

The U.S. Corporate Tax Code: Ripe for Bipartisan Reform

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Summary

- The U.S. corporate tax code is ripe for bipartisan reform—the U.S. has the highest corporate tax rate of any OECD country but collects some of the lowest federal corporate tax revenues as a share of GDP.
- A low-rate flat tax on the broad base of business value added, with minimal deductions, exemptions, exclusions or loopholes, would collect the requisite revenues while impeding prosperity the least. A low tax rate would give businesses little incentive to evade, avoid or otherwise not report taxable income.
- A lower U.S. corporate tax rate would lead to improved equity valuations by way of more companies locating in the United States, the companies that are here being more profitable, and increased employment leading to more money flowing into the stock market.

The recent bout of acrimonious political confrontation has placed personal income tax reform and reform of entitlements out of the reach of political compromise for at least two years. Corporate tax reform, however, faces no such obstacles. In fact, Republicans and Democrats have indicated that if any arena of compromise exists, it is in corporate tax reform. And there is a lot in corporate tax to reform.

For those of you who don't think bipartisanship is possible in today's Washington D.C., we'd like to remind you of a similar period in history when partisan rancor was equally as prevalent:

In the late 1970s, in the aftermath of Spiro Agnew's disgraced dismissal as Vice President and then President Nixon's forced resignation after Watergate revelations, Republicans had become an endangered species. The Democrats controlled all seven positions of political power: 1) the Presidency, 2) the Senate, 3) the House, 4)

the Supreme Court, 5) the Fed, 6) state governorships and lastly, 7) state legislatures. President Jimmy Carter pushed the U.S. sharply to the left.

By 1981, Ronald Reagan was President and the Senate too was Republican and radical changes were occurring in the House and state governorships and legislatures. In the Senate alone, Reagan's 1981 30 percent tax cut bill passed by a vote of 89 to 11 with only 10 Democrats voting against.

The 1986 tax cut, which dropped the highest income tax rate from 50 percent to 28 percent and dropped the highest corporate rate from 46 percent to 34 percent, passed the Senate by a vote of 97 to three with only three Democrats voting against. Today's political environment is no more rancorous or partisan than was the world of Jimmy Carter's America. It can be done now, just as it could be done then.

Economists far and wide agree that the current U.S. corporate tax code doesn't work. Today the U.S. has the highest federal statutory tax rate in the OECD at 35 percent and is also the only major country that taxes profits earned outside the U.S. at the U.S. tax rate when repatriated with a credit for foreign taxes paid. In turn, you won't be surprised that U.S. federal corporate tax revenue as a share of GDP is one of the lowest in the world at 1.2 percent in 2011. U.S. corporate profits held abroad (i.e. not repatriated) add up to over \$1½ trillion and are growing at about \$250 billion annually. And finally, in 1987 pass-through corporations such as LLCs and "S" Corps surpassed in number "C" Corporations and have nearly tripled relative to "C" Corps since then.

Objective experts and personally-involved participants to a person decry the enormously quixotic, complicated nature of the U.S. corporate tax code, which imposes massive costs on one and all for a mere pittance of net revenues. And, as if this weren't enough, the U.S. corporate tax code universally punishes success while often rewarding failure.

What the U.S. needs to do today is to revamp the U.S. corporate tax code by substituting a far broader tax base for corporate profits, eliminate all sorts of deductions, credits, write-offs and other loopholes, and lower the tax rate. In static terms, a 1½ percent tax rate on a value added tax base could fully replace all federal corporate tax revenues and create far higher GDP growth rates.

I. THE IDEAL CORPORATE TAX CODE

The U.S. Corporate net income, or profits, tax is truly an odd duck. While there is a crude logic for a progressive personal income tax that centers on the notion of a more even U.S. income distribution, no such rationale can be used for corporations or businesses.

Why on earth would anyone want to redistribute income from highly profitable companies to the corporate sector's biggest losers? They wouldn't. It's not like corporations are people after all. For people, rich people helping poor people, whether done voluntarily or not, is universally lauded. For corporations, it is just as likely that the shareholders of profitable companies have lower average incomes than do shareholders of profitless companies.

The very existence of a profits tax in the first place calls into question the criteria politicians use in choosing what to tax and how to tax it. Here in America today, we tax the living bejabbers out of profitable companies that produce highly desirable products at low cost if they eschew the use of fancy accountants, high-priced lawyers, lobbyists and other artificial favor-grabbers. At the same time we give bailouts, tax credits and subsidies to loser companies which inefficiently produce inferior products and populate their corporate offices with consultants, lawyers, accountants, lobbyists and influence-peddlers. Go figure!

The logical choice of a tax base for corporations would much more reasonably be a company's value added, i.e. its total use of scarce natural resources. Not only is the value added tax base more logical in the abstract, but it is also much more efficient to administer and much simpler and easier for the taxpayer to comply with. A value added tax base gets government out of the way of private business decisions all the while collecting the requisite revenues to carry out the functions government was commissioned to carry out.

Conceptually, the higher a tax rate is, the more likely an increase will actually reduce tax revenues. It is also true that the higher a tax rate is, the more damage to the economy an increase will create.

Likewise, the narrower the tax base, the more likely an increase in the tax rate applied to that base will reduce, rather than increase, tax revenues. Furthermore, for any given increase in tax revenue resulting from a tax rate increase, narrower tax bases will reduce prosperity more than broader tax bases.

And finally, the longer a tax increase has been in place, the less will be the increase in tax revenues and the greater will be the harm done to the economy.

Ideally a low-rate flat tax is the lowest tax rate on the broadest tax base for the long term and thereby such a tax system will have the greatest chance of raising tax revenues at the lowest cost to the overall economy.

For reporting purposes, businesses would only need to know their sales to whomever and purchases from other tax reporting entities. The value added tax base is simply sales minus purchases from other tax-reporting entities. As you can quickly see, capital expenditures, whether produced in-house or purchased from other companies, would be 100 percent expensable in the year of purchase. This value added tax is ideally suited to business because part of a business's *raison d'être* is to handle financial transactions. In fact, businesses already transmit some 80 percent of all federal taxes to the government even though businesses are liable for as little as 10 percent of all federal taxes.¹ Businesses are the tax collectors of choice. In other words, businesses are much better able to administer receipts and disbursements and keep financial records than is the average individual.

