



TAX FOUNDATION

Tax Foundation University

Session 2: The Business Tax Code

Areas of Focus

- The Basics of Corporate Income Taxes
- The Basics of Noncorporate Income Taxes
- The Impact of Corporate Taxes on Investment and Workers
- Do Corporations Pay “Zero” in Federal Taxes?
- Industrial Policy and Options for Tax Reform

Principles of Sound Tax Policy

Simplicity

- Tax codes should be easy for taxpayers to comply with and for governments to administer and enforce.

Neutrality

- Taxes should neither encourage nor discourage personal or business decisions. The purpose of taxes is to raise needed revenue, not to favor or punish specific industries, activities, and products.

Transparency

- Tax policies should clearly and plainly define what taxpayers must pay and when they must pay it. Hiding tax burdens in complex structures should be avoided.

Stability

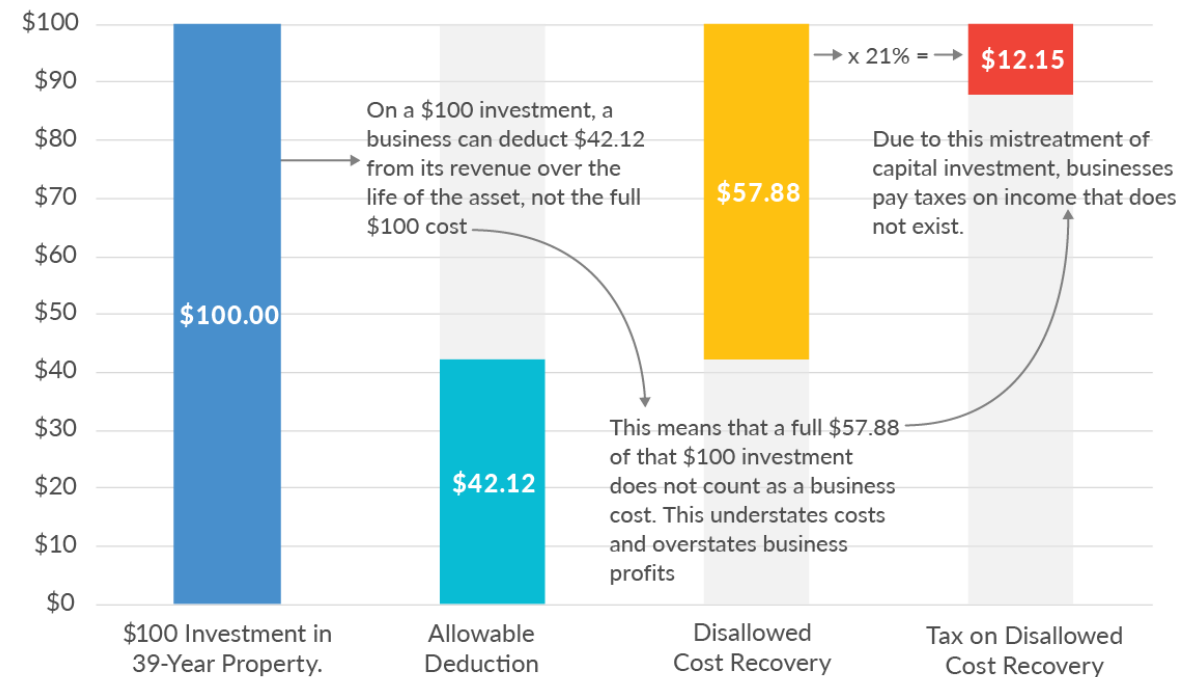
- Taxpayers deserve consistency and predictability in the tax code. Governments should avoid enacting temporary tax laws, including tax holidays, amnesties, and retroactive changes, and strive to establish stable revenue sources.

