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Policy Brief

Corporate Income Taxation and Business Dynamism

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Key messages

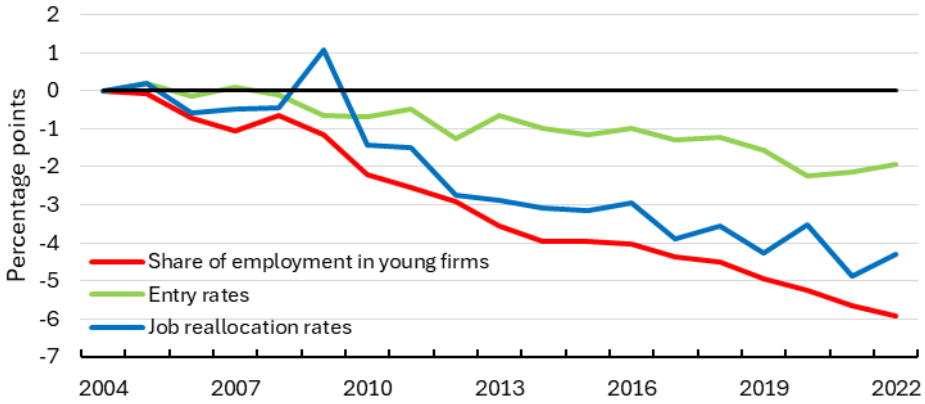
- **Concerns about declining business dynamism and the impact on growth are rising.**
- **Corporate income tax (CIT) rate can increase firm entry, though the magnitude of the effect remains unclear.** Firm exit is less sensitive and may be driven more by market selection. The impact of CIT rate changes is larger for smaller and younger firms.
- **Tax compliance costs and the costs of complexity are particularly high for small and young firms and can limit entry.**
- **CIT can exacerbate or alleviate financial frictions for small and young firms.** Targeted CIT support for these firms can reduce cash constraints, but tax is not the primary policy tool in this regard.
- **Tax incentives can support investment and innovation but can increase incumbency advantages.** R&D tax incentives can support young intangible-intensive firms, and size-based tax incentives can support firm entry and firm growth. However, drawbacks should be carefully considered; poorly designed incentives can generate an unlevel playing field between incumbents and new entrants. For small and young firms refundability and carryover provisions of R&D tax incentives can be important.
- **Loss offset provisions can reduce risk-aversion but can bias against start-up investments.** Small and young firms are often loss-making and may not be able to benefit from many forms of tax relief. Incomplete loss carryover can create a bias against riskier projects and result in both inefficient and efficient firms to exit the market prematurely, while overly generous loss offset provisions may induce risky overinvestment or delay the exit of low-productivity loss-making firms.
- **CIT may indirectly favour larger firms.** These firms tend to exploit tax incentives and tax planning opportunities more efficiently. This can confer a competitive advantage over smaller and younger businesses, with potential negative effects on business dynamism.
- **Other taxes can also impact firm entry decisions and business growth.** While not studied in detail in this note, the impact of taxes beyond CIT may be important for supporting dynamism and entrepreneurship, including through supporting the deepening of capital markets through household savings.

The decline in business dynamism

Concerns about a decline in business dynamism are on the rise. Business dynamism refers to the continuous process through which firms enter, expand, contract, and exit the market, and the associated creation and destruction of jobs. Different studies have documented a long-run decline in business dynamism, reflected in falling start-up rates, lower job reallocation, a shrinking share of employment in young firms, and fewer high-growth firms (Akcigit and Ates, 2023[1]). While the early literature documented and analysed this phenomenon in the United States, evidence from the OECD DynEmp project suggests that the decline in business dynamism has been experienced in many other advanced economies (Calvino, Criscuolo and Verlhac, 2020[2]). Data for a sub-set of OECD countries confirms that these trends have persisted in recent years (Figure 1).

