CHAPTER

The Next Business Tax Regime: What Comes After the TCJA?

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The Next Business Tax Regime: What Comes After the TCJA?

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ABSTRACT

This essay presents the case for a better US business tax regime. First, we provide an overview of the business tax base in the United States and describe how business activity is taxed, with special focus on the 2017 Tax Cuts and Jobs Act (TCJA). We then review early evidence of the TCJA's effects on economic activity and compare these effects to policymakers' predictions. We conclude by considering policy implications and make several recommendations for improving the US business tax regime. We propose a future regime that can raise substantial revenue from business without inventing new policy instruments. Our proposal would preserve productive business activity, promote efficiency by harmonizing tax rates across income tax bases, and improve tax progressivity

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1. Introduction

Amid economic recovery from the pandemic, the federal deficit remains historically high as a share of GDP. This fact can be seen in figure 1, which shows federal spending and revenues as a share of GDP from 1980 to the present. There is a post-2000 pattern of persistent deficits even at times when the economy is operating at or beyond full employment. Policymakers are presently debating both spending and tax-based measures to address these imbalances. This essay focuses on the revenue side of the ledger. We draw on insights from our academic research along with that of other scholars on the taxation of business income in the United States to sketch a promising picture for the next business tax regime.

Our focus on business income tax is motivated by three factors. First, given their importance for the overall tax base, taxes on business income will play a key role in upcoming fiscal debates. Second, since a substantial portion of top income and wealth comes from business activity (Smith et al. 2019; Smith, Zidar, and Zwick 2023), efforts to increase tax progressivity also require grappling with how to tax businesses. Third, business tax has been an active area of recent policy reform, notably in the 2017 tax reform law—the Tax Cuts and Jobs Act (TCJA). As a share of GDP, the TCJA was the largest corporate tax cut in US history. This reform law has several expiring business tax provisions that deserve reassessment to help policymakers determine what to extend and what to let expire. Taking stock of what we have learned from these reforms is crucial for guiding evidence-based policy going forward.

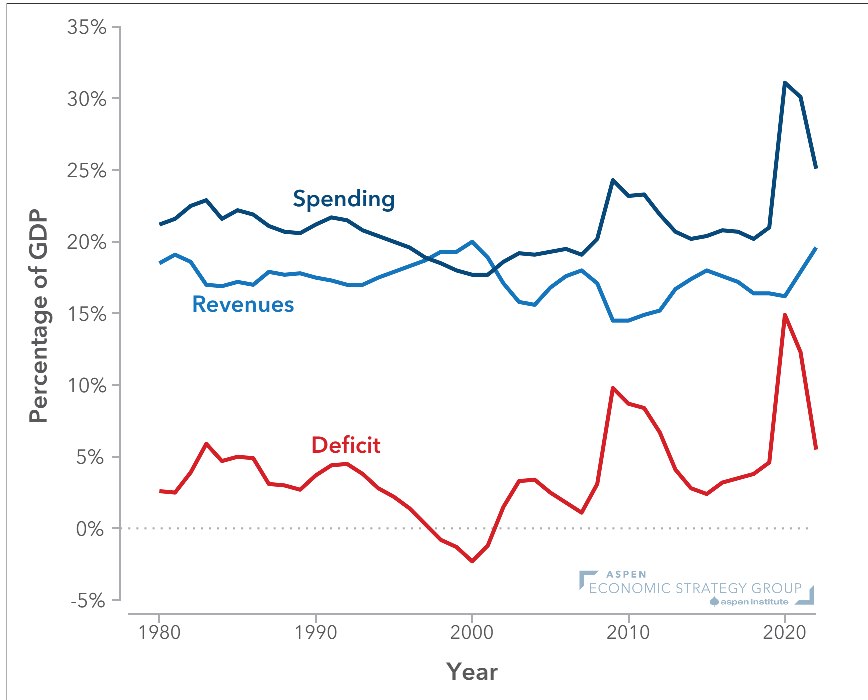
Our proposal would (a) preserve productive business activity, (b) promote efficiency by harmonizing tax rates across income tax bases, and (c) improve progressivity.

We propose a future business tax regime that would raise substantial revenue from business without inventing new policy instruments. Our proposal would (a) preserve productive business activity, (b) promote efficiency by harmonizing tax rates across income tax bases, and (c) improve progressivity. Our reforms recognize that the individual income tax and business tax systems can reinforce or undermine each other depending on whether they are properly integrated. Focusing on individual income taxes alone is problematic because individuals at the top of the income distribution are often able to avoid tax by shifting activity to business income.

This essay has four parts. We begin by providing an overview of the business tax base in the United States and describe how business activity is taxed. Second, we turn to the TCJA and describe how it reformed business taxation. Third, we summarize early evidence of the TCJA's effects on economic activity and compare these effects to

policymakers' predictions. Fourth, we conclude by considering policy implications and making recommendations for the next business tax regime.

Figure 1. Federal Spending and Revenues as a Share of GDP Since 1980



Source: Office of Management and Budget (2023).

