Center on Budget and Policy Priorities

1275 First Street NE, Suite 1200
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org

www.cbpp.org

Updated May 23, 2019

States Should Reject Corporate Demands for "Deferred Tax" Deductions

By Michael Mazerov

In an increasing number of states, lobbyists for large multistate corporations have been pushing for the enactment of a new tax break they call "deferred tax relief." They have primarily been trying to attach this tax break — a new deduction from gross income — to an important loophole-closing measure that often increases corporations' state income tax payments. This tax giveaway is unusual in that it would eventually cause states to forgo *real revenue* needed to fund education, health care, public safety, road maintenance, and other critical services and infrastructure to offset a "*paper*" expense that some corporations must report on their financial statements. Corporate lobbyists have succeeded in passing this tax break in six states though it has not yet led to revenue losses in any of them because the effective dates have been delayed.

Proponents of deferred tax deductions cite a faulty claim that shareholders of publicly traded corporations unfairly suffer a "double impact" from state corporate tax increases. The first adverse impact is the actual reduction in after-tax profits of the company; the second is an alleged reduction in stock value resulting from a one-time increase in income tax expense reported on corporate financial statements. But the second claim is both implausible and unsupported to date by any empirical evidence. Moreover, federal policymakers have never granted such a tax break even though federal corporate tax changes can have analogous and much larger impacts on the amount of tax expense reported on financial statements.

Although corporations have made proposals for deferred tax deductions more palatable to state lawmakers by including delayed effective dates and spreading the deduction over multiple tax years, there is no guarantee these concessions will continue. Enacting this tax break sets a dangerous precedent; future legislatures would be hard-pressed to justify not attaching it to any measure that increases the corporate tax liability of even a handful of companies — perhaps with much more immediate and serious revenue impacts. Deferred tax deductions are unwarranted. No additional states should grant them, and the states that have already enacted them should repeal them.

What Is the "Deferred Tax" Tax Break?

When a change in federal or state tax law increases the actual (or "effective") rate at which corporate profits are taxed, Generally Accepted Accounting Principles (GAAP) may require a corporation to report on its financial statements a one-time increase in its income tax expense in addition to the ongoing increase in its actual tax liability.[1] One of the most common reasons such an adjustment would be necessary is that the corporation has a significant "deferred tax liability" on its balance sheet. This liability often results from the fact that corporate managers usually calculate the income tax expense reported on their financial statements as if they were writing off ("depreciating") their plant and equipment investments evenly over time, while calculating their actual tax liability using "accelerated depreciation." Accelerated depreciation allows them to "bunch" depreciation deductions in the early years after the asset is purchased.

This divergence between "book" and "tax" depreciation requires reporting a "deferred tax liability" on the corporate balance sheet to reflect that the upfront bunching of the depreciation deductions for tax purposes means that the corporation will actually have a greater tax liability in the future than the financial statements would otherwise imply.[2] GAAP requires any deferred tax liability on the corporation's books to be re-valued *upward* when the effective income tax rate of the corporation increases for any reason — including a change in state or federal tax law. This, in turn, results in a one-time increase in financial statement income tax expense.[3]

This one-time increase in tax expense is an "on paper" accounting adjustment. Nonetheless, corporations and their trade associations have successfully lobbied lawmakers in six states to enact a new tax deduction to offset it. The deduction is equal to the amount by which net deferred tax liability has risen as the result of an increase in the corporation's effective tax rate. In five states — Connecticut, the District of Columbia, Massachusetts, New Jersey, and New Mexico — the deduction was attached to legislation implementing corporate tax reform known as "combined reporting."[4] In the sixth, Kentucky, the deferred tax relief deduction was enacted a year after combined reporting was approved.

In all six states, the ability to begin claiming the deduction was delayed for at least four years (in Connecticut, the District of Columbia, and Massachusetts, subsequent legislation pushed it back

---

[1] Deferred tax deductions are also frequently referred to as "ASC 740" deductions, because Accounting Standards Codification No. 740 is where GAAP rules covering corporate income tax accounting are currently set forth. Older discussions of deferred tax deduction proposals in the states often referred to it as "FAS 109" deductions, because at the time Financial Accounting Standard 109 stated GAAP rules for income tax accounting.

