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and Sam van der Vlugt



# Fundamentals of Corporate Income Taxation

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# Fundamentals of Corporate Income Taxation

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This book provides a comprehensive overview of corporate income taxation, offering a global perspective on corporate income tax law and policy. It systematically presents the core concepts and features of corporate income taxation. This book is the third volume of the "Fundamentals of Taxation" series, following the Fundamentals of Taxation (2019) and Fundamentals of Personal Income Taxation (2025), and focuses specifically on corporate income tax systems. The fifteen chapters cover topics including historical context, taxable persons, territorial scope, timing issues, taxable income and taxable events, tax rates, procedural aspects, international aspects, treatment of groups, restructuring and liquidation, tax evasion, avoidance and planning, special types of entities, investment taxation, taxation of special types of activities and the global minimum taxation. This primer is an essential resource for students, professionals and curious learners, fostering a common understanding of corporate income taxation's legal principles and broader implications in a globalized world.

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## Preface

This is the third tax primer on the fundamentals of taxation. It contains a comprehensive analysis of corporate income taxation. Just like the other primers, this book emphasizes the legal component but also includes policy considerations to make it possible for readers to obtain a full picture of what corporate income taxation is about and how it operates across the world. This book contains several references to tax laws of various countries too, but, in line with the concept of the other primers, it relies on none of them; it merely uses references to the laws of the various countries as examples to give a more concrete dimension to the legal rules it describes.

This primer has been designed to operate in parallel with the other taxation primers. Accordingly, it can be used on a standalone basis to study its object. However, since it follows the same structure as the Fundamentals of Personal Income Taxation, it can also be bundled together to achieve a comprehensive study of income taxation, which might be further enhanced by the first primer on the Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration.

Corporate income taxes have been the object of global attention in the context of multinational corporations' global value creation. For this reason, studying their fundamentals on a common basis might be meaningful for a broad audience of tax law and non-tax law experts who might wish to better understand the core of the rules.

The authors have conceived this book as having the same outline as the book on personal income taxation. However, even where the sections have the same headings, the content differs in a way that more closely reflects the fundamental issues that matter with respect to corporate taxation. For instance, when Chapter 7 addresses tax procedures, it focuses less on audits and more on those aspects of tax procedures that are used in corporate practice to assess and enforce taxes in domestic and cross-border contexts. The same can be seen in Chapter 11, which explores a much more intensely regulated area of measures to prevent tax avoidance and evasion than is the case for individuals.

Chapters 1-8 and 11 follow the same pattern of the corresponding chapters in the Fundamentals of Personal Income Taxation.

Chapter 1 explains the reasons for taxing corporate income and its evolution. Chapters 2 and 3 focus respectively on the personal and territorial scope. Chapter 4 contains a comprehensive analysis of timing issues, and reveals a higher degree of complexity as compared with those that arise in connection with personal income taxation. Chapter 5 addresses all aspects of the objective scope and the taxable event, including significant insight into relevant accounting matters and the tax deviations that usually apply in several countries. Chapter 6 addresses tax rates. Chapter 7 focuses on administrative and judicial tax procedures, but also on the procedures that allow for an agreed ex-ante tax assessment. Chapter 8 brings in the cross-border element on a systematic basis and digs deeper into issues that have otherwise been mentioned in other chapters, including a brief overview of some tax treaty issues, which gives a more precise international dimension to the global discourse of corporate income taxation.

The remaining chapters focus on issues that are relevant for corporate income taxation only, such as group taxation (Chapter 9), restructuring and liquidation (Chapter 10), special types of entities liable to corporate income tax or similar regimes (Chapter 12), investment (Chapter 13), special types of activities (Chapter 14), or the rules on global minimum taxation applicable to large multinational enterprises (Chapter 15), making their intricate conundrum accessible to a broader audience in a clear but precise way.

The authors trust that the efforts, contributed with this and the other taxation primers, to broaden the basic technical education in legal and policy matters of taxation using a single methodology can be fruitful and useful for different categories of reader worldwide.

