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TAX·FEATURES

Increasing Corporate Tax Burden Finishes Decade on the Upswing

With federal deficits hovering around $150 billion, the government will continue its drive for more revenues. Corporations are often targeted because they are said to be undertaxed. Despite statistical evidence to the contrary, this recurring theme seems to have a life of its own and always resurfaces when more revenues are required for increased spending. In fact, corporations carry a heavy tax burden and provide a large and growing percentage of the total tax revenue collected by the federal government.

Recent Corporate Tax History

In 1981, Congress enacted a significant corporate tax cut under the Economic Recovery Tax Act of 1981 (ERTA). If it had been allowed to take effect fully, it would have substantially reduced overall corporate income tax liabilities in the 1980s. Instead, there were major contravening tax bills starting with the Tax Equity and Fiscal Responsibility Act (TEFRA) in 1982 and the Deficit Reduction Act (DEFRA) in 1984. Outside of the Tax Reform Act of 1986, the major drive behind tax legislation after 1981 was purely and simply to increase tax revenues. The Tax Reform Act of 1986 obliterated the capital recovery and business tax relief of 1981 and effectively piled on significant net increases in corporate tax liabilities after 1986. More recently, further increases in corporate income taxes have occurred as a result of the Omnibus Budget Reconciliation Act of 1987 and the Continuing Resolution for 1988. Table I on page 2 compares the effect of major enacted legislation in the 1981-1988 period on individual and corporate income taxes currently and projected through 1992. Individuals' taxes are markedly lower than they would have been without the legislation, but the corporate sector is

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(See CORPORATE TAX BURDEN on page 2)

This article is taken from the Tax Foundation's recent Special Report on the corporate tax burden which is available for $2.50 plus $1 p/h.

THIS ISSUE:

Front Burner

by Alan Reynolds
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Tear Down the Protectionist Wall

Some members of Congress want to build the tax and regulatory equivalent of a new Berlin Wall around the United States. This Berlin Wall is designed to keep foreigners out, or in the case of the Burke-Hartke bill, to keep American investment in.

A second group of legislators, often overlapping with the first, is eager to protect the managers of companies susceptible to takeovers or buyouts, whether domestic or foreign, that might threaten to enrich U.S. stockholders.

Both of these anticompetitive interests find common ground in thinly disguised efforts to discourage foreign investment by tinkering with the tax code. Recent attempts to sneak several protectionist proposals into the budget reconciliation process are revealing.

One of them was an attempt to tax the capital gains on sales of stock in U.S. companies by foreigners who own more than ten percent of such stock. With an estimated tax revenue of only $5 million, not billion, revenue obviously was not the point. There was a hidden agenda at work, but it wasn't too well hidden. The *Financial Times* caught it quickly with a headline that said "U.S. Plan Attacks Foreign Buyers."

Foreign retaliation against a proposal like that would be almost guaranteed. The vicious cycle of retaliation would snuff out capital gains revenue windfalls everywhere, as the efficient

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Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial responses are encouraged.

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another story entirely.

Starting in 1984, corporate income tax collections have been steadily increasing, leaping from a low of $37 billion in 1983 to a record $94.5 billion in 1988. The growth in corporate tax revenue has coincided with better business conditions in recent years and, of course, the implementation of the 1982, 1984, and 1986 tax bills which increased corporate tax burdens. The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 repealed more than half of the benefits provided by ERTA to corporations in 1981. The Deficit Reduction Act (DEFRA) of 1984 further reduced corporate depreciation allowances. In fact, the Tax Reform Act (TRA) of 1986, which was supposed to be "revenue neutral," will raise an additional $24 billion in corporate tax revenues this year alone. Nearly everything provided in the so-called "corporate giveaway" of 1981 was taken back before the benefits could be fully realized.

Table I

Impact of Major Tax Legislation, Enacted 1981-1988[a], on Individual and Corporate Income Tax Receipts

Fiscal Years 1988-1992

($Billions)

Income Tax	1988	1989	1990	1991	1992
Individual	$ -201.4	$ -237.6	$ -259.4	$ -288.4	$ -326.9
Corporate	+24.0	+27.2	+33.7	+42.6	+43.7

[a] Budget effect revenue estimates are prepared by the Office of Management and Budget. They measure only the direct effect of tax legislative changes on receipts with "feedback" effect limited to the overall income forecast and its impact on receipts by major source.