Figure 1. Declining business dynamism

Cumulative change since 2004, 12 OECD countries



Note: This figure reports average within-country–industry cumulative changes in (i) the share of employment in young incumbent firms (1-5 years), (ii) entry rates, and (iii) job reallocation rates. Estimates are derived from year coefficients of within-country–industry regressions based on data for 12 countries (Austria, Belgium, Finland, France, Germany, Italy, Hungary, Portugal, Slovenia, Spain, Türkiye and the United Kingdom) over the period 2004-2022. The figure covers manufacturing and non-financial market services (ISIC Rev. 4 sections C and G–N, excluding K). Underlying data on the share of employment in young incumbent firms refers to total employment in young firms (1 to 5 years) as a share of total employment in all firms in a given year. Entry rate refers to the number of entering units as a share of the sum of entering and incumbent units in a given year. Job reallocation corresponds to the sum of job creation and job destruction in all firms as a share of total employment, where job creation (destruction) corresponds to all positive (negative) unit-level job variation between the current and the previous year.
Source: OECD DynEmp v3_3 database, October 2025. See (Calvino, Criscuolo and Verlhac, 2020[2]).

The role of corporate income tax on business dynamism

The effects of CIT on business dynamism are varied and under-explored. CIT influences firms' decisions to enter markets, invest, grow, and innovate. For example, the CIT system could reduce firm creation and shape the choice of the legal business form by affecting whether entrepreneurs choose to incorporate or operate as unincorporated businesses (Dyrda and Pugsley, 2024[3]). CIT may also affect firm growth by tightening or easing financial constraints, possibly distorting access to finance, which can be particularly relevant for young firms. In addition, preferential tax treatments for SMEs may unintentionally discourage growth. Corporate taxation might also hinder firm exit, as preferential regimes can sustain the operation of financially unviable firms. Finally, CIT can shape market competition by advantaging or disadvantaging specific firms, which may give rise to level playing field concerns, which may in turn increase concentration or discourage entry.

The role of tax rates

Reductions in CIT rates can support business dynamism, especially firm entry, though the magnitude of the effects remains unclear. CIT raises the profitability threshold for investment, influencing entry decisions. Some studies find that corporate taxation has an economically significant adverse effect on entry rates, whether measured through increases in effective tax rates (Da Rin, Di Giacomo and Sembenelli, 2011[4]) or statutory tax rates (Venâncio, Barros and Raposo, 2020[5]). For example, evidence from a subset of European countries suggests that a reduction of the effective tax rate from the median (30.8%) to the first quantile (27.57%) implies a 0.88 percentage point increase in the entry rate (Da Rin, Di Giacomo and Sembenelli, 2011[4]). The relationship between taxation and firm entry may be however non-linear, as reductions in effective tax rates may increase firm entry only when tax rates fall below a certain threshold (Da Rin, Di Giacomo and Sembenelli, 2011[4]). In addition, the effects of statutory CIT rate changes on firm entry tend to be stronger in more profitable sectors[1] and to have greater impact in survival rates when the beneficiaries of those changes are high-quality entrepreneurs (Venâncio, Barros and Raposo, 2020[5]). In contrast, some studies suggest that the effect of effective tax rates changes on firm dynamism is relatively small (Block, 2021[6]).[2] Recent empirical evidence from state taxation in the United States suggests asymmetric impacts, finding that a statutory corporate tax rate cut induced business entry among firms with lower predicted growth potential, while tax rate increases do not appear to affect business entry (Sapollnik and Swonder, 2025[7]).

A key channel linking CIT rates to firm entry is through their impact on entrepreneurial risk-taking. CIT represents a recurring cost that reduces expected after-tax returns from business activity, potentially discouraging innovative and high-risk projects and limiting internal funds available for investment and the hiring of workers (Venâncio, Barros and Raposo, 2020[5]). Moreover, CIT is levied on positive profits but often relief is provided for losses, for example, through loss carryover provisions. This can support neutrality of the tax system with respect to entrepreneurial decision-making. This is especially important when financial market imperfections limit risk-sharing with investors (Da Rin, Di Giacomo and Sembenelli, 2011[4]). When profits are taxed more heavily than losses are offset, the insurance role of CIT is weakened, favouring activities with relatively low-income volatility and discouraging entrepreneurial entry into innovative and high-risk projects.[3]

Changes in CIT rates appear to have only weak effects on firm exits.[4] This suggests that incumbents' exit decisions are mainly driven by market selection forces rather than after-tax rewards considerations for bearing risk. In addition, profitable incumbents can use loss-offset provisions to a greater extent than entrants with no prior profits and potentially early losses, making closure decisions by incumbents less sensitive to CIT rate changes. A differential effect in entries and exits can also reflect greater difficulties to unincorporate for already incorporated businesses.

