Enhancing corporate tax systems to support business dynamism



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Executive summary

Concerns about declining business dynamism and the implications for economic growth are rising. Business dynamism – the process through which firms enter, grow, contract and exit markets, together with the associated creation and destruction of jobs – plays a central role in sustaining productivity growth, innovation and job creation. Yet business dynamism has declined over the past two decades across many advanced economies, with evidence of weaker firm entry, lower job reallocation and a declining share of employment in young firms. Similar concerns are emerging in developing and emerging economies. While declining business creation may stem from market share accruing to the most productive firms, which may contribute to increased productivity, declines in dynamism may also result in weak investment and productivity growth and rising market concentration, adding to concerns about medium-term growth prospects.

This report examines the role that corporate income tax (CIT) systems can play in supporting business dynamism. It builds on earlier OECD-G20 studies on CIT as well as past and ongoing OECD work on taxation, structural reform, and growth. This includes the 2015 OECD-G20 work taxation and SMEs and subsequent OECD-G20 work on tax certainty, tax simplification and compliance costs. It also draws on the lessons of the OECD-G20 Base Erosion and Profit Shifting (BEPS) Project, which has highlighted the importance of addressing tax avoidance as a means of supporting a level playing field for businesses. It also builds on ongoing work in the Inclusive Framework on BEPS on how tax can support growth and influence distributional outcomes. While the report focuses on evidence from OECD countries, evidence for emerging and developing countries is included where available.

CIT can affect business dynamism through multiple and sometimes offsetting channels. While far from the only factor that can influence dynamism, it can affect business dynamism in a variety of ways. CIT rates can discourage firm entry by reducing expected after-tax returns, but the magnitude of this effect remains unclear and depends on CIT design. Firm exit appears less sensitive to CIT rates and may be driven more strongly by market selection and other structural factors. The effects of CIT on dynamism are heterogeneous: smaller, younger and financially constrained firms tend to be more sensitive to taxation than larger and more established firms. Ensuring that the CIT system remains neutral with respect to firm size, age and business model can support growth by avoiding distortions to firms' entry, investment and expansion decisions

Small and young firms often face cash constraints, which influence the impact of CIT on entry and growth. Small and young firms tend to face greater constraints in accessing external finance and depend more heavily on internal cash flow to support their operations and investments. Tax systems that reduce cash flow or delay access to tax benefits can therefore affect these firms disproportionately.

Provisions that support firm cashflow can enhance dynamism. CIT features such as loss-offset provisions, refundability and accelerated depreciation can support risk-taking and ease cash constraints, particularly for firms that are not yet profitable, and may offer better value for money in terms of supporting growth compared to other CIT policies. However, these provisions can also entail fiscal costs, administrative challenges, risks of abuse and, without careful design, can lead to bunching below eligibility thresholds, which can constrain growth.

Tax complexity and compliance costs can create barriers to entry and growth. While some complexity reflects policy objectives such as improving neutrality, preventing avoidance or targeting support more precisely, excessive complexity can increase compliance costs and create uncertainty. Compliance costs weigh disproportionately on small and young firms, which have fewer resources to devote to tax compliance and are less able to benefit from economies of scale in tax administration. Complexity can also reduce the take-up and effectiveness of tax incentives and raise the costs of expanding internationally. Simple, stable and predictable tax rules, including internationally, can therefore support business dynamism

The tax system can support or hinder dynamism through its impact on market competition. Large and multinational firms may in some circumstances have greater opportunities to engage in tax planning than competitor firms, which may affect competitive position compared to new entrants. The OECD-G20 international tax agenda may therefore support business dynamism where it supports a level playing field between different firm types. At the same time, additional tax burdens faced by MNEs, such as higher audit risk, additional reporting requirements, and international tax frictions, can reduce the dynamism and productivity spillovers stemming from MNE entry into new markets.

The impact of the CIT on business dynamism should not be considered in isolation. Other tax policies including the taxation of dividends and capital gains may influence entrepreneurship, financing and investment, though magnitudes and challenges need to be further explored.

Non-tax factors are a significant driver of dynamism. Supporting business dynamism therefore requires a coordinated action across a wider set of conditions, including competition and regulation, efficient insolvency regimes, access to finance, innovation and technology diffusion, and labour markets supporting appropriate skills and matching workers to jobs. Throughout, these policies should be considered as reinforcing complements, not substitutes that are all critical to enabling productive firms to enter, grow and challenge incumbents.

The report concludes by highlighting some areas where further work is needed. Further evidence is needed, particularly regarding the role of tax policy on firm exit, growth and competition. Future research should strengthen the measurement of tax effects across the entire firm life cycle, better account for differences between firms, and improve understanding of how tax provisions affect entrepreneurship, scaling and market dynamics. Further work is also needed on the international tax dimensions of business dynamism, including the role of MNEs, cross-border expansion and productivity diffusion.

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1 Introduction

Background

Concerns about a decline in business dynamism in the OECD and beyond are mounting. Economic growth, investment, and productivity across the OECD and beyond have been constrained by structural headwinds with significant implications for welfare. Business dynamism – the process of business creation, expansion, and exit – can contribute to the reallocation of resources towards more efficient uses and can play a central role for long-run economic growth by driving productivity growth, innovation, and job creation. Concerns about declining dynamism are supported by empirical evidence, particularly in advanced economies but also in some developing countries.

This report identifies ways in which corporate income taxation (CIT) can impact business dynamism. CIT may reduce the benefits of firm entry and may raise the costs of capital, which can limit investment. CIT may also exacerbate financial frictions and result in compliance costs, both of which are particularly faced by small and young firms. Larger firms may have greater capacity to use tax incentives and engage in tax planning, potentially contributing to an unlevel playing field that may hinder dynamism. However, larger firms may face other burdens such as higher audit risk, higher statutory tax rates (in some countries), and some other administrative burdens, such as increased reporting requirements. While CIT can strengthen or weaken dynamism, it is rarely the main cause of weak dynamism and should not be considered in isolation from other economic policies.

Business dynamism is not inherently beneficial in all circumstances; its value depends on whether it facilitates the efficient allocation of resources, innovation and productivity growth. Conversely, weak dynamism may be problematic when it reflects barriers to entry, expansion or resource reallocation. Where lack of firm entry stems from lack of access to finance, administrative burdens, barriers to entry stemming from market power, or non-neutralities in the tax system, it can reduce the innovation and growth that come from business creations and expansions. In addition, where entry by new firms falls; incumbent firms may face less competitive pressure to innovate and raise their productivity. However, where low entry rates stem from market share accruing to more productive firms, policies to increase dynamism should be carefully assessed to avoid discouraging investment, innovation and productivity gains. Tax policy should therefore support dynamism, by ensuring that non-neutralities in the tax system do not affect competition and firms' entry and expansion decisions, while allowing productive firms to grow, innovate and contribute to productivity growth.

Tax policies to support dynamism should include carefully considering financial frictions, reducing compliance costs, and supporting a level playing field. The case for reform does not necessarily point towards broad reductions in CIT rates. Rather, it highlights the importance of tax systems that are neutral across firms, across legal forms, and over the business life cycle. Tax policies should support cash flow where financing constraints are most binding, remain simple and predictable, and limit tax-driven advantages for incumbent firms. Tax simplicity, stability, and certainty also support dynamism.

The report considers CIT within a broader policy mix. It zooms in on the potential for tax policy, in particular CIT, to strengthen business dynamism. However, the available evidence suggests that while tax

policies can support dynamism, they cannot replace shortcomings in other policy areas, including pro-competitive regulations, capital markets and access to finance, and skills.

This report is embedded in a long-standing OECD-G20 workstream on tax and structural policies, and growth. In 2015 an OECD study examined the tax policy and tax administration arrangements affecting SMEs in OECD and G20 countries, drawing on results of a questionnaire completed by countries and an existing OECD database (OECD, 2015[1]). Previous OECD-G20 work also considered wider structural reforms to support growth (de Mello and Padoan, 2010[2]).[1] This report builds on these workstreams, as well as previous work on tax certainty (OECD, 2017[3]; IMF-OECD, 2019[4]) and tax simplification and compliance costs (OECD, 2025[5]). While the report focuses on evidence from OECD countries, evidence for emerging and developing countries is included where available.

The report is structured as follows. Chapter 2 discusses recent trends in business dynamism, economic growth, and investment. Chapter 3 discusses the relationship between CIT and firm entry and exit, while also focusing on tax compliance costs. Chapter 4 discusses the relationship between CIT and firm growth, focusing particularly on the barriers faced by firms in dealing with financing frictions and the decisions to scale and internationalise. Chapter 5 discusses the design of tax incentives to support investment and business dynamism, and the relevance of tax certainty and stability. Chapter 6 focuses on CIT and market competition, highlighting how tax avoidance can result in an unlevel-playing field which may hinder dynamism. Chapter 7 discusses the role of the broader tax system. Chapter 8 focuses on policies beyond tax and how they can support business dynamism. Chapter 9 concludes with an assessment of evidence gaps and some areas where the dynamism agenda may be taken forward.

Key findings

Pro-dynamism policies should support productive firm entry and orderly exit

Strong business dynamism requires simple and smooth entry conditions for new businesses, which are often small businesses. The basic architecture of CIT can support dynamism through neutrality, including no implicit adverse treatment of losses, and through simplicity and stability, both of which limit compliance costs. Dynamism also requires that unviable businesses leave the market as the continued presence of “zombie firms” stifles competition and reduces productivity. The interactions between tax and exit decisions are not well understood, however.

Lower CIT rates alone are unlikely to support dynamism. Some studies find that higher CIT rates reduce entry, but the estimated effects vary considerably and are often modest. Responses also differ across firms and sectors. Small, young and internationally mobile firms appear more sensitive to taxation than large and established businesses, but evidence highlights that these effects stem from the impacts of CIT on cashflow. Headline CIT rates therefore provide only a partial indication of whether a tax system supports firm entry.

The treatment of tax losses is particularly important because new businesses commonly incur losses before becoming profitable. A system that taxes profits as they arise but provides only delayed or restricted relief for losses can discourage risk-taking and innovative investment. Loss carrybacks, sufficiently generous carryforwards and, where appropriate, refundable provisions can make the tax system more neutral between profitable and loss-making activities and can ensure the system does not limit risk-taking. Although safeguards are needed to limit abuse, excessive restrictions on loss relief can place young firms at a disadvantage relative to profitable incumbents.

Reducing tax complexity can support dynamism. Compliance and remittance costs weigh disproportionately on small and young firms. Frequent changes in legislation and uncertainty over how rules will be applied can discourage incorporation, investment and hiring. Complexity can also reduce the

take-up of tax incentives, leaving support that is available in principle inaccessible in practice to small and young firms. Simplified procedures, stable rules, accessible guidance and proportionate administrative requirements can reduce these barriers without requiring broad reductions in tax rates. Finally, supporting simplicity, certainty and reducing complexity in the international tax environment can support international expansion of firms, which can support firm entry into local markets, and can also support productivity diffusion across supply chains.

The relationship between CIT and firm exit is less well understood. Exit contributes to dynamism when it releases labour, capital and market space for more productive uses. However, a low exit rate may reflect either the resilience of viable firms or the continued survival of unproductive firms. Available evidence suggests that market conditions, access to finance and the efficiency of insolvency regimes are often more important for exit than CIT rates. Tax provisions should avoid both precipitating the premature closure of promising firms and indefinitely supporting businesses that are no longer viable.

Dynamism requires young firms to have the financial resources and economic incentives to grow and scale

Tax policy should distinguish between increasing the number of firms and supporting the entry and growth of productive firms. Higher entry does not necessarily strengthen dynamism if new firms remain small, reflect changes in legal form rather than new economic activity, or survive mainly because of preferential treatment. Similarly, lower exit is not necessarily desirable if unproductive firms continue to absorb labour and capital. The objective should be to enable productive firms to enter, invest and scale up, while facilitating the restructuring or orderly exit of firms that are no longer viable.

Access to finance is a major constraint on the growth of young firms. These firms often lack collateral, established credit histories and long-standing relationships with lenders. Firms whose value is concentrated in intangible assets may face additional difficulties because these assets are harder to value and use as security. Consequently, young firms tend to depend more heavily on retained earnings to finance investment and expansion.

CIT can constrain growth through its effect on cash flow. Taking cash out of a business to meet tax liabilities may have particularly strong effects when external finance is expensive or unavailable. This strengthens the case for provisions that provide tax relief when expenditure is incurred.

Tax incentives can support dynamism, but design and evaluation are key. Immediate or accelerated deductions reduce the delay between an investment and the associated tax benefit. Refundable tax credits and loss-related refunds can make support available to firms that have not yet generated taxable profits. Such design features may support investment more directly than reduced CIT rates that benefit only profitable firms. By contrast, reduced rates or other concessions that are available only below a turnover, income, or employment threshold can discourage firms from expanding beyond that threshold. They may also encourage firms to divide their activities across separate entities. Complex or non-refundable measures may fail to reach the young and innovative firms they are intended to support and may increase incumbent advantages. Finally, governments should evaluate whether the measures support genuine firm growth rather than changes in legal form or the survival of low-productivity businesses.

