The Myths and Mysteries of the Corporate Income Tax

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Musgrave Lecture

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Introduction/Motivation (1)

- The debates around the CIT have migrated from the academy to the political and popular square
- In that process, the debate has become dominated by a number of “myths” – pieces of conventional wisdom that are taken to be true – but are not well-grounded in reality…
- And, the debate has neglected the more interesting questions – the “mysteries” – that should dominate the discussion

Introduction/Motivation (2)

- We have begun catering to these myths and, in the process, neglected the mysteries

"Unlike some economic purists of today, I admit to more than a scientific motivation… the conduct of government is the testing ground of social ethics and civilized living. Intelligent conduct of government requires an understanding of the economic relationships involved; and the economists, by aiding this understanding, may hope to contribute to a better society. This is why the field of public finance has seemed of particular interest to me; and this is why my interest in the field has been motivated by a search for the good society, no less than by scientific curiosity."

Musgrave, *The Theory of Public Finance*

Quoted in Sinn

Myths and Mysteries

Myths

1. The CIT is broken
2. The digitization of the economy is an existential threat to the CIT
3. Transfer pricing is an existential threat to the CIT
4. The CIT is an effective tool for redistribution

Mysteries

1. The CIT is part of a larger capital taxation question
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Myth No. 1: The CIT is broken (1)

For the last three decades, we have heard about the fatal flaws of the CIT…Most recently…

- IMF: “The international corporate tax system is under unprecedented stress” “Apparently profitable firms pay little tax” “Tax competition remains largely unaddressed” “These difficulties will only increase.”

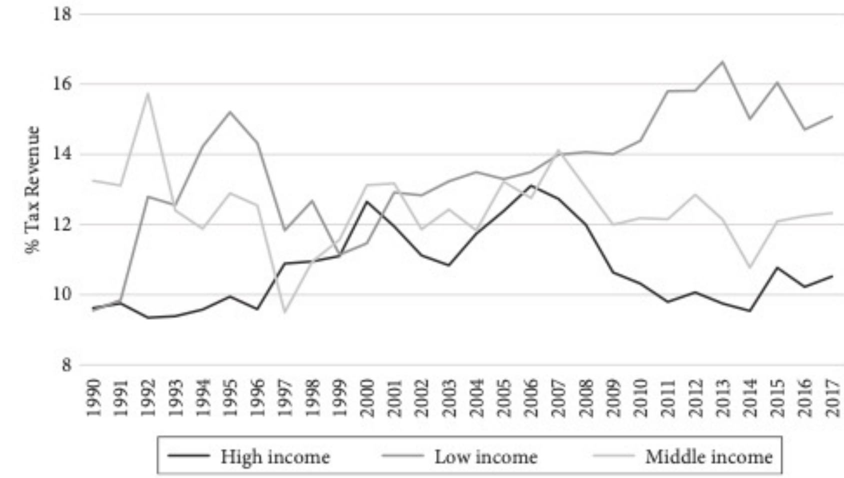
- Oxford Group: “there is a widespread perception that the system is no longer acceptable...A key complaint voiced by governments, international organizations, and tax campaigners…a number of developed countries have voiced their dissatisfaction …The commonly held view that large multinational businesses…the existing system performs badly under our criteria. It distorts real activity thus causing economic inefficiency, it is susceptible to avoidance, it is extremely complex and thus expensive to administer and comply with, and it is not incentive compatible”

Myth No. 1: The CIT is broken (2)

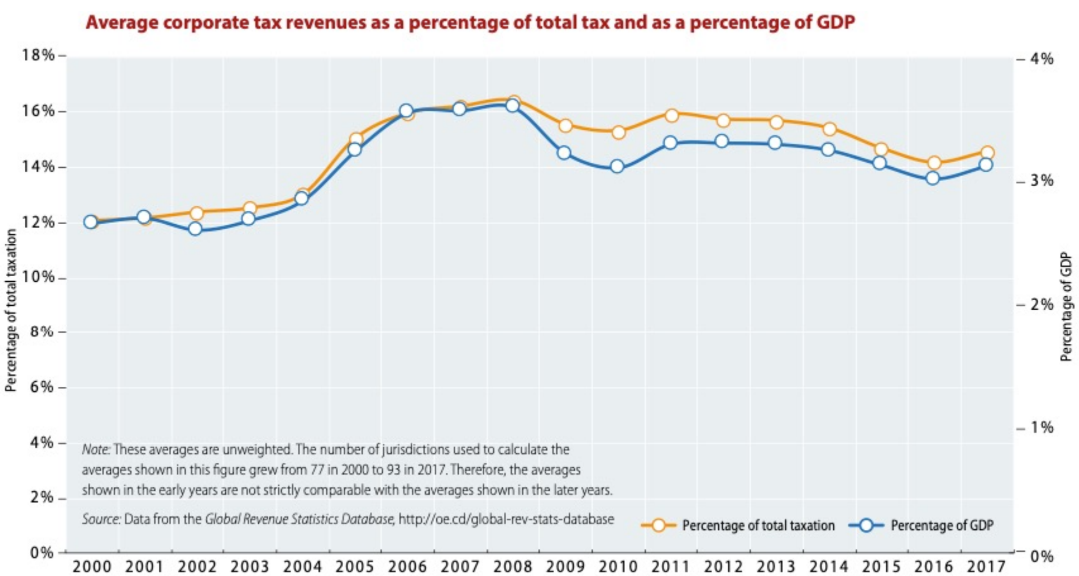
- Various reform efforts are predicated on the CIT being broken
  - Abolition of the CIT
  - DBCFT (transformation into a subtraction-method VAT)
  - Transformation into a regulatory tool
  - Multilateral cooperation required because it’s broken
  - DSTs/DPTs
  - Abandoning ALP
- But is any of this true?

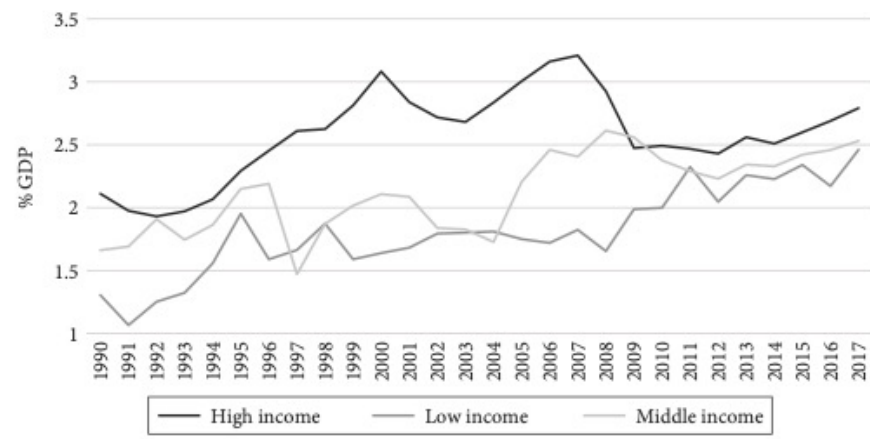
Myth No. 1: The CIT is broken (3)

- It is difficult to find a collection of countries where revenue from the corporate tax is declining – let alone broken...
- The sky is not falling – to say the least.



Corporation tax revenues as percentage of total tax revenues: median of non resource-rich countries, 1990–2017
Source: IMF WoRLD Database





Corporation tax revenues as percentage of GDP: median of non resource-rich countries, 1990–2017
Source: IMF WoRLD Database

OECD, "Corporate Tax Statistics, Second Edition."

Devereux, Auerbach, Keen, Oosterhuis, Schön, and Vella, *Taxing Profit in a Global Economy*.

Myth No. 1: The CIT is broken (4)

- More perversely, doomsayers are hastening the eventuality they purport to regret – propagating these fears give rise to precisely the behavior that might actually harm the CIT
  - Eroding broad trust in CIT
  - Distinctive and incompatible anti-avoidance regimes
  - DSTs
  - Undercutting ALP without reasonable alternatives
  - Unilateral actions that could give rise to double taxation

Myth No. 1: The CIT is broken (5)

- An alternative hypothesis: The U.S. system was broken prior to TCJA and it gave rise to pathologies that were manifest globally…
  - The actions of U.S. MNEs were problematic but were also isolated and overblown in the imagination
  - This does not mean that the CIT is broken
  - And, it does not mean that those pathologies will persist past that broken regime
- In short, we are fighting last year’s battle…

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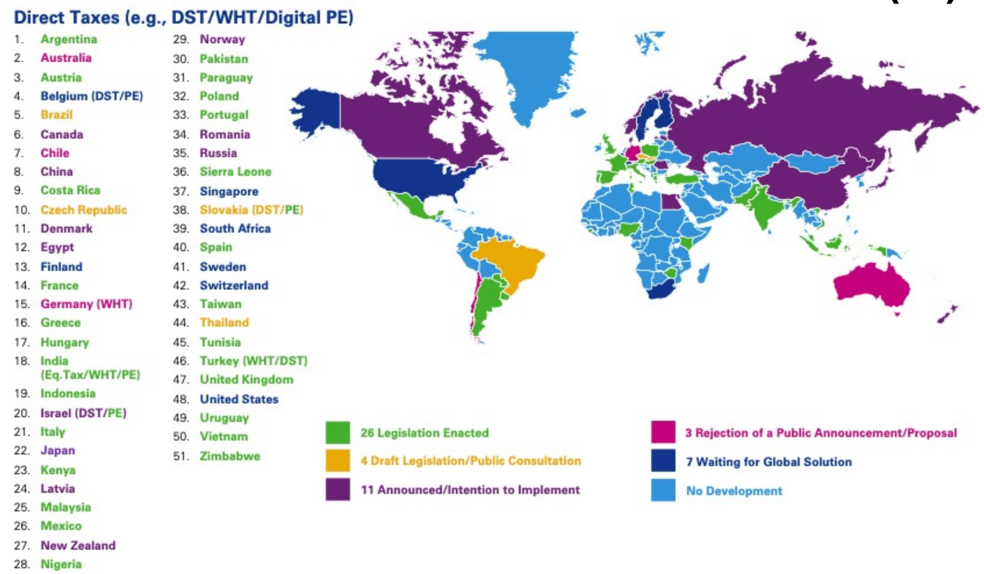
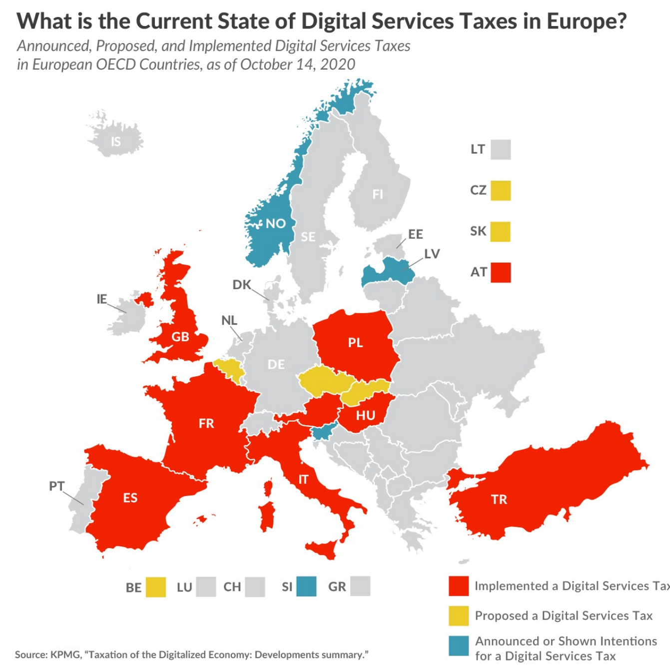
Myth No. 2: Digitization is an existential threat to the CIT (1)

- IMF: “The [problems associated with digitization – the lack of physical presence and free business models] are, however, becoming far more pervasive and salient, suggesting a pragmatic case for action.”

- EC: “Being grounded in the concept of physical presence, the current corporate tax rules no longer fit the modern context…The current situation is clearly unsustainable in an increasingly globalised and digitally connected world, where ever more activity is moving into the digital space. Failure to address this situation will lead to more opportunities for tax avoidance, negative impact on social fairness…and it will destabilise the level playing field for businesses.”



KPMG, “Taxation of the digitalized economy: Developments summary.”

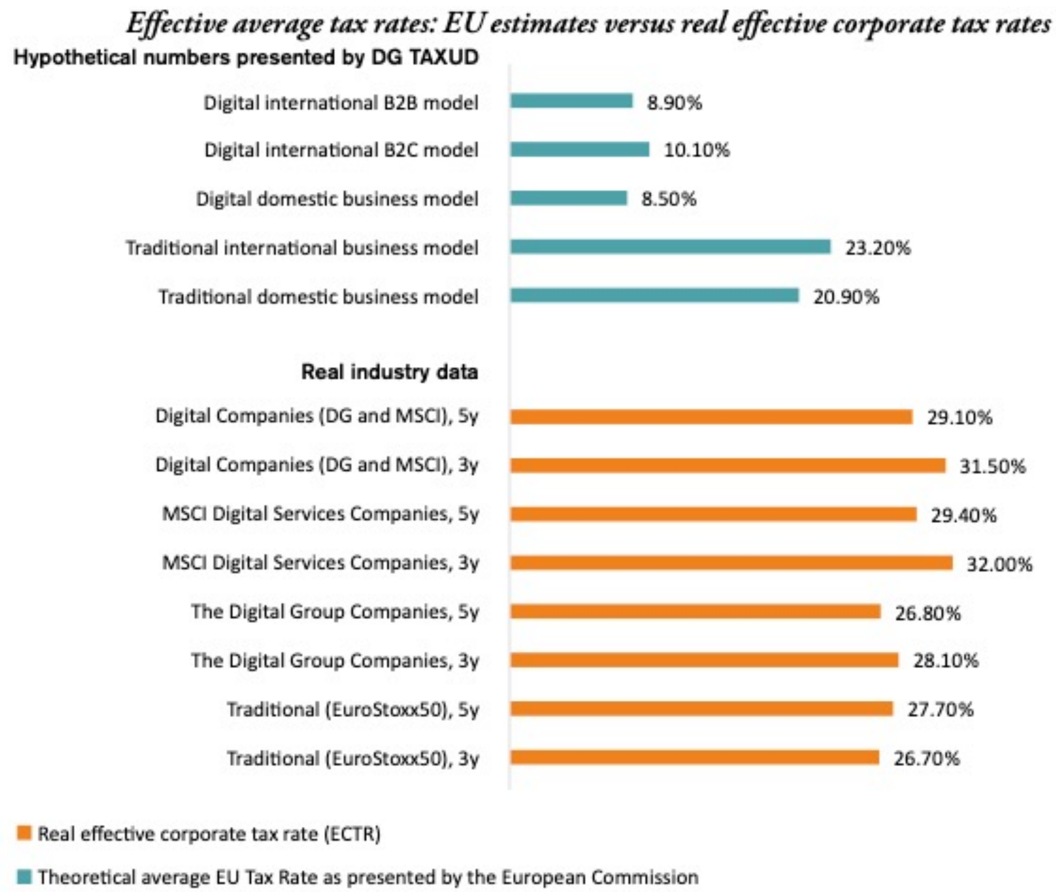


Tax Foundation, “What European OECD Countries Are Doing about Digital Services Taxes.”

