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Tax Reform: Eliminating the Double Taxation of Corporate Income

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Abstract

The current tax system taxes corporate income twice. This double taxation has a pronounced negative economic impact, particularly on wages. It distorts the economy and harms productivity. The double taxation of corporate income is also inconsistent with competing concepts of proper income taxation. Congress should eliminate the double taxation of corporate income. There are three means of eliminating this double taxation in the context of an income tax. Alternatively, Congress could eliminate the double taxation of corporate income by replacing the income tax with a consumption tax.

Key Points

- The current tax system double taxes corporate income. Corporate double taxation has a pronounced negative economic impact, particularly on wages.
- Corporations cannot bear the actual economic burden of the corporate income tax. A corporation is a legal fiction, and legal fictions do not pay taxes—people pay taxes.
- Integrating the corporate and individual income tax is one means of eliminating double taxation, by imposing no entity-level tax; imposing no tax on shareholders with respect to dividends or capital gains on corporate stock; or providing shareholders with credit for entity-level tax paid.
- Because nearly three-quarters of corporate shares are held by tax-exempt organizations, foreigners, or qualified accounts, decisions about how to achieve integration can have substantial revenue effects.
- Consumption taxes offer an alternative means of eliminating the double taxation of corporate income.

The current tax system taxes corporate income twice: It is taxed once at the corporate level, generally at a tax rate of 35 percent;[1] it is then taxed again when the income is paid as dividends to shareholders or as a capital gain when the corporate stock is sold.[2] This double taxation of corporate income has a pronounced negative economic impact, particularly on wages. It distorts the economy and harms productivity.

Congress should end the double taxation of corporate income—meaning that Congress should "integrate" the individual and corporate income tax.[3] In the context of an income tax, this integration could be accomplished in three basic ways:

1. Impose no entity-level tax;

2. Impose no tax on shareholders with respect to dividends or capital gains on corporate stock; or

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3. Provide shareholders with credit for entity-level tax paid.

Senate Finance Committee Chairman Orrin Hatch (R–UT) has often discussed integrating the corporate and individual income tax. At a May 2016 hearing he said: "A better, more efficient system would be one that integrated the taxation of corporate and individual income."[4] In January 2017, Senator Mike Lee (R–UT) called for abolishing the corporate income tax and taxing capital gains and dividends as ordinary income.[5] Economists at the Brookings Institution and the American Enterprise Institute have released an integration proposal.[6] In 2014, former Treasury official and Columbia law professor Michael Graetz and Harvard law professor Alvin C. Warrant Jr. re-released their 1998 book on integration.[7] Many foreign countries have fully or partially integrated tax systems.[8]

Who Pays the Corporate Tax

Who bears the actual economic burden of the corporate income tax is an open question.[9] One thing is certain: It cannot be corporations. A corporation is a legal fiction, and legal fictions do not pay taxes—people pay taxes. The corporate tax could be borne by corporate shareholders in the form of lower returns;[10] owners of all capital (again in the form of lower returns);[11] corporate customers in the form of higher prices;[12] or employees (in the form of lower wages).[13] It is, almost certainly, some combination of these.[14] The economics profession has changed its thinking on this issue several times over the past four decades, but the latest consensus is that workers probably bear more than half of the burden of the corporate income tax because capital is highly mobile.[15] Labor's share of the corporate tax burden is potentially as high as three-quarters.[16] Nevertheless, government estimators continue to assume that the primary incidence of the corporate tax is on those that own capital.[17]

Economic Impact

The corporate income tax is perhaps the most economically destructive tax that the federal government imposes.[18] American Enterprise Institute scholars Alex Brill and Kevin Hassett find that a corporate tax rate higher than 26 percent (including state or provincial corporate tax rates) results in a loss of tax revenue.[19] In other words, they find that the corporate tax results in so much reduced economic output, or in U.S. and foreign corporations moving so much economic activity out of the U.S., that imposing a tax higher than 26 percent reduces rather than increases federal revenue.[20] Because U.S. state corporate taxes on average are about 4 percent, this would imply that reducing the federal corporate tax rate to 22 percent would actually increase revenues.[21] Other studies find that reducing the U.S. corporate tax rate[22] or eliminating the corporate tax altogether[23] would have a pronounced positive economic impact. This is because a lower corporate tax rate will lead to higher investment, higher productivity, higher real wages, and both foreign and domestic businesses choosing to locate headquarters and production facilities in the U.S.