There is limited evidence on the best design of tax support for internationalisation. Dynamism can be supported not just by new small firms entering markets, but by new MNEs entering new locations or expanding internationally. Exporting or establishing operations abroad can provide access to larger markets and support productivity and innovation and can be a key part in firm scaling. In addition, international expansion can also support the spread of productivity and innovation across borders. However, cross-border tax rules can generate (sometimes significant) additional compliance costs that firms need to consider when expanding internationally for the first time. However, there is little evidence on tax, business dynamism and MNE activity.

Dynamism requires tax policies that support competition and neutrality

Business dynamism depends on the ability of new and growing firms to challenge established businesses. Differences in effective tax rates may weaken this process where they arise from tax-planning opportunities that are more accessible to large or multinational firms. Better access to tax planning opportunities can provide larger incumbents with lower post-tax ETRs, which can result in additional resources for investment, acquisitions and expansion. Differences in firm ETRs can be driven by differences in productivity, investment, as well as tax planning behaviours. In addition, differences in firm profitability often reflect economies of scale, market power, productivity differences and access to finance. Careful analysis is required to understand where and whether tax planning results in level-playing field issues that may impede dynamism.

Available evidence documents differences in effective tax rates across firms, but there is more limited evidence on the impact on competition and business dynamism. Nevertheless, tax-driven competitive distortions are inherently a drag on productivity. The tax system should be neutral with respect to different types of firms including large and small firms, and old and young ones, with targeted tax treatment stemming from clear rationalisations based on market failures. In cases where large firms may potentially be more able to engage in cross-border tax planning measures addressing base erosion and profit shifting may support business dynamism and protect tax revenues. Where differences in access to finance or existing competitive distortions can allow some firms to generate higher profits to take better advantage of tax incentives, there may be a case to consider caps on tax incentives. At the same time, the tax system should not be the primary instrument to address competitive distortions such as financing frictions.

CIT forms part of a broader tax system, but more evidence is needed on the impact of other taxes on dynamism. Differences between personal and corporate taxation can distort choices on businesses' legal form, and potentially limit incorporation, which can hinder dynamism, for example, by limiting access to finance. Taxes on dividends and capital gains may affect the returns to entrepreneurship and the availability of equity finance, but evidence differs on the size of the impacts, with some studies finding limited impact.

Many of the main constraints on business dynamism lie outside the tax system. Supporting business dynamism requires pro-competitive regulation, efficient insolvency regimes, and deeper and more diverse financial markets. CIT reform alone will not reignite business dynamism.

Strengthening the evidence base

Effective policies to support business dynamism require a strengthened evidence base. The evidence linking CIT to dynamism remains limited, hindering policymakers' ability to improve policies. Many studies examine intermediate outcomes, such as investment, R&D expenditure or risk-taking, rather than entry, growth and exit directly. Further evidence is needed to distinguish the creation of genuinely new business activity from changes in legal form; productive scale-up from simple survival; and the experience of young, small and loss-making firms from that of the average profitable business.

In-depth cross-country comparisons are hindered due to insufficient evidence across countries, but also across different firm and tax types. Often analyses focus on the average firm, and with less consideration of the impacts of policies on cash constrained firms, or new and young firms. Standard indicators often assume that firms are profitable and able to make full use of deductions and credits. They may therefore understate the burdens associated with restricted loss relief, delayed tax benefits and eligibility conditions based on firm age or size. Finally, there is significant need to expand the evidence base on other tax categories including personal and capital taxes.

Exploring the potential for cross-country collaboration on dynamism requires better insight into the international dimensions of dynamism. Existing measures of dynamism do not clearly distinguish firm entry and growth associated with multinational expansion from the creation and scaling of domestic firms. Nor do they provide sufficient evidence on how tax rules affect the transition from a domestic firm to an exporter or MNE. Further work could also examine whether the concentration of multinational activity promotes productivity diffusion through investment, supply chains and knowledge spillovers, or reinforces the position of leading firms and limits the diffusion of productivity gains.

Note

[1] See also The G20's Enhanced Structural Reform Agenda.

2 Trends in economic growth, investment and business dynamism

This chapter surveys evidence on business dynamism, investment and economic growth. Concerns about declining business dynamism and its implications for economic growth are growing. This chapter highlights that economic growth has been declining and has been constrained by structural headwinds. At the same time, business investment has remained persistently weak, with potentially negative consequences for growth. The chapter then introduces the concept of business dynamism, discusses its key drivers and its link to growth, and shows that business dynamism has declined as well.

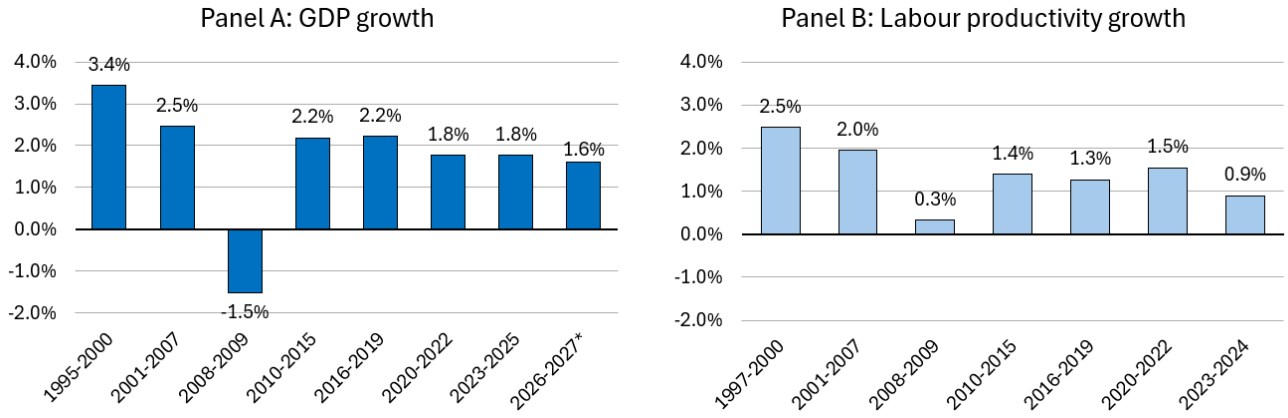
Headwinds for economic growth and the investment shortfall

Despite resilience in the face of global shocks, economic growth across the OECD and beyond has been constrained by structural headwinds. While the global economy has demonstrated remarkable resilience to the COVID-19 pandemic and an energy crisis, the underlying drivers of long-term growth have been showing signs of strain. Structural headwinds have been weighing on growth prospects (Figure 2.1, Panel A). Productivity growth has slowed markedly over the past two decades (Figure 2.1, Panel B). Investment has been subdued since the global financial crisis, weighing on capital accumulation and medium-term growth prospects (OECD, 2025[6]). Labour and skills shortages are affecting many sectors, especially technology-intensive activities, constraining firms' ability to scale up and to fully harness productivity-enhancing innovations, such as artificial intelligence and robotics (OECD, 2024[7]). Population ageing is limiting labour force expansion while exerting increasing pressure on public finances (André, Gal and Schief, 2024[8]; Sicsic and Hourani, 2026[9]).

The slowdown in productivity growth has been a matter of considerable concern and debate. While no single explanation accounts for this trend, a combination of factors has been identified that, taken together, helps explain the slowdown (Goldin et al., 2024[10]). Some studies have pointed to weaker knowledge and technology diffusion across firms has been associated with rising market concentration and widening productivity gaps between frontier and lagging firms, further weighing on aggregate productivity growth (Andrews, Criscuolo and Gal, 2016[11]; Akcigit and Ates, 2023[12]). Productivity slowdown may also be impacted where frictions in the international tax system which may curtail MNEs ability to expand internationally, and to invest, innovate, and export, with associated negative consequences for productivity and innovation spillovers (see Chapter 4 on firm scaling). Finally, it is important to note that aggregate measures of diffusion may conceal differences across firm networks, sectors and transmission mechanisms.

Figure 2.1. GDP and labour productivity growth in the OECD area

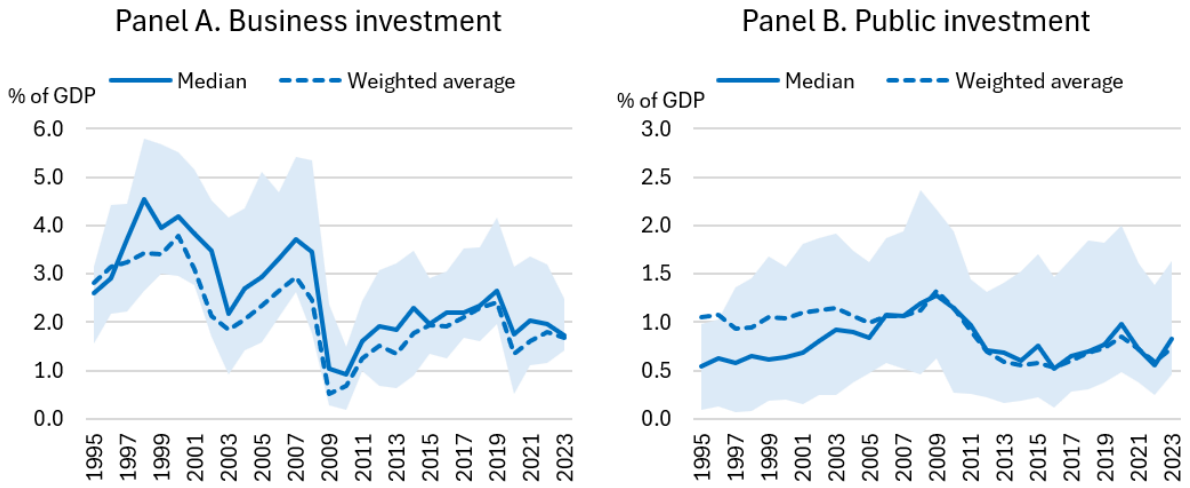
Average annual percentage change



Note: Data for 2026-2027 correspond to macroeconomic projections available in the OECD Economic Outlook 119 database.
Source: OECD National Accounts, OECD Productivity Database, and OECD Economic Outlook 119 database, June 2026.

Figure 2.2. Net investment-to-GDP ratios in the OECD

GFCF minus the consumption of fixed capital in current prices as percentage of nominal GDP



Note: Net investment-to-GDP is defined as the ratio of gross fixed capital formation minus the consumption of fixed capital in current prices, to nominal GDP. Business investment includes the combined investment of the non-financial and financial sectors, while public investment refers to the investment undertaken by the general government. Based on 32 OECD countries for which sectoral investment data are available. The shaded area shows the interquartile range. Weighted average using GDP PPP weights in 2015.
Source: (OECD, 2025[6]), OECD Economic Outlook, Volume 2025 Issue 1: Tackling Uncertainty, Reviving Growth, No. 117.

A prolonged period of weak investment has been a key drag on economic growth. While gross investment ratios have stabilised or increased slightly in some economies in recent years, net investment has declined markedly since the mid-1990s, falling from 2.6% to 1.7% of GDP in the median OECD country (Figure 2.2). This decline has been driven primarily by weaker business investment, which represents more than 60% of total investment in the average OECD economy, although lower public net investment has also contributed. Several factors have weighed on firms' investment decisions, including elevated uncertainty, demand weaknesses, the growing importance of faster-depreciating digital and intangible assets, and rising shareholder payouts through dividends and share buybacks (OECD, 2025[6]). Declining

government investment post-global financial crisis has further exacerbated weakness in capital stock growth, both directly and probably indirectly via adverse spillover effects on business investment (Ollivaud, Guillemette and Turner, 2016[13]). Together, these trends have contributed to weaker capital accumulation (OECD, 2025[6]). In turn, weaker capital accumulation has been pointed as an important driver of the productivity slowdown post global financial crisis (Ollivaud, Guillemette and Turner, 2016[13]; Goldin et al., 2024[10]).

The decline in business dynamism

Business dynamism can support productivity growth, and job creation by supporting innovation and a more efficient allocation of resources. It refers to the continuous process through which firms enter, expand, contract, and exit the market, and the associated creation and destruction of jobs. This process of creative destruction, whereby new entrants compete with and sometimes replace less productive incumbents, is widely recognised as instrumental to long-run economic growth and aggregate productivity gains (Decker et al., 2014[14]), though some studies highlight that increased market concentration may reflect increased market share by the most productive firms Productivity growth is fundamentally driven by experimentation with new ideas, the diffusion of advanced technologies and business practices, and the efficient reallocation of resources toward their most productive uses (Andrews, Criscuolo and Gal, 2016[11]). When these dynamics are impaired, aggregate productivity and economic growth suffer (OECD, 2025[15]).

