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POLICY BRIEF

Who Really Pays? Reevaluating the Corporate Tax Burden

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The incidence of corporate taxation remains a pivotal question in public finance. Many budgetary scoring agencies assume that corporate taxes are primarily borne by capital owners, but empirical evidence increasingly challenges this view. The bulk of empirical studies suggests that labor, particularly in open economies, may bear a substantial share of the corporate tax burden through reduced wages and employment opportunities. This article synthesizes existing theoretical and empirical literature on corporate tax incidence, evaluating cross-country, country-specific, and firm-level studies. By reassessing traditional assumptions, the analysis highlights the economic consequences of corporate taxation for workers and consumers.

Corporate income taxes are often assumed to be a tax on capital. This view underpins much of tax policy: Policymakers argue that corporations and their shareholders should bear the tax burden. Institutions such as the Congressional Budget Office (CBO) allocate a significant portion of the corporate tax burden to capital, estimating that approximately 75 percent of the burden falls on capital owners. The Joint Committee on Taxation (JCT) makes the same assumption, while the Department of the Treasury estimates that capital bears an even larger share of the corporate tax burden—82 percent. However, these estimates are increasingly at odds with empirical evidence suggesting that labor bears a larger portion of the corporate tax burden than previously assumed.

This article critically examines the theoretical underpinnings and empirical findings regarding the incidence of corporate taxation, advocating for a reevaluation of the policy assumptions employed by key economic institutions. First, an overview is provided of the theoretical framework for understanding corporate tax incidence; second, empirical studies at the cross-country, country-specific, and firm levels are presented and analyzed; and finally, the implications of these findings for tax policy are discussed.

Theoretical Framework of Corporate Tax Incidence

Early models of corporate tax incidence

The classical view of corporate tax incidence posits that the burden of corporate taxation is primarily borne by capital.[1] In Arnold Harberger's closed-economy model, the corporate income tax reduces the return on capital, leading to a reduction in investment. However, Harberger's model also suggests that the tax burden is shared to some extent by labor, though in his framework, labor's share of the burden is generally seen as marginal.

In the six decades since Harberger published his early work on the subject, the global economy has become increasingly open. Foreign direct investment in the United States (as a share of GDP) has grown 15-fold since 1970, international trade has exploded to 60 percent of global GDP, and the early assumptions of economists such as Harberger have been turned upside down. Recognizing this dramatic shift in the dynamics of the global economy over the past half century, Harberger revisited his earlier research on corporate tax incidence and reversed his claim that capital bears the cost of tax increases. Harberger's later work notes that in an open-economy model, changes in the corporate tax rate "can only be reflected in the wages of labor and in the prices of non-tradable goods" and that ultimately "a higher corporation income tax will lead to a lower capital stock and to a lower level of real wages."[2]

In the decades following Harberger's initial work, this view was further refined by models that incorporated more realistic assumptions about international capital mobility and factor mobility. When capital is mobile and firms can relocate production across borders, the burden of corporate taxation shifts away from capital and toward labor. The idea is that when capital moves in response to tax differentials, the domestic economy experiences a reduction in the capital stock, which diminishes worker productivity and wages. These models indicate that, in a globalized world, the domestic labor force may bear a disproportionate share of the corporate tax burden.

Open economy and factor mobility models

Economists Jane Gravelle and Kent Smetters expanded on Harberger's work, developing a model that integrates the effects of capital mobility and international tax competition.[3] They suggest that as firms seek out lower-tax jurisdictions abroad, the resulting decrease in domestic capital leads to a lower wage rate for workers, who must compete for fewer capital resources. If domestic goods and domestic savings are used to finance capital investment, then 25 percent of the corporate tax is borne by labor, and 75 percent by owners of capital. In a fully open economy, however, Gravelle and Smetters's analysis indicates that labor could bear up to 79 percent of the corporate tax burden.

Similarly, CBO economist William Randolph applied this open-economy framework to argue that corporate taxes in a globalized world are more likely to suppress wages than reduce returns to capital.[4] Specifically, using a general equilibrium model across five sectors and two countries, the study found that domestic labor's burden equals about 73 percent of corporate tax revenue.

