The Distribution of Corporate Income: Tabulations from the Schedule M-3, 2004–2008

by Caitlin Bokulic, Erin Henry, and George Plesko

Corporations determine the amount of income earned during a year using a variety of reporting standards. For publicly traded companies, annual financial statements must be filed in accordance with Generally Accepted Accounting Principles (GAAP), as issued by the Financial Accounting Standards Board (FASB). Through the Internal Revenue Code (IRC), Congress has provided a separate set of rules that govern the definition of income for tax purposes. During the late 1990s and early 2000s, divergence in the amounts of income reported under each system led to increased interest in learning about the patterns and sources of those differences.

Prior to 2004, Schedule M-1 of the Form 1120 series of corporate income tax returns required a reconciliation of financial reporting ("book") net income with tax net income.[1],[2] Acknowledged shortcomings in the Schedule M-1, including a lack of detail in reconciling both the entities and income included in each of the separate book and tax reports, led to the development of the Schedule M-3. The requirement to include Schedule M-3 with the corporate income tax filing became effective December 2004; Schedule M-3 is required of returns with assets that equal or exceed $10 million.[3] Since Tax Year 2004, a number of papers have provided tabulations of the annual corporate income tax and Schedule M-3 data and have served to create a better understanding of the magnitude of the differences in book and tax measures of income.[4]

Utilizing data from the Schedule M-3, this article makes three contributions. First, it provides an additional set of IRS corporate return data tabulations to better understand the characteristics of the corporations in the SOI sample, as well as in the population of corporate tax filers. Second, it extends prior IRS research on the magnitudes of various income measures that each firm reports to gain a better understanding of how the different income reporting systems (tax and financial) relate to each other. In particular, the next section, *Defining Corporate Income*, reviews the various definitions of income used to report firms' performance and the role that the Schedule M-3 serves in providing a reconciliation of book and taxable income through the information firms report to the IRS. The section also provides an overview of the amount of income firms that file returns in the U.S. report on both a global and domestic level and the amount of taxable income attributed to them. The following section, *Distribution of Returns and Income Across Taxable Income Brackets*, provides tabulations and a description of the distribution of corporate income, as variously defined. The third section of this article, *Income Changes and the Marginal Tax Rate*, presents our third contribution and provides estimates of the change in the marginal tax rate a firm might face in response to changes in firms' income tax positions, either through a change in their underlying economic condition (such as an increase in income caused by increased sales) or owing to changes in the income tax laws that would cause firms to report greater amounts of income.

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Defining Corporate Income

The existence of differences in the way income might be calculated for tax purposes, as opposed to other business purposes, has been recognized for nearly a century. The basis for a separate concept of income tax accounting, as opposed to firms' normal bookkeeping, traces back to the Revenue Act of 1918 and subsequent regulations. Section 212 (b) of the Act of 1918 says in part:

[1] The IRS has previously released data from Schedule M-1. See Plesko, G.A., and Nina Shumofsky, "Reconciling Corporation Book and Tax Net Income, Tax Years 1996–1998," *SOI Bulletin*, Spring 2002, pp. 1–16, and Plesko, G.A., and Nina Shumofsky, "Reconciling Corporation Book and Tax Net Income, Tax Years 1995–2001," *SOI Bulletin*, Winter 2004–2005, pp. 103–108.

[2] Throughout this report, we interchangeably use the terms "financial reporting income" and "book income" to describe a company's consolidated income calculated under GAAP and reported on annual financial statements.

[3] See the IRS's Frequently Asked Questions for Form 1120, Schedule M-3, as well as Form 1120, Schedule M-3, for more information on this form.

[4] Background information on the shortcomings of the Schedule M-1 and the arguments for a revised form can be found in Mills, L., and G.A. Plesko, "Bridging the Reporting Gap: A Proposal for More Informative Reconciling of Book and Tax Income," *National Tax Journal* 56:4 (December 2003), pp. 865–893, and C. Boynton, and W. Wilson, "A Review of Schedule M-3, the Internal Revenue Service's New Book-Tax Reconciliation Tool" *Petroleum Accounting and Financial Management Journal* 25, No.1 (Spring 2006): 1–16. Since release of the Schedule M-3, the IRS has published a number of tabulations. See Boynton, C.; P. DeFilippes; and E. Legel "A First Look at 2004 Schedule M-3 Reporting by Large Corporations," *Tax Notes*, 112, No.11 (September 11, 2006): 943–981; Boynton, C.; P. DeFilippes; and E.J. Legel, "A First Look at 2005 Schedule M-3 Corporate Reporting," *Tax Notes*, Special Report, November 3, 2008; Boynton, C.; P. DeFilippes; E. Legel; and T. Reum, "First Look at 2007 Schedule M-3 Reporting by Large Corporations," *Tax Notes*, August 15, 2011.

> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such a manner as in the opinion of the Commissioner does clearly reflect the income."[5]

Over the past century, as both financial statement and income tax accounting have grown more complicated, numerous differences have arisen between the two measures. Previous Treasury reports, as well as IRS research and tabulations,[6] have documented the extent that book and taxable income have differed across time. But, until the Schedule M-3 was included in corporate income tax filings, it was difficult to precisely identify or measure the causes of many of these differences.

One major difference between financial accounting income prepared under GAAP and taxable income as calculated under the Internal Revenue Code is caused by differences in the rules outlining which entities in consolidated groups are to be included in financial versus tax reports. In calculating a company group's book income, parent companies are required to consolidate and include the income of all entities (both domestic worldwide) in which they have at least a 50-percent ownership. For consolidated tax-reporting purposes, however, parent companies may elect to consolidate and include only the domestic income of all entities in which they have at least an 80-percent ownership. Thus, the consolidated taxable income of a corporate group excludes financial statement income from foreign sources[7] and the domestic income of both domestic and foreign entities in which a parent company owns between 50- and 80-percent interest. Despite explicit consolidation rules for presenting book income on financial reports, prior to the Schedule M-3, there was no uniform definition outlining which entities would be included in the financial statement income number reported on the income tax return. Thus, before the explicit requirements regarding the book income number reported on the Schedule M-3, there was no uniformity in the tax reporting of worldwide financial statement income across corporate tax return filers. As shown and annotated in Figure A, the Schedule M-3 provides a detailed reconciliation and clear definitions of the types of adjustments to be made when reconciling a firm's reported worldwide financial statement income with its reported U.S. taxable income. For example, Page 1 of the Schedule M-3 requires a firm to present not only the worldwide consolidated net income from its financial reports, but also to report the consolidated worldwide net income (or loss) of only those entities included in calculating a firm's taxable income. As a result, consolidation differences, a common driver of book and tax-reporting differences, are able to be identified and quantified.

The second set of differences between financial statement and taxable income relates to the specific differences in the rules governing the calculation of income under each system. Prior to the Schedule M-3, one could not fully separate book-tax differences that were due to differences in the reporting entities from those that were simply due to differences in the book versus tax-accounting rules for recognizing income and deductions. Though these differences do exist and are identifiable via the Schedule M-3, they are not addressed in this article.

