A World of Trouble: Corporate Taxes and the Growing Fiscal Crisis

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Part 1.
The Decline of the Corporate Tax
What caused the four percentage point decline?

- 2.9 percentage points due to lower taxes on foreign earnings
- 0.5 percentage points due to lower state and local income taxes
- 0.5 percentage points due to increase in favorable audit adjustments
Figure 3. Foreign and Domestic Profits of Seven Large U.S. Drug Companies, 1997-2008

Source: Annual reports of Merck, Abbott, Johnson & Johnson, Bristol-Meyers Squibb, Pfizer, Schering-Plough, and Eli Lilly.
Figure 4. U.S. Pharmaceutical Companies, Foreign Shares of Worldwide Profit, Sales, and Assets, 2006-2008

Source: Company annual reports.

Figure 5. Effective Tax Rates of Large U.S. Drug Companies: 1995-97 and 2006-08 Compared
Growth of Foreign Affiliates of U.S. Corporations Between 1999 and 2007—Excluding Two Industries

Figure 2. Foreign Profits Growing Faster than Foreign Business Activity, 1997 through 2008

Growth in foreign business activity is the average growth of sales, assets, property, and employee compensation.
Before-Tax Domestic Corporate Profits as a Percentage of GDP

Corporate profits have been exceptionally large in the second half of the decade. Despite this, tax receipts have remained level.
Part 2.
A Proposal to Reform State Corporate Taxes
Base-Broadening Reforms

- Combined Reporting
- Expanded nexus rules
- Uniform apportionment

Reform Proposal

1. Requires federal corporate tax base to be used as state corporate tax base
2. Uniform apportionment
3. Tax administered by IRS
4. States choose their own rates
Provincial Taxation in Canada

• 8 of 10 provinces use tax collection agreement with federal govt. to collect corporate tax
• “one return, one set of rules, one audit, one appeals process, one tax administrator”
• Recently adopted by Ontario, estimated to save Ontario business C$100 million in compliance costs

EU Proposal for Common Consolidated Corporate Tax Base

• Multiplies rates, common base, uniform apportionment, voluntary, administered by individual countries
• Renewed push with new EU Tax Commissioner, Irish “yes” vote, and relaxed rules for voluntary adoption
ARGUMENTS FOR

• Reduced compliance costs for business
• Reduced administrative costs for govt.
• Rate competition remains
• Revenue

ARGUMENTS AGAINST

• Sovereignty
• Volatility
• Realism
Part 3.
Future Shock

The Do-Nothing Scenario
(Net Federal Debt as a Percentage of GDP)

We are here
Divergent Paths:
Projected US and UK Government Debt as a Percentage of GDP

Sources: HM Treasury, Budget 2010, June 2010. "Public sector net debt" from Table 1.3, and Congressional Budget Office, "The Long-Term Budget Outlook," June 2010, the "Alternative Fiscal Scenario" in Figure 1-2. "Federal Debt Held by the Public" under CBO’s Long-Term Budget Scenarios." On the horizontal axis of this figure "2010" refers to the U.S. government fiscal year beginning on October 1, 2009 as reference to U.S. data. For UK data "2010" refers to the UK fiscal year commonly denoted as "2010-11" in official documents that begins in April 2010.
Projected Federal Spending in 2020

- Medicare (17%)
- Medicaid (8%)
- Social Security (22%)
- Defense (15%)
- Net Interest (14%)
- Other Spending (23%)

Source: Congressional Budget Office.

Rising VAT Rates Worldwide

- Germany 16 to 19% (2007)
- Poland 22 to 23% (2010)
- Greece 19 to 23% (2010)
- Czech Rep. 19 to 20% (2010)
- Hungary 20 to 25% (2010)
- Estonia 18 to 20% (2010)
- Romania 19 to 24% (2010)
- Spain 16 to 18% (2010)
- New Zealand 12.5 to 15% (2010)
- Finland 22 to 23% (2010)
- Portugal 20 to 21%
- Slovakia 19 to 20%
- Ireland 20 to 21%
- United Kingdom 17.5 to 20%
Declining Corporate Tax, Rising Consumption Tax

<table>
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<tr>
<th>United Kingdom</th>
<th>Japan</th>
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<tr>
<td>• Massive deficit</td>
<td>• Massive debt</td>
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<tr>
<td>• Cut corporate rate (from 28 to 24%)</td>
<td>• Cut corporate rate (highest in the world)</td>
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<tr>
<td>• Raise VAT rate (from 17.5 to 20%)</td>
<td>• Raise VAT rate (from 5 to 10 or 15%)</td>
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State Interest in Alternatives to the Corporation Tax

• Michigan - Single Business Tax
• Texas – Margin Tax
• Ohio – Commercial Activity Tax
• California (proposed) – Net Business Receipts Tax
In the United States . . .

**Business Activity Tax***
(or the business component of a Flat Tax, or its progressive counterpart, the Bradford X-tax)

- Replace corporate tax
- Can look a corporate tax (subtraction method)
- Low rate, broad base
- No tax on non-US activity
- Far less revenue volatility

* Yes, it's really a VAT.

Questions and Comments Welcome