

# An Overview of the Corporate Income Tax System

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# An Overview of the Corporate Income Tax System

This report presents information and research on the U.S. corporate income tax to help policymakers understand and evaluate policies to modify it. The structure of the corporate tax can influence the performance of the economy, impact fairness in the overall tax system, and have important administrative consequences. At least two specific policy areas of interest pertaining to the corporate tax appear to be relevant in the current environment. The first involves concern, expressed by some, over recent deficits and the growing national debt. The corporate tax could be one tool to raise revenues and address these concerns. The second concerns the global push for increased international tax coordination led by the Organisation for Economic Co-operation and Development (OECD) and G20, which have developed a multilateral framework to address base erosion and profit shifting agreed to by 142 countries (including the United States) as of December 2022. Implementing certain provisions in the multilateral framework may affect U.S. corporate tax revenue, employment, and investment.

The corporate income tax generally applies only to C corporations. These corporations—named for Subchapter C of the Internal Revenue Code, which details their tax treatment—are treated as taxable entities separate from their shareholders. That is, corporate income is first taxed at the corporate level according to the corporate income tax system. When shareholders receive corporate dividend payments or realize capital gains from the sale of shares, that income is taxed again at the individual shareholder level according to the individual tax system. In contrast, noncorporate businesses—including S corporations, partnerships, and sole proprietorships—pass their income through to their owners, who pay taxes on that income. Collectively, noncorporate business entities are referred to as “pass-throughs.” For these types of entities, business income is generally taxed only once, at individual income tax rates.

Corporate income is subject to a flat statutory tax rate of 21%. Before 2018, there was a graduated rate structure, with a maximum statutory corporate tax rate of 35%. The corporate tax rate alone does not determine how much corporations pay in taxes. Because of a number of business tax benefits, including general business expenses and certain special deductions and credits known as tax expenditures, the effective (or actual) tax rate paid by corporations is typically less than the statutory rate. In 2023, corporate tax expenditures are estimated to result in \$164.2 billion of forgone federal tax revenue. In comparison, individual tax expenditures are estimated to result in over nine and a half times more revenue loss (\$1.6 trillion) to the federal government than corporate tax expenditures.

Relative to the size of the economy and as a share of total revenues, corporate taxes today are less than they were in the years following World War II. The corporate tax reached its post-World War II era peak in 1952 at 5.9% of gross domestic product (GDP). In 2021 (the most recent year that is not an estimate), the corporate tax generated revenue equal to approximately 1.7% of GDP. The corporate tax has also decreased in significance relative to other revenue sources. At its post-WWII peak in 1952, the corporate tax generated 32.1% of all federal tax revenue. In that same year, the individual income tax accounted for 42.2% of federal revenue and payroll taxes accounted for 9.7% of revenue. In 2021, the corporate tax accounted for 9.2% of federal tax revenue, whereas the individual and payroll taxes generated 50.5% and 32.5%, respectively. However, corporate tax revenues are projected to increase modestly in the coming years.

Corporate tax revenues as a percentage of GDP in the United States are below the average of all OECD member countries. In 2020 (most recent data year), the average OECD member collected corporate taxes equal to 2.8% of GDP, while the United States collected revenues equal to about 1.3% of GDP. Corporate tax receipts in the United States have been below the OECD average since 1982.

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This report presents information and research on the U.S. corporate income tax to help policymakers understand and evaluate policies to modify it. Many of the topics and ideas discussed here are analyzed in greater detail in the other CRS reports and academic research referenced throughout. This report first reviews the structure of the corporate income tax. Next, the report presents and analyzes data on which companies pay the corporate tax, how much revenue the tax generates, and how the U.S. system compares to the rest of the world. Finally, the report reviews the economic effects of the corporate tax—including a discussion of the tax’s purpose, who bears its burden, and how to evaluate alternative corporate tax systems.

## Structure of the Corporate Income Tax

The corporate income tax generally applies only to C corporations (also known as regular corporations).<sup>1</sup> These corporations—named for Subchapter C of the Internal Revenue Code (IRC), which details their tax treatment—are treated as taxable entities separate from their shareholders.<sup>2</sup> That is, corporate income is taxed once at the corporate level according to the corporate income tax system. When shareholders receive corporate dividend payments or realize capital gains from the sale of shares, that income is taxed again at the individual shareholder level according to the individual tax system.<sup>3</sup> In contrast, noncorporate businesses—including S corporations, partnerships, and sole proprietorships—pass their income through to their owners, who pay taxes on that income.<sup>4</sup> Collectively, noncorporate business entities are referred to as “pass-throughs.” For these types of entities, business income is generally taxed only once, at individual income tax rates.

Taxes are one factor that influences the decision whether to organize as a C corporation or a pass-through, but other factors also influence the choice of organizational form. C corporations can be more administratively complex and financially costly to operate since they require a board of directors and are subject to more stringent recordingkeeping and reporting requirements. For example, C corporations under the oversight of the Securities and Exchange Commission (SEC)—that is, publicly traded corporations—must file comprehensive and publicly available

<sup>1</sup> Stock repurchases by publicly traded C corporations may also be subject to a 1% tax put in place by the law commonly referred to as the Inflation Reduction Act of 2022 (P.L. 117-169). Since the tax is an excise tax—that is, a tax on a specific item (repurchased stock)—it is not part of the corporate *income* tax. For more information, see CRS Report R47397, *The 1% Excise Tax on Stock Repurchases (Buybacks)*, by Jane G. Gravelle.

<sup>2</sup> For more information, see CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

<sup>3</sup> This treatment leads to the so-called “double taxation” of corporate profits. However, since a large share of corporate equity is held in tax-exempt or foreign accounts, only a portion of corporate income is subject to double taxation in practice. For more, see Leonard E. Burman, Kimberly A. Clausing, and Lydia Austin, “Is U.S. Corporate Income Double Taxed?” *National Tax Journal*, vol. 70, no. 3 (September 2017), pp. 675-706.

<sup>4</sup> An S corporation is a closely held corporation that elects to be treated as a pass-through entity for tax purposes. S corporations are named for Subchapter S of the IRC, which details their tax treatment. By electing S corporation status, a business is able to combine many of the legal and business advantages of a C corporation with the tax advantages of a partnership. A partnership is a joint venture consisting of at least two partners organized to operate a trade or business with each partner sharing profits, losses, deductions, credits, and the like. A partner is an investor in such an entity and may be an individual, a trust, a partnership, a corporation, another entity (such as a limited liability company), or a broker that is holding the ownership interest of an unnamed partner. Corporations and partnerships are established under the individual laws of each state, although their tax treatment at the federal level is determined by the Internal Revenue Code (IRC). The most common partnerships include general partnerships, limited liability partnerships, limited partnerships, publicly traded partnerships, and electing large partnerships. For more information, see CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

financial reports. This is in contrast to privately held pass-through businesses.<sup>5</sup> At the same time, the C corporation form allows a business to take advantage of a number of benefits not available with other forms of organization. Specifically, a C corporation is not limited in the number of shareholders it may have, the classes of stocks it may issue, the types of shareholders it may have, or the citizenship of its shareholders.<sup>6</sup> Shares of C corporation stock are also traded on well-developed exchanges, which allows ownership interests to be transferred readily and at low transaction costs. As a result, C corporations have the ability to raise capital globally from a variety of investors. Still, with the increase in private equity financing, businesses are able to tap into capital markets without necessarily “going public” as C corporations. Additionally, some owners may never see the need to go public when launching a new business and prefer a pass-through structure.

### **Taxation of Pass-Through Businesses**

Businesses that choose an organizational form other than a C corporation are, in general, not subject to the corporate income tax. Instead, the income of these businesses passes through to their owners and is taxed according to individual income tax rates. Examples of these alternative “pass-through” forms of organization include sole proprietorships, partnerships, subchapter S corporations, and limited liability companies (LLCs). LLCs are the creation of individual state statutes, and are not addressed in the federal tax code. For purposes of federal tax treatment, an LLC is treated, by default, as either a partnership (if it has at least two members) or a “disregarded entity” (if it has a single member) that is taxed as a sole proprietor. Alternatively, an LLC may elect to be treated as a C corporation for federal tax purposes. For more information on pass-through taxation, see CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

The corporate income tax is designed as a tax on corporate profits (also known as net income). Broadly defined, corporate profit is total income minus the cost associated with generating that income. The corporate income tax also allows for a number of other special deductions, credits, and tax preferences. Oftentimes, these provisions are intended to promote particular policy goals as they reduce the taxes corporations owe if they engage in certain activities.

A corporation’s tax liability calculation can be generalized as:

$$\text{Taxes} = [(\text{Total Income} - \text{Deductions}) \times \text{Tax Rate}] - \text{Tax Credits}$$

This summary calculation hides the fact that the corporate tax system becomes increasingly complex as one examines its details. The following sections discuss some of the more fundamental features of the tax system.

## **Corporate Taxable Income**

A corporation’s taxable income generally is its total income less allowable deductions. Gross income is income derived from any source, including gross profit from the sale of goods and services to customers, rents, royalties, most interest, dividends, gains from the sale of business and investment assets, plus other sources of income.

