POLITICS

Who Ultimately Pays for Corporate Taxes? The Answer May Color the Republican Overhaul

Investors and workers bear tax burdens, but the politics of tax-code changes hinge on which group carries the heavier load

Lawmakers and Trump administration officials Washington are preparing to mount a business-tax-overhaul campaign this fall, but debate over whether workers or investors bear the brunt of the corporate tax burden may affect the nature of the changes. PHOTO: MICHAEL REYNOLDS/EUROPEAN PRESSPHOTO AGENCY

By Richard Rubin

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WASHINGTON—Tax overhaul efforts in Washington are being shaped by a debate about whether it is workers or investors who bear the greater burden of U.S. corporate taxes.

If the load falls mainly on investors, cutting corporate taxes will mostly benefit high-income households, in which there is a greater proportion of stockholdings, through dividends and other disbursements. If employees bear the brunt of the burden, corporate-tax cuts could be a path to boosting middle-class incomes by raising wages and employment opportunities, which would support the Trump administration's promise to tilt tax cuts toward the middle class.

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Economists largely agree that workers do shoulder a part of the corporate-tax burden and that permanent cuts could help them, particularly if those changes encourage investment. But agreement largely ends there, with wide-ranging differences of opinion about how the share of the tax burden is divided.

Official estimates from Congress and the Treasury Department have said owners of capital pay the majority of corporate taxes—a position held by many Democrats. Trump administration officials, Senate Finance Chairman Orrin Hatch (R., Utah) and conservative advocates are challenging that view as they mount a campaign this fall to lower business-tax rates and build broad support for the idea.

The two views of who is hurt by the corporate tax could lead to fiery disagreements between Republicans and Democrats in the months ahead about who stands to benefit the most from a tax rewrite.

“This is about creating jobs,” Treasury Secretary Steven Mnuchin said on CBS in April, because many surveys show that 70% or more of the tax burden is borne by the American worker. This is about putting money back in the American worker’s pocket.”

Last month, Mr. Mnuchin offered an increased estimate, saying 80% of business taxes are paid by workers.

Although some research supports a 70-30 labor-capital breakdown, many other analyses cut the other way, including work by Treasury Department staff in 2012 and estimates used by the Congressional Budget Office and the Joint Committee on Taxation. Their research attempts to determine how companies would distribute any after-tax profits and which groups would benefit from new, incentivized investments.

The JCT, which will evaluate any tax bill that moves through Congress, estimated that capital bears 75% of the long-run corporate-tax burden, with labor paying the rest. Treasury Department staff estimated that 82% of corporate taxes are paid by owners of capital.

“The focus of tax reform is to deliver a major tax cut for middle-income Americans and encourage American businesses to create jobs, all to build sustained economic growth,” a Treasury Department spokesperson said in a statement. “This will be achieved both through individual- and corporate-tax cuts, as well as simplification.”

However, no academic model or foreign data perfectly captures what would happen if the U.S. was to change its 35% corporate-tax rate for the first time since 1993.

“There’s a pretty wide band of possible outcomes that are plausible,” said Alan Auerbach, a tax economist at the University of California, Berkeley.

An employee at a General Motors Co. facility in Arlington, Texas, works on the assembly line. While some official government estimates have said owners of capital pay the majority of corporate taxes, Treasury Secretary Steven Munchin recently estimated that workers are on the hook for 80% of a company’s taxes. PHOTO: MIKE STONE/REUTERS

Until a few years ago, the Treasury Department and the JCT assumed the burden of corporate taxes fell entirely on owners of capital. Holders of stock get what is left over from a company’s profit after it covers its expenses, including its taxes and worker pay. Reducing corporate taxes would thus mean more money available for shareholders.

The nature of a global economy complicates the situation, however, as corporations are taxed differently depending on their location and as capital flows easily across borders. A high corporate tax pushes investment and hiring to foreign economies, punishing domestic workers. By this logic, reducing the corporate tax could help domestic workers by drawing in capital.

That effect is in turn countered by the fact that the world economy isn’t entirely open and there isn’t unlimited investment that would flow into one country if its taxes dropped.

"I don't think any paper finds that it's a negligible incidence on workers," said Aparna Mathur, a resident scholar at the American Enterprise Institute.

The Treasury Department under Mr. Mnuchin pointed to a 2015 study by Céline Azémar and Glenn Hubbard that estimated that a $1 increase in corporate taxes leads to a 60-cent decline in wages, suggesting a tight link between the two, with labor bearing about 60% of the corporate tax burden. The study also says, however, that the effect is muted in larger economies.

Even if the benefits of a corporate-tax cut flow to workers, the uneven U.S. wage distribution means high-income workers would capture a significant portion of that benefit. And, so far, it is companies, not workers, that have been the loudest advocates for corporate-tax-rate cuts.

Republicans haven't settled on their corporate-tax policies and the full details will determine the economic effects of whatever they try to push through Congress.

"We're starting with half a policy and trying to understand what it would mean," said Greg Leiserson, a former Obama administration economist who is director of tax policy at the Washington Center for Equitable Growth. "But the other half is absolutely critical for figuring out whether anything gets to labor."

The Tax Policy Center assumes that 60% of corporate income taxes fall on what are called supernormal returns, which are the extra profits some companies can earn because of strategic advantages such as monopolistic power. The remaining 40% is split evenly between capital and labor, leading to an overall 80-20 split in that model.

Mr. Mnuchin appeared at a House committee hearing in Washington on July 27. In April, the Treasury secretary said the tax-code overhaul 'is about putting money back in the American worker's pocket.' PHOTO: ZACH GIBSON/BLOOMBERG NEWS

"If you have a sort of monopolist pricing their product, they're going to do that independently of the tax rate they'd pay," said Joe Rosenberg, a senior research associate at the center, a project of the Brookings Institution and Urban Institute run by a former Obama administration official. That means the shareholders would reap the greater benefit from a tax cut.

Economists generally agree that a longer-term, permanent tax cut would be better for workers than something short-term. With a temporary tax cut, companies are less likely to make long-lasting investments that require complementary labor. As a result, benefits accrue to existing owners of capital.

The longer the tax cut lasts, the more those investments can lead to productivity and wage gains.

"If you were to have a very temporary tax cut, you wouldn't expect [wage gains] to happen at all," said Mr. Hubbard, a Columbia University economist who has advised GOP politicians. "If it happens, when it happens, these are really going to be important questions. I've always felt Democrats should support corporate-tax reform for exactly this reason."

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