TAX FOUNDATION Since 1937

Fiscal Fact

March 8, 2011
No. 261

Countdown to #1: 2011 Marks 20th Year That U.S. Corporate Tax Rate Is Higher than OECD Average

By
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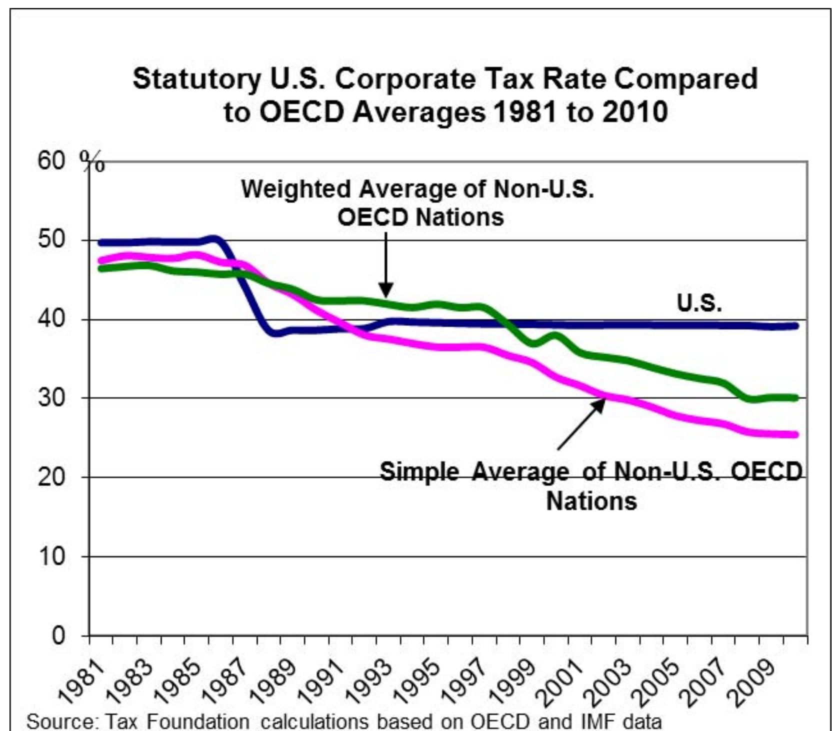
There is increasing recognition in Washington that the U.S. corporate tax rate is out of step with the lower tax rates of most industrialized and emerging nations. Indeed, 2011 marks the 20th year in which the U.S. statutory tax rate has been above the simple average of non-U.S. countries in the Organization for Economic Cooperation and Development (OECD).

It is now well known that with a combined federal and state corporate tax rate of 39.2 percent, the U.S. has the second-highest overall rate among OECD nations. Only Japan, with a combined rate of 39.5 percent, levies a higher rate.

As Figure 1 indicates, the simple average of non-U.S. OECD nations has fallen from 38 percent in 1992 (the first year in which it fell below the U.S. rate) to 25.5 percent today. Similarly, the weighted average – which accounts for country size – has fallen from 42.5 percent in 1992 to 30.1 percent today. The weighted average rate of non-U.S. countries fell below the U.S. rate in 1998. Thus, 2011 marks the twelfth straight year in which the U.S. has been above the weighted average rate.



These figures and rankings do not reflect the changes that have occurred this year or will take place later in the year. On January 1, 2011, Canada's national corporate tax rate was reduced from 18 percent to 16.5 percent, which gives the country an overall rate of 28 percent. On April 1, both Japan and the United Kingdom are scheduled to lower their rates as well. Japan is planning to reduce its national rate by 4.5 percentage points, which will bring its overall rate to below 35 percent. The U.K. rate will fall from 28 percent to 27 percent as a first step of a multi-year plan to lower the British rate to 24 percent by 2014.

After the scheduled rate cuts in Japan and Great Britain take effect, the simple average of non-U.S. OECD nations will drop to about 25 percent and the weighted average will hit 29 percent. This will leave the U.S. rate a full 10 percentage points higher than the weighted average of our major economic competitors.

