

**Labour's
Policy
Review**

Corporate Tax: transparency and reform

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Foreword

In tough times, and when the government is cutting spending and raising taxes, it's more important than ever that everyone plays their part. That means that individuals and companies alike should pay their fair share of tax.

The government has a particular responsibility to make sure that the tax burden doesn't fall disproportionately on one group of taxpayers or another and that the taxes that are due are actually paid. Keeping the tax system up to date and, where necessary, reshaping it to take account of how international business is organised and run, is a vital part of that process.

There is widespread concern that the government is failing to do that. While good British firms and millions of families are paying their fair share, some firms don't seem to be. This is not right and needs to change, and to tackle tax avoidance we need action in a number of areas.

We need to look at how the tax system can be reformed to make sure that it works properly in the modern world and for society today and delivers outcomes that are clearly and transparently fair. We also need to reform the rules that allow companies to have a lot of business in Britain but pay little, or no, tax in this country.

One Nation Labour would put an end to the era of tax secrecy. Some companies that are otherwise compliant are prepared to engage in complex planning that reduces their corporation tax bill to nothing because they think no-one will notice, or find out. If that changes, many of them will change their behaviour as well.

The recent publicity given to cases where companies have manipulated the tax rules to reduce their tax bill have rightly outraged all those people and businesses who pay their fair share of tax, and rely on the public services that tax receipts support. They ask why some seem to think the rules do not apply to them. This is not only unfair, it also undermines companies who do pay their tax reasonably expecting there to be a level playing field.

Sometimes there will be good reasons why companies pay little tax - some companies invest large sums in research and development, assets and infrastructure. We want that real investment here in Britain and we should encourage it, even when it temporarily reduces the tax those companies pay.

But all too often the companies that pay low taxes in this country are simply doing so because they have found they can manipulate the rules to their advantage. We need to know when companies are stripping their profits out of the UK through artificial schemes, with no purpose other than reducing their tax liability.

Ed Balls MP and Catherine McKinnell

Background to Corporation Tax

Corporation Tax, in a form similar to what exists today, has been applied in the UK since 1965, when we moved from a classical to an imputation system of taxation.

In the classical system, a company would pay tax on its profits, and shareholders would pay tax in full on any dividends (paid out of the company's after-tax profits), arguably resulting in double taxation. With the imputation system, a company still pays tax on its profits, but for shareholders, at least part of the tax due on dividends is cancelled as a result of the credit given for tax already paid by the company.

The broad structure of the UK Corporation Tax system has remained relatively unchanged since its first application, albeit with changes to the rates over time. However, there have been some significant recent changes to the basis on which Corporation Tax is charged on UK companies. One of those changes is to move from a residence basis to a territorial basis of taxation.

Until recently, all UK resident companies were taxable on their worldwide income. Companies were deemed UK resident if they were incorporated in the UK, or incorporated elsewhere but managed and controlled from the UK. With the new Controlled Foreign Companies (CFC) rules, the UK has moved to a territorial system, where only corporate profits arising in the UK are subject to tax - see below.

With the rise of multinational corporations, and differing tax regimes across countries, there has been increasing scope for companies to avoid tax in a particular jurisdiction.

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Countries have therefore put in place measures that limit the opportunity for this, both unilaterally, and also through multinational cooperation, primarily through the OECD.

The UK has “anti-avoidance” provisions to prevent international tax avoidance where the main purpose, or one of the main purposes, of a transaction is to enable tax advantages to be obtained. The current major provisions are shown below:

- **Transfer pricing rules:** these rules are intended to prevent two companies under common control trading with each other on a basis that no two unconnected companies would trade. The rules are meant to stop these companies arranging the price at which they trade in a way that shifts profit to a low tax location and costs to a high tax location.
- **Controlled Foreign Companies rules:** these rules work by drawing profit derived by overseas subsidiaries of UK companies into the UK tax system, where there is evidence that that is where they should properly be taxed. The new legislation (effective 1 Jan 2013) shifts the UK tax system towards a more territorial basis as the rules are more focused on artificial diversion of profits from the UK, and is aimed at enhancing the competitiveness of the UK as a holding location for multinational businesses.

While Corporation Tax is the fourth highest source of taxation revenue, it is not the only tax revenue received by the UK Exchequer as a result of business activity. The three largest sources of government revenue are Income Tax, NICs and VAT. These other taxes are all partly dependent on the success of businesses, as employers and providers of goods and services. So we need to look at the contribution of companies who invest here in the UK in the round. If companies are deterred from basing themselves in the UK, the loss of revenue from other sources could render such an approach counter-productive.

