

1988

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Recommended Citation

Forman, Jonathan Barry (1988) "PAC Contributions and Effective Corporate Tax Rates: An Empirical Study," *Akron Tax Journal*: Vol. 5 , Article 3.

Available at: <https://ideaexchange.uakron.edu/akrontaxjournal/vol5/iss1/3>

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PAC CONTRIBUTIONS AND EFFECTIVE CORPORATE TAX RATES: AN EMPIRICAL STUDY

by

JONATHAN BARRY FORMAN*

INTRODUCTION

In recent years, a great deal of concern has been expressed that many corporations have not been paying their "fair share" of federal taxes. Especially troublesome is the fact that some profitable large corporations have been able to avoid paying corporate income taxes altogether. For example, according to a recent study by Citizens for Tax Justice, Boeing, ITT, General Dynamics, Transamerica, First Executive Corp., Mitchell Energy & Development, Greyhound, Grumman, and Lockheed successfully zeroed-out their respective income tax liabilities or received tax rebates in every year from 1981 through 1984.¹

It is commonly asserted that such large corporations have used political influence to secure special tax benefits to reduce their respective tax liabilities. The present study investigates whether, in fact, there is a relationship between corporate political influence and corporate tax liabilities. Specifically, this study examines the relationship between corporate political action committee (PAC) contributions made during the 1983-1984 election cycle and the effective corporate tax rates imposed on the related corporations in 1985.

BACKGROUND

Under the Federal Election Campaign Act of 1971, as amended,² labor unions, corporations, trade associations, and certain professional and membership organizations may establish and finance "connected" political committees to support candidates for federal office.³ In recent years, such political action

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¹ See R.S. McIntyre & D. Wilhelm, Citizens for Tax Justice, Corporate Taxpayers & Corporate Freeloaders: Four Years of Continuing, Legalized Tax Avoidance by America's Largest Corporations 1981-1984, at 3 (1985)[hereinafter cited as Citizens for Tax Justice].

² U.S.C. §§ 431 *et seq* (Supp. 1987). The principal federal election campaign laws resulted from the following Acts: Revenue Act of 1971, Pub. L. No. 92-178, 85 Stat. 497 (1971); Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1971); Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974); Federal Election Campaign Act Amendments of 1976, Pub. L. No. 94-283, 90 Stat. 475 (1976); and Federal Election Campaign Act Amendments of 1979, Pub. Law. No. 96-187, 93 Stat. 1339 (1979).

³ Such committees are allowed to solicit voluntary contributions from persons related to their sponsors. The PACs, themselves, may then contribute as much as \$5,000 for each primary or general election to a candidate for federal elective office. There is no overall limitation on the amount that a PAC can contribute to all candidates. PACs and candidates for federal office are required to file periodic reports with the Federal Election Commission.

committees or PACs have made extensive contributions to congressional candidates. For example, during the 1985-1986 election cycle, some 3,152 PACs contributed over \$125 million to Senate and House candidates seeking election in 1986, up from just over \$100 million contributed to candidates seeking Congressional seats in 1984.⁴

Members of the Senate and House tax-writing committees have been especially favored by PAC contributors. For example, in 1985, Senator Bob Packwood (R-Ore.), then-Chairman of the Senate Finance Committee, received the most PAC contributions of any member of Congress — \$965,517.⁵ Similarly, in 1987, Senator Lloyd Bentsen (D-Tex.), the current Chairman of the Senate Finance Committee, received the most PAC contributions — \$1.4 million.⁶ According to Common Cause President Fred Wertheimer, the explanation for such large PAC contributions to members of the tax-writing committees is that “PAC money is being given by special interest groups in order to assure that they get special advantages in our tax system.”⁷

Recent academic literature also suggests that PAC contributions are made in order to secure special benefits.⁸ For example, the theory of economic regulation postulates that special interest groups act as wealth-maximizers who seek to influence the regulatory environment in order to secure special economic benefits. Accordingly, the theory predicts that special interest groups, such as PACs, will make campaign contributions in order to secure special economic benefits through favorable legislative outcomes.⁹ With respect to tax legislation, special interests are expected to make campaign contributions to political

⁴13(8) Federal Election Commission Record 6-8 (August 1987).

