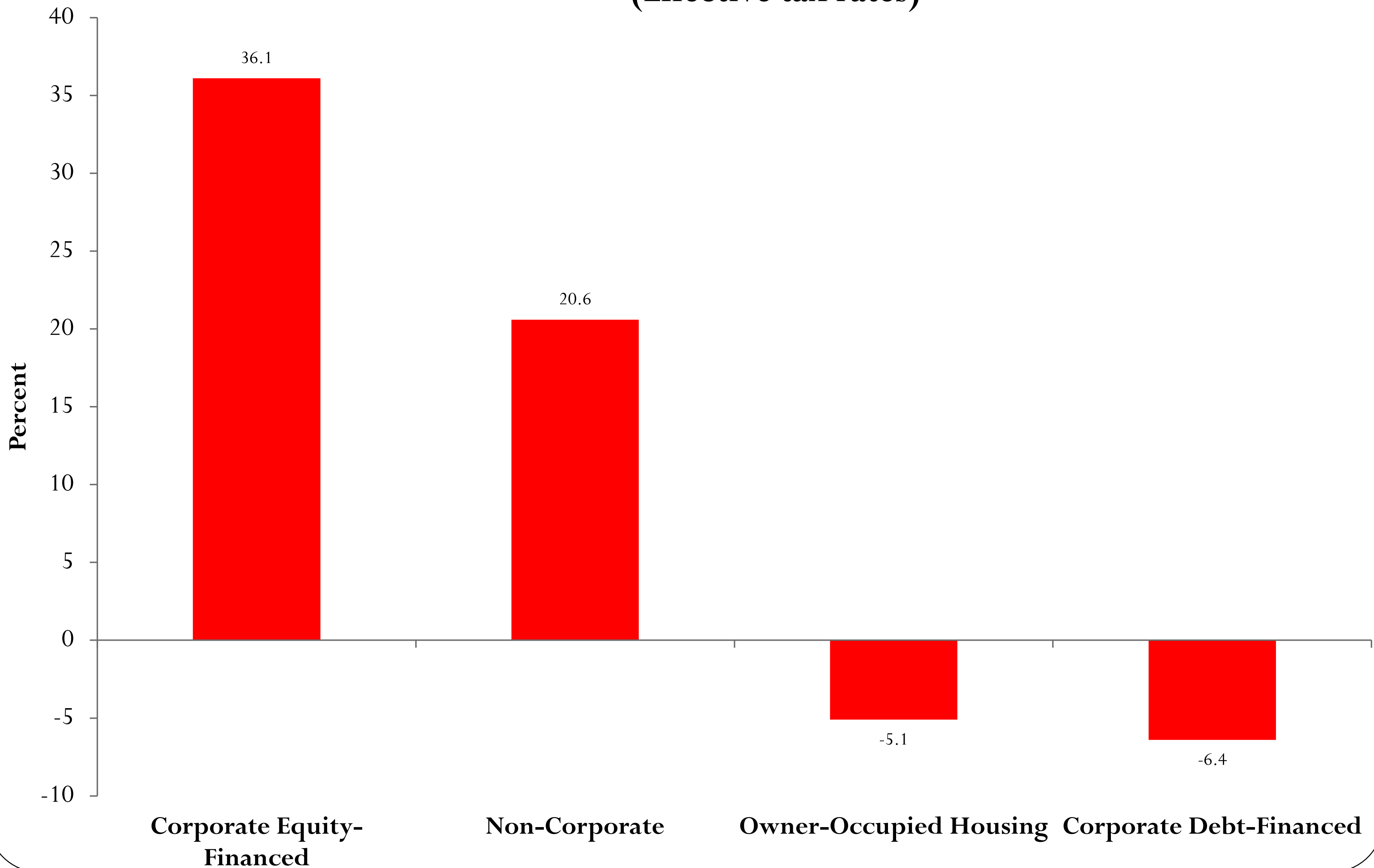
Broadening the Corporate Tax Base

Alan D. Viard, December 12, 2012

Corporate income tax distorts economy

- Penalizes saving relative to current consumption, as do individual income tax, UIMC, estate and gift tax
- Penalizes investment in United States – "global" system does little to change this
- Penalizes C corporations relative to flow-through firms and owner-occupied housing
- Penalizes equity relative to debt
- Penalizes some assets relative to others