While Gravelle and Smetters make an important contribution by extending Harberger's model to account for capital mobility and international tax competition, their framework likely understates the share of the corporate tax burden borne by labor. The demand elasticities used in Gravelle and Smetters's model may not fully capture the true dynamics of international trade. Their approach relies on estimates from bilateral trade equations, which typically suggest that long-run demand elasticities are quite large. This assumption leads to a model where goods produced in different countries are seen as perfect substitutes, implying that shifts in capital across borders would have minimal impact on domestic prices and wages. While the assumption of perfect substitutes might be reasonable in some cases, it oversimplifies the reality of global markets, where significant differentiation exists between goods produced in different countries. The assumption fails to account for variations in the substitutability of goods across different sectors and jurisdictions, a critical oversight when considering the broader economic effects of corporate tax policy.

Additionally, Gravelle and Smetters collapse all corporate tradable goods into a single composite of 20 commodities and apply a single, aggregate elasticity across these sectors. This simplification likely obscures the sector-specific nuances of international trade and the varying degrees of capital intensity and substitutability across industries. As they acknowledge, alternative model specifications that allow for multiple corporate sectors, each with its own degree of capital intensity and varying levels of substitutability across countries, complicate the analysis but also provide a more accurate reflection of the global economy. A model with a finer sectoral breakdown would allow for the possibility that in industries where domestic labor cannot easily be replaced by foreign labor or capital, the incidence of corporate taxes could disproportionately fall on domestic workers.

The core insight of these models is that labor is not a passive recipient of the corporate tax burden. Instead, workers face real economic consequences when corporations adjust their production and investment strategies in response to changes in the tax code. The results of this dynamic are magnified in economies with high capital mobility, such as those in the Organisation for Economic Co-operation and Development (OECD). Summarizing this empirical literature, Treasury economist William Genry noted,

> Overall, the recent empirical evidence, the open economy computable general equilibrium models of tax incidence, and the sensitivity of the amount of capital investment within a country suggest reconsidering the assumption that the corporate income tax falls on the owners of capital; labor may bear a substantial portion of the burden from the corporate income tax.[5]

Empirical Evidence on the Incidence of Corporate Taxation

Cross-country evidence

The empirical literature on corporate tax incidence has grown over the years, with numerous studies examining the effects of corporate tax changes across countries. These studies provide compelling evidence that labor often bears a substantial share of the corporate tax burden, especially in economies with high capital mobility.

Federal Reserve Bank of Kansas City economist Alex Felix conducted an extensive cross-country study using data from OECD countries, focusing on the relationship between corporate tax rates and wages.[6] His findings indicate that a 10-percentage-point increase in corporate taxes is associated with a 7 percent reduction in average wages across member states. This result aligns with the notion that corporate taxes affect labor costs by reducing the amount of capital available for investment, thereby lowering worker productivity and wage levels. Felix's analysis underscores that the effect is more pronounced in economies with low barriers to international investment and high capital mobility. In such economies, firms are better able to relocate capital across borders in response to tax differentials, and as a result, the burden of corporate taxation is increasingly borne by labor in the form of lower wages.

American Enterprise Institute economists Kevin Hassett and Aparna Mathur use a spatial model of corporate tax incidence to analyze the relationship between corporate tax rates and wage levels across countries.[7] Their findings suggest that a 1 percent increase in corporate tax rates leads to a 0.5 percent decrease in wage rates.

European economists Nelly Exbrayat and Benny Geys provide valuable insights into the differential impact of corporate taxation across labor market structures and industries for a panel dataset comprising 24 OECD countries.[8] They find that the incidence of corporate taxes depends not only on the mobility of capital and labor, but also on wage-setting institutions of firms and workers. In industries or countries characterized by rigid labor markets, due to collective bargaining or wage floors, firms may face constraints in adjusting wages downward. Yet the study finds that even in such contexts, firms still manage to pass a portion of the tax burden onto labor through lower wages, particularly where capital is mobile and bargaining dynamics shift in favor of employers. Specifically, the authors' preferred estimates suggest that a 1 percent increase in the statutory corporate tax rate reduces annual average wages per worker by approximately $0.89, highlighting that wage incidence remains significant despite institutional rigidities.