The impact of CIT rates on firm dynamism varies across firm characteristics, such as size, age, and sector. CIT headline rates appear to have much larger effects on employment in small and young firms, while employment in large and more mature firms seem to remain largely unaffected by CIT headline rates.[5] Additionally, CIT rate reductions tend to generate more pronounced responses from individuals with higher educational degree, who are more likely to understand and exploit the opportunities created by changes in CIT (Venâncio, Barros and Raposo, 2020[5]). Sectoral differences further shape the response,

[1] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2103056.
[2] See also https://www.econstor.eu/bitstream/10419/229533/1/cesifo1_wp8715.pdf.
[3] See https://ir.lawnet.fordham.edu/flr/vol84/iss6/5/.
[4] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2103056 and https://www.dnb.nl/media/x4mlaxm5/working_paper_no-780.pdf.
[5] See https://www.tepp.eu/images/pdf/working-paper-2024/corporatetaxationfirmheterogeneity.pdf.

as industries with less mobile production, such as manufacturing, tend to be less sensitive to changes in CIT compared to footloose or tradable sectors (Giroud and Rauh, 2019[8]).

The role of compliance costs

Compliance costs act as a barrier to entry. Complying with the tax code entails costs additional to the financial costs stemming from firms' tax liability. Tax compliance costs increase fixed operating costs, thereby reducing the number of firms in the market and discouraging firm entry. For example, evidence from variation in Switzerland's sub-federal corporate tax codes suggests that reducing tax code length by 10 percent is associated with about a 1.5% increase in new firm creation and employment among new firms (Bacher and Brülhart, 2012[9]), noting that tax code length is only a proxy for ease of compliance. In addition, these costs affect a number of economic margins especially for young and small firms, affecting decisions such as whether to become self-employed, to employ others, to operate in the formal economy and to incorporate (OECD, 2015[10]).

Compliance costs increase with the complexity of the tax system. Compliance costs increase with the number of taxes that must be complied with, the frequency of changes to the tax laws, the existence of different tax administrations, the difficulty interpreting tax laws, and the necessity to meet multiple deadlines for tax payments. Taxpayers incur compliance costs when hiring tax preparers or spending their own time or that of internal staff to interpret the tax code, file their returns, meet international taxation requirements, and follow tax registration procedures (OECD, 2015[10]; Zwick, 2021[11]). In comparison with other compliance obligation and sources of red tape, tax compliance costs are a large part of the total compliance cost burden.[6]

Compliance costs are relatively large for small firms. While total tax compliance costs tend to be higher in absolute terms for large firms, the relative compliance burden tends to decrease with firm size (OECD, 2015[10]). While large firms often employ in-house tax specialists, smaller firms tend to depend on external tax advisers, making them more exposed to hiring agency problems, particularly when there is variation in advisers' quality. For example, evidence from business tax data in the United States shows that claim rates of loss carryback refunds increase with firm size, rising from 31 percent in the lowest decile to 52 percent among the top 0.1 percent (Zwick, 2021[11]).

Tax complexity affects investment decisions. Tax complexity increases expected compliance costs and tax uncertainty while incentivising tax planning. Evidence from the United States suggests that tax complexity reduces firms' take-up of tax benefits, such as claims for loss carryback refunds (Zwick, 2021[11]), thereby limiting available internal funding and investment capacity, which are essential for business growth. Beyond domestic investment, tax complexity also shapes cross-border investment flows by imposing costs and conferring benefits, with studies pointing to an increase in compliance costs (Jacob and Todtenhaupt, 2023[12]) but also in tax planning opportunities, which affects a country's attractiveness for FDI and hence firm entry and business growth.[7]

Remittance responsibility amplifies the impact of compliance costs for businesses. In addition to being taxed directly, businesses act as withholding agents and major tax collectors for tax categories other than CIT, such as sales and value added taxes, social security contributions and taxes on wages. While businesses benefit through their involvement in the tax collection process, for example through cash flow benefits, their remittance responsibilities also entail compliance costs (Milanez, 2017[13]).[8] These costs can extend beyond CIT and affect small firm growth.

