



**Effective
Income Tax Rates
Paid by
United States
Corporations in 1972**

**Department of the Treasury
May 1978**

Effective
Income Tax Rates
Paid by
United States
Corporations in 1972



Office of Tax Analysis
Department of the Treasury
May 1978

Preface

This publication of estimated effective income tax rates paid by U.S. corporations in 1972 is an outgrowth of work initiated in December, 1975 at the joint request of the Chairmen of the Joint Economic Committee and the Senate Select Committee on Small Business. Pursuant to that request, and following a meeting among interested parties, a Steering Committee comprised of representatives of the aforementioned Committees, along with others from the Joint Committee on Internal Revenue Taxation and the Federal Trade Commission, was established to help guide the Treasury in its assembly of information, the decision having been reached that tax return data afforded the best source of income and tax measures.

Through the course of this endeavor, the Treasury staff have benefitted from the exchange of views and technical assistance made possible by this arrangement. Needless to say, the Treasury is wholly responsible for the content of this report. The release of this report to the Congress and the public is made in the interest of furthering understanding of the difficulties and ultimate ambiguities in the construction and interpretation of effective tax rates.

TABLE OF CONTENTS

	Page
Preface	i
I. Introduction.	1
II. Effective Tax Rates, 1972; Nonfinancial Corporations	2
A. Misrepresentation of effective tax rates due to improper aggregation of corporations . .	4
B. Improving the content and better matching of numerator and denominator	8
(1) Adjustments to income (denominators) .	8
(2) Adjustments to taxes (numerators). . .	11
(3) Effective tax rates after adjustment .	13
III. Effective Tax Rates, by Industry	17
IV. Concluding and Precautionary Comments	23
A. Comparisons with effective tax rates based on published financial statements	23
(1) Consolidation rules.	24
(2) Income measurement rules	25
(3) Accounting for taxes	
(a) "Deferred taxes."	26
(b) Other years' transactions in the current year tax account.	32
B. Interpretative precautions	35
(1) Implications of below statutory corporate effective tax rates.	36
(2) Effects on fairness of the tax system	38

1.	Income Measures, United States and Foreign Tax Liabilities; For Nonfinancial Corporations Filing Income Tax returns, By Size of Adjusted Assets; 1972.	43
2.	Effective Tax Rates on Worldwide Income, All Corporations With Income, and Corporations With Under \$1,000,000 of Assets, by Industry; 1972	45
2a.	Effective Tax Rates on Worldwide Income, All Corporations With Income, By Industry and Size of Assets; 1972	46
3.	Effective Tax Rates on U.S. Source Income All Corporations With Income and Corporations With Under \$1,000,000 of Assets, by Industry, 1972.	49
3a.	Effective Tax Rates on U.S. Source Income, All Corporations with Income, by Industry and Size of Assets; 1972.	50
Appendix:	Industry Descriptions	54
	Definitions of terms.	56

I. Introduction.

There is a persistent popular interest in "effective tax rates" paid by two classes of income taxpayers, persons and corporations. There is also widespread misunderstanding about the ambiguities of effective tax rate computation. This report is concerned only with corporation income taxes and is intended to shed light on the taxability of income, by size of corporation and by industrial class, and to set out logical rules for the construction of effective tax rates.

The data relied upon here for measures of income and of its taxability have been derived from individual corporation income tax returns selected by the Internal Revenue Service for statistical processing and for reporting in its annual publication, Statistics of Income: Corporation Income Tax Returns, 1972. For this report, foreign income and tax items from Form 1118 not included in the IRS publication have been extracted and collated with the previously published tax return information. The asset size classification employed in this report also differs from that in Statistics of Income. Here the total assets of a corporation as reported

in its tax return, and which are the basis for size classifications in Statistics of Income, have been adjusted by netting-out trade credit to better represent assets actually employed in its business by the corporation.^{1/}

II. Effective Tax Rates, 1972; Nonfinancial Corporations.

An "effective tax rate" is simply the ratio of some measure of "taxes paid" to some measure of before-tax "income." Much mischief may be done in such a computation by mismatching of the numerator and denominator. The denominator, being an income measure, is generally computed on the basis of accrual rules: the "income" of a year is determined by elaborate accounting procedures which attempt to match the costs of earning the sales receipts during a

^{1/} If accounts and notes receivable exceed accounts and notes payable, the latter is subtracted from both sides of the balance sheet. In this case, the net trade credit extended is capital employed which must be financed by long-term debt and equity. If accounts and notes payable exceed receivables, the receivables are subtracted from both sides of the balance sheet. The excess of payables is then a source of finance for the remaining assets employed in the business.

year, regardless of the timing of actual revenues or expenditures. On the other hand, "taxes due" is basically a "cash accounting" concept under which only the net liability for tax due to the U.S. Treasury during a year is customarily accounted for. If the use of the tax account to clear other years' transactions, such as refunds, is neglected, "taxes due" becomes inappropriate as a measure of tax liability generated by the "income" shown in the denominator.^{2/} Moreover, "income" reported and used as the denominator of an effective tax rate calculation for U.S. taxpayers is invariably worldwide income, for the Internal Revenue Code subjects to tax income from all sources, both foreign and domestic. Obviously, if only the net tax due the U.S. Treasury is shown in the numerator while worldwide income taxes is shown in the denominator, there is an overt understatement of the taxability of any taxpayer with worldwide income.

^{2/} To illustrate the pitfalls of dealing with cash payments of tax relative to incomes that have generated tax liability, consider that many taxpayers finish paying their tax liability for a given year sometime during the first third of the succeeding year; other taxpayers overpay their tax liability during a given year and receive a refund the following year. In either case, the taxpayer's "effective" tax rate for the given year is the tax liability generated by his income for that year, divided by the year's income not the taxes actually remitted.

Indeed, failure to consistently match numerator and denominator is entirely responsible for the common misconception that "small businesses" pay higher tax rates than "big business." The following sequential presentation of various ways of computing "effective tax rates" is intended to put to rest this misrepresentation of fact.

A. Misrepresentation of effective tax rates due to improper aggregation of corporations.

In 1972 more than 1.6 million nonfinancial corporations filed income tax returns (see Row I(a) of Table 1).^{3/} Altogether, these nonfinancial corporations reported \$75.15 billion of taxable income, as measured by the rules of the Internal Revenue Code and from all sources, domestic and foreign. In the tables, this measure of income is referred to as "basic worldwide taxable income" (BWTI). On the basis of BWTI of \$75.15 billion, nonfinancial corporations owed

^{3/} Financial corporations, banks, insurance companies, investment companies, etc., are not reported as a group because size classifications among these heterogeneous enterprises have little meaning. In the case of insurance companies, the measure of taxable income provided in the Internal Revenue Code is so highly specialized it cannot be adjusted to reflect normal concepts of enterprise income; and in the case of investment companies, if they elect to operate as regulated holding companies and distribute currently at least 90 percent of their before tax income, they are not subject to corporation income tax. Banks (commercial and savings), on the other hand, do report income and other data which permit a sensible approximation of before tax income and corresponding tax liability. Thus, while banks are excluded from the figures reported in this section, they will be reported as an industry category in the next.

net income tax to the Treasury, after all credits, of \$29.13 billion. These figures yield an apparent effective tax rate of 38.8 percent overall, the rates ranging from infinity for the smallest size class, which reported a net loss of \$253 million while owing \$211 million in tax, to 29 percent for the very largest. The occurrence of "effective tax rates" computed from BWTI in excess of 48 percent, the maximum statutory rate on taxable corporate income in 1972, is a clear indication that something is amiss in this calculation. The reasons for these incongruous results are that corporations have been aggregated which do not permit comparisons of income and tax liability for the same year.

Corporations reporting losses. Large numbers of corporations, particularly those at the small end of the size spectrum, will frequently report negative taxable income (losses) in a given year. Algebraically adding negative and positive incomes produces a smaller total income in the denominator of effective tax rate calculations; indeed, as we have seen, the smallest corporations in the aggregate report more losses than gains. But, since the tax returns of loss corporations do not show the refund, or "negative tax" for the year due to the net operating loss carryback or carryover, the aggregate "tax due" in the numerator of the effective tax rate calculation is undiminished. The net

result is that we have incomparable numbers in the numerator and denominator of the effective tax rate calculation that produce overstatements of apparent effective tax rates.

Corporations not subject to tax. Certain corporations may elect to be taxed essentially as partnerships under provisions of Subchapter S of the Internal Revenue Code. Some of these corporations report losses, others positive taxable incomes; but although their BWTIs are (algebraically) included in the denominator of the effective tax rates we have just reviewed, their tax liabilities are never in the numerator.^{4/} Their inclusion in the calculation necessarily confuses the meaning of corporation effective tax rates. Similarly domestic international sales corporations (DISCs) file income tax returns but are not, directly, subject to income tax. Instead, half their income is taxable to parent corporations. Obviously DISCs should not be included as separate corporations; rather they should be consolidated with their parents.

^{4/} Subchapter S corporations may generate corporate tax liability in connection with certain capital gain transactions, but this is invariably a trivial amount of tax.

