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U.S. Still Lagging Behind OECD Corporate Tax Trends

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Introduction

The United States has yet to catch the continuing wave of corporate income tax reduction sweeping through many countries in the Organization for Economic Cooperation and Development (OECD). Five countries cut their corporate income tax rates in 2006, and eight more, including Germany, will have cut their rates by January 1, 2008.

As OECD countries continue to lower their corporate income tax rates, they can expect to reap more foreign direct investment from the U.S. A recent study by Devereux and Lockwood found that when an EU member state cuts its corporate rate by 10 percent, from 30 to 27 percent for example, it can expect to reap a 60-percent, short-run increase in investment by U.S. multinational corporations.[1]

While foreign governments entice U.S. investors by lowering their corporate tax rates, the federal government in the U.S. has kept the same rate structure for 12 years. That makes the U.S. one of only two countries in the OECD not to reduce its corporate tax rate from 1994 to 2006, and one of only six OECD countries without a rate cut between 2000 and 2006.

It is clear that the U.S. needs a new policy on corporate tax competitiveness, and with the OECD average corporate tax rate steadily declining, the need for a new policy becomes more pressing with each passing year.

In the OECD, Only Japan Taxes Corporate Income at a Higher Tax Rate than the U.S.
Japan has cut its rate recently, and its 39.5 percent rate now barely claims the world's title of highest corporate tax rate, just above the 39.3 percent in the United States (see Table 1).[2]
Germany is one of several countries that had higher tax rates than the U.S. in 2000 but now levy a lower tax (38.9 percent). Ireland has the OECD's lowest rate at 12.5 percent.

Table 1
U.S. Corporate Tax Rate Is Second-Highest in OECD Ranking, 2000-2006

Country	Corporate Tax Rate in 2000 (a)	Rank in 2000	Corporate Tax Rate in 2006 (a)	Rank in March 2006	Percentage Reduction in Corporate Rate
Japan	40.9%	4	39.5%	1	- 3.3%
United States (b)	39.3%	7	39.3%	2	- 0.1%
Germany	52.0%	1	38.9%	3	- 25.2%
Italy (c)	41.3%	3	37.3%	4	- 9.7%
Canada	44.6%	2	36.1%	5	- 19.1%
Spain	35.0%	11	35.0%	6	0.0%
France	37.8%	8	34.4%	7	- 8.9%
Belgium	40.2%	5	34.0%	8	- 15.4%
New Zealand	33.0%	16	33.0%	9	0.0%
Luxembourg	37.5%	9	30.4%	10	- 18.9%
Australia	34.0%	14	30.0%	11	- 11.8%
Turkey	33.0%	16	30.0%	11	- 9.1%
United Kingdom	30.0%	21	30.0%	11	0.0%
Netherlands	35.0%	11	29.6%	14	- 15.4%
Greece	40.0%	6	29.0%	15	- 27.5%
Mexico	35.0%	11	29.0%	15	- 17.1%
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%
Korea	30.8%	20	27.5%	20	- 10.7%
Portugal	35.2%	10	27.5%	20	- 21.9%
Finland	29.0%	24	26.0%	22	- 10.3%
Austria	34.0%	14	25.0%	23	- 26.5%
Czech Republic	31.0%	19	24.0%	24	- 22.6%
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%
Unweighted OECD Average	33.7%		28.5%		- 15.5%
Unweighted EU 19 Average	33.6%		27.6%		- 18.1%
Unweighted G7 Average	40.8%		36.5%		- 10.6%

Note: Small changes are usually attributable to changes in sub-national rates.
(a) 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.

(b) The sub-central tax rate for the U.S. is calculated as a weighted average of states' top corporate income tax rates in 2000 and 2006, deductible in both years from federal taxable income.
(c) Includes regional business tax which is levied at a rate of 4.25 percent.

Source: OECD data as of July 17, 2007, located at http://www.oecd.org/dataoecd/26/56/33717459.xls, and KPMG's *2007 Corporate Tax Rate Survey*

Not one OECD country raised its corporate tax rate between 2000 and 2006. The average reduction was 15.5 percent, from an average of 33.7 percent to 28.5 percent. Most notably, Germany moved from highest to third-highest by slashing its federal rate by 25.2 percent. Other leaders include Ireland (a 47.9 percent rate reduction) and Iceland (40 percent). Since we published last year's corporate tax rate update,[3] five more countries (Czech Republic, France, Greece, Mexico, and the Netherlands) reduced their corporate tax rates.