Debt and Equity Capital

Firms need capital to operate. That capital can be equity capital from the sale of stock or debt capital from borrowing.[24] In each case, the investors who provide the capital must be compensated for it. The tax treatment of equity and debt finance differs markedly.[25] When a firm borrows from a lender or issues bonds, it pays interest. The tax code treats interest as a tax-deductible expense. The interest is then taxable to the recipient. When a firm issues stock, it pays dividends to shareholders. Dividends are not treated as an expense and are not tax deductible. Thus, the compensation to investors providing equity capital is taxed both at the corporate level and again when received by the investor.[26] For a given pre-tax payment to capital providers, debt is a less costly means of finance because interest payments reduce the firm's tax bill while payments to shareholders do not. This distorts capital markets and encourages firms to rely more heavily on debt finance than they would in the absence of the disparate tax treatment. This higher degree of leverage makes it more likely that firms will fail since interest payments are obligatory while dividends may be suspended if profits decline.[27]

Integration

Properly structured integration of the corporate and individual income tax would eliminate the double taxation of corporate income, eliminate the disparate tax treatment of debt and equity finance, and eliminate the tax-rate differential between regular "C corporations" and pass-through entities.[28] The current tax system already has elements of an integrated tax system.

In the context of an income tax, there are three basic ways to accomplish integration:

1. Impose no entity-level tax;

2. Provide shareholders with credit for entity-level tax paid;

3. Impose no tax on shareholders with respect to dividends or capital gains on corporate stock.[29]

1. Impose No Entity-Level Tax. One approach to integrating the personal and individual income tax is to impose no tax at the corporate level. Under current law, closely held businesses typically do not pay tax at the entity level. The entity reports its income and shareholders or partners pay tax on their share of the entity's income (whether or not the individual owners actually received a payment from the business). This is called pass-through treatment. Electing corporations may elect past-through treatment under Subchapter S of the Internal Revenue Code.[30] S corporations may not have more than 100 shareholders, non-resident alien shareholders, or more than one class of stock. In general, only individuals may be S corporation shareholders. Partnerships are subject to a different, more flexible, set of rules under subchapter K.[31] Limited-liability companies (LLCs) are generally treated as partnerships for tax purposes. Publicly traded partnerships are treated as regular C corporations, and are subject to entity-level tax.[32]

This type of pass-through treatment is appropriate for closely held businesses where ownership interests change hands infrequently. For publicly traded companies, it raises serious administrative problems. A given ownership interest could change hands many times over the course of a taxable year, and allocating income among those who owned the shares or other interest during the year poses both administrative and equitable issues. Either the income would have to be allocated in proportion to the duration for which the interest was held, or, potentially unfairly, the income and tax liability would be allocated to the year-end holder even though the tax liability would be unknown until well after the year ended.

Alternatively, a consumed income or cash-flow-type consumption tax would allow a deduction for capital contributions to a business entity, and payments from the company (whether dividends, distributions, or return of capital) would be taxable.[33] The tax base in a cash-flow tax is receipts less outlays.[34] For example, unlike with the income tax, capital and inventory acquisition expenses would be deductible when incurred. In a national retail sales tax, no entity-level tax would be imposed, either.