Source: Budget of the U.S. Government, FY 1990

Corporate Tax Burden

A good indicator of the corporate tax burden is a comparison of corporate taxes with corporate profits. When looking at the corporate taxes, federal corporate income taxes are only part of the picture. Table II on page 3 illustrates the overall burden of federal corporate income tax when it is combined with the rapidly increasing state/local corporate income taxes and corporate payroll taxes. Such payments can be partially deducted for federal corporate income tax purposes, but they are a substantial and growing burden nonetheless.

For comparability, corporate tax accruals net of Federal Reserve earnings are used instead of actual tax receipts. Given today's full acceleration of corporate tax payments, the accruals figures are close to tax payments.

While Federal corporate income tax revenues have risen 52 percent

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flow of capital around the world is constricted.

Another amazingly provincial proposal would have disallowed deductions for research performed outside the United States by U.S. foreign affiliates. If that were enacted, foreign parent companies would simply license their research, charging royalties to any surviving U.S. affiliates. Obviously, that would reduce U.S. corporate profits and corporate income tax receipts.

. . . a fifth of West German manufacturing is foreign-owned. They don't complain about that. In our case, it is five percent, but we worry.

Such proposals are making it abundantly clear that foreigners wishing to do business in the United States are not welcome. What conceivable problem does foreign investment cause that requires such risky bullying of countries with which we have tax treaties?

Let's examine some basic facts about foreign ownership: Foreigners hold about one percent of U.S. farm land, six percent of U.S. stock, thirteen percent of corporate bonds, and fifteen percent of government debt. U.S. direct investment abroad still exceeds foreign investment here.

Japan, against whom most of the anxiety seems to be focused, is only the third largest investor in the United States, way behind Britain and the Netherlands. Half of Canadian manufacturing and a fifth of West German manufacturing is foreign-owned. They don't complain about that. In our case, it is five percent, but we worry. Foreign ownership accounts for a larger share of all major countries' stocks and bonds, but that is just smart diversification. Pension funds and mutual funds offer the ability to invest in various countries because it minimizes risk.

How could the ownership of a few companies by foreign investors mean they really control anything? They are not going to control our destiny. They cannot force Americans to buy their products. They cannot force us to work for them.

America must quell its fear of foreign investment because the free flow of funds across borders is vital to the nation's economic health. Attempts by legislators to wall off the U.S. from the world economy will alienate other nations, cause stagnation in our economy, and ultimately diminish our own tax revenue.

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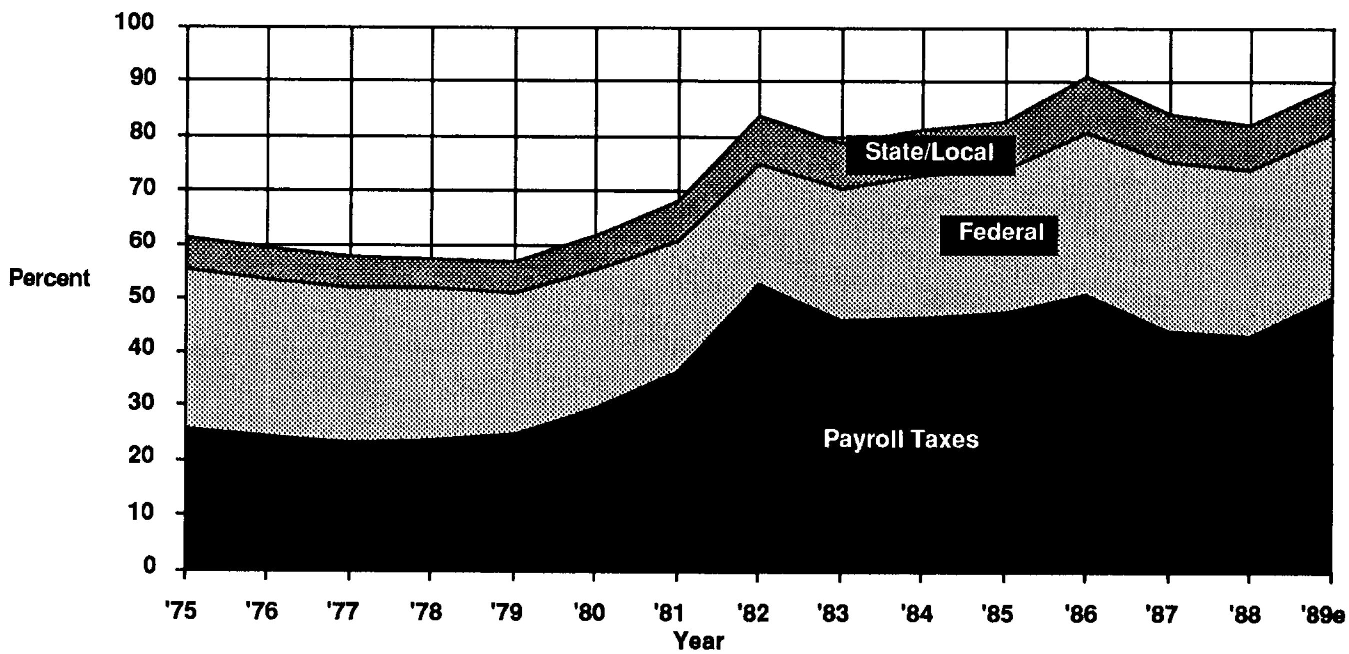
Table II
Federal and State/Local Corporate Income Taxes and Corporate Payroll Taxes
National Income Account Series
1970-1989
(In Billions of Dollars)