Business dynamism has been declining over the past two decades in advanced economies, adding further concerns to medium-term growth prospects. 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 (Decker et al., 2014[14]; Decker et al., 2016[16]; Aguilera-Bravo, Casares and Khan, 2022[17]; Akcigit and Ates, 2023[12]; OECD, 2025[15]). While the early literature documented and analysed this phenomenon for 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[18]). Data for a sub-set of OECD countries confirms that these trends have persisted in recent years (Figure 2.3).[1]

Several studies document lower business dynamism in emerging and developing economies, suggesting that declining business dynamism may be a widespread problem. One study based on firm-level data reveals a decline in business dynamism in the manufacturing sector of the People's Republic of China, including a falling revenue share of young firms and slower life-cycle growth of young firms relative to older incumbents, with adverse consequences for aggregate productivity (Cerdeiro and Ruane, 2022[19]). Another study highlights structurally weak firm dynamics in India and Mexico, where manufacturing plants grow far more slowly over their life cycle than their peers in the United States, depressing aggregate productivity (Hsieh and Klenow, 2014[20]). A further study shows that entry and exit rates of informal firms in Vietnam have declined as local economies develop, with few surviving firms growing thereafter (McCaig and Pavcnik, 2021[21]). In emerging and developing economies, where informality is widespread, high and largely sunk formalisation costs may hinder firms' transition to the formal sector, discouraging entry and growth of formal businesses and ultimately reducing overall business dynamism (Auriol, 2013[22]).

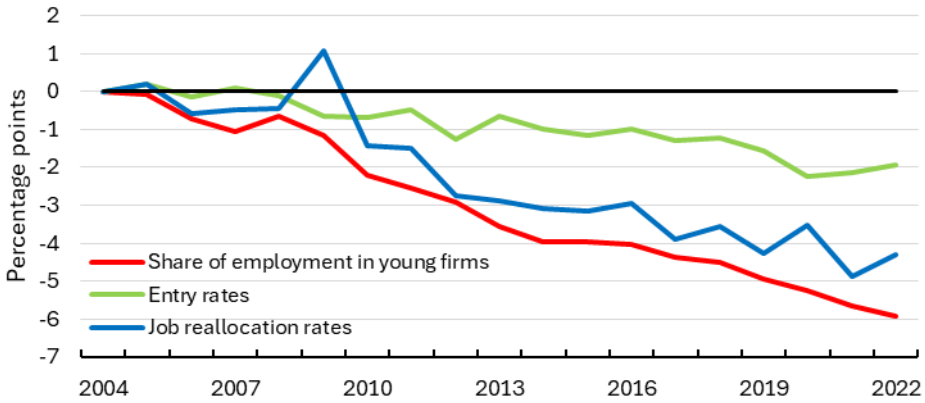
Declining dynamism is also affecting cross-border economic activity. A recent worldwide analysis of international trade data points to a marked decline in the dynamism of import markets over time, closely resembling business dynamism trends observed in domestic activity (Hummels and Yue, 2024[23]). This analysis shows a decline in entry rates for new exporters, weaker reallocation of market shares across exporters, and falling market shares of young exporters relative to longer-tenured incumbents (Hummels and Yue, 2024[23]). According to this study, the average exporter-product entry rate was 50% below the

levels of 1992 by 2001 and 70% below 1992 by 2020. The study attributes this to a growing incumbency advantage, whereby export markets mature and surviving incumbents accumulate productivity gains, raising the minimum productivity level a firm needs to enter the market as a new exporter. Declining market dynamism is observed for the vast majority of countries and products, again suggesting business dynamism issues are widespread. While this could be a result of market share being captured by the most productive firms, it may also point to reduced allocation towards new and innovative firms.

The drivers of declines in business dynamism are the subject of continued debate. The literature has related this phenomenon to several structural factors, including the rising importance of intangible capital and market power, digitalisation, globalisation, larger productivity dispersion between leader firms and laggards, and a decline in the diffusion of knowledge between leaders and laggards (Akcigit and Ates, 2023[12]). Some authors have also pointed to labour supply constraints associated with slower population growth as a contributing factor to declining firm entry rates and the growing concentration of employment and economic activity among older firms (Hopenhayn, Neira and Singhania, 2022[24]). A recent OECD study points to the role of an increasingly constraining regulatory environment in diverting resources from more productive activities (OECD, 2025[15]). However, the literature has not identified any causal relationships, as all these factors are likely interrelated and may jointly contribute to observed trends in business dynamism. The literature has also rarely identified the design of tax systems, or tax policy more broadly, as a driver of this decline or as a primary policy lever to address it.

Figure 2.3. 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[18])).

The impact of CIT on business dynamism remains underexplored. CIT influences firms' decisions to enter markets, invest, grow, and innovate. For example, the CIT system can influence 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[25]), as will be discussed further in Chapters 3 and 7. CIT can reduce the post-tax return on investment and may also affect firm growth by tightening or easing financial constraints, possibly distorting access to finance, which can be particularly

relevant for young firms, as will be discussed further in Chapter 4. In addition, preferential tax treatments for SMEs may unintentionally discourage growth, as will be discussed further in Chapter 5. Corporate taxation might also hinder firm exit, as preferential regimes can sustain the operation of "zombie" firms.[2] Finally, CIT can shape market competition by advantaging or disadvantaging specific firms, potentially amplifying market power concerns, increasing concentration, and discouraging entry, as will be discussed further in Chapter 6.

Notes

[1] Entry rates, job reallocation rates and the share of employment in young firms are commonly used as indicators of business dynamism, though they are imperfect proxies of underlying process of creative destruction through which resources move towards more productive firms. While they can help track changes in business dynamism and in the allocation of resources across firms, they should not be seen as policy goals in themselves.

[2] A zombie firm is a firm that is financially unviable but continues to operate due to external support or lax financial conditions. These firms have persistent problems in meeting their interest payments (Adalet McGowan, Andrews and Millot, 2017[161]). See Chapter 3 for further discussion on tax rates and firm exit.

3 Corporate income taxation and business entry and exit

This chapter discusses the impact of CIT systems on business dynamism through their effects on firm entry and exit. Smooth firm entry and exit help allocate resources towards the most productive firms. This chapter discusses the effects of changes in CIT rates on firm entry and exit, as well as the role of compliance costs and tax loss provisions, in particular for small and young firms.

Tax rates and business entry

CIT rates can impact business dynamism by affecting firm entry, though the magnitude of the effects remains unclear. Where it impacts the cost of capital, CIT can raise 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[26]) or statutory tax rates (Venâncio, Barros and Raposo, 2020[27]).[1] 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[26]). In addition, the effects of statutory CIT rate changes on firm entry tend to be stronger in more profitable sectors (McGowan and Kneller, 2012[28]). CIT may have a stronger impact on survival rates when the beneficiaries of those changes are high-quality entrepreneurs (Venâncio, Barros and Raposo, 2020[27]). In contrast, some studies suggest that the effect of effective tax rates changes on firm dynamism is relatively small (Block, 2021[29]; Krapf and Staubli, 2020[30]). 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[31]). One possible explanation for the different effects of corporate tax increases and decreases provided in this study is the asymmetric taxation of corporate profits. While tax cuts raise expected after-tax returns to entrepreneurship, tax increases may have a more muted effect because firms can offset losses against future profits, particularly in the early years of operation.

CIT rates influence firm entry by affecting 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[27]). However, since CIT is levied on positive profits but often relief is provided for losses, for example, through loss carryover provisions, the CIT system can shift risk from entrepreneurs to the government and can offer insurance for entry and risk-taking. Effective treatment of losses can therefore support the neutrality of the tax system with respect to entrepreneurial decision-making.[2] This is especially important when financial market imperfections limit risk-sharing with investors (Da Rin, Di Giacomo and Sembenelli, 2011[26]). 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 (Clingingsmith and Shane, 2016[32]).

CIT rates affect firm dynamism differently across firms, with heterogeneity arising from firm characteristics, such as size, age, and sector. CIT headline rates are found to have much larger effects on employment for small and young firms compared to other firms, while employment in large and more mature firms seem to remain largely unaffected by CIT headline rates (Albertini et al., 2024[33]).[3] Sectoral differences further shape the response, 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[34]).

Differentials between PIT and CIT rates influence incorporation decisions and can affect firm entry. Entrepreneurs may choose to incorporate to gain access to external financing, improve the extent of liability protection and facilitate ownership transfer (Zawisza et al., 2024[35]; Dyrda and Pugsley, 2024[25]),[4] but the tax treatment of business income may also play an important role in this decision. These issues are discussed further in Chapter 7.

Tax rates and business exits

The presence of zombie firms in the market may have negative effects on the creative-destruction process, which is a fundamental driver of innovation, investment and growth. Zombie firms can be defined as old firms that have persistent difficulties to meet their interest payments. In purely competitive markets, such firms would typically exit (Adalet McGowan, Andrews and Millot, 2017[36]). However, over the past two decades, particularly in the aftermath of the global financial crisis and the Covid-19 pandemic, the number of zombie firms has increased (Albuquerque and Iyer, 2023[37]). Empirical evidence suggests that the growing survival of low-productivity firms congests markets and constrains the growth of more productive firms. It can also constrain the entry and growth of new firms. This in turn reduces the return on investment (Adalet McGowan, Andrews and Millot, 2017[36]). More precisely, a higher share of zombie firms in the market dampens investment, productivity and employment of non-zombie firms (Albuquerque and Iyer, 2023[37]). Several channels may explain these effects. Zombie congestion can inflate wages relative to productivity, reduce market prices and undermine profitability. Weak and inefficient firms could tie up resources, which may crowd-out growth opportunities for more productive firms. This in turn reduces the return on investment and makes investment less attractive. In addition, banks whose balance sheets are weakened due to exposure to zombie firms could provide less credit to healthy firms (Andrews, Adalet McGowan and Millot, 2017[38]).

Changes in CIT rates appear to have only weak effects on firm exits. Empirical evidence indicates that the effect of changes in CIT rates on firm exit is less pronounced than the effect on firm entry (McGowan and Kneller, 2012[28]; Colciago, Lewis and Matyska, 2023[39]). A differential effect in entries and exits might reflect greater difficulties to unincorporate for already incorporated businesses. 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.

Evidence on the effect of the CIT rate on firm exit is limited but suggests the impact depends on firm entry rates and productivity levels. Higher entry rates may raise wages and capital costs and increase competitive pressures, gradually forcing out low-productivity incumbents (McGowan and Kneller, 2012[28]; Colciago, Lewis and Matyska, 2023[39])**.** This may suggest that incumbents' exit decisions in some cases appear to be driven by market selection forces rather than after-tax rewards considerations for bearing risk. However, high CIT rates can support this market selection process by forcing low-productivity firms to exit the market (Holtmann et al., 2025[40]). Such a process can facilitate the reallocation of resources, such as skilled labour, from low-productive firms to more productive firms, thereby potentially fostering innovation activities (Acemoglu et al., 2013[41]).

Excessively high CIT rates could result in inefficient firm exits. CIT rates raise the user cost of capital, thereby lowering firm's capital investment and, potentially, its productivity. CIT can also distort factor prices

and reduce the after-tax return on investment (Cevik and Miryugin, 2021[42]). Lower levels of effective marginal tax rates have been associated with a higher probability of firm survival, although reductions in tax rates from very high levels appear to be detrimental to firm survival (Cevik and Miryugin, 2021[42]).

The effect of CIT on survival is understudied, but available evidence suggests that the impact is heterogenous. Some evidence suggests that the impact of CIT on survival is stronger in developing countries than for advanced economies and the magnitude depends on firm characteristics such as age, size, profitability and indebtedness, with the corporate tax burden having a greater and adverse impact on the survival prospects of older firms, larger firms, firms operating in capital intensive sectors, and firms with higher debt levels (Cevik and Miryugin, 2021[42]). While the role of CIT in forcing inefficient firms out of the market is underexplored, non-tax policies such as improving the design of insolvency regimes to reduce barriers for firm restructuring, and macroprudential policy targeting bank capital and loan restrictions, have been identified as important (Andrews, Adalet McGowan and Millot, 2017[38]) (Albuquerque and Iyer, 2023[37]) and are discussed further in Chapter 8. Generally, neither higher nor lower survival rates clearly suggest a more dynamic economy. While these indicators may reflect the capability of productive firms to remain in the market, they may also indicate that the inefficient firms are not exiting the market.

Tax compliance costs and firm entry

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. Firms enter the market if their expected profits exceed the fixed operating costs. Tax compliance costs increase these 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 increases new firm creation and employment among new firms (Bacher and Brülhart, 2012[43]), noting that tax code length is only a proxy for ease of compliance.

Compliance costs reduce the overall efficiency of the tax system and can lead to a misallocation of economic resources and increasing the effective tax burden without generating additional government revenue (Eichfelder and Vaillancourt, 2014[44]). In addition, these costs affect several economic margins especially for young and small firms, influencing decisions on whether to become self-employed, to employ others, to operate in the formal economy, and to incorporate (OECD, 2015[1]).