Because the Schedule M-3 provides a clearer identification and reconciliation of the financial-reporting includible entities versus tax-reporting includible entities than the previous Schedule M-1, the tabulations presented should not be viewed as a continuation of past trends. The data on the Schedule M-3 allow for the examination of four distinct measures of income, which include two measures of financial reporting income and two of tax-reporting income: 1) pre-tax worldwide book income of those

[5] Now section 41 of the Internal Revenue Code. From Smith, D., and J. K. Butters, "Taxable and Business Income," New York: National Bureau of Economic Research, 1949.

[6] Talisman, J. "Penalty and Interest Provisions, Corporate Tax Shelters." U.S. Department of the Treasury Testimony before the U.S. Senate, Committee on Finance. Washington, D.C., March 8, 2000. See also Plesko and Shumofsky, *supra* note 1.

[7] Given that foreign income is not repatriated to the U.S. parent company during the taxable year.

Figure A

Reconciliation of Net Income (Loss) per Income Statement: Consolidated Worldwide to Includible Corporations

Schedule M-3, Part I: Line Number and Item	Explanation
4a Worldwide consolidated net income (loss) from income statement source	This is the consolidated parent company's worldwide financial reporting income; a common concept for all corporate filers.
5a Net income from nonincludible foreign entities	These two items eliminate foreign income (loss) from entities that are not consolidated for tax-reporting purposes.
b Net loss from nonincludible foreign entities	
6a Net income from nonincludible U.S. entities	These two items eliminate domestic income (loss) from entities that are not consolidated for tax-reporting purposes.
b Net loss from nonincludible U.S. entities	
7a Net income (loss) of other includible foreign disregarded entities	These items add the income or loss from entities that are not part of the consolidated financial reporting entity but which are included for tax-reporting purposes.
b Net income (loss) of other includible U.S. disregarded entities	
c Net income (loss) of other includible entities	
8 Adjustment to eliminations of transactions between includible entities and nonincludible entities	This entry eliminates inter-corporate transactions related to the income (loss) of entities that are reported in lines 5, 6, or 7. Examples are dividends received by the tax entity and adjustments for minority interest.
9 Adjustment to reconcile income statement period to tax year	This adjustment relates to reporting differences in the fiscal years from the tax return to the financial statement entity.
10a Intercompany dividend adjustments to reconcile to line 11	These items are any other adjustments necessary to reconcile worldwide consolidated net income (loss) from financial statements to the net income (loss) per income statement of includible corporations.
b Other statutory accounting adjustments to reconcile to line 11	
c Other adjustments to reconcile to amount on line 11	
11 Net income (loss) per income statement of includible corporations.	Combines lines 4-10 to report the financial reporting income (loss) of the tax entity.

entities included in calculating taxable income;[8] 2) pre-tax domestic book income of those entities included in calculating taxable income;[9] 3) tax net income;[10] and 4) taxable income.[11] Our measure of pre-tax worldwide book income represents both the foreign and domestic income before tax expense of any entity that files a return in the United States, while our measure of pre-tax domestic book income represents only the domestic income of the entities includible in the consolidated tax return. Tax net income represents a firm's taxable income before subtracting any net operating loss carryforward (NOL) or special deductions and is most closely comparable to domestic pre-tax book income.[12] Finally, taxable income includes the effect of net operating loss carryforwards and special deductions and is the basis for calculating the U.S. income tax.

Figure B provides a plot of the four measures of income over the 2004–2008 period for returns other than Forms 1120S, 1120-REIT, and 1120-RIC that included a Schedule M-3. This figure shows the advantages of the Schedule M-3 in its first required

[8] Pre-tax worldwide book income of includible corporations is calculated as the worldwide net income of includible corporations plus the firm's total financial statement tax expense. Specifically, we measure a firm's includible worldwide pre-tax book income as its Net Income (Loss) per Income Statement of Includible Corporations (Form 1120, Schedule M-3, Part I, Line 11) plus the following seven items from Schedule M-3, Part III: 1) U.S. Current Income Tax Expense (Line 1, Column (a)); 2) U.S. Deferred Income Tax Expense (Line 2, Column (a)); 3) State and Local Current Income Tax Expense (Line 3, Column (a)); 4) State and Local Deferred Income Tax Expense (Line 4, Column (a)); 5) Foreign Current Income Tax Expense Other than Foreign Withholding Taxes (Line 5, Column (a)); 6) Foreign Deferred Income Tax Expense (Line 6, Column (a)); and 7) Foreign Withholding Taxes (Line 7, Column (a)).

[9] Pre-tax domestic book income of includible corporations is calculated as the worldwide pre-tax income plus adjustments for foreign income following the 2008 GAO Report, "U.S. Multinational Corporations—Effective Tax Rates are Correlated with Where Income is Reported." Specifically, a firm's includible pre-tax domestic book income is measured as the worldwide pre-tax book income of includible corporations as calculated in footnote 8, less the following six items from Schedule M-3, Part II: 1) Income/Loss from Equity Method Foreign Corporations (Line 1, Column (a)); 2) Gross Foreign Dividends Not Previously Taxed (Line 2, Column (a)); 3) Gross Foreign Distributions Previously Taxed (Line 5, Column (a)); 4) Income/Loss from Equity Method U.S. Corporations (Line 6, Column (a)); 5) Minority Interest for Includible Corporations (Line 8, Column (a)); and 6) Income/Loss from Foreign Partnerships (Line 10) plus the following three items from Schedule M-3, Part III: 1) Foreign current income tax expenses (other than foreign withholding taxes) (Line 5, Column (a)); 2) Foreign deferred income tax expense (Line 6, Column (a)); and 3) Foreign withholding taxes (Line 7, Column (a)).