[6] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2535664.
[7] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4990616.
[8] See https://www.imf.org/-/media/files/publications/wp/2024/english/wpiea2024033-print-pdf.pdf.

The role of financing frictions

Access to finance, key to the growth of small and young firms, is more constrained for these firms. They often have limited financial disclosure, lower collateral capacity, and shorter credit histories, which increase information asymmetries and agency costs for lenders and investors. As a result, small and young firms tend to rely more on internal capital and relational lending than in equity finance (OECD, 2015[10]). Financial constraints can limit the ability of young potentially fast-growing firms to seize attractive growth opportunities and depress growth prospects of already slow-growing firms.

CIT can exacerbate financial frictions, affecting disproportionally small and new firms. A higher CIT burden increases the required rate of return on investment projects. It also reduces after-tax cash flows, which can further restrain investment among firms that rely more heavily on internal financing or are cash-constrained (Dobbins and Jacob, 2016[14]; Egger, Erhardt and Keuschnigg, 2020[15]). Evidence also suggests that financially constrained firms allocate a lower share of tax-related cash flows to capital expenditures relative to unconstrained firms in order to use tax-related cash for additional liquidity (Guenther, Njoroge and Williams, 2020[16]). In addition, small and young firms tend to face tighter financing constraints and greater difficulty accessing debt markets and external investors than larger firms.

Responses to tax depend on the tax instrument. For example, small firms' investment can react more to tax base changes such as accelerated depreciation, likely due to the impact on financial constraints (Zwick and Mahon, 2017[17]), while large firms may exhibit stronger investment responses to changes in marginal rates, reflecting their better ability to finance investment through a combination of both internal funds and debt (Eskandari and Zamanian, 2023[18]).

Targeted tax provisions can ease financing conditions for small and young firms but may also lead to behavioural distortions. Preferential tax treatment for early-stage investors or entrepreneurs can ease barriers to entry by improving the supply of entrepreneurial funds and enabling firms to enter at a larger scale. These could also favour the entry of less productive businesses. However, small and young firms' profits may be too low to benefit from tax concessions. For example, non-refundable tax credits provide little immediate benefit for firms in a tax-loss position, as they cannot be used to offset CIT in the year they are earned. Similarly, a temporary tax rate cut targeted at small firms may increase their tax savings, as well as their investment and productivity levels, but can also trigger behavioural responses such as bunching and disincentives to expand (Cui et al., 2025[19]), and may incentivise firms to break their organisational structure up into several smaller firms.

Refundability and tax expensing can quickly ease cash constraints but can carry immediate and high costs for governments. Tax refundability can extend support to firms that may fail in their business venture or that never report taxable profits. It also increases the volatility of CIT revenues, which are already among the most volatile. Refundability carries also risks of fraud and compliance challenges, as it increases incentives to re-characterise non-targeted activities as those qualifying for the tax credit (OECD, 2015[10]). Full expensing of certain business expenditures and investments can also ease cash constraints, but when these expenditures are debt-financed and there are no interest limitation rules risk providing a "tax-subsidy" for loss-making investments.

Tax policy is not the primary tool to address financial frictions. Financing frictions are often better tackled through non-tax-based instruments. The development of financial systems is essential for enhancing firm entry and post-entry growth. Capital markets' development and financial innovation are key for alleviating financing constraints, in particular for small and young firms. Strong entry regulation can hinder business dynamism. Governments can provide support to small firms through non-tax programmes, such as credit programmes (OECD, 2015[10]). Tax-based measures aimed at easing financing frictions must be carefully balanced against the associated revenue losses to avoid generating economic distortions and undermining tax neutrality.

The role of tax incentives

Governments introduce tax incentives to promote economic activity and steer investment towards targeted sectors, activities or firms. CIT incentives provide favourable deviations from the standard tax treatment to encourage specific behaviour by reducing or postponing tax liability.

