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Taxing corporations: why it is not only bad, but unjust

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Introduction

In recent years the issue of how much taxes corporations pay (and how much they should) has become extremely salient in Western countries. The attention to this issue has been mainly raised by the investigations of three news organizations (the Guardian, the Telegraph and Reuters) on the corporate income tax paid by the subsidiaries of some major multinational corporations among those most appreciated by consumers, like Apple, Amazon, Facebook, Google or Starbucks. These investigations converged on the common observation that many of them paid for various years relatively low or no corporate income tax in their country of activity despite huge sales figures. This outcome was generally achieved by shifting their taxable profits to distribution hubs and/or regional headquarters in low-tax countries such as Ireland (for Europe) or Singapore (for Asia) thanks to the practice of transfer pricing.

These reports gave new arguments to tax-loving politicians and pressure groups and strengthened their allegation that corporations do not pay their "fair share". Hearings of the CEOs of the involved corporations were requested by parliamentary committees and some politicians could not resist the temptation to recur to the old name and shame game to show the appropriate level of outrage to their constituencies. This surely generated some reputational damage for the involved corporations. On that regard, the case of the subsidiary of Starbucks in the United Kingdom is eloquent. Fearing to suffer a loss of customers, its managing director decided that the subsidiary would waive, starting from

2013, all tax deductions relative to royalties and intercompany changes, this in order to pay a corporate income tax amount above what the law would require.[1]

This story puts the spotlights on the fact that, with few exceptions, the strategies used to reduce the taxable profits of subsidiaries were perfectly legal. For this reason, the latest years have been marked by an abundance of proposals to reform national tax codes to patch these alleged "loopholes". Among them, the Base Erosion and Profit Shifting package (BEPS) of the Organization for Economic Cooperation and Development (OECD) is the most alarming one because of its global ambition. Its aim is *to lay the foundations of a modern international tax framework under which profits are taxed where economic activity and value creation occur*.[2] To achieve it, the OECD issued recommendations on the way to determine where profits belong and on reporting requirements that corporations should comply with for taxing purposes. The implementation of this initiative would increment the share of taxable profits to be taxed in high-tax countries, and thus the overall tax burden for corporations. This is not an unusual outcome for recommendations coming from the OECD. In fact, this organization, originally created to collect and publish economic data, in the last decades morphed into a promoter of policies aimed to an increase of tax rates in low-tax countries benefiting the higher-tax governments that finance the organization (see Moriss and Lotta 2013).[3]

The OECD thereby assumes, without any substantiation, that the corporate income tax is both just and an efficient way for governments to collect revenue. This assumption raises many concerns. The purpose of this paper is to explain why. To do so, it is structured in three sections, with a conclusion. The first section analyzes the corporate income tax in the context of all tax revenues generated by business activity in OECD countries and exposes how corporate profits are taxed. The second section states some basic principles of just taxation and explains why the corporate income tax is incompatible with them. The third section adds that, even if a government is willing to compromise justice to increase tax revenues, the corporate income tax is an inefficient tool to achieve this aim. A conclusion states the recommendation to abolish the corporate income tax in order to foster both justice and efficiency.

[1] www.theguardian.com/business/2015/dec/15/starbucks-pays-uk-corporation-tax-8-million-pounds.
[2] http://www.oecd.org/ctp/beps-about.htm.
[3] The OECD appears to have two faces, with its economic research finding that tax avoidance arises from high tax rates (OECD 1998: 157), and that high taxes and high public spending tend to damage economic growth (Bassanini and Scarpetta 2001), while its tax division pushes for the cartelization of tax systems.

An overview on the taxation of business in OECD countries

Governments extract revenue from the activity of businesses in many ways. First, through taxes directly levied on them. The corporate income tax, or tax on corporate (net) profits, is one of these taxes. However, this tax only concerns corporations, i.e. businesses recognized as distinct from their owners. Other forms of business organization, like proprietorships or partnerships, are instead exempted from this tax because they are flow-through entities. This means that they directly pass profits through to owners who then pay tax under the individual income tax. Even if the corporate income tax is the most important direct tax levied on (some) businesses, they often also pay other direct taxes, for example on payroll and workforce, on their property, or on their net wealth.

Second, all businesses pay significant social security contributions in almost all countries.[4] Those contributions are generally considered as additional taxes, including by the OECD, since they are compulsory unrequited payments to the government which, moreover, increase the cost of labor for businesses. In this regard, it should be noted that there is no real difference between employers' and employees' social contributions because both are paid by the product of business activities (see Salin 2014).