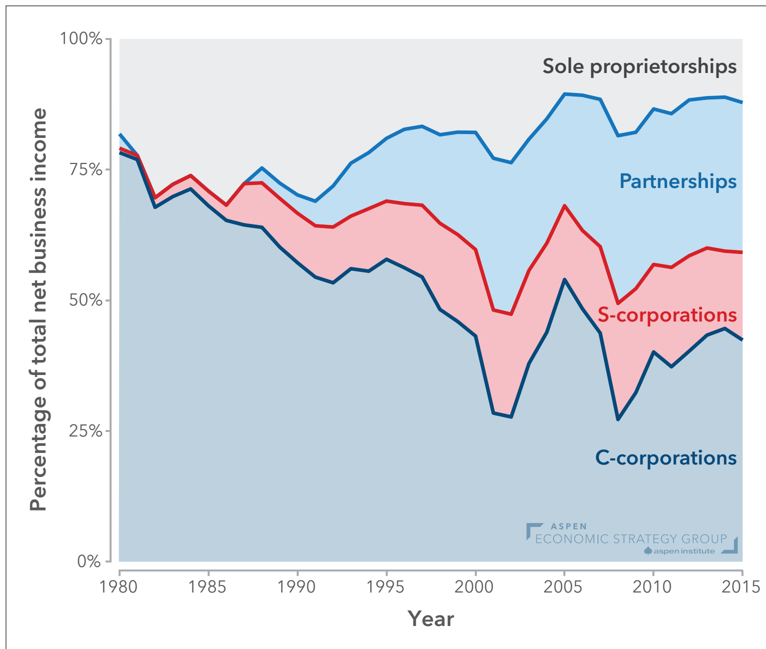
2. Factual overview of business taxation in the United States: Who owns the businesses? Where is the money held? How is it taxed?

To design a business tax regime optimally, it is important to establish where the money is in the economy and who lays claim to it. These facts determine how much can be raised by any given tax and who will bear its mechanical, or statutory, effects.

There are two main types of businesses in the US: *traditional C-corporations*, whose earnings are subject to the corporate income tax, and *pass-through businesses*, whose profits and losses "pass through" to individual owners and are instead subject to those individuals' personal income taxes. These pass-through firms include S-corporations, partnerships, and sole proprietorships. Many firms with individual owners can switch relatively easily between being a C-corporation and being an S-corporation or partnership in response to tax incentives.

Leading up to the TCJA, pass-through income, which had been growing since the Tax Reform Act of 1986 (TRA86), comprised the majority of the business income in the United States. Figure 2 shows the evolution of business income by corporate form. In 1980, most business activity was conducted by traditional corporations, but since individual tax rates were lowered, more activity has migrated outside the traditional C-corporation form and is not subject to corporate tax. Much of the charted rise of pass-through income reflects simple recategorization: to take advantage of lower tax rates, business owners have reclassified C-corporation income as pass-through. While the TCJA changed net incentives (by lowering C-corporation rates more than it lowered top individual income tax rates), history suggests strategy adjustments will take time to evolve, and for now the pass-through form remains attractive to many firms.

