MarketWatch

TaxWatch

Nov. 3, 2011, 5:10 a.m. EDT

Big profits, zero taxes for large U.S. companies

Tax rate for 280 profitable firms ranges from 41% to negative 58%: study

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SAN FRANCISCO (MarketWatch) — The official federal corporate income tax rate in the U.S. is 35%, but plenty of the nation's largest publicly traded companies are paying no taxes — even getting money back from the government in some cases — in years when they reap big profits, according to a new report.

Thirty of the 280 Fortune 500 companies studied paid zero in federal income taxes or enjoyed tax rebates in 2008, 2009 and 2010, according to the study by the left-leaning Citizens for Tax Justice, a Washington-based nonprofit research and advocacy group, and the Institute on Taxation and Economic Policy, a nonprofit, nonpartisan research group.

And 78 of the 280 companies paid nothing in federal income taxes or enjoyed a tax rebate in at least one of those years. Those 78 companies, including General Electric Co. (NYSE:GE) and Pepco Holdings Inc. (NYSE:POM) , earned a total of $156 billion in pretax U.S. profits in the years they paid no income tax, yet received so many tax breaks that they reported negative taxes — a total of negative $22 billion, the study said.

A tax rate as low as -58%

The study comes at a time when taxes are a hot topic in the U.S. As Occupy Wall Street protesters decry the income disparity between the 1% and the 99%, a super committee of Washington lawmakers is trying to come up with ways to slash the nation's massive deficit. And as billionaire investor Warren Buffett calls for higher taxes on the rich, some Republican presidential candidates are calling for a flat tax and a lower corporate tax rate. Read more: Perry flat tax vs. Cain 9-9-9

"Right now there's an important debate going on about whether everyone pays their fair share," said Matthew Gardner, executive director of the Institute on Taxation and Economic Policy.

The question U.S. policymakers should answer is "Are the biggest and most profitable companies doing business in the U.S. paying federal taxes on their U.S. income?" he said. "Is the 35% corporate income tax rate working as well as it should? This study demonstrates unequivocally it is not."

For the three-year period, the average effective tax rate for all 280 companies was about 19%, but rates varied widely by company, from a low of negative 58% for Pepco Holdings to a high of 41% for Coventry Health Care Inc. (NYSE:CVH) , the study said. GE's effective tax rate for that period was negative 45.%. Read the full report here

For the 30 companies that paid no taxes or got rebates, their effective tax rate averaged negative 7% in that period. At the other end of the spectrum, 71 companies paid an average effective rate of 32%. Another 67 companies paid an average effective tax rate of zero, the study said.

To come to their findings, the study's authors focused on companies' 10-K filings — public financial statements filed with the Securities & Exchange Commission that include current federal income taxes. The report focuses solely on companies that reported a profit in each of the years 2008, 2009, 2010.

Some of the companies disagree with the findings. "The report is inaccurate and distorted," said Kenny Juarez, director of financial communications for General Electric. "GE paid billions of dollars in taxes in the United States over the last decade, and we expect our overall tax rate will be approximately 30% in 2011."

Pepco Holdings said in an emailed statement: "PHI pays all its required taxes [and] takes seriously its responsibility to adhere to legal tax requirements and its fiduciary responsibility to its customers and shareholders to minimize costs where possible."

Big tax subsidies

The study also looked at tax subsidies — the difference between what a company would have paid if it paid a 35% rate on its profits and what it did pay. In the three years studied, the 280 companies earned a total of almost $1.4 trillion in pretax profits in the U.S. At a 35% rate, the tax bill would have been $473 billion, but as a group the companies paid about half that.

For all 280 companies, tax subsidies totaled almost $223 billion for the three-year period, and 25 companies got more than half of that total.

With an $18 billion subsidy for the three-year period, Wells Fargo & Co. (NYSE:WFC) topped the list.

In response to the report, the bank said that "significant losses" related to its purchase of Wachovia in 2008 reduced its taxable income. "For example, we recorded losses in excess of $40 billion on purchased credit-impaired loans," said Ancel Martinez, a Wells Fargo spokesman, in an emailed statement. Those losses "are reflected as a deduction on our tax return, which therefore reduced income subject to tax." He also said the company paid more than $30 billion in state and federal income tax in the past 10 years, plus billions more in other types of taxes.

Meanwhile, some critics contend that calculating a company's tax bill from its regulatory filings isn't accurate. "Company corporate tax records are secret," said Chris Edwards, director of tax policy studies at the libertarian Cato Institute, in an email. The study's authors "would not have access to how much actual tax particular companies pay in particular years. Only the IRS, the company, and its accountants do."

Edwards said that when he worked as a tax manager at PricewaterhouseCoopers, he had access to many corporate returns. "I was amazed by the often large, even huge, differences between what the financial statements say and what the tax returns say. There is nothing nefarious about this; it's just that the accounting for the two is different," he said.

Still, the report includes a response to this claim. "The federal current tax expense [reported in the company's financial statements] is just exactly what the company expects its current year tax bill to be when it files its return," the report said.

Because the financial statements are calculated early in the year, and the tax return usually is not filed until September, “things will be found that weren’t accounted for in the financial statement income tax provision, and numbers that were estimated in February will be refined for the actual return,” the report said.

“Those small differences will be included in the following years’ current tax expense, but the impact on our calculations is minimal (especially because we look at the rates over a period of years),” the report said.

“If the differences in any one year were material,” the report said, “accounting rules would require the company to restate the prior year financials.”

Corporate tax breaks

Accelerated depreciation on capital investments, and industry-specific tax breaks — for research and development, making video games and movies, drilling for oil and gas, and for ethanol production, among others, — are two means by which companies reduce their tax hit.

And there are a couple of legal tactics companies can use to receive what amounts to a tax rebate, said Robert McIntyre, director of Citizens for Tax Justice.

In some cases, companies can carry back excess tax breaks to earlier years to receive a refund for taxes paid in those years, he said.

Here’s another way: Sometimes companies calculate their taxes based in part on an “uncertain tax position” — a deduction, say, that the IRS may or may not accept as a valid claim. The company makes the claim on its tax return, but can’t log the claim on its own books until the IRS says the claim passes muster, a decision that could take years. If the IRS sides with the company, that tax benefit is then realized on the company’s books, appearing as a rebate of taxes paid in the year the IRS made its decision, McIntyre said.