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Corporate Tax Competitiveness Rankings for 2012

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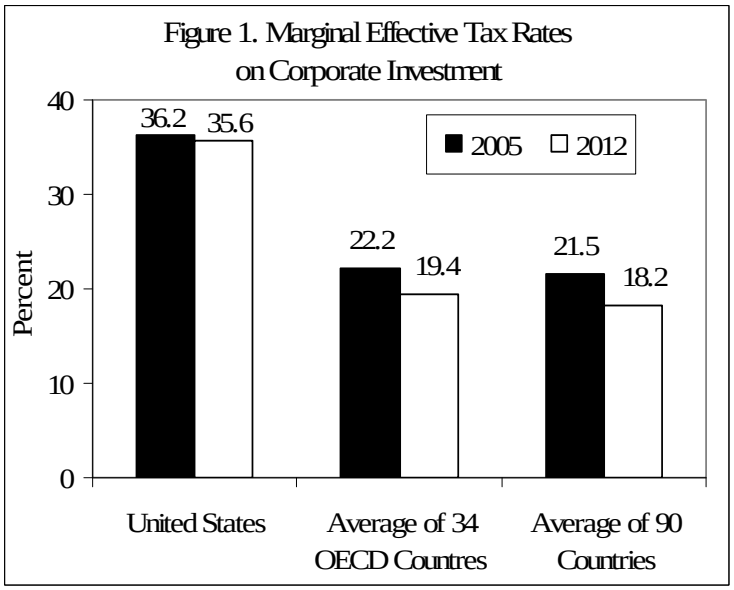
Corporate income tax reform is receiving serious consideration in Washington. The Obama administration has suggested reducing the federal corporate tax rate from 35 percent to 28 percent while broadening the tax base. Presidential candidate Mitt Romney has said that he would cut the corporate tax rate to 25 percent if elected.

The urgency of tax reform increased when Japan recently enacted a reduction to its corporate tax rate. That left the United States in the uncompetitive position of having the highest statutory tax rate in the world, with a combined federal-state rate of about 40 percent.

This bulletin presents new estimates of marginal effective tax rates (METRs) on corporate investment for 90 countries. These tax rates take into account statutory rates plus tax-base items that affect taxes paid on new investment, such as deductions for capital depreciation, inventory costs, and interest expenses. We ignore temporary incentives because they do not support sustained capital investment, but instead shift investment from the future to the present year.

We find that the U.S. effective tax rate on new corporate investment is 35.6 percent in 2012, which is almost twice the average rate for the 90 countries studied, and it is also the highest rate among the major industrial nations. These results underscore the need for U.S. policymakers to tackle corporate tax reform.



Effective Tax Rates for 2012

Figure 1 summarizes our corporate tax rate calculations. The U.S. METR is 35.6 percent in 2012, or almost twice the 90-country average of 18.2 percent. The average rate for the 34 Organization for Economic Cooperation and Development (OECD) nations is just 19.4 percent. While the U.S. corporate tax rate has remained high, the global trend for both statutory and effective corporate tax rates has been downward.

Despite large budget deficits in many countries and the popularity of anti-corporate sentiments, few countries have raised their corporate tax rates in recent years, and many countries have reduced them. Countries have recognized that corporate tax rate cuts help spur growth and that revenue losses will be minimal because lower rates help attract profits from abroad through transfer pricing and financial restructuring.[1]

Table 1 on the next page shows METR calculations for 90 countries, including separate figures for the services and manufacturing sectors. The United States has the fourth highest effective tax rate on corporate investment in the world after Argentina, Chad, and Uzbekistan.

The United States has a high METR, a high statutory tax rate, and numerous special preferences in its corporate tax system. This noncompetitive and nonneutral tax structure is harmful to growth, and it results in relatively low government revenues because the high rates induce businesses to shift their investments and profits abroad.

