The Corporate Tax Burden

By Chris R. Edwards
Economist
tax Foundation

Following the 1992 election, Americans are more concerned about the federal fiscal situation than they have been in years. This concern is justified as the fiscal 1993 budget deficit is a record high of $327 billion. At the same time, President Clinton has a raft of new spending proposals that he needs to finance. Consequently, corporate income is once again being targeted by the government as a source of increased revenues.

The federal government currently raises $100 billion a year from the corporate income tax, and state and local governments tap corporate America for an additional $25 billion. Federal corporate tax rates and bases have been on a roller coaster ride in recent years as rates have gone up and down and bases have expanded and contracted. Under current law, corporate taxable income above $75,000 is subject to an income tax rate of 34 percent.

Trends in Corporate Income Taxes

Because corporate profits are volatile, rising in booms and falling in recessions, so, too, are government receipts from the corporate income tax. Figure 1 and Table 1 show that federal receipts dipped during the recessions of both the early 1980s and early 1990s. However, the long-term trend of federal corporate tax receipts is upward, from $64.6 billion in 1980 to $100.3 billion in 1992.

Also, a long-term downward trend in corporate receipts as a percent of total federal receipts seems to have halted over the past decade (see Table 1). In fact, corporate receipts as a percent of total federal receipts are expected to rise in coming years.

Federal legislation during the 1980s first cut, then raised corporate taxes. The Economic Recovery Tax Act of 1981 (ERTA) represented a significant cut in corporate income taxes, both through lower tax rates and various provisions designed to spur capital formation which effectively reduced the corporate income tax base. However, subsequent legislation largely reversed the impact of the 1981 Act and led to increases in corporate taxes.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) was a straightforward attempt to recapture some of the revenues returned to the private sector by ERTA in 1981. The Tax Reform Act of 1986 (TRA '86), on the other hand, represented a major reshuffling of tax liability. While the 1986 Act lowered the marginal corporate tax rate from 46 to the current 34 percent, it significantly broadened the tax base and, on balance, increased corporate income taxes. Table 1 shows this impact as federal corporate tax receipts rose significantly from 1987 to 1989, then dropped off after 1989 as the economy slipped into a recession.

Total revenue collections tell only part of the story of the impact corporate taxes have on the economy. Effective marginal tax rates, which have a large impact on the level and composition
of corporate investment, have varied widely since 1980.

For example, ERTA substantially increased the attractiveness of corporate investment in equipment after 1981. But just as corporate managers began to respond to this change in the tax laws, Congress passed the 1982 Act, cutting back on these investment benefits. TRA'86 further eliminated the tax advantage of equipment investments.

Despite all this seesawing legislation, the average effective federal tax rate on corporate income in 1992 was about the same as it was in 1980, around 23 to 24 percent. The same is true of state and local taxes on corporate income. The average effective state rate hovered around 6 to 7 percent over the past decade, for a combined federal, state, and local effective rate of 30.3 percent in 1992 (see Table 2).

The Alternative Minimum Tax

During the recent recession, federal corporate tax payments did not fall as much as in previous recessions, largely due to the Corporate Alternative Minimum Tax (CAMT). The CAMT attempts to extract tax revenue from corporations with apparently low effective income tax rates. A more extensive alternative minimum tax was enacted as part of the 1986 Tax Reform Act which increased corporate taxes and imposed additional collection costs on corporations. Despite the recession, federal revenues from the CAMT increased from $3.5 billion in 1989 to $8.1 billion in 1990.

The CAMT has numerous adverse impacts. For example, the recent rise in CAMT revenues during the recession of 1990-91 indicates the tax may hit firms hard when they are already on shaky footing — an undesirable feature of a tax system because it reduces the ability of firms to hire and invest, thereby prolonging the recession.

Other Trends Affecting Corporate Tax Receipts

In assessing the trend in corporate income tax revenues, other factors must be considered as well. One such factor is that total corporate profits have fallen as a percentage of overall national income (see Table 3). This has reduced corporate tax receipts relative to all tax receipts.

Another important trend tending to reduce total corporate tax collections has been the increase in the number of Subchapter S corporations. Federal tax legislation in 1982 and 1986 led to the increased attractiveness of this form of business organization. These corporations share some of the legal features of corporations, but are taxed solely at the shareholder level. After TRA 86, S corporations became particularly attractive as individual tax rates fell below corporate tax rates. The number of IRS filings by S corporations has increased from 258,000 in 1970 to 1.423 million in 1989 (see Figure 2).

Payroll Taxes

Corporate income tax liability rises and falls with corporate profitability. In contrast, payroll taxes burden companies whatever their financial condition. Table 4 indicates that payroll taxes collected by businesses have risen steadily since 1980. Payroll taxes collected by business include primarily old-age, survivors, disability, and hospital insurance (OASDHI) and unemployment insurance (UI) taxes.

While Table 4 includes payroll taxes collected by business, it does not include equal payroll tax collections from employee contributions. Generally, the total of both employer and employee payroll taxes is ultimately borne by workers in reduced after-
tax pay. In addition, business passes along to workers a heavy "dead weight" cost for collection and administration of the tax.

