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U.S. Lagging Behind OECD Corporate Tax Trends

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Introduction

A wave of corporate income tax reduction is sweeping through many countries in the Organization for Economic Cooperation and Development (OECD), but not the United States. The latest to consider corporate income tax rate reductions are Australia,[1] Germany,[2] New Zealand,[3] and Spain.[4] Others, like Canada, are continuing to phase in corporate rate reductions in 2006 and beyond.[5] This movement transcends political philosophy, with center-right (Australia), centrist (Germany) and center-left (New Zealand, Spain) governments all considering corporate income tax rate cuts.

As OECD countries continue to lower their corporate income taxes, they can expect to reap more foreign direct investment from the U.S. A recent study by Deveraux and Lockwood found that a 10 percent corporate rate reduction by an EU member-state can reap a 60 percent short-run increase in investment by U.S. multinational corporations.[6]

While foreign governments entice U.S. investors by lowering their corporate tax rates, the federal government in the U.S. stands pat with the same rate structure it has had since 1994. Indeed, one of the ironies of tax policy during the Bush presidency is that five years of tax-cutting legislation have left the corporate income tax rate unchanged.

In the OECD, Only Japan Taxes Corporate Income at a Higher Tax Rate than U.S.

The United States has the second-highest overall corporate income tax rate (39.3 percent combined federal and sub-federal) among all OECD countries (see Table 1). Japan (39.5 percent) and Germany (38.9 percent) have the first and third highest corporate income tax rates, respectively. The nation with the lowest corporate income tax rate in the OECD is Ireland (12.5 percent).

Table 1: U.S. Corporate Tax Rate Rises to Second-Highest in OECD Ranking 2000-2006

Country	Corporate Tax Rate in 2000[7]	Rank in 2000	Corporate Tax Rate in 2006	Rank in March 2006	Percentage Reduction in Corporate Rate
Japan	40.9	3	39.5	1	-3.3%
United States[8]	39.4	6	39.3	2	-0.3%
Germany	52.0	1	38.9	3	-25.2%
Canada	44.6	2	36.1	4	-19.1%
France	37.8	7	35.0	5	-7.4%
Spain	35.0	11	35.0	5	0.0%
Belgium	40.2	4	34.0	7	-15.4%
Italy	37.0	9	33.0	8	-10.8%
New Zealand	33.0	16	33.0	8	0.0%
Greece	40.0	5	32.0	10	-20.0%
Netherlands	35.0	11	31.5	11	-10.0%
Luxembourg	37.5	8	30.4	12	-18.9%
Mexico	35.0	11	30.0	13	-14.3%
Australia	34.0	14	30.0	13	-11.8%
Turkey	33.0	16	30.0	13	-9.1%
United Kingdom	30.0	21	30.0	13	0.0%
Denmark	32.0	18	28.0	17	-12.5%
Norway	28.0	26	28.0	17	0.0%
Sweden	28.0	26	28.0	17	0.0%
Portugal	35.2	10	27.5	20	-21.9%
Korea	30.8	20	27.5	20	-10.7%
Czech Republic	31.0	19	26.0	22	-16.1%
Finland	29.0	24	26.0	22	-10.3%
Austria	34.0	14	25.0	24	-26.5%
Switzerland	24.9	28	21.3	25	-14.5%
Poland	30.0	21	19.0	26	-36.7%
Slovak Republic	29.0	24	19.0	26	-34.5%
Iceland	30.0	21	18.0	28	-40.0%
Hungary	18.0	30	16.0	29	-11.1%
Ireland	24.0	29	12.5	30	-47.9%
OECD Average[9]	**33.6**		**28.7**		**-14.9%**
Note: Small changes are usually attributable to changes in sub-national rates.					

Source: OECD data as of March 29, 2006, located at http://www.oecd.org/dataoecd/26/56/33717459.xls.

The clear trend among OECD countries is a move to cut corporate income tax rates. In fact, not one country has raised its corporate tax rate in this period. OECD countries have, on average, reduced their corporate tax rates by 14.9 percent between 2000 and 2006. Most notably, Germany has moved from highest to third-highest by slashing its federal rate by 25.2 percent in six years. Other leaders include Ireland (a 47.9 percent rate reduction) and Iceland (40 percent).

