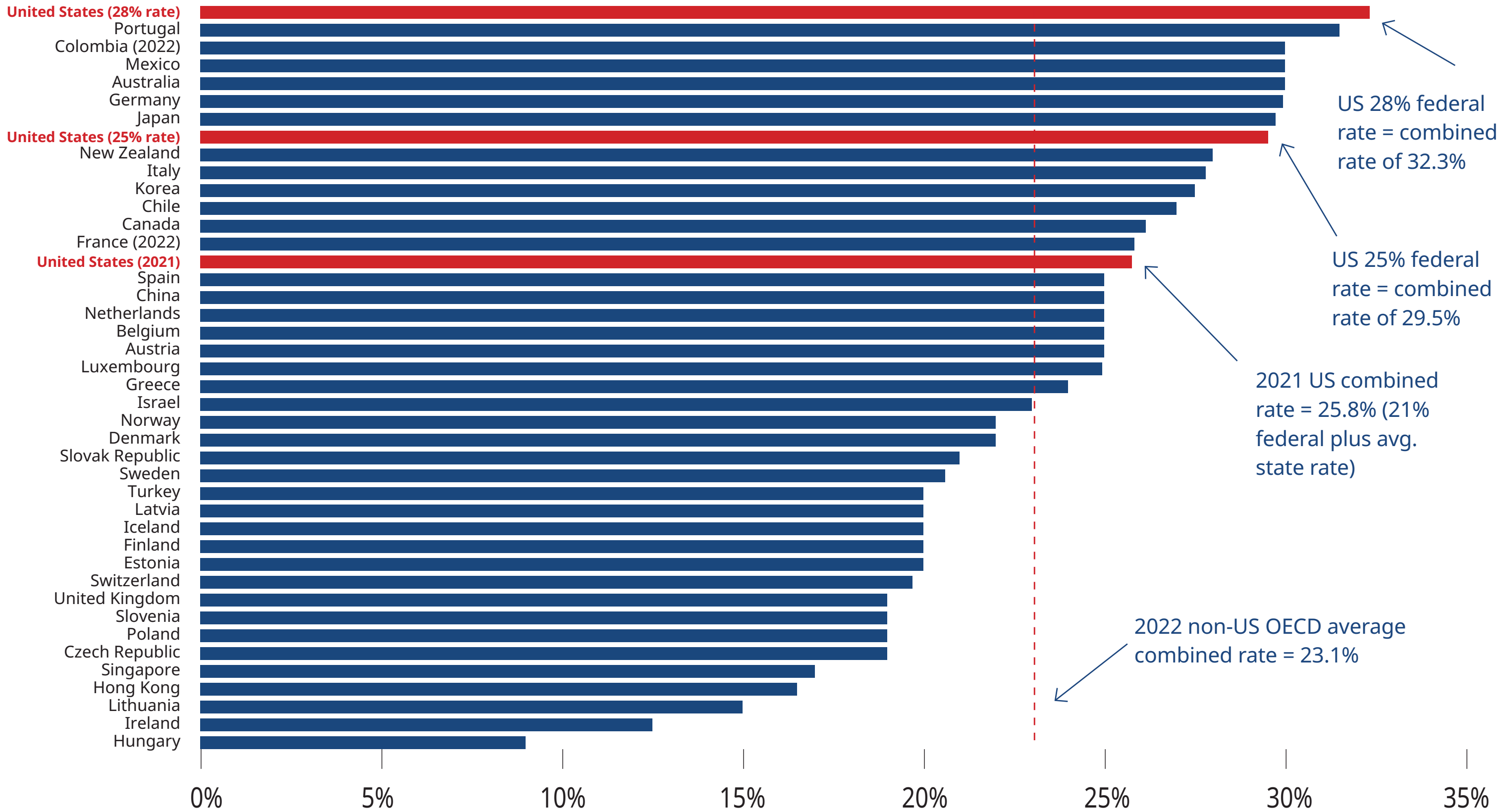
Higher corporate taxes threaten American competitiveness

HOW COMPETITIVE IS THE U.S. CORPORATE TAX RATE?

2022 Corporate Tax Rates In Industrialized Countries (Federal And State)

Increasing the U.S. 21% federal tax rate to 25% would lift the combined U.S. rate more than 6 percentage points above the average OECD rate; 30 OECD countries would have a lower corporate tax rate in 2022.



