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PUTTING U.S. CORPORATE TAXES IN PERSPECTIVE

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The U.S. corporate tax burden is smaller than average for developed countries.[1] Corporations in 19 of the member states of the Organization for Economic Co-operation and Development paid 16.1 percent of their profits in taxes between 2000 and 2005, on average, while corporations in the United States paid 13.4 percent.

Nevertheless, some have argued that U.S. corporate tax rates unduly burden U.S. companies by pointing to the country's top *statutory* tax rate, which is 35 percent. For example, a recent *Wall Street Journal* editorial calling for corporate tax cuts noted that this is the second highest top statutory tax rate among developed countries.[2] While true, this gives the false impression that the corporate tax burden is greater here than in other developed countries. Because the U.S. tax code offers so many deductions, credits, and other mechanisms by which corporations can reduce their taxes, the actual percentage of profits that U.S. corporations pay in taxes — or what analysts refer to as their *effective* tax rate — is not high, compared to other developed countries.

Because the average U.S. corporate tax burden is low, many economists believe a revenue-neutral corporate tax reform that reduces statutory corporate tax rates, while broadening the tax base by eliminating costly tax breaks, could improve economic efficiency and likely benefit the U.S. economy.

- **Effective tax rate much lower than top statutory rate.** Government and independent researchers have long pointed out that the top statutory corporate tax rate is an incomplete measure at best of the burden of corporate taxes. It does not take into account the generous

[1] U.S. Department of the Treasury, "Treasury Conference on Business Taxation and Global Competitiveness: Background Paper," July 23, 2007, Table 5-3 (giving data on a sample of 19 of the 30 OECD states). For an international comparison of corporate-level taxes (taxes paid at the corporate level, including, for example, property taxes, labor taxes and contributions, and sales taxes), see: World Bank and PricewaterhouseCoopers, "Paying Taxes 2008: the Global Picture," http://www.doingbusiness.org/documents/Paying_Taxes_2008.pdf. This study compared the corporate-level taxation that a hypothetical company with 60 employees would face in 178 countries. The study found that the corporate-level taxes the model company would pay, measured as a percentage of its profits, would be higher in 76 other countries (including 15 OECD countries) than in the United States.

[2] "America the Uncompetitive," August 15. The ranking is based on data from the Organisation for Economic Co-Operation and Development.

depreciation rules, exemptions, deductions, and credits (some of which are sometimes termed "loopholes") that corporations may be eligible for. Those special provisions lower corporations' effective tax rate, or the share of their profits they actually pay in taxes, and do so in a way that creates different tax rates for different industries. These differential tax rates across industries are generally regarded as more harmful to economic efficiency than any burden due to the current top statutory rate.

- **The United States has plethora of generous corporate tax breaks.** As the Treasury Department has noted, the United States' low effective tax rate reflects its "narrow corporate tax base," which is the result of "accelerated depreciation allowances [and] special tax provisions for particular business sectors … as well as debt finance and tax planning."[3]

  These tax breaks lead to very low tax rates on certain types of investments — even negative rates in some cases. For example, a 2005 Congressional Budget Office study found that the effective *marginal* corporate rate — the rate paid on the last dollar of income earned and arguably the tax rate most relevant for investment decisions — on debt-financed investment in machinery was *negative*, estimated at -46 percent.[4] This means that the total value of the deductions that companies may claim for such investment is much larger than the tax they pay. (Put another way, it means that other taxpayers effectively subsidize the investment.) A recent Government Accountability Office study similarly found wide variation in effective tax rates across corporations.[5]

  The Treasury Department estimates that various corporate tax breaks will cost the federal government more than $1.2 trillion over the next ten years (2008-2017), a period during which total corporate *revenues* are projected to equal $3.4 trillion.[6]

- **Many smaller corporations do not face the top statutory corporate tax rate.** For small corporations, another reason that the top statutory corporate tax rate is an inaccurate measure

[3] Office of Tax Policy, U.S. Department of the Treasury, "Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century," December 20, 2007.

[4] Congressional Budget Office, "Corporate Income Tax Rates: International Comparisons," November 2005, http://cbo.gov/ftpdocs/69xx/doc6902/11-28-CorporateTax.pdf. Effective tax rates were estimated by Michael P. Devereux, Rachel Griffith, and Alexander Klemm and are available on the website of the Institute for Fiscal Studies, at http://www.ifs.org.uk/publications.php?publication_id=3210. The methodology is described in Devereux, Giffith, and Klemm, "Corporate Income Tax Reforms and International Tax Competition," *Economic Policy*, October 2002.

[5] U.S. Government Accountability Office, "U.S. Multinational Corporations: Effective Tax Rates are Correlated with Where Income is Reported", http://www.gao.gov/new.items/d08950.pdf, August 2008. The paper also noted that for large corporations, "there was considerable variation in effective tax rates across taxpayers. At one extreme, 32.9 percent of the taxpayers accounting for 37.5 percent of income, had effective tax rates of 10 percent or less; at the other extreme, 25.6 percent of the taxpayers, accounting for 14.8 percent of the income, had effective tax rate[s] over 50 percent." One possible cause for this wide variation may be that the tax treatment of corporate investment varies significantly by asset type; for a discussion of this variation in the tax treatment of investments and the potential for beneficial corporate tax reform that reduces this variation, see: Aviva Aron-Dine, "Well-Designed, Fiscally Responsible Corporate Tax Reform Could Benefit the Economy," Center on Budget and Policy Priorities, http://www.cbpp.org/6-4-08tax.pdf, June 4, 2008.

[6] U.S. Department of the Treasury, "Treasury Conference on Business Taxation and Global Competitiveness: Background Paper," July 23, 2007, p 11.

of the U.S. corporate tax burden is that many of these companies do not face the top rate.[7] In contrast to many other developed countries, which apply the same tax rate to all taxable corporate income, the United States has a graduated corporate tax structure, in which corporations with smaller incomes are taxed at rates below 35 percent. While a very large share of taxable corporate income is earned by corporations large enough to face the top rate,[8] in terms of numbers, most U.S. corporations face a statutory rate lower than the 35 percent top rate.

- **Broaden the base, reduce the rate.** Corporate tax reform that eliminates a portion of the existing tax breaks and uses the savings to offset the cost of reducing statutory corporate tax rates would likely improve economic efficiency without increasing deficits and debt.[9]

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7 See United States Government Accountability Office, "Comparison of the Reported Tax Liabilities of Foreign and U.S.-Controlled Corporations, 1998-2005," July 2008, which reported that in 2005, over 66 percent of U.S.-controlled corporations had *no* corporate income tax liability.

8 All taxable income of any corporation with taxable income in excess of $18.3 million is subject to the 35 percent rate, although credits can substantially reduce the effective tax rate on taxable income.

9 See: Aviva Aron-Dine, "Well-Designed, Fiscally Responsible Corporate Tax Reform Could Benefit the Economy," Center on Budget and Policy Priorities, http://www.cbpp.org/6-4-08tax.pdf, June 4, 2008.