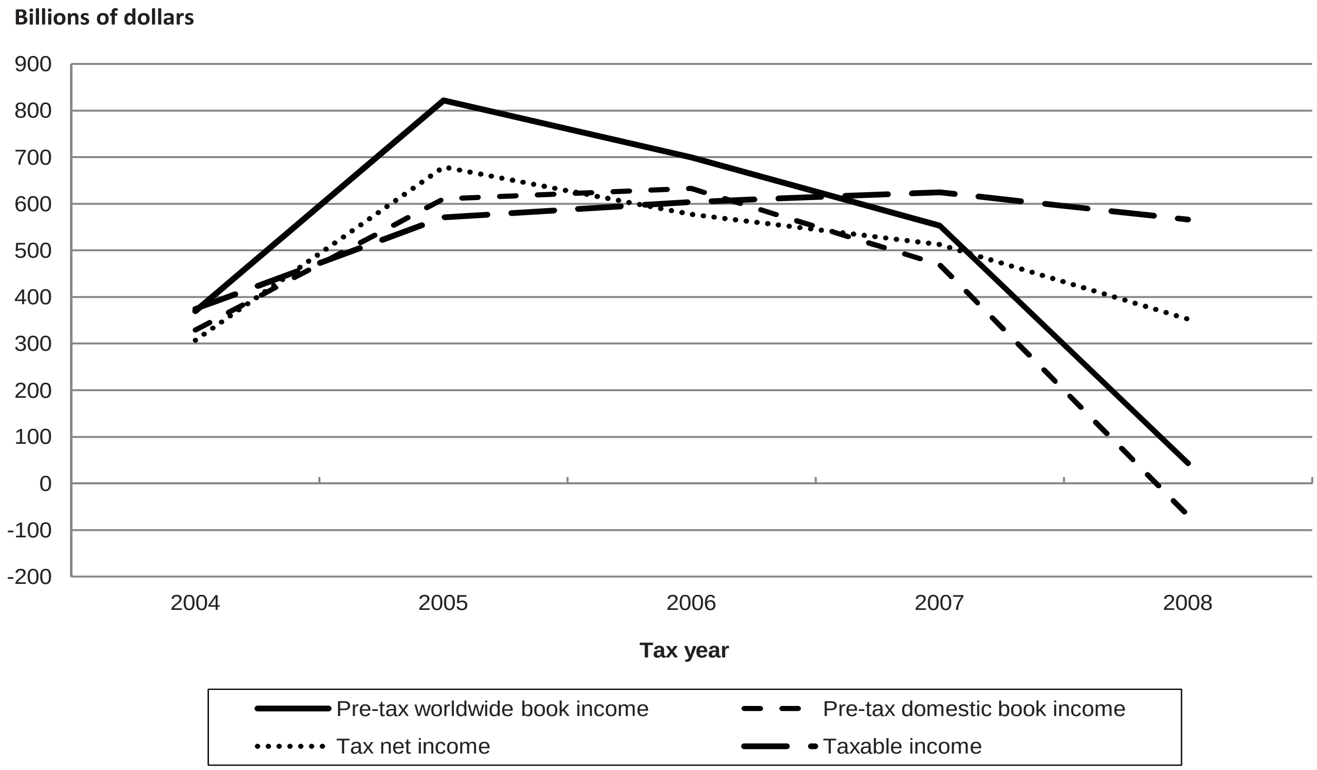
[10] Tax Net Income is equal to Form 1120, Page 1, Line 28.

[11] Taxable Income is equal to Form 1120, Page 1, Line 30.

[12] A firm's domestic pre-tax book income does not include the effect of net operating losses carried forward, and a firm's taxable income does not include earned foreign income.

Figure B

Aggregate Book and Tax Income Measures, Tax Years 2004–2008



year, as it yields new information to understand the book and tax-reporting relations that were previously unavailable. It is worth noting that prior to our sample period (beginning in the early 1990s), book income grew at a faster rate than taxable income, creating large book-tax differences. This trend ended in 2001, a year when aggregate taxable income exceeded aggregate book income.[13] However, Figure B suggests this trend seemed to continue again in the early to mid-2000s with aggregate pre-tax worldwide book income exceeding all other income figures from 2004 through 2006. Taxable income exceeded tax net income and both financial statement income measures in 2007 and 2008. Over the sample period, taxable income increases through 2007, followed by a modest drop in 2008. By contrast, book income, regardless of the measure, and tax net income begin to decline after 2005 and show a sharp decline in 2008, with aggregate pre-tax domestic book income becoming negative.

Distribution of Returns and Income Across Taxable Income Brackets

In this section, the total amount of each type of income is disaggregated into cells defined by the statutory tax rate brackets (corporate statutory income tax brackets are provided for reference in Figure C). In the same way that Figure B provided information on the magnitude of the reporting differences, our analysis here allows for a better understanding of where, as defined by income, the differences arise. In order to better understand those differences, this study examines four separate measures of corporate income by statutory tax rate bracket as previously defined: aggregate pre-tax worldwide book income

[13] Plesko, G., and N. Shumofsky, "Reconciling Corporation Book and Tax Net Income, Tax Years 1995-2001," *SOI Bulletin*, Winter 2004-2005.

Figure C

Corporate Tax Rate Schedule

If taxable income (line 30, Form 1120) on page is:

Over—	But not over—	Tax is	Of the amount over
$0	$50,000	15%	$0
50,000	75,000	$7,500 + 25%	50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	______	35%	0

of corporations includible in the filed Form 1120; the aggregate pre-tax domestic book income of corporations includible in the filed Form 1120; aggregate tax net income; and aggregate taxable income.

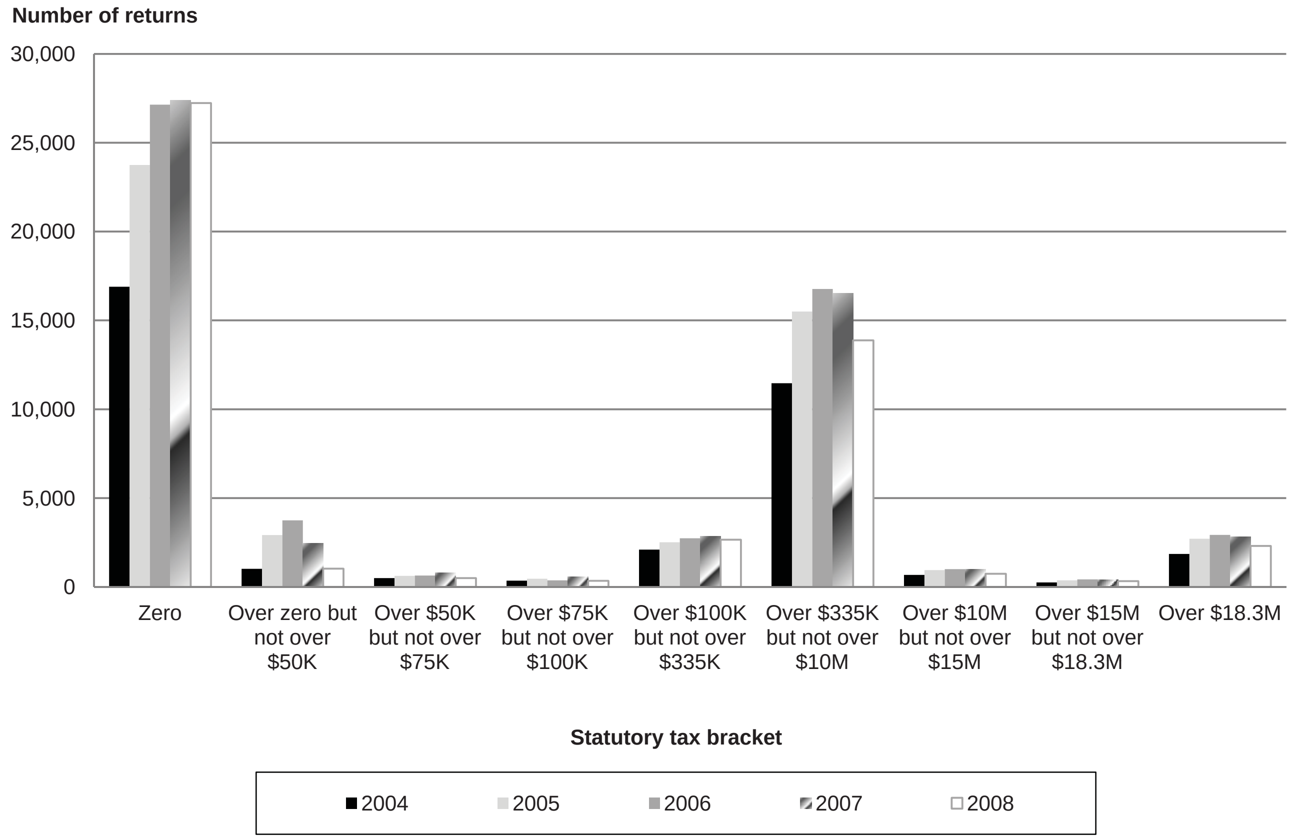
Table 1 provides the annual number of returns and aggregate book and taxable income measures across statutory tax brackets for all active corporate returns (other than Forms 1120S, 1120-REIT, and 1120-RIC) required to file Schedule M-3 and with information sufficient to calculate our income figures. Figures D through H present the figures included in Table 1. The total number of corporate Schedule M-3 filers increases in the 3-year period, from 35,120 returns filed in 2004 to 55,759 returns filed in 2007 and then decreases to 49,013 returns filed in 2008. For each year, the vast majority of corporate Schedule M-3 filers have taxable income falling within either the zero-percent tax bracket (i.e., taxable income equal to zero) or the 34-percent statutory tax bracket with taxable income over $335,000 but not over $10 million. Consistent with the decline in income shown in Figure B, the percentage of firms whose taxable income falls within the zero-percent tax bracket increases over the period 2004–2008 and represents the largest single group of M-3 returns in each tax year under analysis, ranging from approximately 48.1 percent of Schedule M-3 filers in 2004 to 55.6 percent of firms in 2008. The percentage of firms falling in the 34-percent statutory tax bracket with taxable income over $335,000 but not over $10 million decreases over time from 32.6 percent in 2004 to 28.3 percent in 2008. The percentage of corporate filers in any of the other seven tax brackets ranges from 19.3 percent in 2004 to 16.1 percent in 2008.

