

# Corporate Tax Issues

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# What are the issues?

- Current
  - international “competitiveness”
  - profit shifting
- Traditional
  - protecting the individual tax base
  - efficiency
  - distributional issues

# Where do we stand compared to other countries?

- U.S. tax
  - 39%
  - 37% with production activities deduction
- G7
  - 36% individually weighted
  - 38% output weighted
- OECD (19)
  - 31% individually weighted (Treasury), 33% without Ireland
  - 28% individual weighted (C.D.Howe), 36% output weighted
- Effective U.S. tax rates tend to be lower

# Where do we stand historically?

Measure	1953	Current
Percent of GDP	5.6 %	2.0 %
Percent of Revenue	30.0 %	10.0 %
Statutory tax rate	52.0 %	35.0 %
Effective tax rate	63.0 %	30.0 %

# A Corporate Laffer Curve?

- Recent cross section studies suggest a revenue maximizing tax rate as low as 30%
- Brill and Hassett (31)
- Clausing (33/57)
- Devereux
- Mintz (28)

# Problems with Results

- Theory
  - Closed economy: factor shares are constant, no revenue maximizing rate
  - Open economy: 80% or more, growth maximum is 75%
  - International profit shifting implausible: \$340 billion of corporate revenue, \$6 billion cost for deferral
  - Shifting to unincorporated business sector we can fix another way, and still collect revenue

# Distributional issues

- Is the burden borne by capital or labor?
  - Traditional closed economy: capital
  - Small one-good open economy with perfect mobility: labor
  - More realistic model– large country, imperfect portfolio substitution, imperfect product substitution, debt: largely on labor according to Gravelle Smetters model

# The New Cross-Country Wage Studies

- Hasset and Mathur
- Felix
- Desai, Foley, and Hines

# Theoretical Problems

- Results of Hassett and Mathur are not realistic: imply each dollar of corporate tax reduces burden by \$20 to \$25.
- Similar problem with Felix, although not as large; other problems exist.
- Desai, Foley, and Hines restrict, but that is the source of their results (see Randolph's critique).

# Efficiency

- Efficiency issues still remain
- Tax wedges are far smaller than in the past, and the estimated deadweight loss is probably about 10% to 15% of revenue.
- There are many changes that could improve efficiency without sacrificing revenue.

# Potential reforms

- Increase burden at personal level, reduce it at corporate level
- Index interest for inflation and use revenue to lower corporate rate
- Broaden the base
  - Production activities deduction
  - End deferral
  - Eliminate graduated rates
  - Restrict the use of unincorporated business forms

# Corporate Tax Rate and Wages I

	Corporate Tax Rate Variable		
	Top Tax Rate	Effective Average	Effective Marginal
Exchange Rate	-0.836*** (0.294)	-0.608* (0.333)	-0.336 (0.226)
PPP	-0.743** (0.284)	-0.529 (0.324)	-0.229 (0.220)
Real PPP	-0.508* (0.286)	-0.250 (0.309)	-0.106 (0.210)

# Corporate Tax Rate and Wages II

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
t	-0.001 (0.204)						0.020 (0.176)
t-1	-0.201 (0.184)					-0.190 (0.141)	
t-2	-0.076 (0.163)				-0.080 (0.142)		
t-3	-0.041 (0.156)			0.011 (0.142)			
t-4	-0.100 (0.152)		-0.060 (0.144)				
t-5	-0.155 (0.152)	-0.169 (0.144)					
F (Joint)	0.49						
Prob>F	0.813						