2. Shareholder Credit (or Imputation) Method. An alternative approach is to provide shareholders a tax credit for their proportionate share of corporate tax paid at the entity level. This is called the shareholder credit, or shareholder imputation, method of integration. It has been adopted in a number of major foreign countries.[35]

3. Dividend Exemption and Deduction. Entity-level taxation paired with the exemption of dividends from taxation at the individual level, or allowing corporations a deduction for dividends paid, substantially reduces the double taxation of corporate income. To the extent that a corporation retained earnings instead of paying all earnings out as dividends, some degree of double taxation would remain. Current law has a reduced level of taxation for "qualified dividends" and, therefore, partially adopts this approach.[36] Similarly, under current law, some intercorporate dividends are eligible for a full, or partial, dividends-received deduction (DRD), which is functionally equivalent to a shareholder exclusion or exemption.[37]

Consumption Taxes with Business-Level Taxation

The simplest way to eliminate the problem of double taxation at the corporate level is to abolish the income tax and replace it with a tax on consumption. Such a tax could be applied at the point of consumption, such as a national sales tax or a value-added tax, or could be administered through the current system by allowing deductions for savings and investments. Tax reform proponents have proposed four different types of consumption taxes: (1) a national retail sales tax, (2) the Hall–Rabushka flat tax, (3) a business flat tax, or (4) a consumed-income, or cash-flow, tax.[38] Each type of consumption tax effectively integrates the corporate and individual tax, but each handles integration differently. In a national retail sales tax, businesses are not subject to tax but withhold and remit taxes on their sales to consumers. In a business flat tax,[39] all businesses are subject to one level of tax on the goods and services that they sell less their purchases from other businesses. There would be no additional tax on the businesses owners when profits are distributed to them. In fact, all financial transactions would be disregarded in a business flat tax; only the sale and purchase of real goods and services would be relevant to the tax due. In the Hall–Rabushka flat tax, there would also be no additional tax on the businesses owners when profits are distributed to owners and financial transactions are disregarded. In a consumed-income, or cash-flow, tax, there would be, in principle, no tax on reinvested earnings. Only income spent on consumption would be taxed.[40]

The House GOP Better Way plan[41] is a substantial move toward establishing a consumption base for taxation,[42] and similar in many respects to the Hall–Rabushka flat tax.[43] It substantially reduces the double taxation of corporate income by reducing the C corporation tax rate from 35 percent to 20 percent, and by reducing the tax rate on dividends and capital gains from as high as 43.4 percent to 16.5 percent. It does not, however, entirely eliminate double taxation. Under the Better Way plan, pass-through entities would continue to pay tax only at the individual level, at a reduced tax rate of 25 percent.

Tax Base Issues

There are two competing concepts about how to define income for tax purposes. One, the Haig–Simons (or comprehensive) definition of income, defines income as consumption plus changes in net worth.[44] The other, the Fisher–Ture definition of income, defines income as gross receipts less outlays made in order to earn future income.[45] The double taxation of corporate income is inconsistent with either definition of income since it includes corporate income in the tax base twice.[46] Because the double taxation of corporate income taxes corporate income more heavily than other forms of income, the current tax system also violates principles of horizontal and, for that matter, so-called vertical, equity.[47]

In an income tax, the issue of the proper corporate tax base cannot be entirely avoided. For example, even if no entity-level tax is imposed, the amount of income attributed to shareholders or partners is a function of the choice of entity-level tax base. Rules governing capital cost recovery, inventory accounting, the inclusion or exclusion of foreign source income, financial intermediation, and so on, must be provided in order to determine the amount of entity-level income that will be attributed to shareholders. Similarly, with a shareholder-credit method, the tax base at the entity level must be determined to assess the entity-level tax for which shareholders are credited. Even a dividends-paid deduction or exclusion must determine the earnings of a corporation to determine whether the payment to the shareholder is a dividend or a return of capital.[48]

There are, however, two consumption-tax plans that do not require the determination of corporate income. Corporate income would be irrelevant under a national retail sales tax. It could also be irrelevant under a true consumed-income, or cash-flow, tax that was structured as an individual tax only and treated all investments in a business entity (including corporations) as deductible, and all distributions from businesses (including dividends and capital withdrawals) as taxable.

