Corporate Tax Reform Does Not Have to Be Hard

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Hi, I'm Jim Shedivy and I would like to talk a little about corporate tax reform. Today, there is much discussion around how hard it will be to reform the U.S. corporate tax law. I believe Corporate Tax Reform does NOT necessarily have to be hard –

For true reform, the law needs to be simple and transparent. If NYU's Aswath Damodaram's estimated tax rates by various industries is close to being correct, we could simplify the tax law relatively quickly.

1. We could eliminate all legislation granting special incentives or credits to corporations. Instead of arguing about whether or not credits or other incentives are effective, we need to understand that Corporations make decisions based on whether or not they are good business decisions. While tax may be a factor in many business decisions, it is hard to believe that the tax tail wags the business dog in most situations.

2. The elimination of the special incentives and credits would enable the reduction of the corporate tax rate to somewhere between 15 to 20%. This would actually be an increase in the effective tax rate, based on the NYU study which estimates the effective tax rate for the entire market to be 14.07%.

3. We should seriously consider eliminating the double taxation concept, by using the Canadian Tax Law as a model. In Canada, corporate income is subject to both corporate income tax and, on distribution as dividends to individuals, personal income tax. However, the Canadian personal income tax system, through its gross-up and dividend tax credit mechanisms, eliminates double taxation in theory.

   This approach could also eliminate the need for a reduced U.S. tax rate on qualified dividends. However, it may make the exact corporate tax rate very meaningful. If the corporate rate is much lower than the individual rate, there may be an incentive to incorporate as much income as possible. On the other hand, if the corporate rate is relatively high, it could encourage distributions and shareholder involvement in business investment decisions through reinvesting their distributions in additional stock in the company they choose.

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4. Borrowing another concept from Canada, the IRS could also collect state corporate income taxes. In this situation, the states would have to agree to use the federal definition of taxable income, but with the elimination of the special incentives and credits that should be possible. The States would be able to set their own corporate tax rate which would be added to the federal rate. Therefore, tax professionals would only have to be concerned with one tax law.

In this scenario, Congress would still be able to support specific industries; however, to keep the law simple and transparent, their actions would be limited to only modifying the tax rate applicable to the industry. It would also be appropriate to impose a zero sum game by requiring an increase in tax to offset every decrease in tax.

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