Corporate Income Taxes – The Tax Base

- Profits = revenue minus expenses, except for capital investments
 - Capital investments must be depreciated over time
 - Depreciation artificially increases taxable income and the cost of capital
 - Depreciation is counted as a “tax expenditure” but is a normal part of a tax code that is neutral toward investment
- Net operating losses (NOLs) smooth profits over time
- Interest payments
- Current issues – TCJA Phaseouts
 - Phase out of Section 168(k) bonus depreciation
 - Section 174 R&D amortization
 - Section 163(j) interest limitation
 - International tightening

Depreciation Requires Businesses to Pay Tax on Income That Doesn't Exist

Assumes half-year convention, 3.5% real discount rate, 2% inflation rate, and 21% corporate tax rate.



Source: Author's calculations.

TAX FOUNDATION

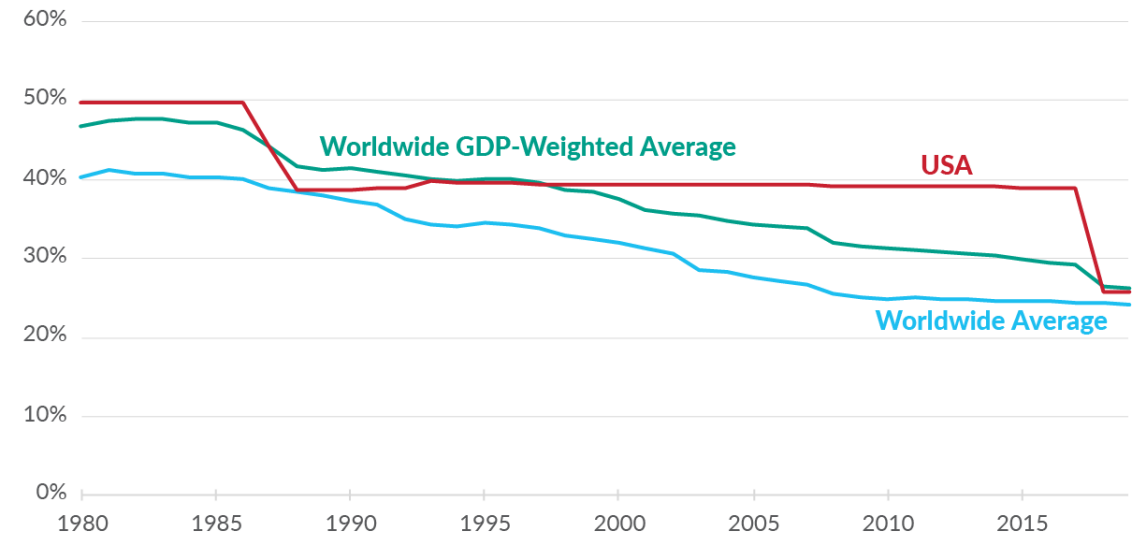
@TaxFoundation

TAX FOUNDATION

Corporate Income Taxes – The Tax Rate

- Current combined statutory tax rate is 25.8%, near worldwide average
- Prior to the 2017 tax reform, it was 38.9%, an international outlier
- Applying the tax rate to the tax base results in a corporation's tax liability
- Tax liability may be offset by tax credits
 - R&D tax credit
 - Green energy tax credits
 - Semiconductor investment tax credit
 - LIHTC

Statutory Weighted and Unweighted Corporate Income Tax Rates from 1980 to 2019



Note: The number of countries included in the averages varies by year as some historic corporate tax rates were not available. The unweighted average represents the simple average worldwide corporate tax rate, while the weighted average represents the average worldwide corporate tax rate weighted by GDP.

Source: Statutory corporate income tax rates were compiled from various sources. GDP calculations are from the U.S. Department of Agriculture, "International Macroeconomics Data Set."

