

Issue Brief

OCTOBER 7, 2021

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What's the Deal With Book Taxes?

What Is Book Income?

- Book income is a form of financial reporting that adheres to Generally Accepted Accounting Principles (GAAP)
- Publicly-traded companies are responsible for reporting book income to their investors and shareholders
- GAAP standards are developed by the [Financial Accounting Standards Board \(FASB\)](#), a private sector non-profit organization that is “recognized by the U.S. Securities and Exchange Commission as the designated accounting standard setter for public companies”
- According to the [Joint Committee on Taxation \(JCT\)](#), the primary purpose of book income (used interchangeably with “financial reporting” throughout this brief) is to “provide information about a company to investors and creditors”
 - This is notably different from taxable income (or “tax reporting”), which may differ significantly from book income (or “financial reporting”) because taxable income is determined by lawmakers and regulators through the Internal Revenue Code

How Do Book Income and Taxable Income Differ?

- There are several ways book and taxable income can differ in a given year for a given company; some differences are temporary and some are permanent
- The following table includes some major book-tax differences but is *not* an exhaustive list by any means:

Table I: Book Income vs. Taxable Income, Temporary and Permanent Differences

Temporary Differences (which smooth out over time)

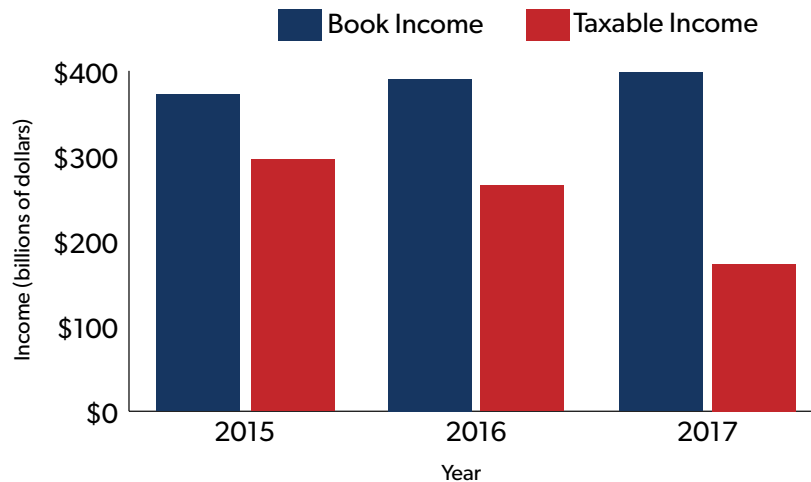
<i>Type of Income/Expense</i>	<i>Book vs. Tax Difference</i>
Capital investments (e.g., machinery, equipment, software)	The cost of capital investments can often be recovered more quickly for tax purposes than they are recorded for book purposes (reducing taxable income relative to book income in the short term; for more: NTU Foundation)
Net operating losses (NOLs)	NOLs can be carried forward, offsetting liability in future tax years; this could lead a company that had losses in prior years but a profit in the current year to report book income that is higher than taxable income (for more: NTU Foundation)
Foreign-source income	"[B]ook foreign-source income reflects distributions out of current and previously taxed income, while tax foreign-source income reflects dividends not already taxed and certain income, called Subpart F" (source: CRS ; emphases ours)
Stock-based compensation	Stock-based compensation is typically recorded as a book expense when it is granted and as a tax expense when it is exercised (reducing taxable income relative to book income in the short term; source: CRS)
Bad debts	"[A]n estimate of [bad debts] must be accrued for financial statement purposes while no tax deduction generally is taken until an account is actually written off" (source: JCT)

Permanent Differences (which do not smooth out over time)

<i>Type of Income/Expense</i>	<i>Book vs. Tax Difference</i>
Business tax credits	The largest three business tax credits are 1) the research credit, 2) the low-income housing credit (LIHTC), and 3) the renewable electricity production credit (PTC); credits reduce taxable income on a permanent basis relative to book income (source: JCT)
Meal and entertainment expenses	Companies may record meals and entertainment as expenses for book purposes, but are limited in how they can deduct meal expenses for tax purposes (and are generally disallowed from deducting entertainment expenses; source: JCT)
Interest income from tax-exempt bonds	Companies may exclude interest income from certain tax-exempt bonds for tax purposes, but would record this income for book purposes (source: JCT)

- Book and taxable income differences can be significant; the following chart illustrates book-tax differences for 50 large corporations from 2015-2017, according to [JCT analysis](#) of IRS data:

Book vs. tax income for 50 large corporations, 2015-2017 (JCT analysis of IRS data)



- Of note, the significant changes to corporate taxation under the Tax Cuts and Jobs Act (TCJA) could account for the significant reduction in taxable income in 2017
 - Or, as CRS has [written](#), TCJA “changed the tax treatment of multinationals, which may explain the significant book-tax difference in 2017, the year before many of the law’s changes went into effect. Firms may have recognized commitments to larger dividend payments from foreign affiliates for book purposes but delayed paying those dividends until 2018, when dividends became exempt.”

Why Do Some Policymakers Want to Tax Book Income?