Figure 2. The Rise of Pass-Through Businesses

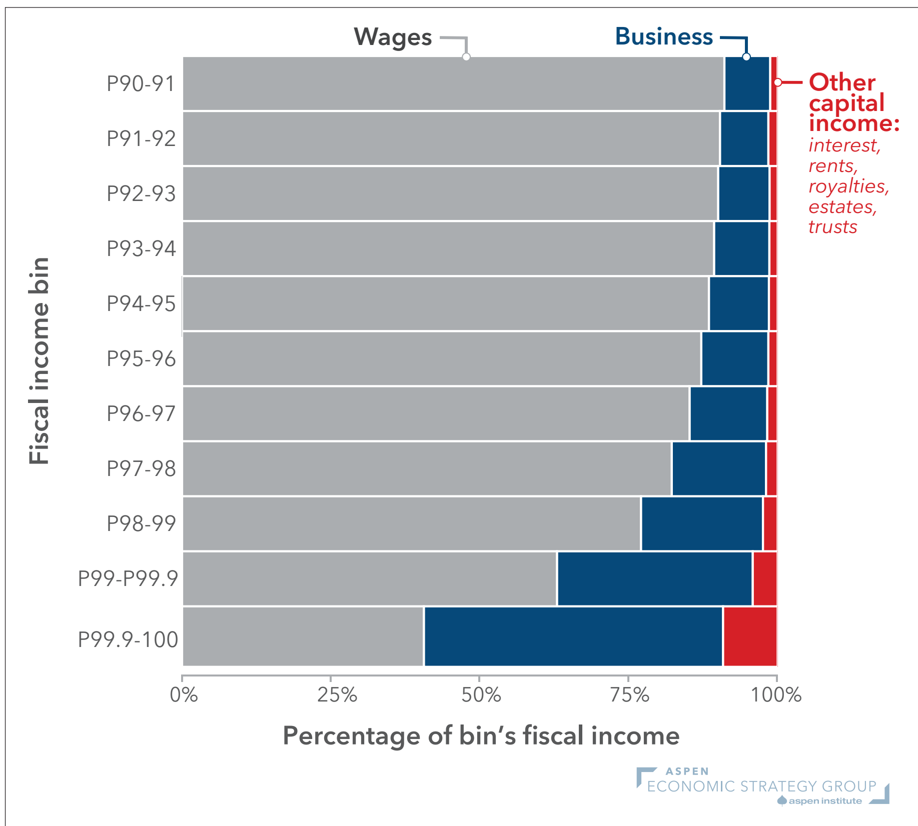


Source: Cooper et al. (2016); updated using public data from the IRS's Statistics of Income program.

Much of this business activity accrues to those at the top of the income distribution. Around two-thirds of every dollar earned by pass-through businesses accrues to the top 1 percent of individual earners. Figure 3 updates data from Smith et al. (2019) to plot the sources of income in the top decile of the income distribution in 2019. It shows that around 60 cents of every dollar of income for top earners comes from nonwage sources. As of 2014, more than 69 percent of the top 1 percent of income

earners and more than 84 percent of the top 0.1 percent of income earners accrued some pass-through business income. In absolute terms, that total amounts to more than 1.1 million pass-through owners with annual incomes of more than $390,000, and 140,000 pass-through owners with annual incomes of more than $1.6 million. In both number and aggregate income, these groups far surpass top public company executives, who have been the focus of much public commentary about inequality.

Figure 3. Top Income Sources in 2019



Source: Smith et al. (2019); updated to (2019).

When we looked at business types prevalent at the top, we found that a one percenter now is typically a doctor, lawyer, or owner-operator of a middle-market business like a car dealership or a beverage distributor. This finding has direct policy implications. Policymakers need to take seriously the nebulous boundary between labor and capital income, especially among business owners who can

flexibly characterize their income either way to minimize taxes (Kopczuk and Zwick 2020). A lot of pass-through income looks like labor income in the sense that the profits decline materially, on average, when the owner dies or retires (Smith et al. 2019). Politicians in both parties, for example, have successfully lowered their taxes through the so-called Gingrich-Edwards loophole—named after former Speaker of the House Newt Gingrich (R-GA) and former senator John Edwards (D-NC)—which involves characterizing compensation for consulting and speaking fees as business profits rather than wages. Eliminating this loophole would raise over $300 billion over the next ten years (US Department of the Treasury 2023).

A substantial amount of top compensation in the form of qualified small-business stock, carried interest, and stock options is more appropriately thought of as labor compensation provided in a tax-advantaged way.

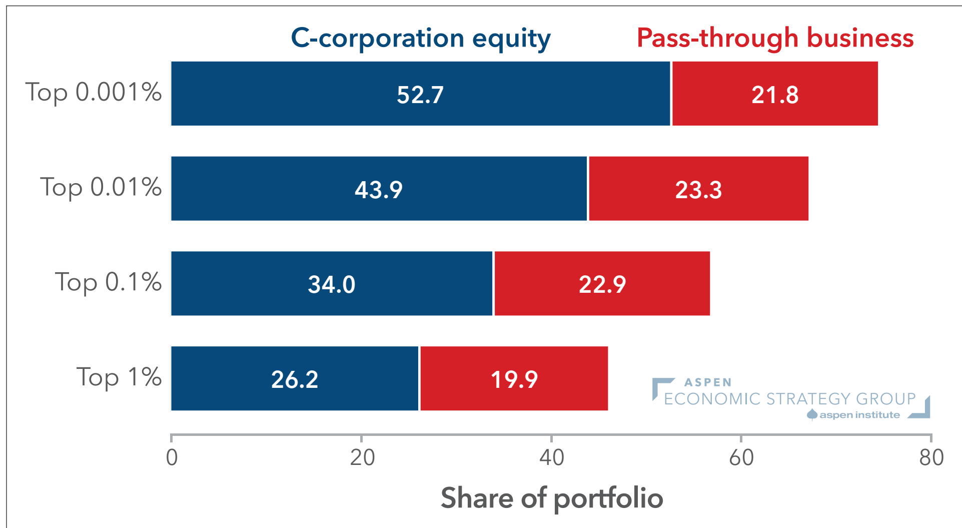
Top earners also respond to tax-code incentives in other ways, such as by deferring labor income as business equity. A substantial amount of top compensation in the form of qualified small-business stock, carried interest, and stock options is more appropriately thought of as labor compensation provided in a tax-advantaged way.

Much of the wealth at the top of the wealth distribution is in business equity. This fact can be seen in figure 4, which reports the share of business equity in top portfolios. This wealth comes in two forms: ownership of pass-through businesses and of traditional C-corporations (including both public and private companies). The graph shows that nearly half the wealth in top-1-percent portfolios is business wealth; this figure rises to 74 percent for the richest top 0.001. Though we should not conflate statutory with economic incidence, the graph suggests business taxes likely contribute to overall tax progressivity, even within top groups.

