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Dear Senator Warren:

We write regarding your proposal to impose a new corporate tax for U.S. companies with more than $100 million in global net income. The tax would be at a rate of 7% on the global net income of U.S. companies in excess of $100 million as reported by companies in their financial statements, with a credit of 1/3 for federal corporate income taxes paid. The tax would be paid in addition to any existing corporate tax liability. **We estimate that this tax would raise close to $700 billion over the ten-year budget window 2023-2032.** About 1,300 public corporations would be liable for this tax and the tax on listed companies alone would raise close to $650 billion over the ten-year budget window.

Details on the estimation

Data sources:

To estimate the tax paid by listed companies, we use Compustat data, which cover all publicly listed U.S. corporations.

Methodology:

1) The tax base is the global, consolidated net income of U.S. public companies, as reported in Compustat variable “net income” (NI). The first $100 million in net income are exempted from the tax. The corresponding tax base adds up to a bit more than $1.5 trillion in 2019.

2) Since the tax is levied on the global consolidated income of U.S. companies, it cannot be avoided by shifting income to low-tax jurisdictions. Moreover, since the tax is based on income as reported in audited and certified financial accounts and does not allow for any deduction or credit, the possibilities of avoidance are limited. There are three ways to avoid the tax: inverting to a foreign country, splitting to reduce income below the $100 million exemption threshold, or manipulating global net income figures in financial statements by exploiting ambiguities in accounting rules. We discuss below how regulations can address

the first two issues. Based on the IRS estimated tax gap for the corporate income tax, we factor in a 15% tax avoidance rate.

3) In 2019, there would have been around 1,250 public companies liable for the tax. The tax base above $100 million would have been $1.52tr. A seven percent tax on this base would have raised $107 billion in 2019. After reducing it by 15% to account for avoidance, tax revenue would have been $91 billion. As the Covid pandemic has had exceptional, major, and conflicting effects on corporate profit, we choose 2019 as our base year for our computations (instead of 2020).

5) Crediting 1/3 of federal income taxes paid reduces revenue by about half. The effective federal corporate income tax rate of listed companies was about 11% of global book income in 2019,[1] so that a 1/3 credit would allow companies to deduct about 3.7% of book income, about half of the 7% tax owed. This computation based on aggregate data has a significant margin of error.

4) To project tax revenues over the 10-year budget window 2023-2032, we assume that nominal taxable income would grow at the same pace as the U.S. economy, at 4.0% per year as in standard projections of the Congressional Budget Office or the Joint Committee on Taxation. This growth is decomposed into 2.0% price inflation, 0.6% population growth, and 1.4% of real growth per capita. This implies that tax revenue over the 10 years window 2023-2032 is 12 times the revenue raised in 2023.[2] This uniform growth assumption is conservative as the income of large companies has been rising faster than U.S. GDP in recent decades. Revenue in 2023 is estimated at $106 billion before credit and $53 billion after credit, based on our benchmark year 2019 and inflating income by 4.0% a year from 2019 to 2023.

5) The 10-year projection implies that revenue raised by this new corporate tax would be 12 * $53 billion = **$636 billion over the 2023-2032 window for listed companies.**

6) This computation is based only on public companies, even though private companies would also be subject to the tax. In particular, the tax would also apply to S-corporations. Based on aggregate amounts reported by S-corporations on their 1120S tax form Schedule M-3 (reconciliation between book and tax income), roughly an additional $50 billion would be collected on S-corporations over the 2023-2032 window**, bringing total revenue to $686 billion**. Because of the lack of data for private C-corporations, we do not include revenues raised on private C-corporations and for that reason our estimates should be seen as conservative.

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[1] Unfortunately, the amount of cash federal taxes paid is not publicly available at the company level (even for publicly listed companies). According to NIPA data, in 2019 federal corporate income tax payments were $217 billion, of which we assume 15% was paid by private companies. Total book income of listed companies (in Compustat) was $1.65 trillion, implying an effective federal corporate income tax rate of 0.85 x 217/1,685 = 11%.

[2] With r=4.0%, we have [1+(1+r)+...+(1+r)^9]=[(1+r)^10-1]/r=12.0.

Anti-avoidance measures

Regulations need to be designed to prevent corporations from artificially splitting to reduce income below the $100 million exemption threshold. The regulations should mandate that corporations that are for all intent and purpose part of a single group (e.g., because they have the same owners and take orders from the same persons) should be treated as such (i.e., consolidated) for tax purposes.

Treasury regulations regarding corporate inversions have been significantly strengthened in 2016 and since then corporate inversions have come to a halt. The higher the effective U.S. corporate tax rate, however, the more pressure there will be on that front. The solution to the problem of tax competition from low-tax countries involves greater international tax coordination (in particular, reaching an international agreement on minimum effective corporate tax rates) and the adoption of defensive measures against tax havens and multinationals headquartered in countries refusing international coordination.

Sincerely,

Emmanuel Saez and Gabriel Zucman