Research

How Does The Corporate Income Tax Burden Workers?

DOUGLAS HOLTZ-EAKIN, GORDON GRAY | AUGUST 14, 2013

Corporations are essentially a legal nexis of capital through shareholders, labor through employees, and consumers through their participation in the economy in which the corporation does business. Corporate taxation will ultimately impose a burden on one or all of those channels. This is a simplified narrative, but it illustrates the nature of corporate taxation in a global economy: Everyone but the corporation itself bears the burden, though not equally.

The modern globalized economy is characterized by ever more mobile capital. Increasingly, investment can flow to areas of lower taxation with greater ease. Labor is not nearly so mobile. A worker who lives in the low-tax jurisdiction will generally benefit as more capital flows to firms while workers in high-tax jurisdictions will forgo higher capital and associated productivity and resultant wage gains. There is therefore the potential for labor to bear a high share of the corporate tax burden, and a number of studies have found this burden to be quite high.[1]

Important contributions in the theoretical literature bear this out. Arnold Harberger, who first determined that capital bore the burden of corporate taxes in a closed economy, has since determined that labor bears most of the burden of corporate taxation in an open economy—over 80 percent.[2] More recent studies have confirmed this view. One noteworthy study from the Congressional Budget Office found that labor bears 70 percent of the corporate tax burden in an open economy.[3]

In addition to theoretical advances, recent empirical evidence has found that labor bears a significant share of the corporate tax burden in an open economy.[4] Using data for 72 countries over 22 years and hourly manufacturing wage data, Hassett and Mathur found that, for every 1 percent increase in corporate tax rates, wages decrease 1 percent.[5] Using a separate approach with firm-level data, Arulampalam, Devereux, and Maffini found that $1 in additional corporate tax reduces wages by 92 cents in the long run.[6] Using cohorts of data covering 1979 to 2000, Felix found that a 1 percent increase in the marginal corporate tax rate would decrease wages by 0.7 percent.[7] Another recent study concluded that labor bears 57 percent of the burden of the corporate income tax.[8]

In addition to these overall wage effects, some studies provide additional insight into corporate tax incidence. For example, Hassett and Mathur found a correlation between high-tax neighbors and high domestic wages. This suggests that nations would engage in tax competition to draw capital by lowering their tax rates relative to their neighbors. Second, Felix found that the wage effects of corporate taxation did not vary with worker skill level—an important finding that should further dispel the notion that labor generally does not bear the corporate tax burden.

While the high incidence of the corporate tax rate on labor is not universally embraced, there is growing acknowledgement of a higher burden from the corporate tax rate borne by labor than previously held. For example, the Tax Policy Center recently updated their methodology on how the corporate income tax is distributed to include the assumption that 20 percent of the tax burden falls on labor.[9]

[1] An excellent review of this literature can be found in “Corporate Tax Reform – The Time Is Now,” Business Roundtable, April 15, 2013.

[2] Arnold C. Harberger, “The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case,” chap. 2 in *Tax Policy and Economic Growth*, Washington, D.C.: American Council for Capital Formation, 1995), pp. 51–73