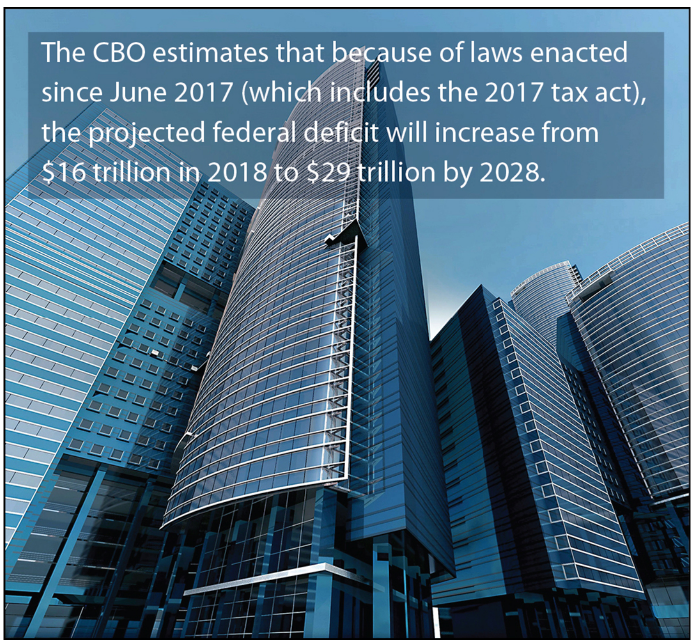
Corporate Income Tax Rates: Overview

Introduction

Corporate income taxes are taxes paid by companies to the federal government and to state governments. Because corporations are often large, multinational, and otherwise complex, taxing them has historically been both complicated and contentious. One of the issues has been whether to tax corporations as entities or to tax the individual owners and shareholders. Another issue is how to tax corporations that do business in both the United States and abroad. Corporations want to avoid double taxation, in which they are taxed both in the US and in other countries, or when they are taxed at both the corporate and shareholder level.



Congressional Budget Office, "The Budget and Economic Outlook: 2018 to 2028," cbo.gov, Apr. 2018.

In the US, corporations pay a federal tax based upon income and other factors. In 2018, the top rate was lowered from 35 percent to 21 percent. In addition, corporations pay a state income tax, which varies by state. The combined state and federal tax is called the "combined corporate tax rate." In theory, the tax paid is equal to the statutory tax rate, the rate listed by the state and federal governments. In practice, however, corporations pay an effective tax rate, which is often lower than the statutory rate, due to various deductions and credits.

The tax rate for corporations is important because taxes fund American infrastructure, education, social services, and defense. Taxes affect a corporation's decisions about how to spend, distribute, and invest money, including whether to keep facilities and offices in the United States or to move them abroad. Members of both major political parties agree that the US tax system needs modification in order to be fair. They also agree that higher corporate tax rates may increase attempts to avoid taxes. They disagree, however, on specific effects of different tax rates because economies are affected by myriad factors, and it is difficult to isolate causes and effects.

Understanding the Discussion

Combined corporate tax rate: The combined state and federal taxes imposed on a corporation, modified to accommodate any relevant deductions.

Double taxation: Occurs when a corporation is taxed on its earnings, and the corporations' shareholders are also taxed on the dividends they earn as investors. Thus, the income is taxed twice.

Effective tax rate: The tax rate as calculated after various deductions and expenditures have been factored in. The effective tax rate is seen as a more reliable way than the statutory rate to compare what corporations pay because the actual tax burden on corporations is affected by a vast array of economic factors.

Statutory tax rate: An income tax rate set by law.

History

The beginnings of corporate taxation are important to understand due to the reasoning behind establishing the practice. As legal scholar Ajay Mehrotra wrote, at the end of the nineteenth and the beginning of the twentieth century, businesses frequently merged to become large corporations. By the 1930s, a relatively small number of corporations controlled a disproportionate amount of assets. People were concerned that corporations would possess too much economic and political power, and would thus be a threat to democracy. In response, the government formulated antitrust laws to inhibit monopolies. The anticorporate sentiment displayed in antitrust legislation is also, to some extent, visible in tax laws. Therefore, Mehrotra writes, managing corporate power has a close relationship with creating a fair system of taxation.

The corporate excise tax of 1909 was an attempt to address issues at the fore of public concern. Before the 1909 law, companies paid the government through tariffs and other means, but there was disagreement about the fairness of taxation practices. With the 1909 law, however, the federal government specifically taxed corporations on their income. In contrast to corporate tax rates in the mid-1900s, the top rate in 1909 was 1 percent on income greater than $5,000.