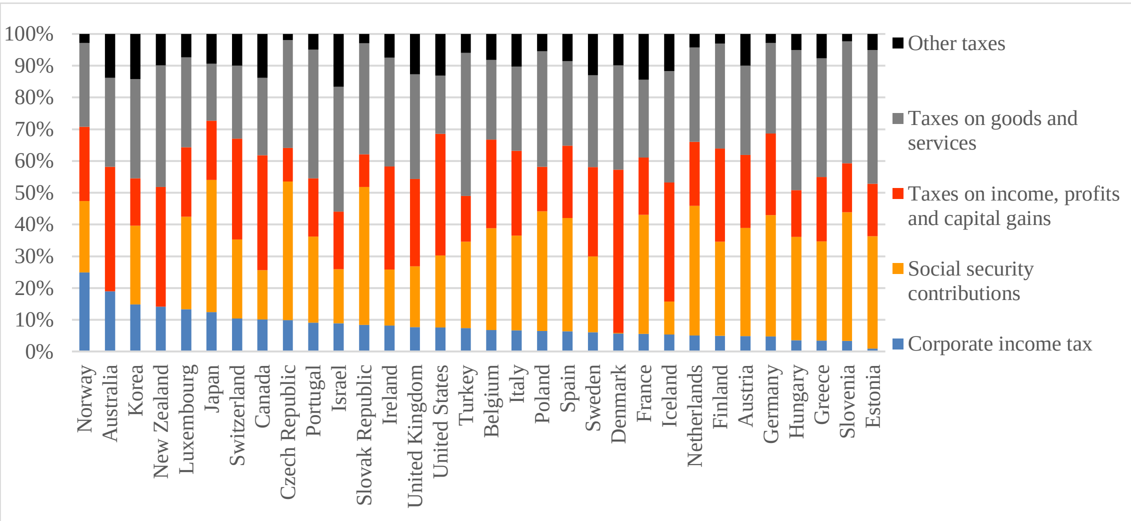
Third, governments also extract revenue from business activity through the taxation of the income of individuals. We already mentioned that non-corporations directly pass profits through to their owners who then pay tax under the personal income tax. However, the wages, dividends and interests paid by businesses generate additional tax revenue for governments by increasing the taxable personal income of a corporation's beneficiaries (employees, shareholders and lenders respectively).[5] It is important to stress that dividends are nothing more than the after-tax corporate profits distributed to shareholders. Thus, unlike the profits of pass-through entities, the profits made by corporations aliment the revenue of both corporate and personal income taxes. The relative contribution of corporate profits to the revenue of each of these taxes diverges by country because, in order to mitigate the double taxation of capital income, many countries reserve a privileged tax treatment to either capital income or dividends (or both). We will return to this issue later.

[4] Australia, New Zealand and Denmark are three notable exceptions among OECD countries.
[5] Furthermore, shareholders and lenders also nourish public treasuries when they sell their valorized stocks and bonds, respectively, in countries that still levy a tax on capital gains.

Finally, the last way in which governments extract revenue from the activity of businesses is through taxes on goods and services like the value-added tax (VAT). Without opening the debate on the exact incidence of such taxes (i.e. who, between the seller and the buyer, take on which share of the burden) it is evident that the revenue of these indirect taxes would be lower in absence of the products sold by businesses.

The main insight to be drawn from the first part of this section is that the corporate income tax is, by far, not the only tax contribution of corporations to governments. One may even claim that any source of tax revenues somewhat owes to business activity. In particular, it should be noted that the tax revenue levied through the corporate income tax are only a small part of all the tax revenue levied by OECD countries (see table 1). In fact, the revenue of this tax rarely represents more than 10 percent of the total, and in many countries much less.[6] This may explain why governments were not very worried by the relatively low taxes paid on profits by major corporations before this was made public and became a political issue. Their social security contributions, the individual income tax levied on the wages of their employees and the revenues generated by the VAT on Frappuccinos and other goods or services were probably more than enough to make of these corporations an asset for the governments of the countries in which they operated.

