

## **The Corporate Tax Void: Record High Profits and Record Low Taxes**

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Tax season is upon us. But, at a time when most households are paying taxes, the General Accounting Office (GAO) just reported that most corporations do not and that 95% of corporations pay less than 5% of their income in taxes. In response, the Chamber of Commerce called these figures misleading since supposedly many corporations did not earn any income. The GAO's report indicates that it ain't so. The corporations that did not pay taxes between 1996 and 2000 appeared increasingly profitable. Further, since 2000, corporate taxes dropped sharply, while profits rose decisively. And rising profits came out of workers' hide since overall wage growth lagged.

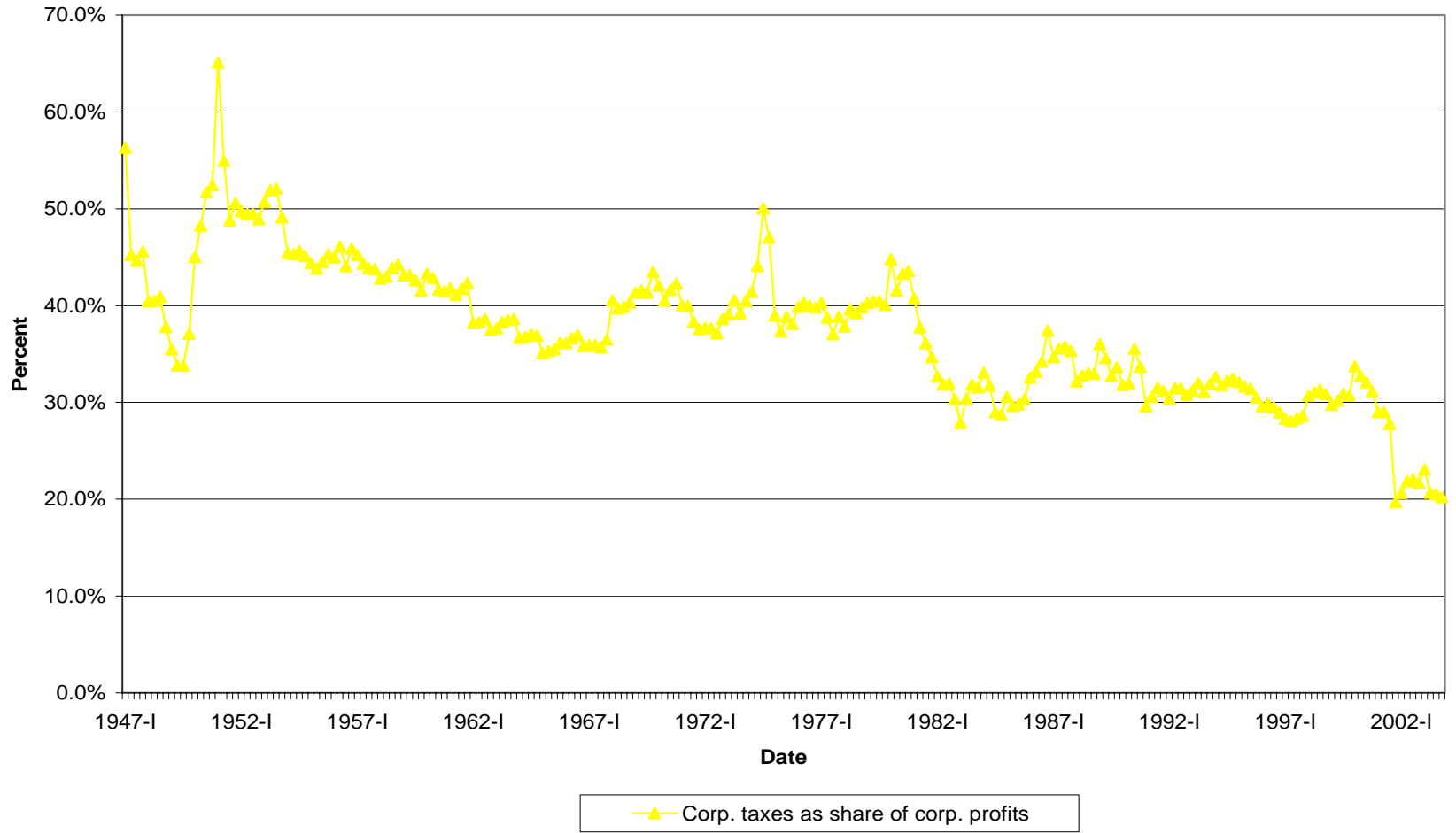
The Chamber of Commerce was quoted on CNN's Moneyline on April 06, 2004, arguing that many companies that are not paying taxes did not turn a profit. This may be true for some, but the report contradicts this assertion. Most strikingly, the share of corporations that paid no taxes constituted a rising majority amid a strengthening economy. It would be an indictment of the U.S. economic model if truly more than half of all corporations were not making a profit, and did so increasingly when the U.S. was enjoying a stellar economic and stock market performance. Against this backdrop, the fact that a growing majority of large financial service corporations did not pay taxes seems especially contradictory.