Myth No. 2: Digitization is an existential threat to the CIT (2)

- Little evidence that digitization has reduced reported profits or taxes from the information industry…

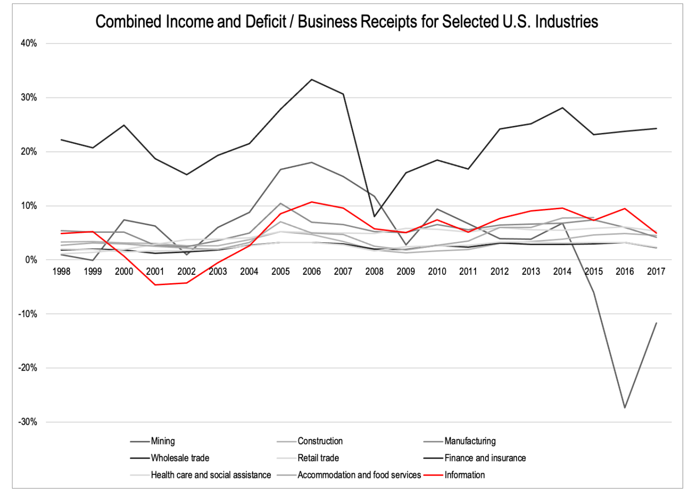
- Bauer: "It is digital companies that show the highest effective corporate tax rates—not traditional companies…real-world data for effective corporate tax rates suggest that there is no systematic difference in income taxes paid by digital corporations compared to their traditional peers."

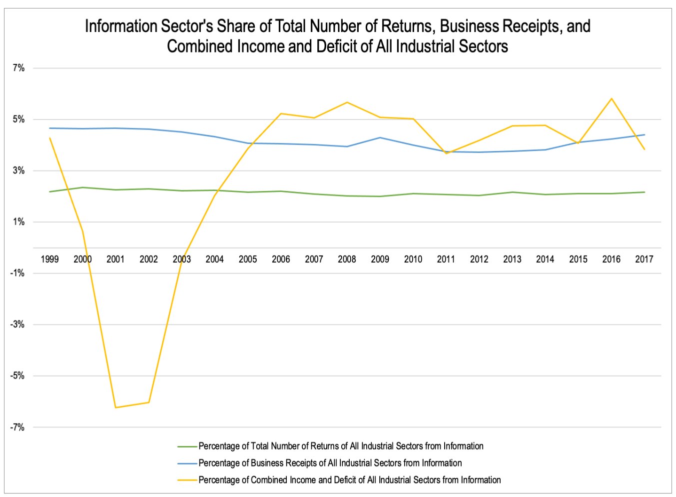


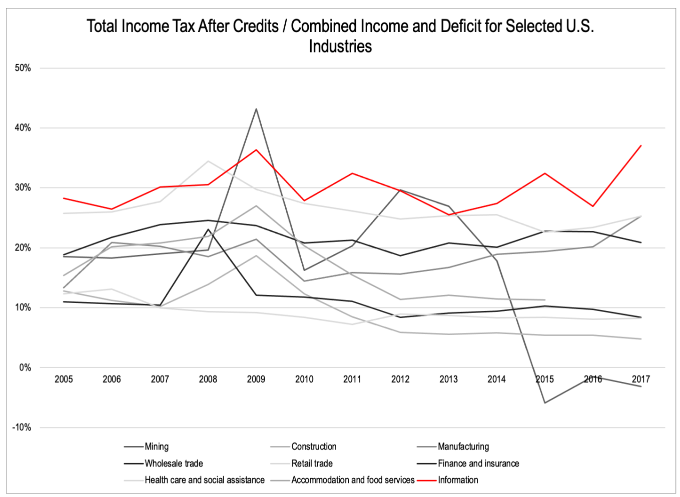
Bauer, "Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions."

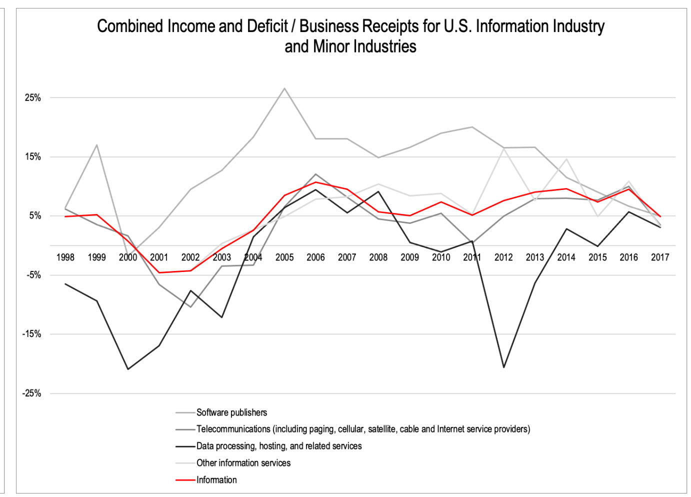
Myth No. 2: Digitization is an existential threat to the CIT (3)

In the U.S., the information industry has performed steadily in terms of share of profitability, actual profitability, and taxes paid – and within the information industry, there is no evidence of digitization leading to lower reported profitability or lower taxes paid









Bottom left: IRS, "SOI Tax Stats – Historical Table 14b," for 1999-2013; IRS "SOI Tax Stats – Corporation Complete Report" Table 1 (Part 1 of 2): Returns of Active Corporations, for 2014-2017.
All others: IRS "SOI Tax Stats – Returns of Active Corporations – Table 1," for 1998-2013; IRS "SOI Tax Stats – Corporation Complete Report" Table 1 (Part 1 of 2): Returns of Active Corporations, for 2014-2017.

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Myth No. 3: Transfer pricing is an existential threat to the CIT (1)

- IMF: “Revenue losses from profit shifting have been substantial for many advanced economies—and even more so for developing countries.”

- Oxford Group: “The commonly held view that large multinational businesses are able to exploit loopholes in the tax system feeds the broader view that the system is rigged in favour of the rich, which in turn undermines trust in the wider tax system and fuels populism on the left and the right…Whatever the overall empirical estimates, however, tax avoidance remains of critical importance.”

- Tørsløv, Wier and Zucman: “Leveraging this differential profitability, we estimate that close to 40% of multinational profits are shifted to tax havens globally.”

Myth No. 3: Transfer pricing is an existential threat to the CIT (2)

At a minimum, this debate is completely unsettled – Experts in this area consider the risk and revenue loss typically bandied about to be highly exaggerated.

- Blouin and Robinson: “Failing to exclude equity income double counts foreign affiliate profits…When we adjust the BEA income measures for equity income, we document estimates of revenue losses that are significantly lower than current estimates. We conclude that many of the existing estimates in the academic literature are significantly overstated.”

- Dharmapala: “In the more recent empirical literature, which uses new and richer sources of data, the estimated magnitude of BEPS is typically much smaller than that found in earlier studies.”

- Hines: “The statistical evidence consistently indicates that the impact [of BEPS] on tax revenues is only modest in magnitude…it appears that even a complete solution to the problem of BEPS, were one available and implementable, would have little direct impact on government finances.”

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Myth No. 4: The CIT is an effective tool for redistribution (1)

Fairness has become a dominant framing for the CIT – and is framed as a means of achieving progressive redistribution

- Hodge: "People are furious that while they are working hard and paying their fair share, big corporations are cheating the system to avoid paying theirs. These companies enjoy the benefits of our public services and infrastructure, so they should make a fair contribution towards funding them."

- Le Maire: "When the largest digital multinationals don't pay their fair share of tax, the rest of us end up paying more."

- Oxford Group: "A tax on business profit (at least at a business level) [is] a weak instrument in the design of a fair and progressive tax system. In aiming for a fair and progressive tax system, it is less suitable than taxes levied directly on better off individuals—on their income, wealth, or transfers—as long as such taxes are feasible to implement and administer."

Myth No. 4: The CIT is an effective tool for redistribution (2)

- How did a tool with unclear incidence become so clearly a tool for progressive redistribution? The most recent available evidence suggests that any such presumption is faulty.
- And, how can one suggest that a DBCFT is more "fair" than the CIT given the incidence of a consumption tax with sizable and unknown effects on wage contracts and exchange rates? Under what SWF?

  - Fuest, Peichl and Siegloch: "We find that workers bear about one-half of the total tax burden…we show that low-skilled, young, and female employees bear a larger share of the tax burden."
  - Suárez Serrato and Zidar: "Firm owners bear roughly 40 percent of the incidence, while workers and landowners bear 30-35 percent and 25-30 percent, respectively."
  - Baker, Sun and Yannelis: "We find the incidence on consumers, workers and shareholders is 31%, 38% and 31%, respectively…a one percentage point increase in the corporate tax rate leads to a 0.17 percent increase in retail product prices…The effects are larger for lower-price items and products purchased by low-income households."

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Mystery No. 1: The CIT is part of a larger capital taxation question (1)

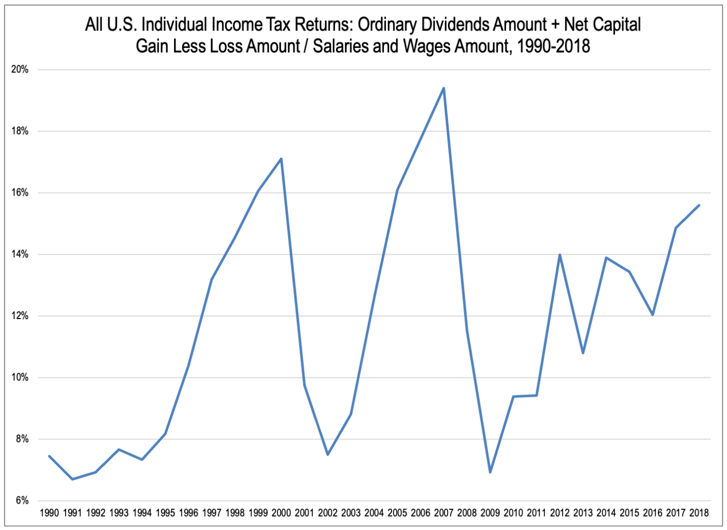
- The broken CIT narrative has become divorced from the more important rationale of (and underlying relationship to) capital taxation more generally—that is, if the CIT is about taxing capital income at the entity level because of a realization based system, then talking about the CIT alone is unhelpful

- Reconnecting to capital taxation makes a discussion of fairness more coherent and addresses important trends—the dramatic rise of tax-exempt investors and the rising importance of capital gains and dividends relative to labor income

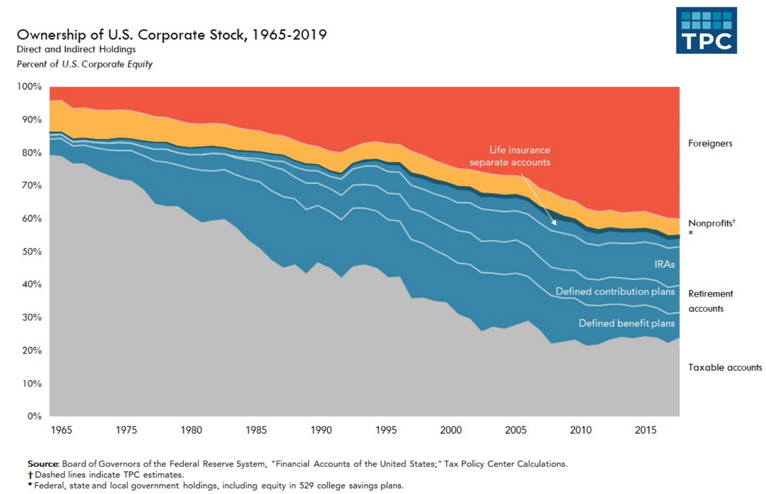
- What are implications of the DBCFT, for example, for the overall question of capital taxation?

Mystery No. 1: The CIT is part of a larger capital taxation question (2)

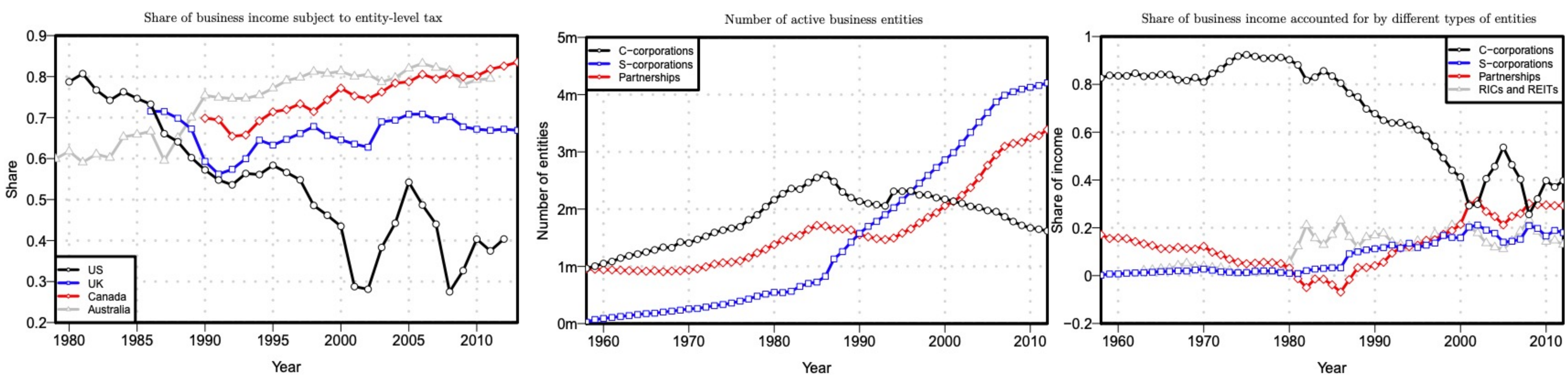
The rise of tax-exempt investors, the increased ratio of (KG+Div)/(Sal+Wage) and the declining importance of C-corps all indicate that such emphasis on the CIT is misplaced – and missing the more important questions



IRS, "SOI Stats – Individual Income Tax Returns Publication 1304 (Complete Report)."



Rosenthal and Burke, "Who Owns US Stock? Foreigners and Rich Americans."



Clarke and Kopczuk, "Business Income and Business Taxation in the United States Since the 1950s."

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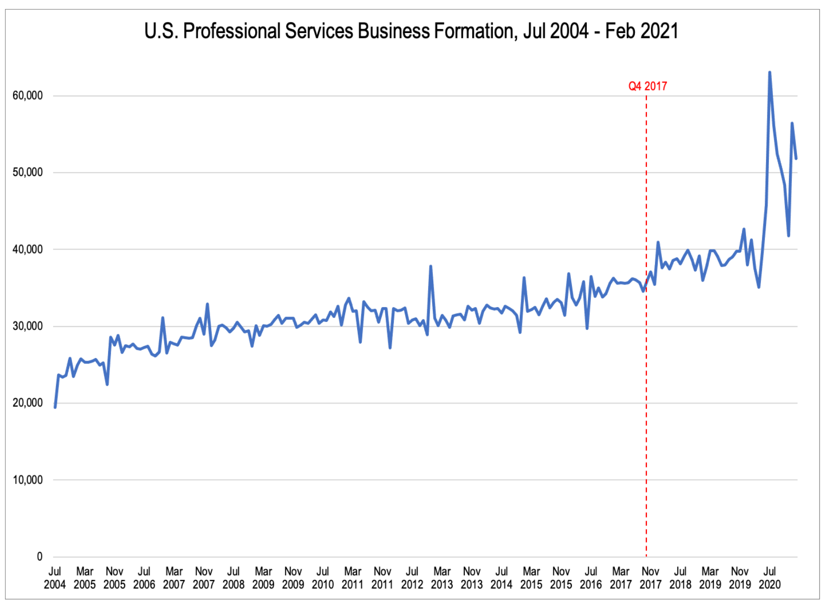
Mystery No. 2: The CIT is primarily about identity, not investment (1)

- Investment is overemphasized as a margin that is impacted by the CIT in a world of shorter equipment lives, expensing, and debt financing

- Identity – reclassifying labor income (as in studies of income inequality), organizational form (as in demise of C-corporations), relocating via M&A (as in inversions) and the relationship to governance – is the underemphasized aspect of the CIT



United States Census Bureau, "[Business and Industry: Time Series/Trend Charts](#)."