Result of reclassification. The dramatic effect of careful aggregation may be observed by comparing Sections I and II of Table 1. In Section II, corporations without BWTI, those electing to be taxed under Subchapter S, and DISCs have been eliminated.^{5/} For nonfinancial corporations, this has involved dropping nearly 900,000 corporate entities, but increasing BWTI by more than \$9 billion. As a consequence, the overall effective tax rate is reduced to 34.5 percent, and the range of "effective tax rates" now begins to approximate the statutory rates prevailing in 1972, 22 percent on taxable income up to \$25,000, 48 percent on the excess. ^{6/}

^{5/} Although DISCs were excluded, they were "statistically" consolidated with their parent corporations by doubling DISC dividends reported by parent corporations. Because DISC dividends reported by parent corporations may refer to prior years, this procedure tends to understate DISC income of the parents, taxation of which is deferred, particularly in 1972 when DISC formation was rapid due to novelty of the program.

^{6/} Exclusion from the tabulation of corporations without taxable income for 1972 in order to maintain comparability of numerators and denominators in effective tax rate calculations has no effect on results if, and only if, tax losses are ultimately refunded. If some losses in 1972 are never requited by carry-back or -forward to other years, then these losses should be retained in 1972 denominators. And if these losses were retained, the 1972 effective tax rates would be slightly elevated. Unfortunately, there is presently insufficient empirical evidence on which to base an estimate of the amounts of any year's reported losses which will not generate a refund.

B. Improving the content and better matching of numerator and denominator.

To this point, we have continued to use U.S. tax due, after credits, in the numerator of the effective tax rate calculation and BWTI in the denominator. This is clearly unsatisfactory. So long as any measure of worldwide income is used in the denominator, worldwide taxes should be included in the numerator. More importantly, the denominator in the calculation is taxable income and we are all aware that this magnitude is overtly understated for tax purposes as a device to subsidize particular economic activities engaged in by corporations--and unincorporated enterprises as well. Moreover, the tax accounts are used to clear refunds pertaining to other years' transactions, a source of distortion which must be removed.

(1) Adjustments to income (denominators):

Restoration of preferential deductions. Subsidies are provided certain specific economic activities in the form of special deductions from gross income in arriving at taxable

income. Among those available in 1972 we might list:^{7/}

(a) Special 5-year amortization privileges, in lieu of normal tax depreciation deductions, for childcare facilities, railroad rolling stock, rehabilitation of low- and moderate-income housing, coal mining safety equipment, and pollution control investment;

(b) Percentage depletion allowances for production of minerals, including oil and gas;

(c) A special deduction for U.S. corporations at least 90% of whose gross income originated in trade outside the United States, but within the western hemisphere.

Clearly, the excess of these deductions over those which would be regularly allowed in the measurement of pre-tax

^{7/} In addition to the preferential deductions listed which apply generally to financial and nonfinancial businesses, are those extra "bad debt" deductions allowed commercial banks and thrift institutions. The effect of bad debt deductions is dealt with in the following section presenting effective tax rates for banking.

income is merely an intentional understatement of taxable income. The excess of these deductions should be restored if the denominator in an effective rate calculation is to substantially represent a corporation's (or any taxpayer's) before-tax income for the year.^{8/}

^{8/} Due to the existence of the minimum tax on preferences, it was possible to identify the magnitudes of these excesses of preferential deductions which might be restored to income for 1972. The minimum tax generated by these preferences, if any, is already included in the U.S. tax element of the numerator. Another significant preference for which no adjustment to the income denominator could be made is the expensing of intangible drilling costs and related preferential treatment of exploration costs for other minerals activities. For these preferences the necessary data, taxpayer by taxpayer, are totally lacking in tax return records.

A case could be made that at least part of the ordinary allowances claimed for depreciation are preferential in that they are in excess of the amounts that would be required to measure income appropriately. This has been particularly documented in the case of tax depreciation allowances for real property. However, this study has generally not attempted to adjust reported deductions for tax depreciation due to the unavailability of sufficiently detailed information on the tax return. Nevertheless, preferences for "accelerated depreciation" deductions taken with respect to certain properties subject to a net lease and which are also part of the minimum tax base have been added back to taxable income.

Restoration of excluded income. Many corporations hold bonds issued by state and local governments the interest on which is exempt from tax. By law, this interest income is excluded from the holders' taxable incomes. Restoration of this exclusion to income yields a better measure of before tax income for the year.^{9/}

(2) Adjustments to taxes (numerators):

Foreign taxes. Under longstanding international conventions observed by the United States, foreign governments are accorded the "first chance" to tax income of U.S. corporations earned within their political jurisdictions. Mechanically, this is accomplished by requiring U.S. corporations to report as taxable income in their U.S. tax returns the income they earn abroad (but in the case of foreign subsidiaries, only when dividends are remitted to the parent), to compute U.S. tax which would be due on that income, and then take as a credit against this tax otherwise due the amount of tax paid to foreign governments.

^{9/} It should be noted that this mode of correction for the exclusion of tax-exempt interest exaggerates the effect of this subsidy to state and local government debt financing in reducing "effective tax rates" of holders of these securities. See discussion of this point in Section IV,

If foreign taxes paid are less than the amount computed under U.S. tax laws, the difference must be paid to the Treasury.

If foreign taxes paid exceed U.S. tax liability, the excess may be carried back or forward to other years to be credited against U.S. tax liability, but only against the U.S. tax attributable to foreign source income. Clearly, if worldwide income appears in the denominator, worldwide taxes generated by that income, both those paid abroad and to the Treasury, should appear in the numerator.^{10/}

Effect of loss carryforward. In any year many corporations that had suffered a loss in prior years but were unable to secure a refund because they had insufficient taxable income in the 3 carryback years will obtain their refund by simply deducting a carryforward of unrequited losses against the

^{10/} Foreign income taxes restored to the numerator are those reported in Form 1118 as taxes paid and accrued and deemed paid.

otherwise taxable income of the current year. This is an eminently sensible and efficient way to accomplish the refund: it avoids the payment of all its current year's tax by such a corporation to be followed by application for a refund. Clearly, then, the deduction from this year's taxable income of a loss carryforward leads to an understatement of this year's pre-tax income and should be restored. Similarly, exclusion from tax due of the amount refunded with respect to the loss carryforward is an understatement of tax generated by this year's income; this, too, should be restored. This adjustment parallels the adjustments for current year's losses described above.

(3) Effective tax rates after adjustments.

Section III in Table 1 shows the outcome of making these necessary adjustments to the numerator and denominator of the effective tax rate calculation. On the one hand, expanding BWTI to include overt understatements and exclusions has added nearly 120,000 nonfinancial corporations to the tabulation and has increased the denominator (income) by over \$9 billion. On the other hand, restoration of refunds due to prior year losses and inclusion of foreign income taxes paid and deemed paid has added \$9 billion to the nonfinancial corporations' numerator (taxes). As a consequence, the 1972

effective tax rate for all nonfinancial corporations becomes 40.9 percent, 6.4 percentage points higher than before. There is also apparent now a clear upward progression of effective tax rates by size of corporation.^{11/}

It is noteworthy that the adjustments to tax and income involved in going from Section II to III have little impact on computed effective tax rates of corporations at the low end of the spectrum but a large impact on those at the high end. This is not unexpected: smaller corporations rarely have foreign income and tax and they less frequently engage in the kinds of economic activities favored by preferential deductions or exclusions from taxable income. Their major preference (in 1972) is the \$25,000 exemption from surtax which holds their effective tax rates near the 22 percent normal tax level.

^{11/} The high effective tax rate in the over \$1 billion asset class is due to the peculiar problems associated with foreign taxes reported by oil companies. See the discussion of that industry's effective tax rate in the section following.

The Section III figures are recommended as the best single indicator of effective tax rate because the numerators (worldwide taxes) and denominators (worldwide income) are most closely matched. However, Sections IV and V of Table 1 present separate computations of domestic and foreign effective tax rates. The domestic income effective tax rates in Section IV were derived by subtracting taxes paid foreign governments from worldwide taxes to obtain the numerator of the ratio and by subtracting foreign source income from worldwide income to obtain the denominator. This leaves in the numerator some tax attributable to foreign source income and causes the effective tax rates on U.S. income to be slightly overstated. Similarly, the foreign source income effective tax rates in Section V involve some mismatching of numerators and denominators, since the former does not include some taxes paid the U.S. Treasury with respect to some of the before-tax income included in the denominator. This causes a slight understatement of these effective tax rates. Nevertheless, the following observations are warranted:

-- Whether with respect to domestic or foreign source pre-tax income, effective tax rates rise with income. In the case of domestic income, the drop-off of the U.S. effective tax rate in the \$1 billion and over asset class, from 40.7 in the preceeding class to 37.7, is accounted for entirely by the dominance of utilities and companies with mineral income in that largest size class, as will be evident in the industry breakdowns to be reviewed below.

-- Although the taxability of foreign source corporate income appears to be substantially above domestic rates, 56.1 as compared with 37.8, this appearance is due almost entirely to the confounding of oil taxes and other payments to host countries. When the oil company foreign income and tax items are eliminated, the effective foreign rate is 40.0 percent, only slightly above the U.S. effective rate on domestic income.

