TAX FOUNDATION

SPECIAL REPORT

March 1993, No. 18

The Corporate Tax Burden

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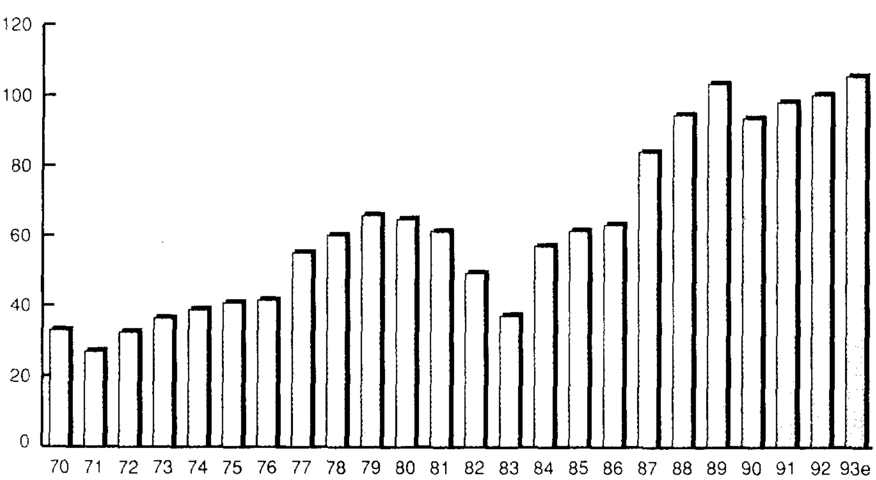
Following the 1992 election, Americans are more concerned about the federal fiscal situation than they have been in years. This concern is justified as the fiscal 1993 budget deficit is a record high of $327 billion. At the same time, President Clinton has a raft of new spending proposals that he needs 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.

Figure 1
Federal Corporate Income Tax Receipts
Fiscal Years 1970-1993



Source: Budget Baselines, Office of Management and Budget, January 1993.

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.

Table 1
Federal Corporate Income Taxes as a Percent of Federal Receipts
Fiscal Years 1970-1993
($Billions)

Fiscal Year	Corporate Income Taxes	Total Federal Receipts	Percent of Federal Receipts
1970	$32.8	$192.8	17.0%
1971	26.8	187.1	14.3
1972	32.2	207.3	15.5
1973	36.2	230.8	15.7
1974	38.6	263.2	14.7
1975	40.6	279.1	14.5
1976	41.4	298.1	13.9
1977	54.9	355.6	15.4
1978	60.0	400.0	15.0
1979	65.7	463.3	14.2
1980	64.6	517.1	12.5
1981	61.1	599.3	10.2
1982	49.2	617.8	8.0
1983	37.0	600.6	6.2
1984	56.9	666.5	8.5
1985	61.3	734.1	8.4
1986	63.1	769.1	8.2
1987	83.9	854.1	9.8
1988	94.5	909.0	10.4
1989	103.3	990.7	10.4
1990	93.5	1031.3	9.1
1991	98.1	1054.3	9.3
1992	100.3	1091.6	9.2
1993e	105.5	1147.6	9.2

Source: Budget Baselines, Office of Management and Budget, January 1993.

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.

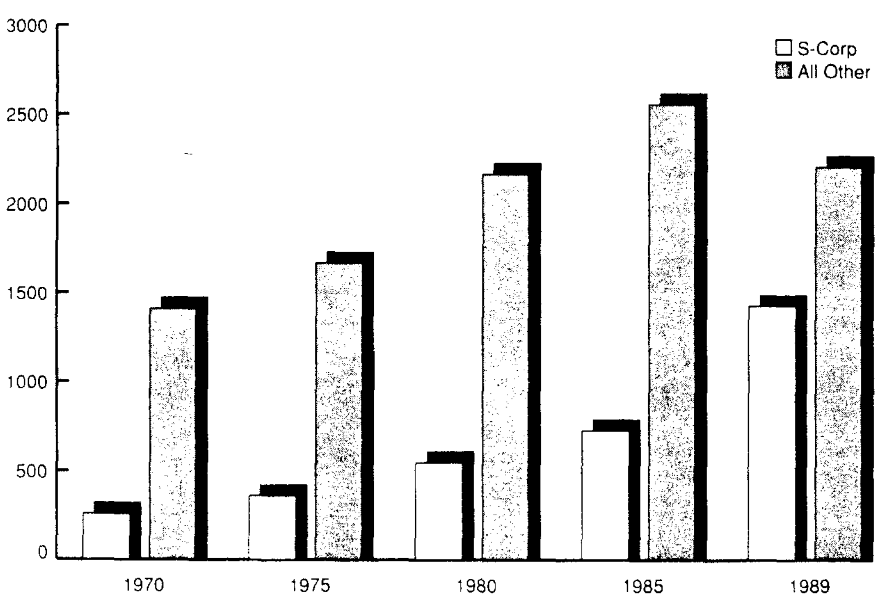
Payroll taxes, like the corporate income tax, distort economic activity, in this case by placing a greater burden on labor-intensive businesses, and their workers, such as services.

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

Year	Before-Tax Corporate Profits	Federal Corporate Income Tax Accruals	State/Local Corporate Income Tax Accruals	Effective Rate of Federal Tax	Effective Rate of State/Local Tax	Effective Rate of Federal and State/Local Tax
1980	$240.9	$58.6	$14.5	24.3%	6.0%	30.3%
1981	228.9	51.7	15.4	22.6	6.7	29.3
1982	176.3	33.8	14.0	19.2	7.9	27.1
1983	210.7	47.1	15.9	22.4	7.5	29.9
1984	240.5	59.2	18.8	24.6	7.8	32.4
1985	225.0	58.5	20.2	26.0	9.0	35.0
1986	217.8	66.0	22.5	30.3	10.3	40.6
1987	287.9	85.4	23.9	29.7	8.3	38.0
1988	347.5	93.6	26.0	26.9	7.5	34.4
1989	342.9	95.4	24.2	27.8	7.1	34.9
1990	355.4	90.3	22.7	25.4	6.4	31.8
1991	334.7	81.7	21.5	24.4	6.4	30.8
1992e	365.7	86.4	24.5	23.6	6.7	30.3

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



Source: Statistics of Income, Internal Revenue Service.