	A	B	C	D	E	F	G
Year	Corporate Profits	Federal Corporate Income Tax Accruals[a]	Effective Rate of Federal Tax (B/A)	State/Local Corporate Income Tax Accruals	Effective Rate of Federal and State/ Local Tax (B+D/A)	Corporate Payroll Taxes[b]	Inc. & Payroll Taxes Relative to Corp. Profits (B+D+F/A)
1970[c]	$ 72.4	$ 27.1	37.4 %	$ 3.7	42.5 %	-	-
1971	84.0	30.1	35.8	4.3	41.0	-	-
1972	98.1	33.4	34.0	5.3	39.4	$ 22.7	62.6 %
1973	122.7	39.0	31.8	6.0	36.7	29.5	60.7
1974	133.2	39.5	29.7	6.7	34.7	33.2	59.6
1975	129.1	38.2	29.6	7.3	35.2	33.6	61.3
1976	164.3	48.7	29.6	9.6	35.5	39.8	59.7
1977	194.2	55.7	28.7	11.4	34.6	45.4	57.9
1978	225.8	64.4	28.5	12.1	33.9	53.7	57.7
1979	247.6	65.1	26.3	13.6	31.8	62.2	56.9
1980	225.2	58.6	26.0	14.5	32.5	66.6	62.0
1981	212.0	51.7	24.4	15.4	31.7	77.6	68.3
1982	154.0	33.8	21.9	14.0	31.0	81.7	84.1
1983	192.8	47.1	24.4	15.9	32.7	89.0	78.8
1984	223.3	59.1	26.5	18.7	34.8	104.4	81.6
1985	224.3	58.5	26.1	20.2	35.1	107.6	83.1
1986	221.6	66.0	29.8	22.5	39.9	113.6	91.2
1987	266.7	83.3	31.2	23.7	40.1	118.1	84.4
1988	306.8	94.1	30.7	26.5	39.3	132.9	82.6
1989[d]	295.3	89.0	30.1	25.1	38.6	150.0	89.4

[a] Net of Federal Reserve Earnings.
[b] Includes corporate employer share of OASDHI, state unemployment insurance tax, federal unemployment tax, railroad unemployment insurance and retirement, and workers' compensation.
[c] Includes some effect from Vietnam period surcharge.
[d] Estimates based on first three quarters of 1989.
Sources: Economic Reports of the President, various years; published and unpublished statistics of the Department of Commerce, Bureau of Economic Analysis, and Tax Foundation Computations.

Corporate Income and Payroll Taxes Relative to Corporate Profits
1975 – 1989



Source: Tax Foundation computations (see table above).

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since 1980, state/local corporate income tax revenues have increased 73 percent for the decade and in 1989

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represented 28 percent of the federal tax take. The combined federal, state and local corporate income tax take has risen steadily since 1982, far surpassing the level of the early 1970s.

The largest element of the business tax burden has become the payroll sector, particularly federal social security and hospital insurance. Furthermore, state unemployment insurance and other social insurance funds have intensified the tax burden. These taxes are not imposed on net income, and some economists argue that even the employer share of payroll taxes is borne by employees who receive lower rates of compensation and benefits than they would in the absence of these taxes. However, where labor is relatively scarce and/or subject to rigidities in compensation, that burden may have been absorbed by the employer. The corporate share of payroll taxes has far outstripped corporate income taxes and currently costs about $150 billion.

Over the past decade, the combined increases in federal income taxes and the state/local and payroll taxes have caused a tremendous increase in the overall corporate tax burden. Compared to profits, the burden increased 32.5 percentage points from 56.9 percent in 1979 to 89.4 percent by 1989. Throughout the 1970s, this rate averaged only about 60 percent. The 1989 overall corporate tax burden, representing a whopping 89 percent of corporate profits, is huge by historic comparison. Federal deficit pressure and the sharp growth trend in state and payroll taxes can easily push this burden even higher.

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