TCJA's Corporate Tax Reform Virtually Paid For Itself

By **George Callas**

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Before enactment of the Tax Cuts and Jobs Act in December 2017,[1] the United States suffered from the highest corporate rate in the developed world at 35% — closer to 40% including the average state corporate tax rate. Even liberal Democrats such as President Barack Obama supported cutting the corporate tax rate to somewhere in the range of 25% to 28%.[2] The TCJA, meanwhile, reduced the corporate rate to 21%,[3] with only Republican votes.

Today, some Democratic presidential candidates claim that it made sense to reduce the corporate rate below 35%, but that the TCJA gave a windfall to corporations in cutting the rate so much. Like others before them, they insist we should bring the corporate rate back to a level in the mid- to high-20s.

Sen. Amy Klobuchar, D-Minn., for example, proposes to raise the corporate rate to 25%,[4] while former Vice President Joe Biden and Sen. Michael Bennet, D-Colo., prefer 28%.[5] Other candidates — Sens. Bernie Sanders, I-Vt., and Elizabeth Warren, D-Mass., and the Mayor of South Bend, Indiana, Democrat Pete Buttigieg — reject that the corporate rate was ever too high and frame their proposals to raise the rate to 35% as "rolling back" the entire corporate tax cut.[6]

The notion that such a large rate cut was a corporate giveaway, however, is betrayed by the facts. The charge implies a substantial loss of federal revenue as a result of the corporate provisions of the TCJA. Contrary to this narrative, the portion of the TCJA affecting corporations virtually paid for itself.

Taking into account both the revenue and macroeconomic estimates of the nonpartisan Joint Committee on Taxation, or JCT, a corporate tax rate somewhere between 21% and 22% likely would have resulted in the TCJA's corporate tax reform achieving revenue neutrality — meaning there is little or nothing for Democratic presidential candidates to roll back.[7]

According to the JCT's official revenue estimate,[8] which by itself does not take into account how tax legislation affects economic growth, corporate tax reform reduced government revenues by about $300 billion over 10 years. Helpfully, the JCT separated the TCJA into three components: individual tax reform, business tax reform and international tax reform.

The numbers for both business tax reform and international tax reform derive overwhelmingly from corporate taxpayers, with a small portion from noncorporate businesses such as partnerships, LLCs and S corporations. While individual tax reform reduced taxes by $1.127 trillion, business and international tax reform only reduced taxes by $329 billion. If even one-tenth of that amount is attributable to noncorporate businesses, then the TCJA provided a net tax cut for corporations of less than $300 billion over a decade, less than $30 billion annually, and therefore barely 0.5% of a federal budget that will exceed $4.6 trillion this year alone.[9]

Democratic presidential candidates gloss over the fact that the TCJA was not just a tax cut; it was tax reform. That $300 billion corporate tax cut is a net figure, hiding roughly $1.8

trillion in corporate tax relief and $1.5 trillion in corporate tax increases. In other words, more than four-fifths of the gross corporate tax relief was offset with tax increases on corporations.

For instance, the JCT estimated that the so-called big three revenue raisers designed to reduce profit-shifting to low-tax jurisdictions — global intangible low-taxed income (GILTI), the base erosion and anti-abuse tax (BEAT), and the Internal Revenue Code Section 965 transition tax — by themselves would raise $600 billion over 10 years.

Some anti-TCJA commentators reject these official estimates, citing the fact that the Congressional Budget Office's baseline assumption for corporate tax receipts over the fiscal year 2018 to 2027 period declined by $750 billion between its last pre-TCJA projection and its August 2019 projection.[10] But this data point is not useful in estimating the effect of the corporate tax reform portion of the TCJA, because it comprises numerous causes other than one single piece of legislation.

For example, Congress enacted tax legislation in February and March of 2018 that reduced tax revenues by roughly $20 billion over 10 years. Tariffs paid by importing industries and uncertainty related to trade policy, meanwhile, have reduced taxable corporate profits. Changes in the CBO's assumptions about macroeconomic variables have a large impact on projected tax receipts. And so on.

So while the JCT's $329 billion estimate isolates the effect of the TCJA on tax revenues, one cannot simply compare tax receipts before and after to determine the impact of a single cause. Put another way, the global economy is not a controlled experiment.

Many of these same critics want to cherry-pick certain provisions and claim they are not real tax increases. The most commonly cited example is the section 965 transition tax — a one-time, reduced-rate tax on post-1986 accumulated earnings and profits of controlled foreign corporations. Because this tax generally is payable in installments over an eight-year period, it stops bringing in revenue in 2026.

Even though the JCT projected this tax to impose $339 billion of additional tax liability on (mostly corporate) U.S. taxpayers, these commentators cite the fact that the revenue is temporary and does not continue in perpetuity to disregard it completely. More sophisticated — and sophistical — versions of this argument claim that because those earnings were merely deferred and eventually would be subject to tax at the full U.S. corporate rate when repatriated to the United States, the transition tax actually is a net tax benefit. This claim, however, is specious for at least two reasons.

First, try telling the taxpayers who are writing huge checks to the U.S. Department of the Treasury to cover this transition tax that they are receiving a tax cut. Most of these earnings are temporarily deferred only in the most theoretical sense. The bulk of this pool, in fact, is permanently reinvested overseas, either as hard assets (e.g., land, depreciable property), intangible assets (e.g., goodwill, patents), or liquid assets (e.g., working capital, regulatory capital) — meaning that under pre-TCJA law taxpayers never would have repatriated these earnings and therefore the earnings never would be subject to U.S. tax.