⁵Common Cause News release, “Gimme a Break” 2-3 (February 11, 1986).

⁶46(9) Cong. Q. Weekly Rep. 488 (Feb. 27, 1988).

⁷Common Cause news release, *supra* note 5, at 1.

⁸Consider *e.g.*, R.E. McCormick & R.D. Tollison, *Politicians, Legislation, and the Economy: An Inquiry into the Interest Group Theory of Government* (1981); G.C. Jacobson & S. Kernell, *Strategy and Choice in Congressional Elections* (1981); Peltzman, *Constituent Interest and Congressional Voting*, 27 *J. Law & Econ.* 181 (1984); and Posner, *Theories of Economic Regulation*, 5 *Bell J. Econ. & Management Sci.* 335 (1974). See also H.E. Alexander, *Financing Politics: Money, Elections, and Political Reform* (3d ed. 1984); Drew, *A Reporter At Large: Politics and Money*, 58 *New Yorker* 54 (December 6, 1982), 57 (December 13, 1982); Mayton, *Politics, Money, Coercion, and the Problem with Corporate Pacts*, 29 *Emory L.J.* 375 (1980).

⁹A number of recent empirical studies have found support for this proposition. See *e.g.*, A. Cassill, *The Influence of Pac Contributions upon Industry Income Tax Burdens: An Empirical Analysis* (unpublished manuscript 1987); Eismeier & Pollock, *Politics and Markets: Corporate Money in American National Elections*, 16 *Brit. J. Pol. Sci.* 287 (1986); Eismeier & Pollack, *Strategy and Choice in Congressional Elections: The Role of Political Action Committees*, 30 *Am. J. Pol. Sci.* 197 (1986); Esty & Caves, *Market Structure and Political Influence: New Data on Political Expenditures, Activities, and Success*, 21 *Econ. Inquiry* 24 (1983); Jacobson, *Party Organization and Distribution of Campaign Resources: Republicans and Democrats in 1982*, 100 *Pol. Sci. Q.* 603 (1985); Jacobson, *Money and Votes Reconsidered: Congressional Elections, 1972-1982*, 47 *Pub. Choice* 7 (1985); Salamon & Siegfried, *Economic Power and Political Influence: The Impact of Industry Structure on Public Policy*, 71 *Am. Pol. Sci. Rev.* 1026 (1977); and Wright, *PACs, Contributions, and Roll Calls: An Organizational Perspective*, 79 *Am. Pol. Sci. Rev.* 400 (1985).

candidates in order to secure special tax benefits.¹⁰

Clearly, Congress has included a variety of special tax exclusions, deductions, credits, and other preferences in the Internal Revenue Code to benefit certain companies and certain industries. For example, the oil industry benefits from provisions that allow percentage depletion and expensing of intangible drilling costs, and the computer industry has benefited from the research and experimentation credit. By taking advantage of these special tax provisions, corporations can reduce the amount of corporate income tax that they pay. The concern is that some of these special tax benefits may be the result of inordinate political influence by special interest groups, rather than the result of good governmental policy planning for the general interest.

One overall measure of the extent to which a given corporation receives special benefits in the federal tax system is that corporation's effective tax rate.¹¹ A corporation's effective tax rate is generally much lower than the maximum statutory rate. For example, while the 1985 statutory tax rate on income in excess of \$100,000 was 46%, according to a recent Tax Analysts study of the effective corporate tax rates imposed on 1,000 of the largest U.S. corporations in 1985, the average effective corporate tax rate imposed on those corporations was just 20.91%.¹² Other studies have found similar low average effective corporate tax rates.¹³