# Brill & Hassett Replication

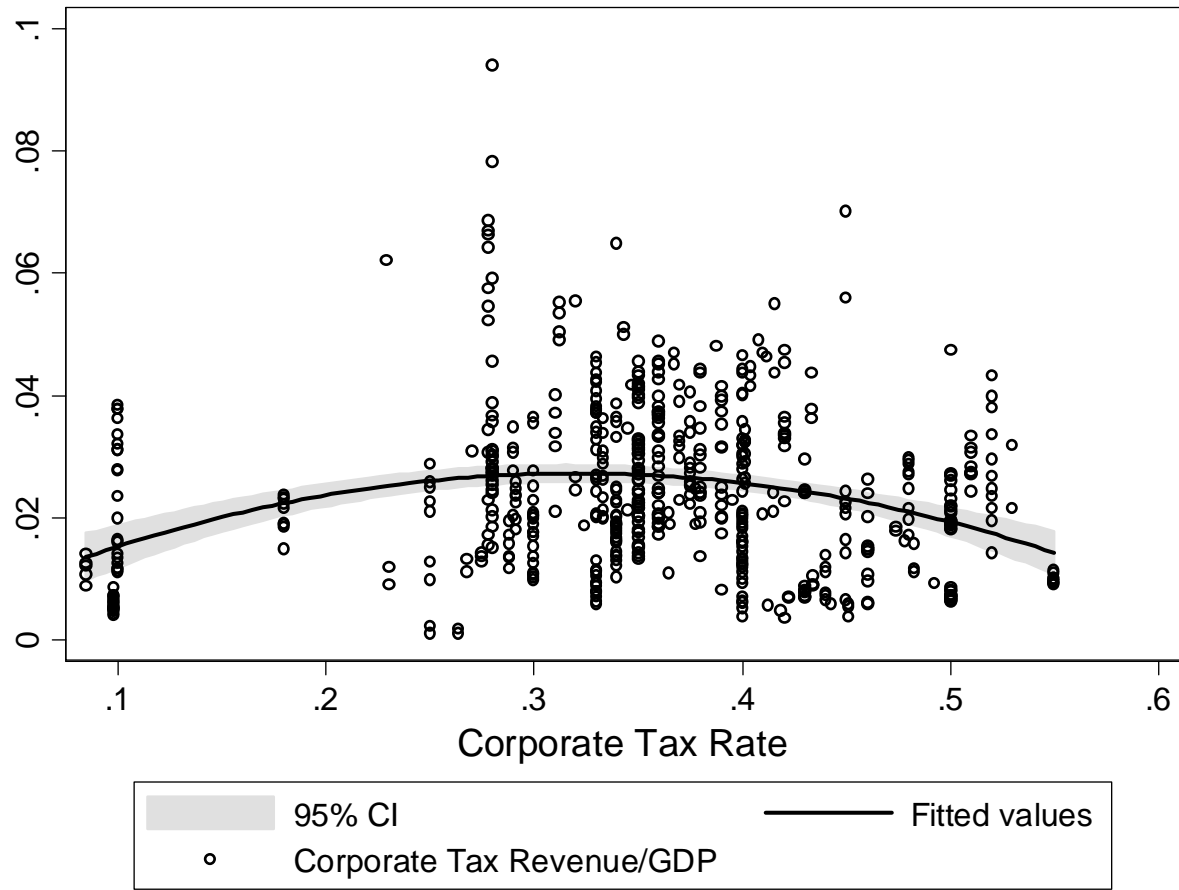
(std. errors in parenthesis)

	1980-1986	1987-1992	1993-1997	1998-2003	1980-2003
<b>A. Central government corporate tax revenues; federal corporate tax rate</b>					
Tax Rate	-0.037 (0.090)	-0.110 (0.081)	0.048 (0.087)	0.049 (0.117)	-0.040 (0.040)
Tax Rate <sup>2</sup>	0.087 (0.109)	0.122 (0.100)	-0.082 (0.129)	-0.060 (0.178)	0.052 (0.053)
F (joint)	5.15	1.21	0.33	0.21	0.51
Prob>F	0.008	0.303	0.719	0.809	0.603
<b>B. Total government corporate tax revenues; total corporate tax rate</b>					
Tax Rate	0.204 (0.195)	-0.042 (0.077)	0.069 (0.076)	0.037 (0.094)	-0.016 (0.038)
Tax Rate <sup>2</sup>	-0.193 (0.214)	0.044 (0.091)	-0.106 (0.109)	-0.008 (0.123)	0.028 (0.047)
F (joint)	2.25	0.21	0.51	0.74	0.44
Prob>F	0.112	0.811	0.602	0.481	0.612