In his speech regarding the 1909 law, President William Howard Taft specifically mentioned one other goal of corporate taxation, which was to address the nation's growing deficit. As discussions of twenty-first-century policy show, the deficit continues to be a consideration in the corporate tax picture. One other feature that has remained constant over time is the greater corporate tax burden imposed by the US compared to other Western countries. Rather than being a recent development, the contrast in tax policy dates back to the beginning of corporate taxation in the US.

The Sixteenth Amendment, added to the Constitution in 1913, repealed the 1909 excise tax. The amendment was not specific to corporations, but it did lay out legislation that allowed a national income tax. With regard to corporations, the amendment allowed the government to levy a corporate income tax that more closely resembled the type of tax that would be in place for the rest of the twentieth century. As Joseph Fishkin and William Forbath of the Texas School of Law note in their commentary, the Sixteenth Amendment greatly increased the amount of revenue the federal government received because it changed the source of revenue from tariffs and consumption taxes to a broad income tax.

Most of the legislative changes specific to corporations occurred after these early laws. The corporate tax rate had its first big increase in 1918, when it went from 6 percent to 12 percent. Rates did not have another dramatic increase until 1938, when they climbed to 19 percent. Corporate tax rates underwent drastic and frequent changes in the years surrounding World War II. This is a contrast to the stability of the mid-1980s to 2017 and even the 1960s to the early 1980s, when corporate tax rates were modestly revised only every few years. To provide some context, the highest corporate tax rate was 19 percent in 1939. By 1950, the rate had undergone numerous changes and the top rate had been raised to 42 percent. The rate's peak occurred in 1968 at 52.8 percent. Thus, both the frequency and the magnitude of changes to corporate tax rates were distinctly different from at other times in history.

One of the biggest changes to corporate taxes came in 1986 with President Ronald Reagan's Tax Reform Act (TRA). The TRA reduced taxes across the board, for individuals as well as corporations. The top tax rate dropped to 34 percent from 51 percent. Reagan stated that his intent was to simplify the tax system while also making it fairer. At the same time, however, the TRA aimed to reduce loopholes, deductions, and other ways of getting around paying taxes. Former deputy secretary of the Treasury Stuart Eizenstat notes that the TRA was specifically designed not to increase the deficit. The act passed with bipartisan support, and Reagan characterized the legislation as helping to fight poverty and create jobs. Reagan also worked with Chairman of the Federal Reserve Paul Volcker to lower inflation. This gave businesses a friendlier economic environment in which to make investments.

One effect of the TRA was that many corporations elected to become S-corporations, a status that allowed them a tax advantage because they distributed earnings to shareholders. The downside to the system was that the corporations then had less money to use for reinvestment.

The American Jobs Creation Act of 2004 made some small changes to corporate taxes, including allowing deductions for state and local general sales taxes, incentives for reinvesting foreign earnings in the US, and a few other measures meant to free up corporate income.

Corporate Income Tax Rates Today

Over a century after corporate taxation became a concrete part of US policy, Eizenstat noted that members of both parties agreed that the US tax system needed modification in order to be fairer. While specific conditions have changed, he wrote, many of the ideas from earlier tax reforms live on.

President Donald Trump signed the Tax Cuts and Jobs Act (TCJA) in December 2017. The act was the largest overhaul to tax law since Reagan's revisions in 1986. Under the TCJA, corporate tax rates for the year 2018 fell from 35 percent to 21 percent. While the act was meant to reduce the tax burden on corporations, it also introduced complications due to changes in what companies are required to report. While some provisions of the TCJA expire after a number of years, the lower corporate tax rate is permanent, meaning that it will remain in place unless a legislative overhaul changes it. Other provisions of the TCJA are that investments of capital may be deducted and that some income earned outside the US may not be taxed.

Several economists, including writers for the Brookings Institution and the Tax Adviser, note that the TCJA has lowered taxes but also increased the complexity of what companies must report to the federal government. Corporations must already comply with state regulations and taxes in forty-five states and the District of Columbia. Therefore, the taxes faced by corporations are more complex than a simple reduction in rate can convey.

While the federal cuts to the corporate tax rate have received a great deal of attention, North Carolina provides a case study of corporate tax rates at the state level. Many of the arguments about federal policy can be seen on a smaller scale since North Carolina's policies are similar to the TCJA. Before the tax cuts were put in place in 2013, North Carolina was rated a terrible place to have a business, but in 2017, it was rated the best in the nation for business. Its tax rate is the lowest in the US: 2.5 percent, as of 2019. Much of the job growth has been in either highly skilled fields or in the service sector, but not in the middle. Another observable effect has been the increase in the state's deficit, expected to reach $1.2 billion in 2020.

About the Author

J. D. Ho has published articles on politics, US history, income inequality, urban development, and social issues. She has a master's degree from Carnegie Mellon University.

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