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The Case for Reducing Business Taxes

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FOREWORD

BACK IN THE LATE 1990s when, as Ireland's Minister of Finance, I started cutting taxes, many people feared that the loss of revenue to the Exchequer would be massive and that the policy would have to be abandoned. But the opposite happened. Far from the policy causing an erosion of the Exchequer's revenue stream, reduced tax rates generated higher economic activity, greater taxpayer compliance and a surge in the tax take for the Exchequer.

Looking at the results, we can see that the policy was an essential part of Ireland's economic boom. Inward investment rose strongly, economic growth has been at levels more commonly associated with a Far East tiger economy than Europe, and the overall tax take – with much reduced tax rates on business, income, and capital gains – has grown well ahead of expectations. It will therefore surprise no-one that I am a committed advocate of lower taxes and tax competition in the European Union – because I am committed to the economic success of Europe as a whole.

This study demonstrates with great clarity that countries cutting taxes – especially on business – see more inward investment, higher growth and higher tax revenues.

It is of course for each Member State to draw its own conclusions from this work by the Centre for Policy Studies. I simply say this to all Governments of our great continent – Europe can be greater still with more tax competition and lower business taxes.

Charlie McCreevy
EU Commissioner for the Internal Market & Services

February 2006



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SUMMARY

- UK business taxes are too high. The level of these taxes means that the amount of revenue they raise has stalled, that inward investment is discouraged and that economic growth is hampered.
- Reducing taxes for large businesses from 30% to 15% and cutting small business tax from 19% to 10% over the course of a Parliament could inspire a wave of inward investment, while tax revenues would be expected to remain stable or even increase. In addition, lower tax rates would facilitate a move to simpler taxes, with the extra benefits of lower costs for business and government.
- Reducing the rates of tax on business would increase prosperity for all, would increase global competitiveness, would increase economic growth and would thereby increase economic stability.
- This paper considers the case for business taxes only.

WHY CUTTING BUSINESS TAX IS A GOOD THING

International experience suggests that cutting business tax rates can *increase* total tax revenues. It can also *increase* inward investment and economic growth.

Cutting business taxes means that the incentive to avoid tax, and the attendant complexity of tax legislation, is reduced. Business would benefit from greater simplicity, lower compliance cost and less money wasted on tax compliance.

Other countries are moving in this direction. The international trend in recent years has been to cut business taxes: the average rate of corporation tax rate in the 30 OECD countries has fallen from 33.6% in 2000 to 29.8% in 2004. In the UK, however, corporation tax has remained at 30% for a number of years.¹

A number of developing economies now have corporate tax rates below 20% – notably in Eastern Europe with countries such as Slovakia

adopting a 19% rate of corporation tax, and Hungary a 16% rate. Most recently of all, on 23 January 2006, the Spanish Finance Ministry announced plans to reduce its corporation tax rate from the current 35% to 30% between 2007 and 2011.²

LOWER BUSINESS TAXES CAN INCREASE TAX RECEIPTS

Some countries have sharply reduced their business taxes in recent years. Details of corporate tax rates and receipts for the 30 OECD countries can be found in Table 1 of the Annex of this paper, but the following outcomes are striking:

- **Ireland** cut its corporation tax rate from 38% in 1996 to 12.5% in 2002. While the rates were cut, corporate tax receipts rose by 170% – from IR£1.4 bn in 1996 to €4.8 bn

	Change in corporate tax rate	Annual growth in corporate tax revenue
Ireland	From 38% to 12.5%	24.3%
Australia	From 36% to 30%	16.6%
South Africa	From 35% to 29%	43.2%

(equivalent to IR£3.8 bn) in 2002. Corporate tax receipts are projected to increase to €5.3 bn in 2004. Annual growth of corporate tax revenue was 24.3% between 1996 and 2002.³

- **Australia** reduced its corporation tax rate from 36% in 1998 to 30% in 2001. Corporate tax receipts have risen by 116% from A\$18.8 bn in 1997/98 to A\$40.6 bn in 2004/05. That is equivalent to an annual growth of 16.6% in corporate tax revenue.⁴
- **South Africa** reduced its corporation tax rate from 35% in 1998/99 to 29% in 2004/05. Corporate tax receipts have risen by 259% from R19.7 bn in 1999/00 to R71 bn in 2004/05. That is equivalent to an annual growth of 43.2% in corporate tax revenue.⁵
- **The Czech Republic** has cut its corporation



