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NEW IDEAS FOR A DO-SOMETHING CONGRESS — NO. 9

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Reserve corporate tax cuts for the companies that deserve it

Americans are fed up seeing corporate profits soaring even as their paychecks inch upward by comparison. Companies need stronger incentives to share their prosperity with workers – something the 2017 GOP tax package should have included.

Though President Donald Trump promised higher wages as one result of his corporate tax cuts, the biggest winners were executives and shareholders, not workers. Nevertheless, a growing number of firms are doing right by their workers, taking the high road as "triple-bottom line" concerns committed to worker welfare, environmental stewardship and responsible corporate governance. Many of these are so-called "benefit corporations," legally chartered to pursue goals beyond maximizing profits and often "certified" as living up to their multiple missions. Congress should encourage more companies to follow this example. One way is to offer **tax breaks only for high-road companies** with a proven track record of good corporate citizenship, including better wages and benefits for their workers.

THE CHALLENGE:
GOOD CORPORATE CITIZENSHIP IS PUNISHED, NOT REWARDED, IN A MARKET THAT PUTS PROFITS FIRST.

The pressure to return profits to shareholders — the tyranny of so-called "shareholder primacy" - is one reason companies have been disinvesting in their workers. As Brookings Institution scholars Bill Galston and Elaine Kamarck have noted, many companies are increasingly reverting to "short-termist" behavior to avoid missing the quarterly earnings targets promised to shareholders.[1] For instance, one notable survey of more than 400 CFOs found that 80 percent would "decrease discretionary spending on R&D, advertising and maintenance ... to meet an earnings target" and 55 percent would "delay starting a new project" even if it meant sacrificing long-term value.[2]

Companies also don't seem to be raising wages or investing in worker training. Even as many firms have been reporting some of their best profits in years during this recovery,[3] companies are cutting back on benefits like health insurance and offering less on-the-job training than they once did.[4] And despite their recent uptick, workers' wages haven't caught up to where they should be. According to a Brookings Institution analysis, real wages for the middle quintile of workers grew by just 3.41 percent between 1979 and 2016, and actually fell slightly for the bottom fifth.[5]

Corporate short-termism is bad for workers, who don't get the wages and training they deserve. It's also bad for companies, which are shortchanging their long-term health to satisfy short-term shareholder demands. But as long as current corporate culture remains fixated on companies' stock prices, firms will feel tremendous pressure to put short-term profits above all other priorities — and often at workers' expense.

THE GOAL:
ENCOURAGE MORE BUSINESSES TO BE "TRIPLE-BOTTOM LINE" CONCERNS THAT PUT PEOPLE ON PAR WITH PROFITS.

A small but growing number of firms have begun to reject the hold of "shareholder primacy" and have organized themselves as "triple-bottom line" companies committed equally to social and environmental good as well as profit. Among these are the growing number of "benefit corporations" specially organized under state law with the purpose of "creating general public benefit."

Since 2010, 34 states and the District of Columbia have passed legislation legally recognizing benefit corporations and protecting them from shareholder lawsuits for decisions that don't maximize profits.[6] Notably, these states include Delaware,[7] which is the leading "domicile" – or legal home – for most of America's major companies. A significant number of benefit corporations have also won third-party certification from the nonprofit B Lab as "Certified B Corps" – essentially a Good Housekeeping seal of approval for benefit companies that have met strict standards for worker treatment, environmental stewardship and social responsibility. Among the many factors considered for certification are the share of workers who get formal training; rates of employee retention and internal promotion; the share of workers receiving tuition reimbursement or similar benefits for training and education; the extent to which "worker voice" plays a role in the company's governance; pay equity; and company practices to reduce its environmental footprint.

According to the nonprofit B Lab, more than 2,500 businesses globally are certified B Corps. While the vast majority of these businesses are small, certified B Corps include such well-known U.S. and global brands as outdoor clothing maker Patagonia, Cabot Creamery, Ben and Jerry's Ice Cream, and New Belgium Brewery, the makers of Fat Tire beer.[8] A small but growing number of B Corps are now publicly traded, including cosmetics company Natura; Sundial Brands, a subsidiary of Unilever; and Silver Chef, a company that finances commercial kitchen equipment purchases for restaurateurs.[9] These firms are proof that companies with an avowed social mission can in fact succeed in a cutthroat capital market. If more companies follow suit, the result could be a dramatic and beneficial shift away from the stranglehold of shareholder primacy and toward better corporate practices.