Corporate income subject to tax also includes income earned from foreign operations. Foreign income earned directly by U.S. companies is treated the same as income earned domestically. Foreign income earned through related legal entities (referred to as controlled foreign

<sup>5</sup> A C corporation can also be privately held and not be subject to SEC oversight. That is, its stock is not traded on a public stock exchange. These are smaller corporations that are outside the common perception of a C corporation. There are also publicly traded partnerships, which, by default, are treated as C corporations for tax purposes unless certain criteria are met.

<sup>6</sup> This is in contrast to the S corporations, which are limited to offering one class of share and limited in the types of citizenship of their shareholders.

corporations [CFCs] in tax jargon) may be taxed in the year earned in some circumstances, while other foreign income is not. Specifically, certain types of passive or easily shifted income are taxed under what is referred to as Subpart F. Other foreign income of related corporations is taxed under global intangible low-taxed income (GILTI) provisions. GILTI is a measure of income earned by foreign subsidiaries of U.S. companies (i.e., CFCs) after an exclusion for returns on tangible assets. GILTI is included in income in the year earned after a 50% deduction—resulting in GILTI being taxed at a lower effective tax rate than domestic profits.<sup>7</sup> A similar treatment applies to intangible income earned abroad from assets held in the United States under the foreign derived intangible income (FDII) provision. Income eligible for FDII treatment is based on the share of exports and a proportionate exclusion for returns on tangible investments. FDII is included in income in the year earned after a 37.5% deduction—resulting in FDII income also being taxed at a lower effective tax rate than domestic profits.<sup>8</sup> Dividends from CFCs, as well as dividends received by corporations owning at least 10% of the shares of a foreign corporation, are exempt through a 100% dividends-received deduction. Credits are allowed for all or part of taxes paid to foreign governments.

Some types of business expenses are deductible in the year incurred. These deductions include ordinary and necessary business expenditures (e.g., wages and salaries, employee benefit programs, and repairs), write-offs for bad debts, taxes (other than federal income taxes), and advertising expenses. Interest paid is also deductible in the year incurred, but subject to limitations.

Other types of business expenses are deductible over several years. These types of expenses support the purchase or development of physical or intangible assets that are expected to help produce income over multiple years. These expenses are recovered over time through depreciation, amortization, or depletion rules defined in statute. Some investments can temporarily be recovered more quickly than under general rules through expensing (bonus depreciation).<sup>9</sup>

In the event these deductions exceed gross income, a net operating loss (“NOL”) deduction may be allowed in other years. A NOL is limited to 80% of taxable income with excess NOLs carried forward to be deducted in future years.<sup>10</sup>

## Corporate Tax Rates

Corporate income is subject to a flat tax rate of 21%.<sup>11</sup> Before 2018, there was a graduated rate structure, with a maximum statutory corporate tax rate of 35%. The graduated rate structure was intended to benefit smaller corporations, encouraging some small firms to incorporate to take

<sup>7</sup> For taxable years beginning after December 31, 2025, the GILTI deduction will be reduced to 37.5%.

<sup>8</sup> For taxable years beginning after December 31, 2025, the FDII deduction will be reduced to 21.875%.

<sup>9</sup> For property placed in service before January 1, 2023, full or 100% expensing was allowed. Assets placed in service during 2023 are eligible for expensing of 80% of the value of the asset. The percentage allowed to be expensed will be 60% in 2024, 40% in 2025, 20% in 2026, and zero in 2027 and beyond.

<sup>10</sup> NOLs generated in 2018, 2019, 2020 could temporarily be carried back (used to reduce prior year taxable income) up to five years and those losses could fully offset taxable income. For more information on net operating losses, see CRS Report R46377, *The Tax Treatment and Economics of Net Operating Losses*, by Mark P. Keightley.

<sup>11</sup> Before 2018, most corporate income was subject to a 35% statutory tax rate. To generate this flat rate, which applied to the largest businesses, income was taxed at rates that varied from 15% on the first \$50,000 of income to 35% on income over \$18,333,333. Corporations providing services in the fields of health care, law, engineering, architecture, accounting, actuarial science, the performing arts, and consulting were taxed at a fixed rate of 35%, regardless of their amount of taxable income.

advantage of scenarios where paying corporate taxes is less costly than paying according to the individual tax system.<sup>12</sup>

The corporate tax rate alone does not determine how much corporations pay in taxes. Because of a number of business tax benefits, including the deductions discussed above and credits discussed below, the *effective* (or actual) tax rate paid by corporations is typically less than the statutory rate. Effective tax rates can vary substantially across U.S. corporations, even within the same industry. For example, some corporations rely more on debt financing (i.e., borrowing money and paying it back with interest), which the tax code treats more favorably than equity financing (i.e., selling a portion of a company's ownership to raise capital), resulting in lower effective rates. Some corporations and industries rely on certain physical assets that can be depreciated ("written off") more quickly than investments made by companies in other industries, which again leads to differing effective tax rates. Corporations and industries with more extensive overseas operations or income may pay lower effective U.S. tax rates through GILTI and FDII (discussed above).

Similar in purpose to Subpart F and interest limitations (discussed above), the base erosion and anti-abuse tax (BEAT) is intended to reduce incentives to shift income to low-tax jurisdictions. Unlike Subpart F, BEAT is aimed not at including certain income but at taxing excess deductions—by imposing a minimum tax equal to 10% of the sum of taxable income and base erosion payments. BEAT applies only to large corporations (with gross receipts greater than \$500 million averaged over three years), and because BEAT is effectively a lower tax rate on a broader base, it will not apply to all taxpayers who have related-party payments.

In addition, a corporate alternative minimum tax (CAMT) of 15% is levied on the adjusted financial statement income of large corporations.<sup>13</sup> The CAMT applies to public and private corporations. Corporations pay the larger of the minimum tax or the regular tax, which is imposed at a 21% rate and includes any additional tax from BEAT. The CAMT applies to taxable years beginning after December 31, 2022.

## Corporate Tax Expenditures

A variety of corporate tax incentives known formally as tax expenditures exist to encourage certain types of behaviors and to assist certain industries or the corporate sector more generally. Tax expenditures include special credits, deductions, exemptions, exclusions, and tax rates that depart from what economists consider a "comprehensive" taxation of income.<sup>14</sup> Tax expenditures typically result in a revenue loss, although there are some that increase revenue.<sup>15</sup> Tax expenditures are not exclusive to the corporate tax system. In fact, individual tax expenditures are estimated to result in over nine and a half times more revenue loss to the federal government than corporate tax expenditures (see **Figure 1**), while the individual income tax collects about six

<sup>12</sup> For more information on benefits for small businesses in the corporate tax system, see CRS Report RL32254, *Small Business Tax Benefits: Current Law and Main Arguments For and Against Them*, by Gary Guenther.

<sup>13</sup> For more information on the corporate alternative minimum tax, see CRS Report R47328, *The 15% Corporate Alternative Minimum Tax*, by Jane G. Gravelle.

<sup>14</sup> The Budget Control Act of 1974 (P.L. 93-344) officially defines a tax expenditure 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." The Joint Committee on Taxation (JCT) generally produces an estimate of most individual and corporate tax expenditures each year. The latest tax expenditure estimates are available at <http://www.jct.gov/>. There is debate among economists about the specifics of what a system that taxes income in a "comprehensive" manner would look like, but the consensus is that it is one that taxes income as computed in a broad and theoretical economic sense.

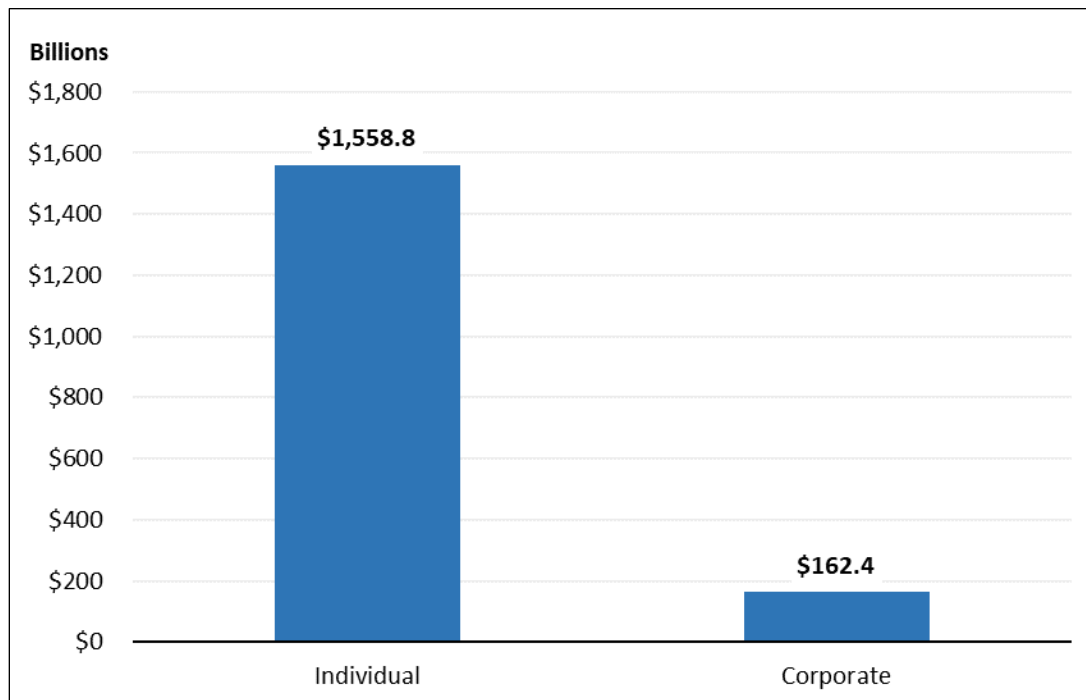
<sup>15</sup> Two examples of tax expenditures that raise revenue are the limits on deducting net operating losses and net interest.



times the amount of revenue. The individual tax expenditures include those benefiting pass-through businesses, which are not subject to the corporate income tax.