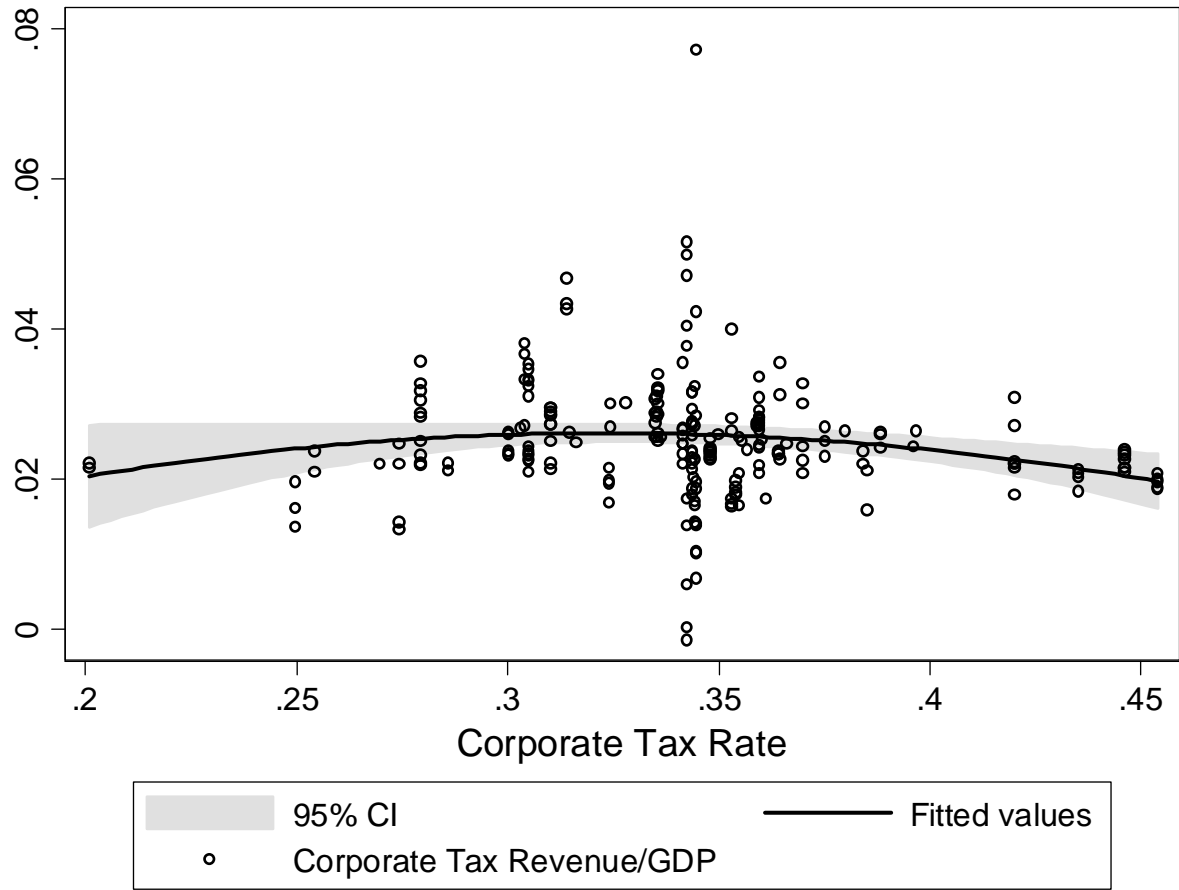
# Clausing Replication

(std. error in parenthesis)

	(1)	(2)	(3)	(4)	(5)
Tax Rate	-0.055 (0.035)	-0.073 (0.111)	-0.075 (0.046)	-0.048 (0.036)	-0.067 (0.047)
Tax Rate <sup>2</sup>	0.078* (0.047)	0.118 (0.147)	0.102* (0.061)	0.069 (0.048)	0.093 (0.061)
Profit Rate		X			
Corporate Share		X			
Unemp Rate			X		X
GDP Gr Rate			X		X
GDP			X		X
Openness				X	X
F (joint)	1.39	0.75	1.45	1.04	1.21
Prob>F	0.251	0.473	0.236	0.354	0.298



**No Fixed Effects**



# Fixed Effects

	<b>Brill and Hassett Data</b>	<b>Clausing Data</b>	<b>Hassett and Mathur Data</b>
<b>Variable</b>	<b>Corporate tax rate</b>	<b>Corporate tax rate</b>	<b>Logarithm of corporate tax rate</b>
Mean	0.362	0.354	-1.106
Overall Standard Deviation	0.092	0.101	0.396
Between Component	0.065	0.078	0.307
Within Component	0.064	0.063	0.248