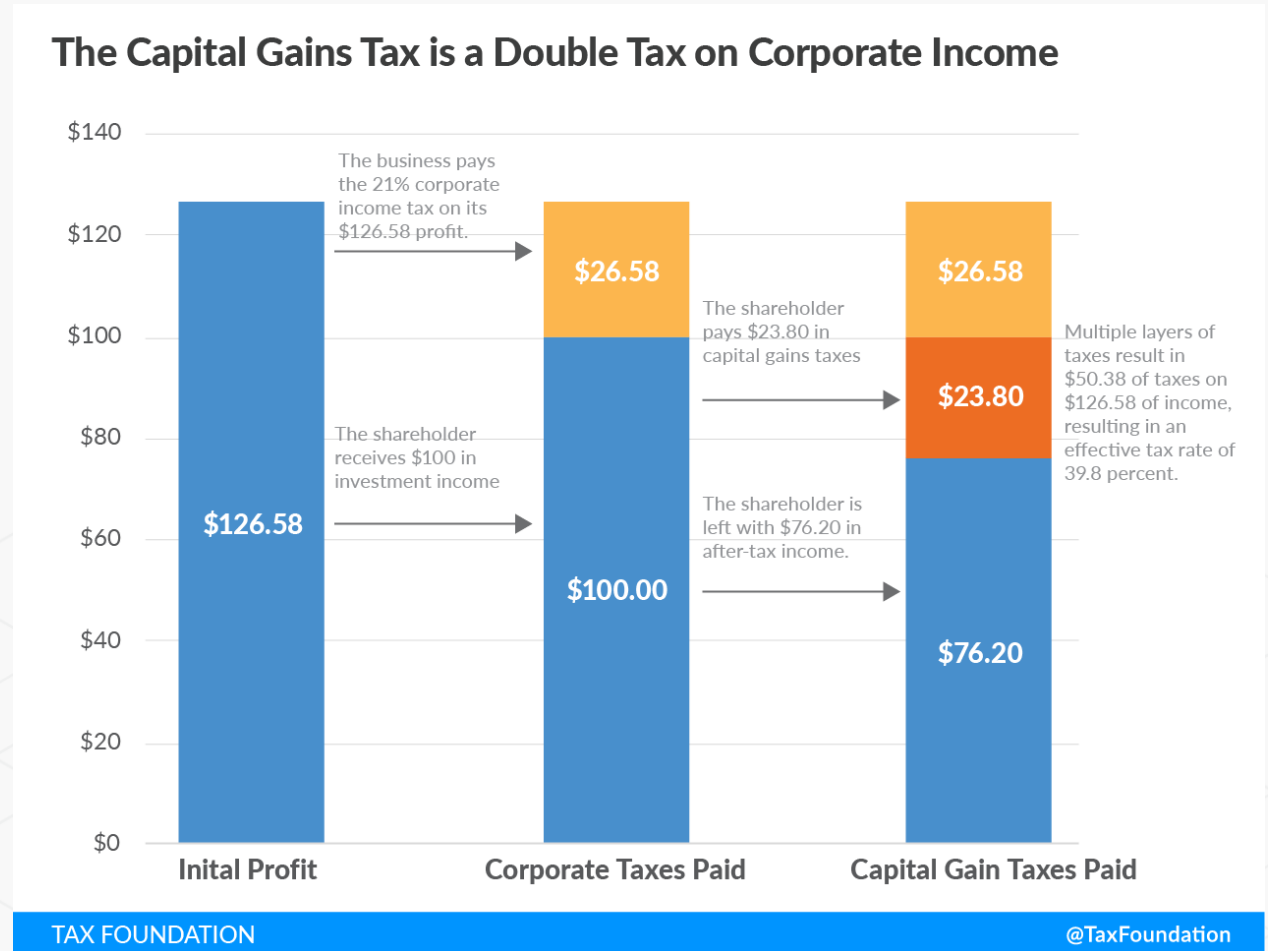
TAX FOUNDATION

@TaxFoundation

TAX FOUNDATION

Corporate Income Taxes – Shareholder Level

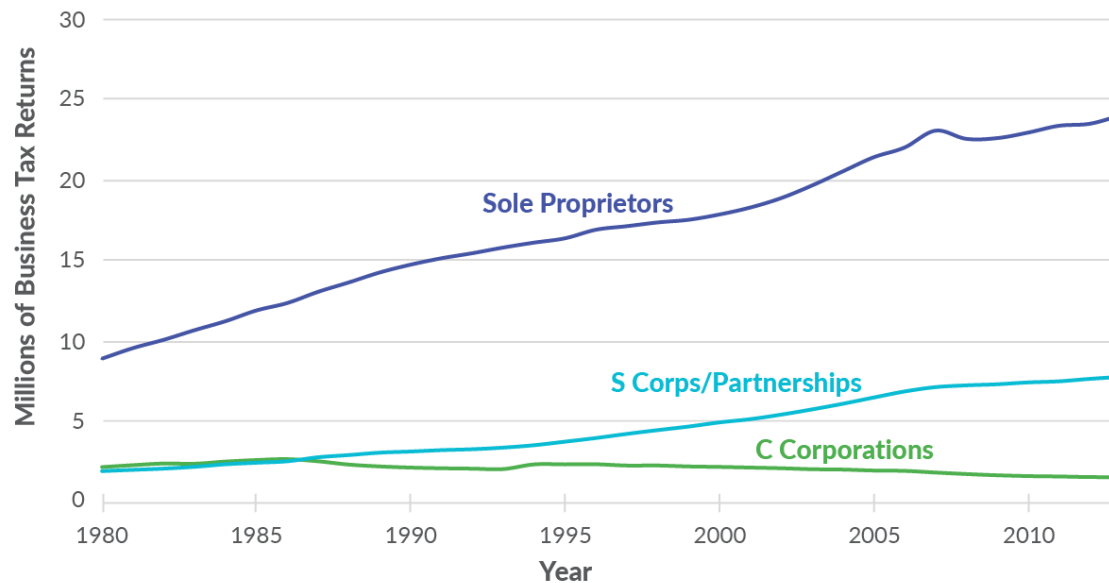
- Corporate profits are **taxed at the entity level** – that's the tax we just reviewed
- And corporate profits are **taxed at the shareholder level** when distributed as dividends or realized as capital gains
- Remember the two layers of tax whenever you hear about corporate taxes or capital gains taxes, together they make up the **integrated rate on corporate income**



Noncorporate Income Taxes

The U.S. Now Has Fewer Corporations and More Individually Owned Businesses