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[1]; Zwick, 2021[45]). In comparison with other compliance obligations and sources of red tape, tax compliance costs are a large part of the total compliance cost burden (Eichfelder and Vaillancourt, 2014[44]).

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 is higher for smaller firms (OECD, 2015[1]). Strong economies of scale in compliance processes, driven by learning behaviour, as well as the decreasing relevance of overheads and specialization advantages, are all explanations for relatively higher compliance costs for small firms. 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 (Zwick, 2021[45]).

Tax complexity affects investment decisions. Tax complexity can increase compliance costs and tax uncertainty and may create opportunities for tax planning. Moreover, while some features of a tax system can support neutrality goals in many tax systems, complexity can distort firms' behaviour and weaken the effectiveness of tax incentives and other tax provisions. Empirical evidence suggest that the complexity of tax incentives may result in lower take-up, particularly for relatively smaller firms (Cui, Hicks and Xing, 2022[46]), 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[47]), which may curtail firms' decisions to internationalise. These internationalisation decisions can be important for firm entry into new markets and for business growth (Euler et al., 2024[48]).

Remittance responsibility amplifies the impact of compliance costs for businesses. In addition to being taxed directly, businesses act as withholding agents and remitters of tax on behalf of others. In this sense, they act as a major tax collector for tax categories other than CIT, such as sales and value added taxes, social security contributions and taxes on wages of employees. 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[49]) (Liu, Lockwood and Tam, 2024[50]). These costs can extend beyond CIT and affect small firm growth. For example, available estimates suggest that the average SME in the European Union incurs an annual cost in meeting its tax compliance obligations related to CIT, VAT, wage related taxes and contributions, property and real estate taxes and local taxes amounting to 1.9% of its turnover (European Commission, 2022[51]). In addition, evidence from the United Kingdom suggests that VAT registration thresholds[5] affect small firm growth, with annual growth in turnover slowing by about 1 percentage point when firm's turnover gets close to the VAT registration threshold (Liu, Lockwood and Tam, 2024[50]).

Tax losses and risk taking

Firm entry is an inherently risky activity which the tax system should not discourage. As discussed above, small and young firms are more likely to be financially constrained and loss making, and their investment decisions can depend on the availability of internal cash flow. This means that the generosity of loss carrybacks and the associated tax refunds can be particularly important for credit-constrained firms in a tax loss position (Devereux and Fuest, 2009[52]) and can increase risk-taking (Ljungqvist, Zhang and Zuo, 2017[53]). This is because as the loss carryover rules allow the government to share some of the downside risk, thereby encouraging firms to undertake riskier investments. One study found 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.[6]

The effects of asymmetrical treatment of profits and losses differ across firms. Governments are often reluctant to offer generous loss offsets due to risk of fraud and abuse. 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[54]).

Limited loss carryovers may increase the risk of bankruptcy, with ambiguous implications for business dynamism. Stricter loss carryover limits can increase the risk of bankruptcies (Olbert, 2025[55]). 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. Overly generous loss offset provisions may induce firms to engage in risky overinvestment, delaying the exit of low-productivity loss-making firms (Bethmann, Jacob and Müller, 2017[56]) (see also the discussion on CIT rates and business exits in this chapter). However, limited loss offset provisions can result in inefficient early exits and discourage corporate risk-taking (Ljungqvist, Zhang and Zuo, 2017[53]).

Notes

[1] 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[26]). Evidence from Portugal suggests that reducing the statutory CIT rate for start-ups, cut in stages from 34% to 10% between 2001 and 2008, was associated with an increase in firm entry of roughly 41 percentage points per month in targeted regions, with the effect driven mainly by the first cut, from 34% to 25% (Venâncio, Barros and Raposo, 2020[27]).

[2] Neutrality with respect to risk would ensure that riskier projects would not be penalised by the CIT system relative to less risk projects with the same expected post-tax return (Hanappi, 2018[174]).

[3] While empirical evidence remains limited, estimates based on changes in state CIT rates in the United States suggest that a one percentage-point reduction in CIT rates is associated with a decline in employment of 1.4% in small firms and about 4.5% in young firms (Albertini et al., 2024[33]).

[4] Divesting ownership in a partnership may require for instance the consent of other partners.

[5] The VAT registration threshold is the minimum annual turnover a business must reach before it is legally required to register for VAT.

[6] 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 (Ministerio de Hacienda y Función Pública, 2023[173]).

4 Corporate income taxation and business growth

This chapter examines how CIT systems can affect dynamism through their impact on the growth of new and young firms. Scaling-up often entails a substantial transformation of the firm often combining innovation, investment in both tangible and intangible assets, and the expansion of business networks (OECD, 2022[57]). The chapter discusses how CIT can exacerbate and alleviate financing frictions, particularly for young and small firms which depend more heavily on internal finance to grow, as well as the effects of corporate taxation on investment. CIT may also affect other growth and expansion margins, including the turnover and employment of growing firms, as well as merger and acquisition (M&A) activities and international expansion.

Corporate taxation and financing frictions

Access to finance is essential for the growth of small and young firms, yet these firms face more financing constraints than larger and established firms. Financing frictions tend to be more severe for small and young firms, reflecting their more 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[1]). 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 affect the cost of investment for all firms, but can particularly exacerbate financial frictions, disproportionately affecting small and new firms. A higher CIT burden reduces after-tax cash flows, which can restrain investment among firms that rely more heavily on internal financing or are cash-constrained (Dobbins and Jacob, 2016[58]; Egger, Erhardt and Keuschnigg, 2020[59]). Evidence also suggests that financially constrained firms allocate a lower share of tax-related cash flows[1] to capital expenditures relative to unconstrained firms, as they tend to use tax-related cash for additional liquidity (Guenther, Njoroge and Williams, 2020[60]). For this reason, CIT policy focused on supporting dynamism should give particular attention to the impact of the tax system on firms' cashflow, as well as their overall cost of capital.

Targeted tax provisions can ease financing conditions for small and young firms but may also be challenging to implement and lead to behavioural distortions. Many countries offer reduced tax rates or other targeted provisions for SMEs to support growth and to address particular compliance burdens. The case for such concessionary treatment is mixed; overly generous provisions could favour the entry of less productive businesses. Reduced rates for firms below a certain threshold can trigger behavioural responses such as bunching and disincentives to expand (Cui et al., 2025[61]), and may incentivise firms to break their organisational structure up into several smaller firms.

Careful design is required to ensure that targeted policies benefit the affected small and young firms where cashflow considerations, complexity, and profitability may all be different from the

broader firm population. Complex targeted tax incentives may have low take-up rates among small and new taxpayers who may not understand the tax concessions available to them. In addition, small and young firms' profits may be too low to benefit from tax concessions either in the form of expenditure-based incentives or reduced rates. 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. The design of tax incentives is discussed further in Chapter 5.

Refundability and expensing of investment can ease cash constraints for small and young firms but can carry fiscal costs for governments and can lead to distortions. Refundability of tax benefits can extend support to firms that may fail in their business venture or that never report taxable profits. However, it increases the volatility of CIT revenues, which are already among the most volatile tax revenue sources. Refundability carries also risks of fraud and compliance challenges, as it increases incentives to re-characterise non-targeted activities as those qualifying for a tax expenditure (OECD, 2015[1]). Full expensing of certain business expenditures and investments can also ease cash constraints, as well as reducing compliance costs, but the productivity implications need to be carefully considered. When an investment can be expensed, and the cost of debt or equity finance may also be deducted from the tax base, there is a risk of providing a "tax-subsidy" for loss-making investments (Adam and Miller, 2023[62]).

Tax policy, and in particular, targeted tax incentives, are not the primary tool to address financial frictions. Designing a CIT system that supports dynamism and small and young firms should include consideration of the cashflow impacts of the system and its impacts on investment and growth. However, designing CIT to expressly provide support for such firms can add complexity, generate distortions and deviate from a low-rate-broad-base approach. Financing frictions as well as broader support for business dynamism are often better tackled through non-tax-based instruments (see Chapter 8). 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.

Tax design and firm scaling

Firm scaling plays a crucial role in business dynamism, as firm entry alone without subsequent growth is insufficient to sustain job creation, innovation, competitiveness and economic performance. Firm scaling is commonly measured in terms of the absolute or relative growth in firm's employment or turnover over a period of time typically between three and four years (OECD, 2022[57]). Empirical evidence shows that only a small percentage of firms in many OECD countries have high growth rates (OECD, 2021[63]). Furthermore, these high-growth firms are often not knowledge-intensive high-tech firms or start-ups, but rather mature SMEs operating in low-tech sectors (OECD, 2022[57]). Yet, fostering the scaling of start-ups and small firms is essential for enhancing business dynamism and innovation.

CIT design may negatively influence the scaling potential of small firms, as the tax burden can rise as they grow. In particular, micro and large firms tend to pay lower effective tax rates than small and medium-sized firms. Evidence from European countries suggest lower ETRs observed for micro firms are likely attributable to tax credits and to preferential regimes that many governments grant to new and very small businesses, reliefs that are typically withdrawn once a firm has operated for a given period or when its activity passes a certain threshold. Consequently, firms transitioning from micro to small firms often experience an increase in effective tax rates (Barrios, Delis and Landabaso Alvarez, 2024[64]), which may discourage firm growth. Similarly, empirical evidence suggests that corporate tax cuts in Finland positively affect small firms' sales (Harju, Koivisto and Matikka, 2022[65]), while others find negative effects of CIT rates on new firm employment (Curtis and Decker, 2018[66]).

Firms may scale up and grow their employment and turnover through M&A, but empirical evidence on the relevant channels is limited. M&A can support growth through the transfer of resources between enterprises or organically through additional investment, improved managerial practices, access to new

technologies, and improved financial performance through economies of scale (OECD, 2025[67]). CIT systems can incentivise M&As if parent firms are better able to use tax benefits (e.g. loss carry forward or tax credits) than the acquired firm (Auerbach and Reishus, 1987[68]). In addition, acquiring firms abroad may enable firms to exploit tax avoidance opportunities in the international tax system to a greater extent (Ahern, 2025[69]), though such behaviours may change with changes to the international tax system to reduce profit-shifting such as the Global Minimum Tax. However, tax differentials may limit productivity improvements than can stem from M&A activity. Empirical evidence suggests that tax differentials between the parent and the acquired firm distort the efficient allocation of resources, leading to reduced gains in total factor productivity of the firm (Todtenhaupt and Voget, 2021[70]).

Firm scaling also involves international expansion, which can be important for productivity and growth. Frontier firms and market leaders can support productivity growth and innovation through the diffusion of technologies and managerial and organisational practices, with MNEs and firms' participation in global value chains playing a key role (Alfaro-Ureña, Manelici and Vasquez, 2022[71]). Evidence suggests that cross-border knowledge and technology flows through foreign direct investment tend to be stronger in high-tech sectors (Keller and Yeaple, 2009[72]) and where host firms have greater absorptive capacity and technologies are more closely aligned with those of investors (Gong, 2023[73]; Ahn et al., 2026[74]).

Tax uncertainty and compliance costs in the international tax system can influence MNEs expansion decisions. Firms can expand their business through the establishment or acquisition of foreign subsidiaries, branches or engagement in exports. Tax compliance associated with cross-border investment activity is more complex than domestic compliance as firms need to deal with multiple tax regimes and interactions between multiple tax regimes (OECD, 2025[5]). This increases the costs of international expansion and may disincentivise firms to expand internationally, with the effect being potentially larger for small and young firms, for which these costs are relatively higher. In the absence of multilateral coordination, compliance costs and complexity would be even greater and firms would be exposed to risks of double taxation (OECD, 2025[5]).

Generally, promotion of scale-up should be pursued as a holistic approach in which CIT constitutes only one component. However, academic evidence on the relative effectiveness of different scale-up policies remains limited (OECD, 2022[57]; OECD, 2025[67]). Non-tax policies to support dynamism are discussed further in Chapter 8.

Tax and investment

A key factor in supporting dynamism is ensuring that the tax system raises revenue with as limited impact as possible on investment, which is stagnating in many countries. In spite of the secular decline in global interest rates and statutory corporate tax rates, investment has been weak in OECD countries since the global financial crisis. The cost of capital, the required pre-tax return on investment to break even after corporate taxation and long considered a key determinant of investment, has fallen steadily over the past three decades, reflecting both the secular decline in global interest rates and cuts in statutory CIT rates (Hanappi, Millot and Turban, 2023[75]), though in recent years, interest rates have risen modestly, and the decline in CIT rates has stabilised (OECD, 2025[76]). However, business investment rates have not risen commensurately (see Chapter 2), suggesting either a declining sensitivity of firms' investment to the cost of capital or that the desired level of investment has fallen because of other factors (e.g. demographic forces, shifts in precautionary savings, the regulatory framework) (Rachel and Smith, 2015[77]; OECD, 2025[15]). This raises questions about the extent to which changes in corporate taxation can stimulate business investment, particularly in the current global environment characterised by higher interest rates and stabilised statutory CIT rates.

