



Rodney's Take

August 10, 2020

Let the Corporate Tax Games Begin

President Trump's tax reform dropped the corporate tax rate by 40%, from 35% to 21%. This was a huge gift to companies and was somewhat meant to level the playing field among the U.S. and other taxing jurisdictions. The administration claimed that companies would use the extra funds to invest in plants and equipment and to pay higher wages. That didn't happen. Instead, they mostly used the extra income to buy back shares.

During the current pandemic and economic shutdown, we're about to give Corporate America another gift via the tax code. The new scheme... er... strategy allows companies to recapture taxes paid in previous years and then repay taxes next year and beyond at lower rates. This wasn't the goal of the program, but that's how it's going to work.

The CARES Act passed in March included a provision that allows companies to apply current-year taxable losses against their last five years of taxable profits instead of carrying over current year losses to future years. This gift puts cash into corporate hands quickly, because businesses can refile tax returns from previous years, which now will show lower profits or no profits at all, and claim refunds. The federal government

did the same thing in 2009, and many companies clawed back billions of dollars in taxes paid in previous years.

Chief among the beneficiaries back then were home builders. These companies booked a lot of profit during the housing bubble, and then got crushed when the Great Financial Crisis (GFC) took hold. As taxpayers, we gifted cash to these companies, which showed up on our books as higher levels of national debt.

The economic crisis of 2020 isn't the GFC of 2009. Today's economic pain wasn't created by greed in the financial and housing markets or by ratings agencies looking the other way, so at least we don't have the irony of rewarding the bad actors. But we're still giving away cash, and this time we've added a perverse incentive, the changing tax code.

The current corporate tax rate is 21%, but prior to 2018 it was 35%. A deduction today, and arguably next year, is worth a measly 21 cents per dollar, or 40% less than it was just two years ago. With the ability to recapture taxes paid in previous years when rates were higher, companies would be crazy not to do everything they can to show the biggest losses possible today, reducing their tax liability in previous years. They should pay the highest compensation, buy the most equipment, write down all the inventory... throw in the proverbial kitchen sink. After generating a gigantic loss, companies can refile previous tax returns and get big, fat refunds. Once again, this will show up as more national debt for taxpayers.

Next year, after the pandemic passes and business is back to some version of normal, these same companies will likely show much higher taxable profits because they have pulled forward deductions and write-offs. That's not just okay, that's the point. The higher profits earned in 2021 and after will be taxed at the lower 21%, or possibly 28%, rather than the 35%

of previous years. Voilà! Businesses can almost magically generate free cash.

The process isn't very complicated, and every firm, whether effected by the pandemic or not, should be running the numbers to see if it can benefit.

It's possible the government will close this tax loophole with a future pandemic relief package, but until and unless they do, just think of it as one more unintended gift that Congress gave away at the expense of the national debt.

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Got a question or comment? You can reach us at info@hsdent.com.