Source: OECD and country updates for 2022

KEY TAKEAWAYS

- As the U.S. economy begins to recover from the pandemic, the **goal of policymakers should be to restore full employment as rapidly as possible. Congress should not do anything that would put our nation's immediate and full economic recovery at risk.**

- **According to the Organisation for Economic Co-operation and Development (OECD), corporate income taxes are uniquely harmful to economic growth** because they discourage investment in capital and diminish productivity — two activities critical to bolstering the economy.

- **A durable economic recovery requires competitive U.S. tax policies that create a level playing field for American companies** relative to their foreign-headquartered competitors. This in turn requires a competitive corporate tax rate and competitive rules for taxing foreign earnings of American companies.

- **In 2018, when the U.S. corporate tax rate became more in line with other countries, globally competitive American companies hired more people and invested more capital in the United States than they did abroad,** and their investment and employment in the U.S. grew faster than the average for the prior 20 years.

- **Raising corporate taxes above the level of competitor countries — whether the headline tax rate or the U.S. tax imposed on the foreign income of American companies** — would immediately disadvantage U.S. companies and risk reigniting inversions and foreign takeovers. Moving first and hoping that other countries will follow and increase taxes on their companies is not a sound strategy for improving American competitiveness against China and other advanced economies.

- A significant share of the corporate tax burden is borne through lower wages. Combined with the burden of the tax on investors, half of the corporate tax burden was estimated by President Obama's Treasury Department to be borne by households making less than $400,000.

EXECUTIVE SUMMARY

For the first time in decades, the U.S. tax code has put American companies on a more level playing field with their global competitors. Before 2018, the 35% corporate tax rate in the U.S. was the highest in the industrial world[1]. Our current 25.8% combined federal and state tax rate is more in line with the world's other leading economic powers — 12 countries have higher rates and 27 have lower rates.[2]

In 2018, the first year in which the new tax code took effect, U.S. multinational companies headquartered in the United States grew faster domestically than they did abroad. The growth in the U.S. occurred across the board: more jobs; increased capital expenditures in property, plant and equipment; and increased R&D investment. This growth was faster than the average for the prior 20 years.[3]

If the U.S. raised its corporate income tax rate to the proposed 28%, the U.S. would once again have the highest combined tax rate in the industrialized world. Even at a 25% federal tax rate, the U.S. rate (including state corporate taxes) would be 6 percentage points higher than the OECD average.[4] In either scenario, **American workers would be put at a significant disadvantage because fewer plants would be built or expanded in the U.S.** Maintaining a competitive tax rate that is squarely in the range of other industrialized countries' rates would continue to promote investment and jobs at home.

As the U.S. economy begins to recover from the Covid-19 pandemic, policymakers should not take any actions that put American jobs and competitiveness at risk. A corporate tax increase would destabilize American businesses at a precarious moment, undermine their competitiveness with global peers, and undercut their capacity to expand their payrolls.

1 https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II1

2 https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II1

3 Bureau of Economic Analysis, "Activities of U.S. Multinational Enterprises, 2018," News Release BEA 20- 40, August 21, 2020.

4 https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II1

IN-DEPTH: THE CONNECTION BETWEEN TAX RATES AND COMPETITIVENESS

Effects on Companies: Slowing Hiring and Investment

Federal lawmakers are considering a variety of proposals to raise corporate income taxes on American companies. A tax hike would harm the ability of American companies to compete globally, reduce U.S. investment, and ultimately disadvantage U.S. workers.

Research demonstrates that corporate taxes affect where a company is headquartered, where that company makes its investments, and how successful the company is in competing in the foreign markets where 95% of the world's population and 75% of world GDP reside. Prior to 2017, many U.S. companies were renouncing their U.S. headquarters and moving abroad – or were being taken over by foreign-headquartered companies – because U.S. tax rules made it uncompetitive to be an American company.

Announcements of major companies looking to leave the United States regularly made newspaper headlines and affected jobs and communities in every state.[5] **The benefits of having strong, global companies headquartered in America are not just economic; these corporations support our country's strong position on the world stage and serve as emissaries for American values.**

The U.S. experience prior to 2017 is not unique. A competitive tax system can attract investment and an inhospitable one can repel investment. As the OECD has noted, "location decisions are becoming more sensitive to tax."[6] Raising corporate taxes would reduce employment throughout the U.S. economy, both by directly limiting U.S. employment and investment and from the adverse ripple effect that lower employment and investment would have on the broader economy, costing jobs throughout companies' supply chains and in the communities where their employees shop and live. **The Penn-Wharton Budget Model estimates that President Biden's Made in America Tax Plan together with the American Jobs Plan would result in large economic losses – $296 billion in lost economic activity in 2031 alone,** and far greater cumulative losses over this decade and the decades that follow.[7]

Higher U.S. corporate taxes would make American companies less competitive both at home and abroad. Passing along the cost in the form of higher prices is not generally sustainable when competing against companies who are not subject to these higher tax costs. As American companies lose market share, they will invest less and support fewer American jobs, all to the benefit of foreign-headquartered companies and their foreign workforces.

