Ending the Corporate Tax

By: Richard Rahn - February 27, 2013

Can you name the worst tax? In recent weeks, there have been a slew of articles in major publications about how many multinational corporations have found legal ways to reduce their tax burdens by running some of their operations through low-tax jurisdictions. Many who love high taxes and big government demand that corporations pay more.

Economists dislike the corporate income tax because it reduces productive labor and capital and is an additional tax on income that has already been (or will be) taxed. Politicians love the tax because it is largely invisible to most voters. Because of tax competition among countries, corporate tax rates have been dropping globally, resulting in the United States having the world's highest rate.

Now the high-taxers are fighting back. Liberal senators such as Bernard Sanders of Vermont have introduced proposals to make it more difficult for corporations to engage in legal tax minimization strategies. The Paris-based Organization for Economic Cooperation and Development has released a paper explicitly arguing for more international harmonization of the corporate tax base, which would make it easier for countries to tax corporations worldwide. The organization's bureaucrats, who enjoy tax-free salaries, of course, forgot to ask the basic question of whether the corporate tax is beneficial or destructive.

To answer that question, one would need to know who actually pays the corporate tax, what the economic effects of the corporate tax are, and whether the benefits of leaving the money with the corporations to spend exceed the benefits of enabling the politicians to spend it.

Who pays the corporate tax? A corporation is only a legal means by which to do business. Taxes may be levied upon it, but only people pay taxes. Thus there always has been much debate about who pays the corporate tax. Is it passed on to customers in higher prices? Is it passed on to workers in the form of lower wages? Or is it passed on to the stockholders in the form of lower dividends and capital gains? One can find studies to support differing combinations of each of the above, depending on the methodology and assumptions made and sometimes based on the ideology of the author.

The truth is that the burden of the tax varies by industry. Those who argue that the final customer does not bear the burden note that many goods and services can be produced not only by corporations, but also by sole proprietorships and various types of limited liability companies that are not corporations. Thus, market competition will prevent the corporation from passing the cost of the tax to the customer. However, some types of businesses, such as automobile companies, require so much capital that they are almost forced into a corporate form. In this case, the corporate tax is a cost of doing business for all competitors, so at least some of it can be passed to the final consumer in the form of higher prices.

Most studies show that some part of the corporate tax is passed on to workers in the form of lower wages and benefits. Those who want corporations to pay are implicitly arguing for lower wages, whether they know it or not.

Finally, many argue that much of the burden of the corporate tax falls on the providers of the capital — that is, the investors. Who owns corporate stock? Certainly, there are very rich people who have large individual stock holdings, but most large corporations are owned mainly by pension and mutual funds, university endowments, etc. The union-managed pension funds for firefighters, teachers and others are largely in corporate stocks. When union leaders call for higher corporate taxes, whether or not they understand it, it is a call for reduced pensions for their own members.

Mutual funds are merely collections of the savings of millions of middle-class individuals. These savings are for retirement, medical emergencies and things like tuition. Increasing corporate income taxes reduces the returns to these middle-class savers.

If a corporation has to pay higher income taxes, it will have less money for research and development, expansion and job creation. The money invested in corporate stocks has already been taxed at least once when it was earned, and it will be taxed again when it is paid out in dividends or sold for a capital gain. How many times should the same income be taxed?

Ask yourself, who is likely to spend the money in a way that will bring more human satisfaction and create more jobs — corporate executives trying to make money by producing goods and services people want, or politicians and government bureaucrats trying to enhance their own power?

As most good economists and knowledgeable others understand, the world would experience a better allocation of resources and more job creation if the corporate income tax was abolished. Fights over which jurisdiction gets to tax and how much it can tax would disappear. The so-called revenue loss would be made up by taxes on the dividend and capital gains increases, and by the extra economic growth and employment that would result from ending the corporate tax.

Congress could save the taxpayers some money if it would quit funding the Organization for Economic Cooperation and Development and other international organizations that lobby for higher taxes and a less-free world.