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Bad news for lawyers, but good news for taxpayers

You might not like it, but lower corporation rates might increase the total tax take in the long term, says Jonathan Ivinson

How much should big companies mitigate their tax liabilities — both legally and morally? The controversy over Tesco's tax structuring techniques involving sale and leaseback arrangements with offshore companies highlights a practice increasingly common among large companies. The revelations triggered an outcry about the behaviour of large multinational companies; some even argued that Tesco should ignore such lawful tax planning opportunities and simply volunteer 30 per cent of its profits in corporation tax out of a sense of social responsibility.

At the heart of the debate is the question of the morality of such attempts to lessen tax liabilities within the law. Critics argue that as companies derive benefits from the social infrastructure that the tax system pays for (in particular education, healthcare and transport), they should be willing contributors to the maintenance of those services. Yet with an employer's national insurance contributions at 12.8 per cent of total payroll, levied irrespective of whether a company is profitable or not, companies may well feel that their social responsibilities have been discharged.

At the other extreme is the view that minimising a company's tax liability within the confines of the law should be regarded as a duty to shareholders. This is becoming a significant issue for UK boards of directors constantly under pressure to deliver returns to shareholders that are as high as possible. As corporation tax reduces the net return, companies naturally will seek to organise their affairs in order to minimise this cost. On this view, corporation tax is just an overhead like any other. Exploiting loopholes in UK tax legislation, therefore, becomes another way of reducing overhead. And in some cases, tax-driven migration out of the UK is seen as a way of increasing returns to shareholders.

Multinational companies have the freedom to organise their tax affairs so as to keep their group-wide 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 leaving a high-tax jurisdiction in search of friendlier fiscal climes. The UK's 28 per cent corporation tax looks unappealing in the face of effective rates of less than 10 per cent in Switzerland or 12.5 per cent in Ireland.

What the Chancellor of the Exchequer should be concerned about is the overall tax take and how to secure it. In this sense, the publicity over Tesco should serve as a timely reminder that the boards of public companies have a duty to deliver returns. Fiscal altruism serves only to diminish those returns.

High rates of corporation tax spawn ingenious tax-planning schemes and, in some cases, the migration of taxpayers. So it is worth considering the seemingly counterintuitive idea that lowering corporation tax rates in fact might help to secure the tax base in the long run.

One only needs to look at the economic performance of Ireland over the past decade where a corporation tax rate of less than half that of the UK produced a huge amount of inward investment, generating highly skilled employment which, in turn, significantly increased the overall tax take of the Irish exchequer. It is worth noting that employment taxes represent the majority of the tax base in Britain, whereas corporation tax accounts for only 10 per cent 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.

The author is a partner and head of tax in London and Geneva for the international law firm Hogan & Hartson