Table 1. Marginal Effective Tax Rates
on Corporate Investment for 90 Countries, 2012

Country	Marginal Effective Tax Rate			Rank on
	Overall	Manufacturing	Services	Overall Rate
Argentina	43.2	47.8	41.5	1
Chad	36.4	40.5	35.5	2
Uzbekistan	35.7	39.2	34.4	3
United States	**35.6**	**33.9**	**37.2**	**4**
France	35.1	36.8	34.8	5
India	33.5	28.1	34.9	6
Colombia	33.4	35.8	32.9	7
Brazil	31.6	34.0	30.8	8
Japan	30.4	30.6	30.4	9
Venezuela	30.2	30.8	30.0	10
Korea	29.9	32.2	28.9	11
Russia	29.5	32.0	28.9	12
Costa Rica	28.2	35.3	26.1	13
U.K.	26.7	25.3	26.9	14
Spain	26.3	25.4	26.4	15
Australia	26.2	27.9	25.9	16
Austria	26.0	25.9	26.0	17
Pakistan	25.8	29.1	24.7	18
Lesotho	24.8	13.2	28.2	19
Philippines	24.7	26.1	24.2	20
Germany	24.6	26.7	23.9	21
Norway	24.5	23.3	24.6	22
Sierra Leone	23.7	17.9	24.0	23
Italy	23.2	25.2	22.7	24
Portugal	23.0	20.9	23.4	25
Peru	23.0	29.8	21.3	26
Bolivia	22.2	29.8	20.3	27
Tunisia	21.8	24.1	21.3	28
New Zealand	21.7	22.5	21.5	29
Saudi Arabia	21.0	18.2	21.7	30
Iran	20.6	28.0	19.0	31
Indonesia	20.4	23.8	18.6	32
Sweden	19.9	18.5	20.2	33
Canada	19.9	13.8	22.4	34
Tanzania	19.4	15.1	20.1	35
Kazakhstan	19.0	24.1	18.1	36
Denmark	18.9	20.8	18.5	37
Georgia	18.9	21.3	18.4	38
Jamaica	18.6	15.9	18.9	39
Finland	18.5	20.4	17.9	40
China	18.5	21.5	15.8	41
Rwanda	18.2	27.0	17.1	42
Malaysia	17.8	19.5	16.8	43
Switzerland	17.8	17.0	17.9	44
Mexico	17.5	19.0	17.1	45
Netherlands	17.3	16.2	17.6	46

Table 1 continued

Country	Marginal Effective Tax Rate			Rank on
	Overall	Manufacturing	Services	Overall Rate
Zambia	17.2	24.2	16.1	47
Belgium	17.1	16.3	17.2	48
Luxembourg	17.1	18.1	17.0	49
Ecuador	16.8	21.6	16.0	50
Hungary	16.6	17.5	15.7	51
Israel	15.0	13.2	15.3	52
Uganda	14.7	9.6	15.2	53
Bangladesh	14.6	12.9	15.1	54
Poland	14.5	13.8	14.7	55
Iceland	14.2	11.6	14.6	56
Botswana	14.2	8.3	14.6	57
South Africa	14.1	15.6	13.7	58
Ghana	14.0	14.3	14.0	59
Fiji	13.9	17.6	13.1	60
Nigeria	13.5	20.4	12.8	61
Ethiopia	13.4	27.0	12.2	62
Morocco	13.4	17.9	12.4	63
Madagascar	13.1	17.7	12.0	64
Slovak Rep.	12.8	16.5	11.4	65
Czech Rep.	12.7	12.9	12.7	66
Vietnam	12.6	19.6	9.1	67
Thailand	12.1	14.9	10.1	68
Trinidad	12.0	3.6	16.8	69
Slovenia	11.9	12.1	11.8	70
Estonia	11.4	11.4	11.4	71
Greece	11.3	10.6	11.4	72
Ireland	11.2	10.6	11.4	73
Taiwan	11.1	13.3	10.0	74
Jordan	9.5	11.5	9.1	75
Egypt	9.4	12.6	8.4	76
Singapore	9.3	7.0	10.1	77
Croatia	9.1	11.7	8.5	78
Kenya	9.0	-24.0	15.4	79
Kuwait	8.7	9.8	8.5	80
Romania	8.6	11.0	7.7	81
Mauritius	7.9	8.8	7.7	82
Chile	6.7	7.3	6.6	83
Qatar	5.8	9.1	5.2	84
Latvia	5.8	7.4	5.5	85
Turkey	5.7	5.0	5.9	86
Ukraine	5.6	11.4	3.6	87
Bulgaria	5.0	5.3	4.9	88
Hong Kong	3.9	3.5	3.9	89
Serbia	-4.0	-11.2	-2.2	90
Average for 90 Countries	**18.2**	**18.9**	**17.9**	

