Funding the Future

Has Ed Balls got a cunning plan on tax?

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I was willing and able to welcome the the announcements that Labour made on tax on Saturday. They made sense, took it in the right direction and reflected what might be called genuine left of centre thinking.

This morning there will be considerable doubts amongst many Labour supporters concerning the further announcements on tax that Ed Balls will make in a speech this morning. To summarise what we know right now there are three elements to this second raft of proposals.

The first is to cancel the proposed cut in corporation tax for large companies from 21% to 20% next year. This proposal has been specifically made to finance a freeze in business rates for smaller, UK-based, companies. I welcome that.

Second, there is a commitment to ensure that the UK continues to have the lowest rate of corporation tax in the G7. That is a rhetoric that sounds worrying to someone like me, but right now the next lowest rate is 26.5%. In practice this commitment means that Labour has got plenty of scope to increase corporation tax rates for larger companies if it wishes because whilst overall trends in corporation tax rates are downward the very clear evidence that recent changes in the UK tax regime have not attracted new foreign direct investment can offer little encouragement to other countries to follow the current government's course. Ed Balls has adopted Tory rhetoric here but it is by no means clear that he has adopted Tory plans.

Thirdly, Ed Balls is looking at an “allowance for corporate equity” as part of reforms to encourage more long-term attitudes in business. I admit that this one does cause me concern. There can be no doubt that the UK's very generous tax relief for interest paid by companies has been significantly abused. We have seen takeovers of football clubs, like Manchester United, funded almost entirely by debt which has been loaded onto the companies themselves, with the result that massive tax subsidies have been given to the buyers. The same is true of mainstream companies. Indeed, this is the whole allegation about tax avoidance at Boots. What worries me about the approach that Ed Balls is looking at is that instead of tackling this abuse it seeks to give an equivalent tax allowance to those companies that fund their activities using shareholder money instead of borrowings.

I have three problems with this approach. Firstly, it does not tackle the problem of excessive debt funding or the tax relief given upon it. Secondly, it simply creates another corporate tax giveaway, and big business has enjoyed a whole raft of these over recent years meaning that this is the one sector of the economy as a whole that has enjoyed tax cuts. Thirdly, this is another arrangement that favours big business over small enterprise. No small company has significant shareholder funds so this relief is going to leave them almost unaffected whereas large companies do, however much their debt, tend to have a significant value of shareholder funds. That means they're bound to get this tax relief, so upsetting the balance between small and large business yet again, with the bias being, once more, against small business.

I look forward to reading this speech in detail - and I have not seen an advance copy. Right now I am lukewarm about the way these announcements have been pitched. They may be clever positioning that gives away nothing. They could be indication of a worrying trend. As I said on Saturday, the devil is in the detail. We will have to see how that pans out.