As a final point on this low-rate flat tax for business, the tax rate should be one single rate applied equally to all value added, and that tax rate should be sufficiently low so as not to unduly impede prosperity. There are convincing reasons to eliminate any and all deductions, exemptions or exclusions of any sort. Value added should be taxed once and only once, and all components of value added should be taxed at the same low tax rate from the first dollar to the last dollar. As Henry George wrote long ago:

THE BEST MEANS [emphasis in original publication] of raising public revenues will be one that meets these conditions:

1. It should bear as lightly as possible on production—least impeding the growth of the general fund, from which taxes must be paid and the community maintained.
2. It should be easily and cheaply collected, and it should fall as directly as possible on the ultimate payers—taking as little as possible from the people beyond what it yields the government.
3. It should be certain—offering the least opportunity for abuse and corruption, and the least temptation for evasion.
4. It should bear equally—giving no one an advantage, nor putting another at a disadvantage.²

Such a low-rate flat tax on business value added would also greatly encourage voluntary compliance and discourage tax evasion, avoidance, deductions, exemptions, exclusions, lobbying and other tax dodges. Because of a low tax rate, businesses would have little incentive to evade, avoid or otherwise not report taxable income. Tax reduction schemes just wouldn't be worth the hassle and the hoops that companies would have to jump through. And with such a broad tax base as value added would be, companies would have few easily-accessible places into which they could place their taxable activities to shelter them from the taxman. Considering personal income taxes, the IRS estimates that the noncompliance rate—the amount of tax liability for a given year not paid voluntarily and in a timely fashion as a percentage of the total “true” tax liability—is between 16.9 and 18.8 percent.³ One can only imagine how large the percentage of noncompliance is for corporations.

II. OUR CURRENT CORPORATE TAX CODE

But, for whatever reason, the United States corporate tax code has evolved into a misguided, highly arcane, complicated and confusing structure. Just read this quote, which comes from “Corporation Income Tax Brackets and Rates, 1909-2002,” an official IRS data release:

Because of the complexity of defining the income base subject to the corporation income tax rates, no attempt has been made to account for year-to-year changes in the base...The complexity is so great, in fact, that a history of the corporate tax base could not be summarized in an article such as this.⁴

And it's almost as if corporations act as prey and the tax community acts as predator. These two living organisms have co-evolved as a dynamically stable system to where they are today—joint products of survival of the fittest. What makes

the corporate/government nexus different from most biological systems is that in biological systems, individual predators and prey rarely morph into being members of the opposite group. In the case of the government/corporation nexus, individuals move seamlessly, instantaneously and frequently from one side to the other and then back again. No secrets can ever be kept. Self-dealing is the rule, not the exception.

In order to illustrate the dynamic interchange of the corporate/government nexus, we quote once again from “Corporation Income Tax Brackets and Rates, 1909-2002.” Income tax brackets have been “altered almost from year to year due to revised tax laws, changing accounting practices, and changes in the economy (not to mention the taxpayers’ ever-growing sophistication in tax avoidance).”⁵

In biological systems, survival of the fittest and counteracting defensive and offensive mutations work to advance life and are deliciously costly and deliberately wasteful. Biology doesn’t provide easy meals for anyone. When it comes to our present corporate tax system, there is an equivalent amount of waste and inefficiency when there shouldn’t be.

Costly tax systems that raise little revenue and yet lead to inefficient allocations of resources are anathema. What is needed in tax systems is low-rate flat taxes that do the least damage per dollar of revenue. It is far more cost effective to raise cattle commercially than it is to roam the forests hunting wild bovines. However, treating corporate taxation as a commercial enterprise is not what is happening today. In fact, what is happening today is almost the precise opposite. Our corporate tax code exacts the least amount of revenue at the highest tax rates and requires the largest regulatory overhead imaginable.

With a truly broad-based tax system there would be no deductions, exclusions or exemptions. The tax base would approximate total GDP. Therefore a federal tax rate in the range of 1½ percent would produce the same tax revenues as does our current corporate tax system with a highest statutory tax rate of 35 percent. Each additional percent increase in the value added tax rate would produce somewhere between \$125 and \$150 billion in tax revenues.

Not only do corporations squander vast resources trying to avoid (and evade) the corporate taxman, but the government also expends huge amounts of treasure trying to ensnare what they believe to be their rightful plunder. What ends up as a result of this titanic struggle is a tiny morsel left over to provide the wherewithal for government programs.⁶

Individuals and businesses must not only pay the government the taxes they owe, but they also are liable for the costs of their own time spent filing and maintaining all of their tax records and complying with the tax code. And then there are the tax collection costs of the IRS and the tax compliance outlays that individuals and businesses pay to tax professionals to help them file their taxes. And, lest we forget, there are always the pleasures and financial encumbrances incumbent upon an IRS audit.

In a study published by The Laffer Center, one of the authors (Laffer), along with colleagues Wayne Winegarden and John Childs, estimates that these costs for businesses and individuals alone were, as of 2008, a staggering \$431 billion annually. This is an out-of-pocket cost markup of 30 cents on every dollar paid in taxes. And this is not even a complete accounting of the costs of tax complexity.⁷ Compliance costs for corporations per dollar of tax revenue are most likely higher than they are for individuals.

Like taxes themselves, tax-compliance costs change people’s behavior. Taxpayers, whether individuals or businesses, respond to taxes and tax-compliance costs by changing the composition of their income, the location of their income, the timing of their income and the volume of their income. So long as the cost of changing one’s income is lower than the taxes saved, the taxpayer will engage in these types of tax-avoidance activities.

A complete accounting of compliance costs would also include the efficiency losses created when individuals and businesses invest in tax-avoidance activities that lower their tax liability at the expense of creating more jobs and economic growth. These lost opportunities are impossible to measure but could be the largest cost of all.

