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U.S. should ax destructive tax

Corporate levy trashing returns

Richard Rahn | Tuesday, September 25, 2012

It's difficult to say definitively which tax is the most destructive. The corporate income tax is a leading candidate for causing higher prices to consumers, lower wages to workers and lower returns to investors. It misallocates capital, resulting in higher levels of unemployment and lower levels of economic growth and opportunity, and it taxes income that has already been taxed as least once before.

The 2012 annual rankings of "Corporate Tax Competitiveness" was published in Canada by University of Calgary and in the United States by the Cato Institute. In the study, authors Duanjie Chen and Jack Mintz of the school of public policy at the University of Calgary present new estimates of effective tax rates on corporate investment for 90 countries. "These tax rates take into account statutory rates plus tax-base items that affect taxes paid on new investment, such as deductions for capital depreciation, inventory costs, and interest expenses." The United States is in the "uncompetitive position of having the highest statutory tax rate in the world, with a combined federal-state tax rate of about 40 percent." Only the economic basket cases of Argentina, Chad and Uzbekistan have slightly higher effective marginal tax rates. The United States at 35.6 percent has almost twice the average rate (19.4 percent) of the other developed nations.

Other nations have been cutting their corporate tax rates, and some do not even have the tax. Canada has reduced its federal rate to 15 percent versus the U.S. rate of 35 percent. The report notes that even though Canada reduced the federal-provincial tax rate by 31 percent from 2000 to 2010, and despite the 2009 recession, corporate tax revenues have remained roughly constant as a share of gross domestic product. Even Sweden has a much lower rate, and it has just announced a further reduction to 22 percent. The government said in its announcement: "This improves the conditions for new jobs and investment in Sweden."

Most large corporations now operate in multiple countries. The boards of these companies have a fiduciary responsibility to their stockholders to minimize costs, including tax costs, in order to maximize profits. Hence, many multinationals have moved their headquarters out of the high-tax United States.

There are some members of Congress and others who do not seem to understand that a corporation is just a legal form for doing business. Most large companies are owned by tens of thousands, or even millions, of different people. Even if you do not own stock directly in a corporation, you probably indirectly own corporate stock through mutual funds or your retirement program. If governments tax corporations at higher rates, the value of your mutual fund and pension is likely to fall.

Sen. Carl Levin, Michigan Democrat, held a hearing last week in which he complained, as he often does, about multinationals finding ways to legally minimize their corporate tax, often by locating some of their operations in low-tax jurisdictions. A few weeks ago, I incorrectly wrote that Mr. Levin does not release his tax returns, and his staff rightly complained. The senator does post his tax returns on his website, and so I looked at them. I noticed that he has a couple of real estate investments in limited liability companies (LLCs). LLCs and partnerships are legal entities, like corporations, for doing business, but unlike corporations, they do not have to pay an additional level of tax. Increasingly, people like Mr. Levin use LLCs and other forms of business that are not subject to the corporate income tax. In fact, now more than half of all business income is earned outside the corporate form.

Recently, one of the more astute Washington lawyers, Paul Allen, said to me, "Do you know how President Obama could almost instantly create full employment? Abolish the corporate income tax. Within weeks, companies from all around the world would relocate and invest in the U.S., creating millions of new jobs." I don't know if the movement into the United States would occur quite as quickly as he thinks, but he is, no doubt, right that it would soon cause the United States to regain its economic leadership and be a powerful engine for job growth.

The corporate income tax is only about 7.9 percent of federal revenue. Abolishing the corporate income tax would result in much higher dividends and capital gains for stockholders, which would be taxed, plus there would be new tax revenue on the wages of the millions of additional workers. Over the long run, the abolition of the corporate income tax may well end up yielding greater total tax revenue.

Businesses don't pay taxes, people do. Those people who own stock in corporations, rather than holding their business investments in LLCs, partnerships, etc., should not have to pay an additional level of tax that drives businesses out of the country.

I also noticed that Mr. Levin reported income from "Fidelity Investments," which I expect were in mutual funds (though that detail was lacking). Many mutual funds are registered in the Cayman Islands for reasons of regulatory efficiency, and many mutual funds hold securities in companies that are registered in many low-tax jurisdictions. All of this should be moot and not a concern of anyone, including the good senator, if the United States would go all the way and get rid of the destructive relic known as the corporate income tax.

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