Most studies of effective corporate tax rates have found that effective cor-

¹⁰ A number of authors have expressed this concern. See e.g., J.H. Birnbaum & A.S. Murray, *Showdown at Gucci Gulch* (1987); *Common Cause, Gimme a Break* (1985); *Common Cause, Financing the Finance Committee* (1986); J.F. Witte, *The Politics and Development of the Federal Income Tax* (1985); A. Cassill, *supra* note 9; Doernberg & McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 Minn. L. Rev. 913 (1987); Reuben, *Tax and PACs: Drawing the Connection*, 29 Tax Notes 1335 (1985); and Timberlake, *Revelation of Members' Breakfast Clubs Renews Controversy Over PACs' Influence*, 34 Tax Notes 541 (1987). With respect to the role of special interests in the tax legislative process generally, see e.g., Graetz, *Reflections on the Tax Legislative Process: Prelude to Reform*, 58 Va. L. Rev. 1389 (1972); Hoffman, *The Role of the Bar in the Tax Legislative Process*, 37 Tax L. Rev. 411 (1982); Surrey, *The Congress and the Tax Lobbyist — How Special Tax Provisions Get Enacted*, 70 Harv. L. Rev. 1145 (1957); and Waggonner, *Aspects of Legislative Persuasion: Business*, 32 Nat'l Tax J. 290 (1979).

¹¹ Generally, an effective corporate tax rate is a fraction, the numerator of which is the total tax paid by the corporation and the denominator of which is some measure of the corporation's pretax income.

¹² F.D. Marovelli & S.D. O'Donnell (Tax Analysts), *Effective Corporate Tax Rates 1985*, at 17 (1986) [hereinafter cited as Tax Analysts].

¹³ See e.g., Internal Revenue Service, *Statistics of Income — 1982, Corporate Income Tax Returns* (1985); Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., *Study of 1983 Effective Tax Rates of Selected Large U.S. Corporations* (Comm. Print 1984); Staff of the Joint Comm. on Taxation, 98th Cong., 1st Sess., *Study of 1982 Effective Tax Rates of Selected Large U.S. Corporations* (Comm. Print 1983); *Citizens for Tax Justice, supra* note 1; F.D. Marovelli (Tax Analysts), *Effective Corporate Tax Rates 1980-1984* (1986); M.L. Starcher (Tax Analysts), *Quantifying the Impact of the Tax Reform Act of 1986 on Effective Corporate Tax Rates* (1986).

For additional discussions of the methodology involved in the determination of effective corporate tax rates, see Bradford & Stuart, *Issues in the Measurement and Interpretation of Effective Tax Rates*, 39 Nat'l Tax J. 307 (1986); Fullerton, *The Use of Effective Tax Rates in Tax Policy*, 39 Nat'l Tax J. 285 (1986); Fullerton, *Which Effective Tax Rate?* 37 Nat'l Tax J. 23 (1984); and Spooner, *Effective Tax Rates from Financial Statements*, 39 Nat'l Tax J. 293 (1986).

porate tax rates vary dramatically from company to company and even from year to year for the same company. Some of the variation can perhaps be explained by the fact that corporations in certain industries generally seem to have lower effective corporate tax rates than corporations in other industries. For example, in the Tax Analysts study of 1985 effective corporate tax rates, the average effective tax rate for corporations in the mining industry was just 8.13%, while the average effective tax rate for corporations in the apparel industry was 40.47%.¹⁴ Other studies suggest that some of the variation in effective corporate tax rates results from differences in corporate capital structures and investment patterns.¹⁵

Another possibility is that some of that wide variation in effective corporate tax rates can be explained by the theory of economic regulation; that is, lower effective corporate tax rates may be related to greater campaign contributions made by the connected corporate PACs. Indeed, the results of one recent study indicate that corporate PAC contributions do have an effect on *industry* average effective tax rates.¹⁶ The present study explores the relationship between corporate PAC contributions and effective tax rates of the connected *specific* corporations.

METHODOLOGY AND RESULTS

Hypotheses

Academic theories of economic regulation suggest that corporate PACs make political contributions in order to secure additional tax benefits for their connected corporations. Receipt of these additional tax benefits should be reflected in relatively lower tax rates for those connected corporations. Accordingly, if corporate PAC contributions do, in fact, secure corporate tax benefits, then one would expect that corporations with PACs making extensive campaign contributions will have relatively lower effective tax rates than corporations making minimal or no campaign contributions. Several empirically testable research hypotheses follow from this last proposition.