A tax reform of a simple low-rate flat tax with no deductions would significantly reduce the current complexity inherent in our progressive tax system, which is full of loopholes, exemptions and special interest carve-outs. Based on the estimates from the Laffer Center study, if a static, revenue-neutral flat tax reform were to reduce the tax complexity in half, the long-term growth in our economy would increase by around one-half of 1 percent per year.⁸

III. U.S. CORPORATE TAX HISTORY

But here is where we come to the crux of the matter. In the following pages we are going to attempt to describe to the reader that whether one views the U.S. corporate tax code in static terms, as it is today, or in dynamic terms over time or whether one views the U.S. corporate tax code as one of many corporate tax codes in the context of the world economy, the U.S. corporate tax rate, because it is too high, and the U.S. corporate tax base, because it is too narrow, have led to reduced corporate tax revenues to fund government and have greatly impeded economic growth and prosperity.

In the “Review of the Literature” section of this study, we cite the Strulik and Trimborn study at some length, but here we have a more brief quote where they state: “our general equilibrium analysis suggests that corporate taxes can be drastically reduced with little effect on total tax revenue and that the revenue-maximizing tax rate on capital gains is zero.”⁹ As you will see from our review of corporate taxation, Strulik and Trimborn are totally correct.

In Figure 1 on the next page we have plotted both the highest U.S. corporate statutory tax rate and corporate tax revenues as a percent of GDP from the mid-1930s to the present. While many important features are absent in such a broad span of time and at such a high level of abstraction, the picture created is informative.

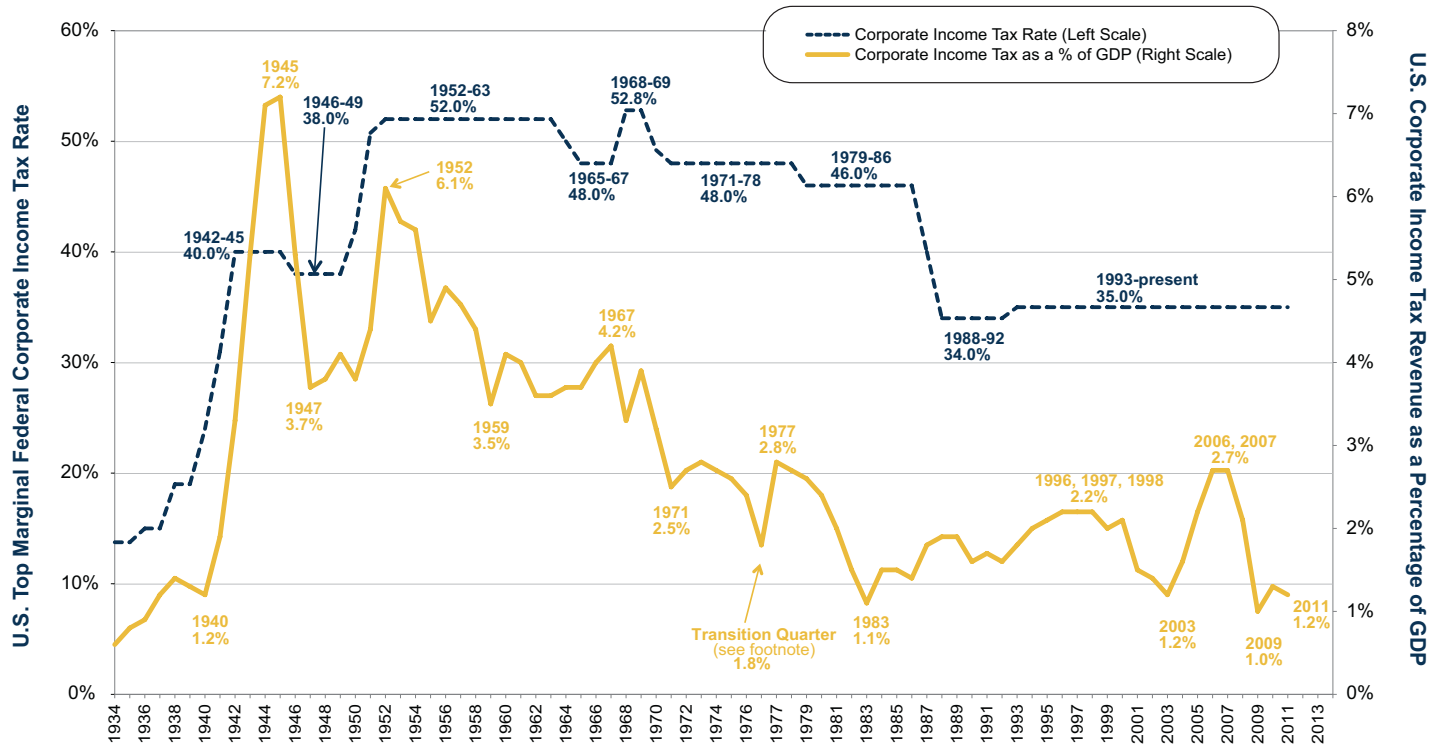
Just prior to the outset of World War II, the highest corporate statutory tax rate was increased stepwise to about 40 percent in 1942 from 13.75 percent in 1935. With increasing profits, especially war time profits, plus the increase in tax rates and excess profits taxes, corporate profits as a share of GDP jumped from 1.2 percent in 1940 to 7.2 percent in 1945. After the war the corporate tax rate dropped from 40 percent in 1945 to 38 percent in 1946, where it remained until 1950, while corporate tax revenues fell back to around 4 percent of GDP.

The highest statutory corporate profits tax rates rose again from 38 percent in 1949, stepwise to 52 percent in 1952, where it remained on through the 1960s. With the increase in tax rates, corporate tax revenues at first surged to 6.1 percent of GDP in 1952 and then started their steep decline to 1.1 percent of GDP in 1983.

The behavior of tax rates and tax revenues from 1952 through 1983 is one of the best examples of how incentives work in a political context; lobbyists interacting with politicians, accountants cooperating with corporate lawyers and ever-growing sophistication in tax avoidance leading to ever-lower tax collections. The bottom line here being that because of higher tax rates, corporate tax revenues as a share of GDP eroded substantially, going back to where they had been in the late 1930s when the highest corporate tax rate was in the range of 15 percent to 19 percent as opposed to the 46 percent it was in 1983. This is a perfect representation of the dynamic Laffer Curve applied to corporate taxation.