[2] For a simplified example of how this arises, see Joint Committee on Taxation, "Present Law and Background Relating to the Interaction of Federal Income Tax Rules and Financial Accounting Rules" (JCX-12-12), February 7, 2012, pp. 17-18, https://www.jct.gov/publications.html?func=showdown&id=4395.

[3] Corporations with net deferred tax *assets* (such as operating loss carryforwards) on their balance sheets may have to report a one-time increase in tax expense when their effective income tax rate *drops* due to a change in tax law.

[4] Combined reporting treats a parent corporation and some or all its subsidiaries as a single corporation for tax purposes, nullifying a variety of techniques corporations have devised to shift income onto the books of subsidiaries located in low- or no-tax states. When a state switches to combined reporting from "separate entity" taxation (which treats the parent and subsidiaries as separate corporations for tax purposes), corporations employing these income-shifting strategies may experience a higher effective tax rate in that state — necessitating the upward restatement of deferred tax liability. See Michael Mazerov, "State Corporate Tax Shelters and the Need for 'Combined Reporting,'" Center on Budget and Policy Priorities, October 26, 2007, https://www.cbpp.org/research/state-corporate-tax-shelters-and-the-need-for-combined-reporting. Twelve states plus the District of Columbia have enacted combined reporting since 2008, and the total number of states that have enacted this policy now stands at 29 (including D.C.).

further), and the deduction itself has to be spread out anywhere from seven to 30 years. The deduction can be claimed beginning in tax year 2020 in the District, and 2021 in Connecticut and Massachusetts and beyond that in the other three states, so no actual revenue losses have occurred yet. Only publicly traded corporations can claim the deduction, and in several of the states they must disclose to the revenue department in the first year after the deduction is enacted how much they ultimately will claim once they're allowed to start doing so.

Adverse "Double Impact" of Corporate Tax Increases on Stockholders Is Implausible

Deferred tax deductions would eventually rebate *real* dollars to eligible corporations to offset the impact of combined reporting (and potentially other changes in state corporate tax policy)[5] on how much profit they report *on paper* to their stockholders and the public. The "double-impact" justification for the tax break effectively posits that stock market participants are incapable of distinguishing between the effect of the tax change on the amount of profit retained by the corporation after paying its state corporate income tax and the effect on the corporation's financial statement profit. But there are scores of skilled, highly compensated stock market analysts whose job is to do precisely that: to make adjustments for the many arbitrary line-drawings entailed in preparing financial statements under GAAP and thereby develop a more accurate picture of a corporation's recent and likely future economic performance. Some individual investors may not have access to this kind of sophisticated analysis, but institutional investors certainly do, and their buying and selling activity in the stock market drives stock pricing.[6]

The claim that corporations' stock valuations are harmed if they report an increase in financial statement tax expense due to state corporate tax increases is even less plausible when one considers the magnitudes likely to be involved. Take, for example, NextEra Energy, a corporation that has

---

[5] A bill to create a deferred tax deduction in response to a different change in state tax law — a switch to "single sales factor apportionment" — was proposed in Maryland in 2019 but was not approved. Changing from the traditional property/payroll/sales apportionment formula to single sales factor apportionment can also increase the effective income tax rate for out-of-state corporations that have substantial sales but relatively little property or staff in the state. See Michael Mazerov, "The 'Single Sales Factor' Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?" Center on Budget and Policy Priorities, revised September 1, 2005, http://www.cbpp.org/3-27-01sfp.pdf.

A deferred tax deduction was enacted in 2007 when Michigan repealed its Single Business Tax and substituted the Michigan Business Tax (MBT), a dual tax on business profits and gross receipts. The latter tax was repealed in 2011 in favor of a conventional corporate profits tax, before the deferred tax deduction attached to the MBT could be claimed. The business community lobbied unsuccessfully to have a deferred tax deduction included in the new corporate profits tax. See Council On State Taxation letter to Governor Rick Snyder and legislative leadership, "In Support of FAS 109 Relief in House Bill 4362," April 28, 2011, https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-comments-and-testimony/letter-re-need-for-fas-109-relief-in-mi-hb-4362.pdf.