As shown in Figure B, aggregate worldwide pre-tax book income increased from 2004 to 2005 and then decreased from 2005 through 2008, and domestic pre-tax book income increased from 2004 to 2006, then decreased from 2006 to 2008. Tax net income exhibits a pattern similar to worldwide pre-tax book income, increasing from 2004 to 2005, and decreasing from 2005 to 2008, though the decline in tax net income is not as severe in those years as the decline in worldwide book income. However, taxable income continues to increase from 2004 to 2007 and only begins to decrease from 2007 to 2008. The modest increase in taxable income through 2007 is at first glance at odds with Figure D, which shows an increase in the number of zero-bracket returns, but there is also an increase in the total number of returns from 2004 to 2006. As shown in Table 1, the total number of returns increased from 35,120 in 2004 to 55,759 in 2006, then fell in each of the next 2 years. While previous studies document significant differences in financial statement and taxable incomes across time, this study documents similar patterns in both book income measures and tax net income. Taxable income, however, exhibits different behavior across time from the financial statement measures and even tax net income.

Examining Figures E and F for Tax Years 2004–2007 shows aggregate worldwide and domestic book income to be far greater than aggregate book losses. However, aggregate domestic book losses of $431.1 billion experienced by filers whose taxable income fell in the zero-percent statutory tax rate bracket in 2008 are larger than the $323.9 billion in aggregate domestic book income experienced by filers whose

Figure D

Number of M-3 Returns Across Statutory Tax Brackets, Tax Years 2004–2008



taxable income fell in the 35-percent statutory tax rate bracket, possibly indicative of the U.S. economic downturn during Tax Year 2008.

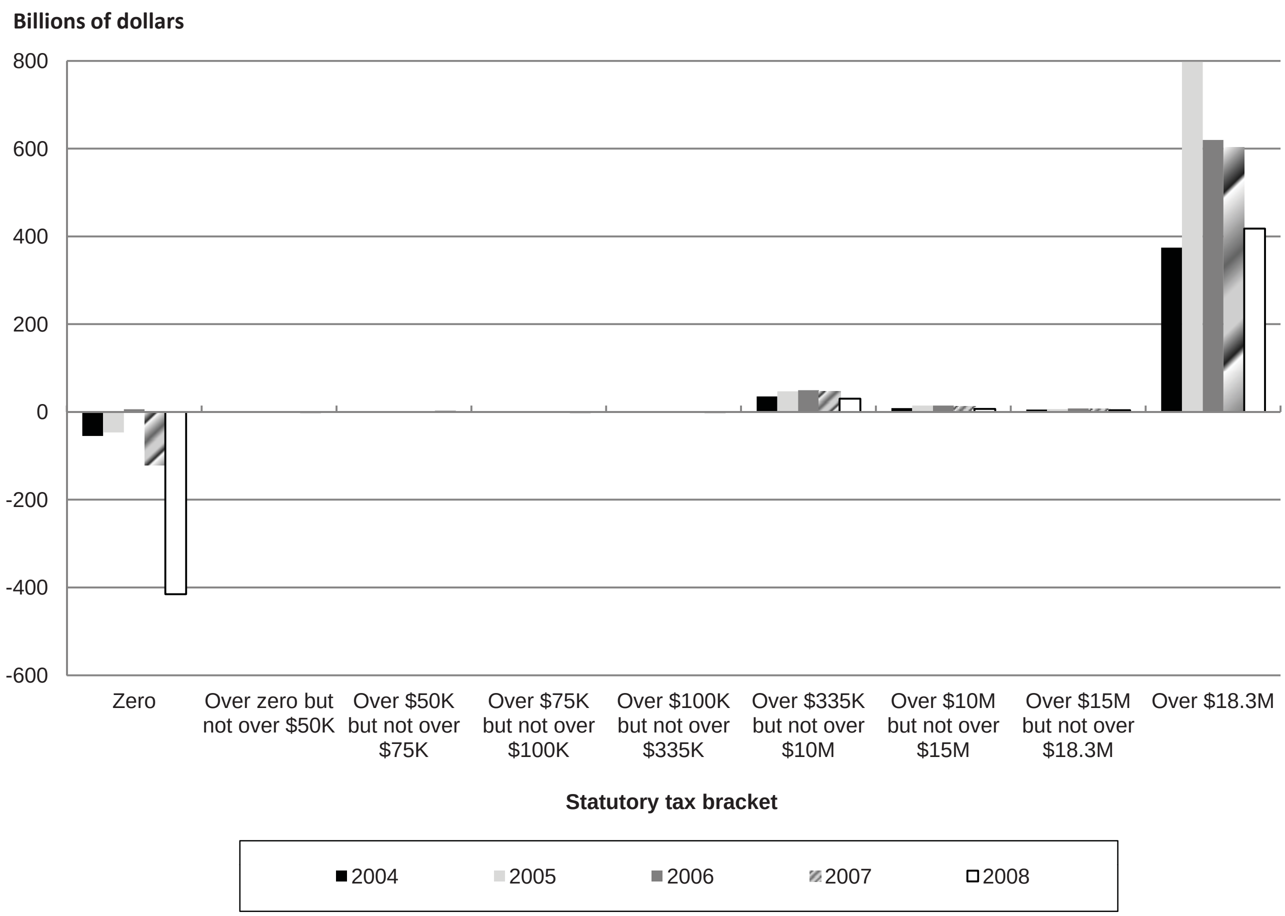
While the taxable income of the majority of corporate Schedule M-3 filers falls within the zero-percent or 34-percent (with taxable income over $335,000 but not over $10 million) statutory tax bracket (see Figure D), the few firms whose taxable income falls within the highest statutory tax bracket threshold of over $18.3 million (i.e., facing a statutory tax rate of 35 percent) possess the largest aggregate levels of worldwide and domestic book income and both taxable income measures. Thus, although they comprise only a very small percentage of corporate Schedule M-3 filers (ranging from a high of 5.4 percent in 2005 to a low of 4.7 percent in 2008), these businesses earn the largest amounts of both book and taxable incomes. This is consistent with the concentration of income shown in tabulations of corporate income by assets. Based on the 2008 Statistics of Income Complete Report, for example, the largest asset group for all active corporate income tax filers (with assets over $2.5 billion) possess approximately 81 percent of all assets, 68 percent of net income, and pay 76 (68) percent of total income tax before (after) credits.[14]