Higher Corporate Income Tax Rates Don't Guarantee Higher Revenue
Many people would expect high tax rates to yield high tax revenues, but the reverse is often the case. Collection data from 2002 (most recent) demonstrate that many countries with high corporate tax rates — such as the U.S., Germany, and France — have lower-than-average corporate tax collections as a percentage of total tax collections. In fact, of the 13 states with above-average corporate tax rates, nine of them have below-average collections.10

The converse is also true: of the 15 states with below-average corporate tax rates, six of them (including Ireland, which has the lowest corporate tax rate in the OECD) collect higher-than-average revenue. In fact, only 13 of the 30 OECD countries meet traditional expectations by matching their high corporate rates with high corporate revenue or their low corporate rates with low corporate collections.

Conclusion
The U.S. has the second-highest corporate tax rate in the OECD and yet collects less revenue (as a percentage of total revenue) than other OECD countries with lower rates. U.S. lawmakers should look to lower the federal corporate tax rate from 35 percent to something well below 30 percent, for three reasons:

• The OECD average is 28.7 percent. Since state corporate tax rates in the U.S. range from zero to 12 percent, the federal government should aim for a federal rate that will give states a chance to compete with a combined rate that is close to the world average.

• State governments would feel less pressure to offer special tax preferences and credits in their efforts to attract new international business investment.

• U.S. multinationals would feel less pressure to engage in corporate inversions and other forms of profit-shifting.11

To be sure, the biggest obstacle to cutting the top corporate rate is its perceived cost to the U.S. Treasury. Calculated on a static basis, almost any cut in the corporate tax rate would certainly be scored as a revenue loss. However, other nations are faring well with their lower rates, so the U.S. might not have the continued luxury of doing nothing.

Footnotes
1. *See* Elizabeth Colman, "Company tax take 'too high'," *The Sunday Times* (4/13/2006), located at http://www.sundaytimes.news.com.au/common/story_page/0,7034,18800111%255E462,00.html.
2. *See* Patrick Jenkins and Hugh Williamson, "Steinbruck Hints at Corporate Rate Cuts," *Financial Times* (4/26/2006), located at http://news.ft.com/cms/s/ca8c0c80-d4c0-11da-a357-0000779e2340.html.
3. *See* Mary Swire, " Cullen Hints At New Zealand Corporate Tax Cut," *Tax-news.com* (March 2 nd, 2006), located at http://www.tax-news.com/asp/story/story_open.asp?storyname=22869.

4. *See* Jose Palacios, " Spain: Government Plans to Cut Corporate Tax Rate and Scrap Credits," *International Tax Review* (March 2006), located at http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=21456&SID=616740&TYPE=20.
5. *See* Tax Bulletin (August 2003), located at http://www.fin.gc.ca/toce/2003/taxratered_e.html
6. *See* "Study says inward investment to UK would be increased 60% if UK cut its average corporate tax rate by 10%," *Finfacts.com* (4/25/2006), located at http://www.finfacts.com/irelandbusinessnews/publish/article_10005618.shtml. For a copy of the study on which the story is based, *see* Michael Devereux and Ben Lockwood, *Taxes and the Size of the Foreign-Owned Capital Stock: Which Tax Rates Matter?* , located at http://www.ifs.org.uk/conferences/etpf_lockwood.pdf.
7. Rates for 2000 and 2006 are combined central and sub-central tax rates. Where sub-central income tax is deductible against central government tax, this is reflected in the net rate of the central government.
8. The sub-central tax rate for the U.S. is calculated as a weighted average of state corporate income marginal income tax rates, 6.7 percent in 2000 and 6.6 percent in 2006, deductible in both years from federal taxable income.
9. Unweighted average.
10. *See* OECD in Figures—2005 Edition, located at http://dx.doi.org/10.1787/634788846751. The data used for these comparisons is from 2002. Mexico and Portugal were not included due to incomplete data.
11. *See, e.g.,* Martin A. Sullivan, *Economic Analysis: A New Era in Corporate Taxation*, 41 Tax Notes Int'l 415 (Feb. 6, 2006) ("…with rate cuts, a government can directly reduce corporations' incentives to move profits to low-tax countries by paying their affiliates interest, royalties, and artificially high prices.").

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