[6] A recent study, discussed below in the body of this report, observes that "SEC Regulation S-X requires firms to disclose material items that explain the difference between tax at the statutory rate and total tax expense [reported on financial statements]. Thus, we expect [professional stock] analysts and investors can identify nonrecurring income taxes and adjust for them. For example, motivated users of financial [statement] information should be able to understand that nonrecurring income taxes generated by rate changes do not persist. . . ." Dain C. Donelson, Colin Q. Koutney, and Lillian F. Mills, "Nonrecurring Income Taxes," unpublished, April 2018, pp. 12-13, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2720464 (hereafter, "Donelson").

taken a leading role in pushing for this tax break nationally.[7] In a fact sheet recently circulated in New Mexico and in testimony recently delivered in Maryland, the company stated that the adjustment to its deferred tax accounts that *would* result from New Mexico's adoption of combined reporting and that *did* result from Maryland's adoption of a "single sales factor" apportionment formula would lead to additional financial statement tax expense in the "millions of dollars."[8] Yet NextEra reported $4.3 billion in profit from current operations nationally in 2018.[9] Given that NextEra's current stock value is driven overwhelming by its future earnings prospects, which in turn depend on such factors as future domestic economic growth, world energy market conditions, technological developments affecting the cost of producing and storing wind and solar energy, and a host of other factors, an additional one-time financial statement expense in the "millions of dollars" likely would have no discernible impact on the stock value of a company this large.

Rather than being motivated by concerns about an adverse impact on stockholders, it seems far more likely that the push for deferred tax breaks are driven by the desire by corporate managers to maximize their own compensation. As accounting professor Lillian F. Mills has noted: "[M]anager bonuses . . . are frequently based on reported book income and balance sheet amounts."[10]

Deferred Tax Deduction Advocates Haven't Provided Any Empirical Evidence of Adverse Stock Price Effects

Half the states that have switched from separate-entity corporate taxation to combined reporting in roughly the last decade have done so *without* attaching a deferred tax deduction. Some two dozen states have switched during the past 20 years to a single sales factor apportionment formula for multistate corporations; *none* of the states making this change in corporate tax policy attached deferred tax deductions to the legislation.[11]

If the claim that upward revaluations of deferred tax liabilities had a distinct adverse impact on stock market values were true, surely these shifts in tax policy would have provided evidence that

---

[7] In addition to testifying in support of 2019 Maryland legislation proposing a deferred tax deduction (see Note 5), a NextEra representative made the case for the policy at two consecutive meetings of the National Conference of State Legislatures (NCSL) Task Force on State and Local Taxation in August and November 2016. See Angela Pitale (NextEra Energy Resources) and Stephen Kranz (McDermott Will & Emery), "Financial Reporting: Publicly Traded Companies (and why it matters for state tax policy)," http://www.ncsl.org/documents/taskforces/Financial_Reporting.pdf. NextEra staff appear to have authored a one-page document circulated in New Mexico in early 2019 making the case for the inclusion of a deferred tax deduction in legislation mandating combined reporting. The document is titled "What is deferred tax relief and why is it necessary?" and states that "For NextEra, this is an immediate impact of millions of dollars."

[8] For New Mexico, see the unattributed one-page document described in the previous note. For Maryland, see the video recording of the hearing on Senate Bill 458 held on February 26, 2019, http://mgahouse.maryland.gov/mga/play/dd7e655b-301f-4143-816c-8d9394e2deed/?catalog/03e481c7-8a42-4438-a7da-93ff74bdaa4c&playfrom=2535000.

[9] See NextEra Annual Report to the Securities and Exchange Commission (Form 10-K) for the 2018 tax year, https://www.sec.gov/Archives/edgar/data/37634/000075330819000039/nee-12312018x10k.htm.

[10] Lillian F. Mills, "Five Things Economists and Lawyers Can Learn from Accountants: An Illustration Using the Domestic Production Activities Deduction," *National Tax Journal*, September 2006.