Two-thirds of estimated pass-through wealth is held by the top 1 percent of the wealth distribution. The ownership distribution of C-corporations is harder to determine due to data limitations. Unlike pass-through ownership, which is easy to identify (as business earnings flow directly to the owners), C-corporation ownership is not always clear from administrative data. While top investors and their ownership shares are listed in public investor filings, C-corporations that do not pay dividends do not generate tax forms that allow researchers to determine who owns them. As a result, researchers estimate the concentration of C-corporation ownership by using the distribution of dividends received from C-corporations and realized capital gains on C-corporation stock. Regardless of the assumptions used, the basic conclusion—that directly held C-corporation equity is disproportionately held at the top—is robust. At the same time, more than two-thirds of overall public C-corporation stock

is held by non-taxable groups, in pensions, and by foreigners, so the C-corporate tax is the primary avenue for taxing these business owners.

Figure 4. Business Wealth as a Component of Top Wealth Portfolios



Source: Smith, Zidar, and Zwick (2023); baseline series.

These facts about the prevalence of business equity at the top are also relevant for capital gains tax proposals. Two points are salient for understanding the tax base. First, 42 percent of all unrealized capital gains are in the form of private business gains, according to data from the Survey of Consumer Finances (Saez, Yagan, and Zucman 2021).[1] At the top of the wealth distribution, the importance of private business grows. For example, among centimillionaires (those with at least $100 million in wealth), two-thirds of unrealized capital gains are in the form of private business equity. Thus, policies that focus on mark-to-market taxation or taxing the wealth of centimillionaires will miss a large amount of top-owned wealth if they do not tax private business in some way. Second, in terms of realized capital gains, pass-through business activity also looms large, especially at the top (Sarin et al. 2022). For instance, venture capitalists and private equity partners derive much of their compensation in the form of capital gains (e.g., carried interest) and typically structure their firms as pass-throughs.

1 These calculations rely on reported business valuations by private business owners in the Survey of Consumer Finances (SCF), which generally exceed the equivalent concept in the US Financial Accounts. Smith, Zidar, and Zwick (2023) present evidence suggesting these valuations may be optimistic relative to true market values and that they entail a fair amount of sampling uncertainty due to small samples in the SCF. Bricker, Moore, and Volz (2023) argue that the SCF's private business values are reasonably informative at the aggregate level.

Similar points also apply to the estate tax base. In estate tax data, about half of the reported value of estates among those with $20 million or more at death is in the form of private business. This fact arises despite the well-known challenges facing valuation for unlisted assets in estate taxation.

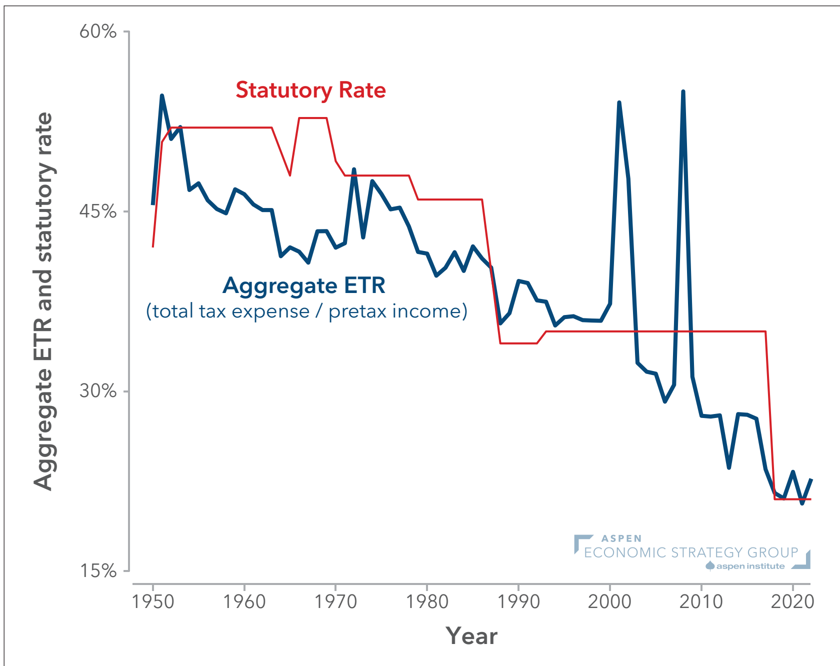
3. The 2017 Tax Cuts and Jobs Act was the largest change in the tax treatment of business income since 1986. What did it do?