International Considerations

Integration raises a number of important international tax issues.[49] These fall into two basic categories. First, how to treat international transactions for purposes of calculating the entity-level tax base. Second, how to tax foreign shareholders of U.S. corporations (or U.S. branches of foreign corporations).[50] These issues are complicated by the fact that the traditional focus of the *corporate* income tax is on the source of the income, while the traditional focus of the *individual* income tax is on the residence of the taxpayer.[51] Residence and source principle-income taxation do not lead to the same tax base decision in an international context. Furthermore, taxation on the basis of consumption leads to different results than income taxation.

In an integrated system, policymakers would still need to decide whether a tax system was territorial or worldwide, destination principle or origin principle, and whether foreign investors would be subject to withholding, or other, taxes on their U.S. source income. The tax treatment of foreign investors in U.S. companies arises in different ways in different tax plans. If there is no entity-level tax, should foreign shareholders of U.S. corporations be subject to some tax on the dividends or other distributions paid to them? If there were no withholding tax, they would effectively not be subject to any tax on U.S. source corporate income. In case of an entity-level tax, should foreigners be afforded any credit for the U.S. entity-level tax paid or provided the exclusion that U.S. shareholders would receive? If there is a dividends-paid deduction, should the corporation receive a deduction for dividends paid to foreigners? If so, should there be a withholding tax on those dividends paid? There is also the issue of whether the tax treaty network that dramatically reduces withholding rates on dividends should be rethought in an integrated system. The resolution of these issues will have very large revenue effects given the magnitude of international capital flows and transnational investments. Foreigners hold about one-quarter of U.S. stocks.[52] Although they are often substantially simpler, consumption taxes also have international issues that need to be addressed.

Tax-Exempt Organizations and Qualified Accounts

Under current law, taxable shareholders only account for about one-quarter of corporate-share ownership.[53] Tax-exempt organizations hold corporate stock. Qualified accounts (such as Individual Retirement Accounts, 401(k) plans, and employer-sponsored defined-benefit retirement plans) hold about 37 percent of all corporate stock.[54] Investments held in life insurance contracts are tax deferred. Thus, the tax treatment of dividends and other distributions from businesses to tax-exempt institutions or tax-deferred accounts is of major importance. The current corporate tax imposes a significant tax burden on the investment made by these institutions or accounts that would be eliminated should the corporate-level tax be repealed. Unless some form of withholding tax on dividends paid to tax-exempt organizations and qualified accounts were instituted, a large portion of corporate income would not be taxed currently and, in some cases, would never be taxed. However, it is not appropriate to tax qualified accounts' income until withdrawn for consumption purposes in a consumption tax.

Conclusion

The current tax system double taxes corporate income. This double taxation has a pronounced negative economic impact, particularly on wages. It distorts the economy and harms productivity. The double taxation of corporate income is also inconsistent with competing concepts of proper income taxation. Congress should eliminate the double taxation of corporate income. There are three means of eliminating this double taxation in the context of an income tax. Alternatively, Congress could eliminate the double taxation of corporate income by replacing the income tax with a consumption tax.

Although there are a wide variety of secondary issues that must be resolved in order for an integrated system to work properly, solutions exist and integrated systems function well in many other countries. Furthermore, since nearly three-quarters of corporate shares are held by tax-exempt organizations, foreigners, or qualified accounts, these decisions can have substantial revenue effects.