To illustrate just how sensitive U.S. corporate tax revenues are to tax rates since the early 1980s, take a look at the highest U.S. federal corporate income tax rate (Figure 1). The highest U.S. federal corporate tax rate was 46 percent until the 1986 Tax Act took full effect in 1988. By 1988, the highest U.S. federal corporate tax rate had dropped to 34 percent. That’s one heckuva large drop in a very short period of time. Since 1988 the highest federal corporate tax rate has remained amazingly stable at about 35 percent.

Figure 1
U.S. Federal Corporate Income Tax Revenue
as a Percentage of GDP vs. U.S. Top Marginal
Federal Corporate Income Tax Rate¹⁰
(annual, 1934 to 2011)



Switching now from tax rates to tax revenues, in 1983, federal corporate tax revenues were about 1.1 percent of GDP. Since the highest corporate federal tax rate's precipitous decline from 1985/86 to 1988, federal corporate tax revenues as a share of U.S. GDP seem to have risen a little. In 1996, 1997 and 1998 total U.S. federal tax revenues were 2.2 percent of GDP. Lower tax rates and a broader tax base did the job they were supposed to do, e.g. they made the tax code fairer and simpler and they made tax rates less punitive. And, *voilà*, the economy responded just as it should.

What one might wonder from the above discussion is, if the prohibitive range of the Laffer curve is alive and well, why didn't U.S. corporate tax revenues as a share of U.S. GDP rise by more than they did following the dramatic corporate tax rate reduction of the 1986 Tax Act? Again, basic economic forces were at work.

The 1986 Tax Act did significantly lower corporate tax rates in the U.S. But, as we discuss in the next section of this paper on U.S. corporation taxation in the context of the rest of the world, the 1986 Tax Act's huge benefits to the U.S. were followed by other countries' lowering their corporate tax rates, thus eroding some of the revenue-raising consequences of lower U.S. tax rates to U.S. corporations.

The 1986 Tax Act did two other things as well which turned out to be highly significant. The 1986 Tax Act reduced personal income tax rates. And just as U.S. taxable corporations (i.e. "C" Corps) compete with foreign corporations for reported taxable income, so too do U.S. corporations compete with U.S. individuals and other pass-through corporate tax forms ("S" Corps, LLCs, individual partnerships, farms, sole proprietorships, etc.) for reported taxable income.

The highest federal personal income tax rate fell first from 70 percent in 1980, to 50 percent in 1981 and stayed at 50 percent until the 1986 Tax Act passed and then finally to 28 percent in 1988. While prior to the 1986 Tax Act the highest corporate and personal income tax rates were roughly the same, after the 1986 Tax Act took full effect the highest corporate tax rate at 35 percent was quite a bit higher than was the highest personal income tax rate of 28 percent.

In addition to lowering corporate tax rates and personal income tax rates, the 1986 Tax Act broadened the corporate tax base by repealing the 50 percent net capital gains exclusion and by disallowing tax-free distributions of assets in liquidation. There were also substantial changes in real estate depreciation schedules, which also increased reported corporate taxable income in conjunction with lower corporate tax rates. In the vernacular of the times, the double taxation of corporate income increased substantially, all the while the corporate tax rate declined. Pass-through entities thus became more attractive.

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Individuals who owned corporations after 1988 were incentivized to reorganize their corporations into subchapter “S” corporations (now called “S” Corps), LLCs (limited liability corporations) and other corporate structures where income would be taxed only once at the personal level, collectively known as pass-through entities.¹¹ Even small, tightly-owned regularly taxed “C” corporations were able to increase payments such as dividends and salaries of shareholders to reduce corporate taxes and thereby turn themselves into de facto pass-through corporations. According to a recent report by the Joint Committee on Taxation,

The vast majority of businesses in the United States are organized for tax purposes as sole proprietorships. In 2009, there were more than 22.6 million nonfarm sole proprietorships out of 33.6 million total business returns. There were approximately 1.7 million C corporations, 1.9 million farms, 3.1 million partnerships, and 4.1 million S corporations. The number of passthrough entities surpassed the number of C corporations in 1987 and has nearly tripled since then, led by growth in small S corporations (those with less than \$100,000 in assets) and limited liability companies (“LLCs”) taxed as partnerships.¹²

IV. U.S. AND FOREIGN CORPORATE TAX PRACTICES

But the story of the U.S. corporate income tax cannot stand on its own. We live in a world economy, not as an island economy in isolation. The U.S. corporate sector is greatly impacted by the fact that the U.S. is one nation in a sea of nations. Corporations have choices. Corporations can and do operate across national boundaries, and taxes—specifically different countries’ corporate taxes—do affect corporate behavior.

There’s probably no proposition in economics more intuitive than if taxes are increased in location B and lowered in location A, businesses and people will move from B to A. Along with all the other ways businesses can reduce their tax burden, moving taxable activities from one tax jurisdiction to another tax jurisdiction based on effective tax rates is a surefire path to greater profitability. The current controversy over unrepatriated foreign-held corporate profits by U.S. corporations is a striking example of just how corporations do take advantage of different national tax jurisdictions. As it so happens, the United States is the only major country that taxes U.S. corporate profits that have been earned and taxed abroad a second time when they are repatriated to the U.S. The U.S. as

