HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HM 717 Federal Corporate Tax Rate
SPONSOR(S): Burgin
TIED BILLS: **IDEN./SIM. BILLS:** HM 685, SM 1038

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Federal Affairs Subcommittee	11 Y, 2 N	Bennett	Camechis
2) State Affairs Committee	12 Y, 1 N	Camechis	Hamby

SUMMARY ANALYSIS

Concern over the corporate tax code has increased as a result of expanding global interdependency. In April 2011, it was reported that President Obama and Congressman Paul Ryan expressed support for federal corporate tax reform. Many policymakers, practitioners, and taxpayers agree that changes to the federal corporate tax code are needed; however, the form, scope, and aim of reform remain the subject of vigorous debate. At least 26 proposals have been introduced in Congress to eliminate, reduce, or otherwise reform the corporate tax code. To date, none of the proposals have passed.

This memorial urges Congress to cut the corporate federal tax rate, but does not suggest what the new tax rate should be.

Copies of the memorial will be provided to the President of the United States, the President of the United States Senate, the Speaker of the United States House of Representatives, and each member of the Florida delegation to the U.S. Congress.

The memorial does not have a fiscal impact on state or local governments.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Effect of Proposed Changes

This memorial urges Congress to cut to federal corporate tax rate, but does not suggest a new tax rate.

Current Situation

Background

The federal Tariff Act of 1909 established that "every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares" pay a "special excise tax with respect to the carrying on of doing business."[1] Since that time, the federal corporate tax code has been augmented and modified numerous times to create the modern corporate tax code.

A corporation is taxed on its net income from business operations, interest, rent, dividends, royalties, and capital gains (minus the costs of purchased goods, labor, interest, and other expenses).[2] Since the 1980s, the tax has accounted for between 6 and 13 percent of the federal revenue and roughly 1 to 3 percent of the gross domestic product (GDP),[3] making it one of the largest sources of federal revenue.

Concern over the corporate tax code has increased as a result of expanding global interdependency. Tax experts caution that the "U.S. international tax system stands at a crossroads" and that "[i]t is outdated, overly complicated, and increasingly ineffective in supporting the goals of either government or businesses in today's competitive global marketplace." [4]

In April 2011, it was reported that President Obama and Congressman Paul Ryan expressed support for corporate tax reform.[5] Although policymakers, practitioners, and taxpayers may agree that changes to the corporate tax code are needed, the form, scope, and aim of reform remain the subject of vigorous debate.

Tax System

Also at the center of corporate tax reform is the current tax codes' allocation and collection system. The two most common systems are territorial and worldwide. Under the far more common territorial system, a corporation's domestically generated income is taxed and income earned abroad is not. Alternatively, six countries operate under the worldwide system where income is taxed regardless of where it was generated.[6] The United States uses a unique hybrid of the two systems, but the approach is more in line with the worldwide system; a corporation must pay taxes on all domestically generated income, while tax on income earned abroad is deferred until it is repatriated to the U.S.[7] The U.S. Treasury Department described the inherent problems of the unique system in 2002:

> No country has rules for the immediate taxation of foreign-source income that are comparable to the U.S. rules in terms of breadth and complexity. For example, the U.S. tax system imposes current tax on the income earned by a U.S.-owned foreign

[1] Ajay K. Mehrotra, *The Public Control of Corporate Power: Revisiting the 1909 U.S. Corporate Tax from A Comparative Perspective*, 11 Theoretical Inquiries L. 497, 507 (2010).
[2] "Challenges to Corporate Tax Enforcement and Options to Improve Securities Basis Reporting," GAO, July 2006, www.gao.gov/new.items/d06851t.pdf
[3] *Id.* at 6.
[4] Barbara Angus, Tom Neubig, Eric Solomon & Mark Weinberger, "The U.S. International Tax System at a Crossroads," 127 Tax Notes 45 (Apr. 5, 2010).
[5] Scott Horsley, "Obama, Ryan Agree: Business Tax Codes Need Reform," NPR, April 16, 2011; http://www.npr.org/2011/04/16/135464262/left-right-agree-business-tax-codes-just-too-hard.
[6] Chile, Ireland, Israel, Mexico, Poland, and South Korea; the average statutory corporate tax rate in these countries is 20.7 percent, as opposed to the United States rate of 39.2 percent.
[7] *See* PERAB, *supra* note 11 at 84.

