Corporate Rate Cuts Are a Poor Way to Help the Economy and Most Workers — and Could Hurt Them

Center on Budget and Policy Priorities

The case for slashing corporate tax rates is thin: U.S. companies are posting record profits, and what they actually pay (after tax breaks and loopholes) is in line with other high-income countries. Corporate rate cuts are costly: for example, the tax framework that the Trump Administration and congressional Republican leaders announced on September 27 includes cutting the top corporate rate to 20 percent at a cost of $2 trillion over ten years. Most of the benefit would flow to high-income investors, and if such tax cuts were not paid for by reducing corporate tax breaks and loopholes, they could hurt growth and the majority of Americans by increasing budget deficits or requiring cuts to investments that help working families and the economy.[1]

Instead of slashing the corporate tax rate, true corporate tax reform — which addresses inefficient corporate tax breaks, loopholes, and the tilt of the tax code towards debt and foreign investment — would be more likely to foster growth.

Corporate Profits Are Near All-Time Highs

Little suggests that the current corporate tax — or poor corporate profitability — is a major constraint on the U.S. economy or U.S. corporations' "competitiveness."

- U.S. corporate profits are near their highest level in 85 years as a share of the economy, while employee compensation is close to its lowest level. Corporations don't need major tax breaks; tax reform should focus on raising typical workers' incomes.
- The U.S. stock market continues to outperform European Union stocks coming out of the recession.
- As they post record profits, many large U.S. multinationals are flush with cash — and in recent years they've paid out much of it to shareholders through record dividends and share buybacks. This belies multinationals' claims that cutting taxes on their profits would free up cash that they would use to invest. Rather, they're likely to continue increasing payouts to high-income shareholders with the new tax cuts.

U.S. Corporate Tax Rates Are in Line with Other Developed Economies

When taking into account tax breaks and loopholes that corporations use to lower their taxes, U.S. corporate tax rates are well below the 35 percent top statutory rate and in line with those in other high-income countries (those most likely to be similar to the United States in their attractiveness for companies to locate and invest for reasons unrelated to tax rates). The Treasury Office of Tax Analysis estimates:[2]

- The average corporate tax rate on profits from new investments made in the United States is 24 percent; the average corporate rate on profits from new investments made by companies in other "Group of Seven" (G-7) industrialized, democratic countries, weighted by the size of their economies, is 21 percent. This measure of tax rates is useful when considering how corporate taxes affect companies' decisions about where to make new investments.
- The share of worldwide profits that U.S. multinational corporations pay in U.S. and foreign income taxes is about 28 percent; the average for companies headquartered in other G-7 countries, weighted by the size of their economies, is 29 percent. This measure of tax rates that a multinational might face on its income from all countries is useful for considering how corporate taxes might affect where multinationals choose to reside for tax purposes.

Unpaid-For Corporate Rate Cuts Do Little to Help Workers, Could Hurt Growth

- Most corporate rate cuts go to high-income investors and don't "trickle down" to workers. Proponents of corporate rate cuts often claim workers will benefit because companies will invest more and therefore boost wages. But mainstream estimates are that only a very small share of corporate rate cuts eventually flows to workers — and even taking this effect into account, the Tax Policy Center finds that about 70 percent of the benefit of a corporate rate cut ultimately flows to the top fifth of households, and more than a third flows to the top 1 percent.

- Corporate rate cuts could even hurt growth and the majority of Americans. If they aren't paid for by cutting corporate tax breaks and loopholes, the higher deficits would reduce national saving, meaning there would be less capital for investment and interest rates could rise. And these deficit-financed tax cuts would eventually have to be paid for, through increases in other taxes or cuts to government services. Given these costs, unpaid-for corporate tax cuts would likely leave most Americans worse off in the long run, even if they had modest near-term economic benefits.

Cutting the Corporate Tax Rate Won't Solve Inversions

Corporate "inversions" are a maneuver by which U.S. firms change their tax citizenship to another country to avoid paying U.S. taxes — while continuing to benefit from American customers, employees, and infrastructure. Treasury Secretary Steven Mnuchin has said cutting the corporate tax rate would be the best way to address inversions. But *untaxed* profits are driving inversions — so slashing the corporate tax rate wouldn't solve it.

