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A TAX ON BUSINESS IS A TAX ON JOBS

- Corporation tax rates have been falling internationally over recent years.
- Tax receipts have remained resilient despite the falling corporation tax rate.
- A higher corporation tax rate could lead to a fall in employment of 96,000 by 2018/19.
- Higher business taxes will damage UK growth, investment and living standards.

1. INTRODUCTION

The level of business taxation is critical because it directly affects investment, employment and ultimately the prosperity of a nation. During this Parliament the main rate of corporation tax in the UK has been cut from 28% to reach 20% today, as suggested by the CPS. This means that the main rate of corporation tax and the small profits rate have now been unified into a single flat tax rate. It also means that the UK now has the joint lowest corporation tax rate in the G20. Lower corporation tax allows firms to retain more of their profits to pay wages and invest in new technology. Furthermore, despite the cut in the tax rate, the revenues from corporation tax have remained remarkably resilient throughout this Parliament.

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2. GLOBAL TRENDS

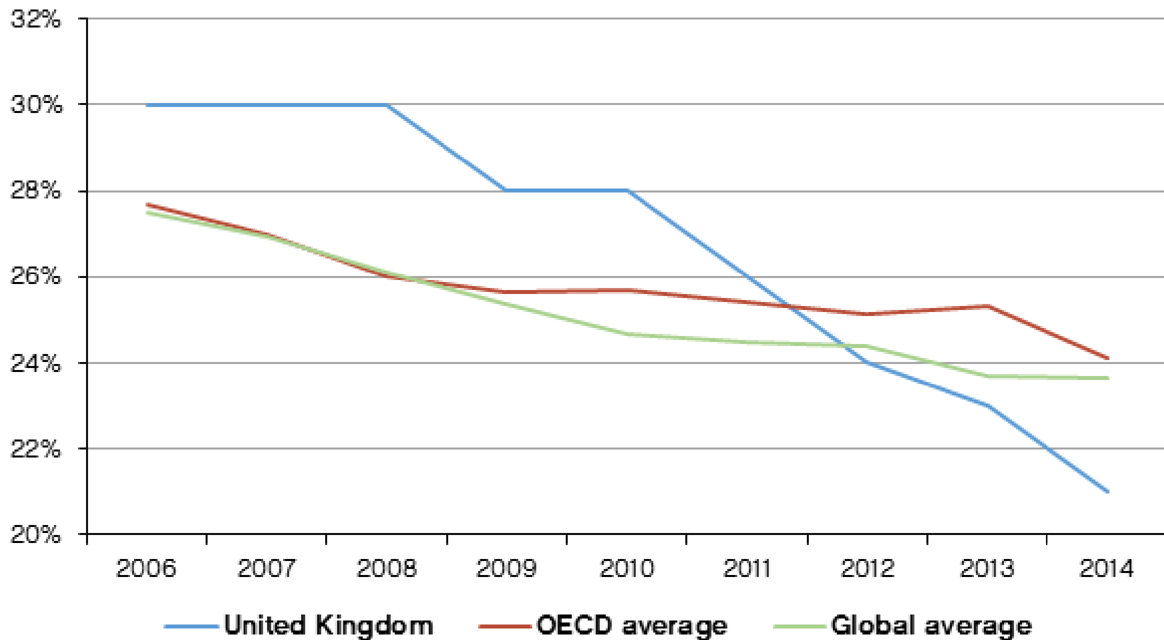
Corporation tax rates have been declining across the World. Greater recognition that higher retained profits lead to higher investment and economic growth has created pressure to cut tax rates. In addition, the rising mobility of businesses, profits and entrepreneurs has driven international tax competition. The relaxation of capital controls has contributed substantially to this increased tax competition. Countries seeking to attract foreign direct investment and corporate activity have been able to do so by cutting the main corporation tax rates.

In 2006, the Global average corporation tax rate was 27.5% and this had fallen to 23.64% in 2014. Developed countries have cut corporation taxes as well as developing countries and over the same time period, the OECD average corporation tax rate fell from 27.67% to 24.11%. Across the EU, the average rate fell from 24.83% to 21.34%.

This recent downward trajectory is continuing a long-term trend. The standard rate of corporation tax was at 52% in 1982 in the UK and has today fallen to 20%. The average OECD rate fell from 48% to 26% from 1981 to 2010. Between 2004 and 2012, the OECD average combined rate has been lower than the main UK rate. However, since 2010 the UK has taken the lead in the cutting the corporation tax rate and is now lower than the Global, EU and OECD averages.

