UNIVERSITÀ DEGLI STUDI DI UDINE
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UNIVERSITÀ DEGLI STUDI DI TRIESTE

QUALITATIVE DIFFERENTIATION IN CORPORATE INCOME TAXATION

Research aim: sound analysis of corporate income taxation // qualitative differentiation in corporate income tax

Research question

Are the multiple forms of corporate tax differentiation justifiable in the light of an alleged higher (or lower) ability to pay shown by corporate income perceived by the companies affected by the differential tax treatment?

The research intends to examine how the principle of tax differentiation in corporate taxation finds concrete realization as well as investigating the suitability of a such a differentiation from the qualitative and quantitative point of view.
This approach aims at testing whether the current rationales for a differentiated tax treatment are reasonable and, specifically, whether it is advisable to provide for specific tax regimes for SMEs, for progressive taxation of corporate income and for the existing multiple forms of differentiation of incomes based on the economic sector of the recipient subjects.

Methodology

Part I

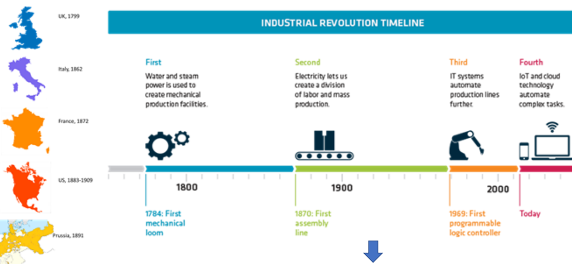
- Comparative analysis of corporate income taxation from its historical origins to the current trends of modern tax systems
- Income's differentiation for physical persons: principles

Part II

- Income differentiation: the case of small and medium enterprises
- Progressive taxation of corporate income
- Income differentiation based on the economic sector of the recipient subject
- Income differentiation and artificial intelligence's inputs

Life without income tax... until 19th century

Taxation as we now understand the term is something new in world's history. Corporate taxation in particular did develop as a response to the widespread use of legal entities as productions means and revenues gaining.



Corporate income taxes

During the first two decades of the 19th century, banks and insurance companies formed the chief examples of corporations. During the twenties and thirties, the development of transportation facilities led to the creation of many canal and railway companies.

Corporations and ability to pay

- Benefit principle (Adams, 1917)
- State as «silent partner» (Paton, 1922; Seeger, 1924)
- Taxing corporations' «privilege» (Borgatta, 1928; Giardina, 1951; Kelley, 1958)
- Legal personality (Wuttemberg)
- Indirect way to address shareholders' ability to pay (Einaudi, 1932; Groves, 1936; Blough, 1936; Goode, 1951; Cosciani, 1953)
- «Special» ability to pay (Vanoni, 1943)
- Social control (Avi-Yohah, 2004)

Income's qualitative differentiation: *principles*

«It is **necessary** at all events to make a **distinction between different kinds of income**, since the same amount of income derived from different sources often connotes a **varying degree of ability to pay**. We are therefore logically forced to the conclusion that the **relative equality**, or the uniformity which is demanded by justice, **is not only compatible with, but in reality leads to, the principle of discrimination**»
Seligman E.R.A., 1914

- Different classes of income may be treated differently for tax purposes.
- The qualitative differentiation, indeed, aims at detecting the difference between incomes of an equal initial amount, taking into account their source and extraction.
- The *rationale* lies in the idea that these incomes express different ability to pay and therefore must receive a different tax treatment. The principle of tax differentiation rests on the equality of sacrifice theory.
- Temporary and permanent incomes, labor and property incomes, spontaneous and fixed incomes, industrious and lazy incomes.