Targeted tax incentives can support business entry and growth but can also have important drawbacks. Tax incentives, such as tax allowances and credits, that target investment-related expenditure, are generally more effective than those providing relief on income. This is because expenditure-based incentives are more closely linked to policy goals by directly reducing the costs of specific investment or expenditure (e.g. R&D, training costs, green technologies). By contrast, income-based tax incentives, such as tax exemptions and reduced tax rates, carry the risk of resulting in windfall gains without incentivising additional investment.[9]

Tax incentives can be targeted based on firm size, but this can bring drawbacks. Size-based incentives often aim to support small and young firms by offsetting the fixed costs of tax compliance or inducing investment behaviour. These tax incentives can apply directly to the owner or to the investor, providing relief for initial investment, ongoing income, or the disposal of the firm's assets (OECD, 2015[10]). Yet, they may weaken business dynamism by encouraging firms to remain below eligibility thresholds (Bachas and Soto, 2021[20]).[10] Targeting tax incentives can stimulate additional investment at lower revenue forgone though narrow targeting. However, this may increase complexity, administrative and compliance costs, and the risk of distortions from picking winners.[11]

R&D tax incentives can support intangible-intensive firms. Intangible capital, such as R&D, software and data, is a key driver of innovation and firm performance. However, there is evidence that sectors and countries with higher intangible and digital intensity have experienced a faster decline in entry rates and job reallocation rates (Calvino, Criscuolo and Verlhac, 2020[2]). Investments in intangible assets involve irrecoverable (sunk) costs that are difficult to finance for small and young firms, and their scalability via economies of scale and network effects favours the emergence of very large firms and "winner-takes-all" dynamics that may raise entry barriers and limit catch-up.[12] Many studies show that well-targeted R&D tax incentives may help addressing this, as small, young and financially constrained firms tend to exhibit stronger responses to such incentives (Dechezleprêtre et al., 2023[21]), potentially driven by a lower level of initial R&D performance (OECD, 2023[22]). However, other work finds weaker effects for small firms.[13] Carryover or refundability provisions for R&D expenditure may be key to amplifying R&D responses among small, young and financially constrained firms (Agrawal, Rosell and Simcoe, 2020[23]), as these firms often do not generate profits in the early years of operation. However, refundability can be costly for governments and forecasting revenue foregone can be difficult.

Tax incentives may inadvertently impede dynamism by disproportionately benefiting incumbents and are often only a second-best option. Empirical evidence suggests that large incumbents typically engage more intensively in R&D, which means that R&D tax incentives are predominantly claimed by large firms (OECD, 2015[10]). Large firms may also be more effective in taking up R&D tax incentives. This may strengthen incumbents' market positions, raise entry barriers, and reduce job reallocation (Calvino, Criscuolo and Verlhac, 2020[2]). Generous incentives for large firms have been also associated with a less dynamic growth distribution and slower resource reallocation in R&D-intensive sectors, due to the presence of more stable firms and fewer growing or shrinking firms.[14] Besides such distortions, tax

[9] See https://www.tax-platform.org/publications/draft.
[10] See also https://www.imf.org/-/media/files/publications/wp/2024/english/wpiea2024033-print-pdf.pdf.
[11] See https://doi.org/10.1787/b0de19dc-en
[12] See https://www.jstor.org/stable/j.ctvc77hhj.
[13] See https://dialogic.nl/wp-content/uploads/2019/04/Evaluation-WBSO-2011-2017-Summary-8-03-2019-def.pdf.
[14] See https://academic.oup.com/economicpolicy/article/31/88/703/2614039.

incentives involve costs that can outweigh their benefits. For this reason, other policy instruments, such as direct support, may be more efficient (OECD, 2023[22]), especially for cash-constrained firms. Compared with tax incentives, direct grants can target firms more directly and do not require profitability, which can increase policy efficiency. However, they also risk "picking winners" and distorting competition (OECD, 2015[10]). Refundable tax incentives offer a hybrid instrument, which like direct grants, is non conditional on profitability levels and can support loss-making and liquidity-constrained firms. In addition, refundable tax credits preserve the broad-based (less-selective) nature of tax incentives, which may ease compliance with certain competition and international trade rules. However, their broader coverage can entail higher fiscal costs compared to more targeted direct support measures. Transferrable tax credits available in some jurisdictions also provide firms with the ability to monetise their tax benefits by selling unused tax credits to other taxpayers.