III. Effective Tax Rates, by Industry.

Reference has already been made to a number of causes for the departure of effective tax rates from those specified in the Internal Revenue Code. Over the years, remission of tax has been used as a means for effecting non-revenue Federal policy objectives. We have noted the several preferential deductions from pre-tax income to arrive at taxable income; when these are restored to better measure before tax income, effective tax rates fall. Additionally, two credits against income tax otherwise due that year were available in 1972. One was a 7 percent investment credit (4 percent for regulated utilities) for the purchase of certain kinds of depreciable assets; the other was a credit of 20 percent of certain expenses incurred in the employment of welfare recipients (usually unemployed mothers with dependent children), commonly referred to as the "work incentive program" (WIN). Since both these subsidies are paid via a reduction of tax otherwise due, the earning of these subsidies naturally reduces the numerator in effective rate calculations and, hence, apparent effective tax rates.

The magnitude of the effect of clearing subsidies through the tax system on computed effective tax rates among industries will depend on the degree to which the activities

subsumed in the industries are favored by tax subsidies. Moreover, most of these subsidies are capital related, i.e., in the form of extra deductions connected with the acquisition and use of certain kinds of equipment, or as an investment credit for other kinds of capital equipment. Consequently, they tend to be of relatively less importance to smaller businesses, for, in any industry, small businesses are typically more labor, less capital, intensive. Tables 2 (for worldwide income) and 3 (domestic income) illustrate these differentials in tax subsidies by type of activity and size of enterprise.

In Table 2, effective worldwide tax rates for corporations in 19 industries are listed in descending order of tax rate. The highest industry tax rate, 59.4 percent, is that for corporations engaged in all stages of the petroleum and natural gas industries, except natural gas distribution; the lowest worldwide tax rate is that for banking, 19.4 percent. The low rank of banking simply reflects the magnitude of their tax subsidy in the form of artificial bad debt deductions and their institutional capacity to hold bonds yielding tax-exempt interest.

However, as noted earlier, the petroleum and natural gas worldwide effective tax rate is swollen by the ambiguous character of most of the payments they are required to pay host countries: since the host country is both the taxing power and the original owner of the mineral resources, the host country is able, under its tax laws, to extract from oil companies a share of the companies' income from oil and gas discovery that, in a property system like that of the United States, would accrue to the companies or to co-owners of the mineral rights. Under the tax laws and regulations prevailing in 1972, a large volume of these ambiguous "taxes" were regarded as shares of before-tax income paid as taxes and this had the effect of producing a 59.4 percent effective worldwide rate. Since there is no analytical basis for disaggregating oil company payments to foreign governments into those which might legitimately be called an income tax and those that represent an allocation of before tax income

to the mineral owner, we may obtain a more reasonable measure of the taxability of income in this industry under U.S. tax laws by excluding the confounding foreign items from both numerator and denominator. This is done in Table 3. Arrayed by size of effective tax rate on U.S. income, (see Table 3) petroleum and natural gas companies rank 17th among the 19 industry groups with an effective tax rate of 24.7 percent.^{12/}

Excepting this difference in ranking in the two tables of effective tax rates, the other industries' rankings are quite stable. "Other manufacturing," which includes the manufacture of motor vehicles, chemicals, electrical and electronic equipment, among others (See Appendix), is subject to the highest rate of tax, 41.9 percent on worldwide income, 42 percent on U.S. source income. The median industry worldwide rate of tax, 33.1 percent, was experienced by the ferrous metals group (iron mining, steel manufacture, etc.); the median tax rate on U.S. source income, 31.6 percent, was experienced by the services industries.

^{12/} This effective tax rate does not reflect the benefit of expensing intangible drilling costs of wells that later prove to be productive. As previously noted, the information required to adjust taxable income for this preferential deduction is not available.

Banking is consistently taxed at low rates, 19.4 percent worldwide, 18.6 percent on U.S. source income.

Within industry groups, effective tax rates by size of corporation generally reveal the expected pattern: small corporations experienced lower effective tax rates than did the larger. This may be seen in Tables 2 and 3 by comparing the industry-wide effective tax rates with those in the adjoining column that represent the effective tax rates for all corporations in that industry grouping with less than \$1,000,000 of assets. In Table 2 (worldwide tax rates), small corporations experienced lower effective tax rates than the industry average in each category, save ferrous metals and banking; in Table 3 (U. S. tax rates), the same condition prevails, except in banking alone.

Tables 2a and 3a present the detailed effective tax rates on worldwide and U.S. source income, respectively, by asset size of corporations. The patterns in these latter tables, due to the variance necessarily introduced by smaller numbers in the larger size classes, are far less regular. For example, in Table 3a, the 5 largest corporations in the

nonferrous group experienced an 11.2 percent effective tax rate on U.S. source income because, in 1972, in addition to tax subsidies in the form of percentage depletion allowances in excess of cost (which expands the denominator), these firms earned maximum amounts of investment and WIN credits (which diminish the numerator). Smaller firms in this industry group, being less likely to both engage in mining and to make comparatively large volumes of investment in qualified property, experience lesser reductions from statutory rates.

Nevertheless, except in banking, the two smallest size classes, which overall encompass 75 percent of all corporations subject to income tax, invariably experience effective tax rates well below the industry average in any industry group. In banking the exception to this rule reflects the fact that inclusion of tax-exempt bonds in bank portfolios and the ability to form nonbanking subsidiaries that engage in equipment leasing, and hence earn investment credits, is a function of bank size.

IV. Concluding and Precautionary Comments.

The effective tax rate tabulations reviewed in this report are the most comprehensive set of such computations prepared by the Treasury Department. As later years' data become available, they will be processed and published as resources permit. In this first release of such material it is appropriate to add some brief comment on comparisons between these effective tax rates and others which are published from time to time that are derived from corporations' published financial statements. It is also appropriate to conclude this report with some observations on the limitations of effective tax rates as guides to an appraisal of the characteristics of the tax system.

A. Comparisons with effective tax rates based on published financial statements.

Effective tax rates here presented have been derived from income tax returns. These will not be directly comparable with superficially similar effective tax rates computed from data extracted from financial statements published by the same corporations for the same year. The reasons for this state of affairs have to do both with

measures of "taxes" in the numerator and of before-tax "income" in the denominator. We may summarize these differences as follows: 13/

(1) Consolidation rules.

The rules for consolidating subsidiaries are different for tax and financial reporting. For tax purposes, the criteria for consolidation include the requirement that only corporations chartered in the United States may be consolidated and that there be ownership by the parent corporation of at least 80 percent of the subsidiaries consolidated. For financial reporting, any corporation wherever chartered may be consolidated by another corporation if the latter corporation maintains at least 50 percent ownership of the former. In general, this means that neither

13/ For a more detailed exposition of the problems in deriving effective tax rates from corporations' financial statements, see Pitfalls in the Computation of "Effective Tax Rates" Paid by Corporations; OTA Paper No. 23; U.S. Treasury Department (July, 1977).

the worldwide tax nor the worldwide income reported on tax returns and financial statements will be the same because the reporting entities do not correspond.^{14/} There is no practical way to reconcile these differences.

(2) Income measurement rules.

Since there is no set of universal rules for income measurement, even in those cases where the reporting entity is the same for both tax and financial accounting, before-tax incomes in tax returns and financial statements will differ. Accepted financial accounting principles afford one (nonuniversal) measure of before-tax income; the Internal Revenue Code another measure. Although there are many differences between tax and financial accounting rules, the

^{14/} Note should also be taken of differences between the reporting of foreign source income. In financial reports, all income of consolidated subsidiaries is reported on the same accrual basis. In tax returns, only the foreign source income of subsidiaries chartered in the United States is presented on an accrual basis; the income of subsidiaries chartered in foreign countries is reported only to the extent "repatriated" or paid as dividends to the U.S. parent corporation.

most significant have to do with accounting for capital consumption -- depreciation and depletion. In Section II, above, we noted that tax rules for these allowances incorporate features intended to provide a subsidy for specific kinds of investment and economic activity, and, where possible, we adjusted "taxable income" accordingly. Nevertheless, there is in many instances a remaining difference between the "adjusted income" reported here and the before-tax financial income which would be reported by the same corporations due to their use of financial accounting depreciation formulas that recover depreciable capital costs more slowly. On this account, more often than not, before-tax financial, or "book," income will exceed the "adjusted" income measure used in this report and this will raise a reconciliation issue, to which we now turn.

(3) Accounting for "taxes."

"Deferred taxes."

When financial accounting for depreciation differs from that used for tax purposes, the accepted accounting procedure for reconciling the difference between the two measure of before-tax income, often referred to as "normalization,"

gives rise to a quantity called "deferred income taxes." This item, of course, never appears in a tax return, for tax accounting merely requires the derivation of taxable income. When the method for determining the allowance for depreciation for financial accounting purposes differs from that allowed in tax accounting so that the current year financial allowance is less than that used in computing taxable income, say because financial accounting employs less "accelerated" methods and/or longer lives, then the before-tax financial income measure will exceed taxable income. Inasmuch as this difference between financial and tax accounting procedures essentially involves the time distribution of depreciation allowances which ultimately must aggregate to the same quantity, namely the cost of the depreciable assets, the difference between financial and taxable income, and hence the tax liability, must logically

be treated as a "deferral" of taxable income and a corresponding tax liability generated by this year's before-tax income. 15/ Thus the accepted accounting procedure requires that the amount of tax "deferred" be included with the net tax due the current year as "tax expense" the total of which when subtracted from before-tax (financial) income yields "net" or after-tax (financial) income.

