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WHY PRESIDENT BIDEN SHOULD ELIMINATE CORPORATE TAXES TO BUILD BACK BETTER

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President Biden has proposed pairing his eight-year, $2.3 trillion American Jobs Plan with a "Made in America Tax Plan" geared toward generating more than $2 trillion over 15 years in order to, in the White House's words, "more than pay for the mostly one-time investments in the American Jobs Plan and then reduce deficits on a permanent basis" (White House 2021).[1] Raising the corporate income tax plays a central role in Biden's proposal.

At first glance, raising this tax would appear to have a lot going for it. Corporate taxes have a long history and can be justified from several angles. From inception, the idea was that corporations are supposed to serve a public purpose, which is why they get charters and special treatments such as limited liability. They receive other benefits both explicitly and implicitly. In return for these benefits—many of which are supplied by government—it is argued that they should pay taxes, their "fair share" of the costs of public provisioning. Furthermore, in recent years many of them have earned bad reputations for innumerable scandals: destruction of the environment; irresponsible treatment of employees, customers, or neighbors; offshoring to hide income and

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avoid taxes; inversions; union busting; selling data or inadequate protection of data from hackers; and for the shenanigans that led up the last global financial crisis. It is understandable why hiking taxes on corporate profits could become a politically useful device.

While we are sympathetic to such justifications, we think it is worthwhile to examine the wisdom of pairing corporate tax increases with the President's public investment plans. More broadly, we argue the downside to the federal corporate income tax in general outweighs whatever benefits are derived from it and, therefore, alternatives ought to be considered.

As Modern Money Theory (MMT) explains, a sovereign government does not really use taxes to finance spending (Wray 2015). However, taxes do serve useful purposes—such as decreasing private spending to release resources for government use, providing incentives to reduce bad behavior (sin taxes) or promote the public interest (solar energy tax credits), and reducing inequality by taxing high-income and high-wealth households. Here, we will examine the proposed corporate profits tax hike from the perspective of fighting potential inflation that might result from the American 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. These seem to be the best arguments for taxing corporate profits.

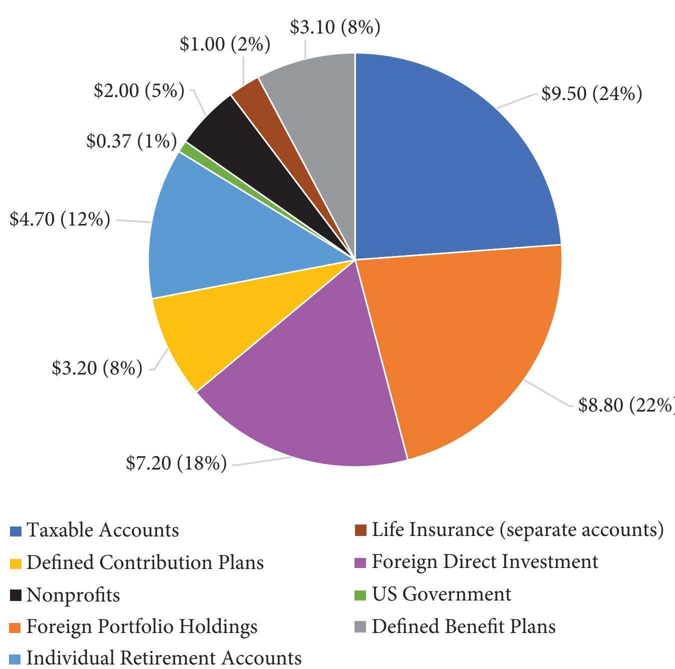
In this policy note, we will leave aside the argument that the United States should work with other major countries to move toward uniform tax treatment of corporate profits. American corporations are said to face unfair competition from low-tax nations—but this would become a moot issue if the US eliminated taxation of corporations as we recommend below, with other nations likely following suit.

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 (Goodman 2021). Hyman Minsky (1986, 340) made similar arguments, but expanded the list of undesirable impacts, arguing that a profits tax on corporations encourages spending on advertising, marketing, and perks for executives that could be written off of taxes.

To the extent that corporations can raise prices to pass the tax burden 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-adjusting wage increases (reducing disinflationary pressures and increasing wage inequality). The best hope in terms of reduction of inequality is that the taxes are passed on to shareholders in the form of lower dividends and stock price gains, since individual shareholders have higher-than-average incomes and wealth. However, even in this case, the reduction of wealth inequality in the United States would be much less than imagined (see Figure 1), as the proportion of stock ownership in individual household accounts[2] is about 25 percent, with the balance owned by foreigners (about 40 percent), retirement accounts (about 30 percent), and the rest owned by nonprofits (Rosenthal and Burke 2020).

As an inflation reducer, taxes on shareholders will be rather impotent, since most shares are held by institutions or

Figure 1 **US Stock Ownership 2019 ($ trillions)**



Source: Rosenthal and Burke (2020)

foreigners—and so will not significantly reduce spending on domestic output. Further, of those held by individuals, the holders have low marginal propensities to spend (and they are relatively few in number in any event). The "bang for the buck" in terms of inflation reduction will be very low: for every ten dollars of extra corporate taxes paid, there will be little reduction of domestic spending—perhaps much less than ten dollars (Nersisyan and Wray, forthcoming).

As MMT explains, 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? It is our view that, in fact, federal taxes on corporate profits ought to be eliminated entirely.