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tax rate from 31% in 2000 to 26% in 2005 (it will be cut further to 24% in 2006). Over that period, corporate tax receipts have increased by 54% from CZK76 bn in 2000 to CZK117 bn in 2004. That is equivalent to an annual growth of 10.8% in corporate tax revenue.⁶

In contrast, countries which have not cut their corporate tax rates have tended to see corporate tax revenues stall.

- **The UK** headline rate of corporation tax remained at 30% between 2000 and 2005. In 1997/98, corporation tax receipts were £30.4 bn. In 2004/05 receipts are estimated to have

	Change in corporate tax rate	Annual growth in corporate tax revenue
UK	Static at 30%	1.7%
US	Static at approx 40%	0.2%
Japan	Static at 41%	- 0.85%

barely increased to £34.1 bn. That is equivalent to an annual growth of only 1.7% in corporate tax revenue.⁷

- **The US** has a 35% rate of Federal Tax plus State Tax (usually around 5%) making an overall corporate rate of about 40%. In 2000, revenues were \$255 bn and are estimated to be \$258 bn in 2004. That is equivalent to an annual growth of only 0.2% in corporate tax revenue.⁸
- **Japan** has an effective rate of corporation tax that can reach 41%. It saw tax yields fall from ¥18,720 bn in 2000 to ¥18,075 bn in 2004. That is equivalent to an annual fall of 0.85% in corporate tax revenue.⁹

MORE INWARD INVESTMENT FROM LOWER CORPORATE TAXES

Countries that have been cutting their rates of corporate tax have seen benefits from higher foreign direct investment (FDI).¹⁰ Table 2 in the Annex shows how low corporate tax countries tend to have stronger FDI inflows: not surprisingly, investors prefer to invest in countries with a low tax regime. Conversely, high corporate tax countries tend to have FDI outflows.

The FDI results are striking when one considers the countries whose business tax policies are considered above. The countries which reduced corporate taxes between 1995-2004 saw the following increases in FDI:

- **Ireland:** net FDI inflow of US\$92.7 bn.
- **Australia:** net FDI inflow of US\$44.4 bn.
- **Czech Republic:** net FDI inflow of US\$39.4 bn.

In contrast, those countries which did not reduce their corporate taxes saw the following reductions in FDI:

- **UK:** net FDI *outflow* of US\$404.1 bn.
- **Japan:** net FDI *outflow* of US\$223.5 bn.
- **US:** net FDI *outflow* of USD \$50.2 bn.



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A PLAN FOR REFORM

Headline UK business tax rates could be halved over the course of a Parliament.

- The mainstream corporation tax rate can be cut from 30% to 15%.
- The small companies rate can be cut from 19% to 10%.

Rather than an immediate reduction, with the consequent immediate revenue shortfall, a phased reduction over a five year period is recommended. This will allow businesses to plan their investment strategies in the expectation of lower business taxes; and will smooth the transition from higher tax rates while maintaining a steady revenue stream.

PHASING OF REDUCTION IN CORPORATE TAX RATES

	Main rate	Small company rate
Year 0	30%	19%
Year 1	27%	17%
Year 2	24%	15%
Year 3	21%	14%
Year 4	18%	12%

OIL COMPANIES

Oil company taxation would be exempt from this reform. There are environmental arguments for doing so. There is also a bespoke petroleum taxation regime which amounts more to a form of duty than to a profits tax – so such companies fall outside the argument advanced in this paper.

ENDNOTES

¹ “Tax policies vary widely”, OECD press release, 12 October 2005. OECD corporation tax rates from 2000 – 2005 are available from the OECD Tax Database. See www.oecd.org/document/60/0,2340,en_2649_34533_1942460_1_1_1_1,00.html table II.2. This source is used widely throughout this document.