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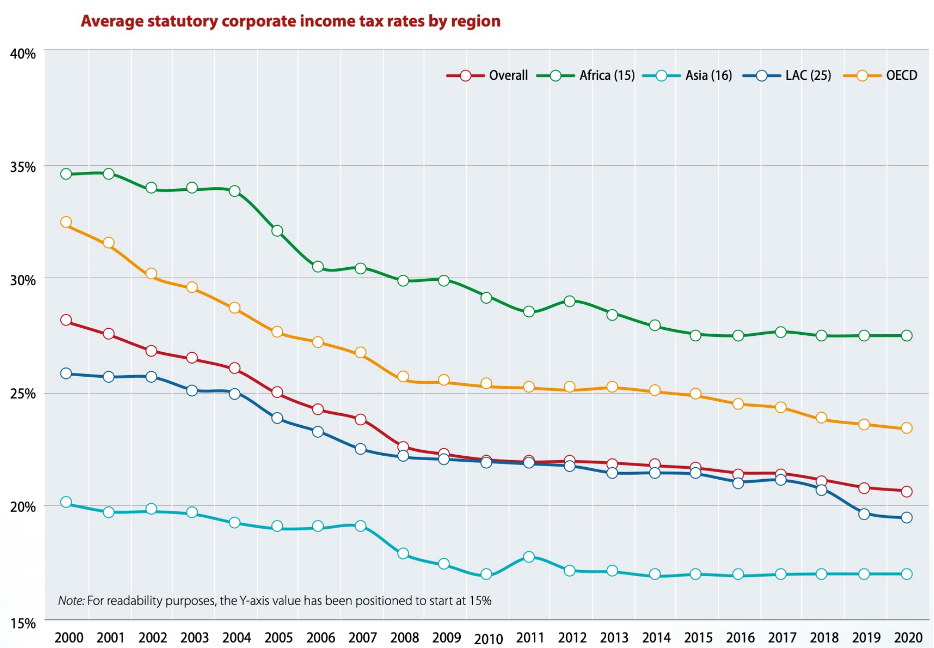
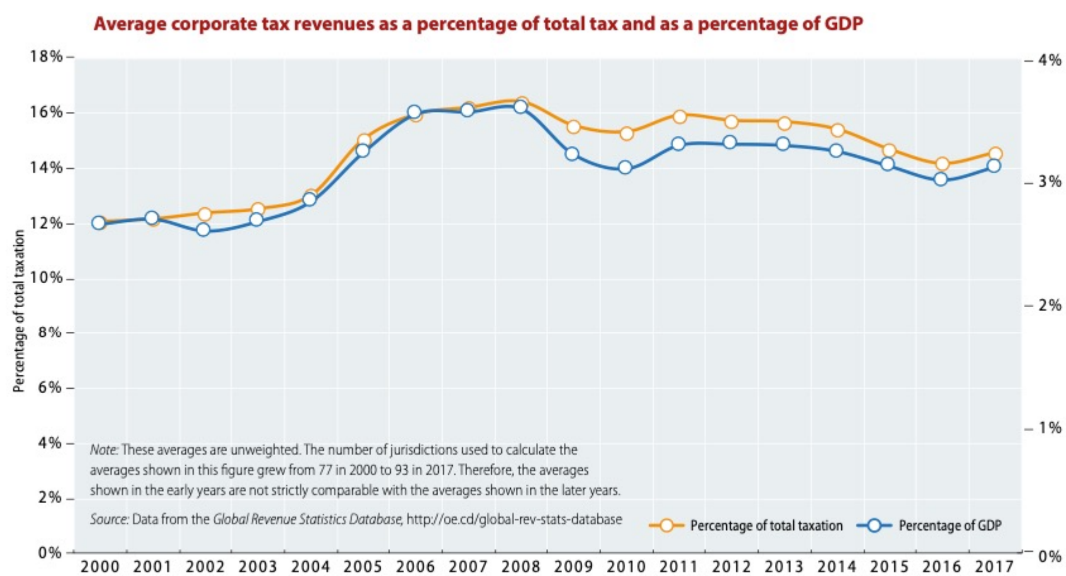
Mystery No. 3: The success of corporate tax reforms over the last thirty years (1)

If thirty years ago, one would have envisioned a world of substantially lower statutory rates and a steady share of revenue for the CIT, many would have considered this a resounding success…

How did it happen?

What can we learn from it?



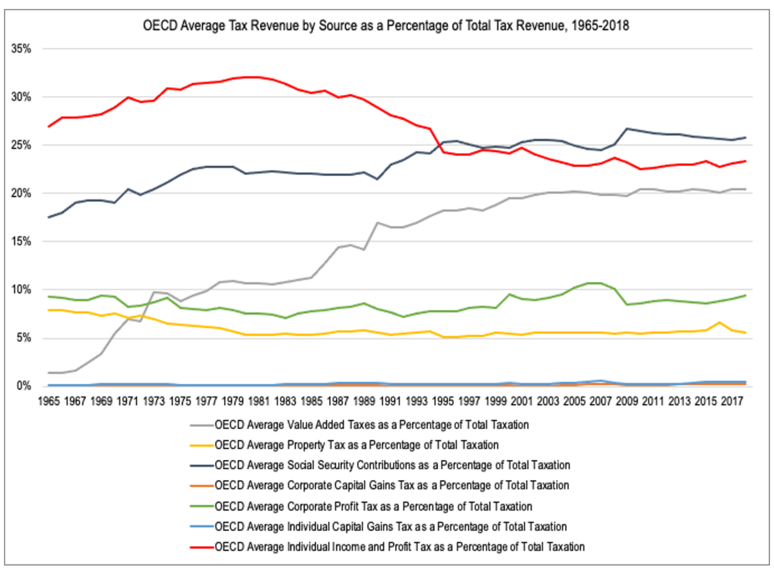


OECD, "Corporate Tax Statistics, Second Edition."

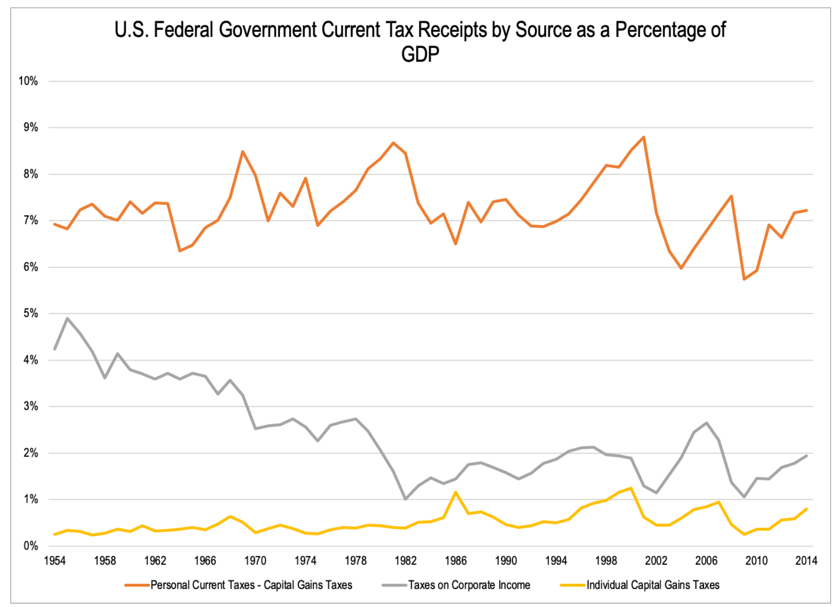
Mystery No. 3: The success of corporate tax reforms over the last thirty years (2)

If anything is broken, it is the personal income tax – the first order story in the OECD is the rise of consumption taxes and the weakness of the individual income tax

In the U.S. over the last thirty years, we have seen an increasing reliance on capital gains for the individual income tax and steady corporate income tax – and a surprisingly volatile revenue collection from individual income tax



OECD, "Revenue Statistics."



FRED, "Federal government current tax receipts: Personal current taxes"; FRED, "Federal government current tax receipts: Taxes on corporate income"; FRED, "Gross Domestic Product"; Tax Policy Center, "Historical Capital Gains and Taxes."

Conclusion

Myths

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- At a first approximation, the corporate tax is not broken…the problems were a manifestation of a problematic U.S. regime – we are fighting yesterday's battle
- Repeatedly pronouncing its demise doesn't serve us well as it accelerates unhelpful trends, is founded on questionable readings of the data and feeds populist sentiment
- The interesting mysteries of the CIT – how it fits into capital taxation more broadly, how it changes identity and how it is succeeding – are obscured by a preoccupation with these myths

Appendix Myth 1 (1)

Devereux, Michael P., Alan J. Auerbach, Michael Keen, Paul Oosterhuis, Wolfgang Schön, and John Vella. *Taxing Profit in a Global Economy*. Oxford, United Kingdom: Oxford University Press, 2020.

International Monetary Fund Fiscal Affairs Dept. and International Monetary Fund Legal Dept. "Corporate Taxation in the Global Economy." Washington, D.C.: International Monetary Fund, March 2019.

OECD. "Corporate Tax Statistics, Second Edition." Paris, France: OECD, 2020.

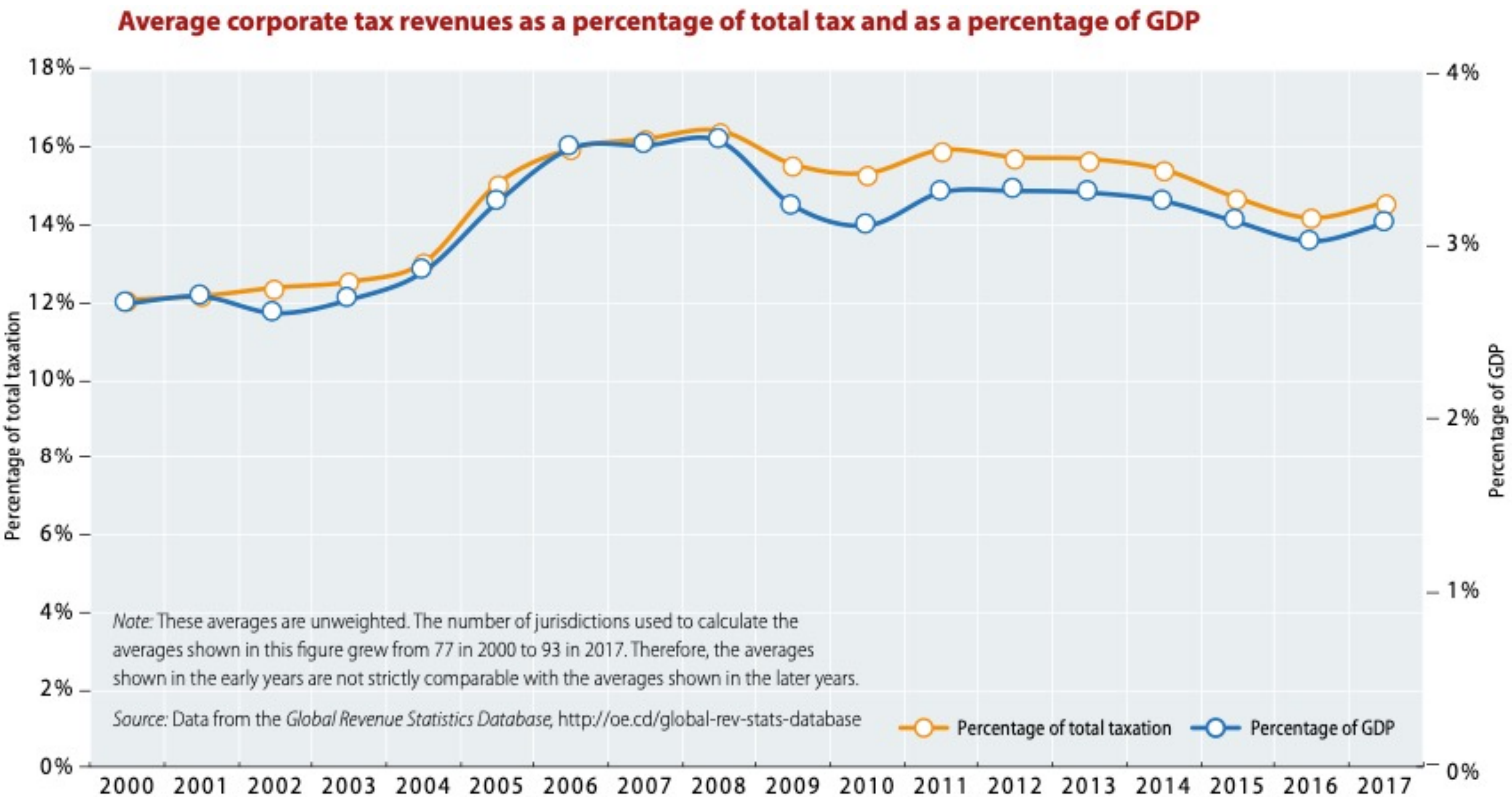
OECD. "Revenue Statistics 2020: Tax revenue trends in the OECD." Paris, France: OECD, 2020.

Data Sources

"State and Local Finance Data: Exploring the Census of Governments." Urban Institute.

- "These data come largely from the US Census Bureau's Census of Governments and Annual Survey of State and Local Government Finances; additional data are from the US Bureau of Economic Analysis and the US Bureau of Labor Statistics."

Appendix Myth 1 (2)



OECD, "[Corporate Tax Statistics, Second Edition](#)."

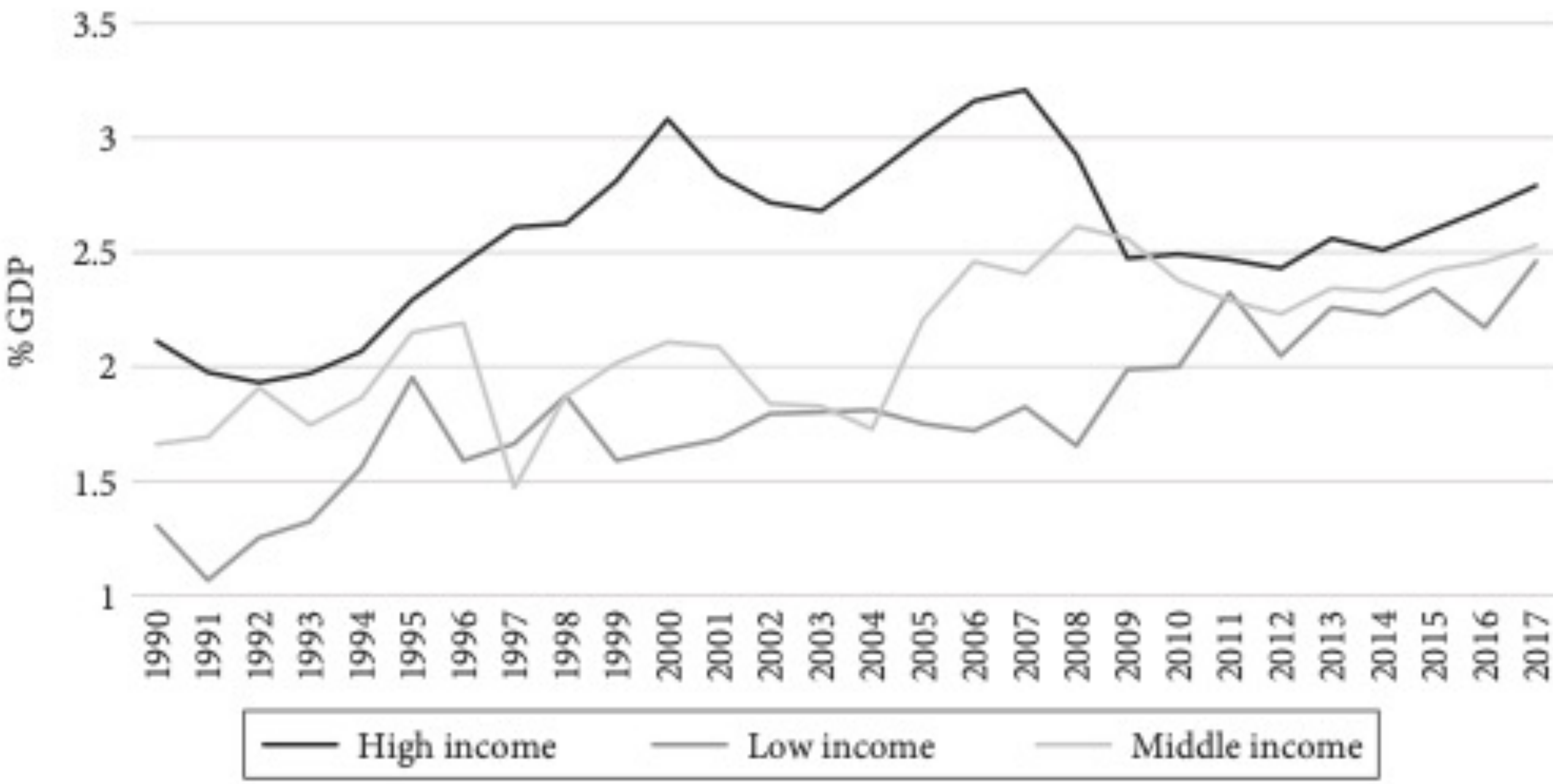
Appendix Myth 1 (3)

Corporation tax revenues as percentage of total tax revenues: median of non resource-rich countries, 1990–2017

Source: IMF WoRLD Database

Devereux, Auerbach, Keen, Oosterhuis, Schön, and Vella, *Taxing Profit in a Global Economy*.