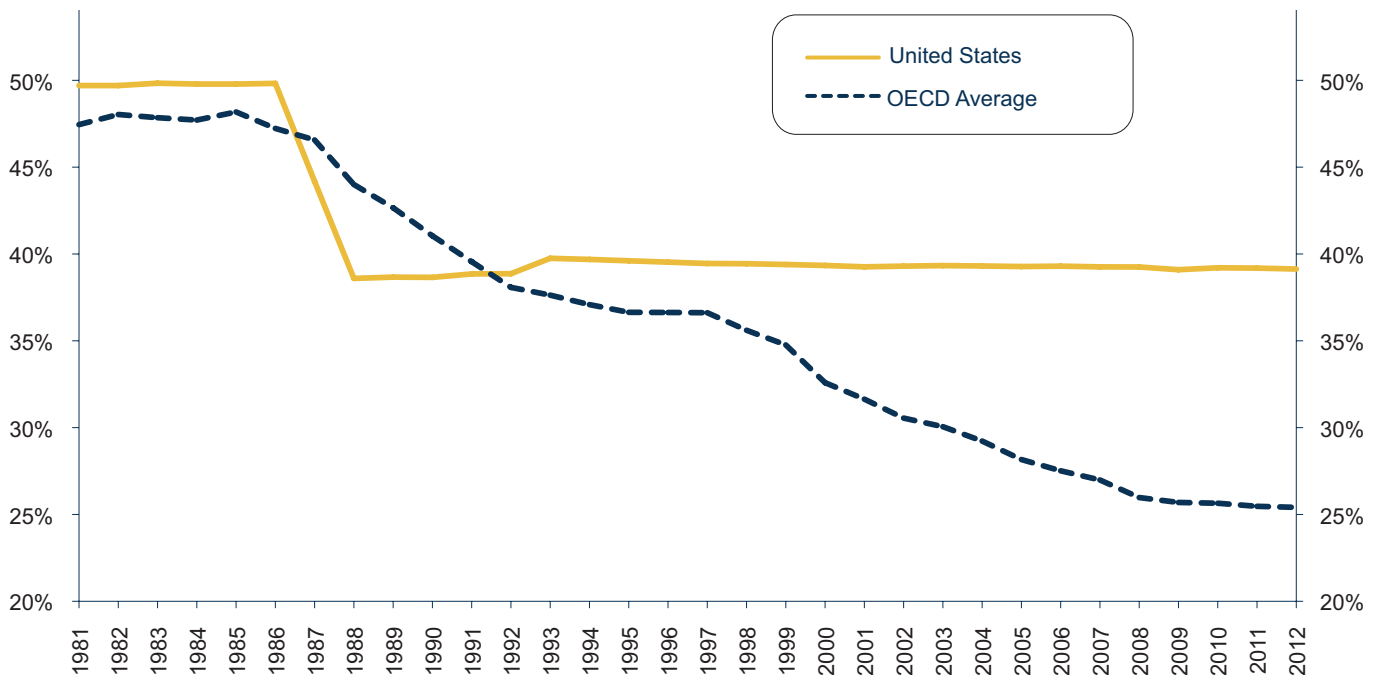
of today also has the single highest corporate tax rate in the entire world. Therefore, no matter where the corporation earned its profits and paid local taxes, there will be additional tax liabilities once those profits are repatriated to the U.S.

Double taxing U.S. corporate profits earned and taxed abroad puts U.S. businesses at a distinct cost disadvantage versus corporations chartered in other countries. Is it any wonder why today there are some \$1.7 trillion in unrepatriated U.S. corporate profits? That figure is growing by some \$300 billion annually.¹³ The U.S. policy of taxing foreign earned profits of U.S. corporations after they have already been taxed abroad is not only unfair, but it leads to reduced tax revenues and lessened U.S. growth. In the words of *Wall Street Journal* business writer Kate Linebaugh,

In accounting terms, the location of the funds may be just a technicality. But for people on both sides of the contentious debate over corporate-tax reform, the situation highlights what they see as the absurdity of rules that encourage companies to engage in semantic games, legal gymnastics and inefficient corporate-financing methods to shield profits from U.S. taxes.¹⁴

In Figure 2 below we have plotted the U.S. and the average of the OECD's highest statutory federal, state and local corporate tax rates for major countries from 1981 on up to 2012.¹⁵

Figure 2
Top Statutory Tax Rates:
United States vs. OECD¹⁶
(annual, 1981 to 2012)



Source: OECD

What is fascinating is how globally competitive U.S. corporations became after the 1986 Tax Act took full effect and then how U.S. corporations lost their competitive edge on the world scene in the years following, up to the point where today U.S. corporate tax rates are literally the highest in the world (see Table 1).

Table 1
U.S. vs. International:
Highest Statutory Combined Corporate Income Tax Rate
(Federal, State and Local) and
Corporate Income Taxes (again Federal, State and Local)
as a Share of GDP ¹⁷