If one is to compute an effective tax rate from financial statements, then, the observer must decide whether he believes the financial statement measure of depreciation is more nearly correct, in a given year, than the tax return measure of depreciation.

15/ Since the preparer of a financial statement must certify the "correctness" of reported before-tax income, he is obligated to use his measure of depreciation for the year as "correct." The departure from this by the Internal Revenue Code is, from this point of view, an aberration.

- If he concludes the tax measure of depreciation is more nearly correct, then he should reduce before-tax (financial) income by the apparent understatement of depreciation and ignore "deferred tax." He should compute the effective tax rate from the financial statement by dividing income taxes due that year by the adjusted measure of before-tax income.

- If he concludes the financial statement of depreciation is more nearly correct, he must then estimate the probability that the "deferred tax" will ever be paid, and he must adjust the numerator, and/or denominator accordingly. There are two procedures that might be used for the adjustment: one follows a cash accounting approach, the other accrual methods.

Cash accounting:

Permanent deferral: If the observer believes that the corporation will continue to replace its depreciable capital indefinitely, then he will conclude the probability of repayment of "deferred tax" is zero. In this event, under

"cash accounting" rules, "deferred tax" may be ignored since it will never be repaid; and an effective tax rate would be computed by dividing the remaining tax due by the before-tax income reported in the financial statement.

Temporary deferral: If the observer believes that the corporation will experience a contraction in the near future, the "deferral" of tax reported in the current year is only temporary, for when failure to replace occurs, the relationship between financial and tax accounting depreciation allowances reverses and "deferred tax" will be repaid. It is the present value of this future payment of tax which, when added to tax due for the year, enters the numerator of an effective tax rate calculation, with financial before-tax income in the denominator. This involves some accrual procedures to account for the likelihood of future events.

Accrual accounting: Under this approach, the adjustments entail consistent accrual of tax expense for the year regardless of the form in which the tax is "paid" and corresponding adjustments to financial before-tax income.

Permanent deferral: If the probability that the tax will ever be repaid is zero, in effect the Treasury is making a nontaxable grant of the "deferred tax" to the corporation. Then this amount should be added to the reported financial before-tax income to signify the accrual of this income to the corporation during the report year. Since the tax generated by the corporation during the year is the sum of "deferred tax" plus tax otherwise due, this sum should be the quantity divided by the adjusted financial before-tax income to compute an effective tax rate. Altogether, permanent deferral entails two transactions: generating a tax liability during the year, part of which is "paid" in the form of a noninterest-bearing IOU; the other is recognizing that the future payment of the IOU is unlikely to occur, an implicit increase in the year's income resulting from the corporation's investment in property accorded preferred tax treatment.

Temporary Deferral: In this event the observer must again compute the present value of the tax to be paid in the future. The difference between this amount and the "deferred tax" for the year is a gain to the corporation. Then the amount of this gain, which is less than the total "deferred tax" should be added to the reported financial before-tax

income for use as a denominator in computing an effective tax rate. The numerator in this case, as in the case of permanent deferral above, includes both tax otherwise due and (total) "deferred tax."

- (b) Other years' transactions in the current year tax account.

We have already noted that the tax account is used to clear refunds and subsidies in the form of credits in tax returns. The same usage occurs in financial accounting. However, the problems posed by this usage in financial statements are more severe because the current year's tax account will include refunds due to the carryforward of

unrequited losses and credits attributable to prior years.^{16/} The effects of these non-current-year transactions need to be removed from the financial statement measure of tax in order to obtain the amount of tax attributable to this year's pre-tax income.

^{16/} Problems posed by the financial accounting treatment of the investment credit should also be noted. There is no prescribed accounting standard for presenting the impact of the investment credit earned during a report year. Under one approach, the investment credit is simply treated as a "reduction of tax" in the year earned. Since the arithmetic of this procedure merely reduces the provision for income tax that is subtracted from income before-tax to derive "net income", this is called "flow-through." An alternative procedure treats the investment credit as a subsidy received from the government, the value of which is distributed over the life of the qualified investment. Provision for income tax is reduced only by the amount of the subsidy expiring during the year, not by the credit earned that year. Since this method distributes the "reduction in tax" over the life of the assets rather than all in the year the credit is earned, the procedure is called "normalization." Obviously, one needs to know how a corporation treats the credit if he is to use the "taxes" reported as the numerator of an effective tax rate calculation.

The information needed to effect all these adjustments to financial reports of income and taxes is rarely available. The recent Federal Trade Commission computation of effective tax rates paid by manufacturing corporations, submitted in testimony before the Subcommittee on Antitrust, Consumers and Employment of the House Committee on Small Business (March 21, 1978) illustrates these difficulties. That report, based on financial data submitted to the FTC quarterly by a sample of manufacturing corporations could not deal with "deferred taxes" by either of the two options mentioned above. For this reason, its reported effective tax rates are overstated. Nor could it rectify the annual "provision for Federal income taxes" to eliminate the embedded clearance of other years' transactions. The effect of this confusion of elements in the effective tax rate numerators is not predictable.

Due to all these difficulties in the use of financial statements, plus the broader coverage of corporations by size and industrial classification available in tax returns, and notwithstanding the remaining omissions from adjusted taxable income that have been noted previously, tax returns appear to afford the single best source of data on the taxability of corporation income.

B. Interpretative precautions.

The divergence between effective tax rates and statutory rates and the wide disparities in tax rates experienced by corporations in different industries exhibited in this report cannot be viewed as surprising. Since 1918, when Congress enacted the progenitor of percentage depletion in order to stimulate the discovery of additional petroleum reserves because gasoline supplies were then in dangerously short supply, the income tax has been utilized as a vehicle to modify resource flows in the private sector of the economy. Some of these uses of the tax laws, like percentage depletion, have been intentional: artificial bad debt deductions have been provided to facilitate the expansion of banking services; capital gains treatment was afforded timber production as a conservation measure; the investment credit was aimed to subsidize growth of the private capital stock to increase productivity per man-hour; the WIN credit was intended to encourage the employment of welfare mothers; the Western Hemisphere Trade Deduction was intended to foster greater participation of U.S. companies in the development of this part of the world; exemption of interest paid by state and local governments is intended to enable these governmental units to borrow more cheaply; and rapid

write-offs of depreciable assets have been provided to subsidize a wide range of particular kinds of investment perceived to be in the public interest, ranging from childcare facilities to pollution control equipment. Others, like intangible drilling cost deductions and similar treatment of other preproduction expenses, have crept into the tax laws inadvertently but were subsequently either sanctioned by explicit enactment or by refusal to amend the tax laws to eliminate the inadvertent preference.

(1) Implications of below statutory corporate effective tax rates.

In view of this history, it is important that the existence of low effective tax rates not be misinterpreted to mean only that some owners of corporations are not paying their fair share of tax and thereby enjoy higher after-corporate-tax rates of return. Indeed, as indicators of after-corporate-tax returns, effective tax rates are grossly misleading. If one compares the industry categories shown in Tables 2 and 3 as paying above average effective rates with those paying below average rates, he would be hardpressed in terms of general knowledge of the size, rate of growth and stockmarket status of their shares, to

determine which group of stockholders was enjoying the highest after-corporate-tax rate of return. Does one suppose the stockholders of automobile, chemical, computer and electrical machinery manufacturing companies eke-out a lower after-corporation-tax rate of return than do stockholders of banks and coal companies because the latter experience less than half the effective tax rates of the former? The answer clearly is negative. Because capital owners are concerned with after-corporation-tax rates of return, not with before-tax incomes, it is after-tax rates of return that are equalized through the mobility of capital. Flows of capital between industries ensures that the only difference between high- and low-tax rate industries will be higher pre-tax rates of return in the former, lower rates in the latter. The subsidized industries will have lower pre-tax profits because their expansion in response to the subsidies they have received either depresses market prices of their output or causes them to bid-up the costs of labor and materials they use.

The variances in industry effective tax rates are thus not indicators of shareholder benefits. Rather they are crude indicators of the ways in which the tax laws have been used to influence the pattern of economic activity in the

private sector. Resources have been pushed into the low effective tax rate industries and away from high tax rate industries.

(2) Effects on fairness of the tax system.

In effect, tax subsidies substitute for payments to producers they would normally receive in the form of market prices. Inasmuch as tax subsidies are in the form of tax-exempt income, they also permit taxpayers with above average incomes to escape paying their fair share of tax. For example, because the interest on state and local bond issues is tax-exempt, the bonds sell to yield returns that are below the yields of taxable issues; this is the subsidy element of the tax preference accorded state and local bond issues. Historically, the spread between taxable and nontaxable bonds has hovered around 30 percent -- if 10 percent is the yield on taxable securities, the comparable tax-exempt yield would be about 7 percent. Thus a purchaser of tax-exempt bonds pays, in this example, an "effective tax"

of 30 percent, and he "pays" this tax when purchasing tax-exempt bonds no matter what his income status otherwise would be. In this sense holders of tax-exempt bonds who would be subject to tax at more than 30 percent are not paying their fair share of tax. 17/

17/ In the effective rate calculations in this report, tax-exempt interest was simply added to the denominator. This procedure has the unfortunate effect of exaggerating the nontaxability of this form of income. An analytically correct way to deal with tax-exempt interest would be to include in the denominator the taxable equivalent of tax-exempt interest and include in the numerator the "implicit tax" associated with the spread between the taxable and nontaxable yields. For example, assume \$10 would be the taxable yield for a security held by a bank and the tax-exempt interest it actually earns is \$7. If we merely express actual taxes paid, \$0, as a percentage of the actual income earned, \$7, we obtain an effective tax rate of zero. But, if we add the \$3 spread to \$7 to derive \$10 of income in the denominator and then place the \$3 as an implicit tax in the numerator, we obtain the correct effective tax rate, 30 percent. This analytically superior treatment of tax-exempt interest could not be used for lack of necessary data in tax returns.