Country-specific evidence

One study published by German economists Clemens Fuest and his coauthors provides compelling evidence for the significant share of corporate taxes borne by labor, particularly in the context of high-tax regions.[9] Their study, which leverages regional data from Germany, reveals that workers in regions with higher corporate taxes experience substantial wage reductions, with labor bearing approximately 77 percent of the corporate tax burden. This study is a valuable contribution to the literature because it moves beyond general theoretical models and uses real-world data to assess the impact of corporate taxes on workers in different local tax environments. The authors employ a difference-in-differences methodology, comparing regions with varying corporate tax rates over time. This empirical strategy is robust because it controls for other factors that may influence wages, such as changes in the economic environment or sectoral shifts, allowing for a clearer attribution of wage reductions to corporate tax changes.

A particularly notable finding from Fuest and his coauthors is that the incidence of corporate taxes is not uniformly distributed across different types of workers. Higher-wage workers in more capital-intensive industries experience smaller wage reductions, while lower-wage workers in labor-intensive industries are more vulnerable to the effects of tax increases. This pattern further suggests that corporate tax incidence is not simply a matter of aggregate wage suppression but is influenced by sectoral and industry-specific factors. The variation in wage reductions across different skill levels highlights the importance of considering labor market segmentation when assessing the overall impact of corporate taxation.

Moreover, Fuest et al. provide insights into the channels through which corporate taxes affect wages. They argue that firms pass on part of the tax burden to workers through reduced compensation, but the extent of this pass-through is mediated by factors such as labor market competitiveness, the elasticity of labor supply, and the ability of firms to shift their production or capital to lower-tax regions.

One 2016 study focused specifically on Canadian workers to evaluate the impact of corporate income taxes on wages.[10] Consistent with other studies, the authors' analysis finds that a 1-percentage-point increase in the corporate income tax rate reduces hourly earnings by 0.55 percent to 0.88 percent. The findings also suggest that wage suppression is particularly evident in industries or regions where firms face limited ability to shift the tax burden elsewhere.

Firm-level evidence

Firm-level analyses, such as the study conducted by Wiiji Arulampalam and coauthors, provide further empirical support for the argument that corporate taxes directly affect wages and employment, underscoring the sensitivity of labor costs to changes in corporate taxation.[11] The authors utilize microdata from European firms to estimate the relationship between corporate tax liabilities and wages, finding that in the long run, roughly half of any additional corporate tax is shifted onto labor. In dollar terms, their preferred estimates suggest that a $1 increase in corporate tax liability is associated with about a $0.92 reduction in the firm's overall wage bill. The study highlights the fact that as firms face higher tax burdens, they adjust their wage structures in response to the increased cost of doing business, thereby passing a substantial portion of the tax burden onto workers.

One of the key takeaways from this study is the significant impact of corporate tax rates on wages when firms operate in highly competitive international markets. Firms in open economies are especially vulnerable to tax-induced cost increases, as they are more likely to relocate capital or adjust labor compensation to remain competitive in foreign markets. In such environments, the corporate tax burden is often shifted onto workers in the form of wage suppression, as firms strive to maintain profit margins.

A 2007 study extends the examination of corporate tax incidence to multinational firms, providing crucial insights into how global capital mobility influences the distribution of the tax burden.[12] The research highlights the significant share of corporate taxes borne by labor, particularly in economies characterized by high capital mobility, trade openness, and flexible labor markets. The authors estimate that labor's share of the corporate tax burden ranges from 45 percent to 75 percent, varying across countries depending on economic conditions and institutional factors.

Further studies, such as a 2009 special report by Robert Carroll of the Tax Foundation, explore the relationship between corporate tax increases and wage adjustments at the firm level.[13] Carroll finds that corporate tax increases lead to significant wage suppression, particularly in industries characterized by low capital intensity and high labor input. The author estimates that for every additional dollar in corporate tax liabilities, wages fall by more than $2 in the medium-to-long term, particularly in industries that are highly exposed to international competition.

The notably large labor effect found in this study is rooted in the use of a dynamic general equilibrium framework, which captures the long-run effects of corporate taxation on capital formation and wages. Unlike partial equilibrium models, which assess only direct and short-term effects, Carroll's approach incorporates second-round feedback effects. For example, a reduction in domestic capital due to higher corporate taxes might have a compounding negative effect on labor productivity and wages, leading to a labor share of the corporate tax burden well over 100 percent. By extending the analysis over the long horizon, Carroll accounts for the full adjustment process in both capital and labor markets.

