

# Why we must not replace corporation tax with a sales ta...

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Lord Lawson [has suggested that the UK should replace corporation tax with a sales tax](#). I am not surprised. Nothing would suit the wealthiest in the UK better than that. Because, however, such comments will undoubtedly attract attention and because I have been [called to give evidence before the Treasury Select Committee](#), who are having a hearing on the future of corporation tax on Tuesday morning, let me explain some of the issues involved.

First, let me be clear that corporation tax is charged on profits. I am well aware that there are those get this wrong. And there are also those who like to say that the charge is passed on to the customers or the employees of companies. I think the evidence for that is remarkably weak: if the tax charge could be got rid of so easily then I have no doubt at all that much less effort would be put into avoiding it. In that case whilst I do not deny that the incidence of taxes is not always obvious I think it safe to say that the behavioural responses of companies, their directors and shareholders suggests that they all think that this is a tax that falls primarily on the owners of the capital in the company precisely because that is true.

This is important. If the supposed call to reform corporation tax is actually about changing the people who pay that tax, which would then be charged on a totally different basis, then the likes of Lord Lawson are not actually calling for the reform of corporation tax at all. They are instead calling for its total abolition and replacement not by a new tax on the owners on capital (who are by and large the wealthiest in society) but by a new tax on everyone in society, the biggest proportionate burden of which is almost inevitably going to fall on those with lowest incomes. Despite all that follows this is my most important observation of all. It should never be forgotten.

That being the case, let me also be clear about some of the issues that a new sales tax, if we were to have one, might give rise to. First there is the question of what a sale is. This is a bigger issue than you might think. Currently corporation tax applies to most of the income of companies whether that income be from sales, interest, rents, capital gains, speculative market trading, derivatives, insurance premiums and more. By no means all of these are sales. By no means all of these are accounted for as sales. By no

means all are subject to VAT. Many would not appear in the turnover figure of a set of accounts. Those that do not are almost invariably the returns to capital that the City would no doubt be delighted to see excluded from any replacement for corporation tax, or are rents. So there is a straightforward question to ask, which is whether or not we are willing to see these sources of corporate income fall out of tax? If we are, why? If not, if we have a sales based tax how are they to be taxed?

Second there is the small issue of whether, to beat international tax avoidance we are going to be willing to have a tax system that is different from that in the rest of the world. The opportunities for tax arbitrage, and so avoidance, that this would give rise to are enormous, whilst we would be totally outside the protection provided by the international tax treaty system. Is that something that we really want?

Third there is the question of losses and the small matter that this gives rise to of capacity to pay a tax charged on turnover and not income. Corporation tax deals with this by simply not making a charge to tax when there is a loss. This is important: after all, anyone can sell £10 notes for £9.75, make a massive turnover in a short period of time and a fair sized loss and have no capacity at all to pay tax. Does that mean that a sales tax should be applied nonetheless? And what about the situations where a loss arises because of unforeseen circumstance (and many losses come into that category, unlike the one noted, which was akin to the Northern Rock business model). Would having to pay tax in that case still be considered fair and equitable? I doubt it.

Next there is the question of what rate to apply. In [2015/16 it is expected](#) that VAT will raise about £133 billion and corporation tax £42 billion. VAT is, of course, already a form of sales tax, although a special one (see notes below). The VAT bill represents 7.8% (or thereabouts) of GDP. It should be more but this tax is normally subject to an evasion rate of around 10% (a point to note for those who propose a sales tax to beat corporation tax abuse: according to HMRC VAT is the most evaded tax, which hardly makes it a great basis for replacing corporation tax). It is not 17.5%, of course, because approximately half of all UK economic activity is not subject to VAT for various reasons. This also implies though why a change to VAT could not replace corporation tax. First that half of activity that is not subject to VAT (much of which has already been noted and relates to returns to capital) would fall out of the charge but also rates on remaining activities the VAT rate would need to rise to the high end of EU allowed rates in most cases. This would be deeply inflationary: many rates would increase by more than 5%. Those suggesting such a tax need to say how that, and its consequences, could be managed within our economy.

This then brings us to the distributional impact. There are numerous of these. The first is already noted: any passing on of a sales tax in prices - and it would be impossible to prevent it happening - would result in significant price inflation without any prospect of compensating wage changes for most (pensioners would be an exception, which would then create its own stresses within the composition of total benefits spending). The result would be a significant increase in poverty whilst those who were the owners of

capital would see a reduction in their overall tax liabilities and an apparent increase in their spending capacity and wealth as after tax earnings of companies jumped giving a significant boost to the stock market to the benefit of the relatively small part of society that benefits as a result of such changes. Such a tax change would, then, be deeply regressive.

There would be other potential distributional impacts as well, depending upon tax design. Clearly if only charged on sales as defined for VAT the financial services sector would benefit, enormously, at cost to the rest of the economy. That is exactly the opposite direction of travel from that anyone seems to want right now, and for good reason.