The 2017 tax reform law, commonly known as the Tax Cuts and Jobs Act (TCJA), substantially reduced business tax burdens. It lowered statutory corporate tax rates for C-corporations from 35 percent to 21 percent and repealed the corporate Alternative Minimum Tax (AMT). It also enacted immediate expensing for a five-year period, which allows firms to write off equipment investments in the year they are incurred rather than over multiple years. For years six through ten, it phased down these investment incentives toward the prior depreciation schedules. To offset the budgetary impact of lower tax rates and immediate expensing, the reform enacted several provisions including limitations on loss and business-interest deductions, a reduction in the generosity of research and experimentation tax credits, and the elimination of the Domestic Production Activities Deduction (DPAD), which had effectively lowered tax rates for domestic manufacturers and other producers prior to the reform.

The law also dramatically changed international business taxes. It moved the corporate tax regime in the direction of territorial rather than worldwide taxation. This change exempted foreign profits from the 21 percent tax rate and replaced the worldwide system that taxed foreign profits when repatriated. The motivation for this change was the use by multinational companies of deferral to avoid paying taxes on foreign-source income, a practice that led to massive accumulation of corporate savings in offshore subsidiaries. To transition to this new system, the TCJA introduced a lower tax rate on the untaxed earnings from prior years of foreign subsidiaries of US multinationals, with a rate of 15.5 percent for cash and 8 percent for illiquid assets; it gave firms eight years to pay this tax.

To further offset revenue losses from the tax cuts, the TCJA introduced other provisions. These included a new minimum tax on global intangible income (GILTI), set at 10.5 percent through 2025 and 13.125 percent after 2025, as well as a lower tax rate on export income derived from domestic intangibles (FDII). In some circumstances, such as those related to limits on foreign tax credits and other interactions, these rates can be effectively higher than they were before the law was passed. Another provision was the base erosion and anti-abuse tax (BEAT), which imposed a minimum tax on payments between foreign subsidiaries and US parents that would otherwise be deductible.

Figure 5. The Decline of Effective Corporate Tax Rates



Source: Compustat data accessed via WRDS platform in June 2023.

Among publicly traded firms, the TCJA decreased effective corporate tax rates by around 9 percentage points. Figure 5 puts this decline in perspective by using Compustat data to plot the ratio of aggregate taxes paid (in the US and abroad) to aggregate income of publicly traded corporations since 1950. Note that there were some periods, like 2001 and 2008, when recessions generated substantial business losses, which temporarily caused the aggregate effective tax rate (ETR) to spike. These two years aside, the clear trend since 1950 is a dramatically lower effective corporate tax rate.

The TCJA also changed tax rules for pass-through business income. While the deductions for investment and interest operate like those for C-corporations, the tax rate depends on the individual income tax rate faced by individual owners. Many of these owners are in the top of the income distribution, and the TCJA reduced the top marginal income tax rate by 2.6 percentage points from 39.6 to 37 percent. The TCJA also introduced a 20 percent deduction of qualified business income (QBI) that reduces the top tax rate from 37 percent to 29.6 percent in qualified sectors or

for those with sufficiently low income. On net, by lowering the corporate tax rate more substantially, the TCJA returned the system to the pre-1980s regime by making the C-corporation form more favorable again for many business owners, especially those who plan to defer income and accumulate equity in their firms. Despite this incentive, the lower rate on QBI strengthened incentives for eligible pass-through owners to recharacterize wages as profits.[2]

4. Did the TCJA achieve its promises and predictions?

This section describes how the TCJA affected tax revenues and economic activity and compares its actual and predicted effects. Research in this area is active and has not been fully synthesized. Assessing program impact is additionally challenging given the TCJA's coincidence with the pandemic and President Trump's trade wars, as is isolating the role of individual components in that impact. Nevertheless, we draw some provisional conclusions from the existing evidence.

Tax Revenue. The promise of higher corporate tax revenue was not delivered. Despite predictions of some in the Trump administration, in the House, and in the Senate, the corporate tax reforms in the TCJA did not pay for themselves. While corporate revenues increased in the near term relative to some projections, this increase was not large enough to offset the large mechanical declines from lower tax rates. Specifically, corporate tax collections were around $375 billion per year in the middle of the 2010s and fell to below $250 billion per year following the TCJA. As a share of GDP, corporate tax collections were around 1.8 percent in the middle of the 2010s and then fell to around 1 percent after the TCJA. Since the beginning of 2021, they have been ticking back up—reaching around 1.3 percent in 2022—but they remain well below pre-TCJA levels.

Investment. The promise of a 9 percent increase—or around $300 billion—in domestic investment may have come closer to the mark but was likely overstated (Council of Economic Advisors 2018). In terms of domestic investment in equipment and structures, Chodorow-Reich et al. (2018) find substantial investment responses of C-corporations that experienced large tax reductions from the TCJA. Qualitatively, Hanlon, Hoopes, and Slemrod (2019) document that nearly 100 public firms reported plans to increase investment due to the TCJA; however, it is difficult to infer from these plans the extent of marginal investment induced by the reform.

2 Goodman et al. (2022) quantify the distributional burden of the QBI deduction, as well as the impact of the limitation on QBI for specified service providers.