² Spain issued a draft tax law on 20 January 2006 containing the reform proposals. See www.deloitte.com/dtt/cda/doc/content/es_tax_taxalert_250106.pdf

³ Corporation tax revenues stated as IR£1.4 bn by Irish Department of Finance revised statement for 1996 published on 4 October 2004. See www.finance.gov.ie/viewtxt.asp?DocID=-1&CatID=53&StartDate=1/01/2004. Corporation tax revenues stated as €4.8 bn by Irish Department of Finance Exchequer Returns for 2002 published on 3 January 2003. See www.finance.gov.ie/viewdoc.asp?DocID=992&CatID=5&StartDate=01+January+2003&m=. Estimates for 2004 from Irish Budget 2004 Statistics and tables No. 3. See www.budget.gov.ie/2004/table3.asp#table3

⁴ See Australian Budget Paper No. 1 1998-99, Statement 5. This estimates revenue from companies as being A\$18.79 bn. See www.budget.gov.au/1998-99/bp1/BST5.pdf Australian Budget Paper No. 1 2005-06, Statement 5, estimates revenue from companies as being A\$40.61 bn. See www.budget.gov.au/2005-06/bp1/html/bst5-04.htm

⁵ South African Budget 2000 estimated corporation tax revenues for the year as R19.69 bn in its Estimate of Revenue for the Financial Year ending 31 March 2001. See www.finance.gov.za/documents/budget/2000/er/er.pdf South African Estimate of National Revenue 2006 (published as a South African Budget document on 15 February 2006) estimates that taxation on corporate income for 2004/05 was R70.8 bn. See www.finance.gov.za/documents/budget/2006/enr/enr.pdf

⁶ OECD, *Revenue Statistics 1965-2004* states that Czech taxes on corporate income in 2000 amounted to CZK76.2 bn; and that Czech corporate income tax for 2004 is estimated at CZK 117.2 bn.

⁷ Annex B of the 1999 Budget Report stated the outturn for 1997/98 as £30.4 bn. See www.hm-treasury.gov.uk/budget/budget_99/budget_report/bud99_annex_b_public_finances.cfm. Latest figures for corporation tax revenues were provided in Annex B of the 2005 *Pre Budget Report*, December 2005. These are estimated at £34.1 bn. See www.hm-treasury.gov.uk/media/FA6/58/pbr05_annexB_246.pdf

⁸ OECD, *Revenue Statistics 1965-2004* states that US corporate taxes in 2000 amounted to US\$255 bn while revenues from US corporate taxes for 2004 are estimated at US\$258 bn.

⁹ OECD, *Revenue Statistics 1965-2004* states that Japanese corporate taxes in 2000 amounted to ¥18,720 bn while revenues from Japanese corporate taxes for 2004 are estimated at ¥18,075 bn.

¹⁰ See OECD, *International Investment Perspectives*, November 2005.



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ANNEX

TABLE 1A: COUNTRIES WHICH HAVE CUT CORPORATE TAX RATES 2000-2004

	2000 Corporation Tax Rate %	2004 Corporation Tax Rate %	2000 Receipts (local currency, bns)	2004 Receipts (local currency, bns)	Increase/Decrease 2000-2004 (local currency, bns) %	
Australia	34.0	30.0	43.4	40.4	- 3.0	-6.9%
Belgium	40.2	34.0	9.0	10.7	1.7	18.9%
Canada	44.6	36.1	47.6	46.0	- 1.6	-3.4%
Czech Republic	31.0	28.0	76.0	117	41.0	53.9%
Denmark	32.0	30.0	42.3	46.0	3.7	8.7%
France	37.8	35.4	44.4	45.2	0.8	1.8%
Germany	52.0	38.9	37.1	34.6	- 2.5	-6.7%
Hungary	18.0	16.0	292.7	448.7	156	53.3%
Iceland	30.0	18.0	9.7	11.6	1.9	19.6%
Ireland	24.0	12.5	3.9	5.3	1.4	35.9%
Italy	37.0	33.0	34.2	38.6	4.4	12.9%
Korea	30.8	29.7	19271	27426	8155	42.3%
Luxembourg	37.5	30.4	1.5	1.6	0.1	6.7%
Slovak Republic	29.0	19.0	26.6	29.3	2.7	10.2%