Similarly, the investment credit is a form of tax-exempt subsidy which happens to be cleared through the tax system. As such, \$1 of credit is clearly worth less to a small corporation subject to tax at 22 percent than to a larger corporation subject to tax at 48 percent. For the 22 percent taxpayer, \$1 of credit substitutes for a market (pre-tax) income receipt of only \$1.28; for the 48 percent taxpayer, the credit substitutes for \$1.92 in market income. 18/ Again, in this sense, recipients of the investment and WIN tax credits fail to pay their fair share of tax.

18/ In the effective tax calculations, the investment and WIN credits are treated as "reductions in tax." Another way to view these credits, which are almost indistinguishable from tax-exempt cash grants, is simply to treat them as such. In this event the before-credits tax would appear in the numerator of the effective tax rate calculation, and the credits earned would be added to the denominator. The result of this alternative calculation would be a higher effective tax rate than that computed by the procedure used in this report.

In sum, the pernicious aspect of tax subsidies is not so much that they substitute for explicit subsidies regarded by the Congress as serving the public interest and thereby cause effective tax rates to appear low, but that subsidies provided through remissions of tax almost invariably provide subsidy benefits in nontaxable form.^{19/} This has two highly undesirable effects. First, in an economy such as the United States, market prices serve to value resources. Gross National Product, for example, is measured in market prices. But market prices are generally in pre-tax terms. Thus, when the government wishes to carry out a procurement or other expenditure program, the dollars it budgets must be in pre-tax terms; and this fairly measures the economic significance of the programs. However, if government carries out its programs either by the expenditure of nontaxable funds, as in the case of unemployment compensation and social

^{19/} One recent exception to this generalization is the New Jobs Credit enacted in 1977. This credit is structured so that it enters the taxable incomes of employers (if wages do not rise) or employees, just as would an equivalent wage subsidy paid in cash by the Department of Labor.

security payments, or by remission of tax--a nontaxable "tax expenditure"--the budgetary impact understates the economic magnitude of the government program: if the same program that is financed by tax-exempt expenditures or nontaxable tax subsidies were financed by normal expenditure programs, the dollar cost would be properly seen to be higher. By appearing to be "cheap," tax subsidies may be overused.

Second, in a tax system that imposes progressive rates, implementation of government programs by nontaxable expenditures and tax subsidies confers benefits that are proportional to the income status of the taxpayer. Put another way, such programs enable taxpayers to legally avoid paying their fair, statutory, share of taxes to support the activities of government, including the activities subsidized.

Table 1.-Income Measures, United States and Foreign Tax Liabilities; For Nonfinancial Corporations Filing Income Tax Returns, By Size of Adjusted Assets; 1972

		Asset Size (dollars)												
		1	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	1 bill.	25 bill.	5 bill.	1 bill.	
		under	under	under	under	under	under	under	under	under	under	under	or	
		sizes	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	100,000,000	25 bill.	5 bill.	1 bill.	more
(dollar amounts in millions)														
I.														
All corporations, with and without basic worldwide taxable income:														
Number.....(a)	1,625,113	716,647	604,393	232,789	58,267	6,161	3,606	1,363	732	585	247	148	175	
U.S. tax, after credits.....(b)	29,130	211	1,254	2,738	3,643	1,400	1,691	1,373	1,514	2,285	2,190	2,336	8,498	
Basic worldwide taxable income(c)	75,150	-253	3,810	6,670	7,028	2,699	3,287	2,907	3,317	5,313	5,289	5,952	29,130	
Effective tax rate.....(d)	38.8	-	32.9	41.0	51.8	51.9	51.4	47.2	45.7	43.0	41.4	39.2	29.2	
II.														
Corporations with basic worldwide income taxable as such (excludes Subchapter S and DISC corporations):														
Number.....(a)	752,331	235,978	320,396	149,151	38,008	3,989	2,417	928	532	451	198	129	154	
U.S. tax, after credits.....(b)	29,100	211	1,253	2,736	3,641	1,399	1,688	1,372	1,512	2,283	2,189	2,333	8,481	
Basic worldwide taxable income(c)	84,280	1,003	4,741	7,537	8,585	3,221	3,904	3,227	3,660	5,870	5,803	6,779	29,950	
Effective tax rate.....(d)	34.5	21.0	26.4	36.3	42.4	43.4	43.2	42.5	41.3	38.9	37.7	34.4	28.3	
III.														
Corporations with adjusted worldwide income:														
Number.....(a)	871,865	300,486	357,612	162,049	41,940	4,451	2,707	1,038	593	494	203	134	159	
Worldwide tax liabilities, net of U.S. investment and WIN credits....(b)	38,220	269	1,348	2,811	3,725	1,443	1,761	1,454	1,638	2,632	2,538	2,985	15,620	
Adjusted worldwide income....(c)	93,440	1,305	5,315	8,186	9,382	3,543	4,303	3,542	4,036	6,449	6,251	7,342	33,780	
Effective tax rate.....(d)	40.9	20.6	25.4	34.3	39.7	40.7	40.9	41.0	40.6	40.8	40.6	40.7	46.2	

Table 1.-Income Measures, United States and Foreign Tax Liabilities; For Nonfinancial Corporations Filing Income Tax Returns, By Size of Adjusted Assets; 1972

		Asset Size (dollars)												
		1	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	1 bill.	.25 bill.	.25 bill.	1 bill.	
: All		: under	: under	: under	: under	: under	: under	: under	: under	: under	: under	: under	: or	
: sizes		: 50,000	: 250,000	: 1,000,000	: 5,000,000	: 10,000,000	: 25,000,000	: 50,000,000	: 100,000,000	: 25 bill.	: .5 bill.	: 1 bill.	: more	
(dollar amounts in millions)														
IV.														
Corporations with														
U.S. source														
adjusted income:														
Number.....(a)	871,548	300,435	357,571	161,992	41,856	4,430	2,692	1,029	579	485	199	128	152	
U.S. tax liability														
after investment														
and WIN credit.(b)	29,610	268	1,347	2,808	3,696	1,419	1,719	1,391	1,533	2,313	2,218	2,374	8,521	
Adjusted U.S.														
source income..(c)	78,330	1,302	5,310	8,174	9,298	3,473	4,177	3,375	3,760	5,676	5,348	5,830	22,600	
Effective tax														
rate.....(d)	37.8	20.6	25.4	34.4	39.8	40.8	41.2	41.2	40.8	40.8	41.5	40.7	37.7	
V.														
Corporations with														
foreign source														
income:														
Number.....(a)	4,240	141	423	659	1,111	377	443	276	221	266	123	94	106	
Foreign tax														
liabilities.....(b)	8,530.7	0.4	0.5	2.6	23.9	23.7	39.9	61.4	102.2	308.9	319.4	594.0	7,053.8	
Foreign source														
income.....(c)	15,210.0	3.6	3.2	11.2	85.6	69.4	126.9	172.4	305.8	819.9	889.6	1,527.3	11,190.0	
Effective tax														
rate.....(d)	56.1	11.3	14.3	23.1	28.0	34.2	31.4	35.6	33.4	37.7	35.9	38.9	63.0	
Office of the Secretary of the Treasury														
Office of Tax Analysis														

Table 2.- Effective Tax Rates on Worldwide Income,
All Corporations With Income, and Corporations
With Under \$1,000,000 of Assets, by Industry; 1972

Industry	All Corporations		Corporations with under \$1,000,000 of Assets	
	Industry : rank	Effective : tax rate	Effective : tax rate	Corporations : included
-----P e r c e n t-----				
Petroleum and natural gas	1	59.4	23.8	85.1
Manufacturing, not elsewhere classified	2	41.9	32.3	86.2
Wholesale and retail trade	3	38.8	32.0	94.9
Credit dealers, brokers, insurance agents	4	38.1	29.1	95.1
Paper and allied products	5	37.4	32.4	79.5
Communications	6	35.7	27.6	79.6
Electric, gas, and sanitary services	7	35.4	28.0	89.8
Lumber and wood products (nonfurniture)	8	34.2	32.2	87.5
Contract construction	9	33.7	28.4	95.2
Primary metals: ferrous	10	33.1	33.2	75.7
Primary metals: nonferrous	11	32.4	25.4	72.4
Services	12	31.6	26.5	97.5
Transportation	13	30.3	26.6	94.3
Real estate	14	28.9	26.2	94.7
Agriculture, forestry, and fisheries	15	28.0	23.6	94.4
Unclassifiable businesses	16	27.0	25.4	98.8
Coal Mining	17	26.7	24.7	84.3
Mining, not elsewhere classified	18	26.2	22.4	76.8
Banking	19	19.4	26.8	6.7