**Figure 1. Individual and Corporate Tax Expenditures in FY2023**

Billions of Dollars



**Source:** CRS calculations using estimates in U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2022-2026*, committee print, prepared by Joint Committee on Taxation, 117<sup>th</sup> Cong., December 22, 2022, JCX-22-22.

**Note:** Totals do not include tax expenditures of less than \$50 million (annually). The JCT does not provide estimates in these cases. Additionally, the sum of the tax expenditure estimates may not equal the total value of tax expenditures because of interaction effects. Tax expenditure estimates are projections of foregone revenue (or revenue cost) associated with various tax provisions and thus do not reflect actual revenue loss.

**Table 1** lists the five largest corporate tax expenditure provisions in FY2023.<sup>16</sup> The estimated sum of all corporate tax expenditures in FY2023 is \$162.4 billion, 78.3% (\$127.1 billion) of which is attributed to the five largest tax expenditures.<sup>17</sup> The largest corporate tax expenditure in 2023 is the reduced tax rate on the active income of controlled foreign corporations, with an estimated revenue loss of \$45.1 billion.<sup>18</sup> The four next largest expenditures are accelerated and bonus

<sup>16</sup> The values of three tax expenditures listed in **Table 1** are scheduled to fall over time due to scheduled changes stemming from P.L. 115-97, sometimes referred to as the Tax Cuts and Jobs Act of 2017 (TCJA). The 50% deduction allowed under GILTI will be reduced to 37.5% for tax years starting after 2025. This will lower the tax expenditure estimate for the reduced tax rate on active income of controlled foreign corporations. The full and immediate expensing (100% bonus depreciation) for equipment is reduced by 20% per year for four years starting in 2023. And the 37.5% deduction for foreign-derived intangible income will be reduced to 21.875% for tax years starting after 2025.

<sup>17</sup> The sum of all corporate tax expenditures is calculated using the estimates provided in U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2022-2026*, committee print, prepared by Joint Committee on Taxation, 117<sup>th</sup> Cong., December 22, 2022, JCX-22-22.

<sup>18</sup> For additional background, see CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples, and the entry for “Reduced Tax Rate on Active Income of



depreciation (\$38.5 billion), the credit for research and development expenses (\$17.0 billion), the deduction for the foreign-derived intangible income of U.S. multinational corporations (\$14.9 billion), and the low-income housing tax credit (\$11.6 billion).<sup>19</sup>

**Table I. Five Largest Corporate Tax Expenditures in FY2023**

Billions of Dollars

Corporate Tax Expenditure	Estimated Revenue Loss in in FY2023
Reduced tax rate on active income of controlled foreign corporations	\$45.1
Depreciation of equipment in excess of the alternative depreciation system	\$38.5
Credit for increasing research activities	\$17.0
Deduction for foreign-derived intangible income from trade or business within the United States	\$14.9
Credit for low-income housing	\$11.6
<b>Five Largest Corporate Tax Expenditures</b>	<b>\$127.1</b>
<b>All Corporate Tax Expenditures</b>	<b>\$162.4</b>

**Source:** CRS analysis using estimates in U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2022-2026*, committee print, prepared by Joint Committee on Taxation, 117<sup>th</sup> Cong., December 22, 2022, JCX-22-22.

**Notes:** The sum of the tax expenditure estimates may not equal the total value of tax expenditures because of interaction effects. Tax expenditure estimates are projections of foregone revenue (or revenue cost) associated with various tax provisions and thus do not reflect actual revenue loss. Columns may not sum due to rounding.

**Table 1** does not show a tax provision that occasionally garners attention: the foreign tax credit. The income of U.S. corporations with overseas operations is potentially subject to taxation in the country where it is earned. Additionally, income earned abroad may be subject to U.S. taxation depending on how the income is classified. U.S. corporations may be eligible for a tax credit equal to foreign taxes paid (up to a limit) to prevent double taxation. The JCT does not consider this credit, known as the foreign tax credit, a tax expenditure.

## Taxation of Corporate Shareholders

In addition to being taxed under the corporate income tax, after-tax corporate profits are typically subject to tax again when taxable shareholders realize capital gains or receive dividend distributions. Net long-term capital gains—or gains recognized from the sale of assets (e.g.,

Controlled Foreign Corporations” in U.S. Congress, Senate Committee on the Budget, *Tax Expenditures: Compendium of Background Material on Individual Provisions—A Committee Print Prepared for the Senate Committee on the Budget, 2022*, committee print, prepared by Congressional Research Service, 117<sup>th</sup> Cong., 2<sup>nd</sup> sess., 2022. That entry states that the tax expenditure for the reduced tax rate on active income of controlled foreign corporations “measures the difference between taxing all income of CFCs at full rates (allowing foreign tax credits) and the current taxes which are reduced due to GILTI deductions and the GILTI foreign tax credit rules.”

<sup>19</sup> For more on these tax expenditures, see CRS Report RL31852, *The Section 179 and Section 168(k) Expensing Allowances: Current Law and Economic Effects*, by Gary Guenther; CRS Report RL31181, *Federal Research Tax Credit: Current Law and Policy Issues*, by Gary Guenther; CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples; CRS Report RS22389, *An Introduction to the Low-Income Housing Tax Credit*, by Mark P. Keightley; and CRS Report RL31181, *Federal Research Tax Credit: Current Law and Policy Issues*, by Gary Guenther.

corporate stock) held for more than a year less any losses—are taxed at rates that are generally lower than the rates applied to individuals’ ordinary income (**Table 2**).<sup>20</sup> Qualified dividend income is taxed using the same tax rates that apply to capital gains.<sup>21</sup> Under current law, the tax rate on capital gains and dividends is 0%, 15%, or 20% depending on a taxpayer’s taxable income.

**Table 2. Tax Rates on Capital Gains and Qualified Dividends: Taxable Income Ranges, 2023**

	Married filing Jointly	Head of Household	Single
0%	\$0 - \$89,250	\$0 - \$59,750	\$0 - \$44,625
15%	\$89,251 - \$553,850	\$59,751 - \$523,050	\$44,626 - \$492,300
20%	\$553,851+	\$523,051+	\$492,301+

**Source:** Internal Revenue Code §1(h).

Income from capital gains and dividends may also be subject to a net investment income tax.<sup>22</sup> Since 2013, a 3.8% tax is imposed on the lesser of (1) net investment income; or (2) the excess of modified adjusted gross income (MAGI) above a threshold amount. This threshold amount is \$250,000 for taxpayers filing a joint return, \$200,000 for single filers, and \$125,000 for married filers filing separately.

## Corporate Income Tax Revenues

Relative to the size of the economy and as a share of total revenues, corporate taxes today are less than they were in the years following World War II. The corporate tax reached its post-World War II era peak in 1952 at 5.9% of gross domestic product (GDP) (see **Figure 2**). In 2021 (the most recent year that is not an estimate), the corporate tax generated revenue equal to approximately 1.7% of GDP. The corporate tax has also decreased in significance relative to other revenue sources over time. At its post-WWII peak in 1952, the corporate tax generated 32.1% of all federal tax revenue. In that same year, the individual tax accounted for 42.2% of federal revenue and payroll taxes accounted for 9.7% of revenue.<sup>23</sup> In 2021, the corporate tax accounted for 9.2% of federal tax revenue, whereas the individual and payroll taxes generated 50.5% and 32.5%, respectively.<sup>24</sup>

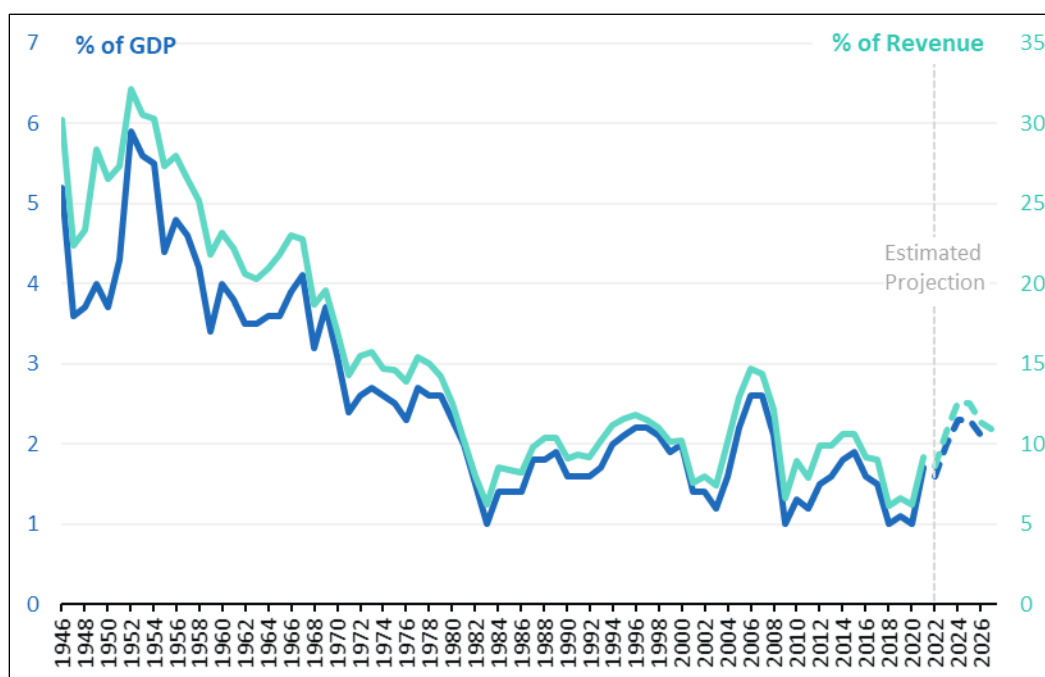
<sup>20</sup> For individual income tax rates by taxable income level, see CRS Report RL34498, *Federal Individual Income Tax Brackets, Standard Deduction, and Personal Exemption: 1988 to 2023*, by Gary Guenther. The tax rate on the gain from investments held less than a year (short-term capital gains) is equal to the taxpayer’s ordinary income tax rate.

