

Lecture 12: Corporate taxation

Petr Janský

Charles University, Prague



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Course schedule

▶ Syllabus

Week	Date	Topic	Chapters	Lecturer
1	Feb 18	Economic rationale for the government	1, 2, 3, 4, 5	Miroslav Palanský
2	Feb 25	Public budgets	10, 26, 27	Natalia Li
3	Mar 3	Inequality		Marek Šedivý
4	Mar 10	Old-age pensions		Ondřej Schneider
5	Mar 17	Health economics	12	Ondřej Schneider
6	Mar 24	Public choice theory	7, 8	Miroslav Palanský
7	Mar 31	Cost-benefit analysis	6, 10, 11	Petr Janský
8	Apr 7	Externalities	9	Miroslav Palanský
9	Apr 14	Public procurement		Miroslav Palanský
10	Apr 21	Taxation, tax incidence	17, 18, 19	Miroslav Palanský
11	Apr 28	Optimal taxation, personal income taxation	20, 22	Miroslav Palanský
12	May 5	Corporate taxation	21, 23	Petr Janský
13	May 12	Tax avoidance	24, 25	Petr Janský

Course requirements

► Syllabus

Requirement	Maximum points	Announced	Deadline
Problem Set 1	10	Mar 24	Mar 31, 23:59
Problem Set 2	10	Apr 14	Apr 21, 23:59
Wiki Edits	20	Feb 18	Apr 28, 23:59
Final Exam	60	Exam 1 on May 19, 14:00 Exams 2, 3 in June Exam 4 in September	
Total	100		

Today's lecture

Corporate finance

Corporate income tax

Conclusion

Questions

- ▶ How government taxes companies?
- ▶ How are companies influenced by taxation?

The decisions by firms

- ▶ What does a firm do? (Auerbach, 2002)
- ▶ What organisational form and where to locate
- ▶ Raises money from investors: debt or equity
- ▶ Makes investment and production decisions
- ▶ Returns money to investors: debt - interest, equity - dividends, repurchases, report profits, retain for investment

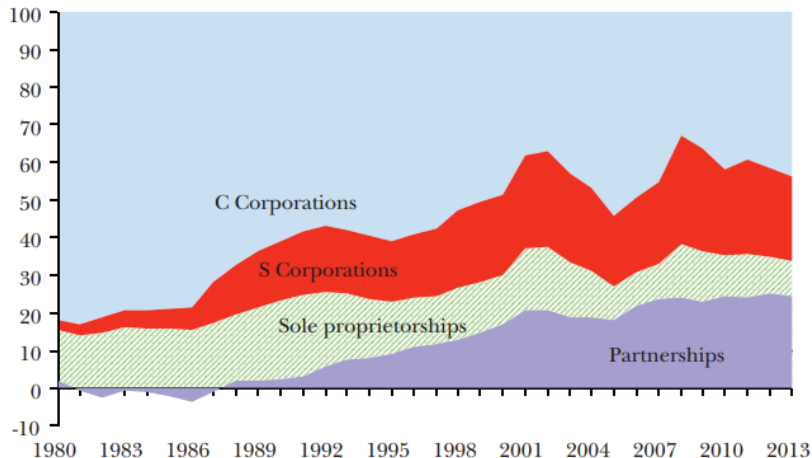
The effects of taxes on corporate finance

1. Organisational: corporate vs individual, international location
 2. Financing: debt or equity
 3. Investment: accelerated depreciation
 4. Payout: dividend taxation
- ▶ Corporate income tax, dividend taxation, capital gains tax

Organisational form: where to locate

- ▶ US: C and S corporations and other forms

Shares of total business net income (%)

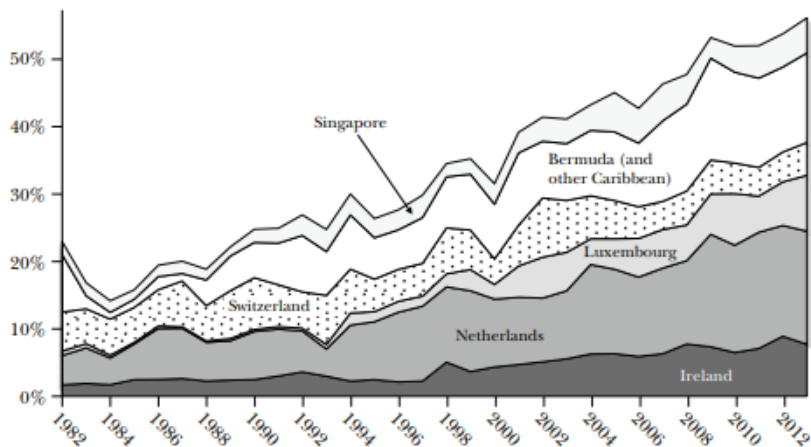


Source: Auerbach (2018); Looney and Krupkin (2017)