[11] See Note 5.

proponents of deferred tax deductions would be citing. But no such evidence has been offered. Moreover, although NextEra Energy testified that it had to report an immediate additional tax expense in the "millions of dollars" after Maryland adopted a single sales factor apportionment formula in 2018, the company offered no evidence that that expense negatively affected its stock value.[12]

Academic Research Doesn't Support Claims of Adverse Stock Price Effects

Nor does recent academic research support the claim that a one-time increase in financial statement income tax expense is likely to independently affect the price of the corporation's stock. A 2018 University of Texas study used sophisticated statistical techniques to evaluate how both Wall Street stock analysts and investors react to one-time — "nonrecurring" — changes in financial statement tax expense.[13] In addition to tax law changes requiring revaluation of deferred tax liabilities (and deferred tax assets), the study included such discrete changes as the settlement of tax audit disputes and the occasional "repatriation" of profits held in U.S. subsidiaries back to U.S. parent corporations. (The latter two changes affect actual corporate tax payments, but, like the upward revaluation of deferred tax liabilities, they are one-time or random events that don't reflect corporations' long-term income trends.)

The study concluded that professional stock analysts generally ignored one-time events affecting financial statement tax expense when they issued their forecasts of corporate earnings.[14] More important, it found that these events did not have a significant impact on stock prices.[15] One of the explanations for both findings is that corporate managers themselves rarely (only 10 percent of the time) include one-time tax expense effects (increases or decreases) in the quarterly earnings reports they issue. Securities and Exchange Commission rules permit corporate managers to present their quarterly earnings on a non-GAAP basis if they believe they are a better reflection of the corporation's actual performance, provided they explain any discrepancy. Managers frequently issue such reports.[16] The study found that "investors seem to ignore nonrecurring income taxes regardless of whether managers include or exclude the [transitory tax] item in their calculation of non-GAAP earnings."[17] That is, such items do not have a significant impact on stock prices.

Turning to current, real-world implications of the study, the authors observed:

---

12 See the second source cited in Note 8.

13 Donelson, 2018.

14 "Consistent with low persistence, analysts generally exclude nonrecurring income taxes from their Street earnings [forecasts]." Donelson, p. 5.

15 "[W]e do not find a statistically significant association between nonrecurring income taxes and earnings announcement returns, consistent with investors interpreting nonrecurring income taxes as transitory to future earnings." Mills, p. 26. "Overall, we find little investor reaction to nonrecurring income taxes. Thus, investors do not appear to misprice nonrecurring income taxes." Donelson, p. 27.

16 "Most managers now issue non-GAAP earnings, which are GAAP earnings after removing earnings items that managers deem less informative for stock valuations, such as transitory items." Donelson, p. 10.

17 Donelson, p. 7.

> Following . . . enactment [of the 2017 federal tax restructuring bill, the Tax Cuts and Jobs Act, or TCJA], financial press headlines highlighted the law's material and immediate impact on corporate earnings, suggesting confusion about the implications of nonrecurring income taxes. . . . Our study suggests non-GAAP earnings should be relatively unaffected, and so nonrecurring tax gains and losses caused by TCJA or other tax events should cause little concern to analysts and investors.[18]

As the next section discusses, federal tax law changes often have much larger effects on the value of deferred tax liabilities and assets than state tax law changes do; if the study's authors expect little impact of TCJA on stock prices, it is even less likely that a single state's enactment of something like mandatory combined reporting would.

Deferred Tax Deductions Haven't Been Provided in Connection With Federal Corporate Tax Policy Changes

Federal tax policy changes can result in increased tax expenses on corporate financial statements identical to — and often many times larger than — those resulting from changes in state tax policies. Indeed, the 2017 Tax Cuts and Jobs Act reportedly has forced multi-billion-dollar reductions in reported financial statement profits for some companies — $22 billion in the case of Citigroup, for example.[19]

Although corporate representatives *have* lobbied Congress in the past to take financial statement impacts into account when considering corporate tax policy changes,[20] CBPP's federal tax policy staff and outside experts consulted are unaware of their ever having sought a deduction or similar tax break that would have resulted in actual revenue losses. Nor are we aware of any official policy positions of organizations of private-sector *federal* tax practitioners asserting that corporations are entitled to such offsets.[21] Federal tax lobbyists for corporations may perceive that Congress has

---

[18] Donelson, p. 8.

[19] John Stittle, "Trump's Tax Cuts Will Play Havoc with Reported Earnings," Mondaq, April 19, 2018, http://www.mondaq.com/uk/x/693812/Corporate+Tax/Trumps+Tax+Cuts+Will+Play+Havoc+With+Reported+Earnings.