Since 1997, no country in the G7 has increased the main rate of corporation tax and it has not been increased in the UK since 1973. The overwhelming trend in corporation tax rates is downwards.

FIGURE 1: Corporation tax rates



3. LOWER RATES, HIGHER REVENUE

The distortion of incentives and the damage to investment and employment means that setting ever higher tax rates cannot lead to perpetually higher revenue. Conversely, by boosting retained profits and thus investment, dividends and employment, at least some of the static loss in revenue from lower corporation tax rates will be recovered through stronger economic growth over time. Whilst tax cuts are rarely entirely self-financing, the Treasury's dynamic analysis of the corporation tax cuts undertaken in this Parliament suggests that between 45% and 60% of the static revenue loss would be recovered over time through higher profits, wages and consumption.

Excluding the volatile receipts from the North Sea, onshore corporation tax revenues are higher at the end of the Parliament with a lower rate than at the beginning of the Parliament with a higher rate. In 2010/11, the rate was 28% and this fell to 26%, 24% and 23% in the following years. However, the onshore corporation tax revenue in 2010/11 reached £35.26 billion compared to £35.72 billion in 2013/14 with the main rate at 23% and a marginal rate at 23.75%.

Initial receipts from April 2014 to February 2015 with the main rate at 21% suggest that revenue continues to rise despite the lower rate. In February 2015, onshore corporation tax receipts were 12% higher than they were in February 2014 and in the financial year to February 2015, receipts were 10% higher than the same period last year. This is despite the reduction in the rate from 23% to 21%. Furthermore, onshore corporation tax revenue as a proportion of total HMRC receipts has remained quite stable at about 7.5% since 2008/09. In addition, as PWC report, the total tax contribution of the biggest businesses in Britain has never been higher.

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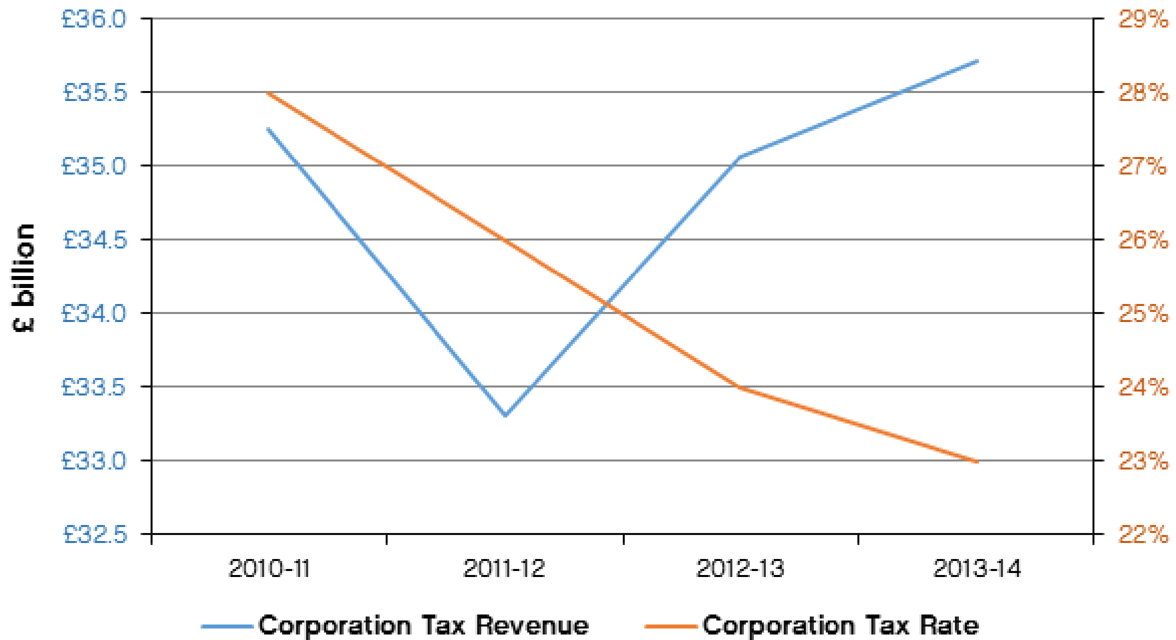
FIGURE 2: Rates vs. revenue



4. GROWTH IMPACT

Yesterday, the Shadow Chancellor Ed Balls again confirmed that if Labour wins the Election, he will increase the main rate of corporation tax from 20% to 21%. The party has also pledged to keep the corporation tax rate at the lowest in the G7 which currently means it could be increased to 26%.