IBFD - Amsterdam, 4 February 2025

Pasquale Pistone, on behalf of all the authors

The books in this Fundamentals of Taxation series:

- (1) Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration (2019)
- (2) Fundamentals of Personal Income Taxation (2025)
- (3) Fundamentals of Corporate Income Taxation (2025) (this book)

## Abbreviations and terms

<b>ALP</b>	Arm's Length Principle
<b>AML</b>	Anti-Money Laundering
<b>APAs</b>	Advance Pricing Agreements
<b>ATAD</b>	(EU) Anti-Tax-Avoidance Directive
<b>BEPS</b>	Base Erosion and Profit Shifting
<b>CbCR</b>	Country-by-Country Reporting
<b>CE</b>	Constituent Entity
<b>CFC</b>	Controlled Foreign Company
<b>CIT</b>	Corporate Income Tax
<b>CIV</b>	Collective Investment Vehicle
<b>CJEU</b>	Court of Justice of the European Union
<b>CRS</b>	Common Reporting Standard
<b>DAC</b>	Directive on Administrative Cooperation in Tax Matters
<b>EBITDA</b>	Earnings Before Interest, Taxes, Depreciation and Amortization
<b>EEIG</b>	European Economic Interest Grouping
<b>EIG</b>	Economic Interest Grouping
<b>EoI</b>	Exchange of Information
<b>ETF</b>	Exchange Traded Fund
<b>ETR</b>	Effective Tax Rate
<b>EU GMT</b>	EU GMT Directive
<b>FATCA</b>	Foreign Account Tax Compliance Act
<b>FATOTA</b>	Fixed Amount of Tax or Tax Assessment
<b>FB</b>	Fixed Base
<b>FDI</b>	Foreign Direct Investment
<b>FIFO</b>	First In-First-Out
<b>FIU</b>	Financial Intelligence Unit
<b>GAARs</b>	General Anti-Avoidance Rules
<b>GloBE</b>	Global Anti-Base Erosion
<b>GMT</b>	Global Minimum Tax
<b>ICA</b>	International Cooperative Alliance
<b>ICAP</b>	International Compliance Assurance Programme
<b>IFRS</b>	International Financial Reporting Standards
<b>IIR</b>	Income Inclusion Rule
<b>IP</b>	Intellectual Property
<b>IPE</b>	Intermediate Parent Entity
<b>IPT</b>	Insurance Premium Tax
<b>JITSIC</b>	Joint International Taskforce on Shared Intelligence and Collaboration
<b>LIFO</b>	Last In-First-Out

<b>LPP</b>	Legal Professional Privilege
<b>LTCEs</b>	Low-Taxed Constituent Entities
<b>MDR</b>	Mandatory Disclosure Rules
<b>OECD</b>	Organization For Economic Cooperation and Development
<b>PE</b>	Permanent Establishment
<b>PEX</b>	Participation Exemption
<b>POPE</b>	Partially Owned Parent Entity
<b>PSD</b>	Parent-Subsidiary Directive
<b>QDMTT</b>	Qualified Domestic Minimum Top-Up Tax
<b>R&amp;D</b>	Research and Development
<b>SAARs</b>	Special Anti-Avoidance Rules
<b>SBIE</b>	Substance-Based Income Exclusion
<b>SEZs</b>	Special Economic Zones
<b>TIEAs</b>	Tax Information Exchange Agreements
<b>UCITS</b>	Undertakings For Collective Investment in Transferable Securities
<b>UN</b>	United Nations
<b>UPE</b>	Ultimate Parent Entity
<b>UTPR</b>	Undertaxed Profits Rule
<b>VAT</b>	Value Added Tax

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## Chapter 1

### Introduction: Purpose of Corporate Income Taxes and the Evolution of Tax Systems

#### 1.1. Some basic elements

This book on the fundamentals of corporate income taxation aims largely to discuss the “how” of corporate income tax, that is, how it functions. This first chapter, though, serves a slightly different purpose. It aims to provide the reader with a brief introduction to the “why” of corporate income tax.

In unpacking the “why”, the chapter will address the basic structure of corporate income tax systems, briefly mention selected elements of corporate tax history, and finally identify the key principles applicable to corporate income tax.

It must first be established what we mean by corporate income tax. Income taxes can be generally split into two categories, namely, income from labour or entrepreneurial activities (active income) and income from capital, usually in the form of dividends, interest and capital gains (passive income). Corporate income tax can impact each of these categories, being traditionally classified as a tax on the return on equity (given that labour costs and interest are deductible in most systems). However, this often ignores that genuine tax incidence (that is, who ultimately bears the tax) may challenge this assertion (see section 1.4.2.).

Simply put, corporate income tax is usually the tax that is levied on an other-than-natural person (non-natural person) that is considered distinct from the underlying individuals impacted by that entity, such as shareholders. However, corporate income tax covers a broad ambit from the self-employed sole proprietor (to the extent subject to corporate income tax) to the large multinational corporation. It is this breadth of coverage that can greatly impact the design of corporate tax in jurisdictions following different legal frameworks. It can also, in some systems, represent a choice between the personal income tax system and the corporate income tax system for business activities where the self-employed person is unincorporated and taxed under the personal income tax system versus incorporating the business and being subject to corporate income tax. There are exceptions to this broad classification, such as Italy and Bulgaria, which tax the business

activities of unincorporated persons under the personal income tax system but after determining the liability under the corporate income tax system for those business activities.

