The Washington Times
www.washingtontimes.com

End corporate income tax

By Richard W. Rahn
Published December 1, 2004

On Nov. 18, in a speech given at the Finance Ministry in Vienna, Austria, the very highly regarded European economist and first woman president of the Mont Pelerin Society, Professor Victoria Curzon Price, called for eliminating the corporate income tax.

There, in the center of socialist Europe, was not only the call to get rid of this destructive tax, but almost everyone in an audience of economists, various government finance officials and public policy experts appeared to agree with her.

The idea and practice of the corporate income tax has been dying slowly for the last two decades. The corporate income tax is a highly destructive tax that greatly distorts proper economic decision-making, taxes the same income more than once, is endlessly complex, and provides a declining share of tax revenue in most countries. For instance, in the United States, corporate income tax revenues fell from 4.2 percent of gross domestic product in 1967 to only 1.2 percent of GDP in 2003, though there was minimal change in the tax rate.

Good economists have long known the corporate income tax causes more problems than it solves. Many countries, seeking higher economic growth and employment, have sharply cut their tax rates. Ireland cut its corporate tax rate from 43 percent to only 12 1/2 percent, attracting investment from around the world and, in turn, becoming not only one of the fastest-growing but one of the wealthiest economies in Europe.

The new market economies of Eastern Europe seeking high growth and rapid job creation have also been cutting their corporate tax rates. Slovakia, Lithuania and Poland have a 19 percent corporate rate; Hungary 16 percent; Slovenia and Latvia 15 percent; and Bulgaria just announced it will move to a 15 percent rate next year. Montenegro, not to be outdone, announced it will go to a 9 percent rate. Estonia has become the champion by going to a zero rate on reinvested profits.

As a result of this competition, even France (34 percent) and Germany (38 percent) have been forced into modest corporate tax reductions, giving them lower rates than corporations face in the United States. American companies now have an average 40 percent rate (including state corporate taxes), and only very poorly performing Japan with its 42 percent rate is higher.

Looking at these numbers, it is easy to understand why corporations doing business around the world elect not to have the United States as their legal home, because it makes them noncompetitive. When running for president, Sen. John Kerry proposed punishing companies for leaving the United States. The correct solution is for the U.S. to abolish the corporate income tax, thereby making it the most desired location on the planet for many companies to incorporate.

Those who oppose eliminating the corporate tax will say we cannot afford the revenue loss. They say such things because they do not think beyond the first order. Think about it for a minute. If you eliminate the corporate tax, corporate profits will increase, causing corporations to hire more workers and/or raise wages and invest more in new and better equipment, and/or increase their dividend payouts. All this will cause the price of corporate stock to rise and the government to receive more in capital-gains tax revenues. The government will also receive more tax revenue from the increase in dividends paid and workers hired. If we look at the experience of other countries who have greatly reduced corporate tax rates, like Ireland, it is clear the additional growth in jobs and profits ended up providing the government more, not less, tax revenue.

The U.S. Treasury and Congress' Joint Tax Committee use very simple-minded static revenue models when estimating proposed tax changes. That is why they almost always get it wrong. I have no doubt a properly constructed dynamic model or, better yet, an actual experiment of eliminating the corporate tax will prove we are better off without it.

The corporate tax is enormously complex and hence extremely expensive to administer; tends to drive companies to set up operations outside the United States; discourages foreign investment in the U.S., thereby driving down the dollar's value; taxes capital income more than once, thus reducing the U.S. saving rate, which also drives down the dollar's value; and makes us less competitive. The corporate rate is also unfair to businesses that need a corporate form as opposed to a single proprietorship, partnership, limited liability company and real estate investment trust (REIT). which are not burdened with the extra level of taxation.

The president has pledged fundamental tax reform. A first step ought to be eliminating the corporate income tax, because it will greatly simplify the tax code and its enforcement, make U.S. companies more competitive, strengthen the dollar, create many new jobs and increase economic opportunity. There are still some, but fortunately a diminishing number of mentally lightweight leftists, who believe you somehow can tax a corporation without taxing the workers, customers, suppliers and stockholders (who in many cases are invested in pension funds) of the corporation. When they make the cry, as they surely will, that eliminating the corporate income tax benefits the rich and rewards the greedy, they should be challenged with facts and logic. Advocates of sound economic policy have too many times allowed themselves to be bullied by loudmouths who claim compassion, yet cause misery. Tax reform is too important to allow ignorance to prevail.

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