Table 1: Tax revenues as a % of total taxation in 2012 by OECD countries

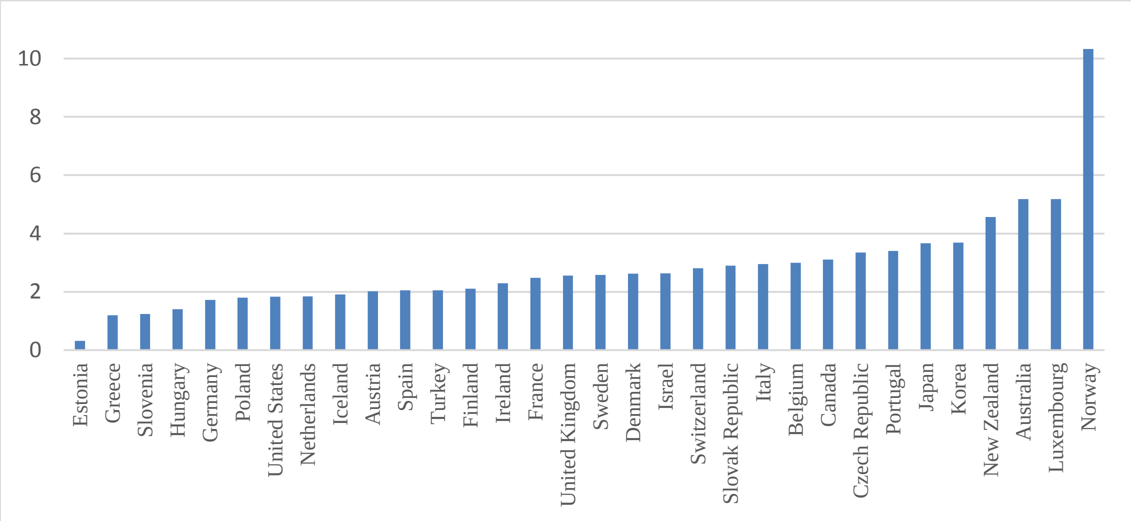


Source: OECD (2016), "Revenue Statistics: Comparative tables", *OECD Tax Statistics*. Data for 2012 are the most recent non-estimation data available in 2016. Mexico and Chile are not reported because of unavailable data.

[6] Even in Norway, where the profits of oil companies strongly contribute to the public treasury, the corporate income tax does not exceed 25 percent of all tax revenues.

It should also be noted that the corporate income tax is not only a source of revenue for governments. From the perspective of corporations and capital owners, this tax is also a burden. The remainder of this section provides some complementary measures of this burden. The revenues levied by countries through the corporate income tax, expressed as a share of their GDP, is a simple measure of its burden for corporations. According to table 2, after the exclusion of Norway, an outlier because of its reliance on oil extraction[7], this tax burden varies between 5.2 percent (Luxembourg) and 0.3 percent (Estonia).

Table 2: Revenue of the corporate income tax as % of GDP (2012)



Source: OECD (2016), "Revenue Statistics: Comparative tables", *OECD Tax Statistics*. Data for 2012 are the most recent non-estimation data available in 2016. Mexico and Chile are not reported because of unavailable data.

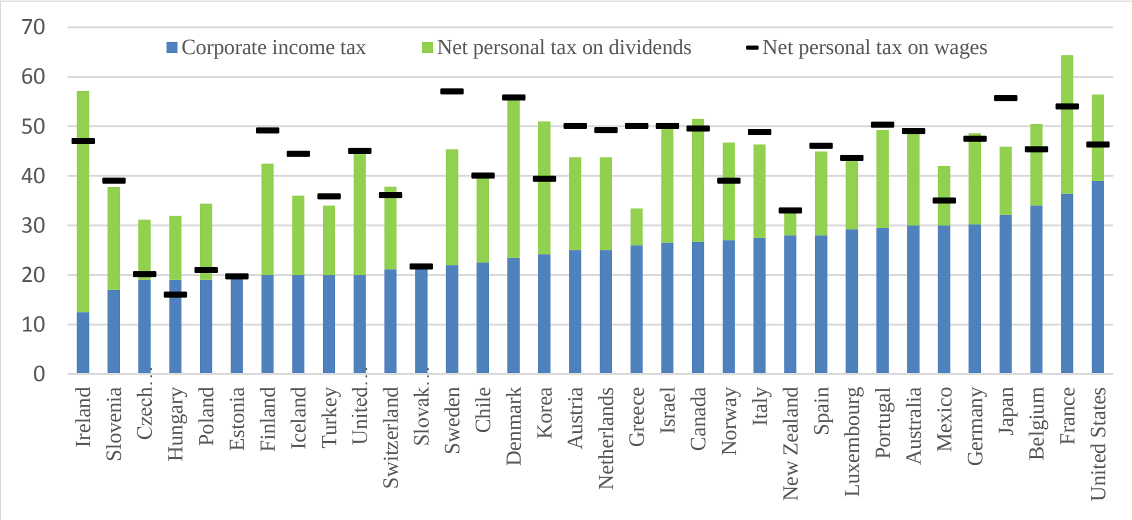
Readers should be aware that this does not mean necessarily that corporate profits are the least taxed in Estonia and the most in Luxembourg. In fact, the tax burden on corporations due to the corporate income tax in a country depends to a large extent on the contribution of corporate income to its national income. The higher this contribution, the higher, *ceteris paribus*, the relative burden on corporations due to the corporate income tax. In particular, countries which shelter more profitable corporations tend to levy more tax revenue through the corporate income tax even if they apply a lower tax rate.

In addition, this first indicator only measures part of the taxes levied on the profits of corporations; in fact, these profits may be taxed twice: first as corporate income and later as dividends. A way to account for this situation is using a second indicator, i.e. the

[7] The figures of New Zealand and Australia are largely inflated by the exploitation of natural resources too.

overall (corporate plus personal) top marginal tax rate on distributed profits. This rate equals to the share of distributed profits that, because of either the corporate or the personal income tax, fails to reach the shareholders. Thus, it is an ideal measure of the share of capital income captured by governments. Table 3 reports these rates for OECD countries and distinguishes between the part of the distributed profits captured by the corporate income tax (blue columns) and the part captured by the personal income tax (green columns). In addition, it compares the overall top marginal tax rates on distributed profits with the top marginal tax rate applied by these countries to the income from wages (black lines).