<sup>21</sup> Qualified dividends include those received by an individual from a domestic corporation or a qualified foreign corporation, where the holding period requirement is satisfied.

<sup>22</sup> For more information, see CRS In Focus IF11820, *The 3.8% Net Investment Income Tax: Overview, Data, and Policy Options*, by Mark P. Keightley.

<sup>23</sup> For more information on the various components of the U.S. tax system, see CRS Report R45145, *Overview of the Federal Tax System in 2022*, by Molly F. Sherlock and Donald J. Marples; and CRS Report R47062, *Payroll Taxes: An Overview of Taxes Imposed and Past Payroll Tax Relief*, by Anthony A. Cilluffo and Molly F. Sherlock.

<sup>24</sup> Data on the percent of revenue by source comes from the Office of Management and Budget, Table 2.2, <https://www.whitehouse.gov/omb/budget/historical-tables/>.

**Figure 2. Corporate Tax Revenue as a Percentage of GDP, 1946-2027**

**Source:** CRS graphic based on data from Office of Management and Budget, FY2023 Budget, Historical Tables, Table 2.2 and Table 2.3, <https://www.whitehouse.gov/omb/budget/historical-tables>.

**Notes:** Data for years 2022 to 2027 are estimates.

Several factors help explain declines in the significance of the corporate tax over the post-WWII period.<sup>25</sup> First, the average effective corporate tax rate has decreased over time, mostly because of reductions in the statutory rate and changes affecting the tax treatment of investment and capital recovery (depreciation). Second, the increasing fraction of business activity conducted by pass-throughs (particularly partnerships and S corporations) has led to an erosion of the corporate tax base.<sup>26</sup> In recent years, corporate tax revenues have fluctuated with changes in economic conditions and changes in corporate tax policy.

## International Comparisons

### Tax Rates

Comparing U.S. corporate tax rates with those of other countries may help policymakers understand how the U.S. tax system affects corporate decisionmaking. Non-economists tend to

<sup>25</sup> For a more detailed analysis of declining corporate tax revenues, see CRS Report R42113, *Reasons for the Decline in Corporate Tax Revenues*, by Mark P. Keightley.

<sup>26</sup> For more on the effects on international profit shifting, see CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by Jane G. Gravelle; CRS Report R47003, *Corporate Income Taxation in a Global Economy*, by Jane G. Gravelle, Mark P. Keightley, and Donald J. Marples; Kimberly A. Clausing, "The Revenue Effects of Multinational Firm Income Shifting," *Tax Notes*, March 28, 2011, pp. 1580-1586; Kimberly A. Clausing, "Multinational Firm Tax Avoidance and Tax Policy," *National Tax Journal*, vol. 62 (December 2009), pp. 703-725; Martin A. Sullivan, "U.S. Multinationals Shifting Profits Out of the United States," *Tax Notes*, March 10, 2008, p. 1078-1082; and Martin A. Sullivan, "Shifting of Profits Offshore Costs U.S. Treasury \$10 Billion or More," *Tax Notes*, September 27, 2004, pp. 1477-1481.

focus on comparing statutory rates. Economists, however, generally prefer to examine effective tax rates when making international comparisons because every country has a different tax system, and the statutory tax rate is just one component. For example, some countries may have higher or lower rates, allow for faster capital recovery (i.e., depreciation), or offer corporate tax credits not available in other countries. Effective tax rates attempt to account for all the system differences and are more indicative of the tax burden in each country.

When making comparisons between U.S. and worldwide tax rates, it is also important to indicate whether tax rates are simple (unweighted) averages or are adjusted (weighted) to account for the size of the economies being compared. If the U.S. tax rate is compared to world tax rates that do not account for the size of other economies, then a small economy, such as Iceland, can have the same effect on the average international rate as a large economy, such as Germany or Japan. It is therefore more contextually appropriate to compare the U.S. tax rate to a weighted average of international tax rates to understand where the U.S. tax system stands in a global economic context. Typically, each country's tax rate is weighted by its gross domestic product (GDP) when computing the average.

**Table 3** compares the statutory tax rate and the weighted effective marginal rate in the United States to the remainder of the Organisation for Economic Co-operation and Development (OECD) and G7 countries,<sup>27</sup> showing that the U.S. statutory tax rate is near the weighted OECD average and below the weighted G7 average.<sup>28</sup> **Table 3** also shows that the tax rate most relevant for investment decisions—the weighted effective marginal rate—is lower in the United States than in other OECD and G7 countries. The OECD and G7 countries, however, exclude several large economies, in particular China and Brazil.<sup>29</sup>

**Table 3. Corporate Tax Rates: Comparing the United States to the Rest of the OECD, 2021**

Tax Rate Measure	United States	Non-U.S. Weighted OECD Average	Non-U.S. Weighted G7 Average
Statutory Tax Rate	25.8%	25.7%	26.9%
Effective Marginal Tax Rate (EMTR)	-2.7%	5.7%	1.9%

**Source:** CRS calculations based on various OECD statistics, [https://stats.oecd.org/Index.aspx?DataSetCode=CTS\\_CIT](https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT), downloaded March 3, 2023.

**Note:** Tax rates include corporate taxes at both the national and subnational level. Negative effective tax rates reflect a net subsidy delivered through the tax code.

## Tax Revenues

Corporate tax revenues as a percentage of GDP in the United States are below the average of all OECD member countries. **Figure 3** displays the average corporate tax revenues for OECD

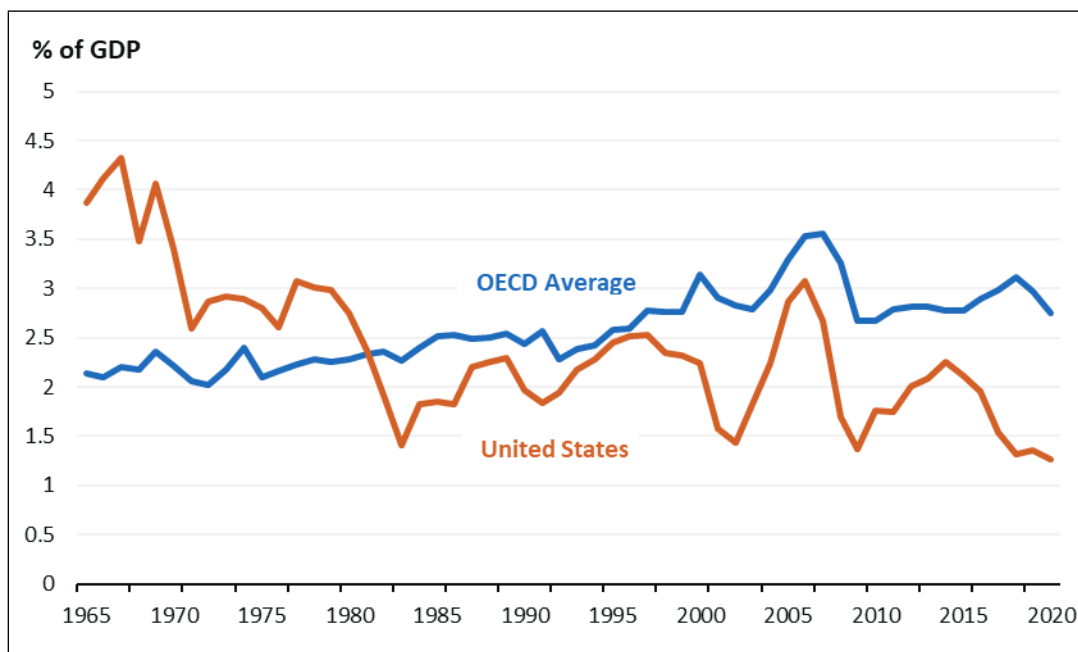
<sup>27</sup> The effective marginal tax rate (EMTR) is a forward-looking measure that summarizes tax-based incentives to invest in certain types of assets. The EMTR combines the statutory tax rate with other features of the tax code (e.g., tax credits and the timing of depreciation deductions).