Canadian Reforms

U.S. policymakers should examine the recent corporate tax reforms in Canada, which is America's largest trading partner. Since 2000 these have included:

- Cutting the federal statutory tax rate from 29.12 percent to 15 percent and cutting the average provincial tax rate from 13.3 percent to 11.1 percent.
- Eliminating most federal and provincial capital taxes, which were levies on a measure of business assets.
- Removing sales taxes on capital goods in most provinces as a result of harmonizing provincial sales taxes with the federal Goods and Services Tax (a form of value-added tax).
- Adopting generally more neutral capital cost allowances for the corporate income tax.
- Scaling back some of the special preferences under the corporate income tax.

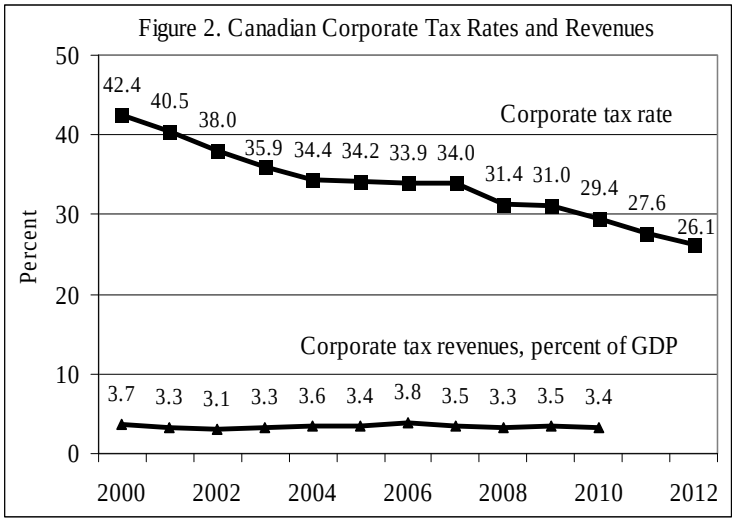
The reforms since 2000 have created a much more competitive and neutral corporate tax system. The METR on corporate investment has been cut substantially, which has spurred greater investment and growth. In addition, multinational corporations seem to be shifting more profits into Canada because of the lower tax rates.[2]

The cut in corporate tax rates does not seem to have lost Canadian governments much, if any, revenues. Figure 2 shows that the combined federal-provincial tax rate fell from 42.4 percent in 2000 to 29.4 percent in 2010. (The rate has fallen further since then). Despite this 31 percent cut and the 2009 recession, tax revenues as a share of gross domestic product (GDP) have remained roughly constant due to rising corporate taxable income.[3]

A Growing Consensus on Corporate Tax Reform

New findings from academic research point strongly to the advantages of corporate tax rate cuts. One finding is that when considering the efficiency characteristics of different taxes, corporate income taxes are the most distortionary, and hence the most harmful for economic growth.[4] Reductions in corporate tax rates can help boost domestic investment and spur inflows of foreign investment.[5]

Another finding is that corporate tax rate cuts in high-rate countries will probably not cause substantial revenue losses. Instead, in a global economy, aligning a nation's corporate tax rate with the international average rate or less helps protect the tax base. Keeping the corporate rate competitive reduces profit shifting by multinational companies to low-tax jurisdictions.[6] As many countries reduce their rates over time, all countries gain as the efficiency of tax systems and the global economy are increased.



A third message from recent studies is that corporate tax rate reductions should be accompanied by base broadening. Broader tax bases can raise a particular amount of revenue to support lower tax rates. The purpose of base broadening should be to enhance tax neutrality, which allows businesses to make efficient decisions that reduce the misallocation of resources and minimize the costs of tax planning and administration. Countries should avoid special tax breaks for particular industries or business activities.

Thus, countries should broaden their tax bases to improve neutrality while reducing rates. But if the rate is still above international norms, a further pure rate cut is in order regardless of "revenue neutrality." One reason is that revenue neutrality is often measured on a static basis, without fully accounting for the positive dynamic effects of tax rate cuts. For example, reducing the U.S. corporate tax rate would spur capital investment and the shifting of profits into the United States, which in turn would generate economic growth and additional tax collections.

In sum, a consensus is emerging among corporate tax experts that tax reforms should aim at achieving longer-term efficiency and economic growth rather than just being guided by a short-term revenue target.