An article in the *National Tax Journal* provides an important contribution to the literature by analyzing the incidence of corporate income taxes under conditions of imperfect competition.[14] Using industry-level data, the authors estimate the extent to which changes in corporate tax revenue are passed on to workers in the form of reduced wages. Their findings suggest that labor bears a substantial portion of the corporate tax burden, even in industries where market structures deviate from the assumptions of perfect competition. The authors estimate that, on average, a $1.00 increase in corporate tax revenue is associated with a $0.60 reduction in wages across all industries. Importantly, their analysis highlights how the tax burden can vary based on industry characteristics, such as market concentration, capital intensity, and price-setting behavior.

Corporate Taxation and Consumer Prices

A 2020 National Bureau of Economic Research working paper investigated the effect of corporate taxes on retail prices at the firm level.[15] The analysis reveals a substantial pass-through of corporate taxes to consumers, suggesting that a significant portion of the tax burden is ultimately borne by those who purchase goods and services. The study estimates that, in their base case, consumers shoulder approximately 52 percent of the tax burden, while workers and shareholders bear 28 percent and 20 percent, respectively. An alternative specification with additional controls yields slightly different results, with consumer incidence estimated at 43 percent, worker incidence at 36 percent, and firm owner incidence at 21 percent. These findings suggest that the bulk of corporate taxes are passed through to consumers in the form of higher prices and to workers in the form of lower wages. In all specifications, shareholders bear only about one-fifth of the corporate tax burden.

One 2023 study examined the extent to which corporate taxes are passed through to consumers by analyzing granular gas price data and exploiting variations in corporate tax rates across different jurisdictions.[16] Its findings provide strong evidence that consumers bear a substantial portion of the corporate tax burden. The study estimates that approximately 64 percent of the corporate tax is ultimately passed on to consumers in the form of higher prices. Importantly, the researchers find that this pass-through effect is more pronounced when firms have limited access to tax planning strategies, face stricter tax enforcement, or operate in markets with less elastic consumer demand. These results highlight the significant effect of corporate taxes on consumer prices and emphasize the importance of considering market characteristics and firm-specific factors when analyzing the incidence of corporate taxation.

Revisiting Policy Assumptions on Corporate Tax Incidence

The assumptions used by institutions such as the CBO and the US Treasury regarding the distribution of the corporate tax burden have far-reaching implications for tax policy. For instance, the CBO assumes that capital bears 75 percent of the corporate tax burden, based on models that focus on capital as the primary tax base. However, this view may be outdated, especially in light of the growing body of empirical evidence indicating that labor bears a much larger share of the burden, particularly in open economies.

Recent research further challenges the outdated view that capital bears most of the corporate tax burden.[17] For example, one study, utilizing a local labor markets approach, finds that, once standard assumptions are made for the unobservable parameters, the incidence share borne by firm owners is close to 25 percent—far lower than the 75–82 percent share allocated by many government scoring agencies. This finding underscores the importance of reevaluating the conventional wisdom regarding corporate tax incidence.

Policymakers should reconsider these assumptions when designing tax policies. If labor bears a larger share of the corporate tax burden, as suggested by the empirical literature, then tax policies that disproportionately target capital may have unintended consequences for wage growth, consumer prices, and labor markets. Current revenue scoring conventions may underestimate the real-world distributional impact of corporate taxes on labor markets. If workers and consumers bear the brunt of these taxes, then corporate tax increases could be far more regressive than assumed, disproportionately affecting middle- and lower-income households.

A tax framework grounded in empirical incidence, not theoretical assumptions, would better align with economic realities.

About the Author

Jack Salmon is a research fellow at the Mercatus Center at George Mason University, where he focuses on economic and fiscal policy, with an emphasis on federal budgets, taxation, economic growth, and institutional analysis. His research and commentary have been featured in a variety of outlets, including *The Hill*, *Business Insider*, *RealClearPolicy*, *National Review*, the American Institute for Economic Research, and *Reason Magazine*. Salmon has provided expert analysis before Congress on the risks of debt accumulation, deficit spending, and inflation. Prior to rejoining Mercatus, he served as director of policy research at Philanthropy Roundtable, where he researched issues impacting the charitable sector and philanthropic freedom. Originally from the United Kingdom, Salmon earned his Master of Arts in political economy from King's College London in 2015.

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