Who Collects the Corporate Income Tax?

The bulk of corporate income taxes are paid by large corporations. Based on 1989 IRS return data, 5,460 corporations with assets in excess of $250 million paid over 70 percent of all federal corporate income taxes. In contrast, over 50 percent of all corporate income tax returns are filed by very small corporations with assets of less than $100,000. This group of small corporations pays only 0.4 percent of the total corporate income tax bill (see Figure 3).

The Clinton Plan

The Clinton Administration has proposed creating a new top marginal tax bracket of 36 percent for corporate taxable income in excess of $10,000,000. According to the Clinton plan, this provision would raise corporate taxes an average of $6 billion annually. The balance of the Clinton program relating to corporations includes an array of tax increases, such as hikes on U.S. businesses operating internationally, but also tax reductions, such as an important reform of the alternative minimum tax.

The overall impact of the Clinton plan is to increase corporate taxes by approximately $4.2 billion per year. This increase represents an increase in federal corporate taxes of about 4 percent.

The Administration has expressed concern that it is important to raise the corporate rate to 36 percent given the Administration's proposal to increase individual income tax rates. The concern is that, without the higher corporate rate, non-corporate businesses would be induced by the higher individual rates to incorporate.

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

Year	Corporate Profits ($Billions)	Percent of National Income
1980	$240.9	11.0%
1981	228.9	9.4
1982	176.3	7.0
1983	210.7	7.7
1984	240.5	7.9
1985	225.0	6.9
1986	217.8	6.3
1987	287.9	7.8
1988	347.5	8.7
1989	342.9	8.1
1990	355.4	8.0
1991	334.7	7.4
1992e	365.7	7.8

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 appear to pay a higher percent of the tax, relative to their income, than lower income individuals.

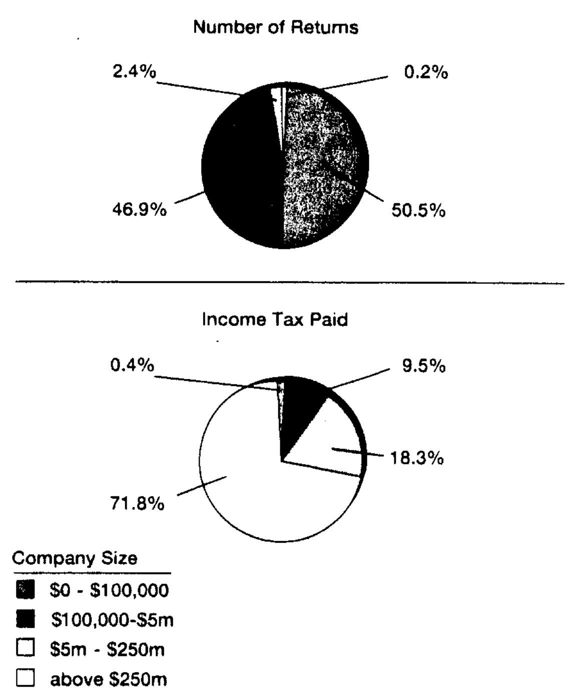
Very generally, if workers bear more of the tax burden, lower and middle income groups will pay relatively more of the tax. If owners of capital bear more of the tax burden, higher income individuals may be hit more heavily by the tax. Even this generalization is problematic. Lower and middle income individuals today own a large percentage of corporate America through pension funds, insurance plans, and other pools of savings. This means that even if the entire burden of the corporate income tax falls on capital, lower and middle income Americans pay a large share of the tax through reduced pensions and other returns to saving. Consequently, taxing corporations imposes a significant tax burden on all Americans.

Table 4
Business-Paid Social Insurance Taxes
Fiscal Years 1980-1992
($Billions)

Year	Federal Government	State/Local Government	Total	Percent of GDP
1980	$75.0	$2.3	$77.3	2.92%
1981	87.6	2.3	89.9	3.03
1982	92.8	2.3	95.1	3.05
1983	101.1	2.3	103.4	3.12
1984	118.5	2.6	121.1	3.28
1985	125.5	3.0	128.5	3.24
1986	132.7	3.6	136.3	3.23
1987	138.0	4.4	142.4	3.20
1988	151.7	5.1	156.8	3.26
1989	159.5	5.8	165.3	3.20
1990	167.7	6.6	174.3	3.19
1991	172.5	7.4	179.9	3.19
1992e	179.9	7.7	187.6	3.20

Source: Survey of Current Business. Department of Commerce.
Note: Includes business employer paid portions of OASDHI, UI, and other.

Figure 3
Tax Returns and Receipts by Company Asset Size
Calendar Year 1989



Source: IRS Statistics of Income.

SPECIAL REPORT (ISSN 1068-0306) is published 6 times yearly by the Tax Foundation, an independent 501 (c)(3) organization chartered in the District of Columbia.

4-12 pp.
Annual subscription: $50.00
Individual issues $8 +$2 p/h.

The Tax Foundation, a nonprofit, nonpartisan research and public education organization, has been monitoring tax and fiscal activities at all levels of government since 1937.

Librarians: Back issues (January 1990 - November 1992) have been numbered retroactively and are all available from the Tax Foundation.

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Production
Taccino/Gray Design, Inc.

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