While removing corporate taxes would be good for the economy in many ways, we recognize it would create windfall gains for many shareholders and top management holding stock options. Although unlikely, this could also generate inflation if the windfall gains are spent. Given that the incomes and wealth of the potential beneficiaries are well-above average, their propensity to consume is low so that inflation is probably not a major concern (President Trump's 2017 tax cuts for the rich did not generate any inflationary pressure in our pre-pandemic world).

And while we do not believe it is necessary to replace lost corporate profits taxes to "pay for" government spending, in the interest of tax fairness we should explore reforms that would shift some of the corporate tax burden to individuals who would benefit the most from their elimination, namely, shareholders. One option is to replace corporate taxes with "mark-to-market" taxation,[3] with realized and unrealized gains taxed annually as ordinary income.[4] Again, the purpose of these new taxes—at least as far as the federal government is concerned[5]—is not to provide revenue but to forestall windfall gains (an equality issue) and inflation (an aggregate demand issue) that could be engendered by eliminating the corporate tax (see Lane and Wray 2020).

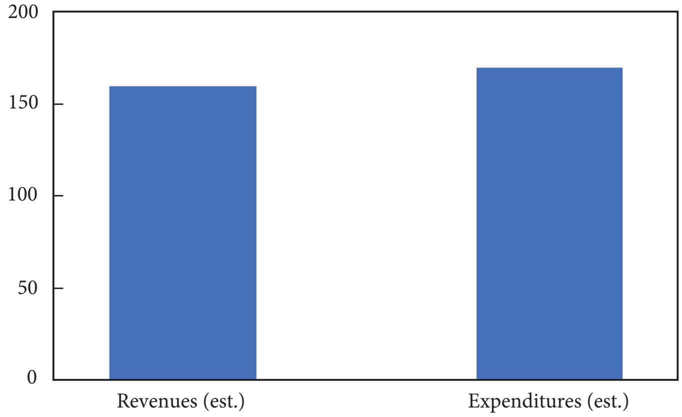
Senator Elizabeth Warren and others proposed a mark-to-market or "accrual" basis of taxation on capital gains in 2016. According to the Brookings Institution, the revenue raised would be about $170 billion per year, in addition to aligning the tax treatment of capital gains with the tax treatment of interest and ordinary income, creating a more equitable distribution of tax incidence (Enda and Gale 2020). If this idea were combined with the elimination of federal income taxes at the corporate level, the incremental revenue raised would be substantially higher, reflecting the impact on security prices due to the corporate tax elimination. Again, we do not view the increase of revenue as important from the perspective of financing government spending, but rather see it as part of a strategy of reducing inequality and improving the fairness of the tax system. As far as fighting inflation goes, taxing capital gains would be only minimally effective, as it is not likely that the taxes would reduce spending by high-income holders of stocks.

What if taxes on corporations were eliminated?

- Deductions would become irrelevant and corporations would be unencumbered by tax rules in making capital expenditures (in essence, the impact of capital budgeting would flow through to share prices and be taxed accordingly).
- 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 United States would be greatly enhanced, leading to greater foreign direct investment and domestic employment.
- Pass-through organizations and corporate owners would be put on an equal tax footing with wage workers.
- Corporate tax compliance costs would be largely eliminated. According to a study done in 2016 (Hodge 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.[6] There is no reason to believe that number has gone down. Note that this is approximately equal to the total federal government revenues from the corporate income tax. That makes this an especially inefficient tax (with an "excess burden" equal to the revenue received).

If elimination of the corporate income tax is infeasible for political reasons, it would be our position that corporate taxes should at least not be increased, that corporations be allowed to deduct dividends, and that our recommendation to impose a mark-to-market tax on unrealized gains (as stated above) be implemented along with retention of the personal income tax on dividends.

Figure 2 **2021 Corporate Federal Income Tax Revenue and Expenditures ($ billions)**



Source: Peterson Foundation (2021)

In fact, eliminating federal corporate taxes would have less impact than many might imagine. As shown in Figure 2, federal corporate tax expenditures in 2021 (defined by the Congressional Budget and Impoundment Control Act of 1974 as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability") are expected to exceed the size of corporate income tax revenues.

To summarize, we believe the best strategy is to eliminate the corporate income tax and replace it with an annual personal tax on unrealized capital gains. The corporate tax is poorly designed for accomplishing the goals of reducing income and wealth inequality or reducing inflation pressure. While its incidence is unknown, most of the burden is not likely to fall on high-income Americans. And the excess burden in terms of compliance costs, as well as offsetting tax expenditures Congress has chosen to award to corporations, mean that it is a very inefficient tax—with net revenues approximately zero, and net costs to corporations likely passed along to consumers in the form of higher prices. Finally, eliminating the corporate tax would take away the incentives for corporations to look abroad for tax havens.

Notes

1. Note that while the amount of the tax "pay for" is under review, the ideas presented in this policy note stand on their own.
2. Share holdings are allocated to households following the Fed's method of allocating equity issuances across various holder categories, ending with the Fed's residual category, the household sector.
3. Internal Revenue Service rules currently support this form of taxation for professional traders.
4. Introduction of across-the-board mark-to-market ordinary income taxation on unrealized gains would eliminate the need to repeal the "step-up cost basis at death" provision in the tax code.
5. Certain states also tax corporate income. Unlike the federal government, states do depend on tax revenue to finance expenditures, so if the states were to eliminate the corporate profits tax, they really would need to find another revenue source. The best solution would be to replace corporate taxes with more-progressive income taxes (overall, state and local taxes are, on average, highly regressive) or, better yet, have the federal government replace lost revenues. See Wray (2019) for a discussion of the justification for this.
6. See https://www.opensecrets.org/federal-lobbying.

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