Because the Tax Cuts and Jobs Act slashed the effective federal corporate tax rate for most corporations, those with net deferred tax liabilities will experience a one-time reduction in financial statement tax expense that will *boost* quarterly financial statement earnings. An examination of the financial statements of S&P 100 corporations estimated that TCJA "winner" corporations would experience $200 billion in financial statement income increases and that "losers" would experience $80 billion in aggregate increased tax expense. See Peter J. Reilly, "Earnings Havoc Unleashed By Tax Act," *Forbes*, December 31, 2017, https://www.forbes.com/sites/peterjreilly/2017/12/31/earnings-havoc-unleashed-by-tax-act/#2e172d27492f.

[20] For a discussion of how some corporations with large deferred tax assets successfully lobbied for what became the (recently repealed) Internal Revenue Code Section 199 "domestic production deduction," see Christopher H. Hanna, "Corporate Tax Reform: Listening to Corporate America," *Journal of Corporation Law*, Winter 2010.

[21] The Tax Executives Institute (TEI), a professional association of in-house corporate tax staff responsible for federal, state, and local tax compliance, has adopted a policy resolution calling on *states* to provide deferred tax deductions: https://www.tei.org/sites/default/files/advocacy_pdfs/2018.02.14%20-%20SALT%20Policy%20-%20Deferred%20Tax%20Relief%20-%20FINAL.pdf. A search of TEI's website for policy statements authored by both its Federal Tax and its Financial Reporting committees revealed no policy statements calling for deferred tax offsets in connection with *federal* corporate tax policy changes.

more tax policy staff familiar with financial statement tax accounting than states do and therefore anticipate a more skeptical reception to proposals for deferred tax offsets that would reduce revenue.

Governments Don't Compensate Corporations for Negative Financial Statement Impacts of Non-Tax Policy Changes

Corporations run numerous risks that real-world conditions will change in ways that will reduce their profitability. Consumers can decide they prefer a competitor's products. A flood or fire can eliminate access to a key production input. A court can rule that a design flaw in their product harmed customers.

Corporations also run the risk that public policies affecting them will change in adverse ways. Congress can impose more stringent pollution control requirements. The Federal Reserve can increase their borrowing costs. If these changes are large enough, they can not only impose direct costs on the companies but also force them to write down the value of certain assets on their financial statements. Although direct costs incurred due to such changes (for example, the cost of additional pollution control equipment) would likely be deductible in calculating income tax liability, governments don't compensate the corporations for the secondary financial statement impacts.[22] There is no good reason why governments should compensate corporations for the financial statement impacts of tax policy changes, either. It is especially unclear why corporations should be compensated for the financial statement impact of adopting combined reporting, which often increases the tax liability of corporations that were engaged in aggressive tax sheltering strategies.[23]

"Transition Rules" for Major Tax Changes Can Sometimes Be Justified, But That Is Not What Deferred Tax Deductions Represent

A legitimate case can sometimes be made that major tax policy changes justify certain transition rules to mitigate inequities created when corporations that made investment decisions under one set of tax rules now confront a different set. Suppose, for example, that a corporation makes a major facility investment where the depreciation deductions will be so large as to put the company into a loss situation for several years. The company makes the investment in anticipation of using those losses in later years, but then the state repeals its corporate income tax and substitutes a gross receipts tax. In such a situation, a transition rule should perhaps allow the corporation to file amended returns for previous tax years and deduct the current losses in those earlier years or deduct them against the gross receipts tax going forward.

But deferred tax deductions are not transition provisions. If they were, they would be made available immediately (rather than with a multi-year delay) to *all* corporations that would experience a higher tax liability due to the switch to combined reporting, single sales factor apportionment, or similar types of policy changes rather than only to publicly traded corporations with negative financial statement impacts. As discussed previously, advocates of deferred tax deductions justify them by claiming that the stockholders of publicly traded corporations alone suffer an adverse "double impact" from such changes, but deferred tax deductions would create discrimination rather

---

[22] If the write-down of the value of the assets results in an actual loss when they are sold or abandoned, then that loss will be deductible at that time.

