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Where grass is greener

Jonathan Ivinson

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In the modern global economy corporate taxpayers are no longer captive - if the tax is too high they can go elsewhere.

Tesco's tax structuring techniques involving sale and leaseback arrangements with offshore companies are fairly common practice among large multinational companies. They have caused a predictable outcry about the behaviour of large multinationals. But is such criticism really justified? And is corporation tax such a good idea anyway?

To minimise a company's tax liability to the lowest possible level is regarded as a duty to shareholders. Boards of directors are under pressure to deliver returns to shareholders that are as high as possible. As corporation tax reduces the net return to shareholders companies are always going to organise their affairs in order to reduce that cost. Companies will always be seeking to lower their overheads and corporation tax is just an overhead. Exploiting loopholes in tax law is one way in which this happens; another - more disturbing - phenomenon for the government is the increasing prevalence of tax-driven migration.

Multinational companies have the freedom to organise their affairs in order to keep their effective rates of tax as low as possible. This is often not a question of clever tax avoidance schemes but more a question of choosing tax-friendly locations in which to do business. Corporate reorganisations will often involve exiting a high-tax jurisdiction in search of friendlier fiscal climes. At 28%, the UK has one of the higher rates of corporation tax in Europe but Ireland, Switzerland and Cyprus all have substantially lower rates. Where the corporation tax rate differential begins to be substantial, companies will inevitably consider reorganising themselves in order to realise this saving.

What the Chancellor should be concerned about is the overall tax take and how to secure it. Here corporation tax can produce a reverse alchemy. High corporation tax rates will make multinational companies consider lower tax alternatives to the UK such as Switzerland and Ireland. Ireland's high levels of inward investment in recent years are attributable in large part to its 12.5% corporation tax rate. Much of that inward investment, particularly by the US technology sector, could have found its way to the UK but for the 17.5% differential in the corporate tax rate. In this sense, corporation tax can be self-defeating as lost inward investment means lost jobs and consequently lost tax revenues. Employment taxes represent the majority of the tax base in Britain. Corporation tax accounts for only 10% of the total.

Politicians should never forget that you first need income and profits to obtain tax receipts. They should remember that in the modern global economy corporate taxpayers are no longer captive. If the price is too high they will shop elsewhere. Lowering corporation tax rates might actually result in a net increase in the tax take as a result of increased inward investment. It would certainly result in fewer migrations and probably less interest in complex tax avoidance products. That might be bad news for tax accountants and lawyers but not a bad result for the taxpayer.

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