The role of tax losses

Loss offset provisions can support risk-taking, especially for start-up firms. Small and young firms are more likely to be financially constrained and loss making. The generosity of loss carrybacks and the associated tax refunds can be particularly important for credit-constrained firms in a tax loss position, whose investment decisions depend on the availability of internal cash flow (Devereux and Fuest, 2009[24]) and can increase risk-taking (Ljungqvist, Zhang and Zuo, 2017[25]). This is because as the loss carryover rules shift risk to the government, encouraging firms to take on more risk. In addition, evidence from Spain indicates that loss-smoothing provisions available to SMEs, i.e. a tax provision allowing a reduction in the tax base in exchange for allocating the same amount to a reserve for future tax loss offset, have a significant positive effect on firms' equity levels and reliance on own funds, thereby contributing to business stability.[15]

The effects of asymmetrical treatment of profits and losses differ across firms. Governments are often reluctant to offer generous loss offsets to avoid these are misused for tax planning purposes. This results in the asymmetric tax treatment of profits and losses, introducing a bias towards less risky projects. In addition, imperfect loss offset provisions can discriminate against start-up investment, as loss relief may not be immediately claimed if the businesses incur losses in early years of activity, while more mature profit-making firms can consolidate with other investments that already generate positive taxable income. The negative consequences of tax asymmetry are thus not borne uniformly, as new firms can be penalised disproportionately as they may be unable or experience delays to offset losses against taxable income (Cooper and Knittel, 2010[26]).

Limited loss carryovers may increase the risk of bankruptcy, with ambiguous implications for business dynamism. Loss carryovers can increase the risk of bankruptcies (Olbert, 2025[27]). On the one hand, bankruptcies are a key way for firms to exit markets, which may positively affect resource allocation across the economy, potentially resulting in positive effects on business dynamism. On the other hand, limited loss offset provisions can result in inefficient early exits and discourage corporate risk-taking (Ljungqvist, Zhang and Zuo, 2017[25]). Similarly, loss offset provisions may induce firms to engage in risky overinvestment, delaying the exit of low-productivity loss firms receiving less restrictive refunds (Bethmann, Jacob and Müller, 2017[28]).

Market power, effective tax rates and business dynamism

CIT can affect business dynamism by affecting market competition. Most of the empirical evidence in this area relies on firm-level datasets that tend to overrepresent large, often publicly traded firms, and may therefore primarily capture differences among larger incumbents rather than between large firms and small startups. When incumbent firms have high degrees of market power, this may discourage firm entry.

[15] See https://www.hacienda.gob.es/GabineteMinistro/varios/informe-revision-beneficios-fiscales-2022.pdf.

This may be because larger firms may benefit from economies of scale that may allow them to discourage new entrants. Existing firms may also benefit from network effects that may make entry challenging. OECD evidence suggests that more concentrated industries are less dynamic in terms of firm entry and job reallocation (Calvino, Criscuolo and Verlhac, 2020[2]), also showing greater entrenchment among market leaders (Calligaris et al., 2025[29]). Preserving a level-playing field and reducing competitive distortions can therefore support dynamism by ensuring new entrants are able to compete with incumbents.

Large firms and firms at the productivity frontier typically pay lower effective tax rates compared to their competitors, which may provide them with competitive advantages. The effective tax rate (ETR) of frontier firms has steadily declined since the late 1990s, whereas the ETR of lagging firms decreased until the mid-2000s and then stabilised, resulting in frontier firms paying lower ETRs than laggards, with the gap widening further after the global financial crisis (Bartolini, 2018[30]). Consistent with this, some evidence suggests that the ETR follows a hump-shaped relationship with firm size, with small firms benefiting from reduced statutory rates and large firms better positioned to exploit tax incentives, leaving mid-sized firms facing the highest ETRs.[16]

Tax planning practices are associated with firm size, productivity, and ETR differentials among firms, contributing to competitive distortions. Large firms and firms at the productivity frontier are often multinationals that can exploit mismatches across national tax systems and benefit from preferential tax treatments (Bartolini, 2018[30]), which may result in competitive distortions. They are more likely to have superior management practices leading to an efficient tax strategy (Bartolini, 2018[30]), and incur lower tax compliance costs relative to turnover when compared to smaller firms.[17] In addition, they may employ most sophisticated tax advisors and maintain in-house tax departments (Zwick and Mahon, 2017[17]), strengthening their capacity to exploit tax planning opportunities. There is evidence that firms with higher profitability and market power face eased credit constraints, which may enable them to undertake riskier activities, including tax avoidance (Kubick et al., 2015[31]).