Conclusions

Growing numbers of tax experts and policymakers recognize that the U.S. corporate tax system is a major barrier to economic growth. The aim of corporate tax

reforms should be to create a system that has a competitive rate and is neutral between different business activities.

At the federal level, policymakers should focus on reducing the statutory rate by 10 percentage points or more and ending preferences to create a more neutral tax base. Such reforms would help spur economic growth and likely lose the government little, if any, revenue over the long run. At the state level, policymakers should make similar corporate income tax changes while reforming other taxes that can fall on capital investment such as retail sales taxes.

Appendix: Calculating Effective Tax Rates

To compute the marginal effective tax rates (METRs) in this study, we take capital-related taxes paid as a share of the pre-tax rate of return on capital for marginal investments.[7] We include corporate income taxes, sales taxes on capital purchases, and other capital-related taxes such as financial transaction taxes and asset-based taxes. We do not include property taxes because effective rates are not observable from data across countries.

Our model assumes a multinational company seeking to maximize the value of its projects around the world, raising equity and debt financing from international markets. The company minimizes its cost of finance by choosing an optimal debt and dividend policy, taking into account tax and nontax factors that influence financial decisions (independent of the investment decision). The cost of equity and debt is determined by international markets and is independent of the availability of domestic savings. Therefore, personal taxes on dividends, interest, and capital gains do not affect the multinational's cost of financing, even though those taxes do affect personal savings decisions.

To calculate the effective tax rate on new investments, similar projects in manufacturing and service industries are assumed in each country. The same capital structure for eight industries (manufacturing, construction, utilities, communications, transport, wholesale trade, retail trade, and other services) is assumed across countries, using data for capital stock weights developed by the Canadian Department of Finance. We also use Statistics Canada's recently estimated economic depreciation rates, and apply them across all countries. For country-specific inflation rates and industrial structures (i.e., the relative GDP shares of manufacturing and services), we rely on the latest statistics published by the International Monetary Fund, the United Nations, and the Canadian Department of Finance.

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[1] Jack Mintz and Alfons Weichenrieder, *The Indirect Side of Direct Investment: Multinational Company Finance and Taxation* (Cambridge, MA: MIT Press, 2010), p. 140.

[2] There has been only a modest shift of income from the personal to the corporate sector because corporate tax rates for small businesses have not been reduced as much as the general corporate tax rate, and most business income in Canada is in corporate form. Unlike that of the United States, Canada's tax system integrates corporate and personal taxes on dividends and capital, thereby resulting in a relatively small unincorporated business sector.

[3] Federal-provincial corporate tax revenues are based on Statistics Canada data. Note that recent federal budget projections show that federal corporate tax revenues as a share of GDP remain stable through 2012 despite the further drop in the tax rate in 2011 and 2012.

[4] See Organization for Economic Cooperation and Development, *Tax Policy Reform and Economic Growth* (Paris: OECD, 2010), p. 10.

[5] A preliminary analysis examined whether METRs have an effect on foreign direct investment (FDI) flows among countries during 2005 to 2008. Taking into account other factors that influence investment (inflation, political risk, GDP per capita, trade protection, human development, and the exchange rate), we found that a one percentage point increase in a country's METR caused FDI as a share of GDP to decline between 0.05–0.08 percentage points. Given that the mean average of foreign direct investment to GDP is about 5.2 percent, this reduction is quite meaningful. See M. Krzepkowski, J. Mintz, and J-F Wen, mimeograph, University of Calgary, 2012, presented at the Congress of the International Institute of Public Finance, Dresden, Germany.

[6] Several studies have shown that income shifting can result in much smaller revenue losses from rate cuts and even Laffer effects, whereby reductions in high rates actually increase revenue. See Kimberly Clausing, "Corporate Tax Revenues in OECD Countries," *International Tax and Public Finance* 14, no. 2 (2007): 115–134; Jack Mintz, "2007 Tax Competitiveness Report: A Call for Comprehensive Tax Reform," C.D. Howe Institute, September 2007; and Alex Brill, "Corporate Tax Rates: Receipts and Distortions," *Tax Notes*, December 22, 2008.

[7] Our methodology is discussed in Duanjie Chen and Jack Mintz, "Taxing Business Investments: A New Ranking of Effective Tax Rates on Capital," World Bank, 2008.