The GAO's figures on corporate income cast further doubt on the Chamber's claim. Large corporations with no tax liabilities reported average gross receipts of \$182 million in 2000. Thus, they had larger gross receipts than the corporations that had some tax liabilities. Although gross receipts overstate earnings, many large corporations with no taxes actually appear to have had a cost advantage over corporations that did pay taxes. For instance, financial service firms that paid no taxes paid only half in interest relative to their revenues of what financial services firms with tax liabilities paid.

Moreover, the GAO's figures also suggest that the earnings outlook improved faster for companies that paid no taxes than for those that did. Corporate income became concentrated among corporations that paid no taxes from 1996 to 2000.

The fact that a growing share of U.S. corporations is not paying taxes is not new. A GAO report from 1999 showed that from 1989 to 1995 a growing share of U.S. corporations had no tax liabilities. Consequently, it seems reasonable to assume that the trend has not reversed since 2000. Another indication is that the share of corporate taxes relative to corporate profits has sharply declined since then (figure 1), reaching its lowest level since WWII. This was the sharpest drop in twenty years.

**Figure 1: Corporate Taxes as Share of Corporate Profits**



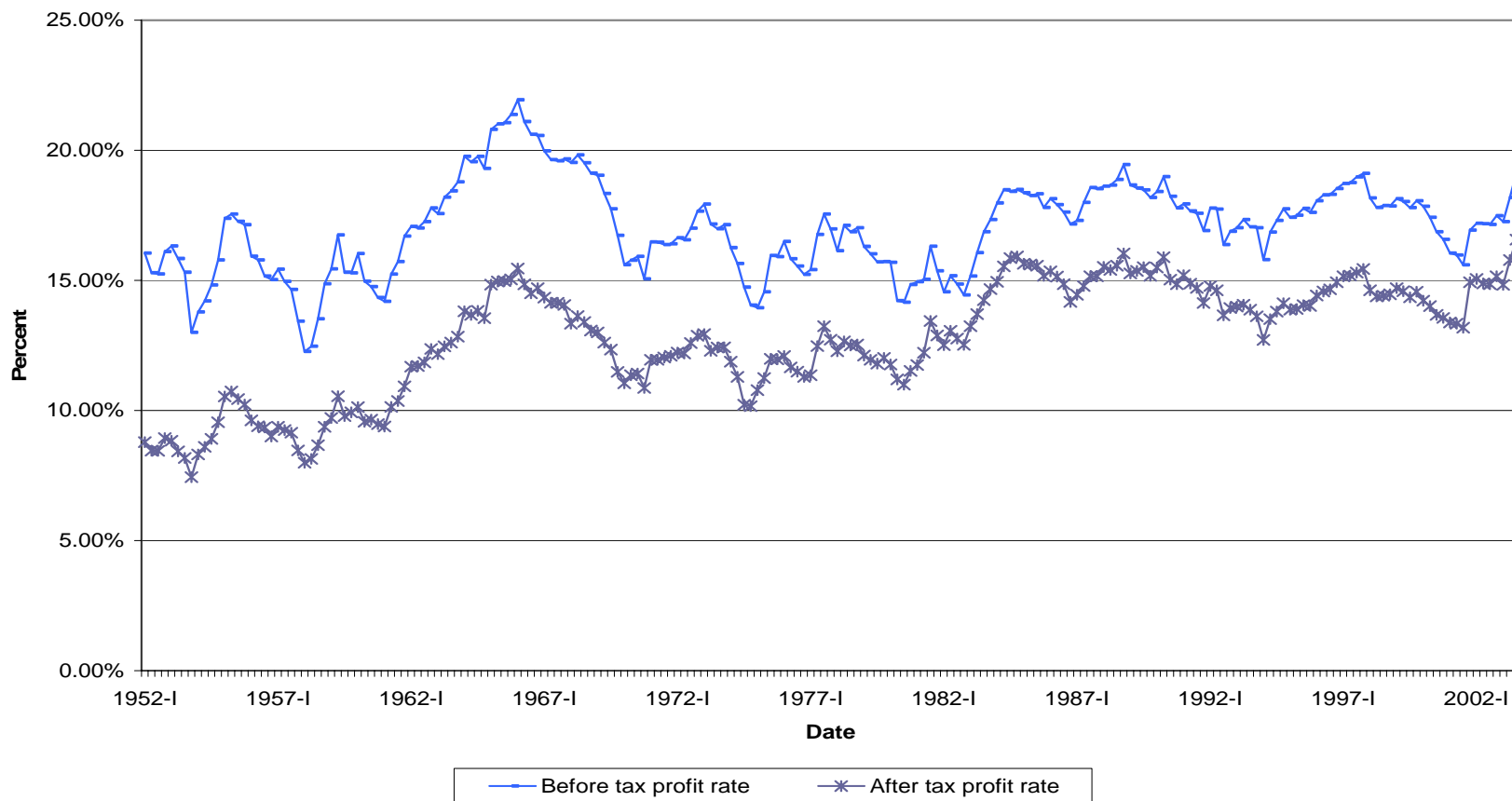
Source: Bureau of Economic Analysis (BEA), National Income and Product Accounts, Washington, D.C.: BEA.

One may suspect that the decline in corporate taxes was due to the weak economy. However, corporate profits actually increased during this recovery. Corporate profit rates have been on a growing trajectory for decades (figure 2). Much of the growth in the rate of return that corporations earn on their assets has been associated with the growing emphasis on shareholder value creation and the rising influence of institutional shareholders since the early 1980s. Profit rates declined slightly in the late 1990s as a booming labor market pushed employment and wages higher, eating into corporate profits. This ended with the weak economy after 2000. Economic growth recovered, while wages and employment did not, thus boosting profits. Thus, corporate profit rates recovered more quickly than in prior recoveries. This is especially true for the more relevant after tax profit rates, which reached record highs in 2003.

The rise in profits in this recovery came at the expense of worker's compensation to a larger degree than in previous recoveries (figure 3). Profit rates increased because corporations could claim a larger share of national income, compared to previous recoveries, for themselves.

