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How Changes In Corporate Tax Rates Impact Profits, Wages And Retail Prices

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President Joe Biden and congressional policymakers have proposed several changes to the corporate income tax, including raising the rate from 21 percent to 28 percent and imposing a 15 percent minimum tax on the book income of large corporations. Higher corporate taxes must result in lower payments to shareholders, lower wages or higher product prices. While many assume that shareholders bear the full or at least the majority of the burden, an important empirical question is how the impact is spread across the three categories.

Scott Baker, Stephen Teng Sun and Constantine Yannelis of the Cato Institute contribute to the literature with their March 2020 study, " Corporate Taxes and Retail Prices," in which they examined the impact of changes in the corporate tax rate (both at the national and state level) on wages, consumer prices and shareholders. They began by noting: " are not incident on households through consumer prices but instead allocates incidence purely to owners of capital and through labor income, with three-quarters being incident on shareholders.

The U.S. Treasury model assumes an even higher incidence on shareholders, with more than four-fifths of corporate tax incidence borne by capital income. However, models used by federal policymakers assume that corporate taxes are fully incident on only capital and labor." They used "linked administrative and survey data to study the impact of corporate taxes on barcode-level product prices, which is key in evaluating the incidence of corporate taxes on consumers." Their data sample included 23 large tax changes, including 10 tax increases and 13 tax cuts. Following is a summary of their findings:

- The elasticity of retail price to the net of corporate tax rates is approximately 0.17—a one percentage point increase in the corporate tax rate leads to a 0.17 percent increase in retail product prices.
- Their model and empirical estimates allowed for a back-of-envelope calculation of the wage elasticity to be 0.43—in line with the estimate found in Germany in the 2018 study " Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany."

- Under the assumption that corporate tax rates do not impact retail prices, workers (through reduced labor income) and shareholders (through reduced profits) bear 42 percent and 58 percent of the tax burden, respectively.
- Considering the impact on retail prices, the impact on consumers, workers and shareholders is 31 percent, 38 percent and 31 percent, respectively.
- The lowest-priced goods tend to respond most to corporate tax changes, with average magnitudes almost twice as high in the lower half relative to the upper half—the impact of an increase in corporate taxes is felt more by those with lower incomes.

Their findings led Baker, Sun and Yannelis to conclude: “Our analysis reveals a striking result that approximately 31 percent of the total incidence of corporate taxation falls on consumers through higher product prices, with capital owners and workers bearing a similar amount.” They added that their findings suggest that “models used by policymakers significantly underestimate the incidence of corporate taxes on consumers.” They did add this caveat: “While we focus on retail goods, incidence may be very different in other sectors or in services.”

Conclusion

Baker, Sun and Yannelis’ paper has important implications for the incidence and progressivity of corporate taxes, as they found that due to effects on prices, corporate taxes are more similar to sales taxes in their effects - they are regressive taxes with greater negative impact on those of lower income.