Key Elements of the U.S. Tax System

Q. How does the corporate income tax work?

A. The United States imposes a tax on the profits of US resident corporations at a rate of 21 percent (reduced from 35 percent by the 2017 Tax Cuts and Jobs Act). The corporate income tax raised $297.0 billion in fiscal 2017, accounting for 9 percent of total federal revenue.

The United States taxes the profits of US resident C corporations (named after the relevant subchapter of the Internal Revenue Code) at 21 percent.

Taxable corporate profits are equal to a corporation's receipts less allowable deductions—including the cost of goods sold, wages and other employee compensation expenses, interest, nonfederal taxes, depreciation, and advertising. US-based corporations owned by foreign multinational companies generally face the same US corporate tax rules on their profits from US business activities, as do US-owned corporations.

Corporate profits can also be subject to a second layer of taxation at the individual shareholder level, both on dividends when distributed and on capital gains from the sale of shares. The maximum tax rate on both dividends and capital gains is currently 23.8 percent (including the 3.8 percent tax on net investment income).

Many US businesses are not subject to the corporate income tax; rather, they are taxed as "pass-through" entities. Pass-through businesses do not face an entity-level tax. But their owners must include their allocated share of the businesses' profits in their taxable income under the individual income tax. Pass-through entities include sole proprietorships, partnerships, and eligible corporations that elect to be taxed under subchapter S of the Internal Revenue Code (S corporations).

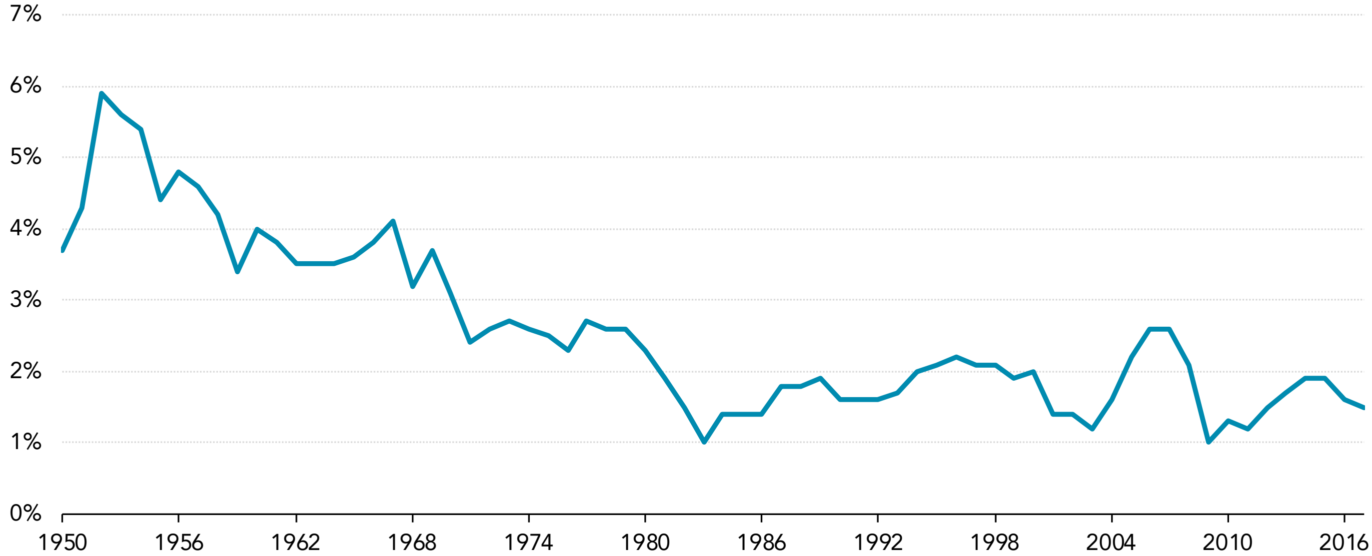
The corporate income tax is the third-largest source of federal revenue, although substantially smaller than the individual income tax and payroll taxes. It raised $297.0 billion in fiscal 2017, 9.0 percent of all revenue, and 1.5 percent of gross domestic product (GDP). The relative importance of the corporate tax as a source of revenue declined sharply between the 1950s and 1980s, but over the past quarter century it has brought in revenues equal to about 2 percent of GDP (figure 1).

How does the corporate income tax work?

FIGURE 1

Corporate Income Tax Revenue

Share of GDP, fiscal years 1950–2017



Source: Office of Management and Budget, Fiscal Year 2019, *Historical Tables*, Table 2.3.

RECENT CHANGES TO THE CORPORATE INCOME TAX

The Tax Cuts and Jobs Act (TCJA) reduced the top corporate income tax rate from 35 percent to 21 percent and eliminated the graduated corporate rate schedule. The new law also repealed the corporate alternative minimum tax.

The TCJA made fundamental changes to the treatment of multinational corporations and their foreign source income. Profits earned abroad by US resident multinationals are now exempt (a "territorial" system). In addition, it created two new minimum taxes—the tax on Global Intangible Low-Taxed Income (GILTI) and the Base Erosion and Anti-abuse tax (BEAT). Another provision of the TCJA provides a new deduction for certain foreign-derived intangible income (FDII).

Before the TCJA, US resident multinationals owed tax on their worldwide profits, but tax on their profits from controlled foreign subsidiaries was deferred until those profits were repatriated (that is, paid back as dividends) to the US parent corporation. Further, these profits were eligible for a nonrefundable credit for foreign taxes paid.

Data Source

Office of Management and Budget. *Historical Tables*. 2.3. "[Receipts by Source as Percentages of GDP: 1934–2023](#)."