

Tax Talk

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Open Season on Corporate Tax Returns

I wasn't a tax lawyer 26 years ago when the Tax Reform Act of 1986 was passed. I paid no attention to our leaders' debates and missed the chance to engage with them as they established the tax policy that would guide our country through the 1990s and into the new century. I do not intend to miss the debate this time around, and I am hopeful that meaningful changes will occur sooner rather than later.

When Congress undertakes tax reform this time around, it should not overlook debating the merits of making portions of major corporate income tax returns open to the public. I don't mean making entire tax returns public, of course, but disclosing enough information to reconcile how corporations that are very profitable, according to the information they have filed with the Securities and Exchange Commission can avoid paying U.S. income taxes. Such public disclosures would make corporate financial and tax accounting differences easier to reconcile and would also help policy-makers and the public understand the policy choices reflected in the United States' corporate income tax system.

Corporate tax returns have not always been confidential. The first corporate excise tax (a precursor to today's corporate income tax) was imposed in 1909 and provided that the returns would be public records.¹ Public disclosure of both individual and corporate returns expanded and contracted through the next decades, but it was not until the 1970s that the confidentiality for corporate returns that we now take for granted came into being.

One of the issues that was revealed during the Watergate scandal was the Nixon White House's considerable interest in using the Internal Revenue Service for partisan political purposes. Specifically, the White House sought to have people on its "enemies' list" audited and harassed.² To its credit, the IRS did not cooperate: an investigation by a congressional Joint Committee on Internal Revenue Taxation found no evidence that the IRS had treated taxpayers on Nixon's enemies' list unfairly because of their political views or activities.

It was in this environment that § 6103 of the tax code was passed. Section 6103 prohibits the disclosure of most information found on a tax return and provides for civil and criminal penalties if unauthorized disclosure occurs. This section is one of the

longest in the Tax Code, and authorized disclosures are narrowly tailored. Even shareholders of public corporations who are permitted to view information included on the corporation's tax returns are not authorized to disclose that information. If a person owns a large enough stake in a corporation—set at 1 percent or more of the outstanding stock—that shareholder can see the corporation's return information.³ But the law prevents that same shareholder from disclosing that information to others.⁴

I do not own anywhere near 1 percent of a major U.S. corporation—or any corporation for that matter. But I do own a little (very little) GE stock in an IRA, and, therefore, I followed with interest last year's media coverage about GE's 2010 tax bill. The media gave conflicting reports about whether GE paid any U.S. corporate income tax for 2010 on its profit of \$14 billion worldwide. Some reports stated that GE paid no taxes, and others implied that the \$3.2 billion tax benefit reported on GE's financial statement was a tax refund. The confusion is understandable, because the reporters were looking at GE's financial information (publicly filed in accordance with securities law), not at the company's tax return (which is not public information).⁵ The documents are written for different purposes and use different accounting rules; figures included in one document do not match up with figures in the other.

If a company's tax return is available, however, once you find the right form and line,⁶ it is relatively simple to figure out the amount of tax the company has paid. But if all you have to look at are the financial reports required under the securities laws, the forms will not show how much tax was actually paid on the federal income tax return.

This discord between financial accounting and tax records has been the subject of growing discussion over the years and has prompted several experts to call for public disclosure of certain information reported on corporate tax returns as a way to increase the transparency of a corporation's tax status. In 2002 and 2003, in response to the various accounting scandals at the time, Sen. Charles Grassley (R-Iowa), a high-ranking member of the Senate Finance Committee, suggested that certain corporate income tax information should be made public. In 2006, Mark Everson, the IRS commissioner at the time, repeated that suggestion, citing the tension that results from using one accounting system for taxes (when a corporation is motivated to mini-



mize income) and another for financial statements (when the motivation is to maximize income).⁷

President Obama's recently issued "Framework for Business Tax Reform" calls for improved transparency and fewer accounting gimmicks to "reduce the gap between book income, reported to shareholders, and taxable income, reported to the IRS."⁸ Certainly one way to achieve this goal is to make information about that taxable income available to the public.

Some public corporations pay a lot of U.S. corporate income tax, despite bold efforts not to pay that much. Efforts to shift income overseas to jurisdictions that have low taxes or no taxes only work under the right conditions, such as with assets that can be easily moved. There may even be corporations that intentionally decline to spend thousands of dollars in tax planning efforts to reduce their taxes by, for example, reorganizing some businesses as pass-through entities. Making public the information about which corporations are paying taxes to the United States might not be objectionable to, and perhaps would even be welcomed by, those corporations that already pay significant sums.

Even corporations that have successfully organized their affairs in a way that minimizes their U.S. corporate income tax burden could benefit from greater disclosure. In my experience, I have found most tax planning and avoidance strategies followed by major U.S. corporations to be legal under the existing corporate tax laws; these entities are constantly being audited want to avoid a tax scandal. There should be no shame in taking advantage of every tax break that exists. Indeed, many would argue that a public corporation has an obligation to its shareholders to pay the least amount of money legally possible in income taxes in order to maximize shareholders' profits. But still, the public perception of seeing large, profitable corporations paying little or no U.S. income taxes rubs many Americans the wrong way.

However, making enough return information public should make it clear how large, profitable corporations are able to reduce or eliminate their income tax burdens legally. Such disclosures could help defuse the rhetoric that often suggests that something improper is going on with corporate tax returns. It also would make it easier to explain how businesses can use the existing tax code to bring down their tax obligations. Armed with this information, perhaps we could then advance the public debate to whether a tax system that rewards businesses for engaging in elaborate tax planning is the type of tax system we want.

It has been 26 years since we have had major tax reform, and it is long overdue. The U.S. Chamber of Commerce is calling for business tax reform, as are major corporations, the President, and members of Congress on both sides of the aisle. Most politicians

agree that our current corporate income tax rate of 35 percent is too high, and that the tax code is filled with too many loopholes. Simplifying the code by eliminating tax expenditures and broadening the tax base is a popular suggestion and may be a good place to start. However, when Congress begins its debate, it should not overlook making public portions of corporate income tax returns that heretofore have been protected from disclosure. If properly selected, this limited information will help policy-makers and the public understand how corporations can be extremely profitable while also achieving a surprisingly low effective corporate income tax rate. By demonstrating how the policy choices reflected in the tax code play out on corporate returns, we may improve the debate surrounding corporate income tax policy. With a little luck, such openness would result in a fairer tax code that enables our country's corporations to stay competitive in the world market. **TFL**

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Endnotes

¹David Lenter et al., *Public Disclosure of Corporate Tax Return Information: Accounting, Economics, and Legal Perspectives*, 56 NAT'L TAX J. 4 (Dec. 1, 2003).

²U.S. Congress, Joint Committee on Internal Revenue Taxation, *Investigation into Certain Charges of the Use of the Internal Revenue Service for Political Purposes*, JCS 37-73, 12 (Dec. 20, 1973).

³26 U.S.C. § 6103(e)(1)(D)(iii).

⁴26 U.S.C. § 6103(a)(3).

⁵A description of how the story broke and was reported can be found at Allan Sloan et al., *The Truth About GE's Tax Bill*, available at features.blogs.fortune.cnn.com/2011/04/04/the-truth-about-ges-tax-bill/?iid=EL (April 2011).

⁶For 2011, it is Form 1120, Line 31.

⁷See Mary Dalrymple, *IRS Suggests Publicizing Corporate Returns*, Associated Press (March 15, 2006) available at www.usatoday.com/money/companies/2006-03-15-corporate-returns_x.htm.

⁸The President's Framework for Business Tax Reform, A Joint Report by the White House and the Department of the Treasury (February 2012).