Chapter 3: Entity Comparison

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Please note. Corrections for all of the chapters are available at **www.TaxSchool.illinois.edu.** For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

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TAX CUTS AND JOBS ACT

The Tax Cuts and Jobs Act of 2017 (TCJA), enacted on December 22, 2017,[1] ushers in major changes to both C corporation and pass-through entity taxation. These changes became effective January 1, 2018. Congressional goals relevant to these business entity tax changes include the permanent reduction of the corporate income tax rate, which Senator Orrin Hatch, Chair of the Senate Committee on Finance, described as "the highest in the industrialized world"[2] in his opening statement on November 13, 2017, at the Finance Committee markup of the original TCJA bill.

> **Note.** Senator Hatch's complete introductory statement in connection with the TCJA is available at **uofi.tax/18b3x1** [www.finance.senate.gov/hearings/open-executive-session-to-consider-an-original-bill-entitled-the-tax-cuts-and-jobs-act]. Senator Ron Wyden's introductory statement is also available at this same webpage.

There are different ways to measure the size and impact of corporate tax rates. Statutory rates are the corporate tax rates mandated by the actual tax law, while effective tax rates (ETRs) measure how much tax is paid relative to corporate economic income. Despite Senator Hatch's remarks, which focused on statutory rates, a March 2016 Government Accountability Office (GAO) study indicated that during each year from 2006 through 2012, at least two-thirds of active corporations had no federal tax liability, and larger corporations with at least $10 million in assets were the most likely to have some tax liability. The GAO study points out that from 2008 through 2012, these larger corporations had an ETR of approximately 14% of pretax net income as reported on their financial statements. Moreover, once foreign, state, and local taxes were accounted for, the average ETR during this period was slightly more than 22% (far less than the statutory tax rate of 35% that is frequently referred to in tax reform discussions).[3]

However, using statutory tax rates as a measure, other studies indicate that U.S. corporate tax rates, when compared to those of other nations, are high. On September 7, 2017, the Tax Foundation published the results of a survey of corporate tax rates for 202 countries. The table below shows the countries with the six highest rates, followed by a table showing those with the six lowest rates for comparative purposes.[4]

Tax Foundation Survey — Countries With the Six Highest Corporate Tax Rates, September 2017

Country	Corporate Tax Rate
United Arab Emirates	55%
Comoros	50%
Puerto Rico	39%
United States	38.91%
Suriname	36%
Argentina	35%

1. PL 115-97.
2. *Open Executive Session to Consider an Original Bill Entitled the Tax Cuts and Jobs Act*. Nov. 13, 2017. United States Senate Committee on Finance. [www.finance.senate.gov/hearings/open-executive-session-to-consider-an-original-bill-entitled-the-tax-cuts-and-jobs-act] Accessed on May 13, 2018.
3. *Corporate Income Tax.* Mar. 2016. GAO. [www.gao.gov/assets/680/675845.pdf] Accessed on Jun. 1, 2018.
4. *Corporate Income Tax Rates around the World, 2017.* Jahnsen, Kari and Pomerleau, Kyle. Sep. 7, 2017. Tax Foundation. [taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/#_ftn1] Accessed on May 22, 2018.

> **Note.** The U.S. corporate tax rate of 38.91% is composed of the federal statutory rate of 35% that prevails through the 2017 tax year (prior to the enactment of the TCJA), plus an average of the corporate income taxes imposed by individual states.

Tax Foundation Survey — Countries With the Six Lowest Corporate Tax Rates, September 2017 (Countries with Non-Zero Corporate Tax Rates)

Country	Corporate Tax Rate
Uzbekistan	7.5%
Turkmenistan	8%
Hungary	9%
Montenegro	9%
Andorra	10%
Bosnia and Herzegovina	10%

Based on the Organization for Economic Co-operation and Development's (OECD) tax database, the United States had the highest corporate tax rate among industrialized nations through 2016.[5]

> **Note.** The OECD tax database's detailed compilation of corporate tax rates among nations can be found at **uofi.tax/18b3x2** [stats.oecd.org/index.aspx?DataSetCode=Table_II1]. In addition, the Tax Foundation survey can be found at **uofi.tax/18b3x3** [taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/#_ftn1].