Office of the Secretary of the Treasury
Office of Tax Analysis

Table 2a.-Effective Tax Rates on Worldwide Income, All Corporations With Income, by Industry and Size of Assets; 1972

		Asset size (dollars)											
		1	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	.1 bill.	.25 bill.	.5 bill.	1 bill.
Industry	All	under	under	under	under	under	under	under	under	under	under	under	or
item	sizes	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	100,000,000	.25 bill.	.5 bill.	1 bill.	more
(dollar amounts in thousands)													
Petroleum & natural gas													
a.....	3,896	1,154	1,443	718	392	60	41	31	13	16	5	4	19
b.....	6,154,972	1,234	7,169	9,435	32,160	11,957	15,689	35,676	12,693	30,385	70,566	106,697	5,821,312
c.....	10,370,000	6,460	32,363	36,108	104,081	46,976	60,184	103,280	56,873	115,072	180,802	205,800	9,424,943
d.....	59.4	19.1	22.2	26.1	30.9	25.4	26.1	34.5	22.3	26.4	39.0	51.8	61.8
Manufacturing not elsewhere classified													
a.....	101,120	24,565	37,698	24,860	10,300	1,547	1,008	434	265	234	96	65	49
b.....	17,740,000	24,674	176,949	661,313	1,369,089	682,593	914,479	797,999	997,162	1,709,830	1,819,956	2,026,364	6,559,199
c.....	42,340,000	118,784	712,213	1,843,761	3,330,523	1,595,464	2,145,554	1,891,828	2,331,000	4,056,048	4,303,458	4,783,185	15,230,000
d.....	41.9	20.8	24.8	35.9	41.1	42.8	42.6	42.2	42.8	42.2	42.3	42.4	43.1
Wholesale and retail trade													
a.....	302,573	84,828	139,258	62,953	13,560	1,020	570	196	90	62	18	10	8
b.....	5,600,293	75,918	569,761	1,208,577	1,208,778	322,161	333,525	283,117	192,095	243,916	181,670	227,769	753,006
c.....	14,420,000	351,246	2,119,501	3,331,895	2,904,028	756,139	799,710	641,879	464,011	574,360	442,469	560,317	1,477,513
d.....	38.8	21.6	26.9	36.3	41.6	42.6	41.7	44.1	41.4	42.5	41.1	40.6	51.0
Credit dealers, brokers, insurance agents													
a.....	49,186	22,228	18,414	6,124	1,836	224	201	77	41	23	9	4	4
b.....	848,433	20,381	74,579	85,942	113,380	50,480	74,247	41,409	87,376	54,318	38,034	87,926	120,362
c.....	2,225,536	96,013	275,261	251,113	283,879	119,061	176,133	100,215	212,911	135,045	92,116	197,713	281,077
d.....	38.1	21.2	27.1	34.2	39.2	42.4	42.2	41.3	41.0	40.2	41.3	44.5	42.8
Paper and allied products													
a.....	2,284	177	780	859	312	50	43	11	22	15	4	6	4
b.....	586,804	78	3,284	21,485	36,527	19,494	22,767	15,437	86,186	73,254	32,681	57,272	218,340
c.....	1,567,136	862	15,354	60,566	87,663	48,119	58,622	38,933	210,008	194,573	101,572	199,643	551,211
d.....	37.4	9.0	21.4	35.5	41.7	40.5	38.8	39.5	41.0	37.6	32.2	28.7	39.6
Communications													
a.....	3,841	633	1,686	739	619	66	44	15	15	10	5	-	6
b.....	1,258,969	407	7,215	10,248	40,406	14,450	28,429	7,793	15,163	38,787	32,211	-	963,451
c.....	3,528,297	2,318	29,270	33,065	108,091	37,280	68,940	20,079	44,598	96,046	87,472	-	2,763,893
d.....	35.7	17.6	24.6	31.0	37.4	38.8	41.2	38.8	34.0	40.4	36.8	-	34.9

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credit; c = Adjusted worldwide income; d = Effective tax rate

Table 2a.-Effective Tax Rates on Worldwide Income, All Corporations With Income, by Industry and Size of Assets; 1972

		Asset size (dollars)											
		1	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	1 bill.	.25 bill.	.5 bill.	1 billion
Industry,	All	under	under	under	under	under	under	under	under	under	under	under	or
item	sizes	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	100,000,000	.25 bill.	.5 bill.	1 bill.	more
(dollar amounts in thousands)													
Electric, gas, and sanitary services													
a.....	4,534	1,700	1,755	615	173	35	60	29	25	41	34	26	42
b.....	1,363,293	646	7,350	12,989	9,556	6,146	19,124	23,933	26,716	107,901	164,417	204,901	779,613
c.....	3,853,979	3,802	31,632	39,506	27,497	17,011	49,756	60,486	69,042	282,289	426,003	577,831	2,269,124
d.....	35.4	17.0	23.2	32.9	34.8	36.1	38.4	29.6	38.7	38.2	38.6	35.5	34.4
Lumber and wood products (nonfurniture)													
a.....	5,871	913	2,641	1,586	591	74	39	10	6	8	-	-	-
b.....	437,308	865	10,809	47,571	95,913	41,148	30,270	13,829	20,068	39,535	-	-	-
c.....	1,279,036	4,352	47,516	132,257	242,519	102,758	77,234	39,097	55,877	117,125	-	-	-
d.....	34.2	19.9	22.8	36.0	39.6	40.0	39.2	35.4	35.9	33.8	-	-	-
Contract construction													
a.....	73,223	28,613	29,438	11,684	3,036	250	132	34	22	11	-	-	-
b.....	901,312	30,711	133,760	219,186	258,879	64,414	63,567	22,851	40,199	62,951	-	-	-
c.....	2,676,493	150,467	542,022	656,713	678,637	167,594	157,361	60,580	102,979	142,199	-	-	-
d.....	33.7	20.4	24.7	33.4	38.2	38.4	40.4	37.7	39.0	44.3	-	-	-
Primary metals--ferrous													
a.....	1,730	405	496	408	282	53	33	19	11	10	5	-	7
b.....	447,086	519	2,514	11,139	46,441	22,205	28,828	25,621	21,680	72,722	25,337	-	189,926
c.....	1,351,713	2,348	10,208	30,184	110,452	53,547	65,761	63,698	59,472	176,901	83,837	-	682,800
d.....	33.1	22.1	24.6	36.9	42.0	41.5	43.8	40.2	36.4	41.1	30.2	-	27.8
Unclassifiable businesses													
a.....	2,865	2,154	487	189	29	-	-	-	-	-	-	-	-
b.....	8,698	2,390	2,188	1,933	1,531	-	-	-	-	-	-	-	-
c.....	32,185	9,269	7,765	8,637	3,513	-	-	-	-	-	-	-	-
d.....	27.0	25.8	28.2	22.4	43.6	-	-	-	-	-	-	-	-
Coal mining													
a.....	737	177	248	196	70	19	10	10	3	-	-	-	-
b.....	52,752	126	1,438	3,026	6,798	5,458	4,410	4,175	4,414	-	-	-	-
c.....	197,596	577	5,655	12,315	24,831	19,836	17,651	21,656	16,723	-	-	-	-
d.....	26.7	21.8	25.4	24.6	27.4	27.5	25.0	19.3	26.4	-	-	-	-

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credits; c = Adjusted worldwide income; d = Effective tax rate

Table 2a.-Effective Tax Rates on Worldwide Income, All Corporations With Income, by Industry and Size of Assets; 1972

		Asset size (dollars)												
Industry item	All sizes	1 under 50,000	50,000 250,000	250,000 1,000,000	1,000,000 5,000,000	5,000,000 10,000,000	10,000,000 25,000,000	25,000,000 50,000,000	50,000,000 1 bill.	.1 bill. .25 bill.	.25 bill. .5 bill.	.5 bill. 1 bill.	1 bill. or more	
	(dollar amounts in thousands)													
Mining not elsewhere classified														
a.....	1,863	-	752	679	248	47	21	11	-	-	-	-	-	
b.....	67,420	-	2,702	9,899	15,268	11,234	7,435	8,586	-	-	-	-	-	
c.....	257,395	-	14,121	42,058	57,260	41,272	26,299	33,279	-	-	-	-	-	
d.....	26.2	-	19.1	23.5	26.7	27.2	28.3	25.3	-	-	-	-	-	
Banking														
a.....	17,947	-	385	823	5,787	3,774	3,528	1,573	897	601	227	117	78	
b.....	1,646,672	-	1,562	3,282	76,063	100,677	157,800	133,218	134,872	220,569	182,813	152,624	483,090	
c.....	8,495,566	-	4,895	13,180	365,883	530,487	869,165	697,609	675,026	1,042,793	901,414	882,036	2,512,773	
d.....	19.4	-	31.9	24.9	20.8	19.0	18.2	19.1	20.0	21.2	20.3	17.3	19.2	

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credit; c = Adjusted worldwide income; d = Effective tax rate

Table 3.-Effective Tax Rates on U.S. Source Income
All Corporations With Income and Corporations
With Under \$1,000,000 of Assets, by Industry, 1972

Industry ^{1/}	All corporations		Corporations with under \$1,000,000 of Assets	
	Industry rank	Effective tax rate	Effective tax rate	Corporations included
		-----P e r c e n t-----		
Manufacturing not elsewhere classified	1	42.0	32.3	86.2
Paper and allied products	2	38.4	32.4	79.5
Credit dealers, brokers, insurance agents	3	38.3	29.0	95.1
Wholesale and retail trade	4	38.0	32.0	94.9
Communications	5	36.1	27.6	79.6
Electric, gas, and sanitary services	6	35.3	28.0	89.8
Lumber and wood products (nonfurniture)	7	34.6	32.2	87.5
Primary metals: ferrous	8	33.7	33.2	75.8
Contract construction	9	33.4	28.4	95.2
Services	10	31.6	26.5	97.6
Transportation	11	30.1	26.6	94.3
Primary metals: nonferrous	12	29.4	25.4	72.6
Real estate	13	28.9	26.2	94.7
Agriculture, forestry and fisheries	14	28.1	23.4	94.4
Unclassifiable businesses	15	27.7	26.1	98.8
Mining not elsewhere classified	16	25.6	22.4	76.9
Petroleum and natural gas	17	24.7	23.8	85.5
Coal mining	18	19.4	24.7	84.3
Banking	19	18.6	26.8	6.7

Office of the Secretary of the Treasury
Office of Tax Analysis

^{1/} See Appendix for detailed industry categories in groupings shown here.