The U.S. tax code now allows U.S. multinationals to avoid U.S. taxes by reporting all their profits in tax havens like the Cayman Islands (which has a corporate tax rate of zero) even if they have no real investment, customers, or headquarters there. Inversions aren't caused by other developed countries attracting real economic activity and investment with lower tax rates. Indeed, as noted, the average U.S. corporate rate is not out of line with the average of other similar countries.

Rather, inversions are attractive to many U.S. multinationals because they allow these companies to *never* pay U.S. taxes on past profits that have faced low or no tax in tax havens. Instead of slashing U.S. corporate taxes, lawmakers should instead close the loopholes that allow multinationals to use tax havens to avoid tax, and consider other policies — such as a minimum tax on foreign profits and an "exit tax" tax on overseas profits for companies that choose to leave the United States — that would make it harder and less lucrative to invert.

True Corporate Tax Reform That Closes Loopholes Could Help Growth

True corporate tax reform would close loopholes and scale back corporate tax breaks that today allow many large, profitable businesses to pay very little in taxes. Such reform could help the economy by helping to ensure that investments flow to where they are most productive, rather than towards tax breaks and tax avoidance schemes. Such tax reform would address the inefficient tilts in the corporate tax code towards:

- Foreign profits. Profitable multinationals can choose to delay paying U.S. taxes on their foreign profits, giving them a huge incentive to report their profits offshore for tax purposes using various tax avoidance techniques.
- Debt. The expected tax rate that companies face on new investments funded by borrowing was *negative* 5 percent in 2016, Treasury estimates — with equity-financed investments facing much higher rates.
- Particular industries. Industry-specific tax breaks mean different industries' tax rates vary substantially. For example, finance companies paid a corporate tax rate about 30 percent (8 percentage points) lower than wholesale and retail companies over 2007 to 2011, Treasury estimates.
- "Pass-throughs." Pass-through businesses like S corporations and partnerships don't pay the corporate tax rate or the tax on dividends. Instead, their income is taxed at the rates their owners face on their wages and salaries. Businesses can generate substantial tax savings by structuring as pass-throughs. As pass-throughs' share of business profits grew, corporate tax revenues fell by about $100 billion between 1980 and 2012, Treasury economists estimate.

Reform that reduces these tilts could raise revenues to reduce deficits or invest in national priorities like education and infrastructure that deliver long-term benefits for the economy.

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[1] See CBPP, "Corporate Tax Cuts Mainly Benefit Shareholders and CEOs, Not Workers," August 21, 2017, http://bit.ly/2erA9SP

[2] See: CBPP, "Actual U.S. Corporate Tax Rates Are in Line with Comparable Countries," April 25, 2017, http://bit.ly/2q2h36Y; Chuck Marr and Brian Highsmith, "Six Tests for Corporate Tax Reform," CBPP, updated February 24, 2012, http://bit.ly/2otldr6; Aviva Aron-Dine, "Well-Designed, Fiscally Responsible Corporate Tax Reform Could Benefit the Economy: Unpaid-For Rate Cuts Would Likely Hurt Most Americans in the Long Run," CBPP, June 4, 2008, http://bit.ly/2pfA0TA; Chye-Ching Huang, "New Trump Executive Action Could Make It Easier for Profitable Corporations to Avoid U.S. Taxes," CBPP, April 21, 2017, http://bit.ly/2q25Bbt; Treasury Office of Tax Analysis, "The Case for Responsible Business Tax Reform," January 2017, http://bit.ly/2p1Jkff; Michael Cooper *et al*., "Business in the United States: Who Owns it, and How Much Do They Pay?," National Bureau of Economic Research, October 2015, http://bit.ly/2piDHdc; Tax Policy Center (TPC), "Distribution of Change in Corporate Tax Burden," June 6, 2017, http://tpc.io/2rUNxRC; and James R. Nunns *et al*., "An Analysis of Donald Trump's Revised Tax Plan," TPC, October 18, 2016, http://tpc.io/2f5xYjZ; and U.S. Bureau of Economic Analysis data.