GAO Highlights

Highlights of GAO-13-789, a report to congressional requesters

September 2013

CORPORATE TAX EXPENDITURES

Evaluations of Tax Deferrals and Graduated Tax Rates

Why GAO Did This Study

Congress and the administration are reexamining tax expenditures used by corporations as part of corporate tax reform. These tax expenditures—special exemptions and exclusions, credits, deductions, deferrals, and preferential tax rates—support federal policy goals, but result in revenue forgone by the federal government.

GAO was asked to examine issues related to certain tax expenditures. This report uses GAO's tax expenditures evaluation guide to determine what is known about: (1) the deferral of income for controlled foreign corporations; (2) deferred taxes for certain financial firms on income earned overseas; and (3) the graduated corporate income tax rate. GAO combined the two deferral provisions for evaluation purposes.

GAO's guide suggests using five questions to evaluate a tax expenditure: (1) what is its purpose and is the purpose being achieved; (2) does it meet the criteria for good tax policy; (3) how is it related to other federal programs; (4) what are its consequences for the federal budget; and (5) how is its evaluation being managed? To address these questions, GAO reviewed the legislative history and relevant academic and government studies, analyzed 2010 Internal Revenue Service (IRS) data, and interviewed agency officials and tax experts.

What GAO Recommends

GAO made no recommendations. Treasury, IRS, the Joint Committee on Taxation, and external experts provided technical comments that were incorporated, as appropriate.

View GAO-13-789. For more information, contact James R.White at (202) 512-9110 or whitej@gao.gov

What GAO Found

Deferral: Both deferral tax expenditures confer the benefit of effectively reducing taxes by delaying the taxation of certain income of foreign subsidiaries of U.S. corporations until it is repatriated to the U.S. parent as dividends.

1. While views on the purpose of deferral have changed over time, currently, it is often viewed by experts as promoting the competitiveness of U.S. multinational corporations. Some experts argue that this view is too narrow. For example, this definition of competitiveness ignores the effect on other corporations that cannot use deferral, such as those that are purely domestic or export without foreign subsidiaries. Further, it ignores impacts on the wider economy.
2. Good tax policy has several dimensions. By delaying the tax on foreign source income, deferral could distort corporate investment and location decisions in a way that lower taxes, but favor less productive activities over more productive ones. Informed judgments about deferral's effect on the fairness of the tax system cannot be made because who benefits from deferral, after accounting for such factors as changes in prices and wages, has not been determined. However, there is widespread agreement among experts and the Internal Revenue Service (IRS) that deferral adds complexity to the tax code.
3. GAO did not identify other federal spending programs that provide similar support to U.S. multinational corporations.
4. Joint Committee on Taxation (JCT) 2011 estimates show relatively modest consequences for the federal budget.
5. No federal agency has been tasked with evaluating deferral.

Graduated corporate income tax rate schedule: The graduated tax rates lower tax rates for corporations with less than $10 million in taxable income.

1. The purpose of the graduated corporate income tax rate schedule is viewed by the sources GAO reviewed as supporting small businesses. However, evidence is mixed on whether it achieves this purpose. The tax rates may not be well targeted toward supporting small businesses because corporations that are large in terms of assets and gross receipts may have taxable income that is small enough to qualify for the rates.
2. The economic efficiency of the graduated rates depends on whether they correct for a market failure. This includes too few small businesses forming, given their potential for profit and innovation, which offsets the possible distortions from its advantaging one type of business organization over others. GAO did not identify any studies of the efficiency effects or those that specifically estimate the distribution of the benefits from the graduated rates. According to IRS staff, while the graduated rates present little complexity, some evidence of tax planning to avoid higher rates has been found.
3. The graduated rates may be related to a number of federal spending programs also targeted to small businesses.
4. JCT 2011 estimates also show modest consequences for the federal budget.
5. No federal agency has been tasked with evaluating the graduated rates.