The use of tax incentives and high intangible intensity may be a key driver of ETR differentials. Some authors find that larger firms exhibit higher take-up rates of tax incentives, such as tax credits and income exemptions.[18] Differences in effective tax rates between firms at the productivity frontier and those lagging behind may be due to reliance on intangible capital that may receive favourable tax treatment in many tax systems (Bartolini, 2018[30]; González Cabral et al., 2023[32]). Large firms may be equipped with more mobile capital and stronger administrative capacity, which may allow them to allocate activities strategically across locations, including special economic zones.

Tax avoidance may support market concentration and reduce market competition. While tax avoidance resulting from tax planning may support entry by reducing tax burdens, it also risks widening the ETR gap between incumbents and entrants. Tax avoidance acts as an inefficient government subsidy to avoiding firms, or equivalently, as an extra tax on non-avoiding firms, leading to misallocation of capital and labour. This may also generate an unlevel playing field which can discourage entry as well as increase firm size and concentration.[19] Differential tax treatment of firms may reduce less productive firms internal funds as well as net return on investments, adversely affecting their capacity and incentives to invest and catch up with more productive firms (Bartolini, 2018[30]). By contrast, large and more productive firms facing lower ETRs as a result of tax planning may use the capital not paid in taxes to increase their investment, as well as having their investment's after-tax return be higher. Some authors find that firms benefitting from lower tax burdens negatively impact their competitors' operating performance, especially if competitors are financially constrained (Donohoe, Jang and Lisowsky, 2022[33]). Tax planning may give a competitive advantage to these firms over their rivals, increasing their market share and reinforcing their dominant

[16] See https://www.taxdev.org/effective-tax-rates-firm-size-and-global-minimum-tax.
[17] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2535664.
[18] See https://www.taxdev.org/effective-tax-rates-firm-size-and-global-minimum-tax.
[19] See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4699638.

position (Sorbe and Johansson, 2017[34]).[20] Other authors find that multinationals engaging in tax planning exhibit higher mark-up rates compared with other firms, and that industries with a strong presence of multinationals engaging in tax planning tend to be more concentrated than other industries (Sorbe and Johansson, 2017[34]).

There is limited and conflicting evidence on whether anti-avoidance measures can impact market concentration and competition. Some authors find no evidence that the introduction of anti-tax avoidance regulations can materially influence industry concentration (Gallemore et al., 2025[35]). By contrast, other authors find that the introduction of Country by Country Reporting (CbCR) was associated with less market concentration in industries where top firms were subject to CbCR.[21]

The role of other taxes

The interplay between CIT and PIT can affect business dynamism. As a result, widening differentials between PIT and CIT rates create incentives for entrepreneurs to select the least-taxed organisational form (Cullen and Gordon, 2007[36]). These incentives are reinforced in tax systems that combined progressive PIT rates with flat CIT rates, as high-return entrepreneurial activities would typically face heavier taxation under the PIT than under the CIT, giving rise to a "risk subsidy" to incorporation (Da Rin, Di Giacomo and Sembenelli, 2011[4]). Evidence suggests that incorporation decisions are associated to PIT-CIT rate differentials (Tazhitdinova, 2020[37]; Zawisza et al., 2024[38]). In addition, recent evidence suggests that most OECD countries effectively tax dividend income more favourably than wages (Hourani et al., 2023[39]), pointing to incentives to shift income from wages to dividends through incorporation.The extent to which tax differentials translate into genuine entrepreneurial entry depends on distinguishing whether incorporation reflects new business creation or merely organisational form switching, and the available evidence on this distinction remains limited (Tazhitdinova, 2020[37]). In addition, tax arbitrage may carry more weight than entrepreneurial or scale-up aspirations. Evidence from Belgium suggests that the introduction of a permanent exemption on payroll taxes for the first-hired employee by first-time employers in 2016 induced more start-ups to hire their first employee, but these firms employed on average fewer employees and were less profitable and less productive compared to previous cohorts.[22]