TABLE 1B: COUNTRIES WHICH HAVE NOT CUT CORPORATE TAX RATES 2000-2004

	2000 Corporation Tax Rate %	2004 Corporation Tax Rate %	2000 Receipts (local currency, bns)	2004 Receipts (local currency, bns)	Increase/Decrease 2000-2004 (local currency, bns) %	
Austria	34.0	34.0	4.3	5.4	1.1	25.6%
Finland	29.0	29.0	7.8	5.4	- 2.4	- 30.8%
Japan	40.9	40.9	18,720	18,075	- 645	- 3.4%
Netherlands	35.0	34.5	16.7	15	- 1.7	- 10.2%
New Zealand	33.0	33.0	4.9	7.9	3.0	61.2%
Norway	28.0	28.0	132.1	170.6	38.5	29.1%
Spain	35.0	35.0	19.6	28.9	9.3	47.4%
Sweden	28.0	28.0	88.8	78.9	10.1	- 11.1%
Switzerland	24.9	24.1	11.4	10.9	- 0.5	- 4.4%
Turkey	33.0	33.0	2.9	10	7.1	244.8%
UK	30.0	30.0	34.7	33.7	- 1.0	- 2.9%
United States	39.4	39.3	254.9	258.3	3.4	1.3%

Source: OECD, *Tax Trend publications and Revenue Statistics*, 2005 (2004 figures).

Note 1: data for 2004 receipts are estimated figures and are liable to revision.

Note 2: data for Greece, Mexico, Poland and Portugal are not available.

Note 2: **the data for corporate tax receipts are nominal figures and do not make allowance for inflation** (which for countries such as Turkey can be significant). In addition, there are many other variables apart from the tax rate – including overall GDP growth rates, allowances and investment trends – which can also affect tax revenues.



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TABLE TWO: CUMULATIVE FDI FLOWS IN OECD COUNTRIES 1995-2004

	Inflows (US\$, bn)	Outflows (US\$, bn)	Net outflows (US\$, bn)	Change in Corporate Tax Rate 2000-2004
UK	534.3	938.4	404.1	0.0%
France	356.0	673.0	317.0	- 6.3%
Japan	57.4	280.9	223.5	0.0%
Switzerland	88.1	209.3	121.2	- 3.2%
Netherlands	273.8	367.7	93.9	- 1.4%
Spain	184.0	268.0	84.0	0.0%
Canada	206.6	275.6	69.0	- 19.1%
Germany	375.5	429.8	54.3	- 25.2%
US	1461.4	1511.6	50.2	- 0.3%
Italy	100.6	126.5	26.0	- 10.8%
Finland	49.5	72.1	22.6	0.0%
Sweden	157.9	166.1	8.1	0.0%
Portugal	30.9	38.8	7.8	
Iceland	1.7	4.2	2.5	- 40.0%
Belgium/Luxembourg	868.4	870.0	1.6	- 15.4%
Norway	36.5	37.0	0.5	0.0%
Austria	43.8	39.7	-4.1	0.0%
Greece	8.9	4.3	-4.5	
Korea	48.6	39.9	-8.7	- 3.6%
Turkey	13.7	4.4	-9.3	0.0%
Denmark	71.2	60.8	-10.4	- 6.3%
Slovak Republic	11.8	0.2	-11.6	- 34.5%
New Zealand	19.7	1.5	-18.2	0.0%
Hungary	35.2	4.5	-30.8	- 11.1%
Czech Republic	41.0	1.6	-39.4	- 9.7%
Australia	118.2	73.8	-44.4	- 11.8%
Poland	56.2	1.6	-54.5	
Ireland	139.3	46.6	-92.7	- 47.9%
Mexico	147.9	10.6	-137.3	
Total OECD	5 538.2	6 558.6	1 020.3	

Source: OECD, *International Direct Investment Database*, 2005.



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The authors would like to acknowledge the help and support in compiling this paper of Damon Lambert and Alistair Craig.

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© Centre for Policy Studies, February 2006

ISBN 1 905389 22 1

Printed by the Centre for Policy Studies, 57 Tufton Street, London SW1P 3QL



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