Corporate Taxes And Corporate Welfare

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I wanted to write an article proposing an interesting idea. I never heard anyone propose it but after doing some research I believe (I am not sure, and cannot find the source currently) that it was the same idea, former Fed Chairman Paul Volker suggested. Currently, companies can reduce the amount of taxes they have to pay by deducting interest expense on debt. I think this practice overall is bad since it encourages companies to take on too much debt. While there may be cases where it is beneficial, especially with smaller companies; it can be very harmful as it encourages corporations which want to raise money to issue debt (tax write off) versus issuing equity (no tax write off and has never caused any corporation to go bankrupt).

As stated below, the U.S. has the second highest corporate tax rate in the world. There is support across the political aisle for the corporate tax rate to be lowered. My proposal would be to eliminate the deduction on interest expense, and offset any revenue increase to lower the corporate tax rate. This would reduce overleverage, and be a deficit neutral plan that would lower corporate taxes. However, I could not find any data on this topic to quote specific numbers (if anyone has ant I would greatly appreciate if they sent it to me). During my search for the data, I came across some interesting facts on corporate taxes which are detailed in this article:

Despite of the fact that United States of America has the second highest corporate tax rate of 35% (preceded by Japan with 39.5%), corporate taxes only make up 9% of total federal revenue and the corporate tax revenue contribution to GDP is an insignificant 3.2% (2010). According to Edward Kleinbard, former head of Congressional joint committee on taxes, U.S multinational corporations have become ‘world leaders in tax avoidance’.

Regardless of the exceedingly criticized high corporate tax rates, U.S corporations in reality enjoy various subsidies and write-offs. The loopholes in the U.S tax system allows for the corporations to pay taxes lesser than the stated official rate which sums up to becoming almost as much as the average OECD tax rate. As stated by WashPIRG (the Washington Public Interest Research Group), two thirds of corporations in United States do not pay taxes!

The high correlation between corporate tax rate and economic growth of a country is undeniable

The U.S, unlike most other developed countries, has various loopholes which allow large corporations to write off debt on taxes. The high rate of corporate tax in U.S makes the option of shifting business to other countries more attractive to U.S companies. This very act increases job creation in foreign countries instead of in the U.S. Moreover, U.S is one of the only countries in the world which levies tax on foreign earnings. This encourages the U.S companies to shift profits to low-tax countries or the U.S companies conducting business abroad to retain their profits within the foreign countries. Along with this, the federal tax laws facilitate the shifting of business off-shore by providing tax cuts.

The U.S Commerce Department in a recent report indicated that multinational companies, including Caterpillar and General Electric, have shifted their business offshore which resulted in 2.4 million jobs being created overseas. It is possible that many of these jobs would have been lost regardless due to lower wages. However, the tax code definitely helps encourage outsourcing jobs.

Assuming an average pay of $43,000 per year over the past decade and an average 20% personal tax rate, and multiplying that number with 2.9 million lost jobs (also stated in the US Commerce Department report), the total job-based revenue loss incurred by the Government of United States adds up to be $25 billion per year or $250 billion over the past decade. The expense and investment tax write-off policies collectively add $150 billion to United States’ loss. Adding the two numbers, we end up with a total figure of $400 billion loss.

With the recent announcement of Japan to decrease its corporate tax rate to 35%, U.S will be put in an awkward position of being the country with the highest corporate tax rate but with one of the lowest tax collections among industrial countries. The low tax revenue represents not just the impact of high tax rate but also the existence of corporate tax loopholes. According to a study conducted by Cato Institute, a 1% cut in the effective tax rate on capital by U.S results in a 0.1% increase in foreign direct investment as a share of GDP. Therefore, a 10% decrease would lead to a 1% increase in direct investment from 1.3% to 2.3% of GDP. Additionally, a regression analysis study identified the revenue-maximization corporate tax rate at 28%. Therefore, a 10% cut in corporate tax rate from 35% to 25% would lead to both short-run and long-run economic growth with the government losing little or no revenue.

Disclosure: None

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