Current-year data from KPMG show the trend is still strong in 2007(see Table 2). Seven more countries cut their corporate tax rates this year, with Turkey leading the way with a 33 percent rate reduction. Germany will again cut its corporate rate by moving to a 30 percent rate starting January 1, 2008. France, Japan, and the United Kingdom may also reduce their rates in the next year.[4]

Table 2
Seven OECD Countries Cut Corporate Tax Rates by 11.6 Percent in 2007

Country	2006 Corporate Tax Rate (OECD)	2007 Corporate Tax Rate (KPMG)	Percentage Reduction
Korea	27.5%	27.4%	- 0.4%
Greece	29.0%	25.0%	- 13.8%
Mexico	29.0%	28.0%	- 3.4%
Netherlands	29.6%	25.5%	- 13.9%
Portugal	27.5%	25.0%	- 9.1%
Spain	35.0%	32.5%	- 7.1%
Turkey	30.0%	20.0%	- 33.3%
Average Reduction:			- 11.6%

Source: Tax Foundation calculations based on data from OECD Table II.1 and KPMG's *Corporate Tax Rate Survey 2007*

Cutting Corporate Tax Rates Doesn't Mean Cutting Revenue
Many would expect high tax rates to yield high tax revenues, but the reverse is often the case. Indeed, corporate tax rates for OECD countries are not a reliable predictor of corporate tax collections. In 2004 (most recent collection data), the countries with high corporate tax rates but low collections included the U.S., Germany, Italy and France. In 2004 only 18 of the 30 OECD countries matched high corporate rates with high corporate revenue or low corporate rates with low corporate collections.

Tax collection data from 2004, the most recent year for which data is final, show that OECD countries collected an amount equal to 3.1 percent of Gross Domestic Product (GDP) by

levying an average corporate tax rate of 29.7 percent. The U.S. rate (39.3 percent that year) brought in only 2.2 percent of GDP, well below the OECD average. Luxembourg and Australia levied rates near the OECD average, 30.4 and 30.0 percent respectively, but they collected the most revenue as a percentage of their GDPs.

A few years ago Germany was talking about forcing tax harmonization in the EU to stop corporate tax competition (mainly from their smaller neighbors in Central and Eastern Europe). That bullying strategy of forcing other nations' tax rates up hasn't worked, so Germany has joined in the competition, lowering its rates. Naturally, the lower Germany's rate—still the highest in Europe—the less resentful other European nations will be about the idea of harmonization.[5]

Conclusion: The U.S. Needs a New Corporate Tax Policy

The U.S. has the second-highest corporate tax rate in the OECD and is one of only two countries that have not reduced their rates since 1994. Despite its high corporate tax rate, the U.S. collects less revenue as a percentage of GDP than other OECD countries with lower rates.

U.S. lawmakers should look to lower the federal corporate tax rate by setting a target rate (likely in the range of 20 to 25 percent) that would give the U.S. a combined rate that equals the OECD average. This policy would have the following four benefits:

- It would enhance the competitiveness of our corporate tax system by reducing the effective tax rate borne by new investment in the U.S.
- U.S. multinationals would feel less pressure to engage in corporate inversions and other forms of profit-shifting.[6]
- U.S. companies would be more likely to reinvest foreign earnings in U.S. companies.
- State governments would feel less pressure to offer special tax preferences and credits in their efforts to attract new international business investment.

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, as the data from OECD show, a lower rate is not a guarantee of lower revenues.[7]

Notes

1. 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.

2. Rates levied by multiple layers of government are combined, taking deductibility into account. The highest rate in the U.S. is found in Iowa where the state rate is 12 percent and the combined federal-state rate is 42.8 percent.

3. Scott Hodge and Chris Atkins, "U.S. Lagging Behind OECD Corporate Tax Trends," *Tax Foundation Fiscal Fact,* No. 55 (May 5, 2006), located at http://www.taxfoundation.org/news/show/1466.html.

4. Henry M. Paulson, Jr., "Our Broken Corporate Tax Code," *Wall Street Journal* (7/19/2007).

5. Carter Dougherty, "Germany to Lower Corporate Tax Rate," *International Herald Tribune-Business* (November 2, 2006), located at http://www.iht.com/articles/2006/11/02/business/tax.php. In this article, Roland Koch, a negotiator for the Christian Democrat party, says that "There is no disagreement between the coalition parties that we have to tax companies differently than in past decades...(t)oday, we're exposed to international and European tax competition."

6. See, for example, Martin A. Sullivan, "Economic Analysis: A New Era in Corporate Taxation," 41 *International Tax Notes* 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.").

7. The federal corporate capital gains rate, currently levied at the same rate as ordinary federal corporate income (35 percent), is also ripe for reduction. A stand-alone reduction in the corporate capital gains rate would almost certainly lead to a short-term increase in revenues as companies sell assets that have been "locked-in" by the high capital gains tax rate.

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