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Darwin & Corporate Taxation – Has the Evolution of the Economy Killed the Basis for Corporate Taxation?

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Darwin's theory of evolution states that complex creatures evolve from more simplistic ancestors, while natural selection ensures that only the fittest survive and the others become evolutionary "dead-ends". The aim of this blog contribution is to address the need to discuss whether or not corporate taxation is an evolutionary dead-end or a highly complex creature (mutation) with a superior advantage prior to changing the current international framework for corporate taxation as addressed by the OECD in the ambitious BEPS project and by the European Commission ("Commission"). The basis for the discussion is the Commission's release from June 17 2015 titled "*A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*".[1] As the title implies, the Commission addresses some of the challenges in the international framework for corporate taxation.

The Commission states that corporate taxation is an important source of revenue for every Member State and that on average 6.5 per cent of the Member States tax revenue came from corporate taxes in 2012 – i.e. 93.5 per cent of the tax revenue was collected from other sources than corporations. The percentage of the tax revenue that came from corporations in the Members States has ranged between 6 and 8.4 per cent from 1995-2012.[2] Despite these stable numbers, the Commission claims that the corporate tax revenue should have increased due to (i) broadening of the tax base, (ii) increased incorporation[3] and (iii) low interest rates and thereby lower deductions. The Commission's explanation of the lack of an increasing rate is that certain companies might be paying far less tax than the statutory tax rate by engaging in aggressive tax planning. This opinion seems to be in line with the current paradigm *Base Erosion and Profit Shifting*, and the popular belief that corporations do not pay enough taxes.[4] The argument is therefore used to suggest amendments to the international framework for corporate taxation, such as the implementation of the CCCTB, changing the definition of a permanent establishment, improving the CFC-rules, and improving the TP framework etc.

However, before going into a further *complex mutation* of the international framework for corporate taxation it would be worth asking if these numbers really show that corporate taxation is an important source of revenue for every Member State, and that the lack of an increasing tax revenue from corporation as a percentage of the total tax revenue is due to aggressive tax planning. The OECD average tax revenue from corporate taxes of 34 countries was 8.5 per cent in 2012.[5]

Further, the OECD average in those 34 countries has ranged between 7.2 and 10.5 per cent (mostly between 7.5 and 9.5 per cent) between 1965-2012, thereby supporting that since 1965, on average, less than 10 per cent of the tax revenue has come from corporate taxes.[6] These rates thus seem to have been quite stable over those 50 years – thereby implying that more than 90 pct. of the tax revenue in these developed countries has always come from other sources than corporations.

However, it seems clear that the international framework for corporate taxation is challenged by the evolution of the economy and the way we do business in the modern world, since corporate taxation is an important factor in influencing business decisions and therefore can result in unintended distortions and costs. As stated by the Commission, it was only as the economy evolved and trade became more globalized that the cracks in the system started appearing,[7] i.e. the evolution in the economy and trade must entail an evolution of the corporate tax legislation. But in order to find solutions for the continuous evolution of such a complex creature as the international framework for corporate taxation one must also rethink the creature itself and ask *what corporate taxation really is*.

A corporation is a legal entity recognized in the law as a separate juridical person. However, having the legal status of a person does not mean that a corporation can feel pain or pleasure like a *real* person. Neither can a corporation bear the economic burden of a tax.[8] This pleasure (or pain) of a tax burden exclusively applies to *real* persons – not phenomena such as a corporation – whether or not we pretend otherwise in a legal context. The misunderstanding that the corporate tax is borne by corporations seems to be the reason behind the tendency of supporting a (higher) corporate tax among the public and some politicians, while economists are much less excited about corporate taxation, among other things due to the uncertainty about who really bears the tax burden, distortions and costs.[9] So *who* are really taxed and *why* are corporations taxed? The answer to that question should be the starting point for discussing and evolving a *Fair and Efficient Corporate Tax System*. However, the problem is that the answer is not clear.

According to *professor Kimberly A. Clausing* economists have for generations discussed who actually bears the burden of a corporate tax, and all corporate tax incidence models that have appeared throughout the years have failed to reach a clear consensus on the question.[10] This is also supported by *Ben Southwood, Head of Policy at the Adam Smith Institute*, who argue that there is nothing like consensus among economist on how the burden of corporate tax is divided between capital (investors), wages (labor) and prices (consumers).[11] We simply do not know *who* actually bears the burden of a corporate tax.