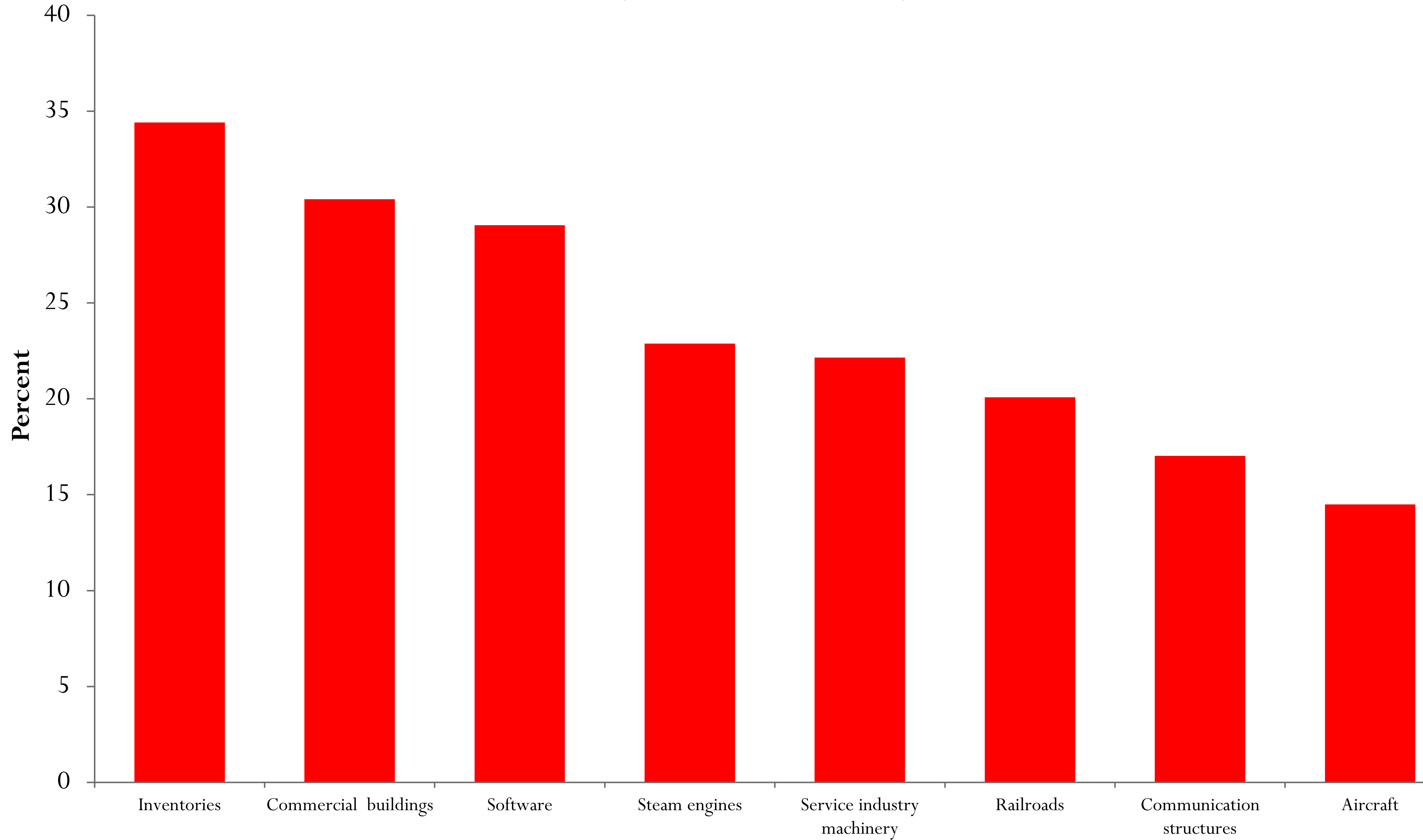

U.S. Tax System Penalizes Corporate Equity-Financed Investment
(Effective tax rates)
Percent
40
35
30
25
20
15
10
5
0
-5
-10
36.1
20.6
-5.1
-6.4
Corporate Equity-Financed
Non-Corporate
Owner-Occupied Housing
Corporate Debt-Financed

Limits of revenue-neutral base broadening

- Doesn't reduce overall penalty on saving
- Doesn't reduce overall penalty on investment in U.S.
- Does little or nothing to reduce penalty on C corporations
- Unless treatment of interest and dividends changed, doesn't reduce penalty on equity
- May reduce penalties on high-taxed assets if done properly – modest potential gains

Corporate Assets are Taxed Unevenly

(Effective tax rates)



Leveling the playing field

- Increasing taxes on low-taxed assets and cutting rates makes playing field more level
- Doesn't increase capital stock, but increase output by allocating capital more efficiently
- Doesn't reduce average effective rate, but narrows dispersion in effective rates

First Potential Misstep: Tilting the Playing Field

- Increasing taxes on *high*-taxed assets is harmful, even if rates are cut
- Tilts the playing field, allocates capital less efficiently, reduces output
- Prime example: LIFO repeal
- Beware flawed definitions of "tax preferences"
- Base broadening and statutory rate reduction are not ends in themselves

Second Potential Misstep: Robbing the Future to Pay the Past

- Statutory rate cuts benefit existing capital, as well as new investment
- Many base broadeners, such as slower depreciation, fall only on new investment
- Using those base broadeners to cut rates benefits existing capital, burdens new investment
- Base broadening and statutory rate reduction are not ends in themselves

Third Potential Misstep: Taxing the Unpopular

- Broadening the base only for selected unpopular firms violates rule of law
- Singling out five unpopular firms (“Big Oil”) – section 167(h)(5), S. 940, S. 2204, percentage depletion hoax
- Base broadening and statutory rate reduction are not ends in themselves

Principles for Corporate Tax Reform

- Accept net corporate tax revenue loss, offset with other taxes or spending cuts
- Narrow the disparity between debt and equity – interest deduction limits, dividend-paid deduction, etc.
- Provide benefits to new investment rather than existing capital – expensing, etc.
- Remove genuine preferences for low-taxed assets
- Brill, *AEI Tax Policy Outlook*, January 2012; Rep. Devin Nunes (R-California), *Washington Post*, October 12, 2012