<sup>28</sup> The unweighted OECD average statutory tax rate is 2.6 percentage points lower than the U.S. statutory tax rate, and the unweighted G7 average statutory rate is 0.6 percentage points higher.

<sup>29</sup> OECD members are generally countries with advanced economies. The OECD works closely with other large economies that are less economically advanced. For more information on current OECD members, see <http://www.oecd.org/about/membersandpartners/>. The G7 is an informal grouping of seven of the world's largest advanced economies, including Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

member countries and the United States as a percentage of GDP from 1965 through 2020. In 2020, the average OECD member collected corporate taxes equal to 2.8% of GDP, while the United States collected revenues equal to about 1.3% of GDP. Corporate tax receipts in the United States have been below the OECD average since 1982.

**Figure 3. Corporate Tax Revenue as a Percentage of GDP in 1965-2020**  
OECD Member Countries



**Source:** OECD Tax on Corporate Profits, <https://data.oecd.org/tax/tax-on-corporate-profits.htm>, downloaded April 14, 2022.

**Note:** Tax on corporate profits includes taxes levied by all levels of government.

There are several reasons why the United States collects less in federal corporate tax revenue than other countries. For example, as **Figure 2** shows, corporate tax revenues in the United States have generally declined since WWII, and that decline appears to have accelerated after 2017. At the same time, corporate tax revenues in other OECD countries (particularly European countries) have remained relatively stable even in the face of declining tax rates.<sup>30</sup> Some countries have adopted base-broadening policies to offset tax rate decreases, typically in the form of reduced investment credits, less generous loss offset rules, and limitations on interest deductibility and depreciation.<sup>31</sup> Recent research also suggests that there has been a shift from the noncorporate to the corporate sector in some countries, and that in other countries limited liability outside the corporate form is not available, making it more attractive to shift to a corporate form.<sup>32</sup> Combined, these factors appear to explain why corporate tax rates have fallen elsewhere while revenues have held steady.

<sup>30</sup> Ruud A. DeMooij and Gaetan Nicodeme, *Corporate Tax Policy, Entrepreneurship and Incorporation in the EU*, European Commission, Directorate-General for Economic and Financial Affairs, no. 263, January 2007, p. 6, [http://ec.europa.eu/economy\\_finance/publications/publication808\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication808_en.pdf).

<sup>31</sup> *Ibid.*, p. 13.

<sup>32</sup> U.S. Department of the Treasury, *Treasury Conference on Business Taxation and Global Competitiveness: Background Paper*, July 23, 2007, p. 18, <https://home.treasury.gov/system/files/136/archive-documents/07230-r.pdf>.

## Economic Considerations

### Why Have a Corporate Income Tax?

Economists and policymakers have offered a variety of reasons supporting the existence of a corporate tax since the enactment of the Corporate Tax Act of 1909 (P.L. 61-4). To avoid constitutionality issues, Congress initially structured the tax as an excise tax on the privilege of doing business in the corporate form (i.e., limited liability and access to capital markets).<sup>33</sup> While the new corporate income tax was challenged by several corporations that claimed it to be unconstitutional, the Supreme Court accepted its rationale and ruled that the privilege of doing business in the corporate form could be measured by profits.<sup>34</sup> The privilege-based rationale for the corporate tax is generally not accepted by economists today. Economists tend to view the risk-sharing from limited liability and pooling of financial capital to finance investment in productive physical capital to be beneficial to the economy.

A more generally accepted rationale for the corporate tax is that it ensures the income tax system is comprehensive. Absent a corporate income tax, corporate earnings would not be taxed until they were paid out to individuals. Thus, corporations would have an incentive to avoid taxes by retaining earnings. Shareholders would avoid taxes so long as corporations did not pay out earnings. Further, shareholders would benefit when corporations retained earnings over long periods of time, as delaying payouts would reduce the present value of the tax burden (assuming no change in tax rates over time).<sup>35</sup> Additionally, without a corporate tax there would be an incentive for business owners and higher-income individuals to incorporate in order to reduce taxes. Relatedly, without a corporate tax it could be difficult to collect tax on dividends and capital gains earned by foreign shareholders. Thus, the corporate tax serves as a withholding tax on foreign investors.

Some economists also support the corporate tax as a tax on economic rents.<sup>36</sup> Economic rents, also known as excess profits, are defined as profits greater than is *required* by a corporation to make an investment or engage in a line of business.<sup>37</sup> If the corporate tax could be designed to tax only excess profits, then it would not create economic distortions or induce efficiency losses because firms would still be earning levels of profit that satisfied their required returns, thus corporate output would be unchanged.<sup>38</sup> In practice, excess profits are difficult to measure, and,

<sup>33</sup> In 1895, the Supreme Court found that portions of an income tax enacted a year earlier were an unconstitutional direct tax not apportioned among the states according to population. See *Pollock v. Farmers' Loan and Trust Co*, 157 U.S. 429 (1895). The individual income tax was enacted in 1913, following ratification of the Sixteenth Amendment (Amendment XVI) to the U.S. Constitution, which allowed Congress to levy a tax on income, regardless of source, without apportioning it among the states.

<sup>34</sup> Joseph A. Pechman, *Federal Tax Policy*, 4<sup>th</sup> ed. (Washington, DC: The Brookings Institute, 1983), p. 129.

<sup>35</sup> Additionally, a significant share of gain is never taxed given the current structure of the estate tax system. Heirs, as recipients of corporate stock, are not taxed on the decedent's gain.

<sup>36</sup> Organisation for Economic Co-operation and Development (OECD), *Fundamental Reform of Corporate Income Tax*, Tax Policy Studies, no. 16, November 2007, [https://www.oecd-ilibrary.org/taxation/fundamental-reform-of-corporate-income-tax\\_9789264038127-en](https://www.oecd-ilibrary.org/taxation/fundamental-reform-of-corporate-income-tax_9789264038127-en).

<sup>37</sup> The term "excess profits" is being used here strictly in the economics textbook meaning of profits above which would be expected in a perfectly competitive market. In a perfectly competitive market, firms earn zero economic profits. Thus, excess profits correspond to positive economic profits.

<sup>38</sup> A pure tax on profits would tax only economic profits, where economic profits are revenues less both accounting costs and economic costs, such as the opportunity costs associated with a firm's factors of production. The opportunity cost of capital, for example, is the return the company could earn if it were employed in its highest return alternative use.



therefore, taxes are levied on accounting profits, as described above (see “Structure of the Corporate Income Tax”). Therefore, the corporate tax as currently applied is not a tax on excess profits or economic rents. Consequently, the corporate tax distorts economic decisionmaking, which can reduce overall economic output.

The corporate tax can also be used to achieve distributional objectives. As discussed in the following section, the traditional view of the corporate tax has been that it is primarily borne (or eventually paid) by corporate shareholders in the form of lower after-tax returns. To the extent corporate income, in the form of dividends and capital gains, accrues disproportionately to higher-income individuals, the corporate tax can be adjusted to increase or decrease the progressivity of the overall tax code.

## Corporate Tax Incidence

Since corporations are legal entities (i.e., they exist only on paper), they cannot bear the ultimate burden of taxes. Instead, the corporate tax must be passed along to individuals—including, to varying degrees, owners of capital (corporate shareholders and bondholders, as well as noncorporate business owners), corporate employees, and corporate customers. For example, the tax can be passed along to these individuals in the form of lower dividends or capital gains (corporate owners), reduced salaries and fringe benefits (employees), or higher prices (customers). The literature, however, generally finds that the corporate tax is not passed along to consumers.

The question of whether the corporate tax burden falls more heavily on capital or labor has been the source of a great deal of theoretical and empirical research over the years, and continues today. Traditional analysis of the corporate tax, in a closed economy, indicates that corporate owners bear the burden of the corporate tax in the short run, and the owners of capital more generally—across both the corporate and noncorporate sectors—bear it in the long run. The burden of the corporate tax spreads to the noncorporate sector as the tax causes capital to flow to the noncorporate sector, which, in turn, reduces the after-tax return to capital in that sector.<sup>39</sup> In contrast, a number of more recent theoretical studies find that labor bears the majority of the tax burden in an open economy.<sup>40</sup> The theoretical findings, however, appear to rely critically on particular assumptions that drive the results, specifically highly mobile capital and highly substitutable products. When these assumptions are relaxed, the burden of the corporate tax is found to fall mostly on capital—in line with the traditional analysis. In recent years, a number of economists have taken a statistical (empirical) approach to determine the incidence of the corporate tax. While these studies tend to conclude that a substantial portion of the corporate tax burden falls on labor, methodological limitations leave these results open to skepticism.<sup>41</sup>

Given the questions about recent empirical research, and the consistency of traditional theoretical models, some economists have been reluctant to move away from traditional incidence

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<sup>39</sup> The traditional view on the incidence of the corporate tax originated with the development of the “Harberger model” in 1962 and subsequent refinements. See Arnold Harberger, “The Incidence of the Corporate Tax,” *The Journal of Political Economy*, vol. 70 (June 1962), pp. 215-240.

<sup>40</sup> A review and critique of recent theoretical research, as well as a discussion of the extensions of the Harberger model can be found in Jennifer Gravelle, “Corporate Tax Incidence: A Review of General Equilibrium Estimates and Analysis,” *National Tax Journal*, vol. 66, no. 1 (March 2013), pp. 185-214.