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Endnotes

1. Internal Revenue Service, "Instructions for Form 1120, U.S. Corporation Income Tax Return," 2016, https://www.irs.gov/pub/irs-pdf/i1120.pdf (accessed April 6, 2017), and Karen Burke, *Federal Income Taxation of Corporations and Stockholders in a Nutshell,* 7th Edition (St. Paul, MN: West Academic Publishing, 2014).
2. The capital gain reflects increases in stock value attributable to retained earnings. (It might also reflect a reduction in the discount rate and improved expectations with respect to future earnings.) The capital gains tax rate varies considerably from 0 percent for lower and lower-middle income taxpayers to 23.8 percent for long-term gains or qualified dividends and 43.4 percent for short-term gains for high-income taxpayers. Thus, the combined or integrated tax rate on corporate income can be as high as 63.2 percent and is often 50.5 percent.
3. Emil M. Sunley, "Corporate Integration: An Economic Perspective," *Tax Law Review*, Vol. 47 (1992), pp. 621–643.
4. News release, "Hatch Statement at Finance Hearing on Corporate Integration," Committee on Finance, U.S. Senate, May 17, 2016, https://www.finance.senate.gov/chairmans-news/hatch-statement-at-finance-hearing-on-corporate-integration (accessed April 6, 2017), and hearing, *Integrating the Corporate and Individual Tax Systems: The Dividends Paid Deduction Considered*, Finance Committee, U.S. Senate, May 17, 2016, https://www.finance.senate.gov/hearings/integrating-the-corporate-and-individual-tax-systems-the-dividends-paid-deduction-considered (accessed April 6, 2017).
5. Mike Lee, "How Congress and Trump Can Reform Taxes to Put America First," *The Federalist*, January 23, 2017, http://thefederalist.com/2017/01/23/congress-trump-can-reform-taxes-put-america-first/ (accessed April 6, 2017).
6. Eric Toder and Alan Viard, "A Proposal to Reform the Taxation of Corporate Income," Tax Policy Center, Urban Institute, and Brookings Institution, June 17, 2016, http://www.taxpolicycenter.org/publications/proposal-reform-taxation-corporate-income/full (accessed April 6, 2017), and Eric J. Toder, "Approaches to Business Tax Reform," testimony before the Committee on Finance, U.S. Senate, April 26, 2016, https://www.finance.senate.gov/imo/media/doc/26APR2016Toder.pdf (accessed April 6, 2017).
7. Michael J. Graetz and Alvin C Warrant, Jr., *Integration of the U.S. Corporate and Individual Income Taxes: The Treasury Department and American Law Institute Reports* (Tax Analysts, 1998, 2014). The 2014 electronic version includes the 1993 American Law Institute study on integration and the 1992 Treasury Department Study. Report of the Department of the Treasury, "Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once," January 1992, https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Integration-1992.pdf (accessed April 6, 2017). For an earlier detailed examination of the issues, see Martin Norr, *The Taxation of Corporations and Shareholders* (Dordrecht, Netherlands: Springer, 1982).
8. U.S. Senate, "Comprehensive Tax Reform for 2015 and Beyond," December 2014, Table 5.14, p. 209, https://www.finance.senate.gov/imo/media/doc/Comprehensive%20Tax%20Reform%20for%202015%20and%20Beyond5.pdf (accessed April 6, 2017).
9. In the economics literature, this question is often phrased as "What is the incidence of the corporate income tax?"