Business Tax Returns by Business Type



Source: Internal Revenue Service, SOI Tax Stats- Integrated Business Data, "Table 1: Selected financial data on businesses," by Form of Business, Tax Year, 1980-2013, <https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data>.

TAX FOUNDATION

@TaxFoundation

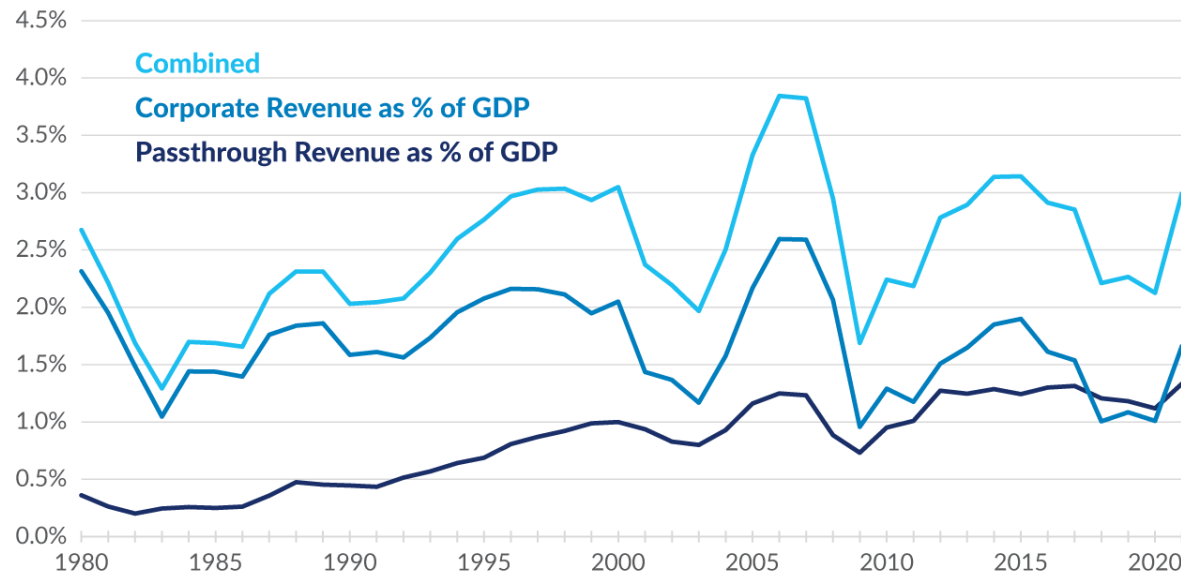
- Pass-through entities pass profits (or losses) directly to individual owners, no double taxation
- Taxed at personal tax rates
- Owners take deductions, such as Section 199A and Section 179
- Vast majority of U.S. companies are pass-throughs

