BACKGROUNDER

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President Biden's Corporate Tax Increase Would Reduce Wages, Harm Economic Growth, and Make America Less Competitive

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KEY TAKEAWAYS

President Biden's corporate tax rate increase, part of the American Jobs Plan, would harm U.S. global competitiveness, reduce wages, cost jobs, and raise prices.

The plan would also add new costly and complex taxes on job creators in America, including U.S.-based international corporations, and a minimum tax on book income.

Congress should reject tax hikes in favor of a pro-growth agenda that keeps all taxes low.

President Joe Biden recently outlined his American Jobs Plan, a massive $2 trillion tax-and-spend proposal. Billed as an "infrastructure" and "jobs" plan, the proposal would include a variety of policies that would centralize more power in the federal government without creating jobs, nor much of what is traditionally considered infrastructure.[1]

This *Backgrounder* focuses on analysis of the tax portions of the proposal. President Biden's tax proposal would:[2]

- Increase the corporate tax rate to 28 percent from the current 21 percent rate;
- Enact a new 15 percent minimum tax on book income for large corporations;

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- Seek an international agreement to impose global minimum corporate taxes that would sacrifice American competitiveness in an attempt to create a cartel of high-tax countries around the world;

- Increase taxes on U.S.-headquartered multinational corporations, including by establishing a 21 percent minimum tax on foreign profits;

- Repeal certain tax policies related to the fossil-fuels industry and create more corporate welfare for "green energy"; and

- Increase funding for the IRS and increase tax-collection enforcement measures.

The White House estimates that these policies would cumulatively increase the tax burden by more than $2 trillion over 15 years.[3]

This tax proposal would reduce wages, cost jobs, restrict economic growth, reduce investment, and make America less competitive. Congress should reject these tax increases.

Corporate Tax Increase

The Tax Cuts and Jobs Act (TCJA) of 2017 reduced the federal corporate income tax rate to 21 percent from 35 percent. Prior to the tax cuts, the U.S. corporate tax rate was the highest in the industrialized world and put American workers at a competitive disadvantage.

A recent review of the economic history of the TCJA showed that the law succeeded at creating jobs, raising wages, allowing new investment, and increasing the size of the economy.[4] In the two years after the tax cuts, wages increased by more than $1,400 above the previous trend for production and nonsupervisory workers. Real household income reached an all-time high in 2019. The unemployment rate fell consistently, reaching a 50-year low of 3.5 percent, and new job openings surged.[5]

Now, these economic gains achieved in large part due to the corporate tax-rate reductions are under threat. President Biden's so-called American Jobs Plan proposes to increase the corporate rate to 28 percent. Including state tax, the tax rates on U.S. corporations would rise to an average of 32.4 percent.[6]

Economic Effects

Heritage Foundation analysts estimate that a corporate tax rate of 28 percent will reduce long-run gross domestic product (GDP) by 0.96 percent—about $1,650 per household.[7] Wages would fall by about 1.27 percent, corresponding to a reduction in income of about $840 per year for the median worker.[8]

An earlier Tax Foundation analysis found that a 28 percent corporate tax rate would reduce GDP by 0.8 percent, cost 159,000 jobs, and reduce wages by 1.8 percent over the long run.[9]

Workers and Consumers. The President claims that increasing the corporate income tax rate would "ensure that corporations pay their fair share of taxes."[10]

But business taxes are borne by people in the form of reduced income by the owners (shareholders) or employees.[11] "Corporations" do not bear the burden of taxes because corporations are "a legal fiction."[12] A review of the economic research by the Heritage Foundation's Adam Michel "shows that workers bear a majority of the economic burden of the corporate income tax in the form of lower wages. Labor bears between 75 percent and 100 percent of the cost of the corporate tax."[13] The corporate tax is a tax on American workers.

Labor and capital are generally complementary, not substitutes. The two factors of production work together to create goods and services, and when there is more capital, labor is more productive, leading to higher wages. Therefore, taxing either labor or capital will hurt the other.[14]