The information reported on Schedule M-3 allows for the observation of differences in book and taxable incomes not driven by differences in the number of entities included in each report. In sum, our tabulations reveal that the majority of corporate Schedule M-3 filers (i.e., those firms with assets greater than $10 million), report no taxable income or taxable income between $335,000 and $10 mil-

[14] See Table 2, Internal Revenue Service, *Statistics of Income—2008, Corporation Income Tax Returns* (Publication 16), p. 40.

Figure E

Aggregate Pre-Tax Includible Worldwide Book Income Across Statutory Tax Brackets, Tax Years 2004–2008



lion, with aggregate corporate taxable income increasing from Tax Years 2004 through 2007 and decreasing from 2007 to 2008. In contrast to the pattern of reported taxable income from 2004 through 2008, reported worldwide pre-tax book income and tax net income only increase from 2004 to 2005 and begins to decrease for the remainder of our sample period (2005–2008), while reported domestic pre-tax book income increases from 2004 to 2006 and decreases from 2006 to 2008. The measures of financial statement income greatly exceed financial statement losses during the first 4 years of our sample period, while aggregate domestic financial statement losses exceed reported aggregate book income during 2008.

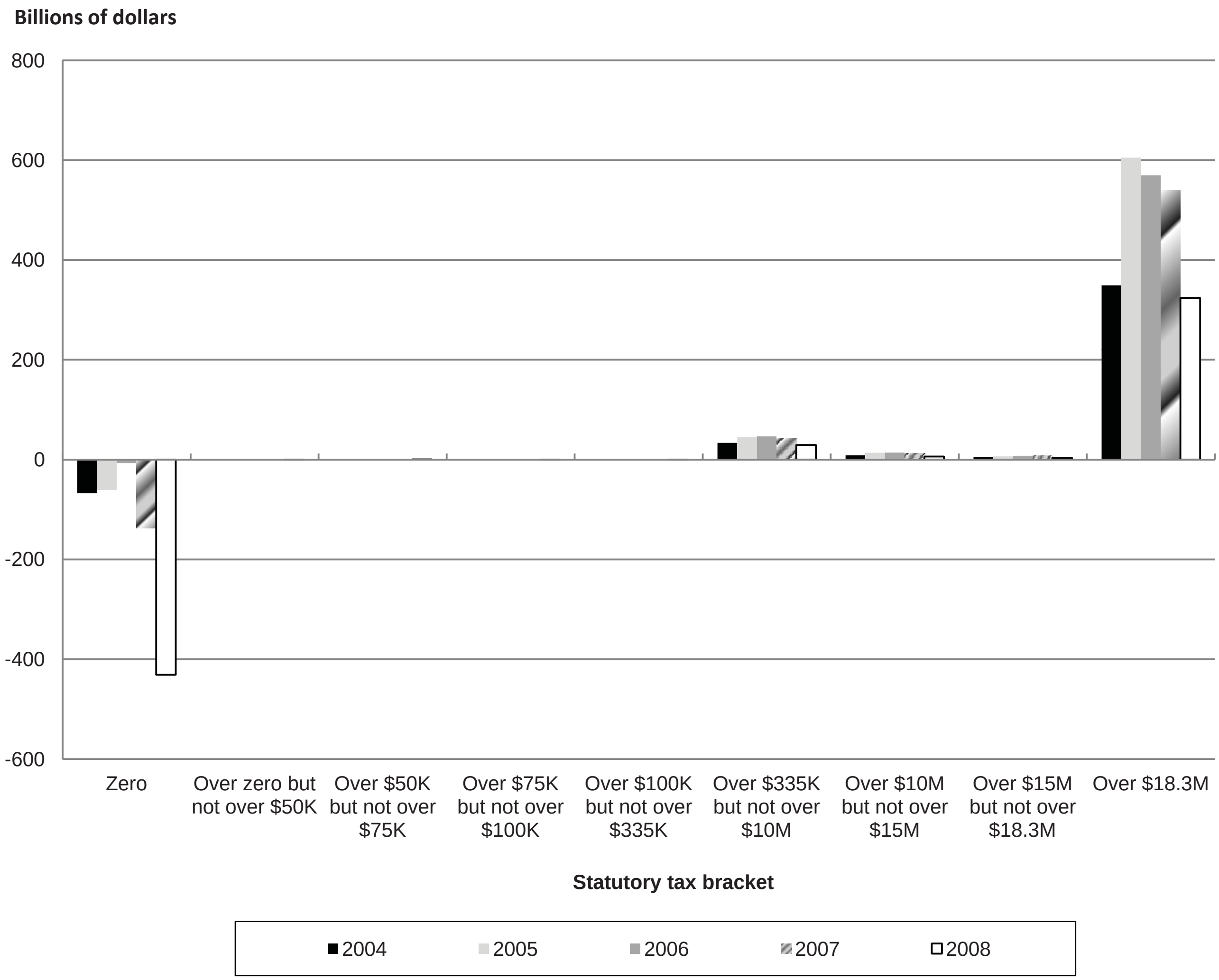
Despite differences in the levels and amounts of reported book and taxable income across time, the figures reporting aggregate financial statement and taxable incomes across statutory tax rate brackets appear quite similar, regardless of the income measure under examination; the highest amount of aggregate income (financial statement or taxable income) is concentrated in the 35-percent statutory tax bracket (taxable income over $18.3 million). Combining this result with Figure D, "Number of Returns Across Statutory Tax Brackets," it is clear that a small number of corporate Schedule M-3 filers earn the largest amounts of both book and taxable incomes.