The tax sensitivity of investment is heterogeneous across various dimensions. Empirical evidence confirms that investment responds negatively to corporate taxation, but this sensitivity has fallen

significantly since the global financial crisis and varies along several margins (Hanappi, Millot and Turban, 2023[75]). It differs by asset type, with investment in buildings being less sensitive at the intensive margin than investment in machinery, equipment or intellectual property products. It differs across firms, with large firms, firms belonging to MNEs, intangible-intensive firms, and highly profitable firms having all become less tax-sensitive at the intensive margin, a pattern consistent with the characteristics of "superstar" firms[2] (Autor et al., 2020[78]; Millot et al., 2020[79]), while small firms tend to respond more strongly.[3] There is also some evidence of higher tax sensitivity to tax policies that affect the intensive margin of investment (e.g. the provision of allowances for investment, or accelerated depreciation). Taken together, the available evidence could suggest that targeted support could be more effective in supporting investment than broad-based tax reductions, though such support would need to be weighed against the added complexity.

Responses of investment to tax depend on the tax instrument. Sensitivity also differs by tax instrument, as non-profit taxes, levied on bases such as real estate or corporate wealth, appear to weigh on investment more strongly than CIT. Similarly, 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[80]), 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[81]).

Accounting for the heterogeneity in the tax sensitivity of investment may support the effectiveness of CIT policies. Because the investment of large and multinational firms has become less responsive to taxation as compared with smaller, younger, less profitable and domestic firms, uniform reductions in the CIT rates may be a relatively costly instrument. Eliminating or reducing distortive non-profit taxes (such as real estate or corporate wealth), which weaken the link between tax burdens and profitability and considering the use of targeted tax incentives that induce strong investment responses could effectively support investment.

Notes

[1] "Tax-related cash flows" can be defined as additional cash flows arising from engaging in strategies that reduce firms' tax payments and that can be allocated to other uses, including new investment, cash savings, and debt repayment (Guenther, Njoroge and Williams, 2020[60]).

[2] Highly productive and innovative firms, which often rely intensively on intangible assets.

[3] The relationship between tax and market power is discussed further in Chapter 6.

5 CIT design and business dynamism

CIT systems can support investment and business dynamism, though trade-offs must be considered. The chapter considers key aspects of CIT design, including tax incentives, which can support or potentially hinder dynamism. It also discusses R&D tax incentives which can support intangible intensive firms and innovation, a key driver of growth, while also considering important trade-offs. In addition, the chapter highlights the relevance of tax certainty and stability for business dynamism.

Tax incentives for investment

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 (Celani, Dressler and Wermelinger, 2022[82]; OECD, 2025[83]).

Targeted tax incentives can support business entry and growth but can also bring important trade-offs. 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, specific technologies). By contrast, income-based tax incentives, such as income tax exemptions and reduced tax rates, carry the risk of resulting in windfall gains without incentivising additional investment (IMF-OECD-WB-UN, 2025[84]).

Tax incentives based on firm size can have important 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[1]). Yet, they may weaken business dynamism by encouraging firms to remain below eligibility thresholds (Bachas and Soto, 2021[85]) (Liu, Lockwood and Tam, 2024[50])or incentivising business owners to recharacterise business income and adjust their organisational form to benefit from the preferential treatment (Devereux, Liu and Loretz, 2014[86]). Targeting tax incentives can stimulate additional investment at lower revenue forgone. However, this may increase complexity, administrative and compliance costs, and the risk of distortions from picking winners (OECD, 2026[87]).

Tax incentives for R&D and innovation

R&D tax incentives can support small and young firms investing in intangible capital, especially when they are cash constrained, though careful design is key for effectiveness. 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[18]). Investments in intangible assets involve irrecoverable (sunk) costs that are difficult to finance for small and young firms. However, economies of scale and network effects can allow successful firms to grow rapidly, which may

support innovation by those firms with ready access to finance, while also contributing to "winner-takes-all" dynamics that may raise entry barriers and limit catch-up (Haskel and Westlake, 2017[88]). 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[89]), potentially driven by a lower level of initial R&D performance (OECD, 2023[90]). However, other studies find weaker effects for small firms (de Boer, 2019[91]). 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[92]), as these firms often do not generate profits in the early years of operation. This is consistent with the importance of the cashflow dimension discussed above. However, refundability can be costly for governments and may lead to compliance and administrative challenges.

R&D and innovation tax incentives may inadvertently impede dynamism by disproportionately benefiting incumbents and are often only a second-best policy option. Empirical evidence suggests that large incumbents typically engage more intensively in R&D activities and claim a larger share of R&D tax incentives (OECD, 2015[1]). Large firms may also be more effective in understanding and taking up R&D tax incentives. While their R&D activity can generate substantial positive spillovers, it may also strengthen incumbents' market positions, raise entry barriers, and reduce job reallocation (Calvino, Criscuolo and Verlhac, 2020[18]). 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 (Bravo-Biosca, Criscuolo and Menon, 2013[93]).

Policy instruments, such as direct support and refundable tax credits, may be more efficient than non-refundable credits, especially for cash-constrained firms and when combined with caps. Compared with tax incentives, direct grants can target firms more directly and do not require profitability, which can increase policy efficiency (OECD, 2023[90]). However, they also risk "picking winners" and distorting competition (OECD, 2015[1]). 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. Caps on the amount of support provided to individual firms or groups may limit revenue costs while also ensuring that take-up imbalances across firms of different sizes do not give rise to level playing field issues.

The relevance of tax certainty and stability for growth, investment and business dynamism

Tax certainty, the extent to which firms can predict the tax treatment of their current and future activities, has long been regarded as a defining feature of a well-designed tax system. The principle that taxation should be certain rather than arbitrary is not new and early economic analysis showed that frequent, unpredictable shifts in tax policy generate welfare costs by distorting saving, investment and labour-supply decisions (Skinner, 1988). At the domestic level, tax certainty is affected by weaknesses in the tax policy process and unclear tax rules, whenever these are, for example, ambiguously drafted or frequently amended. At the international level, tax certainty can be impaired by the absence of coordination between jurisdictions on tax matters or by ambiguities or inconsistencies in the application of tax rules. These concerns have gained renewed prominence over the past decade, reflecting the interplay of elevated economic and political uncertainty, rapidly evolving business models, and successive reforms of the international tax rules (OECD, 2017[3]). Tax uncertainty matters for growth and investment because it

raises the risk attached to largely irreversible investment decisions. In a large OECD survey of business, over 60% of respondents reported that uncertainty related to CIT and VAT was a very or extremely important consideration in their investment and location decisions (OECD, 2017[3]).

Empirical evidence points to positive effects of tax certainty on investment, firm growth and dynamism. Most empirical studies of the topic find that tax uncertainty weighs on investment. Cross-country evidence indicates that higher volatility in effective tax rates on capital income is associated with lower investment per worker (Edmiston, 2004[94]).[1] Complexity and uncertainty in the tax system, for example in the form of multiple tax rates, ambiguous statutory language and inconsistent changes to the tax law, have been found to deter inward foreign direct investment (Edmiston, Mudd and Valev, 2003[95]). Firm-level studies point in the same direction, suggesting that a policy change that increases uncertainty on firms' tax positions lead firms, on average, to delay large capital investments, with the effect concentrated among financially constrained firms and consistent with a higher hurdle rate for investment[2] under tax uncertainty (Jacob, Wentland and Wentland, 2022[96]). Uncertainty about the future intensity of tax enforcement can have comparable effects (Fox et al., 2022[97]).

Tax certainty shapes how effectively tax policy can support investment and innovation, and enhancing certainty can itself attract capital. Evidence from a natural experiment comparing two similar tax incentives for investment introduced in the same country two years apart, one in a period of economic stability and one during the global financial crisis when uncertainty was high, suggests that the tax incentive raised investment strongly under stable conditions, whereas under uncertainty the response was markedly weaker, held back by the firms most exposed to uncertainty (Guceri and Albinowski, 2021[98]).

The relevance of certainty for investment extends beyond taxation to the broader policy and political environment in which firms operate. Tax certainty is one key aspect of wider economic and policy certainty. Heightened policy uncertainty, as measured by a news-based index of economic policy uncertainty, has been associated with reduced investment and employment particularly in policy-sensitive sectors, like health care, finance, and infrastructure construction, while increases in policy uncertainty have been found to precede declines in aggregate investment, output and employment across major economies (Baker, Bloom and Davis, 2016[99]). At the firm level, greater policy uncertainty has been associated with lower capital investment, an effect that is more pronounced for firms whose investments are more irreversible and for those more dependent on government spending, consistent with firms postponing investment for precautionary reasons when the policy outlook is unclear (Gulen and Ion, 2015[100]). Similarly, listed firms facing higher exposure to political risk, as measured by the share of conversations on conference calls on risks associated with politics, have been shown to curtail hiring and investment (Hassan et al., 2019[101]). Taken together, this evidence indicates that a stable and predictable policy environment, of which tax certainty is an important component, supports the investment, entry and expansion decisions that underpin business dynamism and long-run growth.

The OECD has long promoted tax certainty, particularly in the international tax arena. Cross-border business activity, globalised MNEs, and international labour mobility have become increasingly common features of the global economy in recent decades, thereby leading on occasion to disputes relating to the taxation of different types of income. Following a request from G20 Leaders in 2016, the OECD and the IMF have examined the economic effects of tax certainty and identified a set of practical tools for tax administrations to foster a more predictable tax environment, spanning clearer legislative design, more consistent and predictable tax administration, and more effective dispute prevention and resolution (OECD, 2017[3]). A recent OECD report to the G20 has also considered ways to enhance simplification and reduce compliance costs in the cross-border business tax system for both taxpayers and tax administrations (OECD, 2025[102]).

Maintaining and enhancing tax certainty in the international tax system benefits taxpayers and tax administrations alike and is key in promoting cross-border trade investment, jobs and growth. The

OECD's work on tax certainty for international businesses approaches the topic holistically, focusing on three key areas:

- **Simplification** is the first and most fundamental goal, aiming to streamline rules and their administration to reduce complexity and enhance clarity for both taxpayers and tax administrations. This includes considering measures like safe harbours and other simplifications, such as the simplified and streamlined approach under Amount B.
- **Dispute prevention** comes into play in situations that simplification alone cannot address. This includes tools and programmes designed to tackle potential issues in advance and offer taxpayers proactive avenues for early tax certainty, such as co-operative compliance programmes, coordinated risk assessments like the International Compliance Assurance Programme (ICAP), bilateral and multilateral advance pricing arrangements (APAs) and joint or coordinated audits.
- **Dispute resolution** aims at ensuring that, when disputes cannot be prevented, taxpayers and tax administrations have access to efficient, effective, and timely resolution mechanisms, including the mutual agreement procedure (MAP) and arbitration. In this respect, the BEPS Action 14 Minimum Standard and the associated peer review process have had a sizable impact both on the efficacy of the processes as well as their wider adoption.

This integrated approach[3] supports the prevention and resolution of disputes but also provides a clear and predictable framework of tax rules and administration for taxpayers.

Empirical evidence also highlights the positive impact of tax certainty on investment in an international context. Evidence based on firm-level data shows that MNEs invest more frequently in countries with effective mutual agreement procedures, including a broad set of MAP components and faster dispute resolution,[4] with stronger effects observed for vertically integrated and smaller parent MNEs (Zhang and Petutschnig, 2025[103]).[5] This provides empirical support to the emphasis that the OECD has placed on dispute prevention and resolution as a channel through which greater certainty can be translated into higher investment.[6]

Notes

[1] Estimated elasticities range between −0.01 to −0.03, suggesting that a doubling in tax rates volatility is associated with a 1% to 3% decline in investment per worker, where tax rate volatility is measured as a deviation from its trend.

[2] The hurdle rate is the minimum acceptable return on a specific investment or project.

[3] See https://www.oecd.org/en/topics/tax-certainty-and-policy-implementation.html.

[4] The OECD publishes MAP country profiles using a standardised template. These profiles provide details on competent authority, domestic MAP guidelines, and other country-specific information on the MAP process useful for both tax authorities and taxpayers. More on MAP profiles on this website: https://www.oecd.org/en/topics/sub-issues/dispute-resolution-in-cross-border-taxation/mutual-agreement-procedure-profiles.html.

[5] Vertically integrated multinationals are sensitive to effective MAP as they frequently engage in related-party transactions and heavily rely on transfer pricing. Similarly, small parent multinationals typically have

less knowledge and resources to resolve tax disputes and are therefore more inclined to use MAP as an avenue for dispute resolution.

[6] The OECD continues to work in this direction, in part through the OECD-BIAC Tax Certainty Roundtable organised in April 2026 where tax leaders from the public and private sectors discussed with academics and economists involved in the tax certainty field on its benefits on compliance, investment and growth.