¹⁴ See Tax Analysts, *supra* note 12, at 15-16.

¹⁵ See e.g., Siegfried, *Effective Average U.S. Corporation Income Tax Rates*, 27 Nat'l Tax J. (1974); Weiss, *Effective Corporation Income Tax Rates*, 32 Nat'l Tax J. 380 (1979); and Zimmerman, *Taxes and Firm Size*, 5 J. Acct. & Econ. 119 (1983).

¹⁶ A. Cassill, *supra* note 9. Cassill used Federal Election Commission Non-Party Report on Financial Activity tapes (1977-1982), and the Internal Revenue Service, *Statistics of Income — 1982, Corporate Income Tax Returns (1985)* to investigate the influence of corporate PAC contributions to members of the tax-writing committees on industry income tax burdens. His results did indicate that corporate PAC contributions were somewhat related to industry average effective corporate tax rates. Specifically, after controlling for varying levels of income, average effective corporate tax rates were found to be lower for industries making higher levels of PAC contributions relative to industries making lower PAC contributions.

First, one would expect that corporations with PACs generally will have lower effective corporate tax rates than corporations without PACs. Second, of those corporations with PACs, one would expect that those corporations whose PACs make more campaign contributions in one time period will have lower effective tax rates in subsequent periods than those corporations whose PACs make less contributions. In this regard, one might expect that contributions to members of the tax-writing committees would be particularly effective in securing tax benefits and consequently lower effective tax rates. Finally, one would expect that PACs connected to corporations with higher incomes will generally contribute more to candidates than PACs connected to corporations with lower incomes.¹⁷

Data and Variables

To test these hypotheses, this study examined the relationship between campaign contributions made by corporate PACs during the 1983-1984 election cycle and the effective corporate tax rates of the connected corporations in 1985.¹⁸ The data set used in this analysis was developed from the Tax Analysts study of the effective tax rates imposed on 1,000 of the largest U.S. corporations in 1985¹⁹ and from 1983-1984 Federal Election Commission (FEC) records.

Two variables from the Tax Analysts study were used in this analysis. The dependent variable is Tax Analysts' estimate of the corporation's effective U.S. tax rate on U.S. income (USRATE).²⁰ As one of the independent variables, Tax Analysts' estimate of the corporation's pretax U.S. income (USINCOME) was selected.

Two additional independent variables were developed from the FEC

¹⁷ There are two reasons for this hypothesis. First, corporations with higher incomes are generally larger corporations. These corporations should generally have larger PACs because they have more potential employee and shareholder PAC contributors. Second, PACs connected to corporations with higher incomes can be expected to contribute more since these corporations would have relatively greater tax savings from securing lower effective tax rates.

¹⁸ As a study of the influence of corporations on tax legislation, this study is admittedly limited in several ways. First, this study does not take into account any lobbying efforts of large corporations other than PAC contributions. In this regard, some corporations without PACs may receive special benefits by directly lobbying members of Congress and so have no need for PACs. Second, the present study does not consider PAC contributions by industry PACs. These organizations, such as the American Bankers Association BANKPAC and the National Association of Independent Insurers PAC, have contributed thousands of dollars to members of Congress on behalf of their industries. In this regard, some corporations without PACs may receive special tax benefits as a consequence of industry and trade PAC contributions and so have no need for their own PACs.

Finally, this study simply does not consider the aggregate effect of corporate and industry PAC contributions on federal revenues raised by the corporate sector as a whole, yet it is quite plausible that the net effect of corporate PAC contributions by large corporations has been to reduce the effective tax rate for all corporations or, at least, to minimize the share of federal revenues raised by the corporate sector as a whole. In this regard, from 1950 to 1983 corporate taxes declined from 26.5% of total federal receipts to just 6.2% of total federal receipts. See Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., Study of 1983 Effective Tax Rates of Selected Large U.S. Corporations, *supra* note 13, at 19.

¹⁹ See Tax Analysts, *supra* note 12.