Business entry and firm growth are strongly related to the development of capital markets, which in turn can be affected by tax policy. On the one hand taxation can affect the allocation of savings to specific types of assets, with empirical evidence pointing to a portfolio composition altered towards more tax-favoured assets (OECD, 2018[40]). Across most OECD countries, private pension funds and owner-occupied residential property tend to be the most tax-favoured assets, while rental property, bank accounts and corporate bonds tend to be heavier taxed (OECD, 2018[40]). On the other hand, taxation can affect the volume of savings, though the magnitude of these changes depend on external factors, including socio-economic conditions. In addition, the presence or absence of tax financed social protection systems can also impact private incentives to save. This in turn can affect the availability of financing for new businesses.

Favourable tax treatment of capital gains may support dynamism, but evidence remains mixed. Most OECD jurisdictions typically tax capital gains upon realisation, usually at lower rates or with exemptions compared to other forms of income and often offer additional relief for specific assets such closely-held businesses. One rationale for a relatively lower tax rate on capital gains is to incentivise investment and entrepreneurship. However, empirical evidence supporting this latter assumption remains mixed (Hourani and Perret, 2025[41]).

[20] See also https://shs.hal.science/halshs-04103835/file/WP16.pdf.
[21] See https://taxobservatory.world//www-site/uploads/2025/11/WP38-Tax-Compliance-of-Multinationals-and-Industry-Concentration-in-the-European-Union.pdf.
[22] See https://www.nbb.be/doc/ts/publications/wp/wp488en.pdf.

Dividend taxation can affect profit retention inside the firms as well as firms' investment decisions, though different studies find different results. Recent studies suggest that the cost of financing using retained earnings can be lower than that of external financing. Where dividend taxes provide an incentive to retain earnings, they can increase investment. Some authors find that a dividend tax cut does not have an effect on aggregate investment but increases investment in cash-constrained firms relative to cash-rich firms, which is explained by higher external equity in cash-constrained firms (Alstadsæter, Jacob and Michaely, 2017[42]). Similarly, other studies find that dividend tax cuts increase productivity of firms with limited internal funds, indicating that dividend taxes constrain firms with insufficient internal funds in investing efficiently (Jacob, 2021[43]).

What does this mean for corporate income tax policy?

- **Limit compliance costs and tax complexity, particularly for small and young firms.** High compliance costs act as a barrier to entry and can limit small and young firms' take-up of tax benefits and investment.
- **Design tax incentives with narrow targeting and clear and simple eligibility criteria.** Tax incentives should be closely targeted to policy goals, ensuring tax relief is only available for projects that directly support the stated objective and which would not materialise without the incentive. Refundability should be considered when measures are to be targeted towards small and young firms.
- **Ensure loss offset rules support risk-taking without biasing against start-ups.** Loss offset provisions can remove barriers to entrepreneurial risk-taking by sharing risk between businesses and government. In addition, they can help easing small and young firms' financial constraints. Asymmetric treatment of profits and losses can thus discourage innovative and high-risk projects and penalise young loss-making firms. However, generous loss offset provisions may incentivise fraud and delay necessary exit or encourage inefficient risk-taking.
- **Limit tax planning opportunities.** To support revenue-raising capacity and market competition, governments may address gaps in effective tax rates between smaller and larger firms by strengthening anti-avoidance rules and incentivising the uptake of tax incentives among smaller firms, while reducing the capacity of larger firms to exploit tax planning opportunities.
- **Align the design of CIT with that of the broader tax system.** Coordinate the design of CIT with that of other taxes, including personal, dividend and capital gains taxation, to minimise distortions in business organisational form choices and to ensure that tax differentials support genuine entrepreneurship rather than income shifting across tax schemes.
- **Use tax policy together with other policy tools when addressing financing frictions.** Tax policy is not the primary tool to address financing frictions, but without careful design CIT policies may exacerbate these frictions.

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