Table 3a-Effective Tax Rates on U.S. Source Income, All Corporations with Income, by Industry and Size of Assets; 1972

Industry, item	Asset Size (dollars)												
	: All : 1 : 50,000 : 250,000 : 1,000,000 : 5,000,000 : 10,000,000 : 25,000,000 : 50,000,000 : .1 bill. : .25 bill. : .5 bill. : 1 bill.												
	sizes	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	.1 bill.	.25 bill.	.5 bill.	1 bill.	or more
(dollar amounts in thousands)													
Manufacturing, not elsewhere classified													
a.....	101,026	24,565	37,683	24,852	10,276	1,534	1,002	429	255	228	93	62	47
b.....	15,290,000	24,674	176,244	660,443	1,359,798	669,408	889,302	764,692	921,756	1,490,247	1,546,463	1,606,829	5,182,941
c.....	36,430,000	118,784	709,889	1,840,506	3,303,413	1,557,431	2,071,128	1,789,779	2,134,216	3,497,982	3,499,338	3,688,296	12,220,000
d.....	42.0	20.8	24.8	35.9	41.2	43.0	42.9	42.7	43.2	42.6	44.2	43.6	42.4
Paper and allied products													
a.....	2,284	177	780	859	312	50	43	11	22	15	4	6	4
b.....	521,669	78	3,284	21,465	36,523	18,810	22,530	15,378	75,360	72,670	30,312	48,620	176,639
c.....	1,357,882	862	15,354	60,475	87,460	46,370	58,014	38,387	181,414	192,972	95,916	170,936	409,722
d.....	38.4	9.0	21.4	35.5	41.8	40.6	38.8	40.1	41.5	37.7	31.6	28.4	43.1
Credit dealers, brokers, insurance agents													
a.....	49,164	22,228	18,399	6,122	1,836	224	199	76	40	23	9	4	-
b.....	822,426	20,381	74,560	85,596	112,952	50,057	71,710	40,989	83,169	52,145	36,736	87,630	-
c.....	2,147,277	96,010	275,231	250,443	287,627	117,377	168,472	98,760	201,965	127,998	86,854	192,559	-
d.....	38.3	21.2	27.1	34.2	39.3	42.6	42.6	41.5	41.2	40.7	42.3	45.5	-
Wholesale and retail trade													
a.....	302,511	84,828	139,258	62,923	13,545	1,013	567	195	88	61	18	9	7
b.....	5,290,425	75,841	569,760	1,207,296	1,202,369	317,498	328,907	269,661	189,843	220,127	167,395	183,030	558,698
c.....	13,920,000	350,117	2,117,564	3,327,509	2,882,017	740,177	785,031	617,861	457,985	525,114	406,158	448,136	1,267,055
d.....	38.0	21.7	26.9	36.3	41.7	42.9	41.9	43.6	41.4	41.9	41.2	40.8	44.1
Communications													
a.....	3,841	633	1,686	739	619	66	44	15	15	10	5	-	6
b.....	1,232,402	407	7,215	10,248	40,406	14,450	28,429	7,793	13,762	38,464	31,948	-	948,321
c.....	3,413,691	2,318	29,270	33,065	108,091	37,280	68,940	20,079	40,729	92,032	86,831	-	2,694,345
d.....	36.1	17.6	24.6	31.0	37.4	38.8	41.2	38.8	33.8	41.8	36.8	-	35.2

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credit; c = Adjusted worldwide income; d = Effective tax rate.

Table 3a.-Effective Tax Rates on U.S. Source Income, All Corporations With Income, by Industry and Size of Assets; 1972

Industry item	Asset Size (dollars)												
	All sizes	1 under 50,000	50,000 under 250,000	250,000 under 1,000,000	1,000,000 under 5,000,000	5,000,000 under 10,000,000	10,000,000 under 25,000,000	25,000,000 under 50,000,000	50,000,000 under 100,000,000	100,000,000 under 250,000,000	250,000,000 under 500,000,000	500,000,000 under 1,000,000,000	1,000,000,000 or more
(dollar amounts in thousands)													
Electric, gas, and sanitary services													
a.....	4,534	1,700	1,755	615	173	35	60	29	25	41	34	26	42
b.....	1,354,513	646	7,350	12,989	9,556	6,146	19,124	23,727	26,716	107,058	164,417	204,187	772,597
c.....	3,835,767	3,802	31,632	39,506	27,497	17,011	49,756	50,064	69,042	280,523	426,003	574,492	2,256,438
d.....	35.3	17.0	23.2	32.9	34.9	36.1	38.4	39.5	38.7	38.2	38.6	35.5	34.2
Lumber and wood products (nonfurniture)													
a.....	5,871	913	2,641	1,586	591	74	39	10	6	8	-	-	-
b.....	431,952	865	10,809	47,571	95,856	41,036	30,256	13,821	20,033	39,480	-	-	-
c.....	1,248,761	4,352	47,516	132,257	242,087	102,434	76,850	39,044	55,710	116,733	-	-	-
d.....	34.6	19.9	22.8	36.0	39.6	40.1	39.4	35.4	36.0	33.8	-	-	-
Primary metals: ferrous													
a.....	1,727	405	496	408	281	53	32	19	11	10	5	-	7
b.....	390,370	519	2,514	11,130	45,459	22,204	28,503	25,009	20,281	61,842	22,768	-	149,985
c.....	1,157,523	2,348	10,208	30,108	108,399	53,546	64,866	60,904	55,498	152,213	76,480	-	530,446
d.....	33.7	22.1	24.6	37.0	41.9	41.5	43.9	41.1	36.5	40.6	29.8	-	28.3
Contract construction													
a.....	73,215	28,613	29,438	11,684	3,032	250	131	33	21	10	-	-	-
b.....	871,266	30,711	133,760	219,186	255,134	64,303	62,490	21,177	38,136	41,731	-	-	-
c.....	2,604,656	150,467	542,022	656,396	668,216	167,152	152,765	54,633	97,644	98,851	-	-	-
d.....	33.4	20.4	24.7	33.4	38.2	38.5	40.9	38.8	39.1	42.2	-	-	-
Services													
a.....	151,288	90,470	43,321	13,803	3,034	331	194	59	30	27	5	4	-
b.....	1,059,348	78,803	164,799	214,528	177,509	81,642	81,849	77,600	43,842	61,430	15,470	61,876	-
c.....	3,352,128	395,608	666,824	664,049	493,694	215,332	209,466	193,124	132,563	179,077	54,903	147,487	-
d.....	31.6	19.9	24.7	32.3	36.0	37.9	39.1	40.2	33.1	34.3	28.2	42.0	-
Transportation													
a.....	26,521	9,864	10,518	4,630	1,077	174	122	50	29	21	17	7	13
b.....	781,512	7,360	38,693	78,065	91,698	49,223	76,922	54,164	49,504	49,979	134,060	63,360	88,485
c.....	2,593,240	39,677	180,174	247,572	245,013	128,497	192,055	150,823	148,349	149,903	371,861	188,415	550,901
d.....	30.1	18.6	21.5	31.5	37.4	38.3	40.0	35.9	33.4	33.3	36.0	33.6	16.1

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credit; c = Adjusted worldwide income; d = Effective tax rate.

