6 Reasons Corporations Must Pay Income Tax

Corporate income tax is a potential source of significant revenue for states. Apart from the economic or tax policy justifications, the political reality is that states need additional revenue and growing corporate profits can be a source. There are two aspects to this “political” rationale. First, there are inherent limitations and opposition to virtually all other taxes. There is intense political opposition to the personal income and property tax. The state sales tax has been under siege with a shrinking base (untaxed remote sales on the Internet). Other sources of tax revenue—namely excise, license, and severance—are unlikely to grow significantly in the future. Second, it is likely that the public would support higher tax burdens on corporate entities. Periodically, a study will find that the largest corporations in a particular state pay little or no income taxes. Such reports have usually spurred public and private calls for increasing corporate tax responsibility. Recent polling data show that the public is generally willing to increase corporate income taxes to fund government services such as education and health care.

Corporate income tax is necessary to limit corporations’ growing power. This was among the earliest motivations for supporters of the tax. This justification relies on an emotional understanding of what constitutes fair distribution of liability to the state to meet budget demands: the nature of the liberal democratic state requires that corporations’ political, economic, and corporate power should not go unchecked by lack of allocation of that liability. If accountability to the people is an ideal of the democratic state, the “excessive accumulations of private power” ought to be curbed via constitutional means by the government. Especially given the recent Supreme Court decision eliminating limits on corporate campaign spending in Citizens United v. Federal Election Commission, 130 S.Ct. 876 (2010)—holding that the rights of personhood under the First Amendment inure to corporations, and as such their political speech is protected from limitations on spending.

Corporate income tax compensates for deficiencies in property tax. The property tax does not take into account that businesses require varying degrees of property inputs to produce the same level of profit. Consequently, capital-intensive operations (e.g., manufacturing companies) are taxed more heavily by the property tax than are labor-intensive companies, including knowledge-based enterprises such as insurance and high-tech companies. This inequity is compounded by the difficulties in assessing property taxes for intangible property. Instead of relying entirely on taxing business inputs, states, in the interest of greater equity, have included a corporate income tax in their mix of revenue sources.

Corporate income tax helps protect personal income tax revenues. Without a levy on corporate income, taxpayers might shelter personal income in corporate holdings. For example, business owners seeking to avoid personal income tax would incorporate their operations; the corporation itself would then accumulate the dividends or salary that normally would be paid out to the individual. The shareholders could thus escape personal income taxation on these monies until they were paid out as dividends or the company was sold.

Corporate income tax is necessary to support public services. A corporation’s success depends on the adequate provision of public services. Requiring corporations to pay for services provided by the community satisfies the benefits theory of taxation—tax liabilities are imposed to compensate for the benefits received. Corporations use public services provided by the state as much as individuals and unincorporated businesses. They benefit from a state’s transportation infrastructure—the roads, railways, airports, and harbors used to receive materials and to move products to market. Corporations also benefit from public safety operations, including police, fire, and medical emergency services. Also, the state judicial system protects their contractual, intellectual property, and other legal rights. Corporations also depend on the state’s school system to produce an educated workforce—an especially important role in this highly specialized age of electronic commerce. High-quality school systems help attract qualified employees.

Corporate income tax makes state tax systems more progressive. The corporate income tax generally has a progressive effect on a state’s overall public finance system. While a broader segment of the population owns corporate stock than ever before, most of the corporate wealth remains in the hands of the wealthy. Along with the personal income tax, the corporate income tax offsets the regressive effects of the sales and use taxes as well as the excise taxes imposed by many states.

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