Despite these results, it's important to note that public firms are only one subcomponent of aggregate investment in the United States. The other components of investment are large. For example, in 2016, total US investment was composed of $1,650 billion of equipment and structures, $820 billion of intellectual property products, and $700 billion of residential investment. A substantial portion of the investment in equipment and structures occurred among private C-corporations and pass-throughs, and incentives for IP investment were weakened by the TCJA's reduction in tax incentives to do research and development.

Findings from Kennedy et al. (2022) also suggest that the increase in business investment was smaller than the decline in corporate revenue. Using rich US Treasury Department tax data, they compare how investment evolved between similar C-corporations and S-corporations, noting that C-corporations received a larger tax cut per worker: around $2,200 more than S-corporations (or a 5-point larger cut in marginal tax rates). They find the larger tax cut resulted in an 8 percent increase in the share of firms doing positive investment and a 6 percentage-point increase in the investment-to-capital ratio. While it is hard to estimate aggregate effects since these estimates are relative to S-corporations—which experienced a decline in investment rates and may have been affected by common shocks to both types of firms—we can do some rough calculations that suggest there was around $54 to $81 billion of additional investment among mid-sized C-corporations (i.e., those with at least 100 employees and fewer than 1,000).[3] Despite this investment response, the tax cut resulted in a decline in corporate tax revenue of $88 billion.[4]

Wages and Incidence. Based on the estimates of Kennedy et al. (2022), the promise of wage increases for the average worker of $4,000 to $9,000 as a result of the TCJA was not delivered (Long 2017). Their analysis reveals that payrolls of C-corporations increased by 1.2 percent, and that this increase was largely driven by top employees. An increase of 1.2 percent, evaluated at the mean annual wage of $64,000, corresponds to an average wage increase of $770. They find no effect on median

3 In their summary statistics in table 1, the mean net investment among C-corporations in their sample was $26.6 million and the mean investment-to-capital ratio was 0.15, implying that capital was $177 million on average. Under the assumption of homogeneous effects by firm size, an effect of 0.06 *177 million for the 7,645 C-corporations in their sample amounts to $81 billion. By construction of their sample, their estimates do not permit us to say much about the effects of the reform for large multinationals, for which there are not similarly sized S-corporations available for matching. In addition, the effect is measured relative to S-corporations, which appear to have experienced a decline in net investment rates in figure C.1, panel D. Specifically, the figure shows that the net investment rate (i.e., the investment-to-lagged-capital ratio) was around 6 percent for S-corporations in 2016 and steadily declined to around 3 percent in 2019. C-corporations also had an investment rate of around 6 percent in 2016 but reversed the decline, going from around 4 percent in 2017 up to about 8 percent in 2019. Thus, in differences, the C-corporate investment rate increased by 4 percentage points on its own. Applying the same steps using 4 percent instead of 6 percent for the effect gives $54 billion.

4 They estimate that the mechanical decline in corporate tax revenues in their sample is $101 billion (their table 10); the $88 billion estimate incorporates behavioral responses.

worker wages, while the top-paid workers in the firm and firm executives (some of whom were likely firm owners as well) saw wage increases of around 5 percent. In their sample of top-paid workers, nine out of ten of the executives are men, with an average age of 53 and and average annual earnings over $1 million. Overall, the researchers estimate that firm owners received $54.5 billion, executives received $11.3 billion, workers in the top 10 percent of their firm wage distribution received $31.6 billion, and the bottom 90 percent of workers received no pay increase. This finding contradicts claims that had been made suggesting that the benefits of tax cuts would "go to the middle class, not to the highest earners" (Trump 2017). This promise also turned out not to be true.

5. As many TCJA provisions expire, we can use the lessons learned to create a system that meets the country's revenue needs -- via a more progressive tax code -- without sacrificing the country's business competitiveness.

Considering the emerging evidence on the impacts of the TCJA and related research on the distribution of business income, we recommend the following reforms:

5.a. Party like it's 1997.

As a starting point, we highlight our proposal to return to a 1997-style tax policy (Zidar and Zwick 2020). Simulations from the widely respected Penn Wharton Budget Model (PWBM) show that reverting to the tax code of January 1997 would raise trillions in tax revenue and increase progressivity via modest increases in taxes on dividends, estates, capital gains, and top individual incomes. Economic growth was strong in the 1990s, and deficits turned to surpluses. Our country has lowered taxes considerably since then, but there is limited evidence of meaningful growth impacts from those tax cuts.

The most obvious example of a tax cut that did not yield growth impacts is the 2003 dividend tax cuts. Yagan (2015) compares the investment of C-corporations, which are subject to dividend taxes, to that of S-corporations, which are not, before and after the 2003 dividend tax cut from 38.6 percent to 15 percent. He uses administrative tax data on firm outcomes like the change in tangible capital and dividend payouts to carefully examine behavior at similar firms. For example, he systematically tracks the investment of comparable firms like Menards (which is an S-corporation) and Home Depot (which is a C-corporation). Overall, he finds that this large tax cut had no effect on investment in the firms that benefit from the tax cut, relative to similar firms that did not receive a cut. This evidence suggests that reverting back to taxing dividends at top individual income tax rates would likely have limited effects on competitiveness or economic growth.