<sup>41</sup> These studies are reviewed in Jennifer Gravelle, “Corporate Tax Incidence: A Review of Empirical Estimates and Analysis,” Congressional Budget Office, Working Paper 2011-01, Washington, DC, June 2011; and CRS Report RL34229, *Corporate Tax Reform: Issues for Congress*, by Jane G. Gravelle.



assumptions, where owners of capital are assumed to bear most of the burden of the corporate tax.<sup>42</sup> Other economists tend to support the results showing the corporate tax burden falls primarily on labor.<sup>43</sup>

Government agencies that analyze how the incidence of the corporate tax is distributed have changed the assumptions they use to produce distribution tables over time. The Congressional Budget Office (CBO) now assumes that 75% of the burden of the corporate income tax falls on owners of capital, with the remaining 25% assigned to households in proportion to their labor income.<sup>44</sup> Prior to this change, CBO assumed that the entire burden of the corporate tax was borne by owners of capital. Until 2008, the Department of the Treasury made a similar assumption. In 2012, the Treasury reported that it changed its incidence assumption to allocate 82% of the corporate income tax burden to owners of capital and 18% to labor income.<sup>45</sup> In 2013, the Joint Committee on Taxation (JCT) explained that it also assumes the majority (75%) of the corporate tax burden falls on owners of capital, with the remaining 25% falling on labor.<sup>46</sup>

Assumptions about the corporate tax incidence have important implications for policy analysis. When analysis assumes that the entire burden of the corporate tax is borne by capital, revenue-neutral changes in the tax burden do not change the distribution of the tax burden. This means that base-broadening, rate-reducing tax reforms would not change how the tax burden is allocated across households. For example, a corporate tax rate cut financed by decreased depreciation deductions would not change the distribution of the corporate tax because the same people would ultimately pay the tax. However, when analysis assumes that a portion of the corporate tax burden falls on labor, changes in tax rates and changes in deductions that are revenue-neutral may change how the tax burden is distributed. Rate cuts financed by reduced depreciation deduction allowances, for example, would tend to reduce the progressivity of the corporate tax system when part of the burden falls on labor.<sup>47</sup>

<sup>42</sup> For further discussion, see Kimberly A. Clausing, “In Search of Corporate Tax Incidence,” *Tax Law Review*, vol. 65, no. 3 (Spring 2012), pp. 433-472.

<sup>43</sup> For further discussion, see Stephin Entin, “Labor Bears Much of the Cost of the Corporate Tax,” Tax Foundation, Special Report, no. 238 (October 2017), pp. 1-22.

<sup>44</sup> CBO provides background information on the changes in corporate tax rate distribution assumptions in Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2008 and 2009*, Washington, DC, July 2012, pp. 13-15, [http://www.cbo.gov/sites/default/files/cbofiles/attachments/43373-AverageTaxRates\\_screen.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/43373-AverageTaxRates_screen.pdf).

<sup>45</sup> Julie-Anne Cronin et al., *Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology*, Office of Tax Analysis, Department of the Treasury, Technical Paper 5, Washington, DC, May 2012. Part of the tax on capital is allocated to owners of capital in general, with another portion allocated to capital earning economic rents.

<sup>46</sup> The JCT is tasked with a slightly different challenge than CBO or Treasury: JCT must also estimate tax policy changes and the associated distributional effects over a 10-year budget window. In the short-run, the JCT assumes that 100% of the burden of a corporate tax change falls on the owners of capital, in line with the conventional economic thinking. In the long-run, it assumes incidence distributions reported above. The concepts of the “short-run” and “long-run” assist economists with understanding economic impacts over time and are not set time periods. For more on JCT’s methodology, see U.S. Congress, Joint Committee on Taxation, *Modeling the Distribution of Tax on Business Income*, 114<sup>th</sup> Cong., October 16, 2013, JCX-14-13. For an earlier discussion on estimating tax burdens, see U.S. Congress, Joint Committee on Taxation, *Methodology and Issues in Measure Changes in the Distribution of Tax Burdens*, 103<sup>rd</sup> Cong., June 14, 1993, JCS-7-93. For a recent example of JCT estimates of the distributional effect of a corporate tax change, see U.S. Congress, Joint Committee on Taxation, *Distributional Effects of P.L. 115-97*, 116<sup>th</sup> Cong., March 27, 2019, JCX-10-19.

<sup>47</sup> This result arises in part since rate changes are predicted to affect normal returns to capital and labor, and supernormal returns to capital (i.e., returns in excess of the required rate of return). Changes in depreciation deductions are predicted to affect normal returns to capital and labor. Because higher-income persons receive a disproportionate share of the supernormal returns to capital, rate cuts provide a greater benefit to higher-income groups.

## Evaluating the Corporate Income Tax

The corporate income tax can be evaluated using three criteria that are well accepted by economists: equity, efficiency, and administrative simplicity. These criteria can also help policymakers evaluate proposed modifications to the current system. Equity examines how the corporate tax burden is distributed across individuals, both of similar and different abilities to bear the tax. Efficiency looks at whether resources are being directed to their most productive use in the economy. The administrative simplicity criterion evaluates the corporate tax by the compliance costs imposed on taxpayers by the tax system and the resources needed to administer it. A fourth metric discussed in policy debates is “competitiveness.” Policymakers frequently note that the U.S. tax system should be competitive. The precise definition of this concept, however, is often unclear.

### Equity

CBO periodically publishes statistics on the distribution of household income and federal taxes; the most recent available estimates are for 2019.<sup>48</sup> These estimates, a selected portion of which are reproduced in **Table 4**, provide insights into the distribution of the corporate tax across incomes. Specifically, **Table 4** displays how household income, corporate income tax liabilities (burden), and average corporate income tax rates vary across the income distribution. The upper portion of **Table 4** breaks U.S. households into quintiles, or equal 20% groups, according to household income. The lowest quintile represents the poorest 20% of households (accounting for 4.0% of household income) and the highest quintile represents the richest 20% of households (accounting for 54.6% of household income). The lower portion of **Table 4** provides a more detailed breakdown of the highest-income households.

According to CBO’s estimates, the corporate income tax is progressive—meaning its burden increases with the taxpayer’s income.<sup>49</sup> For example, the average effective corporate tax rate for those in the highest income quintile is 2.2%, whereas it is 0.5% for those in the lowest income quintile. Providing further evidence of the corporate tax’s progressive nature, those in the top 1% of the income distribution faced an average corporate tax rate of 4.2% in 2019. Additionally, CBO estimates that households in the lowest quintile bore 1.4% of all corporate tax liabilities, while those in the highest quintile bore 77.3%. The top 1% of households bore 43.9% of corporate taxes.

**Table 4. CBO’s Distribution of Corporate Income Tax**

2019

Household Income Group <sup>a</sup>	Share of Household Income	Average Corporate Income Tax Rate <sup>b</sup>	Share of Corporate Income Tax Liabilities
Lowest Quintile	4.0%	0.5%	1.4%
Second Quintile	8.7%	0.6%	3.3%
Middle Quintile	13.6%	0.7%	6.0%

<sup>48</sup> Congressional Budget Office, *The Distribution of Household Income, 2019*, Washington, DC, November 2022, <https://www.cbo.gov/publication/58353>.

<sup>49</sup> Tax system progressivity is measured by the proportion of taxes paid by various income groups, relative to their share of income received.

Household Income Group <sup>a</sup>	Share of Household Income	Average Corporate Income Tax Rate <sup>b</sup>	Share of Corporate Income Tax Liabilities
Fourth Quintile	20.4%	0.8%	10.4%
Highest Quintile	54.6%	2.2%	77.3%
All Households	100.0%	1.5%	100.0%
91 <sup>st</sup> to 95 <sup>th</sup> Percentiles	10.4%	1.2%	8.3%
96 <sup>th</sup> to 99 <sup>th</sup> Percentiles	13.5%	1.8%	15.7%
Top 1%	15.9%	4.2%	43.9%

**Source:** Congressional Budget Office, *The Distribution of Household Income, 2019*, November 2022, <https://www.cbo.gov/publication/58353>, and the report's data supplement.

**Notes:** For purposes of determining the distribution of corporate income tax liabilities and average corporate tax rate, CBO assumes that workers bear 25% of the burden of the corporate income tax.

- a. CBO's definition of household income, or "income before transfers and taxes," is market income plus social insurance benefits. CBO defines market income as the sum of labor income, business income, capital income (including capital gains), and income received in retirement for past services and nongovernment sources of income. Social insurance benefits are the sum of benefits from Social Security, Medicare, unemployment insurance, and workers' compensation.
- b. CBO computes average corporate tax rates as federal corporate taxes divided by income before transfers and taxes.

The Treasury also publishes statistics on the distribution of household income and federal taxes, the most recent of which are for 2023 and are presented in **Table 5**.<sup>50</sup> However, the Treasury uses a different measure of income (known as "cash income") than CBO and, as was discussed in the "Corporate Tax Incidence" section, allocates less of the corporate income tax burden to workers than does CBO (18% vs 25%).<sup>51</sup> Still, the story is the same: Treasury's analysis finds that the corporate income tax is progressive. The average corporate income tax rate for households in the lowest quintile was 0.5% compared to 2.8% for those in the highest quintile and 5.2% for the top 1% of households. Treasury also estimates that households in the lowest quintile bore 0.6% of all corporate tax liabilities, while those in the highest quintile bore 82.3% of corporate taxes. The top 1% of households bore 48.1% of corporate taxes.

