PENN WHARTON
UNIVERSITY of PENNSYLVANIA
Budget Model

Explaining "Unexplained Weakness" in Corporate Income Tax Receipts

Summary: Recent revisions to estimates of corporate profits may explain the unanswered question of why corporate income tax receipts have underperformed CBO estimates in recent years.

Tomorrow, the Congressional Budget Office (CBO) will release its annual Budget and Economic Outlook, which contains their projections of major indicators such deficits, debt, revenues, and spending. There's a lot to look forward to in the hundred page report, but here at PWBM we'll be paying close attention to new analysis of a lingering mystery: why corporate income tax receipts have underperformed in recent years.

CBO has previously noted this "poorly understood weakness" in corporate income tax receipts—receipts were $38 billion lower in 2018 and $46 billion lower in 2019 than CBO projected in April 2018. While tomorrow's CBO release is expected to address what has caused the weakness in receipts, recent data revisions suggest a likely candidate. In July of 2019—just after CBO had finalized their forecasts for their latest budget and economic outlook (published August 2019)—the Bureau of Economic Analysis (BEA) issued an update to the National Income and Product Accounts (NIPAs), revising down estimates of domestic corporate profits since 2016 by several hundred billion dollars.[1]

Figure 1 compares BEA's revised estimates of corporate profits with the data CBO had available to make its previous projections of receipts. Profits in 2017Q3, the latest data CBO had for its April 2018 projections, were 12 percent ($215 billion) lower than believed at the time. Profits in 2019Q1, the latest data CBO had for its most recent August 2019 projections, were 15 percent ($250 billion) lower than believed at the time. While these earlier data showed rising corporate profits since 2016, the most recent revisions show a decline that began at the beginning of FY2015 and has continued to the present day. Viewed against CBO's projections, which assumed that the pre-revision growth in profits would continue, the effects of these revisions are even larger.

Figure 1. Domestic corporate profits with IVA and CCAdj

Billions of Dollars

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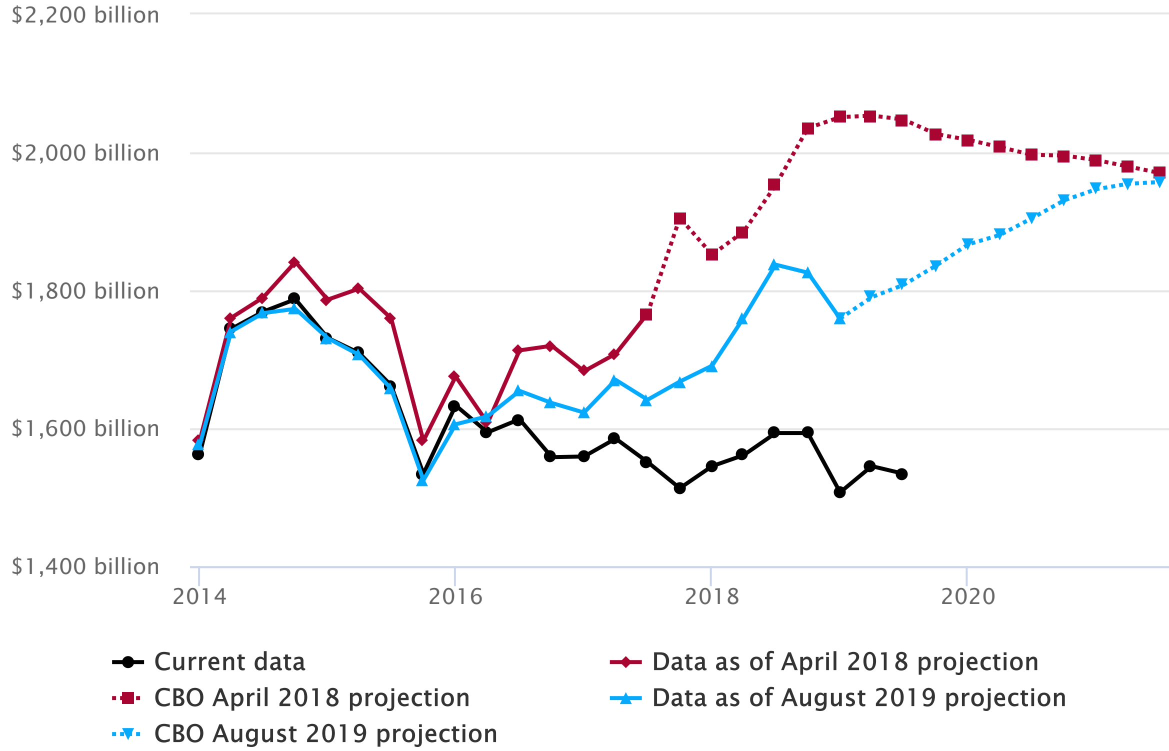

