter, in the words of one analyst, tripling its profits over a year ago. Hess and Unocal also recorded sharply higher earnings.

Aside from oil, other low-tax industries included electronic and electrical equipment manufacturers, paper companies, transportation companies and auto companies. Only one industry, publishing, paid more than 30 percent of its profits over the three-year period.

Defense contractors enjoyed a bonanza in the early 1980s, under Ronald Reagan, paying only 6.3 percent of their profits over the 1981-84 period. Under Bill Clinton in 1998 the 12 largest defense contractors paid 11.8 percent of their profits.

Indeed, the report notes certain historical trends. Reagan's tax cut bill in 1981, which included a series of loopholes, opened the floodgates for corporate underpayment of income taxes. More than half of 250 companies, analyzed in a study done at the time, paid nothing or less in federal income taxes in the 1981-83 period. The ITEP report declares that a “Public outcry forced our elected officials in Washington, including President Reagan, to reverse course.” There may have also been some nervousness within the ruling elite about the continued ability of the government to finance its operations.

The Tax Reform Act of 1986 closed certain loopholes and by 1988 large corporations were paying 26.5 percent of their profits—almost double the rate of the early 1980s. (It was this same Tax Reform Act, incidentally, that cut the corporate tax rate from 46 to 34 percent.) In the 1990s, the trend again reversed, with corporate tax rates falling again (to an average of 20.1 percent of profits by 1998), tax breaks rising and the number of companies paying less than zero in taxes also climbing.

A corporate Alternative Minimum Tax was established in 1986 to assure that profitable companies paid something in taxes, no matter how many tax breaks they claimed. Laws enacted in 1993 (with Clinton in the White House and the Democrats dominating Congress) and 1997 (with Republican control of Congress) weakened the AMT, enabling almost as many companies to get rebates as now pay the Minimum Tax.

Every indicator points in the same direction. During the 1960s corporations paid one-third of the total income tax bill in the US; in the 1970s, 25 percent. Under Reagan, the percentage fell to 15 percent. It climbed again after the 1986 tax reforms, reaching a peak of 21 percent in 1994-96. It is presently falling again. Corporate taxes represented only 18 percent of the total in 1999 and are estimated to have fallen to only 17 percent for fiscal 2000.

Personal income tax payments grew by 28 percent and Social Security and Medicare payroll taxes grew by 22 percent in the 1996-98 period. Corporate income tax payments went up *only 8 percent* over the three years, and “actually fell from fiscal 1998 to fiscal 1999.”

How are corporations avoiding taxes? The ITEP report summary explains: “Companies use a variety of means to lower their federal income taxes, including accelerated depreciation write-offs [tax laws permit companies to write off their capital investments considerably faster than the assets actually wear out], tax credits for things like research and oil drilling, and tax breaks for doing business in Puerto Rico. GE continues to slash its tax bills every year through its leasing activities, where it essentially buys tax breaks from companies that have more than they can use.”

Another popular means of avoiding tax payments involves stock options. “When stock options are exercised, corporations can take a tax deduction for the difference between what employees pay for the stock and what it's worth [presumably a greater amount].” In other words, for tax purposes stock options are considered a business expense, even though they are not treated that way when companies report profits to shareholders.

The report notes that “Microsoft led the pack with $2.7 billion in stock-option tax benefits” in the 1996-98 period. In all, the 250 companies studied lowered their taxes by a total of $25.8 billion over the three years via the stock option route.

The ITEP study further notes that the Treasury Department's assistant secretary for tax policy, testifying before a House committee last year, asserted that “corporate tax shelters continue to be a substantial and ongoing problem” and that “many abusive transactions remain undiscovered and numerous new transactions are created all the time.” US corporations also shift taxable US profits off-shore to lessen their tax burden. In general, companies devise tax-avoidance devices far more rapidly than an undermanned Internal Revenue Service, under pressure from a business-friendly Congress and White House to “get off the backs” of US companies, can detect and combat them.

An article published in the *New York Times* in February (“Corporate Taxes Fall, but Citizens Are Paying More”) reported the comments of Larry Langdon, an IRS official and former tax director at Hewlett-Packard: “The tax department [in a corporation] is viewed more as a profit center and a place that has more of an obligation to more or less aggressively reduce the tax burden.” Langdon noted that in his days in private industry company executives measured any proposal to lower its tax bill by the damage it would do the company's image if it were exposed in the media.

The article continued: “Now, he said, corporate finance and tax officials are under such pressure to increase profits that image is hardly a consideration in whether to cheat on taxes.”