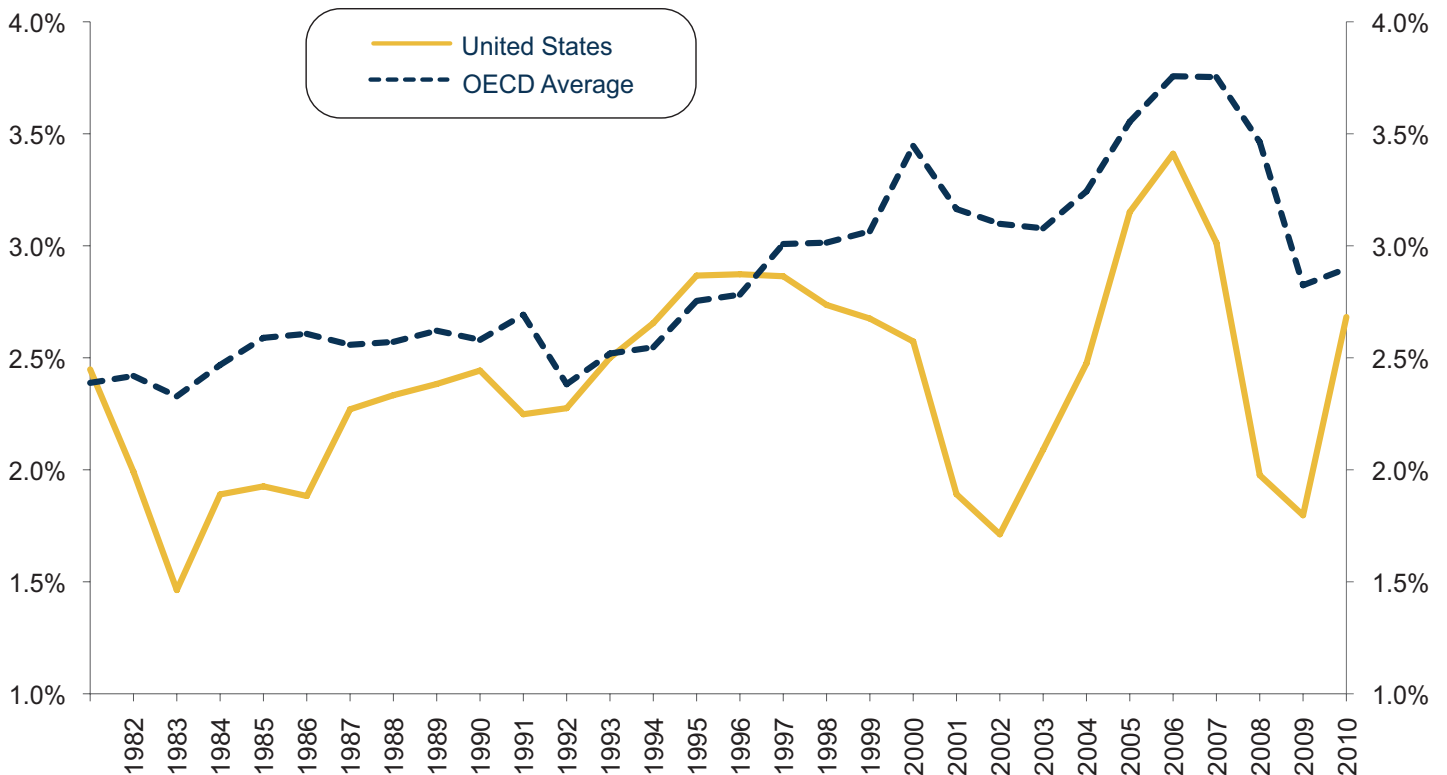
2012	Rate	2010	Revenue as a % of GDP
UNITED STATES	39.13%	Norway	10.10%
Japan	37.00%	Luxembourg	5.74%
France	34.43%	Australia	4.75%
Belgium	33.99%	New Zealand	3.85%
Portugal	31.50%	Sweden	3.48%
Germany	30.18%	Korea	3.48%
Australia	30.00%	Czech Republic	3.40%
Luxembourg	28.80%	Canada	3.31%
New Zealand	28.00%	Japan	3.21%
Norway	28.00%	United Kingdom	3.05%
Italy	27.50%	Israel	2.91%
Sweden	26.30%	Switzerland	2.88%
Canada	26.14%	Portugal	2.84%
Austria	25.00%	Italy	2.83%
Denmark	25.00%	Denmark	2.74%
Israel	25.00%	Belgium	2.70%
Netherlands	25.00%	UNITED STATES	2.68%
Korea	24.20%	Ireland	2.53%
United Kingdom	24.00%	Netherlands	2.17%
Switzerland	21.17%	France	2.14%
Czech Republic	19.00%	Austria	1.93%
Hungary	19.00%	Germany	1.51%
Ireland	12.50%	Hungary	1.23%

Source: OECD

What is highly interesting, to us at least, is that the U.S. lost its competitive edge not by the U.S. raising corporate tax rates but by a corporate tax rate cutting epidemic all around the non-U.S. world. The rest of the world out-Reaganned America after Reagan left office. Corporate tax rate cuts work for foreigners as well as Americans, *n'est-ce pas?* Maybe what America needs is a Ouija board to bring President Reagan back.

The revenue consequences of other countries dropping tax rates on their respective corporate sectors is also noteworthy. In Figure 3 on the next page, corporate tax revenues as a share of GDP are again presented for the average of major OECD countries for the period 1981 to the present. Again, the picture is clear—foreign corporate tax rates fell relative to U.S. tax rates, and U.S. corporate tax revenues fell relative to GDP both absolutely and relative to other countries. Don't give us any guff about the existence of the prohibitive range of the Laffer curve. There it is in black and white.

Figure 3
Corporate Income Tax Revenues as
a Share of GDP¹⁸
(annual, 1981 to 2010)



Source: OECD

To summarize, the history of U.S. corporate taxation shows that higher corporate tax rates raise revenues in the short run, but then economics takes hold and tax revenues fall dramatically in the ensuing years. At the end of the process, high tax rates are associated with low tax revenues and low tax rates with high tax revenues.

The same result is even more clear in cross-country comparisons. As of today, the U.S. has the single highest corporate tax rate in the world and one of the lowest tax revenues. This just says it all.

V. REVIEW OF THE LITERATURE

In a recent paper entitled “Corporate Income Tax Elasticity...,”¹⁹ one of the authors of this paper (Laffer) with two other authors provided a partial review of the literature on the revenue and output effects of changes in the U.S. statutory corporate tax rate.

In general, simple logic would lead one to expect that a) the narrower the tax base—and the corporate tax base is narrow—the more likely revenues will be in the elastic range with respect to taxation, b) the higher tax rates are—and here again U.S. corporate tax rates are the highest in the world—the more likely revenues will be in the elastic range and finally c) the longer the time period analyzed—and here the authors reviewed quite a long time horizon—the more likely tax revenues are in the elastic range with respect to tax rates. No surprises here.

The authors reported the following:

In Deveraux’s Oxford Study (2006), it was found that “[w]hile the average corporate tax rate in a sample of 20 OECD countries had fallen over the period 1965-2004, the level of corporate tax revenues as a percentage of GDP had risen. Previously-higher corporate tax rates had encouraged businesses to employ debt financing, to reduce the domestic share of reported profits, and to shift to non-corporate legal entities.”²⁰

The Clausing Study (2007) “...of 29 OECD countries over the period from 1979 to 2002 found a parabolic relationship, consistent with a Laffer curve, between tax rates and tax revenues and concluded that lowering corporate tax rates would increase tax revenues.”²¹

The Brill and Hassett Study (2007) “...of 29 OECD countries for the period 1980 to 2005 (using five-year subsamples and adjusted top marginal tax rates to include federal, state and local taxes, with offsets in the federal rates for payments of state and local taxes) showed that the revenue-maximizing corporate income tax rate had declined steadily, from close to 34 percent in 1987 to near 26 percent in 2003 and that the lost-tax-revenue penalty from having rates above the peak (or in the elastic portion of the curve) had increased sharply in recent years.”²²

When it comes to the impact of corporate tax rate changes on economic growth, the authors reported the following:

Three OECD Studies (2008), plus studies by Arnold and Schweltnus (2008) and Vartia (2008) found “[t]he burden of corporate taxes exceeds the tax revenue raised due to the often-hidden negative effects on savings, investment, productivity, labor supply, and costs of compliance and administration,” and, “[p]er dollar of revenue raised by the government, the corporate income tax imposes a greater penalty on economic growth than any other tax studied.”²³