Appendix Myth 1 (4)



Corporation tax revenues as percentage of GDP: median of non resource-rich countries, 1990–2017

Source: IMF WoRLD Database

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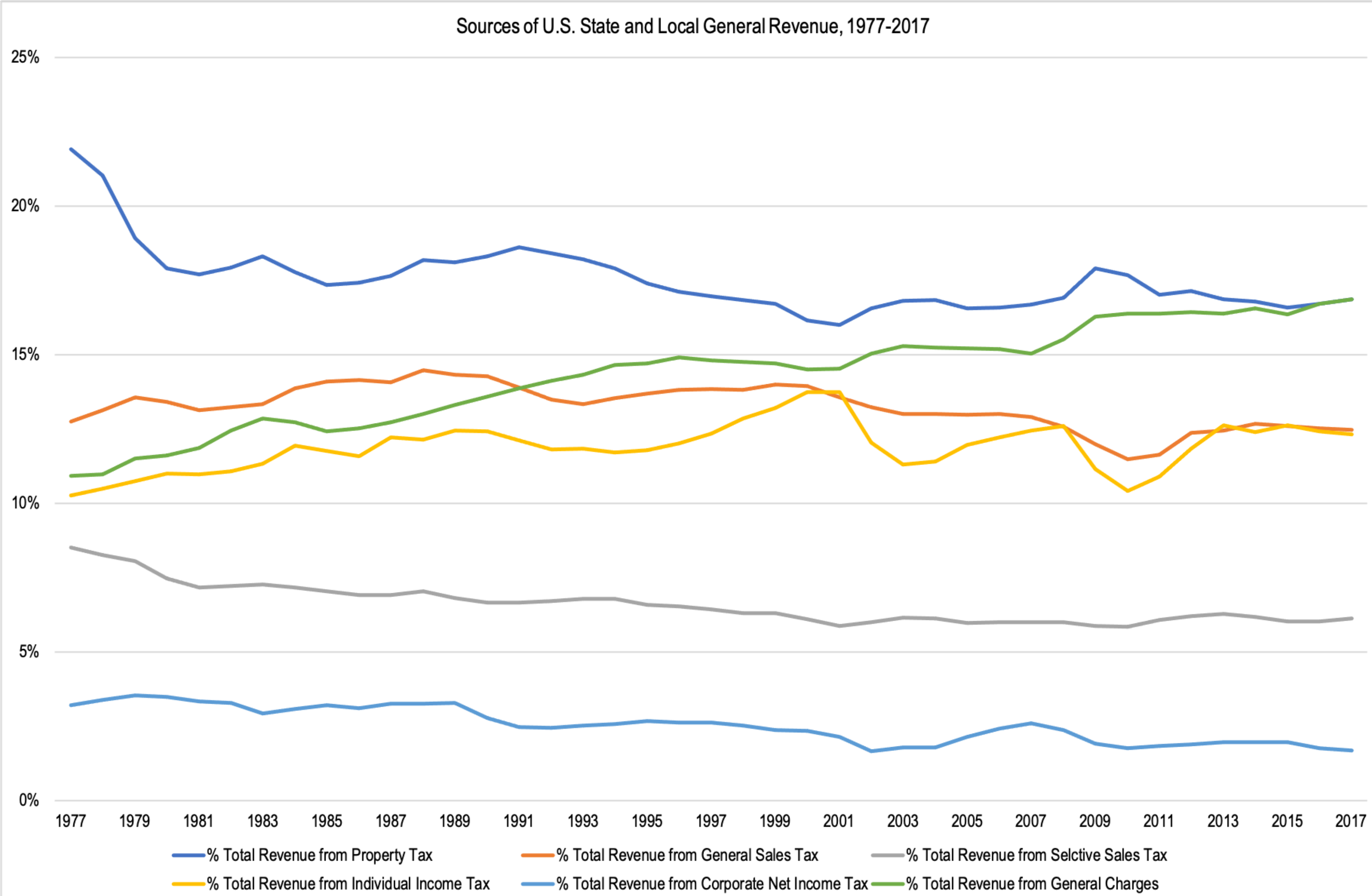
Appendix Myth 1 (5)



"[State and Local Finance Data: Exploring the Census of Governments](),” Urban Institute.

Appendix Myth 2 (1)

Asen, Elke. "What European OECD Countries Are Doing about Digital Services Taxes." Tax Foundation. October 14, 2020.

Asen, Elke, and Daniel Bunn. "Patent Box Regimes in Europe." Tax Foundation. November 26, 2020.

Bauer, Matthias. "Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions." *ECIPE Occasional Paper*, (March 2018).

European Commission. "Commission Staff Working Document Impact Assessment: Fair taxation of the digital economy." Brussels, Belgium: European Commission, March 21, 2018.

International Monetary Fund Fiscal Affairs Dept. and International Monetary Fund Legal Dept. "Corporate Taxation in the Global Economy." Washington, D.C.: International Monetary Fund, March 2019.

KPMG. "Taxation of the digitalized economy: Developments summary." Delaware: KPMG LLP, March 11, 2021.

Data Sources

IRS. "SOI Tax Stats – Corporation Complete Report."

- Table 1 (Part 1 of 2): Returns of Active Corporations.

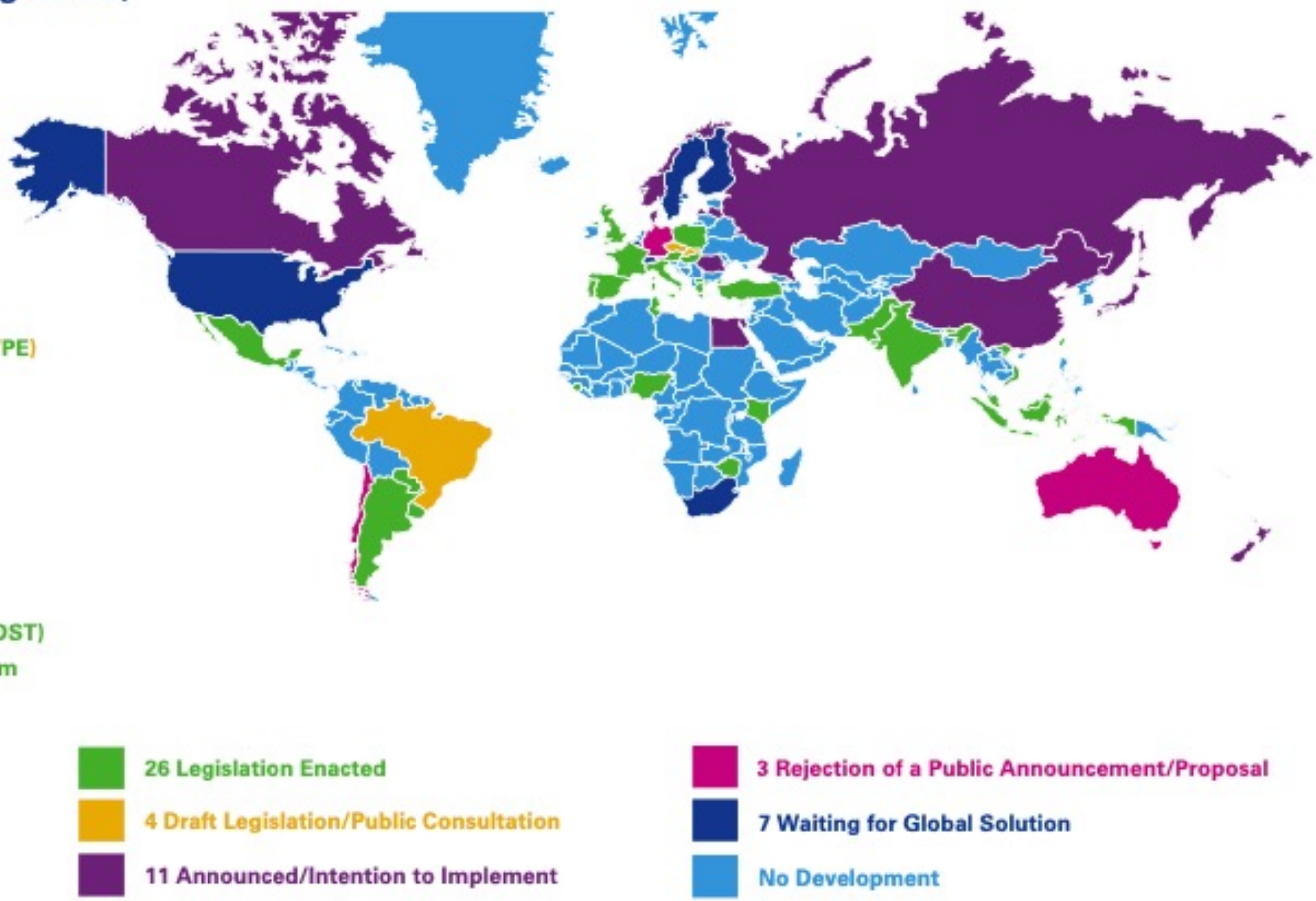
IRS. "SOI Tax Stats – Historical Table 14b."

IRS "SOI Tax Stats – Returns of Active Corporations – Table 1."

Appendix Myth 2 (2)

Direct Taxes (e.g., DST/WHT/Digital PE)

1. Argentina
2. Australia
3. Austria
4. Belgium (DST/PE)
5. Brazil
6. Canada
7. Chile
8. China
9. Costa Rica
10. Czech Republic
11. Denmark
12. Egypt
13. Finland
14. France
15. Germany (WHT)
16. Greece
17. Hungary
18. India (Eq.Tax/WHT/PE)
19. Indonesia
20. Israel (DST/PE)
21. Italy
22. Japan
23. Kenya
24. Latvia
25. Malaysia
26. Mexico
27. New Zealand
28. Nigeria
29. Norway
30. Pakistan
31. Paraguay
32. Poland
33. Portugal
34. Romania
35. Russia
36. Sierra Leone
37. Singapore
38. Slovakia (DST/PE)
39. South Africa
40. Spain
41. Sweden
42. Switzerland
43. Taiwan
44. Thailand
45. Tunisia
46. Turkey (WHT/DST)
47. United Kingdom
48. United States
49. Uruguay
50. Vietnam
51. Zimbabwe



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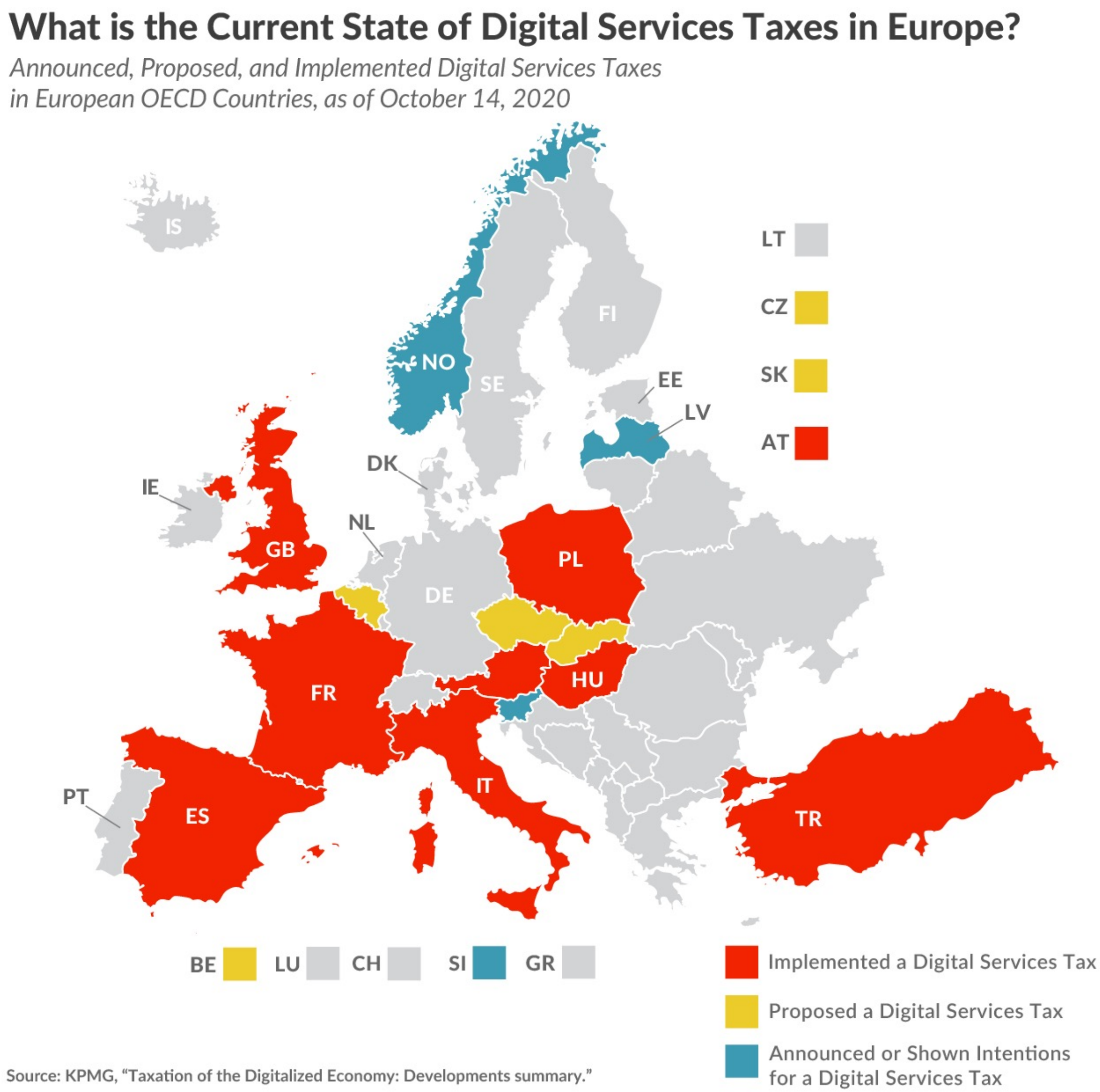
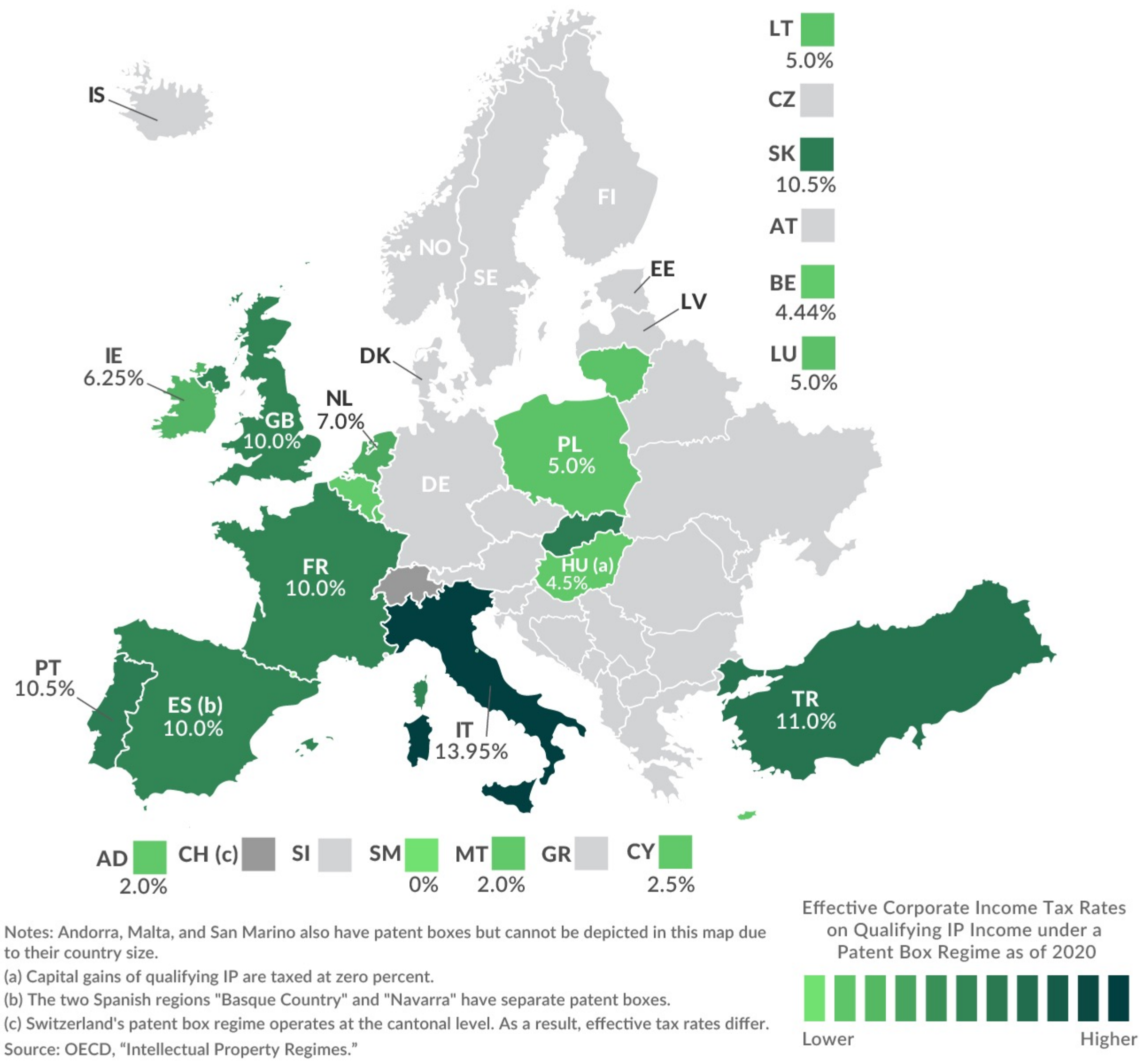


