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Kill the corporate tax

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Normal spin doctoring may be all that's needed for a dramatic change in tax philosophy

The latest issue of *Policy Options* features a startling proposal by Tom Kent, who was prime minister Lester Pearson's principal policy advisor and who is still, at the age of 88, thinking innovatively about public policy. His proposal is to kill the corporate income tax.

Mr. Kent was involved in many of the decisions that led to the welfare-state programs that for several decades have given this country its leftish self-image, so his proposing that we give up on the bedrock leftish idea that our tax system should "make corporations pay" is more than a little shocking. That he calls his idea "A modest proposal," the title of Jonathan Swift's 1729 satire advising the Irish to eat their children, suggests maybe he's not entirely serious. On the other hand, he adds to the ditching of the corporate tax a full list of complementary reforms, some of which would be appealing even to readers of this page, for example, an increased emphasis on taxing consumption. As he says in a coda that finance ministers and critics should make their own, "Smarter taxation will fall more on the spending, less on the making, of money."

Why abolish the corporate tax? Mr. Kent believes globalization will do it in anyway since "much of industry has become footloose." Better to get rid of it deliberately than by default and to make sure it's replaced, rather than simply withers away, leading to higher deficits or lower public spending.

In fact, reports of the corporate tax's demise are premature. On Wednesday the OECD issued a report on taxation and economic growth that shows its member countries are more reliant than ever on corporate income taxes. In 2007, such taxes accounted for 11% of overall revenues, up from just 8% in 1975. That increase occurred despite a decline in corporate tax rates in most countries. Rates fell on average from 47% in 1981 to 25.9% in 2007. (Since 1994, the corporate tax rate has risen only in France and Finland.)

How are countries raising more revenue with lower taxes? It's tempting to think the Laffer curve has kicked in, so that lower rates have brought a flurry of new corporate activity, and maybe in part they have. But most countries have followed economists' time-worn rule: Lower the rate and broaden the base. As rates came down, the generosity of exemptions, deductions and special allowances was cut back — as it should have been

— and so the lower rates applied to a bigger tax base, thus helping offset the revenue loss. Moreover, there has been a secular increase in profits in most OECD countries, so that even constant tax rates and rules would have brought in more funds.

For the OECD, lower corporate tax rates are all to the good. Tom Kent is not quite so enthusiastic, but does argue that “All income tax, personal and corporate, weakens some of the incentives for work and enterprise.” On this point, the market-oriented Montreal Economic Institute also chipped in on Wednesday with a report on how, by reducing the incentive for corporations to invest in capital, or to invest at all, corporate taxes end up lowering productivity and reducing wages. It cited estimates that the effect of a $1 increase in effective corporate tax could be as large as a $1 reduction in overall compensation.

A policy that could rally the support of the OECD, Quebec’s version of the Fraser Institute, and a policy guru who was present at the creation of the modern Canadian welfare state would seem to have a lot going for it.

There would be differences of opinion, of course, about whether or how to make good the revenue lost by doing away with corporate taxes. Tom Kent would favour a personal expenditure tax, which would work like the self-assessed personal income tax we all know and love, though with two big differences. Most deductions and exemptions would no longer be available. And in calculating their taxable income, which would now actually be taxable expenditure, taxpayers would deduct their annual savings, so that they paid tax only when they spent their incomes. It would be a consumption tax, in the spirit of the GST (which would disappear, by the way) but it would avoid the expense and complication of the GST. (The OECD is also down on the economic inefficiency of consumption taxes that make numerous exceptions.)

To my mind, the most interesting part of Mr. Kent’s proposed abolition of corporate taxes is his evident belief that it is now within the realm of political possibility. “Familiarity … can … breed acceptance. It is unlikely to be long before normal doses of spin doctoring are enough to weaken the resistance to further cuts in corporate tax.”

The U.S. has just effected a big compromise on taxes. If all it would taken is normal spin doctoring for our political class to be able to effect a dramatic change in tax philosophy, the only reasonable response is “Spin, baby, spin.”

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