Table 3: Overall (corporate plus personal) tax rates on distributed profits (2015)



Source: OECD (2016), "Revenue Statistics: Comparative tables", *OECD Tax Statistics*.

Table 3 shows that the overall tax rates on distributed profits varies from a minimum of 20 (Estonia) to a maximum of 64.4 (France). This means that, for identical profits, a French shareholder of a French corporation is taxed over three times more on its capital income than an Estonian shareholder of an Estonian corporation. One may readily imagine the different incentives for investment in these two countries. The median share of distributed profits captured by governments in OECD countries is 44.1 percent.

In many countries the overall top marginal tax rate on distributed profits is close to the top marginal tax rate on wages. This is due to the fiscal policies adopted by many governments to mitigate the double taxation of capital income. Without going into the technical details of these policies (for that, see Harding 2013), many countries typically allow either corporations to reduce their taxable income based on how much profits they distribute as dividends or attribute dividend tax credits to shareholders based on the taxes already paid on their behalf by corporations.[8] When distributed profits or paid taxes are fully deducted, double taxation is neutralized. Otherwise, it persists, often in a mitigated form (for instance, in the United States, France and Ireland). In addition, some governments also aggravate the double taxation of capital income by levying a surtax on dividend income. For completeness, we should also note that in a few countries (e.g. Sweden), wages are taxed more than capital income.[9] This inequality of treatment is morally questionable just as double taxation is. The next section will elaborate on this.

Another noteworthy observation is that the distribution of the overall marginal tax rates on capital income between the corporate and the personal income tax is far from being identical between countries. Some countries tax capital income more heavily through the corporate income tax, while others do it through the personal income tax. When shareholders and the corporation are in the same country, this distinction is anecdotal. For these "domestic" shareholders what matters is only which share of the distributed profits finally arrives (and stays) in their pockets. In a globalized world, these differences assume a completely different importance. When a corporation operates in a country different from those in which its shareholders reside, this may rapidly generate an (international) double taxation. In fact, some countries assign no dividend tax credits based on (foreign) taxes paid on corporate income, and these countries often apply a discounted reduction or limit the tax credit to the corporate income tax that the corporation would have paid in the country of residence of the shareholder.[10]

For this reason, corporate income tax rates are an important criterion when a corporation has to decide where to locate. Thus, it is worthwhile to end this section by examining the corporate income tax rates applied in OECD countries. Among them, Ireland stands out with its 12.5 percent rate. This rate is also low in international comparison given that, according to the corporate tax rates table of KPMG[11], this tax is absent only in some small islands (i.e. the Bahamas and the Cayman Islands) and in

[8] Estonia only levies taxes on distributed profits.
[9] The case of Greece is particular. In this country the tax rate on capital and wage incomes were identical until 2009, i.e. before its debt crisis led to a desperate massive hike of personal income tax rates.
[10] The double taxation of capital income is also reinforced by the withholding tax levied by some states on the dividends distributed to foreign shareholders.
[11] https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html. Visited the 6 May 2016.

Bahrein. In addition, the lowest top tax rate in a country with a corporate income tax (9 percent in Montenegro) is not far. On the other side of the spectrum, there is the United States with a 39 percent rate. This rate is rather impressive because, according to the aforementioned source, only the United Arab Emirates have a higher rate.

It should be noted that in countries with a decentralized tax system, the top marginal tax rate may vary depending on the federated state considered. When it is the case, the table reports the top marginal tax rate applied in the economically most significant state. For countries like Switzerland, this has severe implications. In fact, in this country the top marginal tax rate varies substantially (from 12.3 to 24.1 percent) depending on the state considered. The reported figure of 21.1 percent refers to Zürich. Other major Swiss business centers such as Geneva (24.1 percent) and Basel (22.1 percent) lie above that value, whereas yet another important corporate hub, Zug, lies at 14.1 percent.[12]

This section illustrated the contribution of corporations to the tax revenue of governments and the way in which their profits are taxed by them in OECD countries. This presentation has raised two points of interest. First, it illustrated the ancillary role of the corporate income tax in the financing of governments. This increases the saliency of a question: is it worth it? In fact, when a tax levies little revenue, it becomes all the more important to make sure that the deadweight losses that it causes are not disproportionate in comparison with the fiscal gains. The third section will examine this efficiency dimension. In addition, this first crucial observation provides support to the feasibility of an immediate removal of this tax (action that this paper will precisely recommend in its conclusion), since it would not be an insurmountable challenge for public budgets.

