Funding the Future

George Osborne's Â£10 billion a year tax giveaway to ...

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Two illustrations of the fact that tax competition does not work have come to my attention this week. The first arose in evidence given by Chris Sanger of Ernst & Young to the House of Lords on Monday earlier in the session during which I also gave evidence. He said that in his firm's experience tax was the sixth or seventh most important consideration in decisions made by companies on international location. I do need to get one to five from him.

More important is a new paper by Tidiane Kinda for the IMF, the abstract of which says:

Using manufacturing and services firm-level data for 30 sub-Saharan African (SSA) countries, this paper shows that taxation is not a significant driver for the location of foreign firms in SSA, while other investment climate factors, such as infrastructure, human capital, and institutions, are. By analyzing disaggregate FDI data, the paper establishes that, while there is considerable contrast in behavior between vertical FDI (foreign firms producing for export) and horizontal FDI (foreign firms producing for local markets), taxation is not a key determinant for either type of FDI. Horizontal FDI is attracted to areas with higher trade regulations, highlighting interest in protected markets. Furthermore, horizontal FDI is affected more by financing and human capital constraints, and less by infrastructure and institutional constraints, than is vertical FDI.

In other words, tax competition does not work.

Despite that though the Coalition has set out to engage in tax competition to attract new business. It has said:

Since 2010, the Government has undertaken a comprehensive review of the UK tax system, consulting with business on the direction and design of our reforms. We have made tax policy simpler, more transparent and therefore better suited to a globalised trading world and to modern business practice. We believe that the corporate tax system can and should be an asset for the UK, improving the business environment and helping to attract multinational companies and investment.

The cost has been phenomenal. UK corporation tax receipts for the last decade or so have been as follows ([source HMRC](#)) *(click image for a bigger version):*

Forecast [revenues based on OBR data are](#):

I thought it worth plotting the actual data to give an indication of trends:

Give or take large company tax take has fallen on average by £150 million a year over 12 years, admittedly with wild oscillations but with recent behaviour when it is known that profits have been rising confirming the trend. In contrast small company revenues have risen, admittedly partly because there are simply more of them.

I then remodelled the data to 2017-18 using this trend data:

Thius projection forms the base line for comparisons noted below on tax lost from big business. Now, of course, this is extrapolation but the point is very clear: the contribution that big business is going to make to the UK over the next few years is going to fall considerably, and smaller business is going to contribute more. I have little doubt at all that this is true. Indeed, it is confirmed [by the FT this morning](#), who say, triumphantly (given that PWC are behind the story), that:

Britain's biggest companies paid more in national insurance contributions than corporation tax for the first time last year, marking a drop in profits and a historic shift in the way companies are taxed.

A decline in profits from North Sea companies was the biggest factor driving down the corporation tax paid by [The 100 Group](#) of the largest UK businesses, which fell by a quarter to £6bn in 2013.

So what might this policy of tax cutting, promoted because it is believed that it will induce tax competition that will in turn bring business to the UK despite the fact that evidence shows that this does not happen, cost us? To work this out I looked at the OBR forecasts for tax revenues until 2018-19 and expressed these in percentage growth terms, as follows:

The average is for 2013-14 onwards. The figure for self assessment looks to be wrong in 2014-15 unless there is a massive tax hike coming so far not announced or the OBR *believes that business is going to see the most enormous hike in profits. The overall figures actually look absurdly high as well: tax take is planned to increase considerably faster than growth over this whole period which may come as news to all those who think the government is committed to tax cuts However, for the current purpose I am assuming the OBR know what they are doing and it seems fair in that case to assume a growth rate that is based on broad economic activity and since 5.2% would broadly average income tax, PAYE and NIC that is the rate of anticipated tax growth I have used in the first instance.*

Using this rate I have then estimated the growth rate for small business corporation tax contributions and averaged them over 2013-14 to 2018-19. That average is 9.1%, remarkably similar to the self assessment growth rate and oddly the peak is also in 2014-15, where again there is a weirdly high growth rate. I have no idea what the OBR think is going to happen to small business profits next year. The important point is that there is data consistency, and there is.

Then I have applied the 5.2% growth rate to big company corporation tax receipts, making the reasonable assumption that without policy interference they would rise like other taxes. The resulting graph of projected revenues would then look like this:

Expressed in terms of tax lost the data is as follows:

What this means is that over a period of six years more than £30 billion is to be given away to big business to supposedly lure new business activity to the UK when there is no evidence that such a policy works.

This, though, did not seem like the best answer to the question of what this policy might cost. We know that profits are cyclical, and we can see from anticipated self assessment receipts and implicit small company corporation tax receipts that significant additional tax revenues are anticipated in 2014-15 as a result of what must be anticipated profit growth. It would be very odd if the same rate of profit growth was not anticipated for large business, so I then used the rate of projection implicit in the OBE figures for smaller companies and applied it to the large company tax paid data and the following resulted:

Now the total cost of the policy is shown to be as high as £63 billion over six years.

In that case it is likely, on reasonable bases of estimation, that an average of between £5 billion and £10 billion a year is to be lost from tax revenues because of a dogmatic *experiment with a policy that EY says has little impact on decision making and which hard evidence shows is largely irrelevant to business location decisions. But the loss is real nonetheless: those many billions will be lost come what may and all because of misplaced policy. As the FT, again, note today:*

The figures were hailed by PwC, the professional services firm that compiled them, as a sign of a global trend away from taxing profits as governments have tried to stimulate investment and achieve a more stable tax base.

Kevin Nicholson, head of tax at PwC, said: "It's not a surprise that for the first time corporation tax is not the largest tax paid by the UK's bigger employers. Looking at the full picture of tax paid by business, you see that tax on profits has fallen while taxes on labour and property have increased. This is a global trend."

But if this is a global trend (and I think it fair to say there is evidence of that) then it is because people like EY and PWC promote it, even though there is no evidence base for it. In that case it is fair to conclude that the policy is instead intended to promote a simple shift in tax onto labour; there's no evidence of it falling on property.

And yet at the same time the bosses of these firms receiving these windfall tax cuts - most of which will help trigger massive executive share bonuses - are also protesting about the 50p tax rate and are sitting on enormous piles of cash that they have no clue what to do with.

If someone wants to know where some real contributions to the cost of cutting the deficit can be found they could start with large company corporation tax. A rate cut of 7%, the introduction of territorial taxation, the effective ending of the controlled foreign companies rule, the introduction of the patent box and the offshore treasury arrangements have all been designed to give business a tax bonanza and it is going to pay out handsomely at cost to the rest to us. When that cost could be an average of more than £10 billion a year over the next six years no one can ignore this issue.