Tax Foundation, "What European OECD Countries Are Doing about Digital Services Taxes."

Appendix Myth 2 (4)

How Do Patent Box Regimes Compare across Europe?

Effective Corporate Income Tax Rates on Qualifying IP Income under a Patent Box Regime as of 2020



Notes: Andorra, Malta, and San Marino also have patent boxes but cannot be depicted in this map due to their country size.

(a) Capital gains of qualifying IP are taxed at zero percent.

(b) The two Spanish regions "Basque Country" and "Navarra" have separate patent boxes.

(c) Switzerland's patent box regime operates at the cantonal level. As a result, effective tax rates differ.

Source: OECD, "Intellectual Property Regimes."

Tax Foundation, "Patent Box Regimes in Europe."

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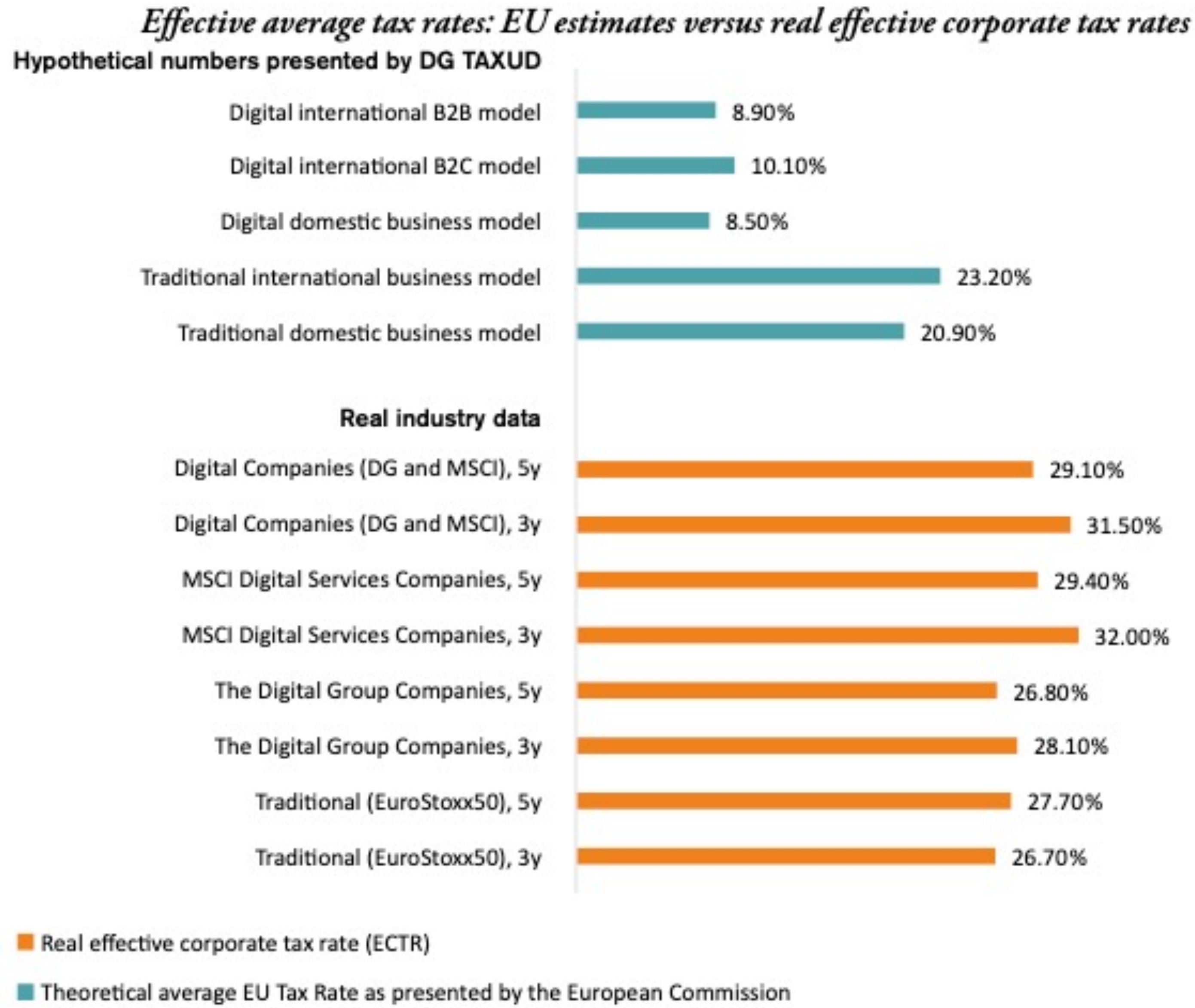

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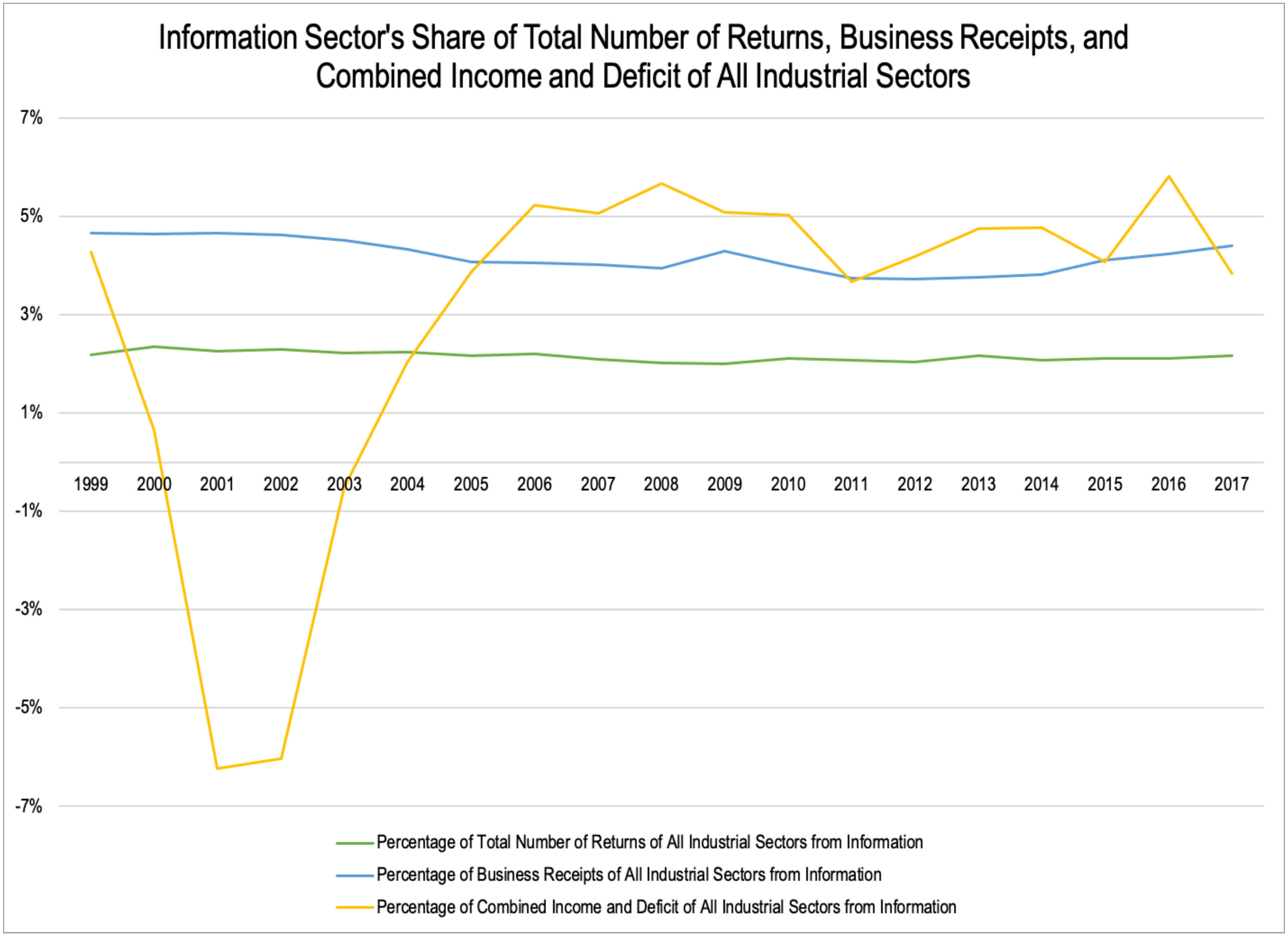
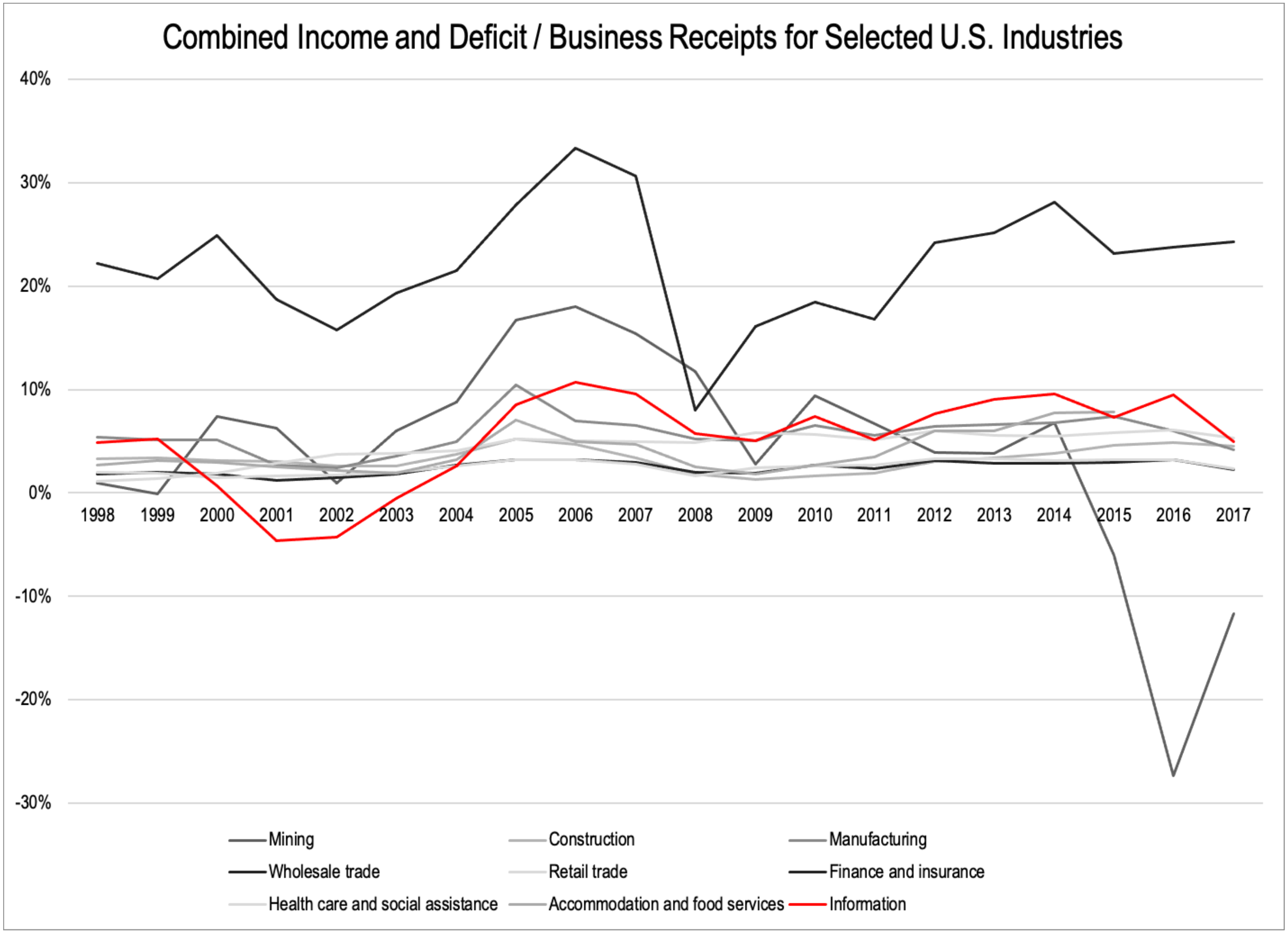


