THE DAILY CALLER

What policymakers can learn from Canada's corporate tax cuts

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By Chris Edwards

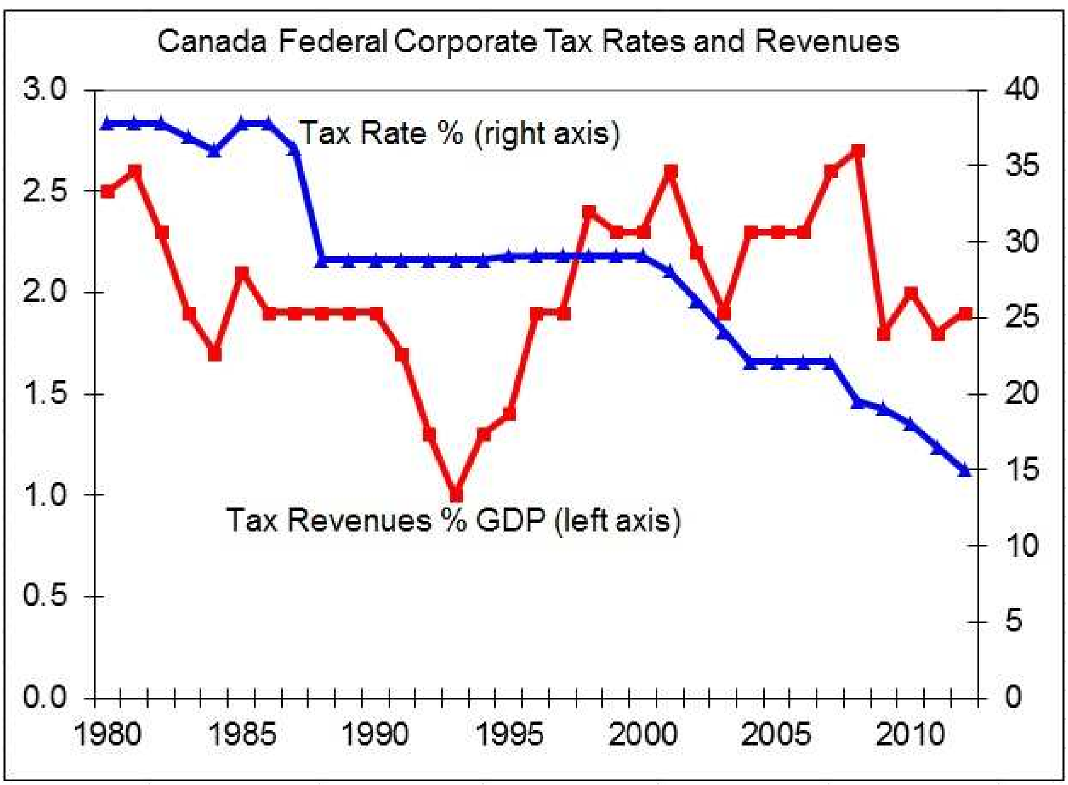
President Obama and most members of Congress agree that the U.S. corporate tax rate should be cut. Thankfully, it is finally sinking in that having a 40 percent corporate tax rate when the world average is just 23 percent is suicide in a globalized economy.

The sticking point on slashing the corporate tax rate has been the fear that the federal government might lose revenues under such a reform. To prevent an expected revenue loss, policymakers have searched for tax loopholes to close in order to "pay for" a corporate rate cut. The problem is that members never find any loophole closings that they can agree on.

I've concluded that the effort to close corporate loopholes is a big waste of time. It is simply blocking desperately needed reforms to the tax rate. If I was drafting a corporate tax reform bill, I'd match a tax rate cut with federal spending cuts, but that idea hasn't caught on either.

The good news is that a corporate tax rate cut without any changes to the tax base probably wouldn't lose the government any money over the long term. Good evidence comes from Canada's corporate tax cuts of the 1980s and 2000s.

The chart shows Canada's federal corporate tax revenues as a share of gross domestic product (GDP) and the federal corporate tax rate. The tax rate plunged from 38 percent in 1980 to just 15 percent by 2012. Amazingly, there has been no obvious drop in tax revenues over the period.



Canadian corporate tax revenues have fluctuated, but the changes are correlated with economic growth, not the tax rate. In the late 1980s, a tax rate cut was followed by three years of stable revenues. In the early 1990s, a plunge in revenues was caused by a recession, and then in the late 1990s revenues soared as the economy grew.

In 2000, Canadian policymakers enacted another round of corporate tax rate cuts, which were phased in gradually. Corporate tax revenues initially dipped, but then they rebounded strongly in the late 2000s.

The rate cuts enacted in 2000 were projected to cause substantial revenue losses to the Canadian government. That projection indicates that the reform didn't have much in the way of legislated loophole closing. But the chart shows that the positive taxpayer response to the rate cut was apparently so large that the government did not lose much, if any, revenue at all.

In 2009, Canada was dragged into a recession by the elephant economy next door, and that knocked the wind out of corporate tax revenues. However, it is remarkable that even with a recession and a tax rate under 20 percent, tax revenues as a share of GDP have been roughly as high in recent years as they were during the 1980s, when there was a much higher rate. Jason Clemens of the Macdonald-Laurier Institute notes that Canadian corporate tax revenues have been correlated with corporate profits, not the tax rate.
If a corporate tax rate is high, there is a "Laffer effect" when the rate is cut, meaning that the tax base expands so much that the government doesn't lose any money. Estimates from Jack Mintz and other tax experts show that cutting corporate tax rates when they are above about 25 percent won't lose governments any revenues over the long run.

The overall Canadian rate this year is about 27 percent when the average provincial rate is included. By contrast, the average federal-state rate in the United States is 40 percent, which is roughly 15 points above the revenue-maximizing rate. That means that Congress can proceed with a corporate rate cut and everyone would win — taxpayers, the economy and even the government.

Corporate tax reform with loophole closing is a wild-goose chase. Congress never seems to agree on which loopholes to close, with the result that our economy continues to suffer under a super-high rate. If we matched Canada by cutting our federal corporate rate from 35 percent to 15 percent, it would generate a large increase in reported income as corporate investment boomed and tax avoidance fell. The tax base would automatically expand without Congress even legislating reductions to deductions, credits or other loopholes.

In 2012, Canada will collect about 1.9 percent of GDP in federal corporate income tax revenues with a 15 percent tax rate. The United States will collect about 1.6 percent of GDP with a 35 percent tax rate. Do we need any more evidence that our high corporate tax rate makes no sense?

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