The Tax Foundation survey notes several relevant points regarding statutory corporate tax rates. These points include the following.[6]

- Of the 202 nations surveyed, 14 do not impose any corporate income tax (but most of these are small island nations such as the Cayman Islands and Bermuda).
- The average tax rate of the 202 countries surveyed is 22.96%.
- Of the 202 nations surveyed, only five countries impose a corporate tax rate higher than 35% (which included the United States).
- Gradually, since 1980, corporate tax rates have declined on a global basis (with the 1980 worldwide average of 38.68% declining to 22.96% in late 2017).

Accordingly, the TCJA's reduction in the U.S. corporate tax rate to a flat 21% seems not only in keeping with the worldwide trend in declining corporate tax rates, but it is also reflective of the average rate found among other nations.

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5. *Table 11.1. Statutory corporate income tax rate.* Jun. 2, 2018. OECD. [stats.oecd.org/index.aspx?DataSetCode=Table_II1]. Accessed on Jun. 2, 2018. This table provides global corporate tax rate data for 2000 through 2018.

6. *Corporate Income Tax Rates around the World, 2017.* Jahnsen, Kari and Pomerleau, Kyle. Sep. 7, 2017. Tax Foundation. [taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/#_ftn1] Accessed on May 22, 2018.

The new qualified business income deduction (QBID) rules for pass-through entities had the Congressional purpose of lowering "the [tax] burden on small business through a fairly unique approach."[7] Ultimately, this approach culminated in the new IRC §199A, which provides the QBID rules that are effective with the 2018 tax year for pass-through entities.

This chapter focuses on the impact of the TCJA changes on business entities and highlights how they compare to one another in our changed tax environment.

> **Note.** For additional legislative resources regarding the TCJA, the Congressional hearings can be viewed at www.finance.senate.gov/hearings. Analyses from the Joint Committee on Taxation can be found at **uofi.tax/18b3x4** [search.usa.gov/search?utf8=%E2%9C%93&affiliate=jct&query=://uofi.tax/18b3x4tax+cuts+and+jobs+act&commit=Search].

Other arguments have been made to justify corporate tax rate reforms, such as a behavioral response to lower corporate tax rates would lead to greater tax revenue, or the need to maintain a degree of parity between personal and corporate tax rates to prevent individuals or corporations from engaging in tax-avoidance behavior. Whatever merit such arguments have, the TCJA made dramatic changes to the corporate tax landscape, and these changes greatly affect how corporations compare to other types of business entities (e.g., pass-throughs) that are affected by the TCJA's personal tax rate changes.

> **Note.** For a detailed discussion that was prepared for Congress in September 2017 about the major arguments for corporate tax reform (which includes summaries of several studies completed to determine which arguments have merit), see the Congressional Research Service's report at **uofi.tax/18b3x11** [fas.org/sgp/crs/misc/RL34229.pdf].

CONCERNS, COMPLEXITY, AND CONTROVERSY

With the advent of the TCJA changes, particularly those associated with business entities, a major concern among tax practitioners is the added complexity associated with such changes. Shortly after the enactment of the TCJA, the AICPA sent letters to Congressional members, the IRS, and the Department of Treasury outlining many concerns. The AICPA called on these parties to provide the necessary resources for guidance and services that practitioners and taxpayers will require to navigate through the details and definitions of the new legislation. The AICPA letter noted 39 different areas that require immediate guidance in order for taxpayers to comply with their obligations.[8]

Among the top areas of concern was the need for additional guidance regarding the new QBID rules for pass-through entities, including the definition of specified service business and the calculation of the QBID for complex business structures.[9]

> **Note.** The AICPA letter is available at **uofi.tax/18b3x6** [www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20180129-aicpa-guidance-request-on-pub-l-no-115-97.pdf].

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7. *Hatch Opening Statement at Finance Committee Markup of Tax Cuts and Jobs Act*. Nov. 13, 2017. U.S. Senate Committee on Finance. [www.finance.senate.gov/imo/media/doc/11.13.17%20Hatch%20Opening%20Statement%20at%20Finance%20Committee%20Markup%20of%20Tax%20Cuts%20and%20Jobs%20Act.pdf] Accessed on May 13, 2018.

8. *AICPA wants more guidance on new tax law and dedicated IRS unit for tax pros.* Cohn, Michael. Jan. 30, 2018. Accounting Today. [www.accountingtoday.com/news/aicpa-wants-more-guidance-on-new-tax-law-and-dedicated-irs-unit-for-tax-pros] Accessed on May 22, 2018.

9. Ibid.