Payroll taxes, like the corporate income tax, distort economic activity, in this case by placing a greater burden on labor-intensive businesses, and their workers, such as services.

Table 2
Average Effective Tax Rate on Corporate Profits
Fiscal Years 1980-1992
($Billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Before-Tax Corporate Profits (Billions)</th>
<th>Federal Corporate Income Tax Accruals (Billions)</th>
<th>State/Local Corporate Income Tax Accruals (Billions)</th>
<th>Effective Rate of Federal Tax (%)</th>
<th>Effective Rate of State/Local Tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>$240.9</td>
<td>$58.6</td>
<td>$14.5</td>
<td>24.5%</td>
<td>6.0%</td>
</tr>
<tr>
<td>1981</td>
<td>228.9</td>
<td>51.9</td>
<td>15.4</td>
<td>22.6</td>
<td>6.7</td>
</tr>
<tr>
<td>1982</td>
<td>176.3</td>
<td>33.8</td>
<td>14.0</td>
<td>19.2</td>
<td>7.9</td>
</tr>
<tr>
<td>1983</td>
<td>210.7</td>
<td>47.1</td>
<td>15.9</td>
<td>22.4</td>
<td>7.5</td>
</tr>
<tr>
<td>1984</td>
<td>240.5</td>
<td>59.2</td>
<td>18.8</td>
<td>24.6</td>
<td>7.8</td>
</tr>
<tr>
<td>1985</td>
<td>225.0</td>
<td>58.5</td>
<td>20.2</td>
<td>26.0</td>
<td>9.0</td>
</tr>
<tr>
<td>1986</td>
<td>217.8</td>
<td>66.0</td>
<td>22.5</td>
<td>30.5</td>
<td>10.3</td>
</tr>
<tr>
<td>1987</td>
<td>252.9</td>
<td>85.4</td>
<td>24.9</td>
<td>29.7</td>
<td>8.3</td>
</tr>
<tr>
<td>1988</td>
<td>34.5</td>
<td>93.6</td>
<td>26.0</td>
<td>26.9</td>
<td>7.5</td>
</tr>
<tr>
<td>1989</td>
<td>342.9</td>
<td>95.4</td>
<td>24.2</td>
<td>27.8</td>
<td>7.1</td>
</tr>
<tr>
<td>1990</td>
<td>355.4</td>
<td>90.5</td>
<td>22.7</td>
<td>25.4</td>
<td>6.4</td>
</tr>
<tr>
<td>1991</td>
<td>334.7</td>
<td>81.7</td>
<td>21.5</td>
<td>24.4</td>
<td>6.4</td>
</tr>
<tr>
<td>1992c</td>
<td>365.7</td>
<td>86.4</td>
<td>24.5</td>
<td>25.6</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Sources: Survey of Current Business. Department of Commerce and Tax Foundation computations.

Figure 2
S Corporation Returns vs. Other Corporate Returns
Selected Fiscal Years 1970-1989

Table 3
Corporate Profits as a Percent of National Income Before Tax
Fiscal Years 1980-1992

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<thead>
<tr>
<th>Year</th>
<th>Corporate Profits (Billions)</th>
<th>Percent of National Income</th>
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<tbody>
<tr>
<td>1980</td>
<td>$240.9</td>
<td>11.0%</td>
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<td>217.8</td>
<td>6.3</td>
</tr>
<tr>
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<td>8.8</td>
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<td>54.7</td>
<td>8.1</td>
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<tr>
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<td>7.4</td>
</tr>
<tr>
<td>1992c</td>
<td>465.7</td>
<td>7.8</td>
</tr>
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Source: Survey of Current Business. Department of Commerce.
Their concern is misplaced. Businesses adopt corporate form for many reasons, foremost of which may be the protection of the firm’s owners from extraordinary legal claims against the firm. A large penalty is imposed for adopting a corporate form through the double taxation of corporate earnings, once through the corporate income tax and again at the shareholder level through taxes on dividends and capital gains. This penalty is not significantly reduced when the individual income tax rate is a few points higher than the corporate rate.

Instead, perhaps the Administration will address the differential taxation of corporate earnings, possibly through proposals to eliminate taxes on capital gains due to corporate retention of earnings and to integrate the personal and corporate income tax systems as proposed by the Treasury Department in January of this year.

Who Bears the Burden of Corporate Income Taxes?

Although Figure 3 shows which corporations collect the corporate income tax, it does not show who ultimately bears the burden of the tax. As non-persons, corporations must pass on the tax it collects to either consumers, workers, or owners of “capital,” that is, equity owners.

The distribution of the burden may vary according to industry and the structure of the economy. As such, it is not clear which income groups in the economy end up bearing the corporate income tax. A common assumption is that half of the corporate income tax falls on the owners of capital and half falls on workers.

Under this assumption, both the highest and lowest income individuals bear a heavier burden while middle income individuals bear a relatively lighter burden.

A 1992 Department of Treasury report follows a methodology which places the entire burden of the corporate income tax on the owners of capital. Under this assumption, higher income individuals bear a heavier burden while middle income individuals bear a relatively lighter burden.

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