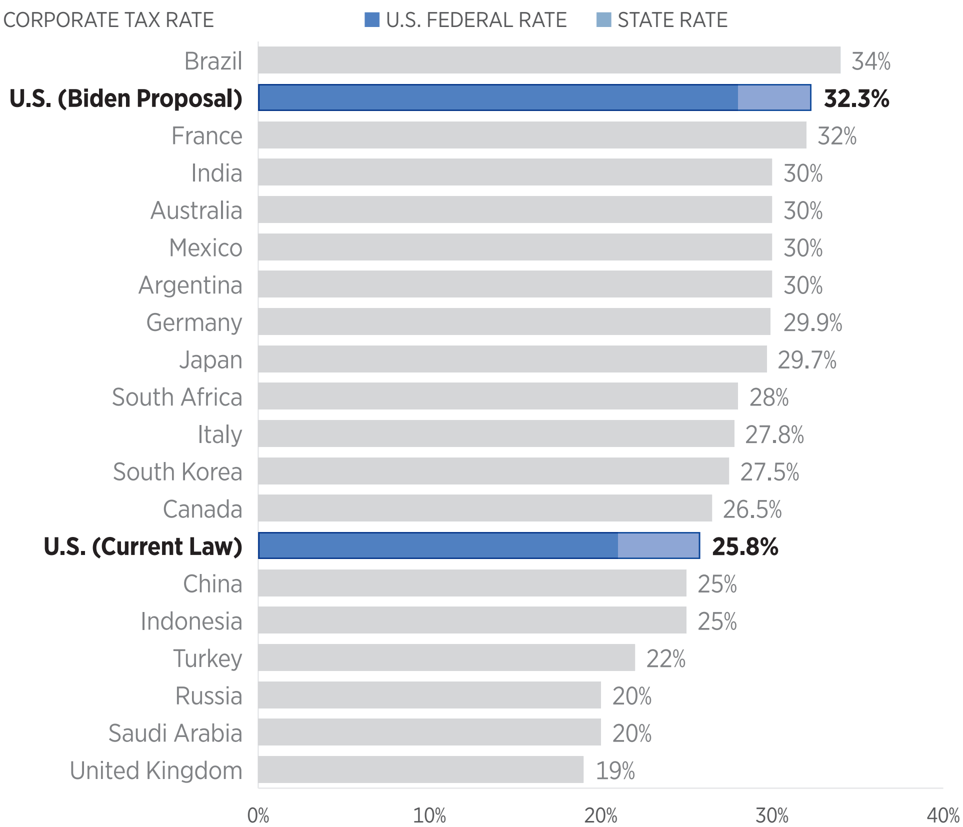
Older theoretical models that predicted that capital bore the full cost of corporate taxation relied on outdated assumptions of a simple closed economy without international investment. Since the 1960s, the economy has become much more open and competitive, and global investment is common.[15] Michel summarizes the result:

> In an open economy where capital can move abroad and the prices of goods are set competitively in the world market, the corporate tax has only one place to shift: to workers. When capital moves abroad, the domestic capital-to-labor ratio declines, slowing productivity and lowering wages.[16]

The corporate income tax is also subject to double taxation.[17] As explained by the Tax Foundation: "After paying the corporate income tax, the firm can either distribute its after-tax profits to shareholders through dividend payments or reinvest or hold its after-tax earnings, which raises the value

CHART 1

Biden Proposal Would Make U.S. Corporate Tax Rate One of Highest in G20



NOTE: Figures for non-U.S. countries include national and subnational rates, where applicable.
SOURCES: Elke Asen, "Corporate Tax Rates around the World, 2020," Tax Foundation, December 9, 2020, https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/ (accessed April 14, 2021), and Daniel Bunn, William McBride, Garrett Watson, and Erica York, "President Biden's Infrastructure Plan Raises Taxes on U.S. Production," Tax Foundation, March 31, 2021, https://taxfoundation.org/biden-infrastructure-american-jobs-plan/ (accessed April 14, 2021).

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of its stock and leads to capital gains."[18] This double taxation is distortive, reduces productivity, and harms the economy.[19]

If the tax rate is increased, many businesses will pass on the costs to consumers through higher prices for products and services. One study found that the price increases after a corporate tax hike "are larger for lower-price items and products purchased by low-income households."[20]

The corporate income tax is inefficient and economically destructive. Instead of increasing the corporate tax rate, Congress should reduce the tax burden on job creators or, ideally, repeal it entirely.

International Competitiveness. Increasing the corporate tax would harm America's international competitiveness. A 28 percent federal corporate tax rate would take the combined federal and state tax rate on U.S. corporations to 32.34 percent.[21]

This would put the United States in the dubious position of having the highest taxes on corporations among its major international competitors. It would be higher than the United Kingdom's 19 percent, Russia's 20 percent, China's 25 percent, Canada's 26.5 percent, Germany's 29.9 percent, Mexico's 30 percent, and even higher than France's 32 percent (which it is reducing to 25 percent next year).[22] The U.S. corporate tax rate would be the highest among all countries in the Organization for Economic Co-operation and Development (OECD), and be the second highest in the G20.[23] (See Chart 1.)

