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Should Corporate Tax Hikes Be Included in Biden's "Build Back Better" Plans?

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Raising the corporate income tax plays a central role in President Biden's proposal to "pay for" his $2.3 trillion American Jobs Plan. While we believe that the notion taxes pay for spending is entirely misplaced, we will not address that issue here. Instead, we will examine the proposed corporate profits tax hike from the perspective of fighting potential inflation that might result from the Jobs Plan (and all the other relief and stimulus plans enacted or announced—now totaling about $9 trillion) as well as from the perspective of taxing the rich to reduce inequality.

There are several reasons to think the corporate income tax is far less effective at fighting inflation and inequality than what many might think. First, the incidence of corporate taxation (that is, who pays) is not known for sure, with the impact falling on shareholders, employees, customers, and suppliers. Estimates of the tax incidence on employees and customers (most of whom are not wealthy) range from 20 percent to 100 percent.

To the extent that corporations can raise prices to pass the burden of taxes forward onto customers, that tax is inflationary and not necessarily progressive (which depends, of course, on the product sold). If it is passed backward to workers—in the form of wage and benefit improvements that are lower than what would otherwise occur—it is largely regressive (with caveats for firms that pay high wages). If workers have to accept lower wages, it could be deflationary, but workers in stronger positions might be able to force inflation-compensating wage increases (reducing disinflationary pressures and enhancing wage inequality). The best hope in terms of inequality reduction is that the taxes are passed on to shareholders through lower dividends and price gains. Since individual shareholders have higher-than-average incomes and wealth, this would reduce inequality. However, even in this case, the reduction of wealth inequality in the United States would be much less than imagined, as the proportion of stock ownership in individual household accounts is about 25 percent, with the balance owned by foreigners (about 40 percent), retirement accounts (about 30 percent), and the rest owned by nonprofits.

As an inflation reducer, taxes on shareholders will be rather impotent, since most shares are held by institutions or foreigners—and so will not significantly reduce spending on domestic output. Further, most individual holders have low marginal propensities to spend (and they are relatively few in number). The "bang for the buck" in terms of inflation reduction will be very low.

As Modern Money Theory claims, corporate taxes are not really used to finance federal government spending, and if their impact on reducing wealth inequality or inflation pressures is marginal, at best, why have them? We follow Hyman Minsky's recommendation that taxes on corporations ought to be eliminated entirely. Eliminating federal corporate taxes would have less impact than many might imagine, as corporate tax expenditures in 2021 are expected to exceed the size of corporate income tax revenues. Where taxes are desired to reduce income and wealth inequality and/or to satisfy the (mistaken, but still pervasive) notion that they help finance government spending, they should be directed to individual taxation. We propose replacing corporate taxes with mark-to-market taxation (Internal Revenue Service rules currently support this form of taxation for professional traders), with realized and unrealized gains taxed annually as ordinary income.

If taxes on corporations were replaced in this manner, deductions would become irrelevant and corporations would be unencumbered by tax rules in making capital expenditures. Efforts by the administration to establish a global minimum tax would no longer be necessary (other countries would likely follow suit for competitive reasons). While foreign owners would receive a windfall, the desirability of investing in the US would be greatly enhanced, leading to greater foreign direct investment and domestic employment. "Off-shoring" to avoid taxes would end. Pass-through organizations and corporate owners would be put on an equal tax footing with wage workers. Tax compliance costs would be largely eliminated. According to a study done in 2016, $193 billion was spent on tax compliance for US businesses—approximately equal to the total revenue raised from the tax—in addition to what likely amounts to several billion spent on tax lobbying efforts. As it is relatively easy (in the technical sense) to make income taxes highly progressive, imputing unrealized capital gains to shareholders and taxing them as normal income ensures that the burden is mostly imposed on high earners.

A more detailed discussion of the issues can be found at levyinstitute.org/publications/is-it-time-to-eliminate-federal-corporate-income-taxes

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