The last thing Britain needs is to hike our most damaging tax

Rory Meakin

3 February 2021

Since 2010, the headline rate of corporation tax has been steadily falling. When David Cameron became Prime Minister it stood at 28%, now it is 19%. According to a recent Times report, however, "new analysis by the Treasury suggests there is little evidence that it has increased revenues".

You don't say! Few economists believe that cutting corporation tax rates would stimulate such a large quantity of new economic activity that it would lead to increased revenues, at least not in the short term. Lower rates certainly make potential projects more viable than they otherwise would be, switching some at the margin from non-viable to viable. But enough to outweigh the loss of revenue from profits that would have progressed anyway? Unlikely.

When the coalition government modelled the effects of the rate change in December 2013, they found that increased profits, wages and consumption cushioned the foregone revenue for the Treasury by between 45% and 60% over the long term. That range is within the broad consensus of opinion on elasticity to rates of corporate income tax.

But even if the Treasury sources were misreported and only meant to suggest that corporation tax cuts have not raised any revenue, that too might not be as surprising as it first seems. Ryan Bourne of the Cato Institute recently pointed out that despite the sharp fall in the headline rate, other measures meant marginal tax rates on a typical new investment fell less dramatically, from 22% to 17%, according to figures from Oxford University's Centre for Business Taxation.

Even that fall of five percentage points, rather than the nine percentage point fall in the headline rate, however, may be flattering the Conservatives' record on tax cuts. Last year Dan Neidle, the London tax lead at law firm Clifford Chance, estimated that the share of corporate profits paid in corporation tax actually rose between 2010 and 2018 from around 11% to around 13%.

So while the headline rate of corporation tax may have been cut, the effective rate was put up. It's not easy to say which specific measures pushed up the effective rate, all we know is that the share of profits taken in tax seems to have gone up despite the lower headline rate. Some of the effect will be due to losses carried forward from the recession being used up. But that effect would already have been underway by 2010 and the tightening of allowances combined with the steady work by the Treasury in closing down tax avoidance and evasion over the last decade must have also played a part. As Helen Miller of the Institute for Fiscal Studies noted in a 2017 briefing, compared to other countries "the UK has a much less competitive tax base, largely due to a particularly ungenerous set of capital allowances".

To be clear, cutting the headline rate of corporation tax is still an important way to enhance the profitability of investment projects, and results in higher wages, more jobs for employees and

higher returns for shareholders. But it can't work if what's given with the rate-cutting hand is taken away by the small print hand. Ultimately, incentives matter but what doesn't matter so much is whether the money is extracted from investments in a straightforward way through headline rates or through more opaque changes to rules and allowances. After all, taxes on profits are at the top of the OECD list of the most damaging tax types.

That's what makes the recent remark from a 'senior Whitehall source' that corporation tax rises are favoured because they hit profits so alarming. After the biggest economic shock in living memory from the pandemic along with the disruption to some businesses from Brexit, the very last thing needed is to raise the most economically damaging tax of all. Making profits is precisely what the Government should want to encourage, not penalise. And while anger at stories of international companies paying relatively little UK corporation tax might be understandable, the answer isn't to demonise profits themselves or raise the tax rate on all taxable UK profits. Tax reform and getting the system right is a much broader issue.

Most importantly of all, however, is the need for no nasty surprises from finance ministers over the next year or two. The IMF, OECD, CBI, IFS, the shadow chancellor and even the left-wing think tank Resolution Foundation have all rightly warned that now would be terrible timing to raise taxes. The latter suggest it will not be until "after 2023-24" that the economy might be able to withstand tightening.

Raising taxes at March's Budget would be a disastrous error. Frankly, even talking to the press about it has been irresponsible and may inflict some damage itself. Rather than talking about tax rises, Rishi Sunak should quash the speculation and rule out tax hikes for the next few years, and give businesses the breathing space they need as the country recovers from coronavirus.