The Lee and Gordon Study (2005) found, “[i]n study of a sample of 70 countries between 1970 and 1997, higher corporate tax rates were associated with lower per capita GDP growth, both across countries and within the same country over time.”²⁴

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A World Bank Study (2010) and a study by Djankov (2010), “[c]oncluded that raising corporate tax rates by 10 percentage points in a sample of 85 countries would have the effects of lowering investment by 2.2 percentage points as well as entrepreneurial activity, including reducing gross fixed capital formation as a percent of GDP, reducing direct investment by foreign investors; and reducing the entry rate for new firms.”²⁵

In a Joint Committee on Taxation Study (2005), “JCT analyzed three proposals to reduce taxes by \$500 billion over the period from 2005-2014: (1) cut individual income taxes; (2) increase the personal exemption; (3) decrease the corporate income tax rate. JCT concluded that reducing the US corporate income tax rate has the greatest effect on long term growth because the stock of productive capital accumulates and leads eventually

to higher labor productivity,” and, “[r]esults were based on simulations using Macroeconomic Equilibrium Growth (“MEG”) and Tax Policy Advisers’ overlapping generations (“OLG”) life cycle models.”²⁶

But a more recent paper, “Laffer Strikes Again: Dynamic Scoring of Capital Taxes,” by Strulik and Trimborn reviewing the effects of changes in corporate tax rates on tax revenues and output is even more definitive. In the abstract of their refereed article in the *European Economic Review*, Holger Strulik and Timo Trimborn write: “We find, among other results, a self-financing degree of corporate tax cuts of about 70-90% and a very flat Laffer curve for all capital taxes as well as for tax depreciation allowances. Results are strongest for the tax on capital gains. The model predicts for the U.S. that total tax revenue increases [emphasis added] by about 0.3 to 1.2 percent after abolishment of the tax.”²⁷

Later on they write “comparing steady-states we obtain a degree of self-financing of 1 percent for the dividend tax, 47 percent for the tax on private interest income, and 89 percent for the corporate income tax. For the capital gains tax the predicted degree of self-financing is 445 percent, indicating that the U.S. is on the wrong side of the Laffer curve... We predict that corporate taxes and capital gains taxes could be abolished with little or no negative impact on tax revenue.”²⁸

They also go on and state: “Whether taxes affect long-run growth is still debated. That taxes affect the level of income per capita, however, as suggested by the neoclassical growth model, is theoretically undisputed and empirically well supported; for recent studies see Romer and Romer (2010) and Mountford and Uhlig (2008).”²⁹

In the fifth section of their paper “Dynamic scoring: quantitative results,” they go on and write: “The corporate tax cut, in contrast, is immediately effective in producing a primary self-financing effect of 40 percent through restructuring of firm finance and assets held [sic] by

households. Instantly, primary and total self-financing almost coincide. Over time, however, the expansive power of induced growth adds further self-financing through taxes collected from other sources (through the generally higher scale of the economy). This means that self-financing of tax cuts on corporate income is already positive in the short-run and gets even larger over time.”³⁰ And, “The most striking result... is perhaps the robustness of the self-financing degree for corporate tax cuts. This figure varies between 88 and 95 percent when we compare steady-states and between 71 and 78 percent when we include adjustment dynamics.”³¹ And,

In general, our estimates are more robust for capital taxation compared to labor taxation, a result that we share with Trabandt and Uhlig (2010). This can best be seen by inspecting the aggregate tax cut of all capital taxes. The predicted self-financing degree varies “only” between 66 and 74 percent, whereas the self-financing degree of labor tax cuts is estimated to vary between 35 and 70 percent.³²

As if more quotes were needed, turning to section 6 of their paper, “Dynamic Laffer curves,” they write: “It is more interesting, however, to explore the Laffer curve in the other direction, towards lower taxes. Here our results predict that taxes can be reduced to a large extent with little consequence on revenue,”³³ and, “we can thus ‘only’ conclude that the corporate tax could be reduced by about 14 percentage points without any significant consequence on tax revenue,”³⁴ and, “For capital gains taxation we find, strikingly, that there exists no interior maximum of the Laffer curve for the US. The Laffer curve is continuously falling. While dynamic scoring has already suggested that the US is on the wrong side of the Laffer curve, we now find that there is just one side of the Laffer curve. The revenue-maximizing capital gains tax is zero.”³⁵

VI. THE IMPACT OF OUR CORPORATE TAX RATE

As companies exist to generate after-tax profits for shareholders, it is simply a matter of arithmetic that taxes play a large role in the decision those companies face as to where to locate. As shown in Figure 2, corporate tax rates across the globe have fallen dramatically over the past 30 years, yet they have remained flat in the United States for 25 years. The data indicate that the relatively high U.S. tax rate is inuring to the detriment of the United States. A 2011 Ernst & Young study shows that in 2001 the United States was the headquarters location for 179 Fortune Global 500 companies, while in 2011 that number had fallen to 133 companies. Forty-six companies, just over 25 percent of all Fortune Global 500 companies located in the United States as of 2001, have left the U.S. for what they consider to be greener pastures elsewhere.

Meanwhile, Japan, which for much of that time period was the highest corporate income tax country in the world, lost the second highest number of Fortune Global 500 headquarters at 39, declining from 107 to 68. This outmigration means that Japan went from holding 21.4 percent of the world's 500 largest companies in 2001 to holding only 13.6 percent of the world's 500 largest companies in 2011. While there are a number of issues other than tax rates that affect those counts, E&Y concluded their study as you would expect by writing: "The data show that policymakers should carefully consider the effects of their tax and regulatory policies on the international competitiveness of their headquartered companies if they wish to retain those companies."³⁶

The movement of companies from high-tax areas to low-tax areas is also true within the United States. Over the last decade, there has been a decided movement of company headquarters toward lower-tax states, just as there has been toward lower-tax countries. The number of Fortune 500 companies headquartered in the seven states with the highest corporate income tax rates decreased by nine from 2001 to 2012, whereas the number of Fortune 500 companies headquartered in the seven states with the lowest corporate income tax rates increased by six over the same time period.

