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Recession Dividend: A Boom in Corporate Tax Credits

By Stephen Gandel

Corporate America's biggest assets coming out of the recession could be its losses.

By the end of this year, companies in the Standard & Poor's 500 are likely to have lost as much as $400 billion since the start of 2008, according to S&P. It's a sign of just how badly the recession has hit big companies. But it could also turn out to be a leg up for corporations in the recovery. All that red ink could turn out to be a little-noticed boon for corporate bottom lines. That's because companies are allowed to record a tax credit for current losses in order to lower their tax bill when they return to profitability. (See six year-end tax tips.)

This isn't all that out of the ordinary for a recession. Typically, companies ring up tax credits in down years and use the credits to plump up the bottom line when business picks up. But what is turning the run-of-the-mill tax credit into a bonanza this recovery is the huge amount that corporate America has lost in the past two years. Also, stimulus spending has turned around the economy and corporate profits faster than normal for a particularly deep recession. The speedy turnaround in corporate profits, which are expected to soar 60% in the fourth quarter, is raising the value of the tax credits because they can be quickly cashed in. What's more, Congress is close to passing a bill that would make it even easier than usual for companies to turn recent losses into immediate cash.

"The last time we saw this kind of corporate tax relief was in the early days of the Bush Administration," says Robert Willens, a tax expert.

It is hard to know just how much that $400 billion in losses will end up lowering corporate America's tax bill. Companies are allowed to record tax credits for current losses and use those credits to lower their bill when they return to profitability. If companies have more tax credits than profits, they are allowed to carry those credits forward for up to 20 years or until they are used up. (See 10 ways to spend your tax refund.)

Public companies record two types of earnings, one to the SEC and one to the IRS. It is perfectly legal for these numbers not to match, and often they don't. In 2008, retailer Macy's lost just under $5 billion, but only $33 million of that qualified as a tax loss eligible for credits against future profits. Other times a company books a much bigger tax benefit than its actual losses. Citigroup, for instance, had a bottom-line loss of nearly $28 billion in the numbers it reported to shareholders and the SEC. But at the same time, it recorded a $30 billion increase in tax credits in 2008.

Normally, it can take years for companies to cash in these tax credits, and when they do their value may be greatly diminished if inflation has reared up. But the stimulus is producing a sharp turnaround in the economy, allowing companies to cash in their credits sooner than usual. What's more, continued low inflation is allowing the credits to retain their value. (See the top 10 tax dodgers.)

Congress is moving to make those tax losses even more valuable. Typically, when a company loses money, it can apply for a refund of the taxes it has paid on profits over the past two years. However, Congress is moving closer to extending the so-called tax loss carryback provision to five years, instead of two. Senate majority leader Harry Reid recently threw his support behind the extension of the tax refund, adding it to a bill that would extend unemployment benefits. On Nov. 2, the Senate voted to close debate on the bill, which means a final vote to approve the bill would come later this week. It is expected to pass both houses of Congress easily.

The extension would mean big bucks for corporate America. And unlike "carryforwards," which can only be realized if a company returns to profitability, carrybacks generate immediate cash, as long as the company has earned money in the past half-decade. The Joint Committee on Taxation recently estimated that the carryback extension would result in refunds of $33 billion to companies in 2010.

"Tax credits can matter a lot," says Blake Christian, a tax partner at accounting firm Holthouse Carlin & VanTrigt. "For a midsize company that is still struggling to get loans, the ability to monetize these losses through carrybacks and getting a refund can mean the difference between the company surviving or not."

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