Second, this section showed how the taxation of capital income through the combination of a corporate income tax and the taxation of dividends as personal income tend to generate a double taxation of this income and lead to important fiscal complexities. In view of this, one may wonder what makes so necessary to have two different taxes on capital income. The next section tries to give an answer to this question by investigating the moral arguments behind the direct taxation of corporations. Unfortunately for the advocates of the corporate income tax, this discussion will show how this tax is not only deprived of any justification, but also the cause of many injustices.

[12] https://assets.kpmg.com/content/dam/kpmg/pdf/2016/05/ch-clarity-on-swiss-taxes-2016-de.pdf.

Why is the corporate income tax unjust?

Any assessment of the just nature of a tax may not avoid making a first reference to the controversy on whether taxation may be moral at all. In fact, its morality is contested by many thinkers (see, for instance, Chodorov 1962 and Rothbard 1982). Their argument may be summarized as follows: since the compulsory nature of taxes requires to transgress the property rights of individuals in order to collect them, this act is nothing more than theft or robbery. It does not matter for what noble cause this is done or the way in which taxation is decided (e.g. by the vote of a majority). The violation of the non-aggression principle is enough to qualify taxation as immoral and to legitimate tax resistance. If one agrees with this argument, any action resulting in less taxes being paid, such as the abolition of a tax or even its avoidance is a step toward more justice.

This claim is far from being consensual given that other thinkers consider that, under some more or less restrictive circumstances, taxes may find a moral justification. It is not the purpose of this paper to discuss the merits of each of these philosophical perspectives. However, it is evident that rejecting the corporate income tax solely on the ground that it is a tax is likely to leave many readers unconvinced. A more mainstream argumentative path consists into assuming, in a completely agnostic way, that taxation is necessary to raise a certain amount of revenue for some definite reasons[13], and then ask the following question: what is the most equitable way to spread its burden?

Economists generally cite two main principles that may help judging the justice of a tax system: the benefit principle and the ability-to-pay principle. The benefit principle states that individuals should pay taxes based on the benefits that they derive from the services provided by the government. According to this principle, a fair tax system should then make sure that whoever derives a benefit from these services pays for them accordingly. For its part, the ability-to-pay principle states instead that individuals should pay taxes based on their capacity to shoulder their burden. Two notions of justice are often derived from this second principle. The first notion, horizontal justice, is the idea that a fair tax system should demand an identical effort from individuals with the same ability to pay. The second notion, vertical justice, is the belief that individuals with a greater ability to pay should pay more taxes. Unlike the former, this second notion is controversial because there is no real consensus on how much (and whether) more

[13] A typical invoked reason is to finance public goods.

prosperous individuals should pay more and if they should pay a larger fraction of their income or a larger nominal sum.

At a first examination, one may naïvely conclude that the corporate income tax answers to the imperatives of justice set by both the benefit and the ability-to-pay principles. Mentioning the first principle, a sponsor of this tax may claim that it makes corporations pay their just part for the many services provided by governments (i.e. public security, transport and communication infrastructures or courts) that they regularly use in their activities. Referring to the second principle, this same sponsor may instead argue that the corporate income is the equivalent of the individual income and a good approximation of the capacity to pay of a corporation. Thus, a corporation should be taxed proportionally to this income. In addition, if this sponsor is an adept of progressive taxation, he/she may even argue that, since many corporations realize an income much larger than most individuals, the tax rates applied to their income should be steeper.

These arguments are plainly wrong because they ignore the crucial fact that corporations are, obviously, not individuals. Corporations are nothing more than a sum of contracts between many individuals (owners, shareholders, lenders, employees, clients and suppliers) brought to interact with one another by their own interest. In fact, corporations act as screens between an economic activity producing (in the hopes) an added value and the individuals that will, at different stages, share it. This has two entwined implications. First, the whole value created by corporations is sooner or later transferred to various individuals, may it be as dividends (for owners and shareholders), interest payments (for lenders), wages (for employees) and payments for the provided goods and services (for suppliers). Second, corporations as such do not pay taxes. This is a cardinal rule of the tax incidence analysis performed by economists. In fact, at the end of the day the burden of any tax levied on them has to be carried by an individual.

Acknowledging the abstract nature of corporations permits to shed new light on the two aforementioned arguments in favor of a tax on corporate income. First, the claim that corporations derive benefits from the services of governments is inaccurate. In reality, the ones that eventually reap these benefits are the individuals who create and make a corporation an economic entity. Thus, assuming that income is a good measure of the benefits that one derives from the services provided by the government (and this has to be demonstrated), individuals who get a significant part of their personal income from the economic activity of corporations already pay their fair share to state treasuries through the taxation of their personal income.[14] Second, corporations have no own ability to pay because each single part of their income rightly belongs to individuals.

