PENN WHARTON
UNIVERSITY of PENNSYLVANIA
Budget Model

Business Taxation in the Biden Tax Plan

Summary: We use PWBM's new dynamic model enhancement of the business sector to analyze several foreign and domestic business taxation provisions from the Biden tax plan. While raising the effective tax rate on foreign profits increases domestic capital, wages, and GDP, provisions that raise domestic business taxes have the opposite effect—when combined, these business tax provisions decrease the capital stock by 0.21 percent and decrease wages by 0.69 percent in 2050.

Introduction

The Biden presidential campaign has put forward a number of policies related to business taxation. Building on our previous analysis of the Biden tax plan, we use an improved model of firm decision making to re-analyze several of these proposals. This analysis focuses on only the business provisions and does not estimate the full Biden policy package.

This post summarizes the current state of international business taxation, our enhanced model of firm investment, and the macroeconomic effects of the domestic and foreign business tax provisions in the Biden tax plan.

Current Policy

Currently, firms based in the United States are taxed on profits earned both at home and abroad, with various credits and deductions for taxes paid to foreign governments. Taxation of foreign income for U.S.-based firms includes:

- The tax on Global Intangible Low-Taxed Income (GILTI), which aims to encourage U.S. based multinationals to locate *intangible* intellectual property in the U.S. rather than in foreign jurisdictions.[1] For taxable years beginning after December 31, 2017, and before January 1, 2026, a deduction of 50 percent of GILTI is allowed, which implies an effective tax rate of 10.5 percent under a 21-percent corporate tax rate. The deduction is lowered to 37.5 percent for taxable years beginning after December 31, 2025. A "deemed-paid" foreign tax credit equal to 80 percent of foreign taxes paid is also allowed.
- Taxation of income by the country of the foreign affiliate.
- U.S. taxes on foreign affiliate income other than GILTI, which includes branch income, interest, royalties, Subpart F and other foreign affiliate income included in U.S. taxable income before and after the Tax Cuts and Jobs Act (TCJA).

- Foreign tax credits from foreign affiliate income other than GILTI.

PWBM's dynamic model captures all four of these channels.

Enhanced Model of Firm Behavior

PWBM recently expanded our dynamic modeling with a model of a value-maximizing firm which owns its capital (in contrast to a profit-maximizing firm where households lend capital to the firm at the market interest rate). This enhancement allows (a) an explicit modeling of financial markets in firm equity, (b) multiple production sectors in the economy with differing production functions and tax treatments, and (c) the option for firms to produce using both domestic capital and capital located abroad.

Time-varying equity asset prices are determined from household and foreign portfolio demand for the asset's dividends and capital gains. Firms maximize their net present value under the endogenous equilibrium interest rates of the model by setting dividend and investment policy. Firms also optimize their choice of labor demanded and capital location based on factor prices and tax policy. Each production sector is modeled by a separate representative firm with sector sizes in the economy exogenously specified.

In the policy experiments in this post, the production sector is divided into corporate and pass-through sectors. The corporate sector can invest in production abroad while the pass-through sector cannot. Foreign capital investments are considered to be foreign-affiliates of the multinational firm and produce output for sale in the foreign market.

Policy Scenarios

Using the above model of firm behavior, we consider several of the business sector and foreign tax provisions from Biden's tax plan:

Table 1. Summary of Biden Domestic and Foreign Business Tax Proposals

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Category	Provision
Domestic	Raise the corporate tax rate from 21 percent to 28 percent.
	Impose a minimum tax on corporate book income.
	Tax capital gains and dividends at ordinary rates.
	Limit the deduction of certain pass-through income through Section 199A.
Foreign	Lower the GILTI deduction to 25 percent, raising the effective minimum rate on foreign profits.

More detailed descriptions of these provisions are available in our analyses of the original and updated Biden tax plan.

We use the enhanced model of a value-maximizing firm to re-estimate the effects of the major business sector provisions of the Biden plan.[2] Since the new enhancement allows for explicit modeling of foreign capital investment choices by corporations, we focus our analysis on the effect of international tax provisions.

We examine three alternative policy scenarios and compare the effects to our current policy baseline:

1. Maintain current policy but implement foreign tax changes.
2. Implement all business sector policies except those related to foreign taxation.
3. Implement all business sector policies including foreign tax.