TAX FOUNDATION

Business Tax Revenue

Combined Business Tax Collections Remain Close to Historical Norm

Business Tax Collections as a Portion of GDP, 1980 to 2021



Note: Estimates for tax years 2019 through 2021 are tentative based on data from OMB and the BEA on corporate profits and individual income tax revenue.

Source: Internal Revenue Service Statistics of Income, "Integrated Business Data," "Partnership Returns Line Item Estimates (Publication 5035)," "S Corporation Statistics," "Nonfarm Sole Proprietorship Statistics," "Individual Income Tax Returns (Publication 1304)," Congressional Budget Office, Office of Budget and Management, Bureau of Economic Analysis, Tax Foundation calculations.

- Decline in number of corporations has led to a decline in corporate tax revenue as share of GDP
- FY2023 corporate tax revenues totaled \$420 billion out of \$4.4 trillion in total taxes
- Combining corporate and noncorporate tax revenues, total business tax revenue in the U.S. is near historical norms

Impact of Corporate Taxes on Investment

- Three rates to pay attention to
- **Statutory tax rates** affect location of profits; at the margin, a higher statutory tax rate encourages profit shifting to jurisdictions with lower statutory tax rates (impact location of profits)
- **Marginal effective tax rates** are an indicator of marginal investment incentives within a jurisdiction (impact the level of investment)
- **Average effective tax rates** are an indicator of asset-location incentives (impact location of investment)

| | METR | AETR |
|-------------------------------------------|-------|-------|
| United States, maintain TCJA biz policies | 11.2% | 21.5% |
| United States, current law | 18.3% | 23.4% |
| OECD average | 15.5% | 22.9% |

Note: Estimates do not account for R&D tax credits.

Source: Kyle Pomerleau, "The tax burden on corporations: A comparison of Organisation for Economic Co-operation and Development countries and proposals to reform the US tax system," American Enterprise Institute, Oct. 13, 2021, <https://www.aei.org/research-products/report/the-tax-burden-on-corporations-a-comparison-of-organisation-for-economic-co-operation-and-development-countries-and-proposals-to-reform-the-us-tax-system/>.

Impact of Corporate Taxes on Workers

- Legal incidence says, “Corporations pay the taxes!”
- Economic incidence asks, “But who bears the burden?”
 - JCT: 75% of the burden falls on capital, 25% of the burden falls on labor
 - Tax Foundation: 50% on capital and 50% on labor
 - Range in literature suggests in some cases, labor bears 70% to 100%
- Fuest et al find corporate taxes reduce wages more for young workers, the low-skilled, and women
- Most economists, including at the OECD, find the corporate income tax is the most harmful and least efficient way to fund priorities