10. As discussed below, the Joint Committee on Taxation and the U.S. Treasury Department assume that shareholders bear most of the burden of the corporate tax.
11. The non-corporate sector can be affected because competition will eventually cause wages, prices, and after-tax returns in the corporate and non-corporate sectors to be the same. For a more detailed explanation, see Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, Vol. 70, No. 3 (June 1962), pp. 215–240.
12. The focus of the economics profession to date has been almost exclusively the impact on capital and labor rather than customers.
13. Arnold C. Harberger, "The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case," in *Tax Policy and Economic Growth* (Washington, DC: American Council for Capital Formation, 1995); Arnold C. Harberger, "The Incidence of the Corporation Income Tax Revisited," *National Tax Journal*, Vol. 61, No. 2 (June 2008), pp. 303–312, http://www.ntanet.org/NTJ/61/2/ntj-v61n02p303-12-incidence-corporation-income-tax.pdf (accessed April 6, 2017); Matthew H. Jensen and Aparna Mathur, "Corporate Tax Burden on Labor: Theory and Empirical Evidence," *Tax Notes*, June 6, 2011, https://www.aei.org/wp-content/uploads/2011/06/Tax-Notes-Mathur-Jensen-June-2011.pdf (accessed April 6, 2017); Kevin A. Hassett and Aparna Mathur, "A Spatial Model of Corporate Tax Incidence," American Enterprise Institute, December 1, 2010, https://www.aei.org/wp-content/uploads/2011/10/-a-spatial-model-of-corporate-tax-incidence_105326418078.pdf (accessed April 6, 2017); Robert Carroll, "The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States," Tax Foundation *Special Report* No. 169, August 3, 2009, https://taxfoundation.org/corporate-income-tax-and-workers-wages-new-evidence-50-states/ (accessed April 6, 2017); Desai Mihir, Fritz Foley, and James Hines, "Labor and Capital Shares of the Corporate Tax Burden: International Evidence," December 2007, http://isites.harvard.edu/fs/docs/icb.topic185564.files/Spring%202008%20Papers/Desai%20Foley%20Hines%20corporate%20tax%20incidence.pdf (accessed Mary 8, 2017); and Jason J. Fichtner and Jacob M. Feldman, "Why Do Workers Bear a Significant Share of the Corporate Income Tax?" in *The Hidden Cost of Federal Tax Policy*, Mercatus Center, 2015, chapter 4, https://www.mercatus.org/system/files/Fichtner-Hidden-Cost-ch4-web.pdf (accessed April 7, 2017). For a contrary view, see Kimberly A. Clausing, "In Search of Corporate Tax Incidence," *Tax Law Review*, Vol. 65, No. 3, 2012, pp. 433–472, http://ssrn.com/abstract=1974217 (accessed April 7, 2017).
14. Alan J. Auerbach, "Who Bears the Corporate Tax? A Review of What We Know," National Bureau of Economic Research *Working Paper* No. 11686, October 2005, http://www.nber.org/papers/w11686.pdf (accessed April 7, 2017); William M. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax," Department of the Treasury, Office of Tax Analysis *OTA Paper* No. 101, December 2007, https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-101.pdf (accessed April 7, 2017); and Stephen J. Entin, "Tax Incidence, Tax Burden, and Tax Shifting: Who Really Pays The Tax?" Heritage Foundation *Center for Data Analysis Report* No. 04-12, November 5, 2004, http://s3.amazonaws.com/thf_media/2004/pdf/cda04-12.pdf.