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Falling Behind by Standing Still

Japan and the U.S. have not always held the number one and number two corporate tax rate rankings. As Table 1 shows, just 10 years ago Germany and Canada held the top spots while Japan and the U.S. held the third and sixth spots, respectively. During that ten-year period, the corporate tax rates in Japan and the U.S. stood still while Germany cut its rate by roughly 22 percentage points, more than any other country. This dramatic change lowered Germany's rate from first to fifth among OECD nations.

Canada's story is even more impressive. The Canadian government has explicitly set the goal of having the lowest corporate tax rate among the major G-7 nations. Over the past ten years, Canada has cut its rate more than 13 percentage points, which dropped it eight places in the OECD rankings.

Between 2000 and 2010, nine countries cut their corporate tax rates by double-digit figures. In addition to Germany and Canada, these countries include: Greece (16 points), Turkey (13 points), Poland (11 points), the Slovak Republic (10 points), Iceland (15 points), and Ireland (11.5 points). All of these nations fell considerably in the OECD rankings.

By contrast, some nations cut their corporate rates or remained static but still rose in the rankings. Aside from the U.S., the most notable were Sweden and the United Kingdom. Sweden cut its corporate tax rate from 28 percent to 26.3 percent and still rose 11 places in the rankings. Similarly, the U.K. cut its rate from 30 percent to 28 percent, yet rose 10 places in the rankings. Australia and New Zealand cut their corporate rates by 4 and 3 percentage points respectively, but still rose eight places in the rankings.

Table 1: Corporate Tax Rates in OECD Countries

	2010 Rate	2010 Rank	2000 Rate	2000 Rank	Change in Rate	Change in Rank
Japan	39.54	1	40.87	3	-1.3	2
United States	**39.2**	2	**39.3**	6	-0.1	4
France	34.43	3	37.76	7	-3.3	4
Belgium	33.99	4	40.2	4	-6.2	0
Germany	30.2	5	52.0	1	-21.9	-4
Mexico	30	7	35	11	-5.0	4
Spain	30	9	35	13	-5.0	4
Australia	30	6	34	14	-4.0	8
New Zealand	30	8	33	16	-3.0	8
Canada	29.52	10	42.57	2	-13.1	-8
Luxembourg	28.59	11	37.45	8	-8.9	-3
United Kingdom	28	13	30	23	-2.0	10
Norway	28	12	28	26	0.0	14
Italy	27.5	14	37	9	-9.5	-5
Portugal	26.5	15	35.2	10	-8.7	-5
Sweden	26.3	16	28	27	-1.7	11
Finland	26	17	29	24	-3.0	7
Netherlands	25.5	18	35	12	-9.5	-6
Austria	25	19	34	15	-9.0	-4
Denmark	25	20	32	18	-7.0	-2
Korea	24.2	21	30.8	20	-6.6	-1
Greece	24	22	40	5	-16.0	-17
Switzerland	21.17	23	24.93	28	-3.8	5
Turkey	20	24	33	17	-13.0	-7
Czech Republic	19	25	31	19	-12.0	-6
Poland	19	27	30	22	-11.0	-5
Slovak Republic	19	28	29	25	-10.0	-3
Hungary	19	26	18	30	1.0	4
Chile	17	29	15	31	2.0	2
Iceland	15	30	30	21	-15.0	-9
Ireland	12.5	31	24	29	-11.5	-2

Emerging Nations Have Cut Corporate Rates Too

Of course, OECD nations have not been the only countries reducing their corporate tax rates to remain competitive. As illustrated in the appendix to this report, since 2006, some 75 nations have cut their rates, many multiple times.

In addition to the 17 OECD nations that lowered their corporate rates during this period, there were 17 nations in Eastern Europe and Central Asia that followed suit, including Russia which lowered its rate from 24 percent to 20 percent.