subsidiary from its shipping operations, while that company's foreign-owned competitors are not subject to tax on their shipping income. Consequently, the U.S.-based company's margin on such operations is reduced by the amount of the tax, putting it at a disadvantage relative to the foreign competitor that does not bear such a tax. The U.S.-based company has less income to reinvest in its business, which can mean less growth and reduced future opportunities for that company.[8]

Tax Rates

The federal corporate tax rate and various state corporate tax rates are separately imposed by federal and state law on the capital earnings of a corporation.[9] The combined U.S. corporate tax rate of 39.2 percent (35 percent federal rate combined with the average state rate of 4.2 percent) is the second highest statutory rate among the thirty-four countries of the Organization for Economic Cooperation and Development (OECD).[10] In comparison, the average statutory rate of the other OECD member countries was an estimated 25.4 percent.[11]

The effective tax rate (ETR) is the rate corporations actually pay after accounting for all tax deductions and credits, thus the ETR is generally lower (occasionally it is substantially lower) than the statutory rate of 39.2 percent. For example, a 2008 study by the Government Accountability Office took into account various tax credits, deductions and operating losses, and estimated that 42 percent of U.S.-controlled corporations reported no tax liability in 2 or more years between 1998 and 2005.[12] The study also estimated that 25 percent of the U.S.'s large corporations, those with more than $250 million in assets, paid no federal income taxes in 2005.[13]

The U.S.' ETR is estimated to be between 18.5 to 34.6 percent; the wide margin is due to complex measurement factors, many of which are subjective and susceptible to manipulation.[14] Most studies, however, have estimated the ETR to be between 25 and 30 percent.[15] In August 2010, the President's Economic Recovery Advisory Board stated that, based on a Treasury Department study, the U.S.' ETR was roughly 29 percent.[16] The ETR of OECD countries was 20.6 percent in 2003.[17]

Recent Federal Executive Branch Activities

In his 2011 State of the Union address, President Obama asked "Democrats and Republicans to simplify the system. Get rid of the loopholes. Level the playing field. And use the savings to lower the corporate tax rate for the first time in 25 years."[18] In September 2011, the President proposed legislation to close a tax loophole for corporate jet depreciation, and stated that the corporate tax rate could be lowered "if we get rid of all these special deals."[19] The administration's tax reform plan was

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[8] Office of Tax Policy, United States Department of the Treasury, *Corporate Inversion Transactions: Tax Policy Implications* (Washington, DC: Office of Tax Policy, May 2002).
[9] All states and the District of Columbia currently impose some form of corporate income or franchise tax, except for Nevada, South Dakota, Washington (state) and Wyoming
[10] The OECD 2011 Tax Database; http://www.oecd.org/dataoecd/26/56/33717459.xls; (Japan has the highest rate at 39.5%).
[11] Challenges in Designing Competitive Tax Systems, Tax reform trends in OECD countries. Page 3, Paris, June 30, 2011; www.oecd.org/dataoecd/9/23/48193734.pdf .
[12]Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1998-2005," GAO, July 2008, at 8. www.gao.gov/new.items/d08957.pdf
[13] *Id.* at 7.
[14]*See* Citizens for Tax Justice and the Institute on Taxation and Economic Policy Release *"Corporate Taxpayers and Corporate Tax Dodgers, 2008-2010*" November 3, 2010 (Estimated ETR of 18.5%); *See also* Jack Mintz and Duanjie Chen, *New Estimates of Effective Corporate Tax Rates on Business Investmen*t, Tax & Budget Bulletin no. 64, February 23, 2011 (estimated ETR of 34.6%).
[15] A report on the 13 latest ETR studies; Tax Foundation Special Report No. 195, "U.S. Corporations Suffer High Effective Tax Rates by International Standards" by Philip Dittmer, September 2011; *www.taxfoundation.org/news/show/27609.html*
[16] Rate based on new investments in corporate sector. The President's Economic Recovery Advisory Board, "The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation," page 66, August 2010. ("PERAB") http://www.whitehouse.gov/sites/default/files/microsites/PERAB_Tax_Reform_Report.pdf
[17] Congressional Budget Office, "Corporate Income Tax Rates: International Comparisons," November 2005, http://cbo.gov/ftpdocs/69xx/doc6902/11-28-CorporateTax.pdf. (Because the rates are compared are calculated with OECD and treasury data which use differing measures, this comparison should only serve as an approximation.)
[18] Barack Obama, *Remarks by the President in State of Union Address* (Washington, DC: GPO, January 25, 2011); http://www.whitehouse.gov/the-press-office/2011/01/25/remarks-president-state-union-address.
[19] The American Jobs Act (S. 1549) (H. Doc. 112-53) and (H.R. 12), Sec. 421; President Barack Obama, *Remarks by the President on Economic Growth and Deficit Reduction,* White House Rose Garden September 19, 2011; www.whitehouse.gov/the-press-office/2011/09/19/remarks-president-economic-growth-and-deficit-reduction.