- Some leading policymakers, including **President Joe Biden** and **Sen. Elizabeth Warren (D-MA)**, have proposed either minimum taxes or surtaxes on book income
- President Biden [refers](#) to “significant gaps in current tax law,” “offshoring incentives,” and “a variety of allowances” under current law which create differences between book and tax income that must be taxed
 - As noted above, what the President and his administration often fail to discuss is that the “gaps” and “allowances” they critique are often the result of temporary differences and/or provisions of the code that have earned widespread support from policymakers
 - The Biden administration implicitly acknowledges this by allowing companies to account for NOLs, previous book income taxes, and business tax credits in their calculation of book tax liability (more on the Biden proposal below)
- Sen. Warren (along with Sen. Angus King (I-ME) and Rep. Don Beyer (D-VA)) [frames](#) the issue as “corporate double dealing” that “exploit[s] a host of loopholes, deductions, and exemptions”
 - While some book-tax differences could be attributable to “aggressive positions for either book or tax purposes” (more from JCT [here](#)), it bears repeating: many book-tax gaps are the result of either timing differences or popular provisions of the code
- An influential series oft cited by book tax proponents is the Institute on Taxation and Economic Policy’s (ITEP) [series](#) on corporations that reported paying no federal corporate income taxes in a given year. Much like the Biden and Warren critiques, the series paints with a broad brush and characterizes all book-tax differences that are a result of tax policy -- including NOLs, accelerated depreciation, and tax credits -- as “loopholes.”

What Are the Major Proposals to Tax Book Income?

- The two major proposals to tax book income come from President Biden and Sen. Warren; here are the details of those plans:

	Biden Book Tax Plan (April 2021)	Warren Book Tax Plan (August 2021)
Base	Companies with net book income of \$2 billion or more (~200 companies, according to the Biden administration)	Companies with net book income of \$100 million or more (~1,300 companies, according to Sen. Warren)
Rate	15% of book income	7% of book income above \$100 million
Full Credit for Regular Tax Liability?	Yes, regular tax liability reduces book tax liability dollar for dollar	No, regular tax liability reduces book tax liability by 33 cents on the dollars (i.e., companies receive a 33% credit for regular tax liability)
Credit for Business Tax Credits?	Yes	No
Credit for Foreign Tax Credits?	Yes	No
NOL Carryforwards Allowed?	Yes (via Urban Institute analysis of then-candidate Biden's plan)	No
Book Tax Allowed to Offset Future Regular Tax Liability?	Yes, but "credit [can] not reduce tax liability below book tentative minimum tax in that year" (via Treasury's Green Book)	No
Estimated Revenue Impact	\$148 billion to \$184 billion over 10 years (Treasury Department ; PWBM)	\$700 billion over 10 years (Sen. Warren estimate)

What Are Some Potential Consequences of a Book Minimum Tax?

Economic Consequences

- A Tax Foundation [estimate](#) of an earlier version of Sen. Warren's book minimum tax found the tax would:
 - Reduce GDP 1.9%
 - Reduce the nation's capital stock 3.3%
 - Reduce wages 1.5%
 - Reduce the number of full-time equivalent (FTE) jobs by 454,000
 - Note:* Tax Foundation modeling does not account for the new version of Warren's book minimum tax proposal, which includes a partial credit for regular tax liability
- A book minimum tax could **undermine investment** in the U.S., if the book minimum undercuts provisions that allow companies to run a net loss (which can arise from [making investments](#)) and to fully expense the costs of capital investment (such as full and immediate expensing for machinery and equipment under TCJA)

Global Consequences

- A book minimum tax would make the U.S. an [outlier](#) among its economic peers
 - China, Japan, Germany, the United Kingdom, France, Canada, Russia, Brazil, Australia, Spain, and Mexico are among the high-GDP countries that do not have

a corporate alternative minimum tax (AMT); India, Italy, and Korea are among the high-GDP countries that do have a corporate AMT

- Combined with the proposed [changes to the international tax regime](#), the Biden or Warren book minimum taxes could make the U.S. a less competitive place for multinational companies to headquarter and/or make investments

Political Consequences

- Experts have warned that conforming taxable income to the book income standards effectively set by FASB could politicize a non-profit, privately-run organization (see the following [analysis](#) from AEI's Kyle Pomerleau)
 - Alternatively, as JCT has [written](#): “proposals which rely on the Congress to set out new accounting standards to be used for both financial accounting and tax purposes would contradict decades of practice in the accounting and auditing fields”

Unintended Consequences

- JCT has [pointed out](#) that companies that *are* using “aggressive positions” for either book or tax purposes could continue to do so, if there is no “healthy tension” to report high book income and low taxable income
 - This could apply to companies that are **not publicly traded**
 - This could apply to companies that are not “motivated to maximize profits in particularly profitable years,” because they and/or their investors value steady earnings more

Where Can I Find Additional Resources?

- JCT, “[Corporate Tax Receipts And Corporate Tax Liabilities](#),” February 2020
- JCT, “[Present Law And Background Relating To Corporate Tax Reform: Issues Of Conforming Book And Tax Income And Capital Cost Recovery](#),” May 2006 (due to numerous changes in the tax code since publication of this report, some analysis in this JCT report is out of date)
- Treasury Department, “[General Explanations of the Administration’s Fiscal Year 2022 Revenue Proposals](#),” May 2021
- CRS, “[Minimum Taxes on Business Income: Background and Policy Options](#),” August 2021
- AEI’s Kyle Pomerleau in *Tax Notes Federal*, “[Joe Biden’s alternative minimum book tax](#),” October 2020
- Tax Foundation’s Erica York and Alex Muresianu, “[Senator Warren’s Corporate Book Tax Is Wrong Way to Fund New Spending](#),” August 2021
- Former NTU Foundation VP Nicole Kaeding, “[Profitable Companies Aren’t Always Profitable](#),” January 2020

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