NEW YORK UNIVERSITY
NYU STERN
LEONARD N. STERN SCHOOL OF BUSINESS

THE VINCENT C. ROSS INSTITUTE OF ACCOUNTING RESEARCH
40 WEST 4TH STREET, RM. 300, NEW YORK, NY 10012

Baruch Lev, *Director*
e-mail: blev@stern.nyu.edu
Seymour Jones, *Associate Director*
e-mail: sjones@stern.nyu.edu

Ross Roundtable on Income to Investors and to the IRS

Over the five years prior to its demise Enron reported $13 billion of income to investors, and all of $63 million to the IRS: A 200-to-1 book-to-tax income gap. Was Enron an aberration? Only in magnitude, not in direction. Extensive research shows that over the last 20 years U.S. public companies reported to their shareholders income numbers which were 50-75% higher, on average, than taxable income. Furthermore, the book-tax income gap has been constantly increasing throughout the 1990s.

We are thus witnessing a significant and pervasive phenomenon, having important social, ethical and economic implications. These implications and possible corrective actions will be thoroughly discussed by experts in the May 19, 2003 Ross Roundtable.

Research also shows that the increasing book-tax income gap is partly due to the growing sophistication of companies in avoiding and evading taxes (Enron, for example, had 441 entities formed in the tax-free Cayman Islands), and mainly due to manipulation and fraud of book (shareholders reported) income. Earnings manipulation—the core of public concerns during the last three years—is therefore integrally related to the book-tax income gap.

Research further shows that firms whose book income is substantially larger than taxable income, experience in subsequent years serious earnings declines and often losses. The book-tax gap can therefore serve as a signal for investment and valuation activities.

The book-tax phenomenon thus raises various important policy and practical issues, which hardly received attention in the recent governance and accounting debates, and therefore will be thoroughly aired in the next Ross Roundtable. Specifically, we will ask:

1. What are the main reasons for the wide and growing book-tax income gap, and should policymakers strive to narrow the gap?

2. Since taxable income is not reported to investors, and given that the book-tax gap is highly informative about earnings manipulation and the company's future performance, should public companies be required to report their taxable income?

3. Pushing further the previous question, should companies be required to disclose their Schedule M-1 filed with the IRS, detailing the reasons for the book-tax difference?

4. And the ultimate question: Should accounting and tax regulators (SEC, FASB, IRS) strive to narrow the wide gap between accounting and tax measurement principles? (Such accounting-tax conformity exists in several major economies, like Germany and Japan.)

5. Finally, irrespective of regulatory changes, how should investors estimate taxable income, and use the book-tax gap in investment analysis and valuation?

The Ross Roundtable will host a thorough debate around the above questions, led by experts covering the entire spectrum of interested parties.

DATE & TIME: Monday, May 19, 2003 from 4:00pm to 6:00pm

LOCATION: New York University
Leonard N. Stern School of Business
44 West 4th Street
Kaufman Management Center
Cantor Boardroom, 11th floor (11-75)
New York, NY 10012

CONTACT: **212-998-4143**

ROUNDTABLE COORDINATOR: Baruch Lev, *Philip Bardes Professor of Accounting and Finance*

The Ross Roundtable provides a forum for "public opinion shapers" -- business writers, financial analysts, educators, corporate financial executives, regulators, etc. -- to discuss with policymakers important developments in capital markets and the financial world. To provide ample opportunity for participants to voice their opinions, the size of the Roundtable is limited.

New York University, Stern School of Business is registered with the National Association of State Boards of Accountancy (NASBA), as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN, 37219-2417. NASBA phone number: 615.880.4200. Web site: www.nasba.org

Requirements for participation in program: Adequate business and/or academic experience

Recommended CPE Credits: 2