Mexico was the only nation to increase its corporate rate during this period, from 28 percent to 30 percent. However, Mexico had cut its corporate rate from 29 percent to 28 percent in 2007. Macedonia perhaps went the furthest of any country by lowering its tax rate on undistributed profits from 10 percent to zero.

Among Asian nations, America's biggest economic competitor, China, lowered its corporate tax rate from 33.3 percent to 25 percent in 2008. Nearby Vietnam lowered its rate from 28 percent to 25 percent in 2009, while Taiwan reduced its corporate rate from 25 percent to 17 percent in 2010. No doubt, these Asian trends are a factor in Japan's decision to lower its own rate.

What Rate Does the U.S. Need in Order to Be Competitive?

While there is a growing consensus that the U.S. corporate tax rate needs to be lowered to improve our global competitiveness, there is less agreement on the ideal rate. Indeed, a variety of proposals have been put forward in recent years that would lower the federal corporate tax rate while eliminating or scaling back many of the deductions available to businesses.

The first of these plans was proposed by former Ways and Means Chairman Charlie Rangel in 2007. Rangel's plan cut the federal rate from 35 percent to 30.5 percent in exchange for eliminating provisions such as the Domestic Manufacturing Deduction and making significant changes to the tax rules affecting U.S. multinational firms.

Rangel and others argued that the plan's 30.5 percent rate was a good first step in restoring U.S. competitiveness. However, they overlooked the fact that 44 states impose their own corporate income tax (at an average rate of 6.47 percent), so what matters for global comparisons is the combined federal and state-level rate.[1]

Therefore, as Table 2 shows, when the average state rate is added to the proposed 30.5 percent federal rate (and adjusted for the federal deductibility of state taxes), Rangel's plan would reduce the overall U.S. rate to just 35 percent – a level that does not alter the U.S.'s high OECD ranking.

Table 2: How Different Plans Affect the Overall U.S. Rate and OECD Ranking
(Adjusted for federal deductibility of state taxes)

	Federal Rate	Average State Rate	Combined Rate	Resulting OECD Rank
Current Law	**35**	**6.47**	**39.2**	**2**
Rangel Plan (2007)	30.5	6.47	35	2
Bowles/Simpson (2010)	28	6.47	33	5
Match OECD Weighted Avg.	25	6.47	30	7
Wyden/Gregg (2010)	24	6.47	29	11
Match China/OECD Simple Avg.	20	6.47	25	19

[1] Nevada, South Dakota, and Wyoming do not levy a corporate income tax. Ohio, Texas, and Washington levy a "gross receipts" tax on businesses, but not a corporate income tax.

Two plans worth noting were released in 2010. President Obama's National Commission on Fiscal Responsibility and Reform, chaired by Erskine Bowles and Alan Simpson, presented a menu of tax reform options for both the corporate and individual income tax systems. The leading proposal eliminated most of the tax expenditures available to corporations while lowering the corporate rate to 28 percent. This is the general direction that President Obama is reported to be favoring at this time.

However, Table 2 shows that, when combined with the state average rate, the Bowles/Simpson plan would reduce the overall U.S. corporate rate to 33 percent, which would still leave the country with the fifth-highest rate among OECD nations.

A plan developed by Senators Ron Wyden (D-OR) and Judd Gregg (R-NH), would reduce the federal corporate tax rate to 24 percent while significantly broadening the tax base by eliminating most corporate deductions. But, contrary to the direction taken by most countries, the plan also eliminated the deferral of U.S. tax on income earned abroad. Table 2 shows that a 24 percent federal rate would lower the overall U.S. rate to 29 percent, slightly below the weighted average of all OECD nations.

While a 29 percent overall corporate tax rate would be vastly more competitive than the current rate – putting the U.S. on par with Spain, Australia, and New Zealand – it would still leave our rate above the majority of OECD nations, including major trading partners Canada and the U.K.