Then there is the impact on small business. If this tax was charged not as VAT (where a VAT registered trader can reclaim the VAT charged to them by other VAT registered traders in most cases, meaning that the VAT charge ends up, by and large, on the end consumer) but was instead charged as a sales tax - where the tax levied was not recoverable by the next person in the supply chain - then long supply chains would be penalised by cumulative tax charges. This may have real consequences. As example, a supermarket may be able to buy product straight from a manufacturer: supply chains are short in their case. That is not true of the small retailer, many of whom will buy through a wholesale chain adding one or more steps into the supply chain that will mean that they will carry a higher base cost if a genuine sales tax was charged than would be the case with a VAT style tax. A proper sales tax would then appear to discriminate against the conventional small business.

But that would not be true in the case of some small businesses. Consider the case of the very large number of small companies that are, in effect, one person only labour supply organisations that charge customers for the supply of their owner / directors services, pay that same person a modest salary to get a national insurance credit, pay dividends out of the remaining profit on which they should also pay corporation tax and then use that corporation tax paid as an effective credit against their income tax bill. The aim of many such companies is, of course, to avoid national insurance at present. But now consider what would happen with a sales tax. A tax rate of maybe 5% or 6% would be applied to sales (if pro rate to VAT, although it could be lower in the case of a genuine sales tax and still recover £42 billion) and now the owner / director pays almost no tax in the company, at all because there is no corporation tax. You can imagine the incentive to incorporate would increase enormously.

Now, of course I can anticipate the obvious response, which is that tax rates on dividends would have to be charged in full through tax returns in that case given that there would be no tax credit attached to them anymore. It is the obvious reaction, but there are very real difficulties attached to that. First, let's be blunt: [evidence I have documented](#) suggests that there may be hundreds of thousands of small companies already trading and not declaring any of their tax liabilities. Any incentive to increase the risk of that is an obvious mistake: tax evasion in this area already imposes a far

bigger cost on the UK Exchequer than does offshore tax abuse by large companies. I would urge people to keep all issues in proportion. Second, the compliance cost of having dividends untaxed at source is very high: the number of additional tax returns required even given the (absurd, forthcoming) exemption from tax on the first £1,000 of savings income would be enormous. Is that the direction of travel we want to go in? Then there is the risk of significant increases in tax bad debt when more people might owe by assessment, let alone straightforward increases in evasion as sums are omitted from returns.

And this is all before we consider another distributional impact. Some people simply do not need to live on their incomes. They have enough in capital to defer ever paying themselves from the companies they own: if corporation tax is abolished they will be given even greater opportunity than now to accumulate their income in a low or no tax environment, exacerbating the already distinct wealth divides in society.

So, at that point the obvious thing to do is say that corporation tax should be abandoned on small companies and all should be charged to tax as if the profit they earned belonged to their shareholders and that those shareholders must pay whether or not they actually get the income or not. But what if, as is entirely possible, a minority shareholder in such a company did not receive the income but was asked to pay the tax? How is that fair? And what too if the ownership of the company was registered as on offshore company that did not pay tax, to add another complication into the chain (I assure you it would be so obvious a ruse it would happen)? What then? The only obvious answer would be to get the company to make a full tax payment on behalf of the members on account of their liability which they could use as credit against their tax bill. To prevent higher rates of tax being lost this might need to be at above 20%.

That suggestion would definitely work but it is important to note then that such a system is, of course, in effect what a proper imputation system of corporation tax (where the corporation tax paid is imputed to be an income tax payment in the hands of the taxpayer) does: we are back to where we started. As a matter of fact then we cannot abolish corporation tax for companies then if we are to have anything like tax justice in the smaller, privately owned business sector.

But does that mean we should only let larger companies off this tax bill? Wouldn't that just mean that big business would be rewarded for its abuse by a sales tax it could always pass on to customers and a massive competitive advantage over smaller business as a result of introducing a sales tax that could never be made available to small business because of the chaos that would result? Surely no one would want that, would they? Unless they stood to gain massively as a result, of course.

To summarise, sales taxes as substitutes for corporation taxes are a non-starter because they would create massive complications in the tax system, would shift the burden of tax onto the lowest paid and small business, would increase income and wealth inequality and would give big business a real boost in their competitive

advantage as a result of that tax boost. I can see every reason why Lord Lawson might be keen on a sales tax as a result. I can see every reason why a lot of lobbying will be thrown in the direction of such a tax now. And I can see every reason why we must work very hard indeed to resist it because this will deliver injustice of extraordinary proportions.

The answer is we need to make corporation tax work on larger companies. That is not hard.

We need to move towards [unitary taxation](#).

We need [full country-by-country reporting](#) on public record to embarrass them into paying.

We [need to give HMRC the resources to chase these companies](#).

We need a [Board of HMRC with the courage to take on big business tax abuse](#).

And we need to have politicians with the political will to tackle this issue with courage and insight.

We could have those things.

What we will never need is a sales tax to replace corporation tax.

Please beware of false promises and those who bear them.