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An Analysis of Senator Warren's 'Real Corporate Profits Tax'

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Key Findings

- Senator Elizabeth Warren (D-MA) released a proposal for a surtax on corporate profits called the "Real Corporate Profits Tax."
- The Real Corporate Profits Tax would be equal to 7 percent of a corporation's profits as reported on its financial statement with an exemption for the first $100 million in profits.
- According to the Tax Foundation Model, the Real Corporate Profits Tax would reduce long-run output by 1.9 percent, shrink the capital stock by 3.3 percent, and reduce wages by 1.5 percent.
- The Real Corporate Profits Tax would raise approximately $872 billion between 2020 and 2029 on a conventional basis.
- The smaller projected economy over the next decade would result in lower individual income, payroll, and excise tax revenue collections. As a result, we estimate that this tax would increase federal revenue by $476 billion between 2020 and 2029 on a dynamic basis.
- The Real Corporate Profits Tax would reduce after-tax income for taxpayers at all income levels. However, it would raise taxes more for high-income taxpayers, increasing the progressivity of the U.S. tax code.

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Introduction

Senator Elizabeth Warren released a proposal to enact a surtax on U.S. corporations. According to the Warren campaign, the "Real Corporate Profits Tax" would be equal to 7 percent of the worldwide profits reported on a corporation's financial statement. The first $100 million in profits of a corporation would be exempt from the tax.[1]

According to Senator Warren, the goal of this policy is to prevent companies that report profits to their shareholders in a given year from paying little to no federal income tax. The senator's aim is to close the "book-tax" gap in profits. Under current law, companies have an incentive to report high profits to their shareholders while reporting low profits to the IRS. This tax would be based entirely on book profits to reduce this incentive.

Economic Effects

According to the Tax Foundation General Equilibrium Model, this proposal would reduce economic output (GDP) by 1.9 percent in the long run. We also estimate that the capital stock would be 3.3 percent smaller and wages 1.5 percent lower, with about 454,000 fewer full-time equivalent jobs.

TABLE 1.

Economic Impact of the "Real Corporate Profits Tax"

Gross Domestic Product (GDP)	-1.9%
Capital Stock	-3.3%
Wages	-1.5%
Service Price of Capital	2.6%
Full-time Equivalent Jobs	-454,000

Source: Tax Foundation General Equilibrium Model, March 2019

The Real Corporate Profits surtax would reduce output primarily through an increase in the service price of capital, or the required return necessary for investment to break even, after tax and depreciation, in the United States. We estimate that the service price would rise by 2.6 percent under this proposal. A higher service price means that capital investment would become less attractive, leading to reduced investment and, eventually, a smaller capital stock. The smaller capital stock would lead to lower output, lower worker productivity, and lower wages.

Notably, the surtax would have a larger negative impact on the incentive to invest in the United States than a 7 percentage-point increase in the corporate income tax rate. This is chiefly because companies would not be able to use expensing or accelerated depreciation for their capital investments.

1 Elizabeth Warren, "I'm proposing a big new idea: the Real Corporate Profits Tax," Medium, April 11, 2019, https://medium.com/@teamwarren/im-proposing-a-big-new-idea-the-real-corporate-profits-tax-29dde7c960d.

The extent to which the corporate income tax distorts investment decisions depends largely on how much of a given investment can be deducted against taxable income in present value. Under current law, companies can expense, or deduct immediately, short-life assets against their taxable income. Long-life assets qualify for accelerated depreciation. The result is that many investments are exempt or partially exempt from taxation. Under the surtax, however, companies would not have access to expensing. The result is that all investment would be fully subject to the surtax.Other aspects of the surtax would also distort corporate investment behavior. It appears that companies would not be able to carry forward losses into future years. As a result, investments that might lose money for several years before turning a profit could face high effective tax rates. Based on descriptions of the plan, the surtax also would include foreign income in its tax base with no deduction or credit for foreign taxes. This would make it less likely for U.S. companies to own foreign investments and would ultimately reduce national income.[2]

Revenue Effects

We estimate that the Real Corporate Profits Tax would raise $872 billion between 2020 and 2029 on a conventional basis. Corporate tax collections would be $79 billion higher in 2020. Over the next decade, collections would grow as corporate profits increase with the U.S. and world economy. By 2029, the surtax would raise $102 billion.

TABLE 2:

Revenue Impact of the "Real Corporate Profits Tax" (billions of dollars)

Year	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2020-2029
Conventional Estimate	$79	$79	$79	$81	$84	$87	$90	$94	$98	$102	$872
Dynamic Estimate	$72	$66	$59	$53	$49	$45	$39	$34	$31	$28	$476

Source: Tax Foundation General Equilibrium Model, March 2019. Values may not add to total due to rounding.

On a dynamic basis, the proposal would raise $476 billion over the same period. The smaller revenue collections on a dynamic basis are due to lower output over the next decade. Wages and profits would be lower, reducing revenue collections from the individual income tax, payroll tax, and excise taxes. Revenue from these taxes would be $396 billion lower over the next decade as a result of the proposal.

Distributional Effects

According to the Tax Foundation General Equilibrium Model, the Real Corporate Profits Tax would make the tax code more progressive. However, taxpayers at all income levels, on both a conventional and dynamic basis, would see a reduction in after-tax income.

On a conventional basis, the bottom 80 percent of income earners would see a reduction in after-tax income of between 0.49 percent and 0.59 percent. Taxpayers in the 80th to 99th percentile would see a slightly larger reduction in after-tax income of between 0.64 and 0.89 percent. The top 1 percent

2 We do not explicitly model this effect.

of taxpayers would see a much larger reduction in after-tax income of 2.35 percent. Overall, after-tax income would fall by 0.93 percent.

