

The Top Total Income Tax Rate on Corporate Profits, 1913-2011

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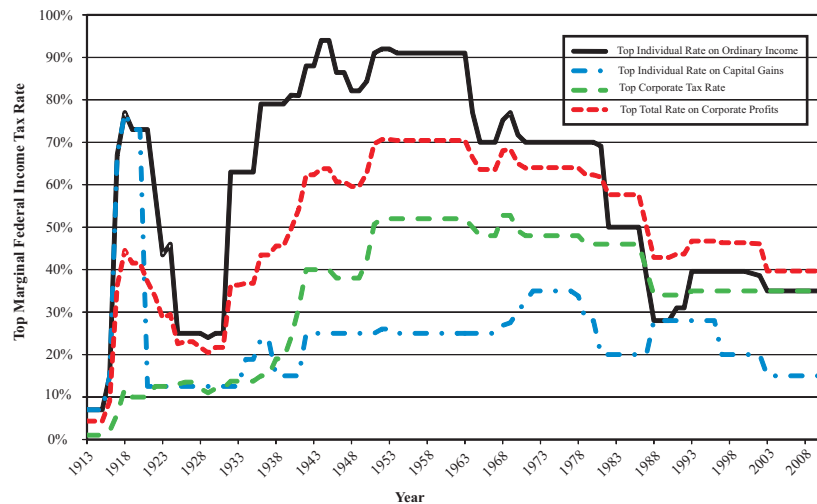
Corporate profits are taxed under both the corporate and individual income taxes. The total income tax rate on corporate profits therefore depends on the corporate rate and the individual rates on dividends and capital gains, as well as on the share of after-tax profits corporations pay as dividends, the share of stock held in retirement and other nontaxable accounts, and the timing of capital gains realizations. To illustrate how these factors determine the total income tax rate on corporate profits, I made assumptions about corporate distributions, stock holdings in tax-favored accounts and patterns of capital gains realizations, and applied those factors to the top corporate and individual rates on dividends and capital gains over the 1913-2011 period (see graph).

From 1913 through 1981, the top corporate rate was generally well below the top individual rate on

ordinary income and, except for a few years, the top rate on capital gains was even lower. So even though the top rate on dividends was the same as the top rate on ordinary income, the top total rate on corporate profits was lower than the top rate on ordinary income (including profits from sole proprietorships and passthrough enterprises — partnerships and S corporations) in all years. The lower top total rate on profits of corporations compared with the top rate on profits of noncorporate enterprises encouraged the corporate over noncorporate forms for conducting business.

Since 1982 the top corporate rate has been relatively close to the top individual rate on ordinary income, so the additional tax on dividends and capital gains has made the top total rate on corporate profits exceed the top rate on ordinary income in every year. The reduction in rates on dividends and capital gains starting in 2003 mitigated but did not eliminate the differential. These higher rates on corporate profits encouraged the conduct of business in noncorporate forms.

Top Corporate Rate, Top Individual Rates on Ordinary Income and Capital Gains, and Top Total Rate on Corporate Earnings, 1913-2011



Assumptions used in calculating the top total rate on corporate profits in all years: Profits are fully subject to corporate income tax; corporations distribute 60 percent of after-tax earnings as dividends; 1/3 of corporate stock is held in retirement and other nontaxable accounts; another 1/3 of stock is held until death; and the present value of tax on realized gains is 60 percent of the tax liability (computed using the current-year capital gains rate).



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