Income Changes and the Marginal Tax Rate

The information on the distribution of taxable income is useful to better understand the composition of the corporate tax base (by one measure of size)

Figure F

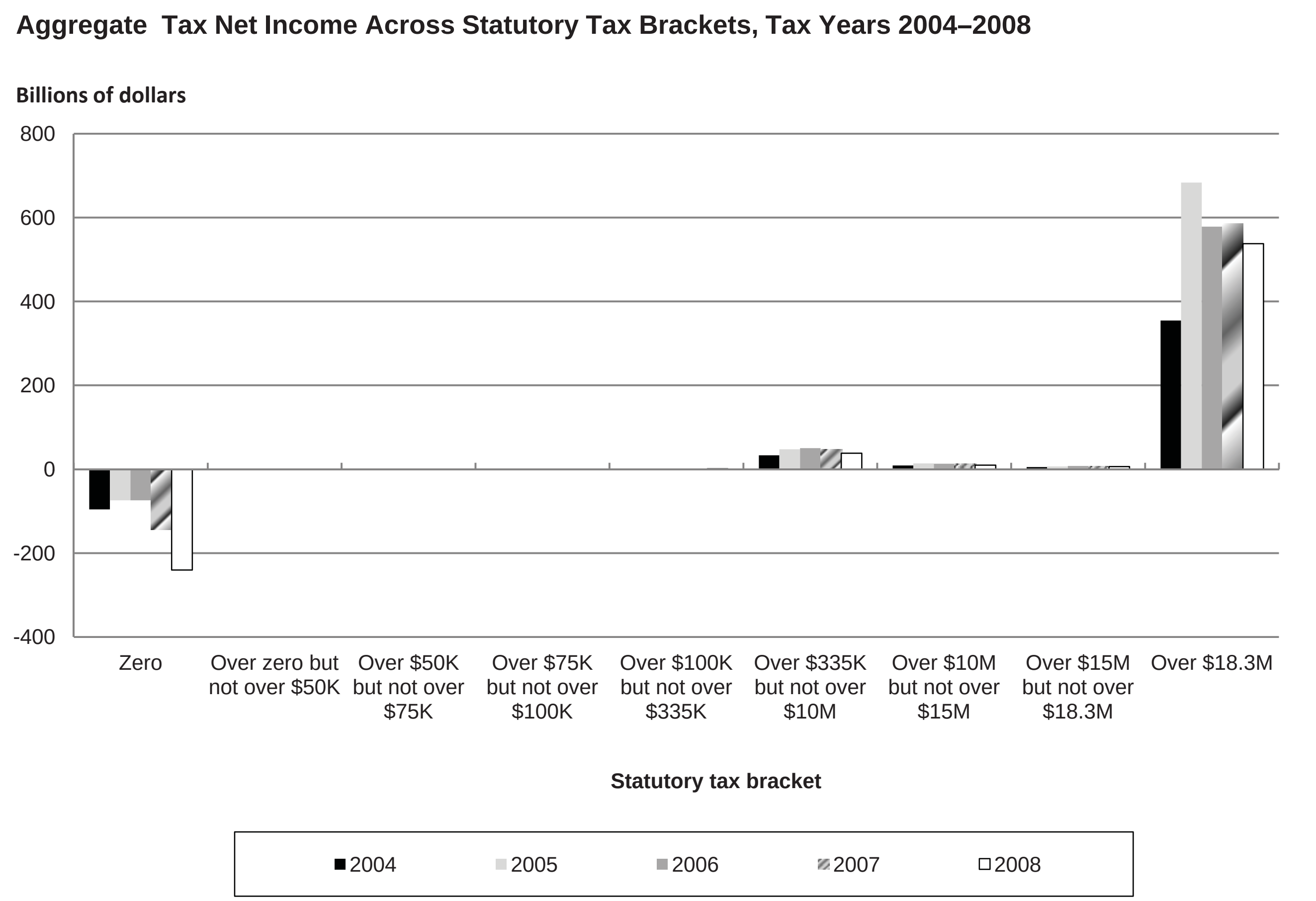
Aggregate Pre-Tax Includible Domestic Book Income Across Statutory Tax Brackets, Tax Years 2004–2008



and the relation between alternative measures of income. This section addresses a complementary issue regarding whether the distribution of income measures across statutory tax brackets would change if there are changes in the amount of income reported by businesses. This question is important for two reasons. First, as the economy grows, it is expected that each business will have, on average, higher income as well. The tabulations in this section provide insight on the rates at which any growth in taxable income will be taxed. Second, recent tax policy discussions have suggested the need to broaden the corporate tax base. An increase in the base, similar to the effects of economic growth, could cause the amount of taxable income in each bracket to rise and potentially move firms into higher rate brackets unless there are concurrent changes in the rate structure.

Table 2 shows the effects of changes in underlying tax net income (i.e., taxable income before NOL and special deductions) on our sample of firms' statutory tax rates from 2004 to 2008. To determine whether a firm's marginal tax rate would change, tax net income (Form 1120, Page 1, Line 28) is increased by 5 percent, and the firm's statutory tax rate is de-

Figure G



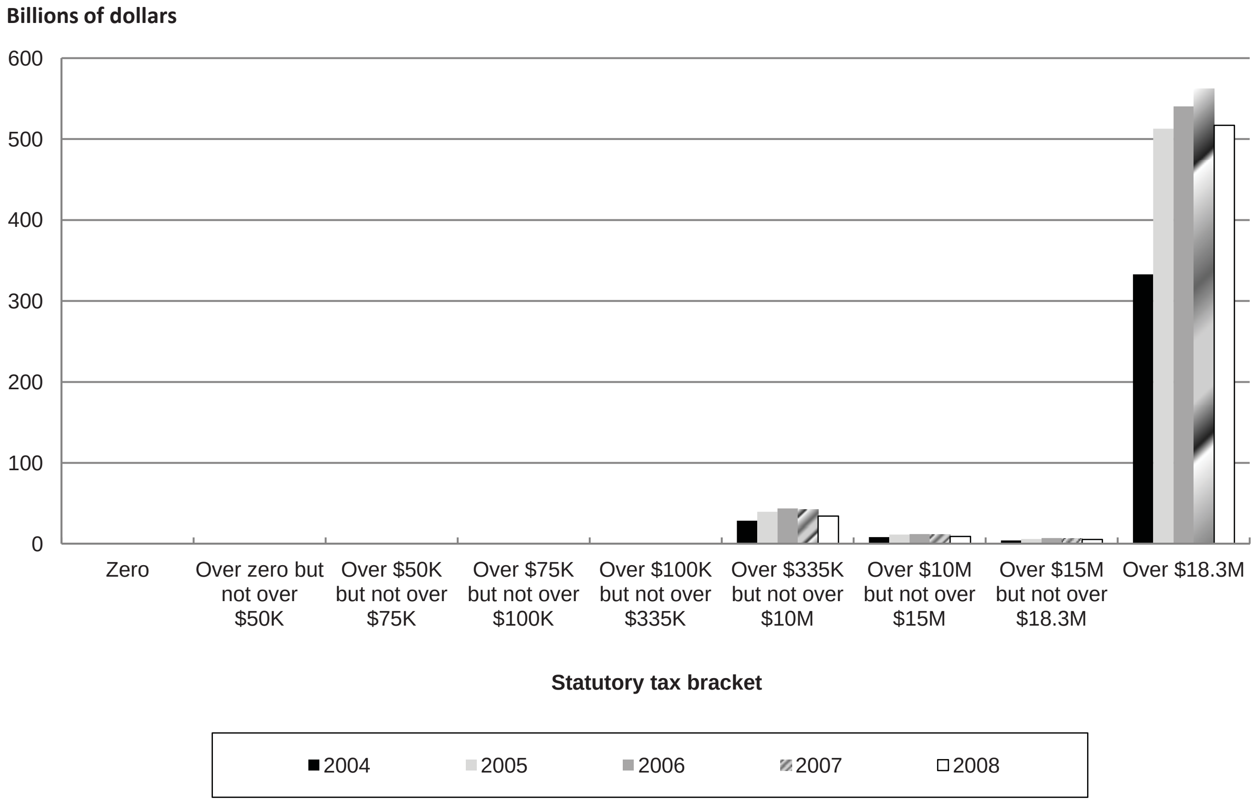
termined using the adjusted taxable income figure.[15] There is a substantial amount of upward movement across statutory tax brackets and across years in response to a 5-percent increase in a firm's tax net income. In particular, mobility is most pronounced for those firms originally falling in the zero tax bracket, the 25-percent bracket with income over $50,000 but not over $75,000, the 34-percent bracket with income over $75,000 but not over $100,000, and the 38-percent bracket with income over $15 million but not over $18.3 million. The percentage of firms that move from the zero statutory tax rate bracket to a higher tax bracket ranges from a low of 17.9 percent (4,863 of the original 27,230 firms in the zero-percent bracket) in 2008 to a high of 25.1 percent (4,236 of the original 16,896 firms in the zero-percent bracket) in 2004.[16] The relatively large percentage of firms originally in the 25-percent bracket with