6 Corporate income taxation, business dynamism and competition

CIT systems can shape dynamism not only through their impact on new and young firms, but also through their impact on incumbent firms. This chapter discusses how effective tax rate (ETRs) for larger firms, particularly MNEs, as well as their market power, can affect the growth prospects of small and young firms. In addition, it explores whether differences in firm's ability to engage in tax planning may affect their competitive position.

Market power, effective tax rates and market competition

Market power can impact business dynamism through various channels. When incumbent firms have high degrees of market power, this may weaken competitive forces, discouraging firm entry. Market power can arise from a variety of sources. Larger firms may benefit from economies of scale, managerial and technical advantages, and higher capacity to undertake large-scale investments (Bloom and Van Reenen, 2010[104]; Syverson, 2019[105]; De Loecker, Eeckhout and Mongey, 2021[106]). They may also benefit from network effects and be better placed to absorb the sunk costs and risks associated with intangible investments (Crouzet and Eberly, 2019[107]). While these factors can support innovation and productivity growth (Autor et al., 2020[78]), they may also make it difficult for new firms to enter the market (De Loecker, Eeckhout and Mongey, 2021[106]). However, the empirical evidence on their implications for business dynamism is limited, with some studies finding no significant association with changes in dynamism (Albrecht and Decker, 2026[108]).

Recent evidence highlights the link between market power and dynamism. OECD research finds that more concentrated industries are less dynamic in terms of firm entry and job reallocation (Calvino, Criscuolo and Verlhac, 2020[18]), also showing greater entrenchment among market leaders (Calligaris et al., 2025[109]). Some studies point to weakening knowledge and technology diffusion across firms, alongside rising market concentration and widening productivity gaps between frontier and lagging firms, with potential implications for aggregate productivity growth (Andrews, Criscuolo and Gal, 2016[11]; Akcigit and Ates, 2023[12]). Preserving a level-playing field and reducing competitive distortions can therefore support dynamism by ensuring new entrants are able to compete with incumbents.[1]

Some evidence suggests that large firms and firms at the productivity frontier typically pay lower effective tax rates compared to their competitors. The ETR of firms with relatively high levels of productivity compared to competitor firms ("frontier firms") has steadily declined since the late 1990s, whereas the ETR of non-frontier ("laggard") 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[110]). Consistent with this, some evidence suggests that the ETR follows a hump-shaped relationship with firm size, with one study finding that small firms benefit from reduced

statutory rates and large firms are better positioned to exploit tax incentives, leaving mid-sized firms facing the highest ETRs, though this evidence only comes from a relatively small sample of countries (Bachas et al., 2025[111]).

The use of tax incentives and high intangible intensity may be a key driver of ETR differentials. Some studies find that larger firms exhibit higher take-up rates of tax incentives, such as tax credits and income exemptions (Bachas et al., 2025[111]). 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[110]; González Cabral et al., 2023[112]). 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 planning practices are associated with firm size, productivity, and ETR differentials among firms, which may contribute to competitive distortions. Large firms and firms at the productivity frontier are often MNEs operating in many jurisdictions and therefore exposed to a variety of tax provisions and rules. In some cases this may create opportunities to benefit from mismatches across national tax systems and preferential tax treatments (Bartolini, 2018[110]), which may result in competitive distortions, though these patterns may change with the ongoing implementation of the Global Minimum Tax They are more likely to have superior management practices which may lead to additional tax planning and lower ETRs (Bilicka, 2019[113]; Bartolini, 2018[110]), and incur lower tax compliance costs relative to turnover when compared to smaller firms (Eichfelder and Vaillancourt, 2014[44]). In addition, they may employ most sophisticated tax advisors and maintain in-house tax departments (Zwick and Mahon, 2017[80]), strengthening their capacity to understand and use complex tax rules strategically. 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[114]).

The implications of differences in ETRs across different types of firms may have implications for dynamism, though further research is needed. Where differences in ETRs stem from tax planning, this activity may give some firms a competitive advantage over others, which may have negative impacts on dynamism. However, ETR differences may also depend on higher investment or R&D intensity by the most productive firms, which may signal an efficient allocation of capital. Further evidence is needed to understand how these ETR differentials translate or affect business dynamism.

There is some evidence that large firms and firms at the productivity frontier are less sensitive to tax. These firms may respond less to tax because they may have a dominant position in the market and may be incentivised to continue investing to maintain their dominant position (Millot et al., 2020[79]). They may also be highly profitable firms with significant market power, so that taxes are levied on monopoly rents rather than on normal returns to capital, with smaller effects on investment choices. They may also have ample financial resources which makes them less credit-constrained and thus sensitive to a potential increase in taxation. In the case of MNEs, tax planning opportunities and the ability to shift profits could make them less sensitive to local taxation than domestic firms (Sorbe and Johansson, 2017[115]).

Tax planning opportunities and the role of anti-avoidance measures

Where tax avoidance creates persistent differences in ETRs unrelated to firms' productivity or investment decisions, it may contribute to resource misallocation and reduced dynamism (Martin, Parenti and Toubal, 2025[116]). While tax avoidance resulting from tax planning may support entry and growth by reducing tax burdens, it also risks widening the ETR gap between incumbents and entrants, and between large global firms and smaller competitors. Tax avoidance acts as an inefficient government subsidy to firms who engage in avoidance, 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 (Glover and Levine, 2023[117]). 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[110]). By contrast, large and more productive firms that may face lower ETRs as a result of tax planning may use the capital not paid in taxes to increase their investment and benefit from higher after-tax returns. However, there is some evidence that small firms may also have opportunities for tax planning (Zawisza et al., 2024[35]).

A small but increasing literature points to links between corporate tax avoidance and competition. 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[118]). Differences in tax burdens may give an additional competitive advantage to these firms over their rivals, potentially increasing their market share and reinforcing their dominant position (Sorbe and Johansson, 2017[115]; Martin, Parenti and Toubal, 2025[116]), though as discussed above, this may depend on the source of the differentials in ETRs. Some authors find that MNEs engaging in tax planning exhibit higher mark-up rates compared with other firms, and that industries with a strong presence of MNEs engaging in tax planning tend to be more concentrated than other industries (Sorbe and Johansson, 2017[115]).

International action on tax avoidance may, where well-designed, support dynamism by promoting a level playing field. The OECD/G20 BEPS project, launched in 2015, equips governments with a set of policy instruments to curtail tax avoidance by MNEs, as well as progressing to the implementation of the Global Minimum Tax (GMT) which is also expected to reduce avoidance. Under the OECD/G20 Inclusive Framework on BEPS,[2] over 140 jurisdictions are working together to implement fifteen measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. While international action may support competition by reducing inappropriate tax advantages, these benefits need to be realised in a way that minimises the associated compliance burdens which may also have negatively impact MNEs' investment decisions and business dynamism.

Preliminary evidence suggests positive impact from the implementation of the BEPS project and the GMT, though challenges remain. The OECD/G20 Inclusive Framework Stocktake Report to G20 Finance Ministers and Central Bank Governors released on the tenth anniversary of the BEPS project shows that the BEPS Project has yielded tangible results (OECD, 2025[119]). Despite some limitations in data availability, there are indications of a positive economic impact of the BEPS Project across a variety of metrics, including a better alignment between profits and substance, a 12% decline in the sensitivity of the location of profits to tax rates, the stabilisation of statutory tax rates, a substantial increase in transparency with the introduction of Country-by-Country Reporting (CbCR),[3] and an expansion in the use of Mutual Agreement Procedure (MAP) to resolve disputes related to the interpretation and application of tax treaties. At the same time, the report noted continued work to be done on implementation and highlighted economic trends that may exacerbate BEPS risks. Recent OECD evidence has suggested that the GMT is likely to reduce profit-shifting by 23-47%.[4] Other research has highlighted that the GMT has raised effective tax rates particularly for firms more likely to engage in profit-shifting (Contreras, Hugger and Zawisza, 2026[120]).

The literature suggests that anti-avoidance measures may limit market concentration and support competition, but there are few studies and some disagreements over the size of the magnitudes. One study found that the introduction of CbCR was associated with less market concentration in industries where top firms, as measured by their sales, were subject to CbCR (Bajgar et al., 2025[121]). By contrast, other authors find that the introduction of anti-tax avoidance regulations reduced concentration only in industries where MNEs are concentrated and avoidance amongst leading firms is high but does not find impacts elsewhere (Gallemore et al., 2025[122]).

Notes

[1] Caution is however needed when analysing the empirical evidence in this section and the one that follows, as most analyses rely 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.

[2] The Inclusive Framework on BEPS (Inclusive Framework, often noted as IF) is the technical and political authority for handling the BEPS project recommendations and the continuation of related work. At its inaugural meeting in June 2016, there were 82 members. Since then, the membership of the Inclusive Framework has grown to over 145 countries and jurisdictions, including 16 observer organisations.

[3] CbCR, consistent with Action 13, is particularly relevant for monitoring purposes, as CbCR rules ensure that MNEs annually report relevant statistics (e.g. revenues, profits, tax liabilities, number of employees, tangible capital) for each tax jurisdiction in which they operate, and that Inclusive Framework member jurisdictions exchange this information in order to track base erosion more efficiently.

[4] https://www.oecd.org/en/events/2026/07/economic-impact-assessment-of-the-global-minimum-tax-2026.html

7 The broader tax system and business dynamism

Business dynamism may be affected by taxes beyond CIT. This chapter discusses the impact of non-CIT taxes on business dynamism. In particular, the chapter explores how the interplay between CIT and personal income tax (PIT) may affect incorporation decisions and how dividend and capital gains taxation affects investment and allocation of investment. In addition, the chapter examines the effects of social security contributions and payroll taxes on firm growth, investment innovation and human capital accumulation. The chapter also discusses the effects of taxation on household savings and on capital markets.

Shareholder-level taxation

Empirical evidence confirms that incorporation decisions respond to the interaction of PIT and CIT systems but evidence of an impact on business dynamism is limited. Evidence suggests that incorporation decisions are impacted by the interaction of the taxation of different forms of income, including wage income, personal capital income and corporate income (Tazhitdinova, 2020[123]; Zawisza et al., 2024[35]; Harding and Marten, 2018[124]). Understanding the extent to which tax differentials, which may favour incorporation, translate into genuine entrepreneurial entry requires distinguishing between whether incorporation reflects new business creation or merely organisational form switching, and the available evidence on this distinction remains limited (Tazhitdinova, 2020[123]). For example, evidence from the United Kingdom suggests that a 10% increase in the PIT-CIT tax wedge is associated with a 2.1% rise in new incorporations, with only around half attributable to genuine business entry rather than reclassification of existing activity (Tazhitdinova, 2020[123]). Generally, the tax system should support neutrality of business form, as non-neutralities may lead to inefficiently large incorporations which may in turn distort the allocation of capital and reduce productivity. However, there may be some evidence that incorporation may support dynamism on the margin, because of incorporated firms' better access to external finance and limited liability (Devereux and Lui, 2016[125]; Galanakis and Savagar, 2025[126]).

Interactions between CIT and PIT rates may also impact incentives to engage in risky activity which is key for dynamism. Many systems combine progressive effective PIT rates with flat CIT rates, which can mean that 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[26]). This subsidy is starker where personal taxation of business income offers less generous loss-offset provisions than CIT, further discouraging investment in high-risk projects under the PIT and limiting the internal financing available to unincorporated businesses (Gentry and Hubbard, 2000[127]; Cullen and Gordon, 2007[128]).

The available evidence does not offer a clear picture on the impact of dividend taxation on retained earnings, and thus on firm investment. Recent studies suggest that the cost of financing using retained earnings can be lower than that of external financing (Myers and Majluf, 1984[129]; Catherine et al., 2022[130]). Higher shareholder-level taxation can provide an incentive for firms to retain earnings due to the

tax value of deferring tax liability. Where this retention means that otherwise cash-constrained firms may have access to additional cashflow, some evidence suggests dividend taxes can be associated with increased investment by affected firms, though not all (Miller, Pope and Smith, 2026[131]). However, the same retention outcomes may result in lower available capital for other firms. Some authors find that a dividend tax cut does not have an effect on aggregate investment but a reallocation effect, by increasing investment in cash-constrained firms relative to cash-rich firms (Alstadsæter, Jacob and Michaely, 2017[132]). 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[133]). However, in this area again, the evidence is mixed, with other papers finding limited investment impact (Yagan, 2015[134]).

The favourable tax treatment of capital gains is a long-standing feature of many tax systems, reflecting enduring views about its role in fostering economic growth. Most OECD jurisdictions typically tax capital gains upon realisation, usually at lower rates or with exemptions relative to other forms of income and often provide additional relief for specific assets or businesses, such closely held businesses or owner-managed firms. A commonly cited rationale for tax relief on capital gains raises the after-tax return to saving and investment, thereby encouraging domestic capital accumulation and supporting entrepreneurship (Hourani and Perret, 2025[135]). Other rationales include mitigating the "lock-in effect" that arises from taxing gains only upon realisation,[1] avoiding double taxation of business income already taxed at the corporate level,[2] and preventing the taxation of purely inflationary gains.