<sup>50</sup> See U.S. Department of the Treasury, *Distributional Analysis of the U.S. Tax System*, <https://home.treasury.gov/policy-issues/tax-policy/office-of-tax-analysis>.

<sup>51</sup> For CBO's definition of household income, see note a in **Table 4**. Treasury explains in its analysis that "cash income consists of wages and salaries, net income from a business or farm, taxable and tax-exempt interest, dividends, rental income, realized capital gains, unrealized gains at death, cash and near-cash transfers from the government, retirement benefits, and employer-provided health insurance (and other employer benefits). Employer contributions for payroll taxes and the federal corporate income tax are added to place cash on a pre-tax basis." See U.S. Department of the Treasury, *Distributional Analysis of the U.S. Tax System, 2019 Distribution of Income*, <https://home.treasury.gov/policy-issues/tax-policy/office-of-tax-analysis>.

**Table 5. Treasury's Distribution of Corporate Income Tax**  
At 2023 Income Levels

Cash Income Group <sup>a</sup>	Share of Cash Income	Average Corporate Income Tax Rate <sup>b</sup>	Share of Corporate Income Tax Liabilities
Lowest Quintile	2.6%	0.5%	0.6%
Second Quintile	6.7%	0.6%	1.9%
Middle Quintile	11.4%	0.8%	4.4%
Fourth Quintile	19.6%	1.1%	10.2%
Highest Quintile	60.2%	2.8%	82.3%
All Households <sup>c</sup>	100.0%	2.1%	100.0%
90 <sup>th</sup> to 95 <sup>th</sup> Percentiles	10.9%	1.6%	8.5%
95 <sup>th</sup> to 99 <sup>th</sup> Percentiles	15.0%	2.2%	16.0%
Top 1%	19.0%	5.2%	48.1%

**Source:** CRS analysis of U.S. Department of the Treasury, *Distributional Analysis of the U.S. Tax System, 2023 Distribution of Income*, <https://home.treasury.gov/policy-issues/tax-policy/office-of-tax-analysis>.

**Notes:** For purposes of determining the distribution of corporate income tax liabilities and average corporate tax rate, Treasury assumes that workers bear 18% of the burden of the corporate income tax.

- Treasury notes in its analysis that “cash income consists of wages and salaries, net income from a business or farm, taxable and tax-exempt interest, dividends, rental income, realized capital gains, unrealized gains at death, cash and near-cash transfers from the government, retirement benefits, and employer-provided health insurance (and other employer benefits). Employer contributions for payroll taxes and the federal corporate income tax are added to place cash on a pre-tax basis.”
- Treasury computes average corporate tax rates as total corporate tax burden for the income group divided by cash income for the income group.
- Based on Treasury's data notes, households with negative incomes are excluded from the lowest quintile but are included in the “All Households” line. Thus, the sum of the quintiles may not equal the “All Households” line.

## Efficiency

Economists look toward estimated effective tax rates across the economy to gain insight into the efficiency impact of the corporate (and overall) tax system. If tax rates vary across investments and activities, corporations could be making decisions based on taxes rather than on real economic factors. Unless there is an economic policy rationale for using taxes to incentivize certain corporate investments and activities (e.g., a market failure or distributional concerns), differing tax rates can reduce economic efficiency. However, distilling the tax system's efficiency impact down to a single figure is difficult given the complexity of the tax system and various factors that affect investment decisions. As a result, researchers are required to make certain assumptions about temporary versus permanent tax provisions, financing sources, and type of investment.

Along these lines, **Table 6** presents estimates for the marginal effective tax rates across various corporate domestic investments made shortly after the enactment of P.L. 115-97, sometimes referred to as the Tax Cuts and Jobs Act of 2017 (TCJA). Estimates that account for temporary

provisions and permanent provisions are presented separately. The estimates assume the investments would be financed with 68% equity and 32% debt and do not incorporate shareholder-level taxes. However, the exact mixture of debt and equity used to finance an investment will alter these rates, which, in turn, raises economic efficiency concerns because the U.S. corporate tax system contains a tax-induced bias toward debt financing. The primary factor contributing to this bias is the fact that interest payments can be deducted (subject to a limit) from income, while dividend payments cannot. Therefore, all else equal, the effective tax rate on a given investment will fall the more debt financing is used.<sup>52</sup>

**Table 6** shows that marginal effective tax rates can vary considerably depending on the investment being made. For example, investments in nonresidential and residential structures face marginal effective tax rates of 10.7% and 8.2%, respectively, whereas most other investments face large *negative* tax rates. The marginal effective tax rate also varies depending on whether one considers the temporary provisions included in the TCJA that affect the cost recovery of investment (i.e., expensing of equipment and research costs) or the permanent provisions in TCJA (i.e., equipment and five-year amortization for research).<sup>53</sup>

**Table 6. Marginal Effective Tax Rates for Debt- and Equity-Financed Investment, 32% Debt Share**

Asset	Post TCJA: Temporary Provisions	Post TCJA: Permanent Provisions
Equipment	-9.6%	5.4%
Public Utility Structures	-9.6%	5.8%
Nonresidential Structures	10.7%	10.7%
Residential Structures	8.2%	8.2%
Intangibles		
Research	-95.4%	-52.2%
Advertising	-9.6%	-9.6%
Other	-9.6%	-9.6%
Total	-6.6%	1.8%

**Source:** CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

Some of the exemptions, credits, deductions, and other tax preferences in the U.S. tax system that result in varying tax rates represent attempts to address instances where markets fail to maximize economic efficiency. Take, for example, tax incentives for research and development (R&D) related activities.<sup>54</sup> R&D that leads to technological innovation is associated with positive externalities (spillovers). That is, there are benefits to R&D that accrue to those not directly involved in or paying for the research itself. Economic theory suggests that markets tend to underinvest in activities that generate positive externalities. Thus, granting a tax subsidy for R&D

<sup>52</sup> See Tables 1 and 2 in CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

<sup>53</sup> For more information on cost recovery, see CRS In Focus IF11187, *Tax Depreciation of Qualified Improvement Property: Current Status and Legislative History*, by Gary Guenther.

<sup>54</sup> For background on tax incentives for R&D, see CRS Insight IN11887, *Tax Treatment of Research Expenses: Current Law and Policy Issues*, by Gary Guenther.

could lead to additional R&D and improve overall economic efficiency by directing additional economic resources to R&D-related activities.<sup>55</sup>

However, providing tax preferences that narrow the tax base may necessitate higher tax rates to raise sufficient federal revenues over time. The potential for economic distortions caused by higher marginal rates should be weighed against the potential efficiency gains associated with various tax preferences to evaluate net efficiency gains. Tax preferences or tax expenditures that narrow the tax base and that do not otherwise enhance economic efficiency can ultimately reduce economic efficiency by requiring higher marginal rates over time.<sup>56</sup>

Removing certain provisions, such as accelerated depreciation, in exchange for reduced tax rates will not necessarily improve economic efficiency. Slowing depreciation, and making depreciation more neutral across different types of assets, could increase the cost of capital. Additionally, modifying depreciation to be more neutral across assets while reducing the corporate tax rate provides a windfall benefit to existing capital that was the result of investment decisions made under the previous corporate tax rate. The burden on new investments increases from slower depreciation, but all capital benefits from reduced tax rates.

The differential treatment of domestic and foreign-source income by U.S. multinational corporations also raises concerns that their business decisions may be motivated by tax policy rather than nontax business factors. If multinationals allocate real economic resources (i.e., capital and labor) differently than they would under a neutral tax policy, current tax policy creates economic inefficiencies, barring the existence of externalities. If, however, resource reallocation in response to tax rate differentials is limited (i.e., there is limited capital mobility), then efficiency losses may be small. A corporation's decision of how to allocate real economic resources, however, can be different from its decision of how to allocate its global profits to minimize taxes. Even if real resource allocation is relatively unresponsive to tax differentials, policymakers may still be concerned about profit shifting and the resulting loss in tax revenues.

Finally, the economic efficiency of the corporate tax depends on what is actually being taxed. If a corporate tax can be designed such that the tax is levied only on economic profits (i.e., supernormal returns), the tax should not change firms' output decisions in the short run, and thus should have limited efficiency consequences. In practice, however, the corporate tax is not levied on pure economic profits. In this sense, the corporate tax acts as a tax on capital, and could discourage capital formation in the corporate sector.

## **Administrative Simplicity**

Complexity in the tax code contributes to increased compliance costs as taxpayers are required to devote more time and economic resources to tax preparation.<sup>57</sup> Tax code compliance creates inefficiencies to the extent that resources devoted to tax preparation are not available for other

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<sup>55</sup> The effectiveness of the research tax credit depends on whether the credit motivates additional research activity, rather than simply rewards companies for engaging in research activity that would have taken place without a tax credit. For more on this issue, see U.S. Government Accountability Office, *The Research Tax Credit's Design and Administration Can Be Improved*, GAO-10-136, November 2009, <http://www.gao.gov/new.items/d10136.pdf>.