In particular, provisions in the Made in America Tax Plan would make U.S. tax rules on the foreign income of American companies uncompetitive and "would likely reignite corporate inversions," as recently concluded by the Tax Policy Center, a joint venture of the Brookings Institute and the Urban Center.[8]

5 See, for example, Kate Linebaugh and Liz Hoffman, "Tax-fueled Trend in Cross Border Deals," Wall Street Journal, May 12, 2014; Hester Plumridge and Peter Loftus, "Inversion Frenzy Rocks Drug Sector," Wall Street Journal, June 21, 2014; Dana Mattioli, "Acquirers Plot Escape from a Turn on Taxes," Wall Street Journal, July 7, 2014; Liz Hoffman and Hester Plumridge, "Race to Cut Taxes Fuels Urge To Merge," Wall Street Journal, July 15, 2014; Tom Fairless and Shayndi Raice, "In Inversion Deals, U.K. Is a Winner; Location, Language, Lifestyle Are Draws as U.S. Companies Buy Firms Abroad," Wall Street Journal, July 28, 2014; Emily Chasan, "Companies are Running the Numbers on Potential Tax Inversions," Wall Street Journal, August 26, 2014. Roberto A. Ferdman, "We finally have an idea of how much money Burger King will save by moving to Canada," Washington Post, December 11, 2014. For an analysis, see Congressional Budget Office, "An Analysis of Corporate Inversions," September 2017.

6 https://www.oecd.org/berlin/46391708.pdf

7 https://budgetmodel.wharton.upenn.edu/issues/2021/4/7/president-biden-american-jobs-plan-effects

8 https://www.taxpolicycenter.org/taxvox/oecd-pillar-2-provides-good-model-biden-us-worldwide-tax

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Effects on Workers: Lowering Wages and Reducing Opportunities

Ordinary Americans benefit from the U.S. having a strong position on the global stage, as demonstrated by positive economic conditions between 2018, when the new tax rates went into effect, and 2020, when Covid-19 reached American shores.

- Real wages grew 4.9% between 2018-2019, the fastest two-year growth rate in real earnings since 1998-1999. In comparison, there was no real wage growth during the two previous years, 2016-2017.[9]
    - Wage growth was greater for those on the factory floor and in non-supervisory roles than for their managers from the start of 2018 to the end of 2019. This was a reversal of prior trends.[10]
- Unemployment reached a 50-year low of 3.5% in 2019.[11]
- Median household income reached $68,703 in 2019, an increase of 6.8% from 2018.[12]

A corporate tax increase, especially just as our economy is beginning to recover from the pandemic, would make it harder to return to these better economic times.

Moreover, decades of research show that workers bear a significant share of the corporate tax burden through lower wages.[13] The Joint Committee on Taxation, the Congressional Budget Office, and the U.S. Treasury Department all agree in this assessment.[14] **The analysis from the Wharton School of Business found increasing the corporate tax rate to 28% would cause a 0.7% decline in wages by 2031.[15]**

A separate 2016 analysis from then-President Obama's Treasury Department estimated that the poorest half of Americans on average bear a larger burden from the corporate income tax than they do from the individual income tax.[16] This same analysis estimated that half of the corporate tax burden is borne by households making less than $400,000.

Current Tax Rates Protect American Competitiveness and Provide Certainty

Before raising corporate income taxes, including the taxes imposed on the foreign income of U.S. companies, American policymakers need to carefully consider the current competitiveness of the U.S. tax system relative to our trading partners. Raising corporate taxes and hoping foreign countries embrace a sky-high global minimum tax on their companies would immediately disadvantage American companies and their workers. The U.S. is currently the only country in the world that has a global minimum tax – it's been over three years since the U.S. adopted its minimum tax and not a single country has followed. Doubling our minimum tax with the unfounded hope that other countries will follow is not a sound strategy. Such a move would severely handicap American competitiveness and hinder U.S. companies from selling their products and services in global markets, which account for over 95% of the world's population and are vital to the future growth of the U.S. economy and U.S. jobs.