Evidence is limited and mixed regarding the extent to which favourable tax treatment of capital gains supports dynamism. However, empirical evidence supporting the effectiveness of capital gains taxation in supporting increases in investment, innovation and entrepreneurial risk-taking remains mixed (Hourani and Perret, 2025[135]). Some studies find little support for the claim that capital gains taxes affect entrepreneurial entry and firm growth since, unless rates are particularly high, they tend not to be a first-order consideration for entrepreneurs, particularly those that establish firms with the expectation of high payoffs albeit at a low probability (Fleischer, 2019[136]). Other studies suggest that capital gains taxation can affect investment in cash-constrained firms (Moon, 2022[137]).

Favourable treatment of capital gains taxation may support the access to external equity financing which may play a role in enabling young and small firms to scale-up their operations. By easing financial constraints and addressing capital market failure, external equity financing may support business expansion, employment growth and increases in turnover. The tax treatment of capital gains upon the disposal of an investment may influence the risk-taking and decision making of an investor, while tax incentives for capital gains reduce the effective marginal costs of investing (European Commission, 2022[51]). Compared to subsidies, which are not related to investment success and may therefore incentivise entry rather than growth, tax cuts on capital gains tax raise the return from successful investment and therefore may support investment in effort (Keuschnigg and Nielsen, 2004[138]). Some, though not all, empirical evidence suggests that capital gains taxation can reduce external funding for start-up investments (Edwards and Todtenhaupt, 2020[139]; European Commission, 2022[51]). More recent evidence suggests that by lowering the cost of investment, capital gains tax incentives may encourage the allocation of capital towards riskier and more innovative firms. Firms, which are financed by tax subsidized investment often experience higher rates of business failure, however, those that succeed have shown higher economic returns, reflected in higher valuations (Campello and Junqueira, 2026[140]).

Payroll taxes and social security contributions

Payroll taxes and employer social security contributions may affect firms' growth and employment by directly affecting the cost of formal employment. Unlike CIT these taxes are typically levied on the wage bill from the moment a firm hires its first worker and regardless of whether the firm is profitable. This

makes them a particularly salient cost for young and cash-constrained firms, many of which are working towards profitability (Guo and Wallskog, 2025[141]). Some studies on the incidence of payroll taxes have documented that pass-through to wages tends to be incomplete, with a substantial share of the burden borne by firms in the form of lower employment, reduced production, or lower investment (Benzarti and Harju, 2021[142]). For example, recent evidence from the United States shows that payroll taxes weigh on new-employer firm entry, lowering the survival rates of young firms and slowing their subsequent employment growth (Guo and Wallskog, 2025[141]). Other studies, however, find that the incidence of mandated employer benefits is fully on wages, with little to no effect on employment (Gruber, 1997[143]) or average sales (Deslauriers et al., 2021[144]), with others finding the effect depends on the extent of the linkage between benefits and contributions (Bozio et al., 2026[145]).

The effects of payroll taxes and social security contributions on firm growth and investment are heterogeneous across firms. The impact of reductions in payroll taxes and social security contributions on firm growth varies with firm size and financial situation. In France, one study found that general reductions in employers' social security contributions were associated with faster business employment growth, but the gains were concentrated in fast-growing and larger establishments (Garsaa and Levratto, 2015[146]). In Colombia, a reform shifting the tax mix from payroll to corporate income raised employment and wages on average, with employment gains concentrated in micro and small firms rather than in medium and large firms where the bulk of employment was concentrated (Bernal and Eslava, 2017[147]).

However, as in the CIT space, efforts to use targeted reductions in payroll taxes or social contribution to support firm growth should be considered with caution. 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 (Deng et al., 2026[148]).

Household savings, capital markets and financing for new firms

Business entry and firm growth are strongly related to the development of capital markets, which in turn may be affected by tax policy. Tax policies may have an impact on the early development of the capital markets by reducing household savings or by shifting the composition of savings from financing that is available to small and young firms compared to other assets such as real estate (OECD, 2018[149]). The development of capital markets influences the amount of capital in the market that may be available for financial intermediation and lending to businesses. To the extent that firms rely on external finance, a reduced supply of savings may increase financing constraints and costs of capital for domestic investors. This may negatively affect firm entry and firm growth, particularly for younger and smaller firms depending more heavily on external sources of finance. While domestic taxation of savings may have more limited impact on foreign investors, there remain greater frictions in attracting investment from abroad than in attracting domestic investment (Gaar, Scherer and Schiereck, 2022[150]; Karlsson and Nordén, 2007[151]).

Taxation may affect the volume of household savings. Income taxation may discourage saving by reducing the after-tax return of savings and making future consumption relatively more expensive than consuming today (Adam, 2010[152]; Hourani and Perret, 2025[135]). However, there is limited evidence on the response of aggregate savings to capital gains taxation, and the available evidence suggests aggregate responses that are modest in size (Hourani and Perret, 2025[135]; Chetty et al., 2014[153]). In addition, these effects may depend on external factors, including socio-economic conditions, and income versus substitution effects.[3] Moreover, the presence or absence of tax financed social protection systems and consumption taxation can also impact private incentives to save.

Taxation may affect the allocation of savings to specific types of assets affecting the flow of capital to entrepreneurial ventures. Achieving tax neutrality, whereby the tax system does not distort the

allocation of savings across asset types, is challenging, as capital gains, unlike interest or dividends, are usually taxed upon realisation rather than as they accrue. This deferral reduces the ETR on capital gains, particularly for assets held over long periods. As a result, it creates a preferential treatment for assets that generate returns through capital gains rather than through current cash income (Adam, 2010[152]). Empirical evidence points to a portfolio composition altered towards more tax-favoured assets (OECD, 2018[154]). 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. This may impede business dynamism by limiting the flow of capital to entrepreneurial ventures, innovative firms, and young but high-growth firms.

Notes

[1] Because capital gains are typically taxed when an asset is sold ("realised") rather than as they accrue, asset holders have an incentive to defer sales purely to postpone tax rather than for economic reasons, which can misallocate capital by discouraging otherwise efficient sales.

[2] Corporate profits reflected in a higher share price may be taxed twice: once through CIT at the firm level, and again through the capital gains tax when the shareholder sells the asset. Favourable capital gains treatment is sometimes justified as offsetting this double taxation, though how much double taxation actually occurs depends on the firm's effective CIT rate and financing structure (Hourani and Perret, 2025[135]).

[3] Income effects occur when reduced taxation means individuals save less to maintain the same level of consumption in the future since a higher return increases future income; substitution effects occur when individuals save more due to higher returns as the opportunity cost of consuming today increases.

8 Supporting growth and business dynamism beyond tax policy

The tax system shapes firms' incentives to enter a market, invest, and innovate, but tax policy is only one instrument among many in the broader policy mix that may impact business dynamism. The long-run decline in business dynamism has unfolded alongside a broad-based slowdown in productivity growth and rising market concentration, both of which are likely driven by structural and regulatory conditions as well as by the tax system (Calvino, Criscuolo and Verlhac, 2020[18]) (Goldin et al., 2024[10]; OECD, 2025[15]). Supporting business dynamism therefore requires a coordinated action across a wider set of conditions, including competition and regulation, efficient insolvency regimes, access to finance, innovation and technology diffusion, and labour markets supporting appropriate skills and matching workers to jobs. Throughout, these policies should be considered as reinforcing complements not substitutes; strengthened competition without adequate access to finance may facilitate entry but constrain scaling; while strengthened finance without improved competition may reinforce incumbents. These complementarities imply that tax policy could be most effective in fostering business dynamism when embedded within a coherent policy framework.

Strengthening competition and easing the regulatory framework

A pro-competitive regulatory environment is a key non-tax lever for supporting business dynamism. A pro-competitive regulatory environment that removes unnecessary barriers to entry, growth, competition and exit, while supporting the creation and expansion of innovative businesses, can speed the reallocation of resources towards more productive firms, and increase incentives to innovate and to adopt better technologies and management practices (Aghion et al., 2005[155]; Bloom and Van Reenen, 2010[104]; OECD, 2025[15]). It minimises fixed costs associated with regulatory compliance and the related administrative burdens, which typically weigh disproportionately on small and young firms as well as potential entrants, while discouraging incumbents from innovating (OECD, 2025[15]). It also narrows the scope for established firms to shape regulation in ways that raise rivals' costs and entrench their own positions (Macedoni and Weinberger, 2026[156]).

Pro-competitive regulations support productivity and economic growth. Empirical evidence suggests that increases in regulatory compliance costs, as measured by the share of labour resources devoted to regulation-related tasks, are associated with a lower share of workers employed in young firms and weaker labour productivity (Andrews, Turban and Tyros, 2026[157]). Beyond these direct effects, anticompetitive regulations in upstream sectors can also reduce productivity across the wider economy by raising costs and limiting efficiency gains in downstream industries (Andrews et al., 2025[158]). This suggests that gains are larger where pro-competitive regulatory reforms ease regulations in network sectors, i.e. sectors that supply inputs to the rest of the economy, such as energy, telecommunications and transport, as well as retail and professional services (Andrews and Égert, 2026[159]). This is because of the benefits spread to downstream firms (OECD, 2025[15]).

Effective regulatory governance is central to reconciling regulatory objectives with business dynamism. Regulations are essential to achieve economic and social objectives, but their design and cumulative implementation can weigh disproportionately on entrants and young firms. Supporting dynamism therefore requires not only reducing unnecessary barriers to entry but also improving the management of the existing regulatory stock. More systematic ex-post evaluation, regular review of cumulative burdens, greater legal predictability and the use of risk- and outcome-based approaches can help ensure that regulatory objectives are achieved while limiting unnecessary economic costs.

A pro-competitive regulatory environment delivers its full return only against a backdrop of macroeconomic and policy stability. Elevated uncertainty and a lack of predictability keep the hurdle rates that firms apply to investment decisions well above their cost of capital, holding back the investment and increasing the option value of waiting for clarity (Hanappi, Millot and Turban, 2023[75]; OECD, 2025[6]). Predictable, transparent and consistent regulatory frameworks together with sound institutions reduce this risk premium. Strengthening legal certainty and improving the predictability and transparency of rulemaking are essential to ensure clear and stable regulatory frameworks and support firms' investment by reducing regulatory risk (OECD, 2025[15]).

Efficient insolvency regimes and orderly firm exit

Efficient insolvency regimes promote the reallocation of resources towards more productive firms, encouraging technological diffusion and supporting innovation and risk-taking. Efficient and predictable insolvency regimes facilitate the exit or downsizing of non-viable firms in a timely manner, freeing capital, labour and market space for more productive uses, while helping viable firms to restructure rather than liquidate. They also allow for the experimentation of new business models by reducing the cost of failure (André and Gal, 2024[160]). Where insolvency regimes are slow and costly, markets experience congestion of unproductive firms, more labour and capital misallocation and weaker technological diffusion, with measurable losses to aggregate productivity growth (Adalet McGowan, Andrews and Millot, 2017[161]; André and Gal, 2024[160]).

Well-designed insolvency regimes support productivity growth and business dynamism. Insolvency reforms that reduce the time to discharge, i.e. the number of years a bankrupt debtor must wait until being discharged from pre-bankruptcy indebtedness, reduce the costs and stigma associated with business failure (OECD, 2025[15]). Simplified and out-of-court insolvency procedures for SMEs can help reduce the number of inefficient SMEs continuing to operate because they lack scale to cover the fixed costs associated with formal insolvency proceedings (Adalet McGowan, Andrews and Millot, 2017[162]). Reducing barriers to corporate restructuring by allowing creditors to initiate restructuring and avoiding situations where a minority of dissenting shareholders block a restructuring, allowing firms that encounter temporary distress to be restructured in a timely fashion. Reforms to personal and corporate insolvency regimes in this direction could raise productivity growth by incentivising firm entry and experimentation with risky business strategies, as well as promote productivity-enhancing reallocation of resources and the exit of non-viable firms (OECD, 2025[15]).

Improving access to finance and deepening financial markets

Well-functioning financial systems are a key driver of firm entry and post-entry growth. The development of financial systems is essential for enhancing firm entry and the subsequent growth of new entrants (Beck and Demirguc-Kunt, 2006[163]), with benefits accruing disproportionately to firms facing most binding financing constraints, i.e. small and young firms, and firms whose value lies on intangible assets that are difficult to value and to pledge as collateral (Demmou, Franco and Stefanescu, 2020[164]). Capital markets' development (Gupta and Gregoriou, 2018[165]; Didier et al., 2021[166]) and financial innovation

(Kame Babilla, 2023[167]) are key for alleviating these constraints, as market-based financing and digital financial services undermine information asymmetries and are better suited than collateral-based bank lending to funding innovative, high-risk ventures.

