DRAFT FOR DISCUSSION PURPOSES

Indirect Consequences of Taxation For Corporations and Individuals

1. Corporations

Corporate taxpayers may generally transfer their burden of taxes to consumers of their products and to the Federal government through deductions on their income tax returns. However, the timing of the transfer of tax payments varies with the type of tax imposed. Based on the time value of money concept, transfers currently are more valuable to the corporation than transfers in future years. Not all taxes allow a current transfer of the burden.

- **VAT, Sales Taxes & Excise Taxes**: These types of taxes for financial accounting and income tax purposes (uniform capitalization rules) must be added to the cost of the asset or product to which they are associated.

  Sales Tax Example — The sales tax paid on the construction of a building is added to the basis of the building. This cost is recovered by the corporation through depreciation of the building. The life of a commercial building for tax purposes is 39 years. Thus, it takes the corporation 39 years to transfer part of the sales tax burden to the Federal government.

  VAT Example— The VAT tax incurred by a corporation is added to the cost of the product being sold. It is passed on the consumer and deductible for tax purposes in the year the product is sold. This is not a problem when the products are produced and sold within the same year. However, when the products take more than a year to produce or the products are not sold in the year in which they are produced, the value of transferring the taxes declines. Also, there is a cost to tracking the VAT through a accounting and taxing system that is not trivial.

  Excise Tax Example—The excise taxes are considered part of the cost of the product. They are deductible for income tax purposes when the product is utilized by the corporation.

- **State Income Taxes and Business & Occupation Taxes**: These taxes are not required for accounting or tax purposes to be added to the cost of assets or products. Thus, they are currently deductible for Federal income tax purposes. How the tax cost is transferred to consumers will vary by corporation, based on their in-house costing methods.

Property Taxes: For financial accounting purposes these taxes are deductible in the year in which they are incurred. For income tax purposes, property taxes may be expensed in the current year or be required to be added to inventory costs under the uniform capitalization rules. If capitalized, the taxes are deductible when the inventory is sold. This can cause the same problems as VAT taxes discussed above. Further, the capitalization for income tax purposes but deductibility for financial purposes causes a book to tax difference. This difference must be shown on a corporation’s financial statements. Accountants must determine these differences and auditors must verify the book to tax differences, consequently adding to the costs of this tax.

Individuals
Theoretically, consumers pay a lower price when part of the corporate tax cost can be shifted to the Federal government.

Individual taxes that are currently deductible for Federal purposes: state income taxes, real property taxes, personal property taxes. A credit is allowed for fuel taxes paid on fuel used for non-highway purposes.