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9 Bureau of Labor Statistics, Employed full time: Median usual weekly real earnings: Wage and salary workers: 16 years and over [LES1252881600Q].

10 Bureau of Labor Statistics, series for "Average Hourly Earnings of Production and Nonsupervisory Employees,"[CES0500000008] and "Average Hourly Earnings of All Employees" [CES0500000003].

11 Bureau of Labor Statistics, series for unemployment, [LNS14000000].

12 **https://www.census.gov/library/publications/2020/demo/p60-270.html**

13 See, for example, Clemens Fuest, Who Bears the Burden of Corporate Income Taxation?, European Tax Policy Forum Policy Paper, 2015; Juan Carlos Suárez Serrato and Owen Zidar, Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms, American Economic Review, 2016; Clemens, Andreas Peichl, and Sebastian Siegloch. 2018. Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany. American Economic Review, 2018.

14 The Joint Committee on Taxation assumes 25 percent of the corporate income tax is borne by workers (Modeling the Distribution of Taxes on Business Income, JCX-14-13, October 16, 2013); CBO also assumes 25 percent of the corporate income tax is borne by workers (The Distribution of Household Income and Federal Taxes, 2008 and 2009, Congressional Budget Office, July 2012, p. 24); and Treasury" assumes 18 percent of the corporate income tax is borne by workers (Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology, Office of Tax Analysis, Technical Paper 5, May 2012).

15 **https://budgetmodel.wharton.upenn.edu/issues/2021/4/7/president-biden-american-jobs-plan-effects**

16 **https://home.treasury.gov/system/files/131/Distribution-of-Tax-Burden-Current-Law-2017.pdf**

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While the OECD is sponsoring discussions about a global minimum tax, consensus has not been reached on one and even if it is a high-level political agreement is not the same as the adoption of minimum taxes by foreign countries. Moreover, **no country has suggested they would adopt rules as onerous and out of step as those proposed by President Biden.** The doubling of the current U.S. global minimum tax rate proposed by President Biden would result in an effective minimum tax rate of 26.25%[17] on the foreign income of U.S. companies – more than double the tax rate previously considered by the OECD and higher than the top tax rate in more than 70 percent of OECD countries. Already, major countries are casting doubt on any minimum tax proposal, notably including China, which is the home to more of the largest multinational companies than any other country. This is one area where the U.S. cannot afford to "lead" and assume that other countries will follow. The damage to U.S. companies and their workers in just a short period of time from these anti-competitive policies could be permanent, and the other countries who would benefit from America's mistaken impulse would have no incentive to follow us on such a self-destructive path.

In the face of higher corporate taxes, American companies would respond with cost cutting – in the form of wage freezes, layoffs, and reduced spending on research and development and other activities critical for growth. The CEO of Raytheon Technologies, for example, said the tax increase proposed by President Biden would cause his company to cut its annual spending on capital investment and R&D by $1 billion, a 20% reduction compared to their current spend.[18]

In contrast, between 2018 and 2019, the first two years the U.S. had competitive tax rates, capital expenditures at S&P 500 companies increased 20% compared to 2016 and 2017. The investment made by these companies in research and development rose 25% in the same time periods.[19] These investments set up American companies to succeed in the future, helping them to develop new technology and products, while boosting the productivity and incomes of their employees.

As the U.S. continues to recover from a severe recession, American companies need tax certainty and tax policies that encourage investment. Businesses today are planning investments in technology, research and development, and the new hires they will make not just for today but for the next three to five years. Their forecasted tax bills determine whether they will have the cash flow to grow their businesses, create jobs, and fuel economic growth. With millions of Americans still out of work, we simply cannot afford to take risks with our economy.

FURTHER READING

"Growth-oriented Tax Policy Reform Recommendations," OECD, November 2010

https://www.oecd.org/berlin/46391708.pdf

"President Biden's $2.7 trillion American jobs plan: budgetary and macroeconomic effects," University of Pennsylvania Wharton School of Business Budget Model, April 7, 2021.

https://budgetmodel.wharton.upenn.edu/issues/2021/4/7/president-biden-american-jobs-plan-effects

17 Because the U.S. global minimum tax allows a foreign tax credit for only 80 percent of foreign taxes, a minimum tax rate of 21% would continue to apply until the foreign rate of tax exceeded 26.25% (since 80 percent of 26.25% is 21%).

18 https://www.bloomberg.com/news/articles/2021-04-07/raytheon-ceo-sees-1-billion-blow-r-d-risk-from-biden-tax-plan

19 ACT analysis of S&P Data provided by CapitalIQ.