The proposed increase would reverse the improvements enacted in the TCJA, which brought the U.S. corporate rate down to closer to the OECD average, although the current 28 percent corporate tax rate is still higher than that of 25 OECD countries.[24] That increase would make the U.S. far less desirable as a destination for investment and job growth, threatening America's global competitiveness and slowing down the crucial economic recovery. It would make U.S.-based corporations takeover targets and increase inversions to move headquarters out of the United States. All this means fewer jobs, lower wages, and less opportunity for American workers.

Minimum Book Income Tax

The President proposes a new 15 percent minimum tax on "book income" for large corporations.[25] Book income is what corporations report to shareholders in financial statements. The purpose of reporting book income is to provide information about the finances and performance of the corporation for investors and creditors. This differs from the calculation of taxable income that corporations are required to undertake to comply with their tax liability.[26]

Book income and taxable income have different purposes, different audiences, different incentives, and different methods and inputs that are taken into consideration for their calculation. There can be differences in the types of revenues and expenses that are included, as well as when those revenues and expenses are accounted for. Depreciation and expensing of investments, employee compensation, net-operating-loss carryforwards, foreign income, and activities for which Congress has created tax credits or other special treatment can all have different treatment under the two calculations.[27] As another example, when calculating book income, corporations can deduct "fines and bribes," which are not deductible for the purposes of income tax liability.[28]

An important consideration about a minimum tax on book income is how and by whom book income is defined. While taxable income is defined by Congress in law, the "generally accepted accounting principles" for reporting financial statements are set by a private nonprofit, the Financial Accounting Standards Board (FASB).[29] The Constitution gives Congress sole authority of the legislative powers, including to lay and collect taxes. As Kyle Pomerleau of the American Enterprise Institute explains in an understated analysis, allowing the nonprofit FASB "the power to amend the corporate income tax…seems to be in tension with the Constitution's grant of the legislative power of the United States to Congress."[30]

The proposed new minimum tax would add unnecessary complexity to the tax code. The TCJA repealed the corporate alternative minimum tax (AMT), which was ineffective and distortionary.[31] The added complexity would make corporate accountants and lawyers more important but would lead to fewer investments in other employees at companies that face a new tax burden. Lawmakers should establish just one coherent and transparent system to calculate the tax base.

The President's proposal goes in the opposite direction. The Treasury's outline of the proposal states that corporations subject to the minimum tax on book income would receive credit for certain tax credits, including for research and development, clean energy, and housing.[32] But these tax credits were created for the purpose of calculating taxable income, and are not included when calculating book income. This means that firms may have to calculate three different representations of revenues, expenses, and profits, which will lead to more confusion and higher costs. If the President were truly serious about reducing the divergence between a firm's book income and taxable income, he would not propose an incoherent, and even more distortive, way to exempt certain tax credits, even if they may be politically popular.

The differences between book income and taxable income have caused some liberal commentators to claim that some "profitable" corporations pay little or no corporate income tax, when those companies have actually complied with the tax code established by Congress.[33] The corporate income tax is not levied on a business's revenue, or gross income. Instead, the taxable income is the corporation's profits minus deductions. So while a corporation may have high revenue in a given year, if it makes significant investments back in the business or has prior year net operating losses, it may end up with a low taxable income.

Congress should reject any proposals to establish a minimum tax on book income.

Sacrificing American Competitiveness to China, France, and Other Competitors

In a particularly troubling proposal, President Biden says that he will pursue a multilateral agreement to impose global minimum taxes "to end the race to the bottom on corporate tax rates."[34] The White House Fact Sheet on the President's proposal even says: "The time has come to level the playing field and no longer allow countries to gain a competitive edge by slashing corporate tax rates."[35]

Gone are the days of "America First." Instead, the President of the United States and his Administration are actively working to deny a competitive edge for America. It is an attempt to create a cartel of high-tax countries, stamping out competition and innovation.

This potential international agreement could have the effect of outsourcing U.S. tax policy to China, Russia, and other countries around the world. It is dangerous and Congress should reject it outright.