Table 3a.-Effective Tax Rates on U.S. Source Income, All Corporations With Income, by Industry and Size of Assets; 1972

Industry item	Asset Size (dollars)											
	All sizes	1 : under : 50,000	50,000 : under : 250,000	250,000 : under : 1,000,000	1,000,000 : under : 5,000,000	5,000,000 : under : 10,000,000	10,000,000 : under : 25,000,000	25,000,000 : under : 50,000,000	50,000,000 : under : 100,000,000	100,000,000 : under : 250,000,000	250,000,000 : under : 500,000,000	500,000,000 : or more
(dollar amounts in thousands)												
Primary metals:												
nonferrous												
a.....	1,243	177	442	283	238	43	22	7	15	6	-	5
b.....	221,149	387	2,496	4,574	33,402	14,248	13,592	7,922	37,486	21,994	-	17,932
c.....	752,563	4,003	9,057	16,284	80,911	35,163	34,835	19,010	113,431	69,869	-	160,048
d.....	29.4	9.7	27.6	28.1	41.3	40.5	39.0	40.4	33.0	31.5	-	11.2
Real estate												
a.....	133,189	31,081	65,292	29,714	6,218	499	257	82	26	17	-	-
b.....	695,230	19,663	136,041	195,139	169,307	40,094	48,480	34,963	19,107	27,416	-	-
c.....	2,402,425	95,309	553,351	689,793	518,543	137,291	156,492	103,653	51,681	81,442	-	-
d.....	28.9	20.6	24.6	28.3	32.6	29.2	31.0	33.7	37.0	33.7	-	-
Agriculture, forestry, and fisheries												
a.....	18,421	5,324	7,311	4,756	906	74	37	8	-	4	-	-
b.....	177,472	7,145	21,478	48,623	47,798	15,693	13,196	7,993	-	10,184	-	-
c.....	631,835	36,016	110,356	181,193	151,184	42,945	45,603	22,323	-	28,712	-	-
d.....	28.1	19.8	19.5	26.8	31.6	36.5	28.9	35.0	-	35.5	-	-
Unclassifiable businesses												
a.....	2,864	2,154	487	189	29	-	-	-	-	-	-	-
b.....	8,420	2,112	2,188	1,933	1,531	-	-	-	-	-	-	-
c.....	30,368	7,452	7,765	8,637	3,513	-	-	-	-	-	-	-
d.....	27.7	28.3	28.2	22.4	43.6	-	-	-	-	-	-	-
Mining not elsewhere classified												
a.....	1,862	-	752	679	248	47	21	11	-	-	-	-
b.....	61,855	-	2,622	9,899	15,268	11,233	6,628	8,586	-	-	-	-
c.....	241,699	-	13,778	42,058	57,260	41,269	25,104	33,276	-	-	-	-
d.....	25.6	-	19.0	23.5	26.7	27.2	26.4	25.8	-	-	-	-

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credit; c = Adjusted worldwide income; d = Effective tax rate.

Table 3a.-Effective Tax Rates on U.S. Source Income, All Corporations With Income, by Industry and Size of Assets; 1972

Industry item	Asset Size (dollars)												
	All	1	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	.1 bill.	.25 bill.	.5 bill.	1 bill.
	sizes	50,000	250,000	1,000,000	5,000,000	10,000,000	25,000,000	50,000,000	100,000,000	.25 bill.	.5 bill.	1 bill.	or more
(dollar amounts in thousands)													
Petroleum and natural gas													
a.....	3,878	1,154	1,443	718	379	60	40	30	13	15	4	4	18
b.....	714,643	1,234	7,169	9,406	31,026	11,956	12,069	29,609	11,826	25,727	55,172	20,957	498,491
c.....	2,893,401	6,460	32,363	36,050	101,678	46,973	50,104	89,239	53,004	100,517	157,061	118,183	2,101,769
d.....	24.7	19.1	22.2	26.1	30.5	25.4	24.1	33.2	22.3	25.6	35.1	17.7	23.7
Coal mining													
a.....	737	177	248	196	70	19	10	10	-	-	-	-	-
b.....	35,739	126	1,438	3,026	6,798	5,457	4,410	4,176	-	-	-	-	-
c.....	184,017	577	5,655	12,315	24,831	19,834	17,651	21,656	-	-	-	-	-
d.....	19.4	21.8	25.4	24.6	27.4	27.5	25.0	19.3	-	-	-	-	-
Banking													
a.....	17,938	-	384	823	5,787	3,774	3,527	1,578	897	599	227	117	72
b.....	1,413,574	-	1,562	3,282	76,063	100,676	157,735	133,238	134,803	217,336	181,236	147,283	260,287
c.....	7,616,205	-	4,895	13,180	365,883	530,457	868,841	697,541	674,652	1,029,589	892,091	853,489	1,685,280
d.....	18.6	-	31.9	24.9	20.8	19.0	18.2	19.1	20.0	21.1	20.3	17.3	15.4

a = Number; b = Worldwide tax liabilities net of U.S. investment and WIN credit; c = Adjusted worldwide income; d = Effective tax rate.

Office of the Secretary of the Treasury
Office of Tax Analysis

Appendix

Industry Descriptions

- 1 Agriculture, forestry, fisheries
- 2 Banking
 - Mutual savings banks
 - Banks and trust companies
 - Savings and loan associations
- 3 Coal mining
- 4 Communications
- 5 Contract construction
- 6 Credit dealers, brokers, insurance agents
 - Personal, business, and other credit agencies
 - Securities brokers, dealers and flotation companies
 - Commodity brokers and dealers, security and commodity exchange and allied services
 - Insurance agents, brokers, and service
 - Other real estate and combinations of real estate, insurance, loan, and law offices
- 7 Electric, gas and sanitary services
- 8 Lumber and wood products (nonfurniture)
- 9 Manufacturing not elsewhere classified
 - Apparel and textiles
 - Chemicals and allied products
 - Fabricated metal products
 - Food and kindred
 - Furniture and fixtures
 - Leather and leather products
 - Machinery
 - Miscellaneous manufacturing products
 - Printing and publishing
 - Scientific instruments, photographic equipment, watches, clocks
 - Stone, clay and glass products
 - Tobacco
 - Transportation equipment
- 10 Other mining
 - Miscellaneous metal mining
 - Non metallic minerals (except fuels) mining
- 11 Paper and allied products

- 12 Petroleum and natural gas
 - Crude petroleum and natural gas
 - Petroleum refining and related industries
- 13 Primary metals: ferrous
 - Iron ore mining
 - Ferrous metal processing and basic products, and primary metal products not elsewhere classified
- 14 Primary metals: nonferrous
 - Copper, lead and zinc, gold and silver ores
 - Nonferrous metal processing and basic products
- 15 Real estate
 - Except other real estate combinations of real estate, insurance, loan and law offices
- 16 Services
- 17 Transportation
- 18 Unclassifiable business
- 19 Wholesale and retail trade

Definitions of Terms

Adjusted assets - Total assets less the smaller of "accounts payable" or "accounts receivable". Accounts receivable are trade notes and accounts receivable minus allowance for bad debts plus other current assets. Accounts payable are accounts payable plus mortgages due in less than one year plus other current liabilities.

Adjusted U.S. source income - See U.S. source adjusted income.

Adjusted worldwide income - Basic worldwide taxable income plus charitable contributions, tax exempt interest, public utilities dividend paid deduction, Western Hemisphere Trade deduction, other preferences as defined in the minimum tax calculation, foreign taxes deemed paid and not elsewhere included in income, and the net operating loss deduction.

Basic Worldwide Taxable Income - Net income as defined by the Internal Revenue Code, i.e., gross income from all sources less all allowable deductions, including the so-called special deductions for net operating loss carryforward, dividends received, and Western Hemisphere Trade.

Deferred income taxes - When financial report income exceeds taxable income because certain deductions are taken for tax purposes prior to the time they will be recorded in the financial books-of-account, this is taken to mean that income tax on the difference between the two measures of income is "deferred." Deferred taxes are therefore estimates of the current year's tax expense which will be paid in some future year.

DISC corporations - Domestic International Sales Corporations established by The Revenue Act of 1971, Public Law 92-178, are entitled to special tax treatment for taxable years beginning on or after January 1, 1972. The income of these corporations is untaxed and one half of such income is deemed to be distributed to the parent corporation and taxed at the parent corporation level.

Foreign source income - Reported Form 1118 source income plus the Western Hemisphere Trade Deductions plus foreign taxes deemed paid and not elsewhere included in income.

Foreign tax credit carryforward - A credit for taxes paid on foreign source income in excess of U.S. statutory rates in a previous year used to reduce current year U.S. tax payments.

Foreign tax liabilities - Foreign taxes paid and deemed paid

Investment tax credit - A tax credit equal to 7 percent in 1972 of the purchase price of machinery and equipment with a useful life of 7 years or more. The credit for shorter-lived property is reduced. The amount of the credit in any one year cannot exceed the first \$25,000 of tax liability for the year plus one-half the tax liability in excess of \$25,000.

Net operating loss carryforward - A taxable income deficit in previous years deducted from current year income.

Subchapter S corporations - Certain small corporations with fewer than 10 stockholders and having one class of stock that are subject only to capital gains taxes on certain transactions. The taxable income of such corporations is attributed and taxed to shareholders whether or not distributed.

Worldwide tax liabilities, net of U.S. investment and WIN credits - Net domestic income and minimum taxes due plus foreign taxes paid and deemed paid plus foreign tax credits carried forward and taken plus tax on recomputation of the investment credit.

U.S. tax liability after investment and WIN credit - Worldwide tax liabilities net of U.S. investment and WIN credits minus foreign tax liabilities.

U.S. source adjusted income - Adjusted worldwide income minus foreign source income.

U.S. tax after credits - Total taxes paid. This is the net income and minimum tax due and payable to the Treasury after foreign, investment and work incentive credits.

WIN credit - A tax credit of 20 percent of certain expenses incurred in the employment of welfare recipients.

Department of the Treasury
Washington, D.C. 20220

Official Business
Penalty for Private Use, \$300

Postage and Fees Paid
Department of the Treasury

TREAS-551