In addition, the CBO baseline for corporate tax revenues assumes that corporations will repatriate a certain portion of their foreign earnings every year, meaning that the JCT's revenue estimate of $339 billion is a net number that already assumes some of those earnings would have been repatriated at the full U.S. rate. In other words, the main reason cited for disregarding the $339 billion has already been incorporated into the estimate.

Second, the temporary nature of the tax revenue fits together with other international tax provisions that go into effect after the eight-year installment period ends. Specifically, under current law the effective corporate rates for GILTI and the BEAT increase after 2025 — from 10.5% to 13.125% for GILTI, and from 10% to 12.5% for the BEAT.

Congress designed these rate increases to raise an annual amount of revenue comparable to the annual amount raised by the transition tax during the prior eight years, even though their delayed effective dates mean they provide very little revenue within the 10-year budget window.

So far, this discussion has ignored the macroeconomic effects of corporate tax reform. But of course, this is unrealistic, because policies such as a lower corporate rate do, in fact, cause the economy to grow, which in turn brings in more tax revenue. One of the most important rule changes House Republicans implemented a few years ago (which has now been rescinded by House Democrats) was to require the JCT to provide a macroeconomic estimate (also known as dynamic scoring) of major tax legislation, and in response to this rule the JCT estimated that the TCJA would increase economic growth by an amount sufficient to raise an additional $451 billion in tax revenue over ten years.[11]

While this is more than enough to pay for the net corporate tax cut, the JCT did not specify how much of this amount came from corporate tax reform and how much came from individual tax reform. We do know, however, that lowering the cost of capital for corporate investment is one of the most important factors in estimating the macroeconomic effects of tax law changes. We also know that Congressional tax-writers have long used a rule of thumb that a one percentage point change in the corporate rate raises or loses roughly $100 billion or so over the course of the 10-year budget window (i.e., roughly $10 billion per percentage point per year).[12]

Thus, for example, if half of this dynamic revenue came from the corporate side, that would cover two-thirds of the static revenue loss from corporate tax reform. Under such a scenario, Democratic candidates would only need to raise the corporate rate by one point, to roughly 22%, to "roll back" the entire revenue loss from corporate tax reform.

If two-thirds of the additional economic growth came from lowering the corporate cost of capital, then the TCJA's corporate tax reform already would be revenue neutral at a 21% rate — and there would be nothing for Democratic presidential candidates to roll back.

In considering this macroeconomic feedback, it is important to realize that the additional revenue tends to take the form of additional individual income and payroll taxes, as the result of higher wages, and not corporate taxes. Merely looking at changes in corporate tax revenue does not reveal whether such revenue is coming into the government. In fact, increased growth could translate into lower corporate tax revenue, because corporations are investing more and paying higher wages, both of which generate corporate-level deductions that reduce taxable income.

So what are Democratic candidates really proposing when they claim they want to roll back part or all of the corporate tax cut? Despite their characterizations of their proposals, they are really proposing to roll back the entire corporate tax cut several times over. Not only do they propose to roll back a substantial portion of the statutory rate cut, but they also pocket the TCJA's roughly $1.5 trillion in corporate tax increases. By only rolling back one side of the ledger, they propose to increase corporate taxes by hundreds of billions of dollars — and in some cases, by more than $1 trillion — on top of corporate tax levels before Congress

enacted the TCJA.

Instead, if Democratic candidates want to return corporate tax revenues to about where they would be had the TCJA never been enacted, their best bet is to leave the corporate tax rate right where it is.

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[1] 115 P.L. 97.

[2] https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf.

[3] According to the Organization for Economic Cooperation and Development, when combined with the average state income tax rate, the U.S. corporate rate rises to 25.9%. https://stats.oecd.org/index.aspx?DataSetCode=Table_II1. This is a full two percentage points above the OECD average of 23.9%, meaning the United States still has a higher-than-average corporate rate compared to other developed economies — higher even than the Scandinavian welfare states of Denmark, Finland, Norway, and Sweden. https://www.oecd.org/tax/tax-reforms-accelerating-with-push-to-lower-corporate-tax-rates.htm.

[4] https://www.cnbc.com/2019/03/28/amy-klobuchar-proposes-infrastructure-plan-in-2020-challenge-to-trump.html.

[5] https://nypost.com/2019/07/05/biden-wants-to-raise-the-corporate-tax-rate-back-to-obama-era/; https://michaelbennet.com/RealDeal/.

[6] https://taxfoundation.org/2020-tax-plans/.

[7] Joint Committee on Taxation, "Estimated Budget Effects Of The Conference Agreement For H.R.1, The 'Tax Cuts And Jobs Act'" (JCX-67-17) Dec. 18, 2017, https://www.jct.gov/publications.html?func=startdown&id=5053.

[8] Id.

[9] Congressional Budget Office, "An Update to the Budget and Economic Outlook: 2019 to 2029," https://www.cbo.gov/system/files/2019-08/55551-CBO-outlook-update_0.pdf.

[10] https://www.taxpolicycenter.org/taxvox/revisions-revenue-projections-suggest-tcja-cost-more-expected.

[11] https://www.jct.gov/publications.html?func=startdown&id=5055.

[12] https://www.cbo.gov/system/files/2019-06/54667-budgetoptions-2.pdf. The precise estimate varies depending on various factors, including the corporate tax base, current economic assumptions, and the level of the corporate rate itself. For ballpark estimating, however, $10 billion per percentage point per year provides a reasonable assumption.