But then *why* impose a corporate tax *in the blind*? Is it because of the misguided belief that corporations can bear the burden of a corporate tax? *Professor Reuven S. Avi-Yonah* argues no, but acknowledges that the usual arguments for imposing a corporate tax, such as it being an indirect way of taxing shareholders or a form of benefit tax, are inadequate.[12] He argues that a corporate tax is rather imposed on corporate income in order to reduce the power of corporate management and thereby to regulate managerial power, which was the original rationale behind adopting a corporate income tax in 1909 in the US.[13] *Professor Richard M. Bird* also argues that even though there may not be any one good argument that supports taxing corporations, and that none of the possible different rationales for taxing corporations are particularly strong, a properly designed corporate tax is desirable in certain circumstances.[14] This includes circumstances in which a corporate tax improves the economic well-being or where a corporate tax does not harm the economic well-being. He further argues that it may also be convenient to use corporations as tax collectors. Most of the money earned and spent passes through a corporation and corporations usually keep better records than private individuals. It can therefore, from an organizational rationale, seem obvious to collect the taxes from corporations. He paraphrases the famous bank robber Willie Sutton, who chose to rob banks "*because that's where the money is*".[15]

The aim of this contribution is not to answer whether or not corporations should be taxed. The purpose is instead to stress that before jumping to any conclusions on which key actions have to be implemented in order to create a fair and efficient corporate tax system in the European Union, it may be beneficial to stop and wonder why we find it necessary or convenient to have a corporate tax system in the first place. Or to put it simpler; before addressing *how* we should tax corporations we should address *why* we tax corporations and *who* we actually tax. Only after answering these questions can we decide whether or not this highly complex creature of a corporate tax system is a superior one (that should evolve even further), an evolutionary dead-end, or something in-between.

Considering the fact that the (i) tax revenue from corporations represents on average only around 8-9 per cent of the total tax revenue in developed countries, (ii) it is very unclear who bears the tax burden, (iii) it is very unclear why countries even have a corporate tax system, and (iv) the corporate tax system is very complex; is it worth all the fuss, or has evolution killed corporate taxation? I don't know the answer, but a discussion seems relevant before the corporate tax system is evolved to an even more mutated and complex creature.

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[1] See COM(2015)302 final.

[2] See COM(2015)302 final.

[3] See also Joanna Piotrowska and Werner Vanborren, The corporate income tax rate-revenue paradox: Evidence in the EU, Working paper no. 12, 2007.

[4] See also Richard M. Bird, Why Tax Corporations?, Working Paper 96-2, December 1996.

[5] See https://stats.oecd.org/Index.aspx?DataSetCode=REV

[6] See https://stats.oecd.org/Index.aspx?DataSetCode=REV

[7] See COM(2015)302 final.

[8] See also Daniel N. Shaviro in Decoding the U.S. Corporate Tax, 2009, Urban Institute Press, p. 10.

[9] See William Vickrey, The Corporate Income Tax and How to Get Rid of It, Retrosprective on Public Finance, 1991, Duke University Press, pp. 118-132 and Richard M. Bird, Why Tax

Corporations?, Working Paper 96-2, December 1996, p. 1 and 6.

[10] See Kimberly A. Clausing, In Search of Corporate Tax Incidence, Tax Law Review 65 (3), 2012, pp. 433-472.

[11] See Ben Southwood, Who Pays Corporate Tax, Adam Smith Institute.

[12] See Reuven S. Avi-Yonah, Corporations, Society and the State: A Defence of the Corporate Tax, Public Law and Legal Theory, Research Paper no. 40, 2004.

[13] See Reuven S. Avi-Yonah, Corporations, Society and the State: A Defence of the Corporate Tax, Public Law and Legal Theory, Research Paper no. 40, 2004, p. 14.

[14] See Richard M. Bird, Why Tax Corporations?, Working Paper 96-2, December 1996, p. 2.

[15] See Richard M. Bird, Why Tax Corporations?, Working Paper 96-2, December 1996, p. 10.

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