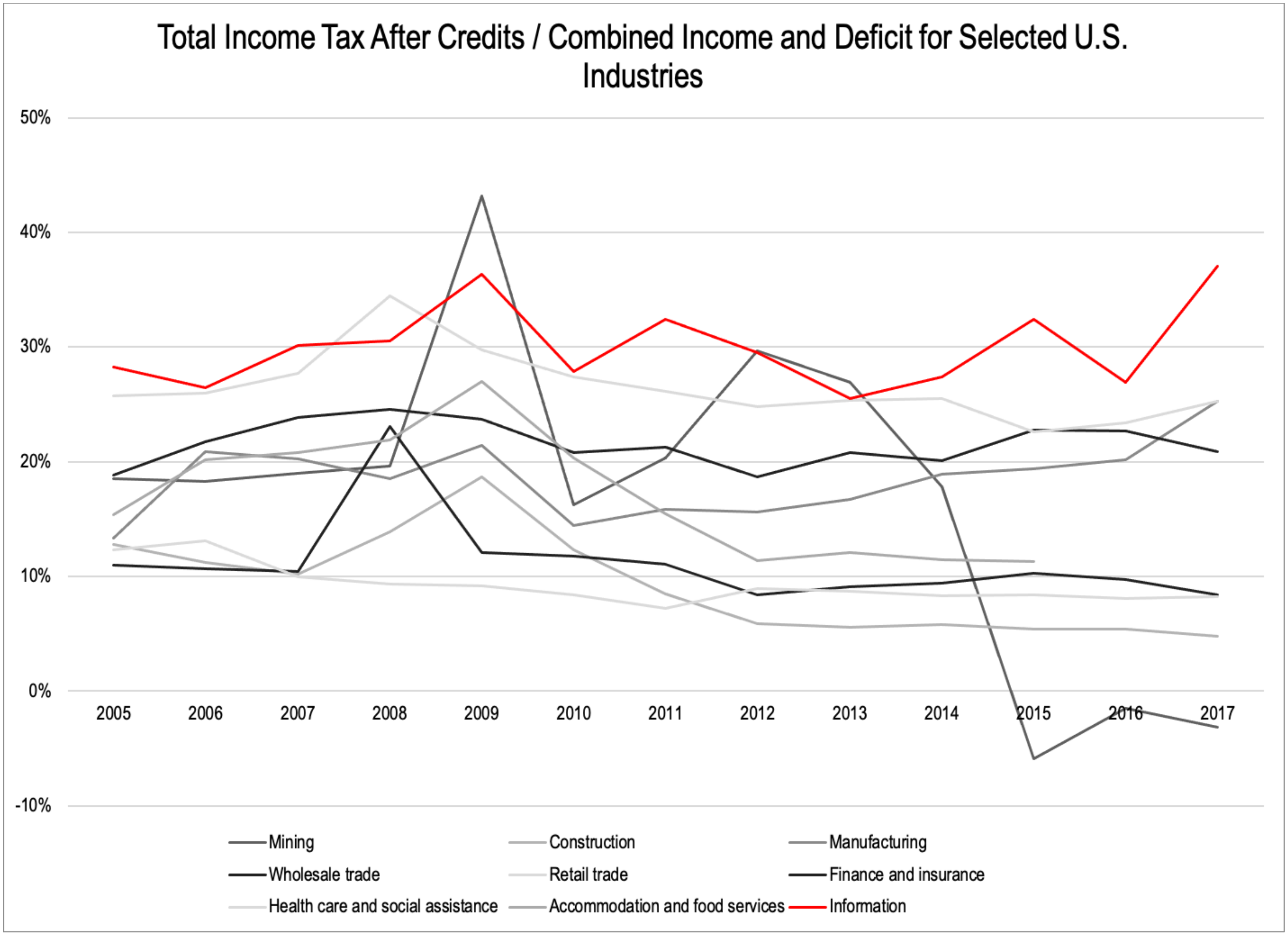
IRS, "SOI Tax Stats – Historical Table 14b," for 1999-2013; IRS "SOI Tax Stats – Corporation Complete Report" Table 1 (Part 1 of 2): Returns of Active Corporations, for 2014-2017.

Appendix Myth 2 (7)



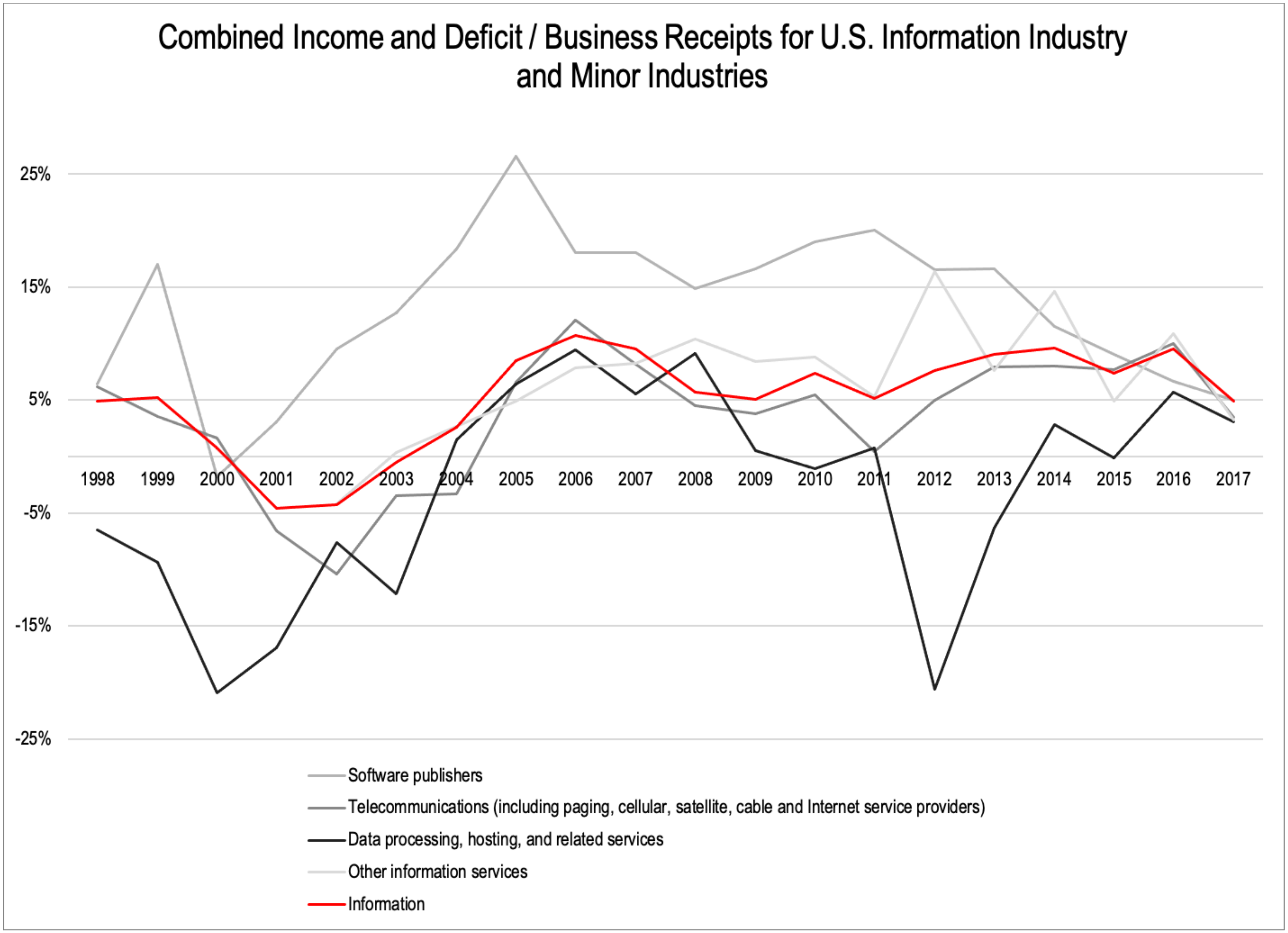
IRS "SOI Tax Stats – Returns of Active Corporations – Table 1," for 1998-2013; IRS "SOI Tax Stats – Corporation Complete Report" Table 1 (Part 1 of 2): Returns of Active Corporations, for 2014-2017.

Appendix Myth 2 (8)



IRS "SOI Tax Stats – Returns of Active Corporations – Table 1," for 1998-2013; IRS "SOI Tax Stats – Corporation Complete Report" Table 1 (Part 1 of 2): Returns of Active Corporations, for 2014-2017.

Appendix Myth 2 (9)



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Appendix Mystery 1 (1)

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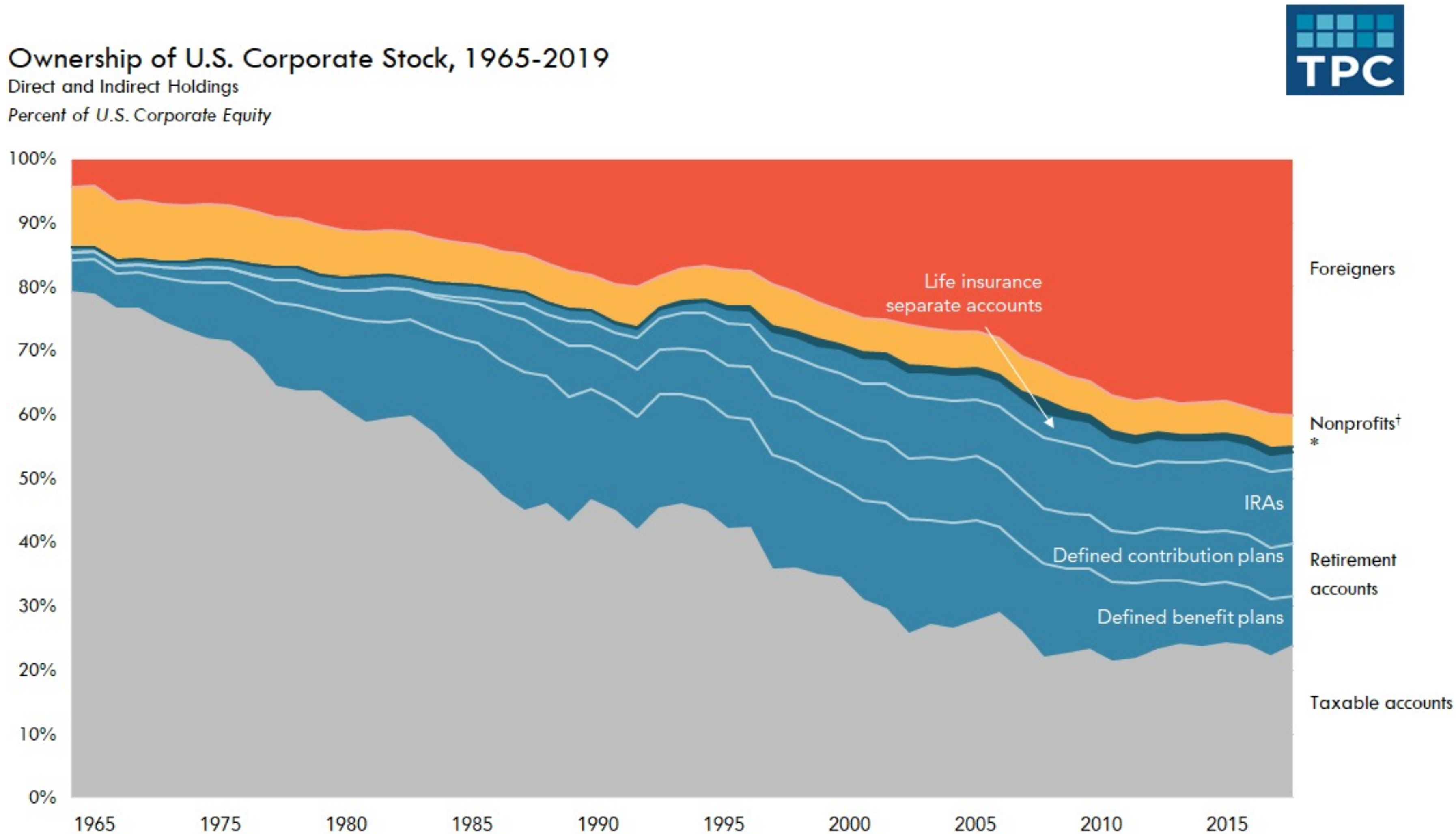
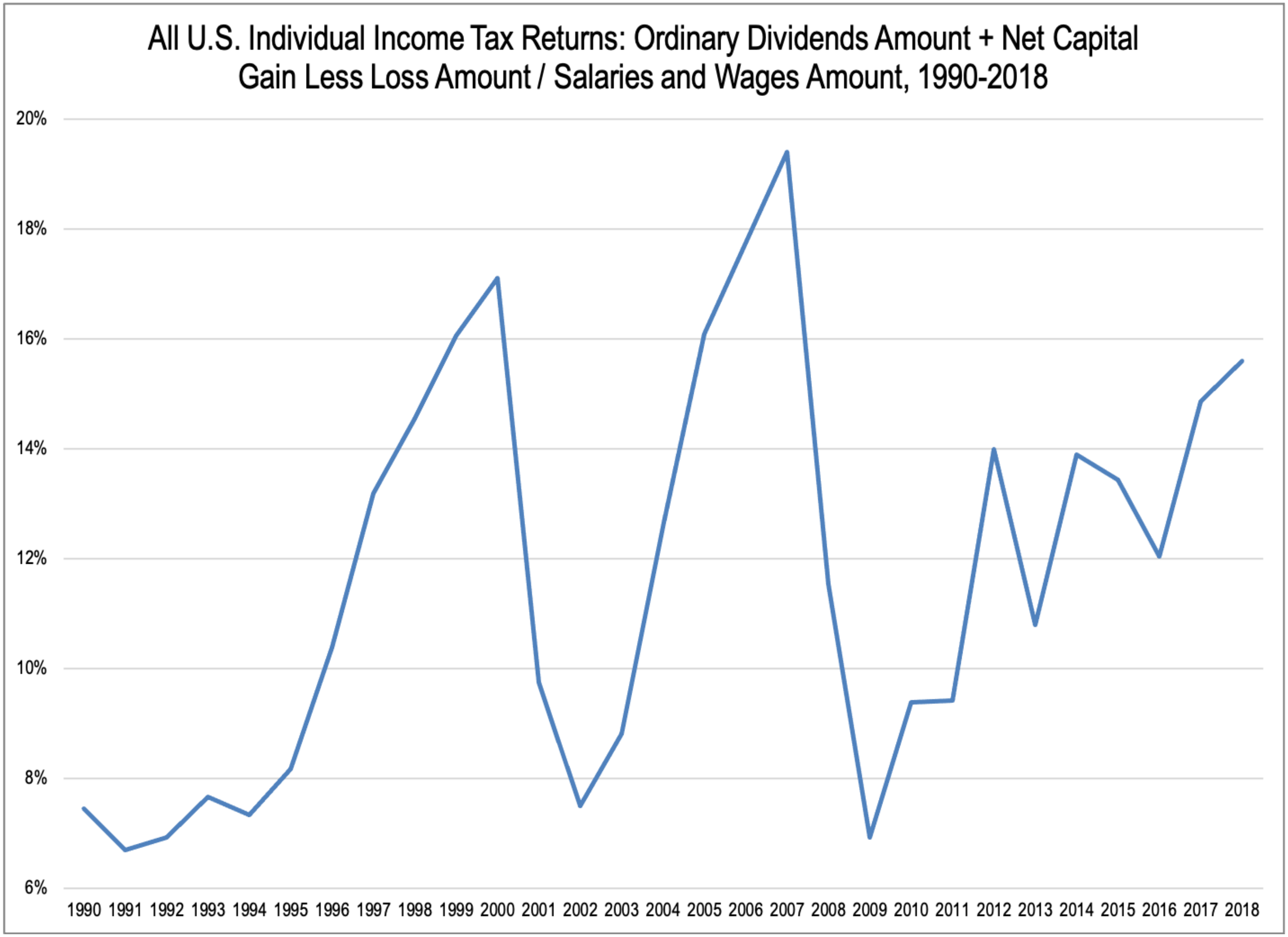
Appendix Mystery 1 (2)



Source: Board of Governors of the Federal Reserve System, "Financial Accounts of the United States;" Tax Policy Center Calculations.
† Dashed lines indicate TPC estimates.
* Federal, state and local government holdings, including equity in 529 college savings plans.