²⁰ USRATE is a fraction, the numerator of which is the corporation's U.S. income tax paid and the denominator of which is the corporation's USINCOME. See Tax Analysts, *supra* note 12, at 3-6. For some

1983-1984 Non-Party Report on Financial Activity computer tape.²¹ First, a determination was made as to which of the corporations in the Tax Analysts study had one or more connected PACs during the 1983-1984 election cycle.²² Then for those corporations with connected PACs, the total PAC contributions made by each corporation's connected PACs to all House and Senate candidates during 1983-1984 (CONTALL) and the total PAC contributions made by each corporation's connected PACs to all members of the Senate Finance and House Ways and Means Committees (CONTTAX) were determined.

Statistical Analyses

Fortune Corporations

Initially, the author considered just the 1985 *Fortune* 500 largest U.S. industrial corporations.²³ Of these, Tax Analysts had computed USINCOME and USRATE for just 358. The overall mean effective U.S. tax rate on U.S. income (USRATE) for these 358 corporations was 25.01%, with a standard deviation of 30.53%.

Of the 358 corporations, 201 had connected PACs and 157 did not. The mean USRATE for the 201 corporations with PACs was 23.27%, and the mean USRATE for the 157 corporations without PACs was 27.24%. Although the difference between the means was in the expected direction, a t-test comparing

of the corporations, the USRATE is negative. For example, a corporation with positive USINCOME would have a negative USRATE if its activities generated tax loss carryforwards. *Id.* In some cases, Tax Analysts did not determine a U.S. rate, typically because the U.S. operations incurred a loss. *Id.* at 316, n.18.

²¹The tape contains two files which detail transactions which occurred between every federal candidate and every non-party political action committee during the 1983-1984 election cycle. The "spread" file contains 4,347 records — one record for each non-party committee. The records are arranged on the tape first by the type organization which sponsors the committee, with committees sponsored by corporations appearing first alphabetically by committee name. Each record also includes, *inter alia*, the committee's FEC identification number, special-interest-group classification (*e.g.*, C = Corporate, and indicates that the committee is connected with a corporation) and extensive information about receipts, contributions, and disbursements made by the committee during the election cycle. The "crosstabs" file contains 106,705 records — one record for each reported candidate-committee combination. The records are sorted in the same manner as the "spread" file. Each record includes, *inter alia*, a committee's FEC identification number, a candidate's name and FEC identification number, and information about that committee's contributions to that candidate.

²²PAC connections for the Tax Analyst corporations were identified primarily by comparing a list of the remaining Tax Analyst corporations with a printout of the FEC 1983-1984 Committee Cross Index and with a printout of the "spread" file of the FEC 1983-1984 Non-Party Report on Financial Activity tape. PACs of affiliated corporations were included in the study as if they were directly connected to the parent corporation.

²³113(9) *Fortune* 174-232 (April 28, 1986).

the two means was not statistically significant.²⁴

Tax Analysts Corporations with PACs

Next, the author considered a somewhat larger sample of corporations with PACs for more detailed analysis. Starting with the 1,000 corporations in the Tax Analysts study, those without PACs were excluded. Of those with PACs, the Tax Analysts study had determined USINCOME and USRATE for just 456 corporations. The mean USRATE for these 456 corporations was 20.38%, with a standard deviation of 25.89%.

Pearson correlation coefficients were then computed to see the relationship among the variables USINCOME, CONTALL, CONTTAX, and USRATE,²⁵ and these coefficients are displayed in Table 1.²⁶ Neither CONTALL nor CONTTAX was significantly correlated with USRATE, although the relationships were in the expected direction. Also, USRATE was not significantly correlated with USINCOME. USINCOME was, however, significantly correlated with both CONTALL and CONTTAX, and CONTALL was significantly correlated with CONTTAX.

As an alternative way to investigate the relationship between PAC contributions to candidates for congressional office and effective corporate tax rates, a multiple regression of CONTALL and USINCOME on USRATE was then run. The results of that regression are set forth in Table 2.²⁷ Again, although the relationship between CONTALL and USRATE was in the expected direction, it was not significant. Also, there was no significant relationship between USINCOME and USRATE.