Reversing the cuts in top marginal tax rates matters for business taxes since most business income in pass-through form is taxed at the top marginal income tax rate. Returning the rate and bracket structure, adjusted for inflation, to where it was in January 1997 would result in a married couple paying 36 cents instead of 24 cents on their 300,001st dollar. And for those making half a million dollars, marginal rates would increase to 39.6 from 35 percent. Under our proposal, a tax credit like the Making Work Pay tax credit from the 2009 American Recovery and Reinvestment Act would offset tax increases for low- and middle-income earners in a targeted way. Altogether, increasing tax rates on ordinary income in this way would raise $1.8 trillion over ten years, according to the 2020 Penn Wharton estimate.

Recall that up to two-thirds of unrealized capital gains at the top of the wealth distribution are in the form of private business assets. There is some recent evidence that the large responsiveness of economic activity to capital gains tax increases is overstated (Agersnap and Zidar 2021). Going back to the higher dividend tax rate as well as the capital gains rate of 28 percent would raise around $600 billion over ten years, according to the Penn Wharton score from 2020. We have argued elsewhere that there are several reasons to think that the revenue potential of raising capital gains taxes is higher than even this score may suggest (see Sarin et al. 2022 for details).

We should increase estate taxation. Resetting the estate tax to inflation-adjusted parameters of 1997 would return the rate to 55 percent and set the exemption threshold to a bit above $1 million. Today, the rate is 40 percent and the threshold is $13 million. Most estate tax wealth is in the form of either private business assets or publicly traded stock. In 2020, Penn Wharton scored this change as raising $222 billion over ten years. Note that this score assumed a concurrent repeal of the "stepped up" basis provision that exempts bequeathed assets from capital gains tax relative to the original asset basis, which could be accomplished via "constructive realization" at death or carryover of basis at bequest.

Finally, we should restore the IRS to the funding levels and audit rates of the late 1990s and first decade of the 2000s. In 2002, the IRS budget as a share of GDP was nearly 0.09 percent, and it has steadily declined to 0.05 percent in 2020 (US Department of the Treasury 2021). Audit rates, especially of businesses and high-income individuals, have also cratered (Rampell and Zhou 2023). The 2022 Inflation Reduction Act attempted to address this decline by increasing IRS funding, but some of this funding was reduced in the recent debt ceiling deal.

5.b. Reduce tax preferences for pass-through businesses.

Congress should eliminate the so-called Gingrich-Edwards loophole for high-end pass-through owners, which would raise $306 billion over the next ten years. As Yagan (2023) recently testified, the US Treasury Inspector General for Tax Administration

has called this loophole a "multibillion dollar employment tax shelter." Active owners are treated inconsistently in terms of Medicare and payroll taxes, and this proposal would ensure that pass-through owners would consistently face the same treatment (i.e., that they would face the net investment income tax rate of 3.8 percent).[5]

We also recommend allowing the expiration of the qualified business income deduction (QBI), which was introduced by the TCJA. Supporters of this deduction—including 140 trade associations representing millions of Main Street businesses such as the NFIB, the National Restaurant Association, and the American Farm Bureau Federation—argue that it is "necessary to balance out the tax treatment of pass-through businesses with the lower, 21-percent tax rate paid by C corporations" (S-Corp 2023). While we agree that the QBI does lower rates for many pass-through businesses, the best evidence to date shows that it has limited economic benefit. Our recommendation of removing the deduction would raise revenue with limited effects on investment and growth.[6] According to the 2020 Penn Wharton score, this repeal would raise $373 billion over ten years. This provision is set to expire in 2025, so the revenue gains would be lower than projected by this original score (since there are fewer years with QBI remaining now than there were in 2020). More generally, reforming the treatment of large private corporations and eliminating tax preferences for pass-throughs are worth considering seriously, as these are the entities for which the boundary between owner-manager labor and capital income is especially difficult to enforce.

The main point is that we can't just keep taxing individual income and having people avoid tax by shifting money into lower-taxed business activity. In addition, there are a host of ways to avoid ordinary income taxes by deferring income into a form classifiable as capital gains, such as carried interest, qualified small-business stock, and incentive stock options. In our view, these carve-outs generally allow individuals to delay compensation and enjoy a lower tax rate on what is often labor income in its underlying nature. Since much of this activity is labor income, it should not be tax-advantaged relative to that of wage earners.

5.c. Raise the corporate rate to 28 percent, restore research and development incentives, and limit interest deductions.

We recommend raising the corporate tax rate to 28 percent. Doing so would raise $1.3 trillion over the next ten years, according to recent US Treasury estimates (US Department of the Treasury 2023: 211). According to estimates from Rosenthal and

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5 See US Department of the Treasury (2023: 73) or Yagan (2023) for additional detail.