Table 2
Fortune Global 500 Companies in High Corporate Income Tax Rate States and Low Corporate Income Tax Rate States: 2001 vs. 2012

High Tax States	2001	2012	Change
Pennsylvania	24	23	-1
New York	55	50	-5
Oregon	2	2	0
Delaware	3	2	-1
Iowa	2	3	1
Minnesota	16	19	3
Illinois	38	32	-6
Total	140	131	-9
Low Tax States	2001	2012	Change
Colorado	4	9	5
Texas	45	52	7
Alabama	7	1	-6
North Dakota	0	0	0
Nevada	3	4	1
South Dakota	1	0	-1
Wyoming	0	0	0
Total	60	66	6

Source: Fortune

We also have terrific data in the United States on the economic performance of states. As you might imagine by now, those states with the highest state corporate income tax rates have seen people and production move to those states with lower corporate income tax rates. Table 3 presents the latest comparison over the past 10 years for the seven states with the lowest corporate income tax rates compared to the seven states with the highest corporate income tax rates. The economic performance in those states with the lowest corporate income tax rates was significantly better.

Table 3
7 Lowest Corporate Income Tax Rates vs.
7 Highest Corporate Income Tax States
(growth rates 2001-2011 unless otherwise noted)

State	Top CIT Rate*	Gross State Product Growth	Population Growth	Net Domestic Migration, 10-Yr. Sum as a % of Population**	Nonfarm Payroll Employment Growth	Personal Income Growth	Total State & Local Tax Revenue Growth***
Nevada	0.0%	64.9%	29.8%	11.1%	18.1%	54.1%	74.0%
South Dakota	0.0%	59.1%	8.7%	1.4%	12.4%	72.5%	48.9%
Wyoming	0.0%	100.7%	14.9%	4.6%	18.9%	76.2%	131.3%
North Dakota	3.3%	110.9%	7.0%	-0.7%	21.5%	90.2%	96.7%
Alabama	4.2%	44.1%	7.5%	2.0%	5.9%	49.6%	41.1%
Texas	4.6%	71.5%	20.4%	3.7%	20.5%	65.7%	65.6%
Colorado	4.6%	46.0%	15.6%	3.7%	9.0%	44.1%	55.1%
7 States with Lowest CIT^	2.39%	71.03%	14.85%	3.68%	15.18%	64.63%	73.24%
50-State Average^	7.17%	51.41%	9.54%	0.87%	7.62%	49.42%	49.79%
7 States with Highest CIT^	11.92%	50.07%	6.58%	-0.86%	4.99%	44.58%	41.75%
Illinois	9.5%	37.7%	3.0%	-4.9%	0.7%	35.6%	33.4%
Minnesota	9.8%	45.2%	7.3%	-1.2%	4.5%	43.3%	34.1%
Iowa	9.9%	58.3%	4.4%	-1.2%	4.7%	54.0%	47.7%
Delaware	10.0%	50.7%	14.0%	5.0%	6.9%	46.1%	36.7%
Oregon	11.3%	73.1%	11.6%	4.6%	6.5%	43.2%	39.5%
New York	16.0%	43.1%	2.0%	-8.2%	7.2%	47.0%	56.8%
Pennsylvania	17.1%	42.3%	3.6%	-0.1%	4.5%	42.8%	44.1%

* Highest marginal state and local corporate income tax rate imposed as of 1/1/12 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable. ** Sum of 2002-2011 net domestic migration as a % of 2011 population. *** 2000-2010

^ equal-weighted average

Source: Bureau of Economic Analysis, U.S. Census Bureau, Laffer Associates

On average, the seven states with the lowest marginal corporate income tax rates saw state GDP growth rates that were 21 percentage points higher than the highest corporate tax rate states, employment growth that was more than 10 percentage points higher and population growth that was 8 percentage points higher. Tax revenue growth exceeded the national average by over 23 percentage points for the seven lowest corporate income tax rate states and exceeded the average for the states with the highest marginal corporate income tax rates by over 31 percentage points.

With the exception of one or two anomalies in each category of metrics, the results are overpowering. Lower corporate tax rates are associated with higher state GDP growth, more rapid employment growth, increased population growth,

stronger personal income growth, and larger domestic in-migration, all without any (let alone catastrophic) revenue shortfall growth. Once again, common sense economics is confirmed by the facts.

The lesson is clear: low corporate income tax rates encourage economic growth, and the tax revenues, if anything, are enhanced, while high marginal corporate income tax rates discourage economic growth.

In addition, corporate tax rates have a big impact on the value of companies. First, in static terms (e.g. revenues and costs remain exactly the same), an increase in tax rates means less after-tax income. In and of itself, this arithmetic effect makes any profitable company less valuable. But there is also a dynamic, or economic, effect of tax rate changes driven by a change in incentives. For instance, when companies consider whether or not to invest in a new project, they calculate the net present value of the after-tax cash flows generated by that project. If tax rates are increased, the expected after-tax cash flows of any investment decrease, meaning companies will invest in fewer projects, employing less labor and less capital, leading to an overall lower level of prosperity in the economy and lower market capitalization of companies.

A lower U.S. corporate tax rate would thus lead to improved equity valuations by way of more companies locating in the United States, the companies that are here being more profitable, and increased employment leading to more money flowing into the stock market. And, the Treasury would gain as well, as the lower tax rate would generate increased tax revenues. Corporate tax reform truly is a win-win-win.

Endnotes

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- 10 For this chart, we have used tax rates from the IRS and tax revenue data from the Office of Management and Budget (OMB). OECD data used in parts of this paper do not allow us to examine corporate tax rates before 1981 or corporate tax revenues as a percentage of GDP before 1965. We compared the OMB/IRS data to the OECD data for overlapping periods and found the OMB/IRS data points to be lower in both tax rates and tax revenues as a percentage of GDP, but very close and moving in sync with each other. Much of the difference in level is likely due to OECD data taking into account federal, state and local tax rates and revenues, while the OMB/IRS data only account for federal rates and revenues. The “transition quarter,” occurred from July-September of 1976 and fell between the end of fiscal year 1976 and the beginning of fiscal year 1977. The transition quarter was necessary because the federal fiscal year changed from running from July 1 to June 30 of each year (for years before the transition quarter) to running from Oct 1 to Sep 30 of each year (for all years after the transition quarter).
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