Organisational form: where to locate

- ▶ US: C and S corporations and other forms
- ▶ Czechia: unincorporated or incorporated entrepreneur
- ▶ International location: where to invest, produce and sell
- ▶ Real economic activity versus reporting profit
- ▶ Recent evidence on (paper or artificial) profit shifting
- ▶ To be discussed in the next lecture on tax avoidance

The share of tax havens in US corporate profits made abroad



Source: Zucman (2014)

Raising capital: Debt or equity

- ▶ Modigliani and Miller (1959) and capital structure irrelevance: Corporate finance irrelevant for firm value and real behaviour in a model with perfect markets and no taxes
- ▶ But taxes exist and financial choices are influenced by them
- ▶ In practice, there are tax differences between debt and equity
- ▶ Deduction of interest from profits (but not of dividends)
- ▶ Empirical evidence: Regress debt/equity ratio on marginal tax rates (e.g., Auerbach (1985), Graham (1996))
- ▶ Empirical evidence: Firms who have less incentive to use debt do use less of it (e.g. 15% of the variation)

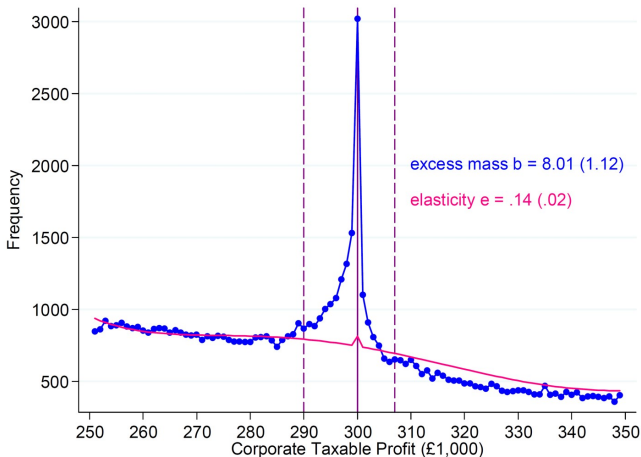
Investment decisions: accelerated depreciation

- ▶ To change level of investment, government changes depreciation rules or provides (e.g. research and development) tax credits for investment (rather than changes in dividend or corporate income tax rates)
- ▶ Expensing: subtract the full amount from profits in the year you buy the machine
- ▶ Economic depreciation: subtract a partial amount from profits per year
- ▶ Expensing reduces effective taxation because interest rate higher than zero
- ▶ Most countries try to proxy economic depreciation (Czechia: 6 groups from 3 to 50 years; US reform)
- ▶ Theory and evidence not covered here

The effects of corporate income tax

- ▶ Theory unambiguous: higher taxes should reduce investment
- ▶ But evidence hard to get on what the magnitude is
- ▶ For example, Djankov et al. (2010) - cross-country correlation of effective rates and investment
- ▶ Devereux et al. (2014) make use of an increase in marginal tax rate from 20% to 32% at 300k GBP in the UK
- ▶ Personal income tax elasticity methodology (Chetty et al., 2011; Saez, 2010)
- ▶ UK tax returns and bunching at the kink
- ▶ Reported profit manipulation rather than real profit response?

Bunching at the 300k GBP Tax Kink



Source: Devereux et al. (2014); for the 2002-2006 period

The incidence of corporate income tax

- ▶ Capital
- ▶ Labour
- ▶ Consumers
- ▶ Mixed evidence

Evidence on corporate income tax incidence

Study	Scope	Share falling on capital	Share falling on labour
Gravelle (2013)	Meta-analysis	60%	40%
Suárez Serrato and Zidar (2016)	US	65-70%	30-35%
Fuest et al. (2018)	Germany	50%	50%
Clausing (2013)	Global	-	no robust link

Sector-specific taxation

- ▶ Sometimes statutory rates differ by sector
- ▶ Each firm faces different effective tax rates
- ▶ Differences in other taxation than corporate income tax
- ▶ For example, financial sector exempted from VAT
- ▶ As of July 2016, there were sector-specific bank taxes or levies in 21 European countries (out of the 29 surveyed countries) and, in addition, 10 EU member states pursued the introduction of a financial transaction tax

Conclusions

- ▶ Companies pay multiple taxes
- ▶ Taxes influence companies—in reporting as well as in real behaviour, but it is often not clear how much

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Thank you!

Petr Janský




petr.jansky@fsv.cuni.cz

petrjansky.cz

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