A Move to the Middle Means a 20 Percent Rate

As Table 2 indicates, for the U.S. to "move to the middle" and match China's rate and the OECD simple average, lawmakers will have to reduce the federal rate to 20 percent. By all accounts, such a rate reduction could not be achieved within the revenue-neutral restrictions of broadening the corporate tax base alone.

If lawmakers see revenue neutrality as paramount, they will have to reach beyond the corporate tax base to find the budgetary offsets – such as new revenues or spending cuts – to the lower corporate rate. On the other hand, they could determine that the benefits of cutting the U.S. rate are so great, that they could justify relaxing the revenue-neutral restriction in the same manner they did when they enacted the "Tax Hike Prevention Act of 2010."

Benefits of Cutting the Corporate Rate

A very important 2008 report by economists at the Organization for Economic Cooperation and Development (OECD)[2] measured the relationship between different taxes and economic growth and determined that the corporate income tax is the most harmful tax for long-term economic growth, followed by high personal income tax rates. Consumption taxes and property taxes were seen as less harmful.

Indeed, the report found that lowering statutory corporate tax rates "can lead to particularly large productivity gains in firms that are dynamic and profitable, i.e. those that can make the largest contribution to GDP growth."[3] Moreover, "lower corporate tax and labour rates may also encourage inbound foreign direct investment, which has been found to increase productivity of resident firms."

Lower Rates Do Not Always Mean Lower Revenues

In observing the worldwide trends toward lower corporate tax rates, the OECD has noted that "Despite the strong reduction in statutory corporate tax rates, corporate tax revenues have kept pace with – or even exceeded – the growth in GDP, and the growth in revenues from other taxes in many OECD countries."[4]

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[2] Asa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, "Tax and Economic Growth," Organization for Economic Cooperation and Development, *OECD Economics Working Paper No. 620.*, July 11, 2008. p. 9.
[3] Ibid. 9.
[4] "Fundamental Reform of Corporate Income Tax," Organization for Economic Cooperation and Development, *OECD Tax Policy Studies No. 16.*, 2007.

This is not to say that corporate tax cuts "pay for themselves." However, OECD economists do offer some possible explanations on why corporate tax collections have not typically fallen after rates were reduced:

- Lower rates were balanced by base-broadening measures such as reduced depreciation allowances and fewer special deductions.

- "[M]ore profitable corporations pay more corporate taxes. This might not only be part of a cyclical movement but might also be the result of fundamental changes in profitability."[5]

- Lower tax rates attract capital and investment from high-tax countries. Increased tax revenues in low-tax countries may have resulted from "the inflow of investment and/or mobile corporate profits that are shifted out of high-tax countries in order to avoid corporate taxes."[6]

- Lower rates reduce the incentive for excessive tax planning and profit shifting. "The reduced corporate tax-planning efforts might therefore have increased the taxable corporate tax base, which may have partly offset the tax revenue loss due to the lower statutory and effective corporate tax rates."[7]

- The move to lower rates was complemented by "stricter corporate tax enforcement policies enacted by OECD countries."[8]

While it is difficult to quantify, the U.S.'s high corporate tax rate has undoubtedly caused some measure of profit-shifting out of the country and discouraged some amount of inbound investment. Thus, it is safe to assume that a meaningful reduction in the U.S. corporate rate would result in more corporate profits remaining within the country while encouraging more investment from abroad. These two factors alone could minimize the static revenue losses associated with a lower rate.

Conclusion

The U.S. is less than a month away from having the highest overall corporate tax rate in the industrialized world, when Japan lowers its top rate on April 1. Remarkably, 2011 marks the 20th year in which the statutory U.S. corporate tax rate has exceeded the simple average of the non-U.S. OECD nations and the twelfth year in which our rate has exceeded the weighted average OECD rate.

Already this year, Canada has lowered its corporate rate in a bid to have the lowest rate among the major G-7 nations. Great Britain too is scheduled to reduce its rate on April 1 in order to avoid losing more corporate headquarters to low-tax jurisdictions such as Ireland, Switzerland, and the Netherlands.

