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Static-minded Senators

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If you wanted to set up a new specialty computer software business, would you establish it as a sole proprietorship, a partnership, or a corporation? Also what country — and in the case of the U.S., what state — would you choose as your company's legal home?

Increasingly, these decisions are driven by tax considerations rather than what makes the best business sense. You may have heard that last month, Sens. Max Baucus, Montana Democrat, and Charles Grassley, Iowa Republican, proposed a bill to raise the tax from 15 percent to 35 percent on "publicly traded partnerships that derive most of their income from asset management and financial services," in effect making them pay the same tax rate as ordinary corporations. At the same time, House Democrats proposed an increase of 4.3 percentage points in the maximum individual tax rate.

The Senate proposal would affect very few companies, several of which are headed by very rich men, so the bill is deemed to have populist appeal. What struck me about this act by Mr. Baucus and Mr. Grassley, which follows in a similar vein bills proposed by Democratic Sens. Byron Dorgan of North Dakota and Carl Levin of Michigan to restrict use of offshore companies and investments, is most politicians' tendency to deal with a perceived problem by immediately calling for more taxes or more regulations. In fact, many problems, such as the ones the bills above are supposed to correct, would appropriately be dealt with by reducing, not increasing, tax rates and regulations.

Politicians love power. As Henry Kissinger said, "Power is the ultimate aphrodisiac." And spending other people's money and regulating them is the manifestation of power — hence, politicians' never-ending desire to tax. Many taxpayers and citizens, who are psychologically unable to get rid of these bums, become the equivalent of "battered wives" who stay with their abusive husbands because that is all they know.

There are two real problems with business taxation that Congress refuses to address: One is that regular corporations are taxed at much higher rates than other forms of business. The second problem is that the combination of federal and state corporate tax rates results in the U.S. having either the highest or second-highest in the world (depending on whether your business is located in a high-tax or low-tax state). Because of both discriminatory taxation of corporations and excessive regulation of publicly traded corporations, investors are opting into nonstandard corporation forms of ownership and taking companies "private" so both taxes and regulations will be less costly.

When John Edwards was a trial lawyer, he and his partners were only taxed at individual rates. But if their same ownership percentages had been in a regular corporation making a lifesaving medical device, the "company" would have had to pay another 35 percent corporate tax before the partners (corporate shareholders) received their share of the profits. The original rational for the difference in taxation was that corporate stockholders had limited liability, but now noncorporate companies (such as limited liability companies — LLCs — and other forms of partnership) can have the same limited liability.

If your software company (in the original example) was likely to have significant non-U.S. markets for its products, it would probably be more sensible to set it up in some foreign jurisdiction with very low corporate tax rates (Ireland has a 12½ percent tax rate, some European Union countries are down to 10 percent, and several other jurisdictions have a zero corporate rate).

The company would still have to pay a 35 percent tax on profits from its sales in the U.S., but would only have to pay 12½ percent on its profits in Ireland, and not 35 percent on those profits as would a U.S.-incorporated company.

As one would expect, business people and investors increasingly opt for noncorporate forms of ownership and moving or establishing companies outside the U.S., undermining the U.S. corporate income tax base. Legislation, like those mentioned above, will only worsen matters over time, by accelerating the moves away from the U.S.-based corporate form of ownership.

Think about an alternative model. What would happen if we reduced the U.S. corporate tax rate to zero? U.S. companies would no longer have a tax reason to leave the country, and foreign and new companies would flock here. There would be many more, and higher-paying, jobs, as well as lower consumer prices.

Those political and media elites who are either willfully or truly ignorant of economics would scream that the "greedy corporations" are going untaxed — ignoring the fact that the corporation tax is "paid for" by lower wages to workers, higher prices to consumers, and lower returns to owners, who most likely are typical Americans saving for retirement and workers' pension funds.

In reality, eliminating the corporate tax is likely to generate more total tax revenue (federal, state, and local), instead of less, due to the increased number of high-paying jobs, other business taxes and the greater affluence resulting from the increased investment and economic growth.

Tax increasers' small minds can only see a static world where they gain by taking freedom and property from others. Tax-cutters, like Ronald Reagan and Margaret Thatcher, had the vision to see a freer and more prosperous world.

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