Tax Model

- <https://www.taxmodel.org/userspecified>

CORPORATE INCOME TAX



YOUNG



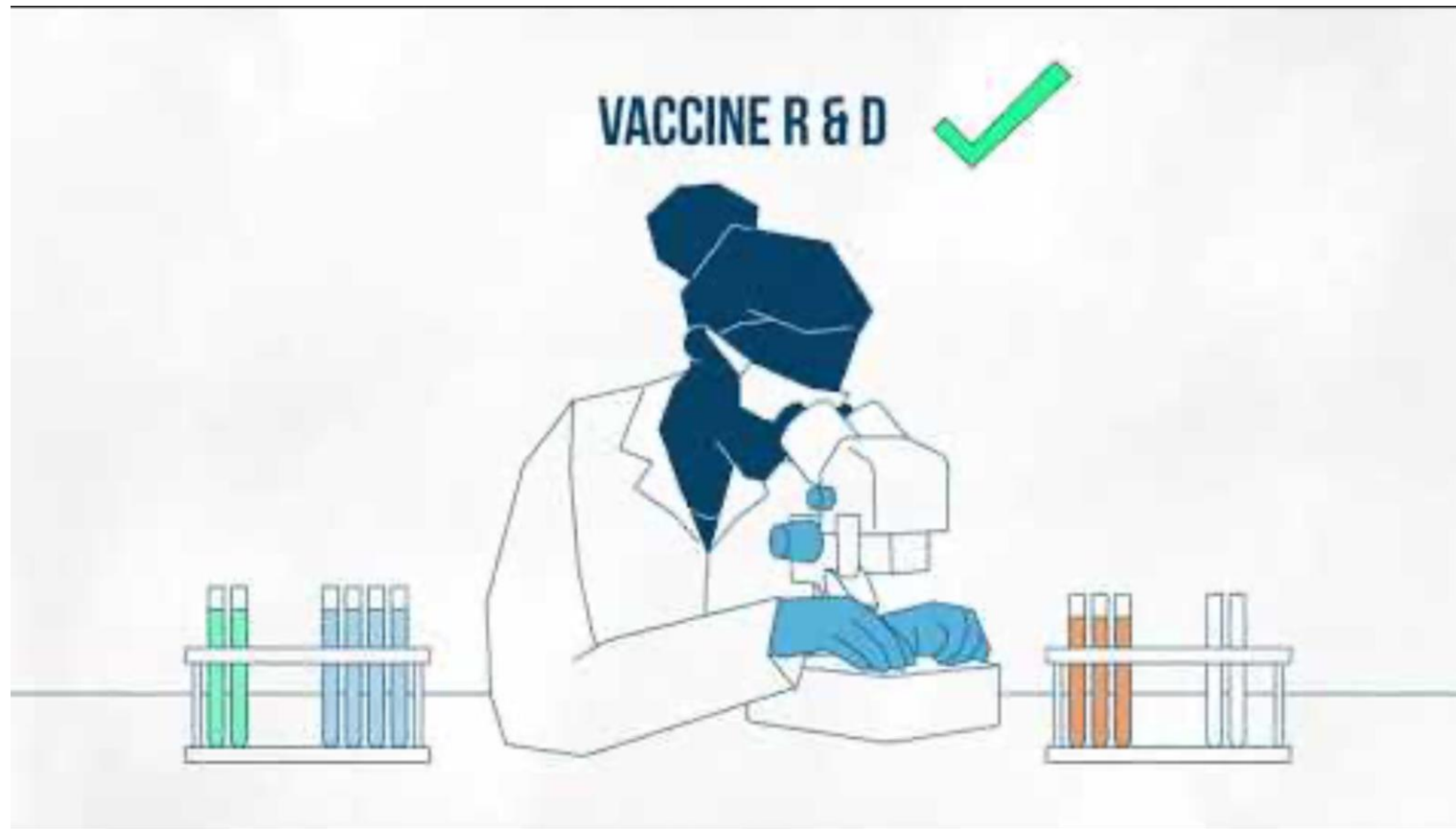
LOW SKILLED



WOMEN

Do Corporations Pay \$0 in Federal Taxes?

- Taxable profits and losses are determined by tax laws
- Book profits and losses are determined by accounting standards
- Real, legitimate reasons explain why tax laws differ from accounting standards



Do Corporations Pay \$0 in Federal Taxes?