15. In a competitive market, capital will flow from jurisdictions with a relatively low expected after-tax return to jurisdictions with a relatively high expected after-tax return until the expected after-tax returns are equal. Social and legal barriers reduce labor mobility relative to capital mobility. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax"; William C. Randolph, "International Burdens of the Corporate Income Tax," Congressional Budget Office, August 2006, https://cbo.gov/sites/default/files/cbofiles/ftpdocs/75xx/doc7503/2006-09.pdf (accessed April 7, 2017); and R. Alison Felix, "Passing the Burden: Corporate Tax Incidence in Open Economies," Federal Reserve Bank of Kansas City, October 2007, https://www.kansascityfed.org/Publicat/RegionalRWP/RRWP07-01.pdf (accessed April 7, 2017).
16. Ibid.
17. 25 percent labor: Joint Committee on Taxation, "Modeling the Distribution of Taxes on Business Income," JCX-14-13, October 16, 2013, https://www.jct.gov/publications.html?func=download&id=4528&chk=4528&no_html=1 (accessed April 7, 2017); 18 percent labor: Julie-Anne Cronin et al., "Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology," Department of the Treasury, Office of Tax Analysis *Technical Paper* No. 5, May 17, 2012, https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/TP-5.pdf (accessed April 7, 2017).
18. See, for example, Asa Johansson et al., "Tax and Economic Growth," OECD Economics Department *Working Paper* No. 620, July 11, 2008, https://www.oecd.org/tax/tax-policy/41000592.pdf (accessed April 7, 2017). ("Corporate taxes are found to be most harmful for growth….")
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21. For state tax-rate estimates, see OECD Tax Database, Table II.1. Corporate Income Tax Rate, https://stats.oecd.org/index.aspx?DataSetCode=Table_II1 (accessed April 7, 2017); Congressional Budget Office, "International Comparisons of Corporate Income Tax Rates," March 2017, p. 2, Summary Table 1. "Corporate Tax Rates in G20 Countries, from Highest to Lowest, 2012," https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/reports/52419-internationaltaxratecomp.pdf (accessed April 7, 2017); and Anton Aurenius, "How the U.S. Corporate Tax Rate Compares to the Rest of the World," Tax Foundation, August 22, 2016, https://taxfoundation.org/how-us-corporate-tax-rate-compares-rest-world/ (accessed April 7, 2017). All put the combined U.S. tax rate at 39 percent.
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28. Alan J. Auerbach, Michael P. Devereux, and Helen Simpson, "Taxing Corporate Income," National Bureau of Economic Research *Working Paper* No. 14494, November 2008, http://www.nber.org/papers/w14494 (accessed April 6, 2017), and Kyle Pomerleau, "Eliminating Double Taxation Through Corporate Integration," Tax Foundation *Fiscal Fact* No. 453, February 2015, https://files.taxfoundation.org/legacy/docs/TaxFoundation_FF453.pdf (accessed April 6, 2017).
29. This would also include distributions from publicly traded partnerships taxed as C corporations under § 7704.
30. Internal Revenue Code §§ 1361–1379.
31. Internal Revenue Code §§ 701–777.
32. Internal Revenue Code § 7704.
33. This is comparable to qualified account treatment under current law (such as traditional IRA and 401(k) retirement accounts). Many cash-flow tax proposals have not provided this treatment for capital contributions or distributions, nor treated debt as taxable and principal repayment as deductible. To this extent, they are not true cash-flow taxes.