Rosenthal and Burke, "[Who Owns US Stock? Foreigners and Rich Americans](#)."

Appendix Mystery 1 (3)



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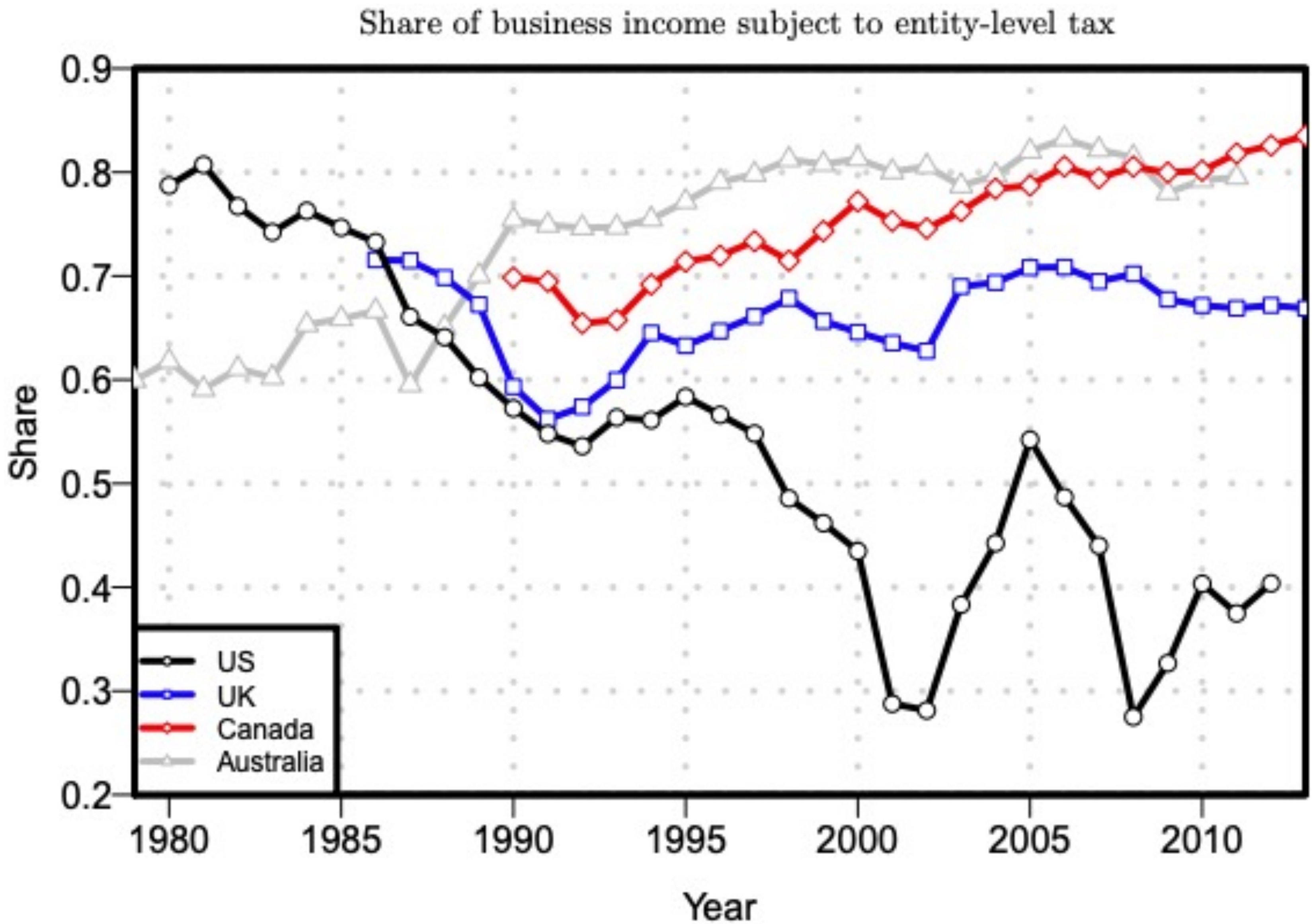
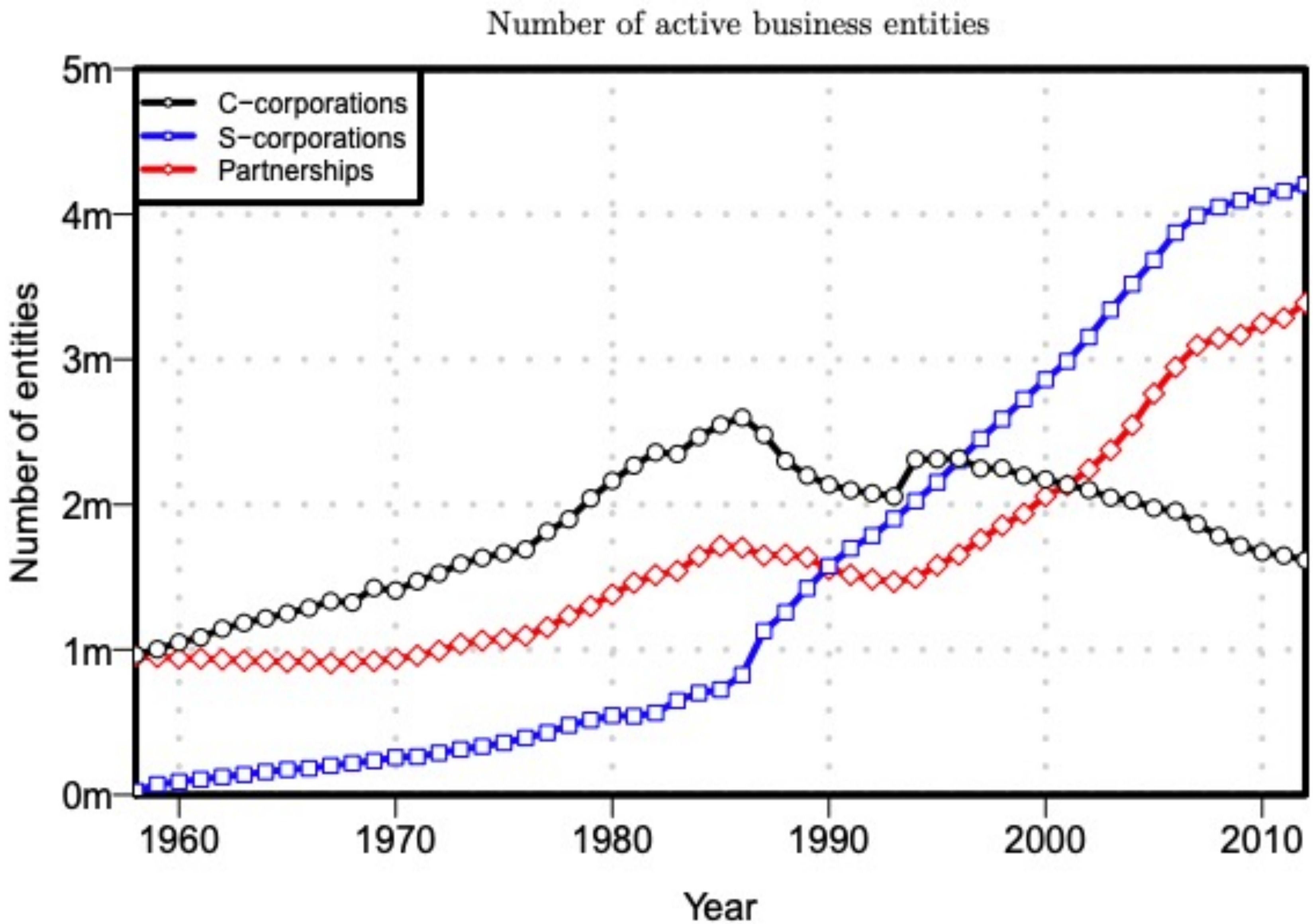
Appendix Mystery 1 (4)



Clarke and Kopczuk, "Business Income and Business Taxation in the United States Since the 1950s."

Appendix Mystery 1 (5)



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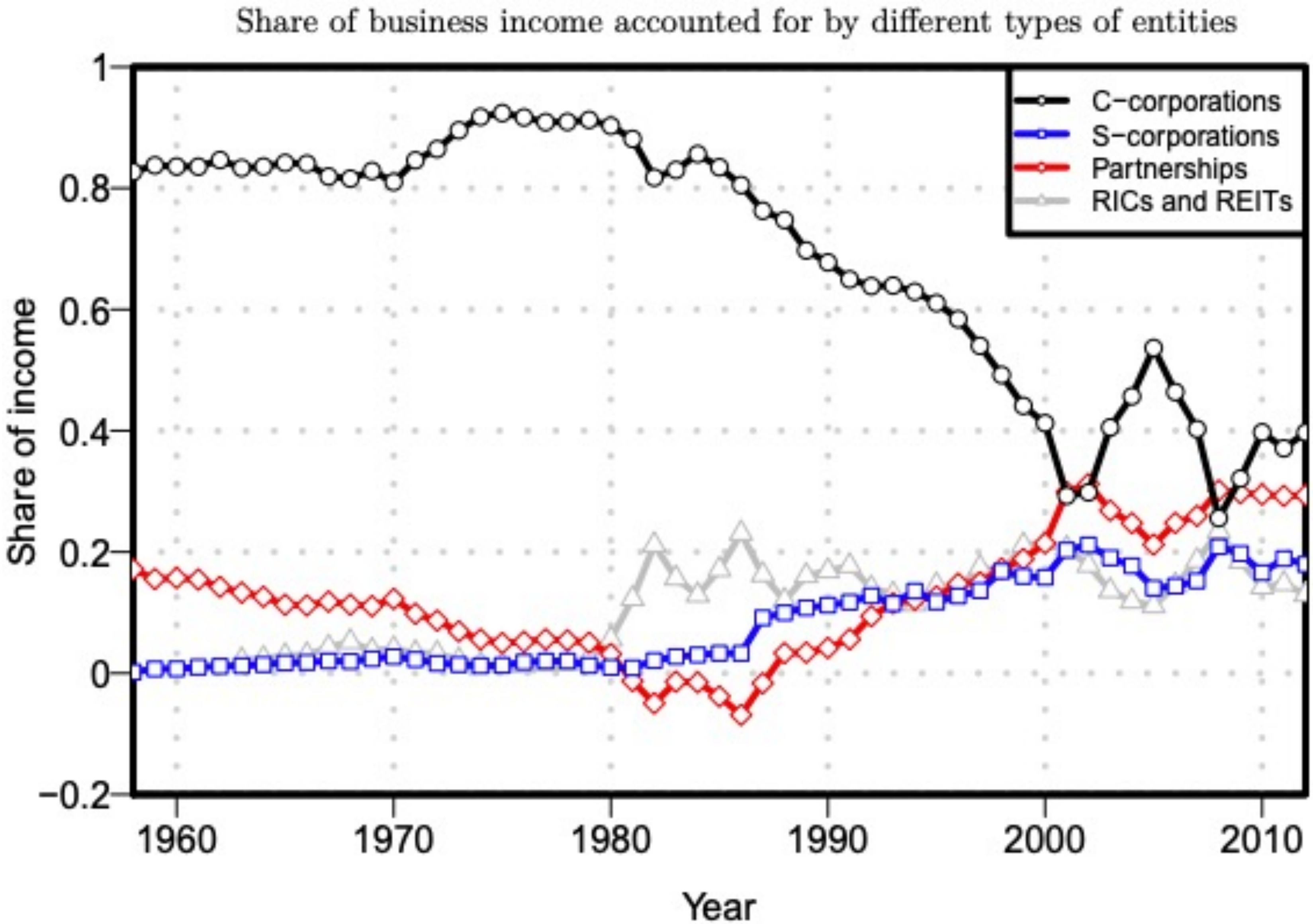
Appendix Mystery 1 (6)



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Appendix Mystery 2 (1)

Data Sources

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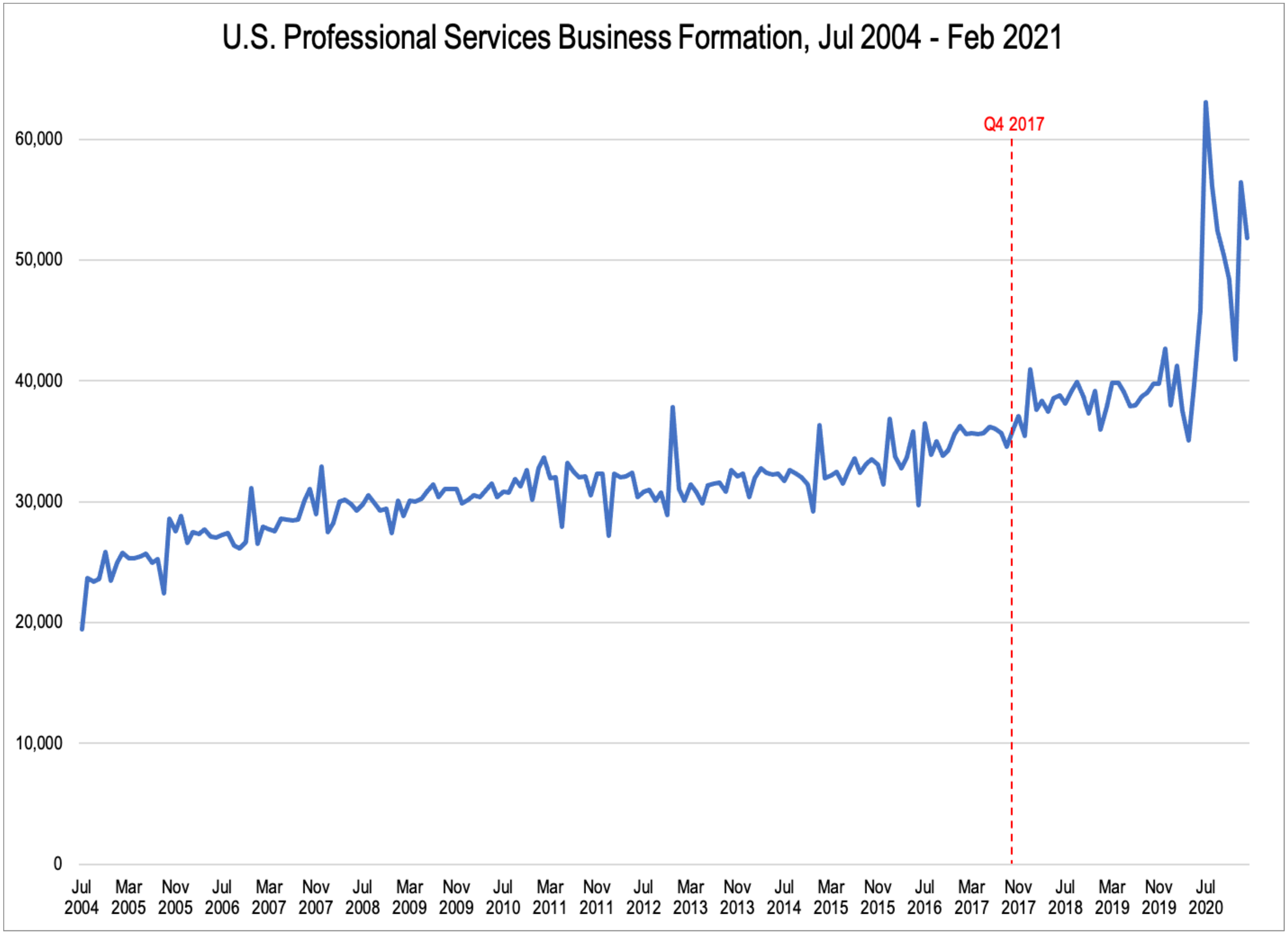

United States Census Bureau, "Business and Industry: Time Series/Trend Charts."