[23] See the source in Note 4.

than compensate for it. Both publicly traded and privately held corporations could be subject to higher tax liabilities as a result of the change in tax policy, but only the former would be eligible for deferred tax deductions that would recoup some of the initial costs.

Attempts to characterize deferred tax deductions as legitimate transition provisions are especially misleading given the circumstances in which corporations would most likely claim them (if a state's law granted them).[24] As discussed above, the divergence between "book" and "tax" depreciation is probably the most common reason a corporation would have a deferred tax liability on its balance sheet. The ability to accelerate depreciation deductions is a valuable tax break that provides a real economic benefit to the company. Due to the time value of money, the additional taxes saved upfront are more valuable than the higher taxes paid later when depreciation deductions are lower than they otherwise would have been. In other words, the ability to claim accelerated depreciation provides the equivalent of an interest-free loan from the government.

It is true that if a corporation has been permitted to claim accelerated depreciation in a state that subsequently increases that corporation's effective tax rate, the value of that benefit falls somewhat because a higher tax rate now applies to the greater taxable income that will be reported in later years. Nonetheless, assertions that corporations are entitled to compensation for losing part of the value of what was a discretionary tax break to begin with seem dubious.

How Much Could a Deferred Tax Deduction Cost?

As previously discussed, all the deferred tax deductions enacted to date have provided for both a delayed effective date and a multi-year claim period. This puts any actual impact on revenues beyond the current budget forecasting window in most states and makes the potential annual revenue loss smaller once the effective date is reached. Delayed effective dates and phase-ins are common tactics employed by tax cut proponents to make their proposals more palatable to current lawmakers. They obviate the need for politically unpopular offsetting tax increases or program cuts to be enacted immediately and make it more difficult for the public and the media to tie lower available funds in the future to tax policy decisions that were made years earlier.[25]

One state — Massachusetts — required corporations intending to claim the deferred tax deduction in the future to report the amount to be claimed and, significantly, made the information public. The state found that 128 publicly traded corporations would have saved $535 million in state

---

[24] The Council On State Taxation letter cited in Note 5 sought to justify the deduction as a transition provision: "A deduction to ameliorate the negative consequence of the proposed tax reform on publicly-traded companies' financial statements would be, by definition, a temporary provision to address an issue solely related to the transition from one type of business tax system to another." The Pitale/Kranz presentation to NCSL cited in Note 7 contains a slide titled "Relief Provided by Some States -Examples," which lists states that have provided a deferred tax deduction and those that have preserved net operating loss carryforwards in transitioning to combined reporting and gross receipts taxation — eliding the fact that the former were limited to publicly traded corporations while the latter were available to all affected corporations.

[25] Eric Figueroa, Michael Leachman, and Michael Mazerov, "Phasing in State Tax Cuts Doesn't Make Them Fiscally Responsible," Center on Budget and Policy Priorities, February 6, 2017, https://www.cbpp.org/research/state-budget-and-tax/phasing-in-state-tax-cuts-doesnt-make-them-fiscally-responsible.

corporate income taxes, or $76 million annually, in the seven-year period over which the deductions could have been claimed. This potential revenue "rebate" represented nearly *one-third* of the anticipated annual revenue gain from enacting combined reporting. Fifty-two percent of the revenue forgone would have reduced the tax liability of just three corporations, and 88 percent of the revenue loss would have benefited just 14 of the 128 companies eligible for the break.[26] In light of these substantial potential revenue losses, Massachusetts lawmakers have pushed back the effective date of the deduction numerous times — it now doesn't take effect until 2021 — and extended the period over which the deduction may be claimed from seven to 30 years.[27]

The specific corporations whose profits comprise the state corporate tax base vary greatly among the states, so not every state attaching a deferred tax deduction to combined reporting legislation might necessarily be at risk of forgoing as much of the revenue gain as Massachusetts. Nonetheless, the Massachusetts data illustrate how large the revenue losses could be and should give lawmakers considering enacting such a tax break pause — especially in light of the underlying lack of a solid policy rationale for the giveaway.