²⁴ Assuming equal variances for the two populations, with 356 degrees of freedom, $t = -1.222$. The probability of a t value greater than that absolute t was 22.26%.

²⁵ Because of missing data values on the FEC tape, CONTALL could not be determined for one company and CONTTAX could not be determined for a different company. Accordingly, most of the statistical tests utilized just 455 observations.

²⁶ TABLE 1. CORRELATION COEFFICIENTS AND PROBABILITIES*

	<i>USINCOME</i>	<i>CONTALL</i>	<i>CONTTAX</i>	<i>USRATE</i>
<i>USINCOME</i>	1.000	0.531*	0.443*	0.005
<i>CONTALL</i>		1.000	0.776*	-0.036
<i>CONTTAX</i>			1.000	-0.069
<i>USRATE</i>				1.000

*Correlations were found to be significant at the .01 level.

²⁷ TABLE 2. MULTIPLE REGRESSION COEFFICIENTS (Probability Value in Parentheses)
DEPENDENT VARIABLE = USRATE

	R^2
INDEPENDENT VARIABLES:	0.0021
INTERCEPT	20.64
USINCOME	0.00000002 (0.552)
CONTALL	-0.0000209366 (0.334)

Finally, to see if there was a relationship between PAC contributions to members of the tax-writing committees and effective corporate tax rates, a separate multiple regression of CONTTAX and USINCOME on USRATE was run.²⁸ The results of that regression are set forth in Table 3.²⁹ Again, although the relationship between CONTTAX and USRATE was in the expected direction, it was not significant, nor was USINCOME significantly related to USRATE.

DISCUSSION

Somewhat surprisingly, the results failed to show any significant relationship between corporate PAC contributions and the effective tax rates paid by the connected corporations. First, corporations that had PACs during the 1983-1984 election cycle did not have significantly lower 1985 effective corporate tax rates than corporations without PACs. Second, considering only those corporations with PACs, relatively greater PAC contributions did not significantly relate to relatively lower tax rates. While counter-intuitive, these findings are reassuring in that they suggest that, at least as among the sample corporations, greater corporate PAC contributions to members of Congress did not secure greater tax benefits.

The results also failed to show a significant relationship between the sample corporations' 1985 U.S. income and their 1985 effective corporate tax rates. Since a corporation's U.S. income is closely related to its size, this result can be interpreted to mean that, all other things being equal, larger corporations and smaller corporations in the sample faced roughly the same effective tax rate. This interpretation is also somewhat reassuring in that it suggests that sheer economic power alone (*i.e.*, size) does not result in disproportionately greater tax benefits.

Finally, the results did show that 1983-1984 corporate PAC contributions were significantly related to 1985 corporate income. Also, corporate PAC contributions to all congressional candidates were significantly related to corporate PAC contributions to members of the tax-writing committees. Since a corporation's U.S. income is closely related to its size and number of possible employee-contributors, these relationships probably indicate nothing more than the obvious:

²⁸ Because of the relatively high correlation between CONTALL and CONTTAX, the separate multiple regressions were run to avoid the problem of multicollinearity.

²⁹ TABLE 3. MULTIPLE REGRESSION COEFFICIENTS (Probability Value in Parentheses)
DEPENDENT VARIABLE = USRATE

	R ²
INDEPENDENT VARIABLES:	0.0064
INTERCEPT	20.94
USINCOME	0.000000003 (0.390)
CONTTAX	-0.0003069204 (0.091)

PACs connected to larger corporations are likely to contribute more to congressional candidates, generally, and to tax-writers, in particular, than PACs connected to smaller corporations.

CONCLUSION

Although the results of this study failed to show any significant relationship between corporate PAC contributions and the effective corporate tax rates paid by the connected corporations, further research may be warranted. It may be worthwhile to examine the relationship between corporate PAC contributions and effective corporate tax rates over more election cycles and more tax years. In particular, it will be interesting to see whether there is any relationship between the extensive corporate PAC contributions made during the 1985-1986 election cycle and the relative effective corporate tax rates of the connected corporations for 1988 when the full effects of the high-stakes Tax Reform Act of 1986 can be measured.

