

Companies do pay tax

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The argument that companies do not pay taxes appears to be coming up, yet again, on this blog. It is, of course, an argument beloved of neoliberal economists. But then, many of them also argue that there is no such thing as involuntary unemployment and that markets are efficient. If you make assumptions that ensure the outcome matches your ideological wish whilst in the process ignoring reality it is quite amazing what an economist can do with maths that has no relationship to the real world.

The argument that companies do not pay tax falls firmly into this category of theory based on ideology supported by maths based on assumptions that have no bearing to reality. [This is what is said on this on the Fair Tax Mark web site:](#)

Large companies, supported by some academics and think tanks as well as big firms of accountants, have been arguing for some time that corporation tax is outmoded and past its use by date. Their argument is based on a claim that companies cannot pay tax - only individuals can.

Theory can, however, be very misleading - and in the case of economic theory, based as it is on some pretty massive assumptions about idealised human behaviour, that is especially true. The result is that we take a pragmatic as well as idealistic approach to the issue of corporation tax and as a result suggest that there are at least five fundamental reasons for charging corporation tax on company profits:

** Companies are not tax neutral. They can significantly change where and when tax is due, who pays it and at what rate. For this reason alone it is vital that there is a corporation tax to tackle the worst of the distortions that the mere existence of companies can create in a tax system.*

** Corporation tax is efficient when compared to taxing shareholders on the profits companies make. We simply do not know who the shareholders in many companies are, with this being especially true in the case of multinational corporations. Moreover shares are traded frequently: it has been suggested that the average period for holding a share in the USA is now around 20 seconds. Many shareholdings are themselves hidden in other companies and trusts, many of which in turn are in tax havens to hide*

their true ownership in an attempt to avoid the taxes due if the true ownership was revealed. In combination these facts mean that replacing corporation tax with a tax on shareholders on the income streams they derive from companies would be a recipe for ensuring some of those owners would pay no tax at all. That would be profoundly unjust.

* Corporation tax charges companies for a benefit provided by society. That benefit is limited liability. This is an extraordinary privilege created, for all practical purposes, in the Victorian era, which if put forward as a new idea now would fail all tests of reasonableness. The idea that a single person may, by signing a few pieces of paper, escape responsibility for paying their debts would be absurd but for our familiarity with it. That privilege may have benefits but also imposes costs on society, partly from tax lost when tax debts are not paid, and partly from society bearing the cost of failed companies. Nothing better illustrates this than the cost of bailing out the banks in 2008. It could be argued that this cost could be recovered by increasing the annual fees charged by most states to the companies that are registered within their domains for the privilege of keeping a company on its official register of companies, but that would be unreasonable: it would be equivalent to a poll tax. The answer comes instead in the form of a tax on profits that compensates society for the costs companies impose on it; costs broadly equivalent to scale and that must, if any system is equitable, be settled based on a company's capacity to pay which profit implies

* Corporation tax is an essential back stop to income tax: if the profits of companies were not taxed there would be considerable incentive for anyone undertaking a trade to incorporate and so either avoid or defer tax on the profits they make. This would, inevitable lead to significant loss of taxation revenue to the Exchequer.

* There is good reason for taxing profit and not, for example, turnover or cash flow. Appropriately measured profit is the best measure of the economic gain resulting from trade and as such is the best guide to the return to capital resulting from its use in a business. Taxing anything but profit is to tax some factor other than the reward to capital. Cash flow is, for example, arbitrary and exceptionally difficult to identify as a measure for taxation in complex business enterprises (as indicated by the failure of the accountancy profession to ever come up with meaningful or comprehensible funds flow statements for inclusion in financial statements) and also gives rise to enormous difficulty in separating capital and income flows whilst any form of tax on turnover, however disguised, behaves in exactly the same way as VAT for economic purposes: the incidence will almost invariably fall on customers in most cases, the impact will be inflationary and so considerably economically distortive and the one thing that can be guaranteed is that capital will go untaxed.

All of these points are important, but perhaps the last is the most important. Corporation tax is an efficient charge on the income earned by capital and nothing else is for all the reasons noted.

However, we accept that this point has also been challenged, with some economists

arguing that the owners of capital (the shareholders) do not in fact pay the corporation tax charged to a company and that the customers, or more often, the employees do. We do not agree, again, and are not alone in our opinion.

A US Congressional Budget Office report concluded in May 2010, that capital(shareholders) bears the majority and maybe all of the corporate tax burden. It was also not alone: another Congressional Budget Office report in March 2011 hedged its bets: it suggested when offering advice on measures that could help close the US fiscal deficit that increasing corporation tax would in the short term (by which it implied several years) increase the tax burden on companies themselves.

Thereafter it recognised that there could be a theoretical shift of the burden onto labour, but by then no one could be sure because other factors would have intervened and a great many further short term changes would have taken place. Any other answer but this comes, in our opinion, solely from the realm of theory and has no practical application. This has not stopped some seriously misleading claims being made with regard to tax incidence. In particular almost all the claims that the incidence of corporation tax falls on labour appear seriously and even fundamentally flawed.

Without going into considerable detail, the studies in question are almost all based on corporation tax increases, a phenomenon now almost unknown. Second, they fail to take into account and control for the fact that the corporation tax increases they studied arose very largely because of difficult economic circumstances where governments were seeking to raise revenue. Those same economic circumstances were commonly linked to downward pressure on nominal and real wage rates. That corporation tax increases may be linked with falling wage rates in such circumstances has little or nothing to do with there being a relationship between the two: a positive correlation does not prove a fact.

Perhaps most significantly though, if those promoting the idea that the incidence of corporation tax falls on labour had been willing to test their hypothesis insituations where corporation tax rates were falling when, if they were right, there should be very clear evidence that real labour rates should increase then the evidence to support their case might be more compelling, but this appears to be something they are very reluctant to do. The fact is that this relationship tax cuts and rising real wages simply does not exist: in the UK, for example, it has not been observed over the last five years or so when corporation tax rates have fallen dramatically but real wage rates have declined.

Nor has it been seen in the UK over the longer term where there has, since the time when corporation tax rates were 52% for large companies, been a fall in the proportion of GDP made up of labour reward of approximately 5%, with profit share(particularly in the financial services sector) rising to make up the difference.

If the incidence of corporation tax is on labour then the evidence for it is absent from

economic data, whilst the fact that behaviourally business still demands tax cuts, something it is unlikely it would do if it planned to pass on all the benefit to its staff, suggests that there is no real belief in this claim.

In that case the claim of labour incidence for corporation tax is best seen as a myth intended to increase the rate of return to capital, and a very poorly related myth at that. As a result we are entirely satisfied that corporation tax is the one tax that definitely falls on the owners of the business and is not a pure charge

for services supplied, as for example business rates and licence fees are, and is not actually paid by others, which is true of employer's national insurance which all economists agree is really paid by labour through lower wages, or VAT, which is paid by customers.

The consequence is that we focus on corporation tax precisely because it is the most important tax that companies themselves pay, which might explain in turn why they appear to put so much effort into avoiding it, whilst seeking to divert attention from that fact by seeking to draw attention to all the other taxes they pay over on other's behalf but do not actually pay themselves or for which services are provided in exchange.

In summary: corporations can and do bear tax and they also change who pays tax, where tax is paid, when it is paid and at what rate.

Can there be a better reason for taxing them at source?