Is There a Corporate Income Tax?

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The Corporate Income Tax

- Most corporations pay a 35% profits tax.
- Many argue that the tax has a bad disincentive effect.
- At the same time, others rail against corporations for tax avoidance schemes.

The hidden secret. The corporate profits tax is really much lower.

The Scenario

- I am considering investing in a project estimated to cost $150 million.
- A partner offers to put up a third of the cost in exchange for a third of the returns.
- Not a disincentive. I will do the same PV calculations and come to the same conclusion.

The partner will, of course, worry about me cheating him out of his third.

Let's assume a \( \frac{1}{3} \) corporate tax rate.

The Scenario

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The Scenario (Revised)

- I am considering investing in a project estimated to cost $150 million.
- The government offers to put up a third of the cost, and takes a third of the profits as “taxes”.
- Not a disincentive. I will do the same PV calculations and come to the same conclusion.

Just as I have incentives to cheat my partner, I have incentives to cheat the government via Tax Avoidance Schemes.

Two Projects

- A new drug costing $150 million.
- Tax laws make the expense deductible, so the after tax cost is $100 million.
- Profits are subject to a one-third tax.

- A new plant, costing $150 million.
- Not deductible, but I can depreciate the plant over six years.
- Profits are subject to a one-third tax.

- The government does give me a $50 million write off, but the PV is not $50 million. Thus it is putting up less than a third of the cost.

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Two Projects

- At 6%, the DPV of the deductions = $42,120 million.
- I put up 72% of the cost, & get 67% of the profits.
- The effective tax rate is 5/72 ≈ 7%.

A Conundrum

- A new plant, costing $150 million.
- Not deductible, but I can depreciate the plant over six years.

A Conundrum

- Some say we are close to a zero corporate profits tax, so why not abolish it and save the paperwork.
- And, we can eliminate some corporate tax avoidance schemes.

A Conundrum

- Some say we are close to a zero corporate profits tax, so why not abolish it and save the paperwork.
- And, we can eliminate some corporate tax avoidance schemes.
- Isn’t that just like making a one-third investment in a plant and then foregoing your right to a third of the profits?

End

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