6 This assessment is based on estimates by Goodman et al. (2022) and the experience of state tax cuts for pass-through businesses, such as the 2013 "real-live experiment" in Kansas (DeBacker et al. 2018; DeBacker et al. 2019).

Burke (2020), three quarters of US corporate stock is held by nontaxable groups, such as foreigners (40 percent), tax-advantaged retirement accounts (30 percent), and nonprofits and others (5 percent). It is not clear that we should subsidize foreign investors or large endowments more than we should domestic investors, especially if the lower rate is paired with strong investment incentives, such as accelerated depreciation, and more generous support for research and development, which was weakened by the TCJA.[7] Moreover, a robust corporate tax is a key component of a progressive tax system that taxes capital income and reduces tax sheltering opportunities for high-earning business owners.

Goodman et al. (2023) have found that the TCJA's limitation on the interest deduction had minor effects on investment, which provides some evidence that there are reasonable ways to offset the costs of providing more targeted investment incentives. Moreover, such limitations are important in a regime with large deductions for new investment, as debt-financed investment can benefit from negative effective tax rates when interest deductions are unlimited. Overall, targeting incentives for responsive activity and activities with large positive externalities like research and development is a better approach than having a low tax rate on everything, including old capital and relatively unresponsive activity. Moreover, to the extent that policymakers are interested in taxing the wealth of tech billionaires, a bolstered corporate income tax is a tried and true (and clearly constitutional) alternative to a direct tax on wealth or accrued gains.

5.d. Reduce the TCJA's incentives to invest abroad by reforming international tax provisions.

We recommend removing incentives to offshore physical investment by reforming the way the TCJA taxes multinational corporations. Effectively, current TCJA rules subsidize the movement by multinationals of capital to other countries—incentives that are not widely appreciated.

The TCJA defines global intangible low taxed income (GILTI) as foreign income in excess of 10 percent of foreign tangible property.[8] Thus, after-tax foreign profits for a GILTI-taxed firm increase when they invest in tangible property abroad, since owning more tangible property reduces total taxable income. Removing the current GILTI deduction for foreign tangible capital and calculating GILTI on a per-country basis would improve this aspect of the current regime.

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7 Furman (2020) proposed some related and reasonable reforms along these lines in a recent paper for the Hamilton Project.

8 Corporations can deduct half of GILTI—37.5 percent starting in 2026—and claim a credit for 80 percent of foreign taxes paid. The levy on the remaining income—set at 10.5 percent through 2025 and 13.125 percent after 2025—is also referred to as a minimum tax, since companies are not subject to taxes on GILTI if their foreign tax exceeds 13.1 percent.

The TCJA also includes an adjustment to domestic income from foreign sources, that is, exports. The TCJA defines deemed intangible income (DII) as domestic income in excess of 10 percent of domestic tangible property, and FDII as the foreign part of DII. A corporation can deduct 37.5 percent of FDII against domestic taxable income through 2025, with this share falling to 21.8 percent starting in 2026. Thus, after-tax domestic profits for a firm with sufficient domestic income are lower than they would be without FDII. Having more domestic tangible property in the US reduces FDII deductions. For this reason, FDII also encourages the offshoring of domestic tangible property. Repealing the deduction for FDII would raise around $115 billion over ten years (US Department of the Treasury 2023: 211).

Table 1. Ballpark Revenue Estimates for Tax Reforms

Suggested reform	Ten-year increase in revenues, in dollars
Party like it's 1997: Individual income	$1.8 trillion*
Party like it's 1997: Dividends and capital gains	$600 billion*
Party like it's 1997: Estate tax	$222 billion*
Repeal QBI deduction	$373 billion*
Raise CIT rate to 28 percent	$1.3 trillion
Repeal FDII deduction	$115 billion
Total	$4.4 trillion

Notes: Starred estimates come from the 2020 Penn Wharton Budget Model referenced in the text; unstarred estimates come from US Department of the Treasury (2023).

There are other reasonable reforms to international tax policy worthy of consideration. For example, Devereux et al. (2021) argue for moving toward a destination-based tax system for multinationals to minimize tax avoidance and inefficiency, while Clausing (2020) supports moving to a similar sales-based formulary system to address tax competition and profit-shifting. Setser (2023) further proposes strengthening subpart F of the tax code to discourage the offshoring of intangible income and ensure companies pay tax in the countries where they generate profits. International coordination is key on these fronts, and we recommend aligning our policy with cooperating nations on global minimum taxes.

6. Conclusion

Imagining the contours of the next business tax regime reveals many ways to improve the fiscal position of the United States and increase tax progressivity while maintaining US competitiveness. In reviewing recent research on business taxation and reconsidering provisions in the Tax Cuts and Jobs Act, we have presented a menu of reforms that would collectively raise more than $4 trillion over ten years. Given the secular decline in business taxation in recent decades and the growth of the deficit since 2000, now is an ideal time to start a new business tax regime that raises more revenue while being mindful of effects on competitiveness, innovation, and growth.

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