This second point raises a follow-up question: if corporations have no ability to pay, who pays their taxes? Even if economists who studied the issue initially claimed that the burden falls only on capital owners (Harberger 1962), today only few economists think that this is the case; most acknowledge that the corporate income tax influences the decisions of firms and capital owners in a way that affect wages and prices. For instance, Slemrod (1995) reports that, in a 1994 survey, more than 70% of the surveyed tax professionals believed that the corporate income tax was largely passed on to consumers and workers. Similarly, Fuchs et al. (1998) observes that, in 1996, the mean estimate of the incidence of this tax falling on shareholders among the public finance specialists of 40 leading economics departments in the United States was only of 41.3 percent. In general, the economic literature on the issue *offers no clear picture of which factor of production bears the burden of the* [corporate income] *tax; reasonable estimates of the share borne by labor range from none to over 100 percent* (Harris 2009: 2).

If the burden of the corporate income tax is not solely carried by capital owners, it means that there is double taxation of income even in countries where the overall top marginal tax rate on distributed profits and the top marginal tax rate on wage income are identical. However, this double taxation does not fall anymore on capital income and, thus, shareholders. Instead, it strikes the income of workers that have their wages diminished because of the existence of the corporate income tax and then successively taxed through the personal income tax. One may even argue that these individuals are triple taxed because, as consumers, they pay another share of the corporate income tax through a diminution of the purchasing power of their wages due to a higher price for goods sold by corporations. Given that two individuals with the same personal income would carry a different tax burden only because one derived it from wages and the other from dividends, the corporate income tax is clearly incompatible with horizontal justice.

The outcome does not improve much if the burden of the corporate income tax only falls on capital owners. In this case, horizontal justice fails to be observed in all the countries that do not equalize perfectly their overall top marginal tax rate on distributed

[14] As a side note, if matching services received and their funding were really the desired outcome, this could be done much more efficiently with market prices, i.e. by making users pay according to their use of a service.

profits with their top marginal tax rate on wage income. Table 3 in the first section showed that this is frequently the case. In addition, horizontal justice also fails to be respected when capital income is overtaxed because of the international double taxation.

Some advocates of the corporate income tax claim that the double taxation of capital income is a desirable outcome. Their core argument is the following: since this double taxation increases the tax burden carried by shareholders who – so goes the argument – have higher incomes, it makes the tax system more progressive and promotes these advocates' own conception of vertical justice, i.e. a conception that requires higher tax rates for higher incomes. The desirability of a strong progressivity in a tax system is debatable. However, their argument also involves two fallacies. First, as stated earlier, it may not be excluded that the burden of the corporate income tax falls, at least in part, on labor and consumers. Thus, if the aim is to overtax shareholders, this tax is a poorly calibrated tool for this purpose. Second, to equate shareholders with wealthy individuals is pure demagoguery. Not only middle-income workers may hold shares (for instance in the corporation for which they work), but they surely hold shares through he intermediary of their pension fund. Applying a corporate income tax means that part of the income of these individuals is taxed at the same tax rate than the income of much wealthier individuals. Thus, this would not contribute at all to having more vertical justice. More generally, we cannot avoid observing that when the incidence of a tax is largely unknown, as in the case of the corporate income tax, justice cannot be achieved by purpose, but only by accident.

Why is the corporate income tax (more) inefficient (than other taxes)?

The previous section showed that it is difficult to provide a moral justification to a tax on corporate income. However, one may be tempted to still defend its existence with the argument that, in years of spending profligacy like ours, governments need any tax revenue that they may grab. This argument may have some leverage among citizens because of its pragmatism and dedication to such a noble goal as budgetary balance. However, the rationale on which this argument relies is plagued by the fallacy already described by the French politician and economist Frédéric Bastiat (1863) in the 19th century: it considers what is seen while it ignores what is not seen. In fact, the mentioned argument focuses on the revenue levied by governments through the corporate income tax while ignoring the deadweight costs imposed to the economy by the distortions, i.e. welfare-destroying changes in the behavior of economic actors, that this tax generates.

To be fair, any tax creates distortions. For instance, proportional income taxes create two main distortions. First, they disincentivize, through an effect of substitution, the activities generating the same income that they tax. On the one hand, taxing work income decreases the work effort of individuals because it diminishes the opportunity cost of leisure. Trivially, the less income after taxes work provides, the less it is worthwhile to work. On the other hand, taxing capital income decreases investment because, by reducing the expected returns of investments, it reduces the opportunity cost of consumption.[15] Second, especially when taxes become excessive, they incite taxpayers to spend part of their scarce resources in tax avoidance and/or tax evasion efforts. This has negative consequences for the welfare of a country because it diverts part of the activity of individuals and firms from production to accounting matters.

A recent review of the empirical studies estimating the cost of these two distortions in the United States (Saez et al. 2012) suggests that they represent between 0.12 and 0.40 U.S. dollar per dollar of revenue raised through the federal income tax.[16] Other empirical studies have estimated the deadweight losses due to the corporate income tax. Even if the estimates vary significantly, the general consensus is that the cost per dollar of raising revenue through the corporate income tax is much higher than the cost per dollar of raising revenue through the personal income tax (for a review, still pertinent today, see Gravelle 1994). This is due to the corporate income tax generating additional distortions. In the next short subsections, we will present and discuss the more problematic among them.