THE SOLUTION:
OFFER TAX BREAKS TO "BENEFIT CORPORATIONS" AND HIGH-ROAD FIRMS THAT DEMONSTRATE SOCIAL RESPONSIBILITY.

Many companies may feel they can't "afford" to invest in their workers if it affects the bottom line for their shareholders. Targeted tax cuts to reward high road companies such as certified benefit corporations could, however, change the calculus for some companies and encourage them to change their behavior. These tax benefits could be structured in one of two ways:

OPTION ONE: PREFERENTIAL TAX RATE.

As PPI has previously proposed, one option is to modify the new corporate tax rate to establish a preferential "public benefit corporation" rate for businesses that meet "high-road" requirements. Only the most deserving companies should qualify for the new 21 percent corporate tax rate; all others should pay a rate that is two to three percentage points higher.

To be entitled to these benefits, companies would meet one of two requirements: (1) that they be legally organized as "public benefit corporations" in their state and can provide good evidence of how they are fulfilling that mission; or (2) they must meet a minimum set of standards for worker treatment and investment, to be promulgated by a new standards-setting body authorized by Congress (effectively behaving like benefit corporations without the formality of legal status). To set the required standards, Congress could establish an inter-agency "workers' council," including representatives from labor and business, to establish guidelines for public benefit corporation rate eligibility (though enforcement would be left to the IRS). Companies would apply for a discounted tax rate in the same way that charities and nonprofits apply to the IRS for tax-exempt status, with the proviso that companies must also report annually on their performance, either in their public filings or in separate submissions to the IRS.

OPTION TWO: BENEFIT CORPORATION TAX CREDIT.

A second option for structuring a high road company tax incentive is to create a tax credit for benefit corporations like the "sustainable business tax credit" offered by the city of Philadelphia. Under this benefit, first launched in 2012, Philadelphia businesses that are either certified B Corps or that can show they meet similar standards of social and environmental responsibility can qualify for a tax credit of up to $8,000 against their revenues. Up to 75 firms can apply for the credit on a first-come, first-served basis.

This structure might be especially beneficial for small and medium-sized benefit corporations structured as "pass-through" entities not subject to the corporate tax rate. As Jenn Nicholas, co-founder of the Philadelphia-based graphic design firm Pixel Parlor told *Governing* magazine, the credit has helped her afford higher wages and other benefits for her 10 workers. "It's a challenge to be profitable and provide benefits to our employees," Nicholas said. "Every tiny bit helps, and it feels like somebody is looking out for us when the general climate [for small businesses] is the opposite."[10]

While some policymakers have proposed requiring companies to treat their workers more fairly, tax incentives for high-road businesses are a better approach. Top-down mandates tend to invite resistance or evasion and will not succeed in changing the overall spirit of corporate culture in favor of shareholders over workers. Encouraging companies to reform themselves will ultimately prove the more enduring tactic. As more businesses see that they can indeed "do good and do well," the grip of shareholder primacy will weaken, and workers will benefit.

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Endnotes

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2 Graham, John R., Campbell R. Harvey, and Shiva Rajgopa. *The Economic Implications of Corporate Financial Reporting*. N.p., 2005.

3 Bureau of Economic Analysis. "Gross Domestic Product, Third Quarter 2018 (Second Estimate); Corporate Profits, Third Quarter 2018 (Preliminary Estimate)." News release. November 28, 2018. Accessed March 28, 2019. https://www.bea.gov/news/2018/gross-domestic-product-third-quarter-2018-second-estimate-corporate-profits-third-quarter.

4 Kim, Anne. *Tax Cuts for the Companies That Deserve It.* Washington, DC: Progressive Policy Institute, 2018.

5 Shambaugh, Jay, Ryan Nunn, Patrick Liu, and Greg Nantz. *Thirteen Facts About Wage Growth.* Washington, DC: Brookings Institution, 2017.

6 B Lab. "State by State Status of Legislation." benefitcorp.net. Accessed March 28, 2019. https://benefitcorp.net/policymakers/state-by-state-status.

7 Title 8: Corporations, Delaware Code §§ CHAPTER 1. GENERAL CORPORATION LAW; Subchapter XV. Public Benefit Corporations-361-386 (2017).

8 B Lab. “Certified B Corporation: About B Corps.” Benefitcorp.net. Accessed March 28, 2019. https://bcorporation.net/about-b-corps

9 Id.

10 Kim, Anne. “The Rise of Do-Gooder Corporations.” *Governing*, Jan 2019.

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