[15] The adjusted taxable income figure is calculated as 1.05 percent of a firm's tax net income less the net operating loss and special deductions. For example, if a firm reported $100,000 of tax net income (Form 1120, Line 28) and a net operating loss of $50,000 on its originally filed return, the firm falls in the 15-percent, over $0 but not over $50,000, statutory tax bracket. To determine the marginal tax rate faced by this firm in response to a 5-percent change in its underlying tax net income, we multiply its originally filed tax net income of $100,000 by 1.05 to arrive at a new tax net income figure of $105,000 and subtract its net operating loss deduction of $50,000 to arrive at a new taxable income figure of $55,000. We then determine the statutory tax rate that corresponds to the increased taxable income figure. In this case, the firm leaves the 15-percent, over $0 but not over $50,000, statutory tax bracket to face a new statutory tax rate of 25 percent (taxable income over $50,000 but not over $75,000).

[16] For presentation of Table 2, we excluded a total of 166 observations that moved from the zero-percent tax bracket to the highest income statutory 34-, 38-, and 35-percent rate tax brackets (28 firms in 2004; 34 in 2005; 42 in 2006; 32 in 2007; and 30 in 2008). These outlier observations occur because these are very high tax net income firms who originally face a zero-percent statutory tax bracket due to a net operating loss equal to or greater than their tax net income. From Form 1120, Line 28, we are only able to observe the net operating loss deducted from originally reported taxable income (i.e., only the amount of net operating loss necessary to bring taxable income to zero). As such, we cannot effectively reduce the calculated increased net income by *potential* or *available* net operating loss.

Figure H

Aggregate Taxable Income Across Statutory Tax Brackets, Tax Years 2004–2008



income over $50,000 but not over $75,000, ranging from 13.7 percent (68 of the original 497 firms in 2004 were outgoing in this tax bracket) to 39.8 percent in 2007 (314 of the original 789 firms), and the 34-percent bracket with income over $75,000 but not over $100,000, ranging from 21.0 percent (72 of the original 344 firms in this statutory tax bracket) in 2008 to 36.9 percent (210 of the original 569 firms) in 2007 that move to a higher tax bracket is likely due to the narrow definition of these tax brackets. Finally, there is substantial movement in the 38-percent, over $15 million but not over $18.3 million, tax bracket, ranging from 21.3 percent (87 of the original 409 firms falling in this statutory tax bracket in 2007) of firms that move to the highest income threshold tax rate bracket to 27.5 percent of the original 258 firms in 2004. Thus, firms' marginal tax rates appear quite sensitive to even a 5 percent increase in their tax net incomes across statutory tax rates and tax years.

Data Sources and Limitations, Form 1120, Tax Years 2004–2008

Estimates of Tax Years 2004–2008 are based on samples of corporate income tax returns with accounting period ending July of one year through June of the following year. These returns represent domestic corporations filing Form 1120 or 1120-A; foreign corporations with income "effectively connected" with a U.S. business filing Form 1120-F; life insurance companies filing Form 1120-L; and property and casualty insurance companies filing Form 1120-PC. Form 1120S (S corporation returns), regulated investment companies filing Form 1120-RIC, and real estate investment trusts filing Form 1120-REIT were excluded from tabulations. Firms included in the sample are only those required to file Schedule M-3 (total assets of $10 million or more) and whose Schedule M-3 provides information sufficient to distinguish between domestic and foreign components of worldwide book income.[17] As a result, the number of firms in each year's sample will differ, and firms are not required to be present in all sample years.[18]

A stratified probability sample was used to produce the statistics. Sample sizes vary by year with stratifications based on combinations of total assets and a measure of income at rates ranging from 0.25 percent to 100 percent. More detail for individual years is available in *Statistics of Income—Corporation Income Tax Returns*, Publication 16.

[17] We excluded from our sample any firm with obvious data consistency issues, including those firms whose Schedule M-3, Part II, Line 30 does not equal Schedule M-3, Part I, Line 11 (two items that must be equal if following form instructions) and any firm whose gross foreign dividends (an item that should always be reported as a positive number) is less than zero. See Boynton, C, P. DeFilippes; E. Legel; and T. Reum, "First Look at 2007 Schedule M-3 Reporting by Large Corporations," *Tax Notes*, August 15, 2011, for a discussion of data consistency issues.

[18] For an alternative analysis of this data see Bokulic, C.; E. Henry; and G. Plesko, "Reconciling Global Financial Reporting with Domestic Taxation," 2012 SOI and University of Connecticut Working Paper.

Table 1. Number of Corporate Returns Filing Schedule M-3: Aggregate Book and Taxable Income Measures Across Statutory Tax Brackets, Tax Years 2004–2008

[Figures are estimates based on samples; money amounts are in whole dollars]

Tax year	Total	Zero	Over zero but not over $50K	Over $50K but not over $75K	Over $75K but not over $100K
	(1)	(2)	(3)	(4)	(5)
2004					
Number of returns	35,120	16,896	1,016	497	353
Pre-tax worldwide book income	369,445,774,060	-54,880,736,019	-1,557,739,766	140,871,416	303,077,098
Pre-tax domestic book income	329,425,968,633	-67,574,108,023	-1,601,550,054	133,337,436	299,337,273
Tax net income	307,180,954,601	-95,863,708,464	455,604,465	87,231,673	82,061,909
Taxable income	374,639,287,936	0	22,891,777	30,873,200	30,630,115
2005					
Number of returns	49,800	23,752	2,922	621	460
Pre-tax worldwide book income	821,448,074,446	-46,542,992,710	490,982,750	200,398,909	132,376,696
Pre-tax domestic book income	611,121,814,903	-60,743,660,573	453,651,595	196,441,523	114,140,987
Tax net income	679,010,121,143	-74,234,994,903	353,307,194	114,631,588	94,027,826
Taxable income	570,848,626,872	0	37,068,496	39,675,894	40,905,915
2006					
Number of returns	55,759	27,140	3,747	640	374
Pre-tax worldwide book income	699,695,765,478	6,096,544,609	373,690,265	111,909,109	72,330,729
Pre-tax domestic book income	632,712,375,819	-6,903,412,017	363,548,021	110,235,041	62,580,401
Tax net income	576,948,990,432	-74,124,508,493	258,843,671	93,230,012	81,507,189
Taxable income	604,127,663,271	0	58,096,736	41,953,939	32,578,584
2007					
Number of returns	54,851	27,412	2,477	789	569
Pre-tax worldwide book income	553,336,726,913	-121,076,598,360	256,972,940	153,789,719	160,364,245
Pre-tax domestic book income	469,417,871,731	-137,411,365,134	135,146,955	161,208,575	155,987,076
Tax net income	512,355,908,090	-144,125,719,538	199,143,529	67,558,673	93,217,014
Taxable income	624,500,018,971	0	56,824,316	50,714,889	50,583,437
2008					
Number of returns	49,013	27,230	1,032	495	344
Pre-tax worldwide book income	43,224,862,340	-415,224,534,728	-19,976,734	99,856,796	-72,915,010
Pre-tax domestic book income	-68,787,977,731	-431,109,865,957	-59,575,566	89,053,129	-82,576,377
Tax net income	352,345,609,056	-240,404,822,324	130,560,794	60,624,561	50,981,369
Taxable income	566,354,788,330	0	22,743,941	30,065,197	29,845,211

