Eliminate the Corporate Income Tax and Level the Playing Field

By Martin Lobel

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Lobel offers a proposal that would level the playing field between traditional C corporations and pass-through business entities, while achieving the goals of simplicity and fairness.

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We could eliminate the economic distortions of the corporate income tax causes by substituting a flat tax on the profits that corporations book and report to the SEC, which the shareholders could use as a credit against their individual taxes. This would simplify the tax code, simplify corporate accounting, and eliminate the incentive to shelter offshore trillions of dollars from taxation. It would also end the tax code's discrimination against domestic companies. A flat tax would make the tax system more progressive, help limit the increasing shift of income from the middle class to the very wealthy, and remove the justification of double taxation for the lower tax rates on dividends and capital gains. The creditable flat tax should be substituted for the taxes paid by the new passthrough entities (limited liability companies, master limited partnerships (MLPs), etc.) to eliminate economic distortions.

Corporations are very effective at collecting taxes owed by their employees through withholding. The same could be true for taxes owed by their shareholders. For example, if a corporation earns $100 and the tax rate is 35 percent, the corporation would distribute $65 to its shareholders along with a tax credit for $35 which the shareholders could then use as a credit against their taxes. To prevent a secondary market to shelter foreign income, the credit would need to be nontransferable. If the shareholder were a tax-exempt institution, it would submit its tax credits to the IRS to get the cash — less, of course, the imputed 35 percent corporate tax, to avoid increasing the benefits the tax-exempt institutions receive under the current system.

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The proposal would level the playing field between the traditional C corporations and the passthrough business entities, while achieving the goals of simplicity and fairness, but it needs to be costed out at various rates.

Every time someone mentions tax reform, tax lobbyists raise their rates and the media concludes there is no chance for reform. However, reform is
possible — but only when we have the next economic crisis. The lesson we learned from the 1986 tax reform is to start thinking before the crisis about how to propose a simple plan in which everyone gains and loses a little so they aren’t sure whether they are better off in the long run. In the long run, however, our country will be better off with a fairer and simpler tax code.