An increase in the corporation tax rate to 21% and potentially higher would create a negative environment for business activity which is the key to growth, jobs and higher living standards. By contributing to a less welcoming environment for business, corporation tax rises will damage wealth creation and the UK's global reputation as a business-friendly country. There is indeed significant evidence that corporation tax cuts boost wages and investment.

Real wage growth, deficit reduction and job creation are all influenced by productivity growth. By cutting the funds available for investment, an increase in corporation tax would damage productivity growth. Businesses would have less to spend on new technology, innovation and in-work training and the result would be a reduction in the long term growth potential of the economy. As the OECD recently reported, private investment as a percentage of GDP is 17.1%. Whilst this has been increasing in recent years, it still lags well behind the average for the G7 and the OECD countries. A higher corporation tax will cut the funds available to increase the investment share of GDP.

Boosting tax competitiveness is increasingly important to attract and retain successful businesses. Living standards depend on businesses being able to invest, hire and grow. Higher corporation taxes make that process more difficult. There are also less tangible, but

no less malign, effects of higher taxes on entrepreneurship and attitudes towards business and wealth creation. By punishing success and aspiration, a higher tax burden on businesses would damage investment, productivity and growth. As the ECB argued in a recent paper, if private sector confidence is a concern and reducing the deficit is essential, then spending cuts are preferable to tax rises.

5. JOBS IMPACT

It is inevitable, that fewer jobs would be created if corporation taxes are increased. Retained profits are one of the key ways that businesses fund their expansion and a higher tax rate would mean that businesses would have less money available to pay wages for new employees. The result would be that firms would find it more difficult to hire new workers. In our recent briefing note, we estimate the impact on employment if the main corporation tax rate is increased by one percentage point for four years. For the remainder of 2015/16, it is therefore assumed that the corporation tax rate is at 21%. The model examines the impact on employment if the rate rises to 22% in 2016/17, then 23% in 2017/18 and finally 24% in 2018/19.

The model is based on the OBR's forecasts outlined in its Economic and Fiscal Outlook published alongside the 2014 Budget. The employment effect is calculated by estimating the impact of the taxes on company profits. Profits are used to pay for dividends and investment as well as workers. A reduction in the funds available for workers ultimately leads to a reduction in future employment. The estimated total employment effect is the deviation in total employment from the OBR's central forecast after the implementation of the higher corporation tax rates.

Our model estimates that, other things being equal, a rising corporation tax rate of one percentage point per year would lead to a reduction in total employment of more than 96,000 by 2018/19 compared to the OBR's estimates of employment under the Government's plans.

6. TAX SIMPLICITY

The main corporation tax rate applies when company profits exceed £1.5 million and is being cut from 21% to 20% today. This means that the small profits rate which is currently set at 20% will be merged to create a single corporation tax rate. It also means that marginal relief for companies earning profits between £300,000 and £1.5 million can be eliminated.

The creation of a single, flat 20% corporation tax rate is a significant achievement of tax simplification. Increasing the corporation tax rate back to 21% would create a needless extra complexity. The unified corporation tax rate creates administrative savings for the Treasury which from today no longer has to deal with marginal relief or the small profits rate. Moreover, increasing the rate would also add extra compliance costs for businesses which have to spend more time and resources on their tax affairs. Small and fast-growing businesses without big compliance departments would be particularly affected.

7. STAMP DUTY RESERVE TAX

It is to be welcomed that there now appears to be a consensus over the need to radically reform business rates. Whilst there is some evidence that direct cuts in business rates could lead to higher rental payments, the system in its current form is inefficient, burdensome and must be updated. Unfortunately, there is not such a consensus over stamp duty reserve tax. Whilst some have argued that its abolition was a "tax cut for hedge funds", the reality is quite different.

Also known as Schedule 19, it was an extra tax targeted at investment funds and was abolished by the Government in order to make the UK more attractive as a hub for fund management. The investment management industry is highly mobile and the UK has lost ground to countries such as Luxembourg and Ireland as the leading location for European funds. Studies have shown that tax is one of the main reasons for locating funds outside the UK, in particular direct tax at the fund level and SDRT. Reintroducing SDRT would therefore place the UK at a competitive disadvantage. This is especially the case given the growth in offshore funds. The tax would feed through to savings and pensions as well as reduce the ability of UK funds to attract non-UK investors.

8. CONCLUSION

The proposal to increase the corporation tax rate to 21% and potentially higher would go against the trend amongst developed economies. The rising global mobility of businesses means that higher corporation taxes would drive more business activity abroad. Moreover, higher business taxes will reduce the funds available to boost productivity. Such a tax rise would effectively be a tax on jobs, wages, and investment.

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