expected to be released in summer or early fall of 2011, but had not been released as of January 4, 2012.[20]

Recent Congressional Activities

In the current 112th Congress, at least 26 pieces of legislation dealing with corporate income tax have been proposed between the two houses of Congress. The bills use a wide variety of approaches to reform the corporate tax code, but generally seek to reduce or eliminate the corporate tax rate, simplify the tax system, change the system to the territorial approach, or create or close corporate tax loopholes. As of November 30, 2011, the majority of these proposals remain in committee.[21] Senator John McCain's "Jobs Through Growth Act" proposed a maximum corporate tax rate of 25 percent, but was defeated in the Senate by a vote of 40 to 56 in November 2011.[22]

Florida Corporate Income Tax[23]

Article VII, section 5(b) of the Florida Constitution governs the imposition of a state income tax, and reads as follows:

> No tax upon the income of residents and citizens *other than natural persons* shall be levied by the state, or under its authority, *in excess of 5% of net income, as defined by law, or at such greater rate as is authorized by a three-fifths (3/5) vote of the membership of each house of the legislature* or as will provide for the state the maximum amount which may be allowed to be credited against income taxes levied by the United States and other states. There shall be exempt from taxation not less than five thousand dollars ($5,000) of the excess of net income subject to tax over the maximum amount allowed to be credited against income taxes levied by the United States and other states.

Certain corporations doing business in Florida must pay tax of 5.5 percent on income earned in Florida. Florida "piggybacks" the federal income tax code in its determination of taxable income. Taxable income earned by corporations operating in more than one state is taxed in Florida on an apportioned basis using a formula: 25 percent on property, 25 percent on payroll and 50 percent on sales. The first $5,000 of net income is exempt. Proceeds from the tax are deposited into the State's general revenue fund.

Due to the above-quoted constitutional constraint on its authority, the Legislature is not permitted to raise the current rate of 5.5 percent without 3/5 approval of the membership of both houses of the Florida Legislature.

All states and the District of Columbia currently impose some form of corporate income or franchise tax, except for Nevada, South Dakota, Washington (state) and Wyoming. Most levying states and the District of Columbia have flat tax rates. These rates range from 4.63 percent to 9.99 percent. Sixteen states use graduated rates. Most of the ranges fall completely between 1.0 and 9.99 percent. Iowa goes up to a 12 percent maximum rate. Ohio, Texas and Michigan have recently made major changes to the structure of their business income taxes.

B. SECTION DIRECTORY: Not applicable.

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[20] Brett Ferguson, *Geithner Expects to Release Corporate Tax Reform Proposal by Autumn*, May 26, 2011; http://www.bnasoftware.com/News/Tax_News/Articles/Geithner_Expects_to_Release_Corporate_Tax_Reform_Proposal_by_Autumn.asp.
[21] H.R.; 25, 86, 99, 462, 609 934, 937, 1040, 1074, 1396, 1634, 1733, 2911, 2382, 2945, 3338, 3400; H. Con. Res. 34; S. Res. 88.
[22] S. 1720.
[23] The information in this section was obtained from the *2011 Florida Tax Handbook.*

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues: None.

2. Expenditures: None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues: None.

2. Expenditures: None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR: None.

D. FISCAL COMMENTS: None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision: Not applicable.

2. Other: None.

B. RULE-MAKING AUTHORITY: None.

C. DRAFTING ISSUES OR OTHER COMMENTS: None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

None.