According to the Treasury Department,

> Under the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, the United States and the international community are pursuing a comprehensive agreement on corporate minimum taxation, providing for minimum tax rules worldwide. Under the agreement, home countries of multinational corporations would apply a minimum tax when offshore affiliates are taxed below an agreed upon minimum tax rate.[36]

Treasury Secretary Janet Yellen further explained the thinking behind this proposal:

> Competitiveness is about more than how U.S.-headquartered companies fare against other companies in global merger and acquisition bids. It is about making sure that governments have stable tax systems that raise sufficient revenue to invest in essential public goods and respond to crises, and that all citizens fairly share the burden of financing government.... We are working with G20 nations to agree to a global minimum corporate tax rate that can

> stop the race to the bottom. Together we can use a global minimum tax to make sure the global economy thrives based on a more level playing field in the taxation of multinational corporations, and spurs innovation, growth, and prosperity.[37]

In other words, the Treasury Secretary of the United States is willing to harm U.S. employers and workers in order to help foreign countries raise more tax revenue.

Secretary Yellen seems to be under the impression that innovation, growth, and prosperity come from government spending. This philosophy is economically misguided and demonstrably false. Competition amongst jurisdictions lowers the burden of taxes on the economy, which facilitates growth that benefits workers and consumers. As Chris Edwards of the Cato Institute explains, international tax competition is not a zero-sum game but "a positive-sum game. Reductions in corporate tax rates generate growth and expand the global economy to the benefit of all."[38]

The President's proposed tax increases would harm American competitiveness and have negative consequences for American workers. Colluding with other countries in an attempt to make their tax systems worse will not cover up the problems created in his proposal.

The Treasury Department admits the problem with this proposal: "Although countries have strong incentives to work together to counter tax competition, they will not stop the race to the bottom unless enough large economies adopt a minimum tax on foreign earnings."[39] As the House Ways and Means Committee notes, "Foreign countries will never raise their taxes as high as Biden's U.S. tax hikes—they know too well how important competitive tax rates are for attracting jobs and growth."[40] The U.S. corporate tax rate is already among the highest of the OECD countries, and President Biden's proposal would subject U.S. corporations to the highest tax rates among its major international competitors.[41]

Instead of harming the economy by raising taxes, the United States should welcome the opportunity to outcompete the rest of the world and put American workers in the best position possible to succeed and thrive.

Rather than participating in destructive negotiations with other nations to raise taxes, Heritage Foundation analysts recommend that Congress withhold voluntary assessments to the OECD until it ceases urging members to increase taxes.[42] The Senate should not approve a treaty that outsources U.S. tax policy or requires tax increases.

International Taxation

Prior to the TCJA, the United States had a worldwide international tax system (with deferral), which placed U.S.-headquartered companies at a competitive disadvantage by taxing profits earned abroad if they wanted to bring that money home to invest in America.[43] This system created an incentive for companies to keep profits abroad and to invert and move headquarters outside the U.S.[44]

The TCJA transitioned this outdated tax regime to a quasi-territorial tax system more in line with international norms.[45] In an effort to counter concerns that the transition to a quasi-territorial system could allow companies to report their income in other countries with lower tax burdens, the TCJA included an alphabet soup of complicated policies meant to prevent base erosion. The TCJA:

- **Placed a minimum tax of 10.5 percent, half of the U.S. statutory corporate tax rate, on global intangible low-tax income (GILTI).** GILTI liability is calculated by blending the earnings of the foreign earnings of a U.S. corporation together. A 10 percent exemption from GILTI is allowed for qualified business asset investment (QBAI), which includes depreciable foreign assets. The point of the exemption was to reflect the reality that physical assets earn a return, which is not "intangible" income.

- **Created the foreign-derived intangible-income (FDII) category, which allows U.S. corporations to take a 37.5 percent tax deduction** on profits stemming from sales to foreign customers resulting from intangible assets (intellectual property, such as patents and software) held in the U.S. Paired with GILTI, FDII was meant to incentivize companies to locate intangible assets in the U.S.[46]

- **Created the base-erosion and anti-abuse tax (BEAT),** a 10 percent minimum tax on certain payments by U.S. multinational corporations to foreign subsidiaries.

It is important to keep in mind that this complex arrangement of anti-base-erosion policies were thought to be necessary because the corporate rate was still too high: Even after tax reform, the U.S. corporate tax rate is higher than that of 25 other OECD countries. A better policy would have been to eliminate or further reduce the corporate tax in order to outcompete other countries with more competitive corporate tax systems, or at a minimum to fix the byzantine and incoherent international tax rules defining the taxable base.

Instead of reforms that would increase the competitiveness of the tax code, President Biden's proposals would make it more complicated and costly for U.S. employers. The American Jobs Plan would:

- **Increase GILTI to 21 percent, calculate it on a per-country basis, and eliminate the 10 percent QBAI exemption,** effectively establishing a 21 percent minimum tax on foreign profits for U.S.-headquartered companies.