On a dynamic basis, the smaller economy would result in an even larger drop in after-tax income. Taxpayers in the bottom four income quintiles (0% to 20%, 20% to 40%, 40% to 60%, and 60% to 80%) would see a reduction in after-tax income of between 1.64 percent and 1.95 percent. Taxpayers in the 80th to 99th percentile would see a slightly larger reduction in after-tax income of between 1.67 and 2.16 percent. Taxpayers in the top 1 percent would see a 4.16 percent drop in after-tax income.

TABLE 3.

The Distributional Impact of the “Real Corporate Profits Tax.” Percent-change in After-tax Income

Income Group	Conventional	Dynamic
0% to 20%	-0.49%	-1.95%
20% to 40%	-0.50%	-1.69%
40% to 60%	-0.55%	-1.70%
60% to 80%	-0.59%	-1.64%
80% to 90%	-0.64%	-1.67%
90% to 95%	-0.70%	-1.81%
95% to 99%	-0.89%	-2.16%
99% to 100%	-2.35%	-4.16%
TOTAL	-0.93%	-2.16%

Source: Tax Foundation General Equilibrium Model, March 2019.

In general, the corporate income tax falls on the owners of capital (shareholders) and workers. Shareholders bear the burden of the corporate tax directly through reduced after-tax returns on their investments. Workers bear the burden of the corporate tax indirectly through reduced compensation. The share of the corporate tax borne by workers depends on how the corporate income tax impacts the incentive to invest. As mentioned previously, the Real Corporate Profits Tax would distort investment decisions by subjecting corporate investment to additional taxation. As such, this tax would fall on U.S. workers in the form of lower wages. We should also expect that this surtax would fall more heavily on workers, through lower wages, than the current corporate tax because it would fall more heavily on investment than the current corporate tax.

It is also worth nothing that the exemption for the first $100 million doesn’t necessarily contribute to the progressivity of the surtax. The annual profitability of a company doesn’t correspond to the well-being of those who ultimately bear the burden of the tax. A large corporation with more than $500 million in profits may be owned by a broad pool of shareholders with modest incomes. In contrast, a small, closely-held corporation that earns $50 million in profits, and falls under the threshold, might only have two high-income owners.

Conclusion

Senator Elizabeth Warren (D-MA) introduced a 7 percent surtax on corporate profits called the "Real Corporate Profits Tax." We estimate that this tax would reduce the incentive to invest in the United States, and result in a 1.9 percent smaller economy, a 3.3 percent smaller capital stock, and 1.5 percent lower wages. The surtax would raise $872 billion between 2020 and 2029 on a conventional basis and $476 billion on a dynamic basis. The tax would make the tax code more progressive, but it would fall on taxpayers in every income group.

Methodology and Policy Assumptions

We use the Tax Foundation General Equilibrium Tax Model to estimate the impact of tax policies.[3] The model can produce both conventional and dynamic revenue estimates of tax policy. Conventional estimates hold the size of the economy constant and attempts to estimate potential behavioral effects of tax policy. Dynamic revenue estimates consider both behavioral and macroeconomic effects of tax policy on revenue. The model can also produce estimates of how policies impact measures of economic performance such as GDP, wages, employment, the capital stock, investment, consumption, saving, and the trade deficit. Lastly, it can produce estimates of how different tax policy impacts the distribution of the federal tax burden.

This analysis is based on details released by Senator Warren and her advisors. Ultimately, the impact of the proposal depends on its final details.

In estimating the impact of the surtax, we assumed that the 7 percent tax would apply only to C corporations (excluding S corporations, Partnerships, LLC, and Sole Proprietorships). We also assumed that the tax base would be equal to book profits minus an exclusion of $100 million.[4] There would be no deductions or credits for taxes paid, nor would companies be able to carry forward losses to future years.

To calculate the revenue effect of the surtax, we started with the current corporate income tax base and then adjusted taxable income to bring it closer to book profits. For example, companies would no longer benefit from expensing and accelerated depreciation, deductions for local, state, and foreign taxes, credits for specific activities, or the foreign tax credit. Foreign profits would be fully taxed each year. We also assume that companies would not receive deductions for losses. Companies would also not be subject to any special taxes or limitations such as BEAT, GILTI, FDII, or the limitation on net interest expense deductions.

3 Stephen J. Entin, Huaqun Li, and Kyle Pomerleau, "Overview of the Tax Foundation's General Equilibrium Model," Tax Foundation, April 2018 Update," https://files.taxfoundation.org/20180419195810/TaxFoundaton_General-Equilibrium-Model-Overview1.pdf.

4 These assumptions are similar to those made by University of California, Berkeley economics professors Emmanuel Saez and Gabriel Zucman in a letter to Senator Warren, https://elizabethwarren.com/wp-content/uploads/2019/04/Saez-and-Zucman-Letter-on-Real-Corporate-Profits-Tax-4.10.19-2.pdf.

In distributing the corporate income tax on a conventional basis, we assume that 50 percent of the corporate tax is borne by labor and 50 percent by capital.[5] On a dynamic basis, we assume that 50 percent of the corporate tax is borne by shareholders as a change in after-tax income, then changes in economic output are distributed to labor and capital in proportion to their share of total output.[6]

5 Stephen J. Entin, Tax Foundation, Oct. 24, 2017, "Labor Bears Much of the Cost of the Corporate Tax," Tax Foundation, https://taxfoundation.org/labor-bears-corporate-tax/.

6 Huaqun Li and Kyle Pomerleau, "The Distributional Impact of the Tax Cuts and Jobs Act over the Next Decade," Tax Foundation, June 28, 2018, https://taxfoundation.org/the-distributional-impact-of-the-tax-cuts-and-jobs-act-over-the-next-decade/.