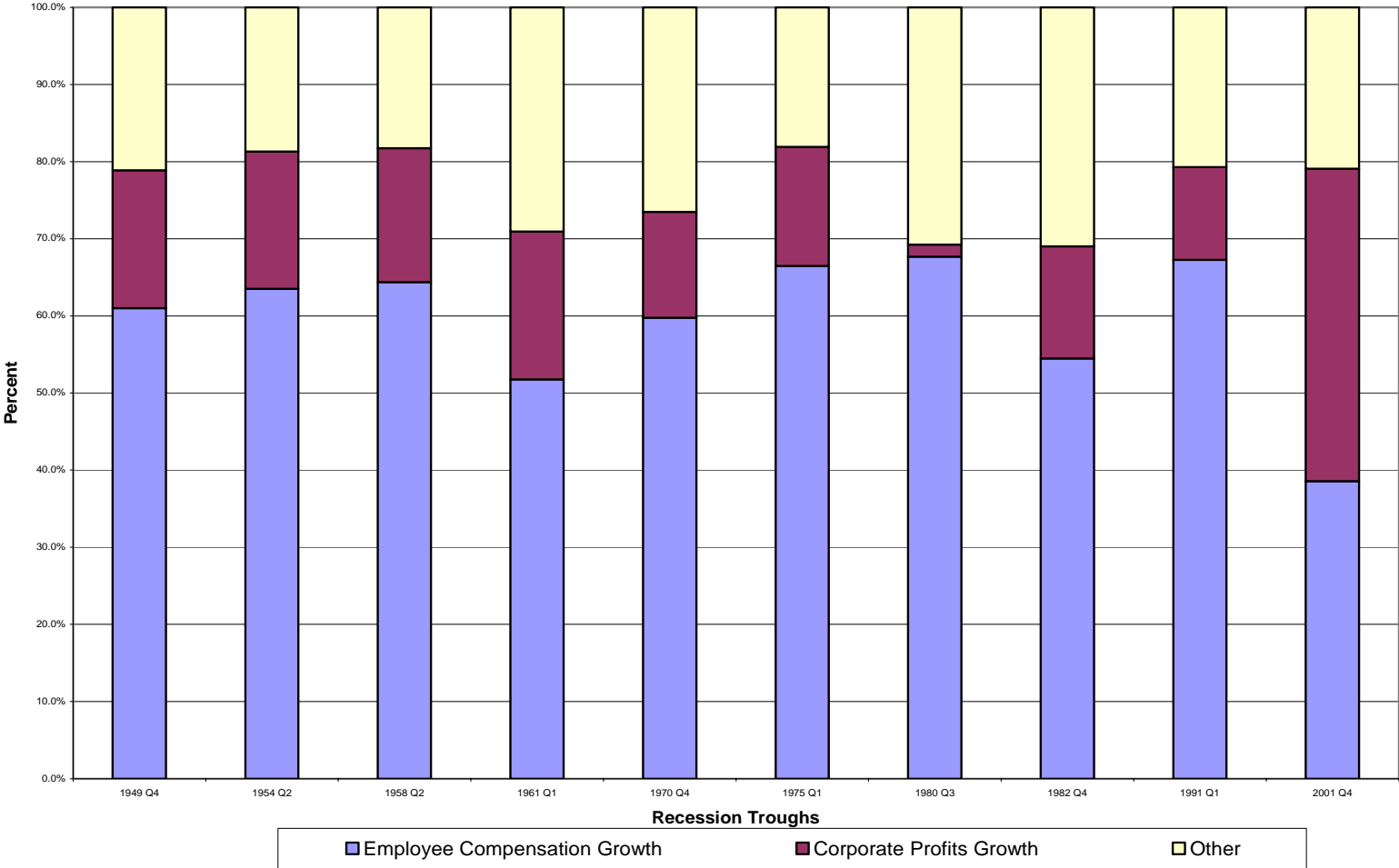
The lack of corporate taxes does not appear to be a result of lack of income gains or profits for corporations. Quite the contrary! At a time when corporations are raking in record profits, their tax payments relative to their profits have fallen to historic lows. Part of this story is the fact that the majority of corporations pay no or very low taxes. As budget deficits loom and as the nation needs to address growing social needs a return to tax fairness between workers and corporations seems in order.

**Figure 2: Before and After Tax Profit Rate**



Notes: Profit rates are corporate profits plus net interest relative to tangible assets. Where data for corporate assets are missing, they are extrapolated using the growth rate for assets for the nonfarm nonfinancial corporate sector. Sources are the Bureau of Economic Analysis (BEA), National Income and Product Accounts, Washington, D.C.: BEA; the BEA, Fixed Assets, Washington, D.C.: BEA; and the Board of Governors, Federal Reserve System (BOG), Flow of Funds Accounts of the United States, Washington, D.C.: BOG.

**Figure 3: Components of National Income Growth Over 8 Quarters Following Recession Troughs**



Source: Bureau of Economic Analysis, National Income and Product Accounts, Washington, D.C.: BEA.