Capital Corner

Our critical mission is to educate policymakers, media and the general public on the importance of capital formation for the overall U.S. economy. Capital Corner brings a unique perspective on topics of interest from the broad spectrum of industries that we represent. These valuable insights from our members reinforce the importance of sound tax, energy, environmental, regulatory and trade policies that facilitate saving and investment, economic growth and job creation.

Our latest column is presented by Randy Mullett Vice President, Government Relations and Public Affairs, for Con-way Inc. .

Difference in Effective Corporate Tax Rates and Tax Reform: What Does it Mean for Different Industries?

By Randy Mullett – July 2013

At a recent event sponsored by the American Council for Capital Formation, I had the opportunity to brief those present about the effective corporate tax rate for my employer, Con-way Inc., a Fortune 500 Trucking and Logistics Company. Our effective rate approaches 40% (which includes federal, state and foreign income taxes) and is similar to that of our competitors. As I listened to other industry representatives speak about effective corporate tax rates in their various industries, it dawned on me that the difference in effective corporate tax rates can result in capital flows into industry sectors much like the difference national corporate tax rates have on capital flows between nations.

Up to this point, much of the discussion of corporate taxes has focused on the difference between worldwide tax rates and how capital flows tend to gravitate towards countries where returns on investment are enhanced by lower corporate taxes. If the global competition for capital is real, then it stands to reason that competition among industry sectors for capital is real as well. Much of the difference between industries is in some ways inadvertent – the cumulative result of years of tax policy changes. This greatly increases the complexity of corporate tax reform as corporations paying an effective rate that is less than the 35% US statutory rate will fight to keep their lower effective rate — and those paying more will do the opposite.

This is fairly easy to visualize and is not surprising. What is less clear is the effect that changes in effective rates, resulting from corporate tax rate reform, will have on capital flows to and from various industry segments. Using Con-way as an example, if the US corporate rate is reduced from 35% to 25% (even with a loss of some traditional deductions) Con-way's effective rate would be reduced substantially. This reduction would increase earnings per share, resulting in increasing share price and market cap. In other words, more capital would flow into Con-way. If results are similar for the entire industry (and they should be), capital would flow into that industry. And of course, the results will depend on where each industry will end up as a result of lower rate and loss of capital cost recovery provisions.

What is harder to quantify is the effect on wages and job creation. The New York Times May 25, 2013, Sunday Review illustrates the differences in effective rates by industry for the entire Fortune 500 in Across US Companies, Tax Rates Vary Greatly. Though it includes international as well as domestic taxes, it is fairly obvious that effective rates vary dramatically among industry segments. This disparity is created by the US tax code as lawmakers over the years attempted to use tax policy to encourage growth and job creation in particular industries through a variety of tax incentives. It really is true that you get what you incent! The practical effect has been the creation an uneven playing field across industries within the US, including a corresponding effect on capital flows to the advantaged segments.
Thoughtful corporate tax reform could have a positive effect on middle class job creation and increased middle class wages by encouraging capital to flow into industry segments where those jobs traditionally exist (i.e TruckingThis notion certainly does complicate the issue of any corporate tax reform. On the other hand, it illustrates the importance of looking at the flow of capital to and from various domestic industry segments. Not simply to determine effective tax rates but to determine the effect on middle class job creation and middle class wages.

The US corporate tax structure is intricately entwined with various industries' capital structures, accounting methods, ability to operate internationally, and a myriad of other variables. It will take a Herculean effort on the part of our lawmakers to achieve meaningful corporate tax reform. Much has been published about the difference between US corporate tax rates and those of other nations and the effect it has on capital attraction and job creation. Recently there has been discussion about the difference in effective corporate tax rates between industries and the ensuing fights among industry advocates to maintain their relative tax advantage. Little thought has been given to the effect of domestic capital flows on middle-class jobs and middle-class wages. I am hopeful that conversation has just been expanded.

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