Choice of organizational form

As previously mentioned, businesses may organize either as flow-through entities or as corporations. Sometimes, because of double taxation, the profits of flow-through entities may end out being much less taxed than the profits of corporations. This is distortionary because businesses that would be more productive in a corporate organizational form, e.g. due to limited liability and the possibility to raise capital through

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[15] Income taxes also have an effect of income that may potentially neutralize the effect of substitution. On the one hand, taxes may incite individuals to work more in the try to counteract the loss of income due to them. On the other hand, taxed individuals may reduce their consumption instead than reduce their savings. However, empirically the effect of substitution tends to outdo the effect of income.

[16] However, it should be noted that some scholars, using a less restrictive definition of tax avoidance, obtain much larger figures (see Feldstein 1999).

stock markets, may renounce this economically sound option because its potential benefits are offset by the heavier taxation of corporate profits. However, it is important to note that some industries can organize themselves as flow-through entities more easily than others. Industries requiring large amounts of capital coming from many investors (e.g. manufacturing or telecommunications) may find it compelling to organize themselves as corporations. Thus, since investors only consider after-tax expected profits when investing, the corporate income tax reduces the attractiveness for them of these industries compared to industries mainly organized as flow-through entities. This has the result of leaving unfinanced profitable investments because of the higher after-tax attractiveness of less profitable investments. This is likely to generate a much larger deadweight loss than the simple renunciation of a particular corporate organizational form.

Corporate finance

Corporations may finance their investment either by equity financing or by debt issuance. The leverage obtained through debt is beneficial for corporations because it increases the financial resources at their disposal for profitable investments. However, since it implies fixed interest payments, debt issuance has a higher financial cost for corporations than equity financing. This cost increases with the debt load given that it tends to equate with a higher risk of bankruptcy. In their pursuit of maximum profits, corporations try to find and adopt their optimal capital structure, i.e. the equity-debt ratio which equalizes the marginal cost of debt with its marginal benefit. In this context, the corporate income tax has the undesirable effect of making debt issuance artificially cheaper than relying on equity financing. This is due to the fact that while regularly taxing equity payouts, corporate income tax legislation typically allows the deduction of the interest paid on debt, although often only in part and under more or less stringent conditions. By doing so, it adds some tax benefits to the aforementioned broader economic benefit of debt issuance.

This tax-induced cheapness of debt has four consequences (Norton 2008). First, it drives corporations into relying on debt more than they would have done without this tax (see Feld et al. 2013 for the empirical evidence). A riskier capital structure increases the risk of bankruptcy of corporations. However, it also has macroeconomic implications since, as observed by the International Monetary Fund (IMF 2009), an excess of leverage by corporations may lead to more severe boom-and-bust cycles.[17] Second, it favors investment in assets that are easier to finance by debt because they represent good collaterals for loans, such as buildings and infrastructure. This is inevitably to the detriment of investments in more intangible, but sometimes more profitable assets like patents or human capital. Third, because of these factors, the tax-induced debt cheapness makes corporations that mainly rely on more tangible assets artificially more profitable than those relying primarily on more intangible assets. Finally, the corporate income tax disadvantages startups because they encounter more difficulties than established corporations in obtaining loans at acceptable interest rates.

Tax privileges

The corporate income tax does not apply equally to all corporations. The most evident deviation from their equal treatment is targeted tax rates in favor of certain corporations. This special treatment often concerns corporations qualified as "small businesses", active in specific economic branches and/or located in specific regions. First, small businesses often benefit of lower tax rates because governments consider them as unduly penalized by other factors (e.g. low visibility among highly skilled workers or lack of economies of scale) in competition with larger entities. Second, industries considered at risk of closing or relocating may receive a special tax treatment to avoid the consequent job losses. Contrariwise, captive industries, i.e. those unlikely to delocalize, may be taxed more heavily. This is often the case of industries active in the extraction of natural resources in mining countries. Finally, governments may also grant a lower tax rate to corporations that locate in less developed regions.

These preferential tax rates create distortions that result in important welfare losses for society. To start with, targeted tax rates for small businesses disincentivize these businesses from assuming their most productive size because losing the status of "small business" may cost them more than the potential pre-tax profit gains (Nicodème 2009). In addition, because of the same mechanisms described in the previous subsection, these targeted rates artificially change the relative profitability of industries that fit more or less well to the size defining "small businesses". The alteration of the profitability of different industries is even more evident when rates explicitly discriminate between them. This may

[17] In addition, there is some evidence that debt bubbles are followed by deeper recessions and slower recoveries than equity bubbles (Jordà et al. 2015).

lead to excessive investment in privileged industries (often obsolete and failing ones) and insufficient investment in emerging, innovative industries. Finally, tax rates discriminating between regions may incite corporations to hamper their pre-tax productivity and competitiveness by locating in regions less adapted to their economic activity.