Cutting the U.S. rate while eliminating "loopholes" will not reduce the rate enough to meaningfully improve our ranking within the OECD and relative to our major economic competitors such as China.

If the U.S. is to "move to the middle," lawmakers may have to find other budgetary offsets (such as lower spending) or abandon a strict policy of revenue-neutrality. The economic evidence suggests that a lower corporate tax rate will improve long-term economic growth and increase workers' wages without necessarily diminishing tax revenues.

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[5] Ibid. p. 33.
[6] Ibid. p. 33.
[7] Ibid. p. 34.
[8] Ibid. p. 34.

Appendix: Table 1

Region/Country	2006/2007	2007/2008	2008/2009	2009/2010
OECD High-Income				
Canada		22.1 to 19.5		
Czech Republic		24 to 21	21 to 20	20 to 19
Denmark		28 to 25		
Germany		38.9 to 30		
Greece	29 to 25			25 to 24
Hungary				20 to 19
Iceland			18 to 15	
Italy		33 to 27.5		
Luxembourg			29.63 to 28.59	
Mexico	29 to 28			28 to 30
Netherlands	29.6 to 25.5			
New Zealand		33 to 30		
Portugal	27.5 to 26.5			
Republic of Korea			27.5 to 24.2	
Spain	35 to 32.5		32.5 to 30	
Sweden			28 to 26.3	
United Kingdom		30 to 28		
Eastern Europe & Central Asia				
Albania		20 to 10		
Azerbaijan	24 to 22			22 to 20
Bosnia and Herzegovina		30 to 10		
Bulgaria	15 to 10			
Georgia		20 to 15		
Kazakhstan			30 to 20	
Kosovo			20 to 10	
Kyrgyz Republic	20 to 10			
Lithuania				20 to 15
FYR Macedonia	15 to 12	12 to 10		10 to 0*
Moldova	18 to 15			
Montenegro			15 to 9	
Russian Federation			24 to 20	

Slovenia	25 to 23			
Tajikistan				25 to 15
Turkey	30 to 20			
Uzbekistan	15 to 12			

Sub-Saharan Africa

Benin			38 to 30	
Burkina Faso		35 to 30		30 to 27.5
Cape Verde			30 to 25	
Republic of Congo				38 to 36
Cote d'Ivoire	35 to 27	27 to 25		
Lesotho	35 to 25			
Madagascar		30 to 25		25 to 23
Mauritius	25 to 22.5			
Niger				35 to 30
Sao Tome and Principe				30 to 25
Seychelles				0-40 to 25-33**
South Africa	12.5 to 10			
Sudan			30 to 15	
Togo			37 to 30	
Zimbabwe				30 to 25

Latin America & Caribbean

Antiqua and Barbuda		30 to 25		
Columbia	35 to 34			
Dominican Republic		30 to 25		
Panama				30 to 25
St. Vincent and the Grenadines		40 to 37.5	37.5 to 32.5	
Trinidad and Tobago	30 to 25			
Uruguay	30 to 25			

Middle East & North Africa

Algeria			25 to 19	
Israel	31 to 29		29 to 26	
Morocco		35 to 30		
Syria	35 to 28			
Tunisia	35 to 30			
West Bank and Gaza	16 to 15			

East Asia & Pacific

Brunei Darussalam			25.5 to 23.5	23.5 to 22
China		33.3 to 25		
Fiji			31 to 29	
Indonesia				28 to 25

Malaysia	28 to 27	27 to 25		
Mongolia	30 to 25			
Philippines			35 to 30	
Samoa		29 to 27		
Taiwan (China)				25 to 17
Thailand		30 to 25		
Timor-Leste			30 to 10	
Tonga				15-30 to 25
Vietnam			28 to 25	

*For Undistributed Profits

**Progressive
Source: OECD, World Bank "Doing Business"

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