Table 1. Number of Corporate Returns Filing Schedule M-3: Aggregate Book and Taxable Income Measures Across Statutory Tax Brackets, Tax Years 2004–2008—Continued

[Figures are estimates based on samples; money amounts are in whole dollars]

Tax year	Over $100K but not over $335K	Over $335K but not over $10M	Over $10M but not over $15M	Over $15M but not over $18.3M	Over $18.3M
	(6)	(7)	(8)	(9)	(10)
2004					
Number of returns	2,100	11,463	676	258	1,861
Pre-tax worldwide book income	1,614,932,444	35,399,622,012	8,633,537,056	5,588,497,309	374,203,712,510
Pre-tax domestic book income	1,603,023,611	33,501,737,139	8,434,492,883	5,407,036,782	349,222,661,586
Tax net income	720,575,691	33,046,477,494	8,970,609,543	5,311,653,214	354,370,449,076
Taxable income	437,102,913	28,628,895,344	8,259,425,970	4,292,717,063	332,936,751,554
2005					
Number of returns	2,515	15,503	948	367	2,712
Pre-tax worldwide book income	1,611,037,564	47,010,442,406	14,483,616,952	6,459,808,388	797,602,403,491
Pre-tax domestic book income	1,488,140,952	44,629,542,421	13,643,385,718	6,483,095,688	604,857,076,592
Tax net income	1,037,895,556	47,480,549,075	13,870,130,456	6,815,207,230	683,479,367,121
Taxable income	524,978,352	39,637,102,956	11,584,685,926	6,068,369,844	512,915,839,489
2006					
Number of returns	2,736	16,771	1,000	426	2,925
Pre-tax worldwide book income	1,498,356,653	49,523,982,497	14,476,220,195	7,955,218,353	619,587,513,068
Pre-tax domestic book income	1,463,446,949	46,403,235,758	13,869,686,220	7,775,015,009	569,568,040,437
Tax net income	1,077,875,572	50,292,132,540	13,138,228,594	7,905,640,167	578,226,041,180
Taxable income	575,177,821	43,783,704,122	12,167,361,126	7,076,169,145	540,392,621,798
2007					
Number of returns	2,851	16,539	986	409	2,819
Pre-tax worldwide book income	1,670,531,280	47,554,970,857	13,792,696,015	7,800,382,174	603,023,618,043
Pre-tax domestic book income	1,202,785,956	43,762,918,360	13,313,729,865	7,700,798,699	540,396,661,379
Tax net income	1,405,189,459	48,349,248,157	13,611,622,619	7,204,451,792	585,551,196,385
Taxable income	604,036,577	42,742,823,880	12,056,738,925	6,761,527,807	562,176,769,140
2008					
Number of returns	2,658	13,881	742	327	2,304
Pre-tax worldwide book income	-345,774,843	30,273,426,322	6,744,030,044	3,869,440,514	417,901,309,979
Pre-tax domestic book income	-329,735,503	29,177,685,124	6,219,513,886	3,367,126,203	323,940,397,330
Tax net income	927,473,804	38,183,861,697	9,588,028,459	6,110,627,779	537,698,272,917
Taxable income	551,305,029	34,292,371,180	9,081,761,891	5,420,850,870	516,925,845,011

Table 2. Number of Corporate Returns Filing Schedule M-3: Effects of a 5 Percent Increase in Tax Net Income on Applicable Statutory Tax Rates, Tax Years 2004–2008

Tax bracket	Type of change	Tax year				
		2004	2005	2006	2007	2008
	(1)	(2)	(3)	(4)	(5)	(6)
Zero	Original total	16,896	23,752	27,140	27,412	27,230
	Incoming	0	0	0	0	0
	Outgoing	4,236	6,563	6,776	5,693	4,863
	No change	12,632	17,155	20,322	21,687	22,337
	New total	12,632	17,155	20,322	21,687	22,337
Over zero but not over $50K	Original total	1,016	2,922	3,747	2,477	1,032
	Incoming	2,173	3,765	4,137	3,207	2,891
	Outgoing	79	108	97	102	94
	No change	937	2,814	3,650	2,375	938
	New total	3,110	6,579	7,787	5,582	3,829
Over $50K but not over $75K	Original total	497	621	640	789	495
	Incoming	429	555	532	546	485
	Outgoing	68	129	195	314	99
	No change	429	492	445	475	396
	New total	858	1,047	977	1,021	881
Over $75K but not over $100K	Original total	353	460	374	569	344
	Incoming	334	447	480	604	314
	Outgoing	88	115	102	210	72
	No change	265	345	272	359	272
	New total	599	792	752	963	586
Over $100K but not over $335K	Original total	2,100	2,515	2,736	2,851	2,658
	Incoming	915	1,278	1,182	1,184	799
	Outgoing	162	262	254	232	169
	No change	1,938	2,253	2,482	2,619	2,489
	New total	2,853	3,531	3,664	3,803	3,288
Over $335K but not over $10M	Original total	11,463	15,503	16,771	16,539	13,881
	Incoming	782	1,132	1,093	1,009	808
	Outgoing	99	138	168	148	113
	No change	11,364	15,365	16,603	16,391	13,768
	New total	12,146	16,497	17,696	17,400	14,576
Over $10M but not over $15M	Original total	676	948	1,000	986	742
	Incoming	99	135	167	145	112
	Outgoing	79	112	109	123	89
	No change	597	836	891	863	653
	New total	696	971	1,058	1,008	765
Over $15M but not over $18.3M	Original total	258	367	426	409	327
	Incoming	79	105	110	122	90
	Outgoing	71	88	112	87	87
	No change	187	279	314	322	240
	New total	266	384	424	444	330
Over $18.3M	Original total	1,861	2,712	2,925	2,819	2,304
	Incoming	71	98	112	92	87
	Outgoing	0	0	0	0	0
	No change	1,861	2,712	2,925	2,819	2,304
	New total	1,932	2,810	3,037	2,911	2,391