Some Background

Who bears the burden of the corporate income tax?

Q. Who bears the burden of the corporate income tax?

A. The burden is shared among stockholders and, unintuitively, among a broader group of workers and investors.

Shareholders bear some of the corporate income tax burden, but they aren't the only ones. Over time, others bear some of the burden because of a chain reaction that begins with the shareholders.

The corporate income tax reduces shareholders' after-tax returns, causing them to shift some of their investments out of the corporate sector. Shareholders will shift some investments to noncorporate ("pass-through") businesses and some to foreign businesses not subject to the US corporate income tax. The shift to these other sectors lowers the after-tax return on investments in these sectors. The shifting of investment out of the corporate sector continues until after-tax returns—adjusted for risk—are equalized in the corporate and noncorporate sectors. Thus, the corporate income tax reduces investment returns in all sectors.

Shifting investments to foreign businesses also reduces the amount of capital (machines, equipment, structures, etc.) complementing US workers, so their productivity, and therefore their wages and other compensation, fall.

In calculating distributional effects, the Urban-Brookings Tax Policy Center (TPC) assumes investment returns (dividends, interest, capital gains, etc.) bear 80 percent of the burden, with wages and other labor income carrying the remaining 20 percent. These assumptions reflect the full, long-term economic consequences of investors responding to changes in the corporate income tax, such as rate changes.

When analyzing the distributional effects of a short-term corporate income tax change before investors have a chance to react, TPC assumes that shareholders bear the entire burden. When analyzing corporate income tax changes that affect only the timing of payments, such as a change in depreciation allowances, TPC assumes that half the burden is on investment returns and half on wages and other labor income. The Joint Committee on Taxation, the US Department of the Treasury's Office of Tax Analysis, and the Congressional Budget Office use similar incidence assumptions.

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Further Reading

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