It is also important to contextualize the contribution of corporate income tax relative to other taxes. The data from 2022 from the OECD (Organisation for Economic Co-operation and Development) shows that corporate income tax as a percentage of all taxes differs significantly across regions of the world. While the aggregations can be skewed based on the varied economies included in the groupings, the outcome remains telling. The OECD average was 12%, compared to the average of 19% in Latin America and 21% in the Asia-Pacific region and Africa.

It is, therefore, critical that corporate income tax be considered alongside personal income tax (and other taxes) when considering the tax system as a whole. Corporate income tax is often referred to as a backstop to the income tax system as impacting individuals (for more, see *The Fundamentals of Personal Income Taxation*). Exactly how the corporate income tax is designed is ultimately a decision of the national legislators, and there may be sound reasons for them to favour one design feature over another.

## 1.2. Corporate income tax structures and systems

Generally, corporate income tax structures follow one of two main forms. The first is the classical corporate income tax structure (“classical system”), which separates the legal entity from the equity owner. Under this structure, income is effectively taxed in the hands of the legal entity before being taxed again (on the distribution of that income) in the hands of the equity holder. The second structure is that of integration (“integrated system”). Under this structure, the legal entity’s profits are attributable to the equity holders, and taxes levied against the corporate entity are creditable against the taxes levied against the equity holder.

The most common of the above structures is the classical system. Some countries feature elements of each type, such as the United States, which has some corporate entities that operate on a “pass-through” of profits basis; that is, the profits are attributed to the shareholders (similar to a transparent partnership), whereas other corporate entities are treated as opaque. Others, such as Australia, apply an imputation system, where the company tax paid on distributed profits is applied as a credit in the shareholder’s hands. In the past, some countries, such as Belgium, applied a third system, which is

often referred to as schedular integration, i.e. an integration predetermined on the basis of a schedule.

The Mirrlees Review (in *Dimensions of Tax Design*) usefully summarizes the corporate income tax systems (both traditional forms and alternative forms) in Table 1.1.

Table 1.1.

Location of the tax base	Types of income subject to business tax		
	Full return to equity	Full return to capital	Rent
Source country	1. Conventional corporate income tax with exemption of foreign source income	4. Dual income tax	6. Corporation tax with an allowance for corporate equity
		5. Comprehensive business income tax	7. Source-based cash flow corporation tax
Residence country	2. Residence-based corporate income tax with a credit for foreign taxes		
Residence country (personal shareholders)	3. Residence-based shareholder tax		
Destination country (final consumption)			8. Full destination-based cash flow tax
			9. VAT-type destination-based cash flow tax

Apart from these two main structures of corporate income tax, the manner in which corporations are taxed is also important to consider (especially in the context of multinational enterprises). Where taxation could be levied may vary depending on the perspective taken in its design. If tax is levied where production takes place, the tax is generally considered to be levied at source. If tax is levied where the corporate residence or the shareholders are found, then tax is levied on a residence basis. Finally, tax could be levied

where the customer is situated (a destination-based corporate tax). Each has advantages and disadvantages, with most systems focusing on taxation where production takes place. The international dimension (see chapter 8.) and its interaction with these domestic models must also be considered. Further critical issues arise for large multinational enterprises in terms of the adjustments that may be made by the global minimum tax (see chapter 15.).

The corporate income tax usually relies on a broad tax base including all forms of income generated by the corporate entity. From an economic perspective, the earnings from a corporate entity can be classified as a return on equity capital and “economic rents” (the “excess” profits that a corporate entity earns by virtue of advantages such as location, low labour costs, monopolistic positions, or other factors).

### 1.3. A brief history of corporate income tax

In a work such as this book, a historical account will be necessarily brief, selective, and incomplete. This section provides just a few key points.

The first key point is that the notion of a corporate entity (that is, an entity that could exist in perpetuity) has a much longer history than that of corporate income tax. How these entities came about and how they were used is beyond the scope of this book. What is important is that commercial and corporate law structures do not always influence corporate income tax.

Second, the introduction of corporate income tax has a varied history depending on the jurisdiction being considered. Therefore, the historical introduction of corporate income tax is illustrated with the example of the United States (for which there is ample literature), but it is stressed that this is a mere illustration of one jurisdiction and that the historical account of the introduction of corporate income tax varies greatly between jurisdictions.