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35. For example, Australia, Canada, and New Zealand are fully integrated, and partial integration exists in the United Kingdom. See U.S. Senate, *Comprehensive Tax Reform for 2015 and Beyond*, December 2014, Table 5.14, p. 209.
36. Internal Revenue Code § 1(h)(11). This provision was enacted by the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108–27.
37. Internal Revenue Code § 243.
38. Burton, "Four Conservative Tax Plans with Equivalent Economic Results."
39. Also called a business-transfer tax, business-consumption tax, business-activity tax, or subtraction-method value-added tax. See David R. Burton, "The Business Flat Tax: How It Works, What It Means for the Economy," Heritage Foundation *Backgrounder* No. 3117, August 15, 2016 (revised and updated November 8, 2016), http://thf-reports.s3.amazonaws.com/2016/BG3117.pdf.
40. This can be accomplished by either treating the corporation as a qualified account (capital contributions would be deductible and dividends received would be included in gross income), or by providing shareholders with a credit for entity-level tax. For the latter approach, see Foster, "The New Flat Tax: Easy as One, Two, Three."
41. GOP, "A Better Way: Our Vision for a Confident America—Tax."
42. It would tax the value created by firms at the business level and the value created by labor at the individual level. Because capital and intermediate expenses are immediately deductible, the Better Way plan moves toward a consumption tax. Only consumption goods and services remain in the tax base. The capital income tax in the individual income tax at half the statutory rate, however, is a significant variance from the consumption tax principle. For a more detailed explanation, see Burton, "Four Conservative Tax Plans with Equivalent Economic Results."
43. The three primary differences are (1) it has graduated tax rates, (2) it is border-adjusted, and (3) it imposes a 16.5 percent tax at the individual level on capital income.
44. Henry C. Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938); Robert Murray Haig, "The Concept of Income–Economic and Legal Aspects," in Robert Murray Haig, ed., *The Federal Income Tax* (New York: 1921), reprinted in Richard A. Musgrave and Carl S. Shoup, eds., *Readings in the Economics of Taxation*, Vol. 9 (Homewood, IL: Richard D. Irwin, 1959).
45. Irving Fisher, "Income in Theory and Income Taxation in Practice," *Econometrica* (January 1937); Irving Fisher, "The Double Taxation of Savings," *American Economic Review*, Vol. 29 (March 1939), p. 1; Irving Fisher, "The Unperceived Double Taxation of Income, Answers to Those that Deny Its Existence," 1946, previously unpublished manuscript published in William J. Barber, ed., *The Works of Irving Fisher*, Vol. 12, "Contributions to the Theory and Practice of Public Finance" (London: Pickering and Chatto, 1997); Irving Fisher, "Paradoxes in Taxing Savings," *Econometrica* (April 1942); Irving Fisher and Herbert Fisher, *Constructive Income Taxation* (New York, NY: Harper and Brothers, 1942); Norman B. Ture, "Supply Side Analysis and Public Policy," in David G. Raboy, ed., *Essays in Supply Side Economics* (Washington, DC: The Institute for Research on the Economics of Taxation, 1982), http://iret.org/pub/SupplySideBook.pdf (accessed April 7, 2017); and Norman B. Ture, "The Inflow Outflow Tax—A Saving-Deferred Neutral Tax System," The Institute for Research on the Economics of Taxation, 1997, http://iret.org/pub/inflow_outflow.pdf (accessed April 7, 2017).
46. Henry Simons opposed the double taxation of corporate income in his book *Personal Income Taxation*. See also Aaron Director, "Simons on Taxation," *University of Chicago Law Review*, Vol. 14, No. 1 (1946), http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2291&context=uclrev (accessed April 7, 2017).
47. Horizontal equity is the principle that taxpayers with the same level of income or consumption should pay the same tax. So-called vertical equity is the progressive principle that taxpayers with higher levels of income or consumption should pay a higher rate of tax. See Paul R. McDalliel and James R. Repert, "Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange," *Florida Tax Review*, Vol. 1, No. 10 (1993), pp. 607–622, http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1706&context=lsfp (accessed April 7, 2017), and David Elkins, "Horizontal Equity as a Principle of Tax Theory," *Yale Law & Policy Review*, Vol. 24, No. 1 (2006), pp. 43–90, http://digitalcommons.law.yale.edu/ylpr/vol24/iss1/3 (accessed April 7, 2017).
48. This is analogous to current law requirements for calculating earnings and profits in accordance with Internal Revenue Code § 312.
49. Graetz and Warrant, Jr., *Integration of the U.S. Corporate and Individual Income Taxes*; John K. McNulty, "International Aspects of Proposals for Corporate Income Tax Reform in the United States: Integration of the Corporate and Individual Income Taxes," *Tilburg Foreign Law Review*, Vol. 3 (1993), pp. 307–333, http://scholarship.law.berkeley.edu/facpubs/946 (accessed April 7, 2017); and Reuven S. Avi-Yonah, "The Pitfalls of International Integration: A Comment on the Bush Proposal and its Aftermath," *International Tax and Public Finance*, Vol. 12, No. 1 (2005), pp. 87–95, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=2667&context=articles (accessed April 7, 2017).
50. The same issues arise with respect to the taxation of distributions from partnerships (including LLCs). In addition, if the integrated system is worldwide rather than territorial, the issue arises as to what credit should be provided to shareholders for foreign taxes paid by the corporation, analogous to the foreign tax credit currently allowed by Internal Revenue Code §§ 901–909.
51. The individual income tax, however, has some source principle provisions (such as withholding on non-resident aliens) and the corporate tax treatment can vary based on the domicile of the corporation and the residence (or domicile) of its shareholders.

52. Steven M. Rosenthal, "Integrating the Corporate and Individual Tax Systems: The Dividends Paid Deduction Considered," testimony before the Committee on Finance, U.S. Senate, Tax Policy Center, May 17, 2016, https://www.finance.senate.gov/imo/media/doc/16MAY2016Rosenthal.pdf (accessed April 7, 2017).
53. Steven M. Rosenthal, "Only About One-Quarter of Corporate Stock Is Owned by Taxable Shareholders," Tax Policy Center, May 16, 2016, http://www.taxpolicycenter.org/taxvox/only-about-one-quarter-corporate-stock-owned-taxable-shareholders (accessed April 7, 2017).
54. Rosenthal, "Integrating the Corporate and Individual Tax Systems: The Dividends Paid Deduction Considered."