Unfortunately, targeted tax rates are only the tip of the iceberg concerning tax privileges. To be levied, the corporate income tax requires a clear accounting definition of the taxable income of a corporation in a given year. Tax codes seek to achieve this by defining in detail the statutory depreciation rates applicable to all kind of assets and all typical business expenses that are deductible from the gross corporate income to determine taxable income. The definition of statutory depreciation rates is problematic because often, voluntarily or by accident, the legal allowances deviate from the actual economic depreciation of the underlying assets, and this is not in a uniform manner between assets (OECD 2007). This may create two kinds of distortions. First, it incentivizes corporations to invest in assets that benefit from a larger positive gap between their statutory depreciation allowances and their actual economic depreciation. Because of that, investment in some profitable assets may be overridden by investment in less profitable, but more tax-friendly assets. This maximizes the after-tax profits of a corporation while reducing its economic output. Second, it favors industries that rely more on assets that benefit from a favored tax treatment.

Lobbying

Some may argue that distortions due to tax privileges are largely offset by their positive influence on the economic decisions of corporations. Typically, one may claim that a country is better-off with an economic structure based on small businesses instead of large corporations, without a dominant industrial sector, and/or with economic activity spread over the entire national territory. Similarly, tax depreciation allowances may be seen as a way to push corporations into investing in more socially desirable assets or in replacing more rapidly their assets for macroeconomic reasons. The problem of this vision is that, unfortunately, tax privileges are strongly determined by the lobbying efforts of different groups of corporations (Richter et al. 2009). In fact, given that a favorable tax treatment may generate more after-tax profits for corporations than their economic activities, businesses are the most likely to care about tax privileges and try to influence them. While profitable for the corporations thriving in it, lobbying is an unproductive activity that requires them to distract their scarce resources from value creation. Thus, it represents a welfare loss for society as a whole.

Conclusion

This paper has shown that the taxation of corporations lacks both a moral and economic justification. As a bundle of contracts a corporation as such does not pay taxes. The tax burden falls inevitably on its employees, customers, shareholders or suppliers to an extent for each group that cannot be determined. The idea therefore that corporations should pay their “fair share”, or more taxes, is at best negligent. Calls by the OECD and other bodies to standardize corporate tax rules and increase tax revenue in high-tax countries in effect would equate to calls for higher prices for consumers, lower wages for workers and lower returns for pension funds. Corporate taxes also depress available capital for investment and therefore productivity and wage growth, holding back purchasing power. In addition, the deadweight losses arising from corporate income taxation are particularly high. They include lobbying for preferential rates and treatments, diverting attention and resources from production and wealth creation, and distorting decisions in corporate financing and the choice of organizational form.

As Europe seeks to restore economic growth, there would be no step more justified than abolishing corporate taxes altogether. (The taxation of dividend income, for its part, could be equally questioned.[18]) For corporations, compliance costs would be eliminated, restoring economic incentives to a range of entrepreneurial and management decisions. Abolishing corporate taxation would also improve honesty and accountability in public governance by making the true costs of the public sector (which does not benefit from market discipline) better fathomable. The immediate and long-term economic benefits of such a move would far outweigh the short-term political costs. Given that the corporate income tax typically represents less than 10 percent of overall tax revenues, it would not be such a challenge to adjust public spending in the face of unprecedented profligacy in recent years. Further, more economic activity generated by higher reinvested profits would inevitably translate into more personal income and consumption tax revenue (which could be addressed by lowering tax rates on personal income and consumption,

[18] Dividend income arises from investments generated by savings. These savings in turn stem from income that has been already taxed as such. As a reward for risk-taking and a reflection of personal time preferences dividends therefore need not be taxed to ensure the consistency and transparency of the tax system. In fact the taxation of dividends is an unwarranted additional burden on economic activity and entrepreneurship.

freeing up more resources for productive uses), in addition to increasing economic well-being for the entire population. This would be all the more important in less competitive countries facing high unemployment and out-of-control public spending structures. Abolishing the corporate income tax would help to restore budget balance through increased productive economic activity.

Again, given that corporations are merely contracts bundled together to generate wealth, there is no valid reason to tax profits. On the contrary, corporate taxation reduces the justice of the tax system and leads to less efficiency in both the economy and the public sector. In addition, the corporate legal status makes it highly unlikely that corporate vehicles could be used to avoid personal income taxes, as is sometimes argued. In definitive, there is no compelling reason to further delay the abolition of the corporate income tax. This reasonable reform of the tax code would enhance equality before the law and the democratic principles of taxation. Furthermore, it would be beneficial for all parties involved, in particular job seekers and low-income households who have the most to gain from higher economic productivity.

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