Lawmakers Shouldn't Count on Corporations' Expectations Not to Claim Deferred Tax Deductions

As soon as a state enacts legislation providing for a future deduction equal to the amount by which a corporation's deferred tax liability increases due to a specific tax change, GAAP rules allow the corporation to avoid having to report any additional income tax expense. There have been some hints that the corporations are seeking only the *enactment* of such provisions; they don't care if they are ever actually able to *claim* the deductions.[28] The fact that several states have enacted legislation postponing the effective date of deferred tax deductions without much evident corporate opposition is further evidence that the principal objective is simply getting the deduction in statute.[29] Accordingly, some lawmakers may view the enactment of deferred tax deductions as providing a benefit to in-state corporations with no ultimate cost in forgone revenue — harmless at worst and potentially politically beneficial to those who vote for it.

Lawmakers should not view deferred tax deductions as benign, however. First, some representatives of major multistate corporations likely *do* intend for the deductions to be claimed eventually. The Council On State Taxation (COST), the trade association that represents the largest multistate corporations on state tax policy and legal matters, has adopted an official policy position stating that "When enacting significant corporate tax law changes, states *must* mitigate the immediate

---

[26] "Massachusetts Department of Revenue Report on FAS 109 Tax Deductions," September 2009.

[27] Massachusetts Department of Revenue, "Tax Changes in the Fiscal Year 2016 Budget," Technical Information Release 15-12, October 28, 2015.

[28] For example, the Tax Foundation has observed that "the state can choose to keep extending when it will pay out the deduction, since what matters to the company is not the money but the deferred tax asset it can put on its books to offset the liability." Joseph Bishop-Henchman, "Easing the Kentucky Combined Reporting Transition," March 19, 2019, https://taxfoundation.org/kentucky-combined-reporting/.

[29] Corporations have fiercely opposed efforts to *repeal* enacted deferred tax deductions, however. See, for example, Jon Chesto, "Beacon Hill Leaders keep corporate tax deduction intact," *Boston Globe*, July 17, 2015, https://www.bostonglobe.com/business/2015/07/17/beacon-hill-leaders-change-their-minds-keep-corporate-tax-deduction-intact/potEpoqzfis6qJcwN5raKI/story.html .

and negative impact of those changes on a company's financial reporting." The statement refers to states "providing a reasonable schedule to *allow the future deduction* of the additional expenses triggered from any book/tax differences."[30] In 2011 written testimony in support of a deferred tax deduction in Michigan, COST defended the provision as "having an implementation date sufficiently far in to the future to avoid any *near-term* budgetary impact in the state."[31] And a policy statement in support of deferred tax deductions by another organization of corporate tax practitioners, the Tax Executives Institute, observes that "States have a great deal of flexibility in the timing of such deductions such that they can control the impact on the state coffers,"[32] anticipating an impact at some future point.

Second, once a deferred tax deduction is on the books, the possibility exists that it will not, in fact, be extended once the date at which it can be claimed is reached. Lawmakers who expected to propose extending the effective date once again may no longer be in office at that time, and corporations could lobby against an extension. At the very least, corporations and other lawmakers interested in enacting other kinds of corporate tax breaks as the effective date approaches could use the looming revenue loss as a bargaining chip to extract other, less costly alternatives.

Third, once deferred tax deductions are on the books, lawmakers and advocates who want these provisions to be extended repeatedly so that no actual revenue loss ever occurs will have to track them in perpetuity and repeatedly devote resources to educating new cohorts of legislators about what they are, their lack of merit, and why they should be extended. This will become more difficult if the business community's growing success in enacting these provisions emboldens them to seek their attachment to more types of tax bills. It is not hard to imagine, for example, that corporate representatives might seek to attach deferred tax deduction provisions to bills that would repeal major corporate tax breaks.

Finally, given the brevity of legislative sessions in many states, the enormous number of critical issues that lawmakers have to deal with, and the lack of resources available to them, there are consequences to compelling them to devote precious committee and floor time periodically to extending a tax break that has so little merit.

---

30 COST Policy Position, "Consequences of Significant Tax Law Changes on Financial Reporting," May 25, 2016, https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/consequences-of-significant-tax-law-changes-on-financial-reporting.pdf. Emphasis added.

31 Council On State Taxation letter to Governor Rick Snyder and legislative leadership. Emphasis added.

32 See the Tax Executives Institute's policy resolution calling on *states* to provide deferred tax deductions.