Below, we present macroeconomic projections for each of these scenarios relative to current policy.[3]

Projected Economic Effects: Foreign Tax Only

Table 2 presents the projected macroeconomic effects of just the foreign business tax provision in Biden's plan, relative to current policy. The increased tax on foreign-earned income encourages U.S. multinational firms to locate relatively more production and capital in the United States. Foreign affiliate capital declines accordingly by about 7.56 percent in 2030, 2040, and 2050, while the domestic capital stock increases by 0.8 percent in 2030 and 0.6 percent in 2040 and 2050. The increase in domestic capital makes domestic labor more productive, thus increasing domestic wages by 0.27 percent in 2030 and 0.19 percent in 2040 and 2050. Overall, GDP increases by 0.29 percent in 2030, 0.24 percent in 2040 and 0.25 percent in 2050. Since firms' total capital is lower and they pay out lower dividends, the value of firms decreases, leading to a reduction in equity asset prices of 0.51 percent in 2030, 0.6 percent in 2040, and 0.58 percent in 2050.

Table 2. Economic Effects of Biden's Foreign Business Tax Provision

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Domestic Variables							
Year	GDP	Capital	Labor Supply	Federal Debt	Wages	Asset Price	Foreign Capital
2030	0.29	0.82	0.02	-1.33	0.27	-0.51	-7.57
2040	0.24	0.61	0.05	-2.47	0.19	-0.60	-7.55
2050	0.25	0.62	0.06	-3.10	0.19	-0.58	-7.56

Projected Economic Effects: Business Sector Taxes Only

Table 3 presents the macroeconomic effects of just the domestic business tax provisions in Biden's plan, relative to current policy. These provisions increase the marginal tax rates on capital, leading to a reduced domestic capital stock. This reduction is partly offset by the reduction in government debt, which crowds-in investment into firm equity. The decrease in domestic capital stock makes domestic labor less productive, thus decreasing domestic wages by 1 percent in 2030, 1.08 percent in 2040 and 1.01 percent in 2050. Lower domestic wages decrease domestic labor supply in 2030 and 2040. Over time, however, domestic labor supply rises as the income effect dominates the substitution effect, increasing by 0.03 percent relative to baseline in 2050. Given the significant drop in domestic capital stock, GDP decreases by 0.44 percent in 2030, 0.54 percent in 2040, and 0.42 percent in 2050. Since the proposal increases the corporate income tax rate from 21 percent to 28 percent, U.S. taxes on foreign affiliate income also rise, which leads to a reduction in foreign

capital of about 12.7 percent in 2030 and 2040 and 12.5 percent in 2050. Equity asset prices also decline as the value of firms decreases.

Table 3. Economic Effects of Biden's Business Sector Tax Provisions

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	Domestic Variables						
Year	**GDP**	**Capital**	**Labor Supply**	**Federal Debt**	**Wages**	**Asset Price**	**Foreign Capital**
2030	-0.44	-1.14	-0.06	-7.22	-1.00	-1.50	-12.74
2040	-0.54	-1.51	-0.01	-16.90	-1.08	-1.58	-12.67
2050	-0.42	-1.26	0.03	-23.96	-1.01	-1.39	-12.53

Projected Economic Effects: Business Sector and Foreign Taxes

When both business sector and foreign tax policies are in place, the economic effects of the domestic business sector provisions outweigh those of the foreign tax provisions. As a result, domestic wages decrease by 0.69 percent in 2030, 0.79 percent in 2040, and 0.69 percent in 2050. Domestic capital stock decreases by 0.15 percent in 2030, 0.58 percent in 2040, and 0.21 percent in 2050. However, higher domestic labor supply mitigates the negative impact on GDP, which decreases by 0.05 percent in 2030, 0.19 percent in 2040, and is approximately the same as the current policy baseline by 2050. Foreign capital decreases by about 22 percent in 2030, 2040, and 2050, while equity asset prices decrease by about 2.59 percent in 2030, 2.61 percent in 2040 and 2.28 percent in 2050.

Table 4. Economic Effects of Biden's Foreign and Business Sector Tax Provisions

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	Domestic Variables						
Year	**GDP**	**Capital**	**Labor Supply**	**Federal Debt**	**Wages**	**Asset Price**	**Foreign Capital**
2030	-0.05	-0.15	0.02	-9.80	-0.69	-2.59	-22.23
2040	-0.19	-0.58	0.05	-21.36	-0.79	-2.61	-21.90
2050	0.00	-0.21	0.15	-29.56	-0.69	-2.28	-21.68

This analysis was conducted by Efraim Berkovich and Zheli He.Prepared for the website by Mariko Paulson.

1. Refer to our blog post, "Trading Tangible for Intangible: The Incentives Created by GILTI and FDII in the TCJA", for a detailed discussion about the incentives created by GILTI for U.S. multinationals to shift production overseas. ↩

2. PWBM's analysis of a previous version of the plan is available here, and an analysis of his updated tax plan is available here. ↩

3. We do not implement business-level debt for these scenarios. Higher debt interest deductions would reduce the impact of the tax increase. ↩