Deepening and diversifying financial systems can broaden firms' financing options and improve the terms on which they access external finance. The development of capital markets expands the range of funding sources available to firms, enabling them to rely less exclusively on bank lending. Empirical evidence shows that firms raising funds on capital markets experience stronger sales growth, faster asset accumulation, and improvements in productive capabilities, with stronger gains for firms that are, ex ante, more likely to be financially constrained, i.e. small, young, and high-R&D firms (Didier et al., 2021[166]). In addition, strengthening competition among financial services providers has been associated with an increase in the entry and exit dynamics, fostering entrepreneurial activity (Kerr and Nanda, 2009[168]). Financial innovation and the spread of digital finance can further ease collateral and borrowing constraints, extending access to finance for firms and regions that have traditionally been underserved (Kame Babilla, 2023[167]).

Well-designed public support can help close persistent financing gaps by complementing private sources of financing. Instruments such as public credit guarantee schemes, public development banks and public participation in equity and venture funding can mobilise capital towards firms and activities that markets tend to underserve (OECD, 2025[169]). These instruments tend to work best when paired with non-financial support such as business advice and financial literacy initiatives.

Boosting technology adoption and diffusion

Supporting dynamism and firm growth requires addressing barriers to both the diffusion of knowledge and widespread technology adoption. Evidence shows that in addition to concentration of market share amongst large incumbents, productivity gains have become increasingly concentrated in a small group of highly productive firms (i.e. “frontier firms”). In addition, the productivity gap between these “frontier firms” and the rest has widened, pointing to a slowdown in technology and knowledge diffusion (Andrews, Criscuolo and Gal, 2016[11]). Some studies suggest that the productivity slowdown in recent years is due to this rising gap as well as a shortage of innovation at the frontier (André and Gal, 2024[160]). The rising importance of digital technologies, intangible assets and tacit knowledge, together with winner-takes-most dynamics, may limit the ability of firms further from the frontier to adopt frontier technologies and catch up in terms of productivity. The same trends may increase the opportunities for market leaders to entrench as discussed in Chapter 6, which may weaken competition and business dynamism (Akcigit and Ates, 2023[12]). Sustaining support to R&D and innovation and creating incentives for firms to continue developing and adopt new technologies and business models can help support technological diffusion and support aggregate productivity growth. Equally important are policies oriented to ensure complementary conditions that make adoption possible, such as the right levels of skills and training, strong management capabilities, necessary digital infrastructure, and access to finance (Berlingieri et al., 2020[170]).

Keeping this process of technology and knowledge diffusion alive also depends on preserving competition and a level playing field. Diffusion tends to stall when markets become less contestable and when leading firms can entrench their advantages, for instance, through the strategic use of intellectual property or through regulation that favours incumbents over entrants and followers (Akcigit and Ates, 2023[12]). Maintaining competitive pressure, lowering barriers to entry, and designing intellectual property and regulatory frameworks that reward genuine innovation without limiting the spread of ideas complement innovation and adoption policies (Calvino, Criscuolo and Verlhac, 2020[18]). This may also apply to tax support that can enable or worsen technological diffusion. As discussed in Chapter 5, it is also important to design support for investment and R&D so that take-up is strong amongst new and young firms. This

can ensure that the benefits from this kind of support do not disproportionately accrue to incumbents in a way that may generate an unlevel playing field.

Building and leveraging human capital and skills

Human capital is critical in ensuring that pro-dynamism reforms promoting competition, access to finance, and innovation, ultimately pay off. Skills determine whether businesses can innovate as well as absorb and apply new technologies. Recent OECD estimates suggest that around one-sixth of the productivity slowdown in OECD countries since the mid-2000s can be accounted for by a weakening in human capital accumulation (Andrews, Égert and de la Maisonneuve, 2024[171]). Boosting human capital accumulation requires prioritising the quality, and not merely the quantity, of education, securing strong foundational skills as the basis for all subsequent learning, and expanding access to high-quality adult and lifelong learning, so that workers and entrepreneurs can respond to the evolving needs of the labour market, including the new demands created by artificial intelligence (André and Gal, 2024[160]). Previous OECD research has highlighted how tax policies can support skills uptake, including over the lifecycle (OECD, 2017[172]).

Faster changes in skills needs require continuously upgrading the skills of those already in work and matching them to the jobs where they are most productive. Lifelong learning and adult training merit particular attention, as does strengthening managerial skills (André and Gal, 2024[160]). Better skills-to-jobs matching requires labour mobility and avoiding excessively strict employment protection, through clear and predictable rules to encourage labour reallocation and experimentation. Matching can also be supported by limiting excessive use of non-compete clauses,[1] reducing occupational licensing, and lowering housing costs in high-productivity places so that workers can move towards new, better opportunities (OECD, 2025[6]). This again links to the discussion on the importance of competition and level playing fields in supporting dynamism.

Note

[1] Non-compete clauses are post-employment restraint clauses, which prevent workers from joining (or starting) a competing firm. Recent OECD work suggests that such clauses tend to reduce productivity growth, by impeding the forces of growth-enhancing job reallocation and knowledge diffusion, as well as wage growth, by limiting workers' outside options (OECD, 2026[175]).

9 Further work

Effective policies to support business dynamism require a strengthened evidence base. This final chapter identifies evidence gaps on the effects of corporate taxation on business dynamism and briefly discusses how future tax policy analysis could address them. This report has described channels through which corporate taxation can shape business dynamism, but the underlying evidence remains limited and largely inferential, hindering policymakers' ability to understand how to cost-effectively support dynamism, especially in fiscally constrained environments. Much of the empirical evidence connects taxation to an intermediate output, such as investment, risk-taking, R&D expenditures, rather than to measures of business dynamism themselves. In addition, empirical findings are typically drawn from single countries, focusing on a single aspect of firm's economic activity, e.g. firm entry, choice of organizational form, investment, among others. Furthermore, different studies rely on different measures of taxation and business dynamism, which calls for caution when comparing the evidence and policy implications across countries and studies. As a result, while the report identifies the direction of the effects, caution is needed when assessing their magnitude and drawing conclusions about the relative importance of the different channels identified. Further evidence can improve tax policy recommendations in the area of dynamism, productivity and growth, while linking tax policies in support of dynamism to the broader policy tools discussed in Section 8.

Expanding the evidence base

Regarding firm entry, further evidence is needed on the magnitude of changes associated with CIT rate change, as well as on the distinction of new business creation from changes in legal forms. Estimated entry responses to CIT rate changes vary across studies, and the relationship may be non-linear, operating only below certain thresholds. In addition, the distinction between genuine business creation and the recharacterisation of existing business activity for tax purposes remains unexplored, despite having very different policy implications.

Evidence gaps are large on the role of taxation on firm exit. Most of the literature concentrates on the impact of CIT rates on firm entry while the discussion presented in this report on the impact on firm exit relies on a limited number of studies. In addition, empirical evidence remains scarce on whether loss carryover and other tax provisions interact with the survival of unviable firms, limiting the understanding of the role of tax provisions on the pace of business exit.

On firm growth, little is known on whether tax concessions translate into scale-up rather than survival. The evidence shows that tax policy can ease cash constraints of small and young firms, while size-based tax rules can lead to bunching and slow growth when firms get closer to the size thresholds. However, evidence on whether these tax provisions support firm growth beyond survival remains scarce.

On competition, ETR differentials across firms are well documented but it is still unclear how these translate or affect business dynamism. Evidence is very limited on whether, and by how much, these differentials deter entry, entrench incumbents or raise concentration. In addition, most analyses documenting ETR differentials across firms rely 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.

Compliance costs and tax uncertainty are often referred to as factors affecting business dynamism, but the empirical base has often linked the former to corporate investment, not dynamism itself. Evidence on the role of compliance costs and tax uncertainty rarely explores the links between these and firm entry, growth and exit. In addition, studies often focus on single countries and rarely trace their impact on the whole firm life cycle.

Taxation and business dynamism beyond the average firm

Better accounting for firm characteristics when estimating tax burdens is essential for designing effective tax policies. ETRs measures are typically abstract from taxpayers' characteristics. Analyses of the tax burden on firms assume investors are profitable, eligible and able to fully benefit from tax provisions. Tax losses at early stages of firm's activity, restricted loss-offset provisions, limited capacity to use tax deductions and tax credits, and the existence of age or size eligibility conditions are ignored when estimating average ETR measures. Enabling ETR measures to capture these characteristics would allow a better understanding of the different tax burden faced by entrants and incumbents and provide a more accurate evidence base for the design of tax policies.

A regular and systematic stocktake of tax provisions targeted at new and small firms could support tax policy design and evaluation. This could consider different design features of CIT systems, such as reduced rates for smaller firms, CIT rate schedules including size thresholds, simplified regimes, loss offset provisions, and tax incentives targeted at young and small firms. Documenting how these provisions are designed across countries and changed over time could contribute to a better understanding of tax policy targeting innovation and firms' growth and support ex-post evaluation of the implemented policies.

The analysis could be extended beyond CIT to other major tax categories and the tax system as a whole. As discussed in this report, the wedge between personal and corporate taxation shapes legal form choices and complicates the measurement of business entry. Dividend and capital gains taxation affect profit retention, investment and the returns to entrepreneurship. The taxation of household savings can weigh on the development of capital markets on which young firms disproportionately depend, in particular taxes levied on bases other than corporate profits regardless of whether firms are profitable. Each of these aspects would benefit from further investigation beyond what is presented in this report.

Dynamism and cross-border tax issues

The international dimension of business dynamism also warrants further attention. Existing evidence rarely distinguishes between the role of MNEs and purely domestic firms when measuring business dynamism. As a result, relatively little is known about the extent to which observed firm entry, growth and market concentration reflect the expansion and entry of MNEs rather than the creation and scaling of new domestic firms. Likewise, while international tax rules are often assessed in terms of their effects on the location of investment and reported profits, much less is known about their role in firms' decisions to internationalise through exporting, establishing foreign affiliates or becoming MNEs. Better understanding the barriers firms face as they expand across borders, the role of corporate taxation and other international tax rules in these decisions, and whether market concentration at the international level facilitates or constrains business dynamism, would strengthen the evidence base for international tax policy.

Further work could also examine the relationship between international taxation, business dynamism and productivity diffusion. Productivity growth depends not only on the emergence of frontier

firms but also on the diffusion of technologies, managerial practices and innovations to other firms. MNEs often play an important role in this process through investment, supply chains and knowledge spillovers, yet little evidence exists on how the international allocation of business activity and the concentration of MNE activity across jurisdictions affect these channels. Understanding whether international tax rules influence productivity diffusion, either by encouraging or discouraging the cross-border expansion of productive firms and the transmission of knowledge, would complement the analysis of business dynamism presented in this report and contribute to the broader growth agenda.

Further work towards lower compliance costs and higher tax certainty should continue, as they both remain important conditions for a dynamic business environment. Multilateral cooperation efforts should continue to be directed towards improving the design of rules governing the taxation of cross-border business income. In addition, further efforts could be oriented to lower compliance costs and increase tax certainty for entrants and small, young and financially constrained firms, which are the least able to absorb the fixed costs of compliance and likely more vulnerable to tax uncertainty. Understanding what simplification and tax certainty mean for start-up firms, and extending existing work in this area to new, young and small businesses, could be a valuable contribution to supporting business dynamism.

Tax policy in the wider policy mix

The effects of CIT reforms should be assessed on a country-by-country basis rather than inferred from average expected outcomes. Changes in CIT rate and in the design of tax provisions can have different effects on business dynamism, depending on the broader institutional and economic context. These effects are likely to vary with the ease of business entry, the extent to which incumbents are entrenched, the efficiency of exit mechanisms, firms' access to finance and the availability of entrepreneurial skills. The impact of tax policies on business dynamism is therefore conditional on the wider economic environment, but these interactions remain largely unexplored in existing literature.

An effective assessment of tax policies requires identifying whether the tax system enables or constrains business dynamism. In countries where business entry or firm growth are constrained primarily by regulatory barriers or limited access to finance, reducing the corporate tax burden is unlikely to generate substantial gains in dynamism while still imposing a fiscal cost. A key challenge is therefore determining whether taxation constitutes the principal constraint in a given context, and if so, which margin of business dynamism it affects (e.g. firm entry, growth, innovation, exit), and for which types of firms. Such an exercise would represent a valuable tax policy contribution to better understand and address the decline in business dynamism.

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Enhancing corporate tax systems to support business dynamism

This report provides an update on ongoing work examining the role of tax policy, and corporate income tax in particular, in supporting business dynamism, investment, and economic growth. Drawing on ongoing OECD research, it analyses how corporate taxation affects business dynamism through channels such as corporate tax design, compliance costs, loss-relief provisions, financing frictions, and competitive distortions. Finally, it situates the analysis within broader OECD work on the non-tax determinants of business dynamism, highlighting the importance of a coherent policy framework that also addresses wider structural barriers to business growth and dynamism.