

THE PROGRESS REPORT

Corporate Income Tax and Shakespeare

By Fred E. Foldvary

In the United States and many other countries, there are two income taxes, one on natural persons and one on corporations as legal persons. Corporations are owned by their shareholders, so in reality the shareholders end up paying some of the tax on corporate profits. Some of the tax is passed onto consumers, and the rest falls on workers, reducing their employment and wages.

Then when a corporation pays dividends to its shareholders, the dividends are personal income, and taxed again by the personal income tax. Some countries, such as the U.K., only tax corporate profits once, but U.S. shareholders pay a double tax on dividends.

The double taxation of dividends induces some corporations to avoid paying dividends, and it encourages excessive borrowing as a substitute for issuing more stock. The large debt burden of corporations is to a large extent the result of the income tax. This debt makes corporations fail when profits fall, because they can't afford to pay the interest. If instead of debt they issued more stock, the fall in profits would just reduce the dividends.

The abolition of the corporate income tax would eliminate this double taxation. However, so long as the personal income tax exists, corporate profits should be taxed the same as the profits or income of natural persons. If the profits are not paid out in dividends, then the shareholders should pay that tax on retained earnings and unrealized gains. In partnerships, the partners pay the tax on profits once; corporations should be treated the same.

Even better would be the abolition of all taxes on income other than from land rent. Then the shareholders would be tax free on their dividend income, just as with interest and wages. The tax on land rent would be based on the market value of the land, regardless of whether the corporation owns the land or rents it. Much of corporate profit is really land rent, and that portion should be collected, since the land value comes from nature and the social environment, including the government-provided public works.

Treasury Secretary Paul O'Neill has for a long time suggested the abolition of the corporate income tax, stating that "Corporations don't pay taxes, they just collect them" (Business Week Online, January 25, 2001).

The abolition of double taxation would stimulate more investment, growth, and employment. But so long as personal incomes are taxed, then that income that is effectively that of the shareholders also needs to be included, otherwise they become relatively privileged. The corporation income tax should be folded into the personal income tax to create one unified system treating all sources of income alike.

Of course, sources are not economically alike, so this would be a splendid time to ask Treasury Secretary O'Neill: since you recognize that income taxes impose a huge excess

burden on the economy, including the waste of complying with the tax, why not at least advocate the total elimination of all taxes on incomes, and instead collect revenue directly from the States in proportion to their land values? Mr. Secretary, do you favor a shift in taxes from wages, profits, interest, and dividends, to land rent?

That is the logical conclusion from the recognition that taxes have a wasteful excess burden. Those who do not favor shifting taxes to rent implicitly if not explicitly want to keep that excess burden. Let's have it out. Take a stand. Shall we shift to rent, or not?

Mr. Secretary, if you were to publicly advocate the elimination of all taxes, replaced by public revenue from land rent, it would create a global sensation. Everyone would talk about it. If you helped shift public opinion to rent-based public finance, you would go down in history as the greatest secretary of the Treasury ever, even greater than Alexander Hamilton.

As William Shakespeare wrote in his play Julius Caesar, "There is a tide in the affairs of men, which, taken at the flood, leads on to fortune." So too there is a tide in public opinion, which taken at its crest, leads to social transformation. That tide is cresting today. The current economic fear of recession provides a splendid opportunity for fundamental reform. The beginning of a new federal administration is when bold policies are possible. Catch the tide now, Mr. Treasury Secretary and Mr. President, before it recedes, or else your chance is lost, forever.