- **Repeal the BEAT and replace it with a provision called Stopping Harmful Inversions and Ending Low-tax Developments (SHIELD),** which would deny "tax deductions by reference to payments made to related parties that are subject to a low effective rate of tax."[47]

- **Repeal the FDII tax deduction,** which would act as a disincentive for American companies to hold "intangible assets" in the U.S.

The President's proposal would move the U.S. back toward a worldwide system of taxation. But, unlike the pre-TCJA worldwide system where U.S. taxation was deferred until foreign profits were repatriated, the Biden system would tax profits as they are earned, whether the funds are invested in America or not. Additionally, calculating GILTI on a per-country approach instead of the current blended method could create even higher compliance costs.[48]

The effect of these proposals would be to once again make it more expensive, and less competitive, to be a corporation headquartered and employing workers in the United States. The proposed global minimum tax would subject U.S. businesses to a new tax burden that foreign companies would not face. Even the left-of-center Tax Policy Center admits that the global minimum tax "would put US firms at a disadvantage relative to foreign multinational enterprises.... All else being equal, Biden's proposal would likely reignite corporate inversions—transactions where US multinationals become foreign multinationals, usually through acquisition by a foreign company."[49]

Repealing the FDII deduction at the same time as increasing the corporate tax rate would be an incentive for multinational businesses to transfer their intellectual property to foreign jurisdictions. This could lead the companies to also move their research and development, manufacturing, and other business operations abroad, resulting in lost jobs for American workers.[50]

Tax Policies Related to Fossil Fuels and More Corporate Welfare for "Green Energy"

The President's proposal says that it "would remove subsidies for fossil fuel companies."[51] However, neither the White House Fact Sheet nor the Treasury's report identifies which policies are being targeted.

Efficient and fair tax policy should be neutral with regard to the energy industry. The Heritage Foundation's Nick Loris has recommended that "policymakers should eliminate fossil-fuel subsidies and should pursue eliminating all energy subsidies."[52]

However, policymakers should ensure that, in their quest to eliminate targeted subsidies, they do not overcorrect and inadvertently or intentionally punish certain industries or companies by denying them tax treatment that is otherwise broadly available. At times, what "anti-oil crusaders label an oil subsidy is neither a subsidy nor a tax treatment specific to the oil and gas industry."[53] As Heritage analysts have noted,

> Ending all energy subsidies, including those for oil and gas, would be good for American taxpayers and consumers. However, Congress should not punish the oil and gas industry with targeted tax hikes, nor should it reward other parts of the energy industry favored by the Administration.[54]

Creating additional tax subsidies for politically favored industries, such as "green energy," would be poor tax policy.

Enforcement

The President's plan says that the government will begin "ramping up enforcement to address corporate tax avoidance."[55] The plan proposes to increase the enforcement budget for the IRS, with President Biden requesting a $1.2 billion increase—from the current $12 billion—for the IRS in the fiscal year 2022 discretionary appropriations budget.[56]

All taxpayers should, of course, pay the taxes that they legally owe. The best way to ensure compliance with the law would be to simplify the tax code, making compliance less complex, and to reduce incentives for avoidance by reducing the tax burden. However, the President's plan would instead further complicate the tax code and make compliance even more costly.

Conclusion

Congress should reject the tax increases proposed by President Biden in the American Jobs Plan. The result of this proposal would be reduced wages, fewer jobs, lower economic growth, and reduced investment, while making America less competitive in the global marketplace. Contrary to rhetoric, "corporations" do not bear the costs of taxation, real people do—in the form of lower income. The burden of these proposed tax increases would be felt by the American people.

These are unlikely to be the last tax increases that President Biden proposes. A forthcoming American Families Plan is expected to include additional spending and tax increases targeted at individuals.[57]

As a part of a pro-growth tax agenda to keep taxes low for all Americans, and to ensure a robust economic recovery, Congress should:[58]

- **Prevent** future tax increases by making the tax cuts in the TCJA permanent;
- **Make** full business expensing permanent and expand eligibility to investment in structures;
- **Establish** universal savings accounts for individuals;
- **Reject** new distortionary tax subsidies; and
- **Enact** reforms to reduce the unsustainable growth of spending, particularly for the major mandatory entitlement programs.

Rather than harming the country through tax hikes, a pro-growth agenda would protect the gains achieved by the 2017 tax cuts and allow the economy to begin to recover from the stringent measures implemented to contain the spread of COVID-19.

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