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All Gain, No Pain: California's "No Tax" Corporations

All California corporations are required to pay at least an annual minimum franchise tax of \$800 for the privilege of doing business in the state.¹ Profitable corporations pay income taxes at a rate of 8.84 percent. However, many profitable corporations – including some very large ones – are able to avoid paying corporate income taxes by using deductions, credits, and other preferential tax treatment. In fact, in 2001, 72.8 percent (378,344) of the corporations doing business in the state paid just the \$800 minimum franchise tax. Even more startling, over half (52.0 percent, 153,441) of the state's profitable corporations paid no more than the \$800 minimum franchise tax, including 46 corporations with over \$1 billion in 2001 receipts.

California Corporations Paying Only the Minimum Franchise Tax (2001)				
All Returns				
Gross Receipts	Corporate Returns Paying Only the Minimum Tax	Percent Of Total	Number Headquartered in California	Total Corporate Tax Returns
Above \$1 Billion	490	0.1%	63	1,331
\$500 M to \$1 Billion	567	0.1%	71	1,069
\$100 M to \$500 M	2,650	0.5%	789	5,081
\$10 M to \$100 M	16,430	3.2%	6,333	31,980
Under \$10 M	358,207	68.9%	330,019	480,595
Total	378,344	72.8%	337,275	520,056
Positive Income Returns				
Gross Receipts	Corporate Returns Paying Only the Minimum Tax	Percent Of Total	Number Headquartered in California	Total Positive Income Corporate Tax Returns
Above \$1 Billion	46	0.0%	6	884
\$500 M to \$1 Billion	65	0.0%	4	566
\$100 M to \$500 M	664	0.2%	326	3,090
\$10 M to \$100 M	4,285	1.5%	1,730	19,835
Under \$10 M	148,381	50.3%	140,167	270,498
Total	153,441	52.0%	142,233	294,873

Source: Franchise Tax Board

How do large, profitable corporations avoid paying taxes on their income? Under California's tax laws, corporations can deduct their ordinary business expenses and losses incurred in prior years.² Corporations with qualifying expenditures can also claim the state's various tax credits.

Who Are the No Tax Corporations?

State law prohibits tax officials from disclosing the identity of corporations that do not pay taxes in California. Studies based on corporate annual reports and securities filings have identified publicly traded corporations that pay no federal income taxes. Since corporations are not required to disclose where they pay state corporate taxes and how much they pay, it is not possible to use this information to identify corporations that pay no California corporate income taxes. California-based corporations that paid no federal income taxes between 2001 and 2003 include Walt Disney, Fluor, Health Net, Ingram Micro, and Computer Sciences.³ Computer Sciences reported US profits of \$1.29 billion and received \$31 million in federal tax rebates during the three year period studied. Ingram Micro received tax rebates in two of the three years.

Many Corporations Pay No Federal Income Taxes

A recent study by the US General Accounting Office found that 73.3 percent of foreign-controlled and 63.0 percent of US-controlled corporations paid no federal income taxes in 2000.⁴ These “no federal tax” corporations included 37.5 percent of foreign-controlled and 45.3 percent of US-controlled large corporations. The percentage of “no tax” foreign-controlled corporations has increased slightly in recent years, rising from 67.6 percent in 1996 to 71.3 percent in 2000, while the percentage of “no tax” US-controlled corporations has remained relatively steady, increasing from 60.3 percent in 1996 to 61.3 percent in 2000.⁵

What About the Alternative Minimum Tax?

Under California law, corporations that claim certain preferences (deductions, credits, and other preferential treatment) may owe the Alternative Minimum Tax (AMT) if their taxable income plus adjustments and preferences exceeds \$40,000. The AMT was enacted in its current form in 1987 when California conformed to the 1986 federal tax act, which closed a number of loopholes and lowered the corporate tax rate.⁶ The AMT was designed to ensure that profitable businesses paid at least a minimum level of tax on their income. However, over time, the goal of the AMT has been undermined as lawmakers allowed certain preferences to reduce the amount corporations would pay under the AMT. Preferences that enable corporations to reduce what it would owe under the AMT include the Research and Development Tax Credit; Low-Income Housing Tax Credit; various Enterprise Zone, Local Agency Military Base Recovery Area (LAMBRA), and targeted tax area credits; and Natural Heritage Preservation Tax Credit.

Jean Ross prepared this paper. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. Support for the CBP comes from foundation grants, publications, and individual contributions.

ENDNOTES

¹ New corporations are exempt from this tax during the first two years in business, some corporations are statutorily exempt, and a limited number pay a smaller minimum franchise tax. Nonprofit corporations are exempt from the minimum tax.

² The ability to deduct losses carried forward from prior years was suspended in 2002 and 2003. The ability to deduct net operating losses was reinstated in 2004 and the percentage of losses that may be deducted was increased for losses beginning after 2003.

³ Citizens for Tax Justice and Institute on Taxation and Economic Policy.

⁴ US General Accounting Office, *Comparison of the Reported Tax Liabilities of Foreign- and US-Controlled Corporations, 1996 -2000* (February 2004), p. 9.

⁵ US General Accounting Office, *Comparison of the Reported Tax Liabilities of Foreign- and US-Controlled Corporations, 1996 -2000* (February 2004), p. 15.

⁶ In 1987, California reduced its corporate rate from 9.6 percent to 9.3 percent, closed a number of loopholes, and replaced the former preference tax with an alternative minimum tax. The current state AMT rate is 6.65 percent.