A Practical Challenge to Stand-Alone Corporate Tax Reform

By Donald B. Marron

Leaders in both parties appear to favor revenue-neutral corporate tax reform that would lower today's 35 percent tax rate while slashing corporate tax breaks. Efforts to reform the individual income tax, in contrast, remain mired in disagreements over revenue targets and marginal tax rates. Many observers thus wonder whether policymakers should pursue corporate tax reform by itself, separate from any individual reforms.

One practical challenge to stand-alone corporate reform is that many corporate tax breaks also apply to noncorporate businesses, which are taxed under the individual income tax. Efforts to broaden the corporate base could therefore have significant effects on individual income taxes, making it difficult to pursue corporate reform separately.

The Joint Committee on Taxation recently identified about $1.3 trillion in income tax expenditures in 2013.[1] The vast majority, more than $1.1 trillion, operate through the individual income tax. Of those, more than $1 trillion have no link to corporate income taxes. The mortgage interest deduction and the exclusion of employer-provided health insurance, for example, operate exclusively through the individual income tax. As a result, it's possible to talk about major, base-broadening reform of the individual income tax without worrying much about collateral effects on the corporate income tax.

The reverse is not true for efforts at corporate tax reform. Partnerships, S corporations, sole proprietorships, and other passthrough entities take advantage of many of the same business tax breaks as C corporations, including accelerated depreciation and the domestic production deduction. In addition, some corporations get the same tax breaks as individual taxpayers, as with the exemption for interest on municipal debt.

As a result, of the $150 billion in corporate tax expenditures, only $69 billion comes from provisions that operate solely through the corporate income tax (primarily the deferral of foreign income by multinationals). The other $81 billion comes from provisions that also reduce individual income taxes. Several of those provisions are primarily focused on individual taxpayers and have more effect on individual revenues than corporate ones. But $62 billion comes from provisions that mostly affect corporate revenues and thus would likely be considered as part of corporate tax reform. These provisions have relatively little effect on individual revenues ($18 billion), but that's enough to complicate efforts to pursue corporate reform separate from individual reform.

Income Tax Expenditures in 2013
($ billions)

	Individual	**Corporate**	**Total**
Individual only	$1,011	—	$1,011
Corporate only	—	$69	$69
Individual and corporate	$129	$81	$210
Total	**$1,140**	**$150**	**$1,290**
Breakdown of individual and corporate			
Mostly corporate	$18	$62	$80
Mostly individual	$111	$19	$130

Source: Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2012-2017," JCS-1-13 (Feb. 1, 2013). A provision is deemed "individual only" ("corporate only") if the JCT estimates that corporate (individual) tax expenditures are no more than $50 million. A provision that affects both individual and corporate income taxes is deemed "mostly individual" if more than 50 percent of revenue impacts occur through the individual income tax; otherwise, it is "mostly corporate."

[1]Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2012-2017," JCS-1-13 (Feb. 1, 2013). The JCT lists the static revenue cost of each individual and corporate tax expenditure, but it does not report an aggregate figure. Adding the separate provisions, as done here, is imprecise because it does not capture how the provisions interact. Nevertheless, it provides useful, albeit approximate, information about how the provisions overlap.