While income taxes had arisen at various times in the past, the corporate income tax really came to the fore in the United States from 1909 (before personal income tax) as a political compromise between the proponents of an individual income tax (which was considered unconstitutional until the United States passed the 16th Amendment to their Constitution) and those opposed to a tax on undistributed earnings in a corporate entity. The tax found its origins as a surtax on corporate earnings. There was a further political aim to prevent excessive power accumulation through corporate structures (see further in section 1.4.).

The tax’s origins reflect the later view that the corporate tax was necessary to prevent the deferral or untaxed accumulation of wealth of capital owners. This view remains evident in the classical corporate tax system but also in the integration systems. Corporate tax is seen as a rough proxy for, and a prepayment of, tax on the return on equity capital. In Estonia, however, corporate tax is only levied on resident companies on distribution of the profits. Accumulated profits that are not distributed remain untaxed.

Corporate income tax systems became more widespread during the 1900s, and by the 1980s, corporate income tax rates were at some of the highest levels. This marked a turning point in which countries became more aggressive in tax competition, by lowering corporate income tax rates and generating incentives to attract foreign investment and intellectual property development but accompanied by base-broadening to prevent revenue loss. This period of significant competition was coupled with a period of increasing tax avoidance and the growth of multinational enterprises, which could take advantage of this competition.

Corporate tax systems have become increasingly complex. This reflects the move from the traditional “brick-and-mortar” type of businesses to the large multinational enterprises whose resources and supply chains are spread over multiple jurisdictions (see chapters 8. and 15. especially) and are increasingly mobile (that is, able to move resources and production factors to low-tax jurisdictions easily – see chapter 11. specifically).

When public attention turned to low effective corporate tax rates relative to the statutory rates, the perceived fairness of corporate income tax was questioned. This followed a period of significant analysis as to harmful tax competition and a desire to end the “race-to-the-bottom”. The global minimum tax (see chapter 15.) is one of the answers to this global phenomenon.

### 1.4. Justifications for corporate income tax

#### 1.4.1. Introduction

Since its introduction, the corporate income tax has been justified using several arguments, each from a different perspective and only representing a part of the puzzle. Combined, these reasons provide a multifaceted argument for a corporate tax, but ultimately, the strongest support for corporate taxation comes from politics.

The justifications for corporate income tax can be broken into several categories, namely:

- administrative convenience: as a withholding mechanism (also linked to tax incidence) or, in the age of large multinational corporations as a means to tax at source rather than final incidence;
- regulatory: exerting control over corporations;
- benefit theory: corporations benefit from the infrastructures supporting them, so they should contribute to the maintenance of that infrastructure; and
- the ability to pay.

#### 1.4.2. Tax incidence

The main difficulty with corporate income tax (in the classical system's legal separation between the owners and the entity, or in any "look-through" type of structure) is that corporate income tax is not a sound proxy for the real incidence of income tax (real incidence – who bears the ultimate tax burden – being distinguishable from nominal incidence, which is just who pays the tax). Real tax incidence ultimately rests with individuals (natural persons). However, in a corporate setting, income taxes can result in the real tax incidence resting on labour, consumers, capital owners, etc., and is remarkably difficult to measure or estimate. How corporate income tax can ultimately rest on each of these types of natural persons can be illustrated as follows: labour may bear some real tax incidence through the receipt of lower wages as a result of the levying of the corporate tax; consumers can suffer higher prices where taxes are raised; capital owners are the most obvious (traditional) example, as corporate income tax is levied before any distribution. This list is not complete but illustrates the concept of real tax incidence. Further, where real tax incidence falls may vary based on variable factors influencing specific economies.

Given the difficulty in measuring real tax incidence, corporate income tax is often justified as being a rough proxy for incidence. It should be noted that the same is generally true for other taxes as well. However, the corporate income tax should still be considered in terms of the effect that it does have on all individuals and in the jurisdiction in which the tax is levied.

#### 1.4.3. Benefit theory

Proponents of this justification for corporate income tax suggest that corporate entities should pay corporate income tax as a charge for the provision of the legal framework in which they operate (including facilitation of incorporation, the corporate legal aspects such as limited liability, etc.) and the general use of the state's infrastructure. However, these benefits do not serve as a justification for the corporate income tax. Profits are not a useful proxy for the "benefits" received. A loss-making company enjoys the same benefits as a profitable company, yet the contribution for such benefits is not the same. Further, the "benefits" of incorporation, limited liability, and so forth are benefits, ultimately, of individuals. The corporate entities themselves do not benefit, as they have no utility.