Appendix Mystery 3 (1)

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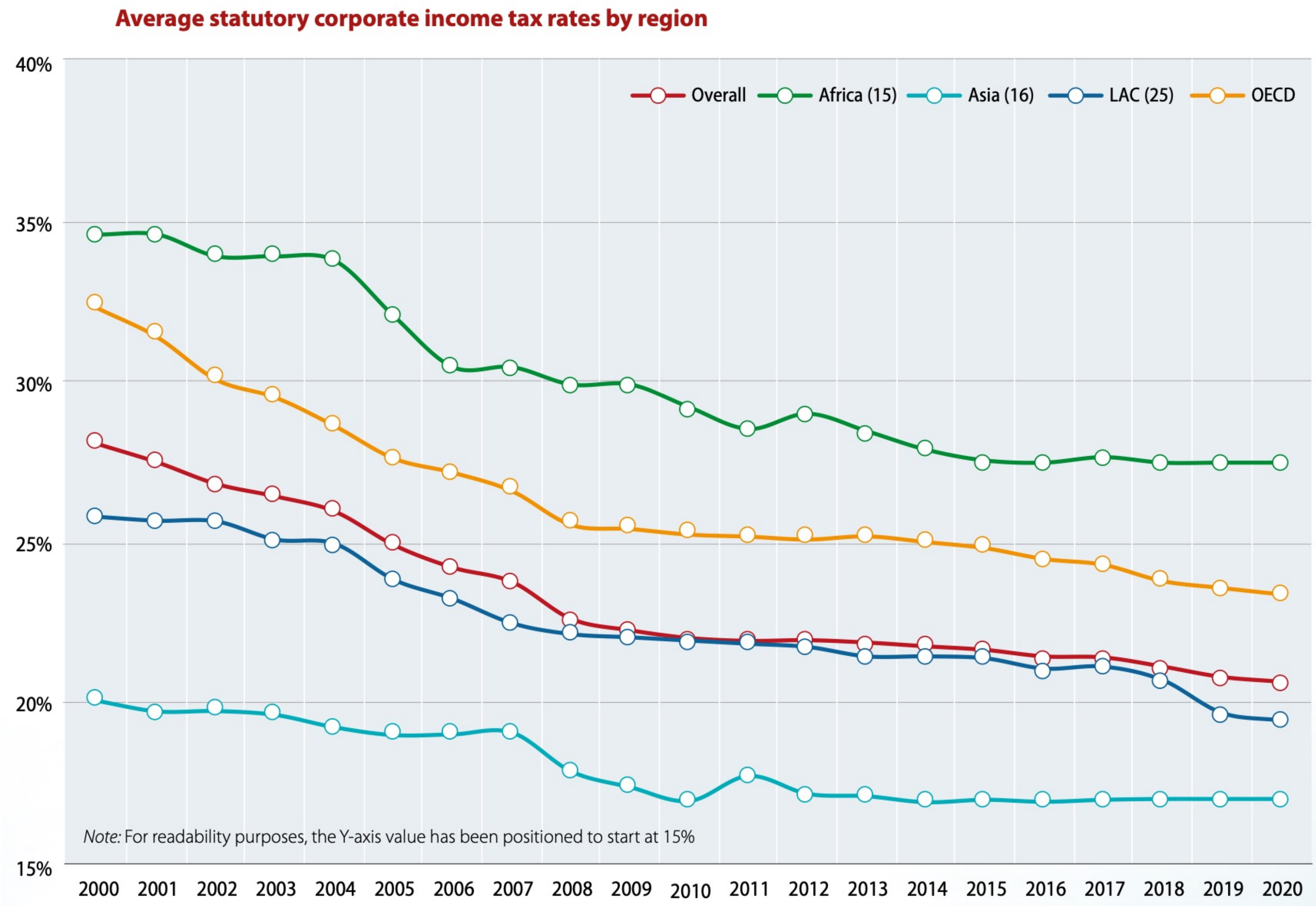
FRED, "Federal government current tax receipts: Personal current taxes."

FRED, "Federal government current tax receipts: Taxes on corporate income."

FRED, "Gross Domestic Product."

Tax Policy Center, "Historical Capital Gains and Taxes."

Appendix Mystery 3 (2)



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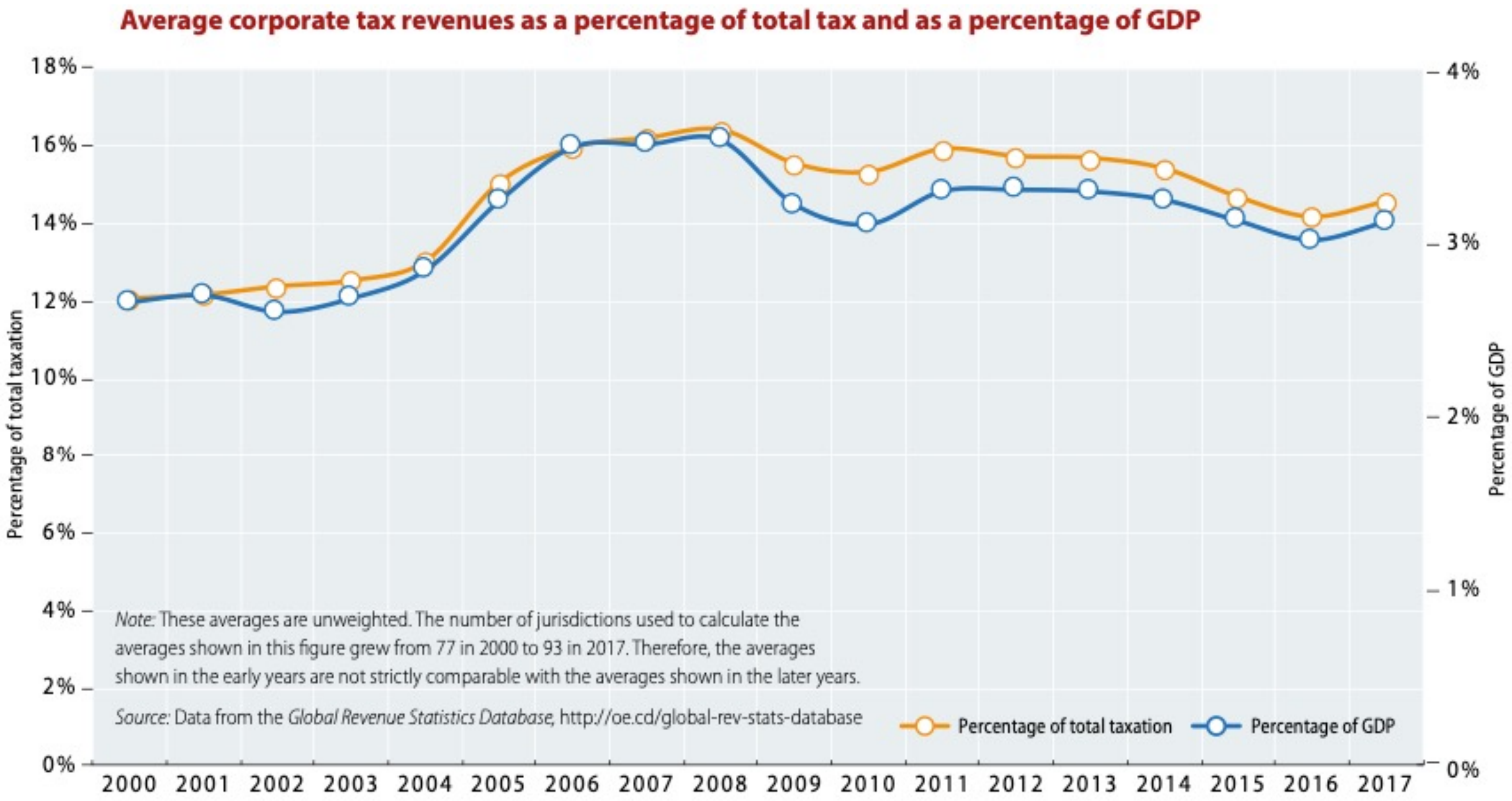
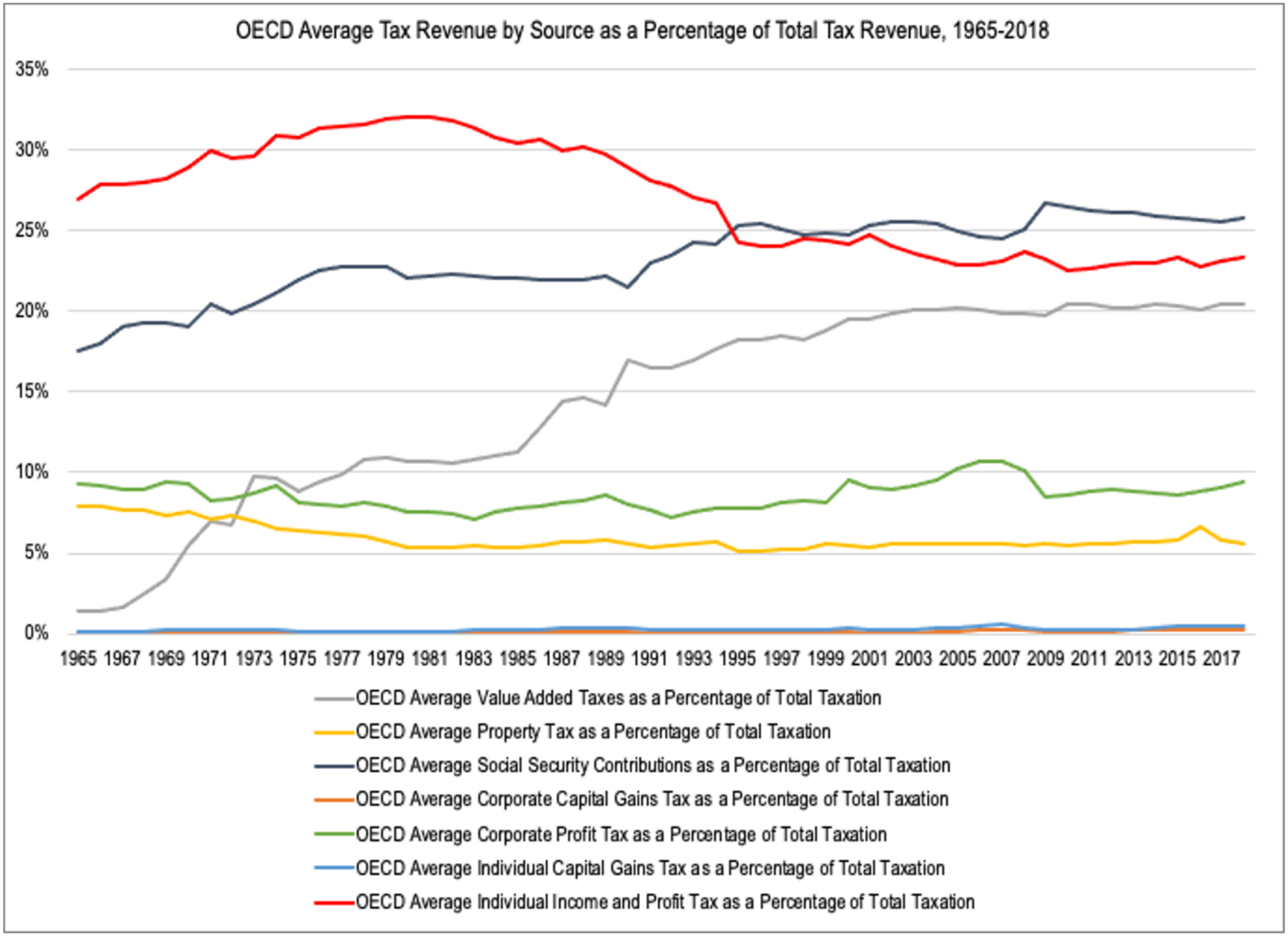
Appendix Mystery 3 (3)



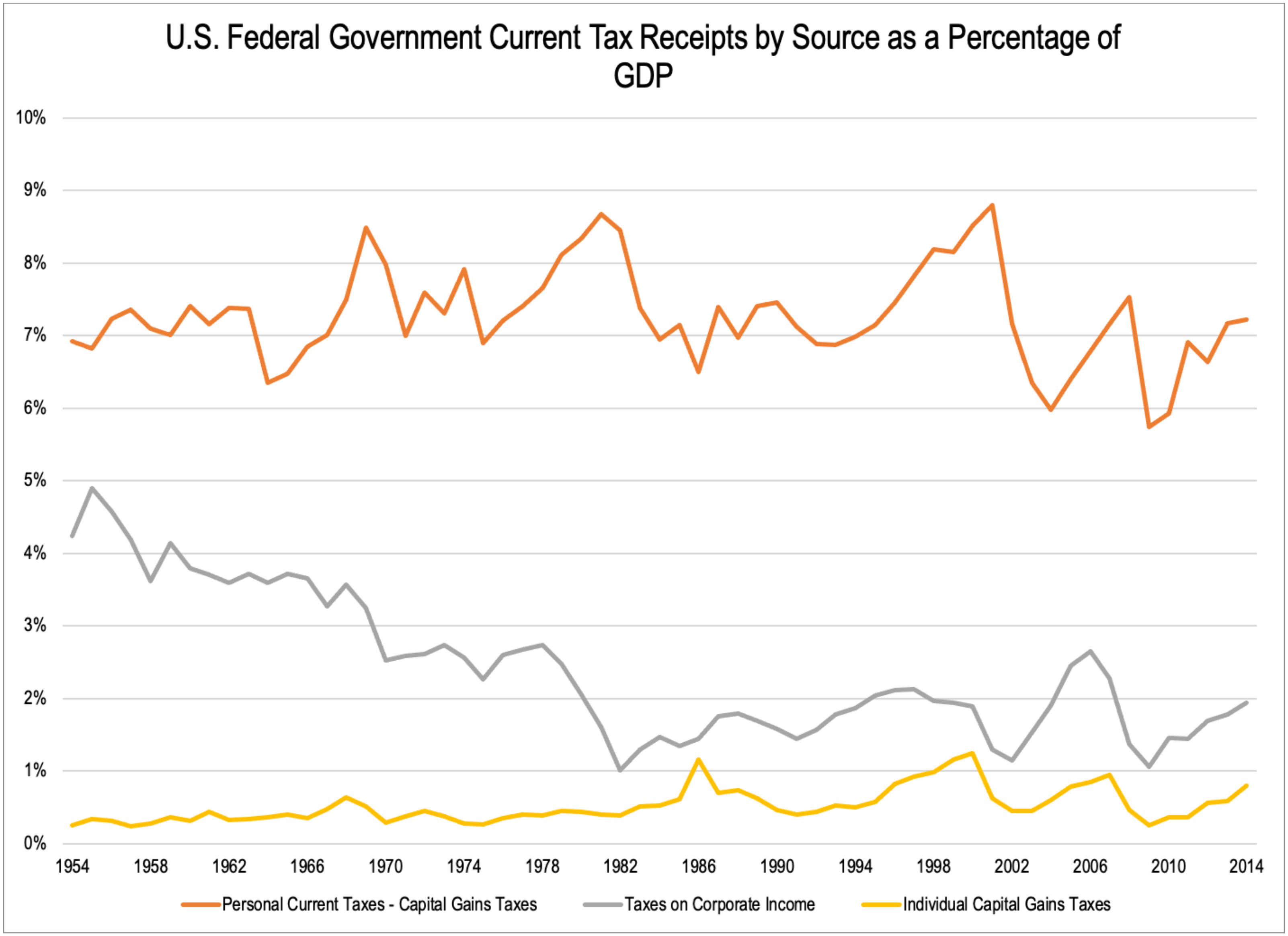
OECD, "Corporate Tax Statistics, Second Edition."

Appendix Mystery 3 (4)



OECD, "Revenue Statistics."

Appendix Mystery 3 (5)



FRED, "Federal government current tax receipts: Personal current taxes"; FRED, "Federal government current tax receipts: Taxes on corporate income"; FRED, "Gross Domestic Product"; Tax Policy Center, "Historical Capital Gains and Taxes."