<sup>56</sup> The government also has alternative revenue generating options, including taxes on individuals. If less revenue is raised through the corporate tax system, the federal government may look to alternative revenue sources.

<sup>57</sup> GAO estimated that the costs associated with tax compliance are roughly 1% of GDP. This estimate includes costs of complying with individual as well as corporate income taxes. See U.S. Government Accountability Office, *Summary of Estimates of the Costs of the Federal Tax System*, GAO-05-878, August 2005, <http://www.gao.gov/new.items/d05878.pdf>.



productive activities. Further, complex tax systems may put certain taxpayers at a disadvantage, as those with limited resources may not be able to claim all the tax benefits to which they are legally entitled.<sup>58</sup> Thus, complex tax systems may be viewed as unfair or inequitable. Tax code complexity also increases administrative and enforcement costs. Simplifying the current tax system could help reduce the tax gap.<sup>59</sup>

One general approach for accomplishing this would be to eliminate some or all tax expenditures. To the extent that policymakers want to retain certain tax preferences, perhaps over efficiency concerns, another approach could be to look for overlap or redundancy in the tax code. The additional revenue generated from eliminating redundancies could be used to finance a reduction in the corporate tax rate, which, along with a broader tax base, could improve economic efficiency.

### *National Competitiveness*

National competitiveness arguments are frequently put forth as a rationale to enact certain corporate tax policies. It is less frequently asked whether competitiveness has meaning for the country *as a whole*. A competition involves two or more parties in a contest, and a contest implies there will be a winner and loser(s), with the gains of the former exactly offsetting the losses of the latter. A competition is therefore a zero-sum game and does not allow for multiple winners. For example, if a consumer purchases an iPhone, that purchase is at the expense of Apple's competitors (such as Samsung) in the form of customers, profits, and market share. Thus, individual companies undoubtedly compete against each other.

In contrast, nations engage in economic trade, which involves mutually beneficial economic exchanges that allow countries to focus their production efforts on those goods that they are *relatively* most efficient at producing and trade for those goods that they are *relatively* least efficient at producing. A fundamental tenet of economics is that a country cannot be the most efficient at producing everything simultaneously.<sup>60</sup> Therefore, divvying up production efforts across countries according to each's relative (or comparative) advantage and engaging in trade can increase the well-being of all trading partners. That is, trade is not a zero-sum game because it allows for multiple winners. Thus, while individual firms may compete, countries trade.<sup>61</sup>

Additionally, strong economic growth in one country does not imply slower growth for other countries. Nor does enhanced economic well-being in one country generally reduce economic opportunities in other countries. In fact, if one country experiences economic growth, those

<sup>58</sup> It has been reported that small- and mid-sized companies forgo certain tax benefits because the costs associated with claiming tax benefits exceeds the value of certain incentives. See John D. McKinnon, "Firms Pass Up Tax Breaks, Citing Hassles, Complexity," *Wall Street Journal*, July 23, 2012, p. A1, U.S. Edition.

<sup>59</sup> The Internal Revenue Service (IRS) defines the *gross* tax gap as the difference between the aggregate tax liability imposed by law for a given tax year and the amount of tax that taxpayers pay *voluntarily* and timely for that year. Relative to the size of corporate tax revenues, the tax gap is generally believed to be small. For additional background, see CRS In Focus IF11887, *Federal Tax Gap: Size, Contributing Factors, and the Debate Over Reducing It*, by Gary Guenther.

<sup>60</sup> More formally, this is known as the Law of Comparative Advantage. Nearly 200 years ago, David Ricardo pointed out that even if a country is more efficient than other nations at producing everything, it is still beneficial for it to focus its production efforts on those goods that it is *relatively* most efficient at producing and trading for items that it is *relatively* least efficient at producing.

<sup>61</sup> Numerous economists have made this point, including Paul Krugman, "Competitiveness: A Dangerous Obsession," *Foreign Affairs*, vol. 73, no. 2 (March/April 1994), pp. 28-44; and Jane G. Gravelle, "Does the Concept of Competitiveness Have Meaning in Formulating Corporate Tax Policy?" *Tax Law Review*, vol. 65 (2012), pp. 323-348.



benefits tend to spill over to that country's trading partners, as higher domestic incomes increase the demand for imported goods and services. As such, the United States benefits from strong growth abroad because it increases the demand for U.S. products and provides U.S. businesses access to expanding markets.

Some economists, in an attempt to define "competitiveness," have noted that "competitive" policies are those that promote domestic business globally, while increasing the U.S. standards of living.<sup>62</sup> Krugman (1994) argues that this and similar definitions are flawed, noting that "the growth rate of living standards essentially equals the rate of domestic productivity growth—not productivity relative to competitors."<sup>63</sup> The policy objective of promoting domestic business globally is also not clear. Is the goal to have tax policies that encourage U.S. firms to invest abroad to better compete in international markets? Or is the goal to prevent the movement of U.S. business operations overseas? These are two different policy objectives often promoted in the name of "competitiveness."<sup>64</sup>

Given the confusion surrounding national "competitiveness" (in an economic context) as a policy objective, focusing on designing a tax system that is efficient, equitable, and relatively straightforward to administer may be useful. At the same time, there may be important national security issues that policymakers may want to consider. These issues fall outside the realm of standard international economic theory and are beyond the scope of this report.

## Concluding Remarks

The structure of the corporate tax can influence the performance of the economy, impact fairness in the overall tax system, and have important administrative consequences. Additionally, the corporate tax generates a nontrivial amount of revenue, although its estimated 10.8% of federal tax revenues in 2023 ranks behind the individual income tax (50.6% of revenue) and payroll taxes (32.6% of revenue). If history is any guide, there will be continued interest in and debate over the structure of the corporate tax and even the necessity for its existence, both within academia and among policymakers.

At least two specific policy areas of interest pertaining to the corporate tax appear to be relevant in the current environment. The first involves concern, expressed by some, over recent deficits and the growing national debt. The corporate tax could be one tool to raise revenues and address these concerns. Policymakers could increase the corporate tax rate, subject more corporate activity to tax (e.g., broaden the base), or enact a combination of the two approaches. Pursuing either approach to generate more corporate tax revenue would require careful consideration given the potential impact on the economy and fairness in the tax system.

For example, base broadening would involve repealing or limiting corporate tax expenditures. As discussed previously (see "Corporate Tax Expenditures"), the estimated sum of all corporate tax expenditures in 2023 is \$162.4 billion. One potential issue is that \$127.1 billion (78.3%) of this total is attributed to the five largest tax expenditures, several of which increase the after-tax returns to investment—specifically, expensing of research and experimental expenditures, accelerated depreciation, and the low-income housing tax credit. Removing these types of

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<sup>62</sup> See, for example, Richard H.K. Vietor and Matthew Weinzierl, "Macroeconomic Policy and U.S. Competitiveness," *Harvard Business Review*, March 2012, <http://hbr.org/2012/03/macroeconomic-policy-and-us-competitiveness/ar/1>.

<sup>63</sup> Paul Krugman, "Competitiveness: A Dangerous Obsession," *Foreign Affairs*, vol. 73, no. 2 (March/April 1994), p. 34.

<sup>64</sup> For further discussion, see Jane G. Gravelle, "Does the Concept of Competitiveness Have Meaning in Formulating Corporate Tax Policy?" *Tax Law Review*, vol. 65 (2012), pp. 323-348.

expenditures could increase the effective tax rate on capital investment, which would likely reduce investment, and therefore output, wages, and short-run employment. However, this may need to be balanced with the potential negative effects deficits and the debt can have on future economic growth because of higher interest rates and potentially higher future taxes or lower future spending.

A second policy area of interest pertaining to the corporate tax is the global push for increased international tax coordination, which is related to revenue concerns but also involves issues of economic efficiency. One driver for these efforts is the revenue loss attributed to base erosion and profit shifting (BEPS), which one post-TCJA analysis estimated at \$77 billion annually.<sup>65</sup> The OECD and G20 have developed a multilateral framework to address BEPS. As of December 2022, 142 countries have agreed to work toward implementing a series of actions to reduce global corporate tax avoidance.<sup>66</sup> Taken together, these actions are aimed at reducing the ability of corporations to shift profits to low-tax countries. However, this overall reduction may need to be balanced with how the implementation of these provisions may affect U.S. corporate revenue, employment, and investment in the United States.<sup>67</sup>

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<sup>65</sup> Tax Justice Network, *The State of Tax Justice 2021*, November 2021, [https://taxjustice.net/wp-content/uploads/2021/11/State\\_of\\_Tax\\_Justice\\_Report\\_2021\\_ENGLISH.pdf](https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf).

<sup>66</sup> See CRS Report R44900, *Base Erosion and Profit Shifting (BEPS): OECD/G20 Tax Proposals*, by Jane G. Gravelle, for information on the specific actions; and <https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf> for the list of countries.

<sup>67</sup> See Organisation for Economic Co-operation and Development, *Members of the OECD/G20 Inclusive Framework on BEPS*, December 2022, <https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>; CRS Report R47174, *The Pillar 2 Global Minimum Tax: Implications for U.S. Tax Policy*, by Jane G. Gravelle and Mark P. Keightley; and CRS In Focus IF11874, *International Tax Proposals Addressing Profit Shifting: Pillars 1 and 2*, by Jane G. Gravelle for discussions concerning the revenue and incentive effects of the BEPS project.