Executive Memorandum

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# THE DANGERS OF A MINIMUM CORPORATE TAX

Various tax hikes are being discussed as a way to cut the federal deficit. One of the most dangerous economically is a proposal for a new corporate minimum tax. Not only would this allegedly raise revenue, claim its boosters, it also would force companies that now pay little or no taxes to pay their "fair share." In fact, such a tax would impose a high penalty on many corporations, inhibit economic growth, slow the creation of jobs and lead to lower tax revenues.

The deficit problem is not due to insufficient taxation. Taxes as a percentage of income are no lower today than they were during the Carter years, and most Americans face average tax rates as high or higher than they were before the 1981 tax cut. The deficit is thus caused solely by overspending. Deficit reduction efforts, therefore, should concentrate on reducing spending and not on raising taxes.

A corporate minimum tax, moreover, is a particularly onerous and unsatisfactory method of raising revenue. Because it is not possible to determine what the effective burden of corporate tax actually is, and because one cannot predict how a new minimum tax might interact with existing provisions of the tax code, what might seem at first glance to be simple way of achieving "tax fairness" could produce a jumble of new loopholes--to the delight of tax accountants. What is worse is that the corporations that must be the engine of accelerated economic expansion may be hurt severely by any new tax.

There is no solid evidence backing the charge that many corporations are not paying taxes. The examples typically cited are highly selective and misleading. In fact, the corporate sector is not undertaxed, but overtaxed. And since people, not corporations, ultimately pay all taxes--in the form of higher prices or lower wages and dividends--a minimum corporate tax would be a very arbitrary way of speading the tax burden and not a "fair" levy.

What is most dangerous about calls for a corporate minimum tax is that it could destroy efforts to enact fundamental tax reform. All tax reform proposals currently under consideration would lower marginal tax rates by broadening the tax base. The effect of this is to raise revenues from some new sources to offset lost revenues from lower general tax rates. This is an acceptable tradeoff if it produces a more efficient and fairer tax system than exists today. But if additional revenue is raised with devices such as a minimum tax, it will claim a source of revenue that is supposed to be used in the general tax reform tradeoff. If the overall burden of taxation gets too high, then broadening the tax base further raises so little revenue that marginal tax rates can only be reduced slightly. For this reason, House Ways and Means Committee Chairman Dan Rostenkowski (D-IL), a supporter of tax reform, steadfastly opposes the minimum tax idea.

Though the corporate minimum tax makes no economic sense, it is politically alluring for legislators hoping to avoid enacting painful budget cuts. This should fool no one. A minimum tax on corporations is a serious tax hike on all Americans. If it is to be considered at all, it must be viewed as part of a separate tax reform measure.

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For further information:

Bruce Bartlett, "The Federal Tax Debate: How Much Should Corporations Pay?" Heritage <u>Backgrounder</u> No. 402, January 8, 1985.