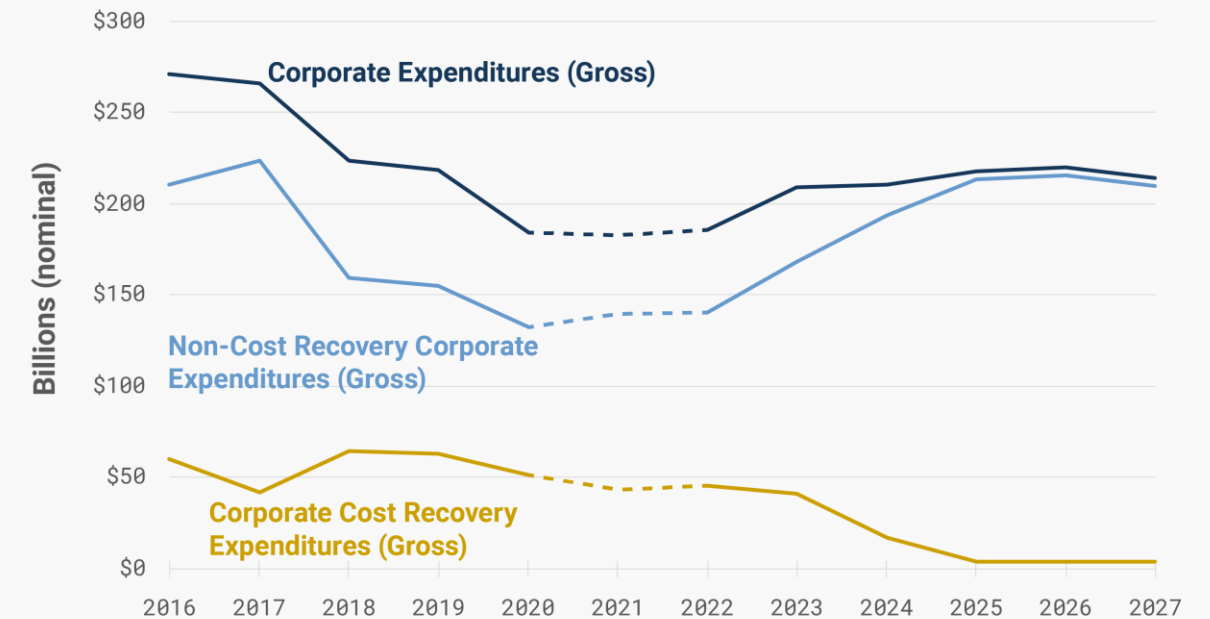
- Misunderstanding the differences between book income and taxable income leads to bad policy
- Corporate Alternative Minimum Tax enacted in IRA, not as simple as it sounds
- Applies to AFSI for corporations with profits over \$1 billion, effective for tax years beginning after December 31, 2022
 - Adjustments include using tax depreciation instead of book depreciation, allowing tax credits, adjustments for ambiguities between book and tax rules, etc.
- But... CAMT payments have been deferred until 2024 as the IRS needed more time to finalize guidance and regulations

Industrial Policy Versus Sound Policy

- Temptation exists to create a tax credit for anything and everything
- Trend is apparent
- Corporate tax breaks have shifted away from deductions for general investment toward subsidies for specific types of investment
- Represents a shift toward suboptimal tax policy

Corporate Tax Expenditures Fell after TCJA, Rose after Inflation Reduction Act

Gross Corporate Tax Expenditures by Category and Year, 2016-2027



Note: 2021 reflects estimates from the 2020 JCT tax expenditures report. Years 2024-2027 are estimates.
Source: Author's calculations; JCT tax expenditures reports since 2016.

Wrapping Up

Rate The 21% corporate tax rate brings the U.S. in line with the worldwide average

Base Any policy short of full expensing discourages capital investment

Burden The burden of the corporate tax falls on workers and shareholders

Tax versus Book Taxable income differs from book income for good reasons

Big Issues Broad investment provisions are expiring thus raising the cost of capital, while narrowly targeted subsidies are growing thus distorting investment incentives



Questions?

Erica York

eyork@taxfoundation.org

[@ericadyork](https://www.instagram.com/ericadyork)