#### 1.4.4. Administrative convenience

It is often argued that corporate income tax is an administrative convenience. The argument takes on a number of variations. First, in large companies, shareholdings are diverse and global. In addition, many individual investors have little to do with the management of the corporate entity, so a "pass-through" approach may be inefficient and lead to significant compliance and collection costs. It is therefore considered efficient to collect the tax at the company level. This does, however, assume that the incidence lies with the equity holder.

Taxing corporations allows income tax to be levied in the source jurisdiction, as tax treaties permit taxation at source for companies operating in multiple jurisdictions.

Flow-through taxation would be inefficient, as many corporate equity holders are mutual funds or pension funds, which are regularly untaxed on their earnings. This leads to an inefficient delay in the collection of taxes pending ultimate payment to the natural person investor or pensioner.

The taxation of corporations allows the state to apply corporate taxation as a policy tool to incentivize or disincentivize various economic sectors. It is, therefore, a tool to support economic competitiveness.

### 1.4.5. Ability to pay

The ability to pay generally represents the tax that should be paid based on the economic capacity of the “person”. It is occasionally argued that corporate entities do not carry an ability to pay (which hinges on the real tax incidence argument). There are other arguments that suggest that corporations paying tax is a proxy for the taxation of equity owners (whose economic capacity should carry the tax burden). The arguments presented suggest that the ability to pay in respect of corporations really reflects the administrative convenience that taxing corporate entities represents, rather than being any definitive justification for the levying of corporate tax.

### 1.4.6. Corporate tax to stay

Ultimately, corporate income tax, despite any weak justification, is unlikely to be repealed. It is, therefore, important to understand its workings. The rest of this book addresses the “how” of corporate income tax. It addresses who to tax (chapter 2.), where to tax (chapters 3. and 8.), what to tax (chapter 5.), and when to tax (chapter 4.), amongst other special topics. But before these topics are addressed, some overarching features should be highlighted.

## 1.5. Statutory frameworks

The way in which corporate income tax is levied in systems varies in both the legislative instruments governing corporate income tax as well as the interpretative force of judicial decisions and administrative practices.

The statutory frameworks can largely be grouped into two categories. In one category are those states with corporate income tax legislation separate from personal income tax legislation (that is, the legislation governing the taxation and determination of tax liability is housed in a separate legislative act from that applicable to individuals), and in the second category are those states in which the income tax legislation is applicable to individuals and entities alike (even if tax rates differ and select legislative provisions are only applicable to one or the other type of person).

In most states, wherever the corporate income tax is housed, the legislation is detailed and supported by administrative acts of the revenue authorities (which may or may not be binding). Case law plays a different role in different jurisdictions, usually depending on whether they are civil law or

common law based. In common law jurisdictions, decisions of the higher courts are binding on the revenue authority and create a precedent, whereas in civil law jurisdictions, the case law decides individual cases and is binding in those cases but does not necessarily create any precedent. In most jurisdictions, the statutory instruments are updated at least annually.

The topics of personal scope (chapter 2.), objective scope (chapter 5.), territorial scope (chapter 3.), and other areas of the framework are discussed in later chapters in this book.

## 1.6. Principles of corporate income tax

Corporate income tax has evolved significantly since its early introduction. Whether as a backstop to personal income tax, a compromise over personal income tax, or the simple prevention of the accumulation of profits that would otherwise go untaxed, the corporate income tax system has evolved. Much of the evolution is the result of globalization and the rise of multinational enterprises whose supply chains span countries and continents.

However, corporate income tax has been found to be a useful policy tool for politicians and an administrative convenience for collection. In terms of sound tax policy principles, corporate income tax meets these principles with varying degrees of success. However, consistency in equity (horizontal, vertical, and inter-nation) is not always found, as different corporate tax systems incentivize different industrial sectors and may differ in approach across various entity types. Such variation is at odds with pure equity principles.

Corporate income tax offers a level of simplicity in that the levying of a corporate income tax on the entity rather than on each underlying equity holder does offer ease of administration, but the application of and compliance with the corporate income tax has become increasingly complex and costly (for the corporate entities as well as the revenue authorities). Equally, the increasing complexity in terms of the legislation and its implementation (also caused by the various incentives and other policy choices made) reduces efficiency in the tax system for compliance and enforcement and drives avoidance behaviours. The complexity of the administration of the tax should also be considered in light of the general contribution it makes to the state’s income. Increasing complexity significantly for little or no revenue is inefficient in a tax system.



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