

Is There a Corporate Income Tax?

$$\tau_r = ?$$

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 Corporate Income Tax

- Most corporations pay a 35% profits tax.
- Many **The hidden secret. The corporate profits tax is really much lower.**
- At the same time, others rail against corporations for tax avoidance schemes.

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 Scenario

- I am considering investing in a project estimated to cost \$150 million.
- A partner **The partner will, of course, worry about me cheating him out of his third.** 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 Scenario

- I am considering investing in a project estimated to cost \$150 million.
- A partner **Let's assume a 1/3 corporate tax rate.** 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 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.

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

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

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- Tax laws make the expense deductible, so the after tax cost is \$100 million.
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- **This is a project without a tax, just a silent partner**

Two Projects

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- 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.

Two Projects

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

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

$$\frac{5}{72} \cong 7\%$$

A Conundrum

- Some say we are close to a zero corporate profits tax, so why not abolish it and save the paperwork.

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- And, we can eliminate some corporate tax avoidance schemes.

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- 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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