A simple back-of-the-envelope calculation suggests that the revisions to corporate profits can almost entirely explain the recent weakness in corporate income tax receipts. To approximate the impact of the revisions, we take the ratio of corporate receipts to profits from CBO's April 2018 projections and directly apply it to the revised NIPAs profits data.[2]

Figure 2. Corporate income tax receipts

Billions of Dollars

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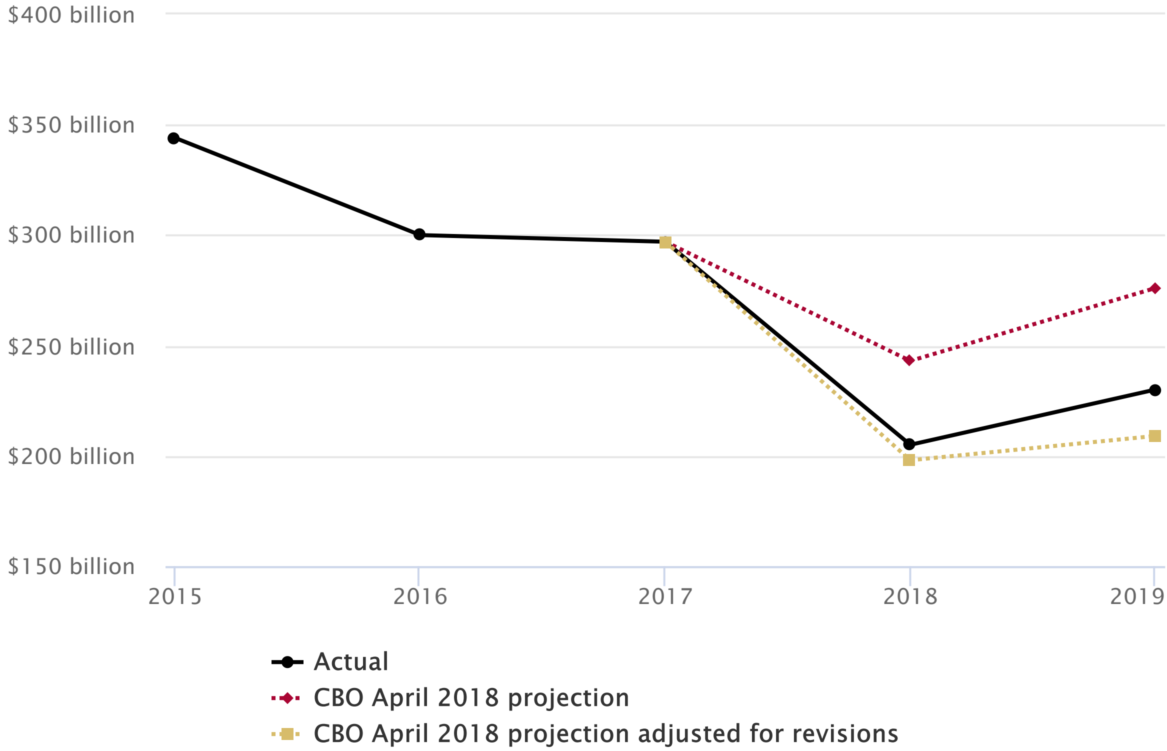

Figure 2 shows the results of this adjustment along with actual corporate income tax receipts and the CBO's original projection. Predicted corporate receipts in 2018 fall from more than $240 billion (17 percent greater than actual) to just below $200 billion (2 percent less than actual). Predicted receipts in 2019 fall from $275 billion (20 percent greater than actual) to $210 billion (9 percent less than actual).

Of course, this is a rough adjustment. But this exercise suggests that weakness in profits is a likely explanation for weakness in receipts, and we hope to see a more complete analysis tomorrow from CBO.

Alexander Arnon produced this analysis with writing support by Kody Carmody.

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1. Corporate profits are related, but not equivalent, to the corporate income tax base. Among other coverage and conceptual differences, NIPA corporate profits include the incomes of S corporations, Federal Reserve Banks, and other entities not subject to the corporate income tax; exclude capital gains and domestic dividends; and reflect different treatment of depreciation and other expenses. ↩

2. This ratio is sometimes described as an average tax rate. However, this characterization is misleading because corporate profits are not equivalent to the corporate tax base (see note 1 above). ↩