The case of small and medium enterprises

"Fiscal policies could exploit the positive externalities created by SMEs and enhance economic growth through R&D and innovation tax allowances" (OECD, *Taxation of small businesses*, 1994)

- Double-sided aim: favor SMEs because of their positive externalities and address MNEs' incomes with higher taxation
- No shared definition of SMEs. Within countries, the definition may vary between sectors, branches and industries. As a general rule, the criterion used is the upper limit on the number of employees, but it is often supplemented by other references, such as the turnover ceiling or total net assets or financial independence of owners.
- Current archipelago of tax advantages and lost connection with ability-to-pay principle

Progressive taxation of corporate income

Defended on different grounds…

- The impersonal-ability theory of business taxation: greater ability to pay?
- Fear of «bigness»: a graduated corporate income tax could be a powerful and successful tool to control «giant» companies (monopoly control and windfall taxation)

… & criticalities

- Conditions under which companies operate are identical?
- Classify enterprises according to relative risks and facility of raising capital?
- Difficulties in administration
- Companies restructurings and business split-up

Japan		
Tax base (Japanese yen)		Tax rate
Paid-in capital of over 100 million		23,2%
Paid-in capital of JPY 100 million or less, except for a company wholly owned by a company that has paid-in capital of JPY 500 million or more:		
	First JPY 8 million per annum	15%
	Over JPY 8 million per annum	23,2%

Korea		
Tax base (KRW million)		Tax rate
-	200	10%
200	20.000	20%
20.000	300.000	22%
over	300.000	25%

Income qualitative differentiation based on the economic sector of the recipient subject

- Special tax regimes addressing companies operating in specific economic fields (energy sector, tourism, oil and gas production, banks and insurance companies)
- Purposes: experimental taxation given changing economic conditions; capture windfall profits; share value creation + fair return
- Methods: tax rates' increase, differentiation at the taxable base level, combination of ordinary corporate income tax and supplementary charges, tax exemption for developing economic fields
- How to distinguish the normal from the extraordinary share of profit to be differentially taxed?
- Differential (higher) taxation effectively hits a special ability to pay?

Income qualitative differentiation and artificial intelligence's inputs

- Brand-new proposed income tax differentiation base on the exploitation of artificial intelligence technologies
- Inter-sectoral type of discrimination: involves companies using AI inputs irrespective of the economic field
- Compatibility with the theory of tax differentiation for physical persons' incomes: productional sacrifice (Seligman, 1980)
- Justifications do not take into account tax principles, but the so-called "technological unemployment" risk and the worries for loss od tax revenues stemming from personal taxation (as individuals as substituted by automated workers)
- The substitution effect could not be considered as a proper tax assumption to justify new tax liability
- It is not possible to consider artificial intelligence technologies as autonomous taxpayers
- Unjustified tax discrimination between companies operating in the same economic field using different inputs, violation of principle of equality

Conclusive remarks

- Currently, corporate tax differentiations mostly respond to non-tax feelings such as, for example, favor the development of small and medium-sized enterprises, avoid the achievement and concentration of high profits, discourage the use of technologies of artificial intelligence to replace traditional labor, etc.
- Although some of these objectives can be considered socially appreciable, the diversification of tax burdens affecting corporate income must always be consistent with the theory of income discrimination.
- Moreover, in the event that alternative regimes of corporate income taxation are to be introduced in the tax system, such deviations from the standard model must also be justified in the light of the principles governing tax law (i.e. the ability to pay principle and the equality principle) and should be coherent with corporate tax theories.
- Corporate tax as advance payment of the personal tax due by shareholders: the forms of corporate tax differentiation could hardly be justified. According to this approach, indeed, the corporate "veil" loses its relevance, and a tax differentiation based on subjective (corporate size) or objective (market and factors of production) characteristics of the taxpayer would be scarcely significant given the aim to reach the shareholders.
- Corporate tax as a tool to control management powers: greater ability to pay perhaps shown by income of larger companies, if demonstrable that it has been earned with low effort. Hypotheses to be satisfies: separation of ownership and control, company occupying a dominant position on the market.
- "Independent" corporate tax: tax diversification could to be considered legitimate if qualitative differences between corporate incomes arise. No connection with income nature or source, but with temporary or perpetual character.

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