So a balanced, proportionate, and fair tax system is needed to allow business to grow and contribute to the UK economy and society.

Review of the current Corporation Tax system

Business practices have been changing rapidly over recent years, and many aspects of the current Corporation Tax system have fallen behind. This includes the growth of multi-national firms, technological change, and the role of brands and other intellectual property in the economy.

Fundamental reform is required in the international corporate tax system. Increasingly the current OECD system of single-entity accounting and transfer pricing does not sufficiently reduce the opportunities for tax havens and artificial shifting of profits. This is particularly disadvantageous to developing countries, which lose significant tax revenues as their tax systems struggle to protect their tax base.

The ability of the international community to address these emerging issues and the need for wider reform is an area of continuous and multilateral discussion. Labour will continue to pursue over the coming months and years the key question of what role the UK plays in international standard setting and compliance.

However, action is urgently required to develop a system which:

- is robust and effective in the modern world;
- supports investment and job creation;
- deals effectively with the complexities of international business;
- is fair to all; and
- is transparent and can be better understood by the public.

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To meet these aims, Labour is focusing on the following areas of the UK tax system:

1. HMRC

Both the administration and enforcement of the tax rules have been impacted by cuts to HMRC resources, with the Chancellor pushing through over £2 billion of deep cuts. The Government plans to cut a further 10,000 HMRC staff, which risk being a false economy, as there has to be a limit to HMRC's capacity to do more with less.

Despite all the rhetoric about tackling tax avoidance, the progress made by this Government is limited at best. The deal struck with Switzerland is less transparent than a similar deal struck with Liechtenstein by the last government.

The latest NAO report has shown what can be achieved when a government is serious about tax avoidance and praises Labour's disclosure laws for closing down avoidance opportunities and bringing in £12bn of extra tax since they were introduced. But HMRC needs to be given sufficient resources to do its job effectively.

We will consider what powers HMRC might be given to strengthen the corporate tax regime in the UK, within international frameworks, and how Corporation Tax could be better administered and collected.

2. General Anti-Abuse Rule

The current government has introduced a General Anti-Abuse Rule (GAAR) targeted, by its own admission, to tackle only the most egregiously abusive tax avoidance schemes.

Although the Government sets great store by this measure, if it means that fewer efforts are made to update targeted anti-avoidance measures, or if it is a mere fig-leaf for the withdrawal of resources from HMRC, then we will not see any reduction in aggressive and abusive schemes.

We will look at how the GAAR can be strengthened to ensure there is a reduction in aggressive, abusive schemes, as well as what additional measures might be required.

We will also consider how we can ensure that tax avoidance activities not covered by the GAAR aren't, by implication, deemed acceptable.

3. Transparency

We need an end to tax secrecy. At the moment it is too easy to set up complex networks of companies within a group, some of which can be based in tax havens, and move profits between them. This can make it very difficult to assess the overall amount of tax paid. Multinational groups can and should be able to structure however they wish, but there is no reason why they should not have to produce a simple statement of the amount of corporation tax they pay in the UK, in a way that all of us can understand, experts and non-experts alike.

To make that happen the government should put concrete proposals on the table for the G8 to deliver internationally agreed action on tax transparency. There are a number of immediate areas where we should be showing leadership:

- i. Pursuing a new system of disclosure for multinational companies, that will require information to be published that will be of and practical benefit to the revenue authorities in developing countries where they operate. An approach based on Intelligent Transparency will deliver real benefits without imposing a heavy administrative burden on companies or creating masses of data that developing country revenue authorities simply cannot use;
- ii. Extending the Disclosure of Tax Avoidance Schemes regime, which Labour introduced, to global transactions;
- iii. Opening up tax havens, with requirements to pass on information about the individuals operating through networks of company or trust structures;
- iv. Assessing the impact of changes to the Controlled Foreign Company rules on the UK and developing countries.

If multilateral agreement takes too long to be achieved, we need to examine how the necessary transparency of revenues, profits, and taxes paid can be delivered through UK government action, to provide leadership in the international community.

Companies will have a strong incentive to pay their fair share of tax when it's clear to everyone where rules are unfairly being manipulated.

So Labour will consider how best to publish a simple statement of the amount of Corporation Tax paid by a company, or group of companies, in the UK. We will also look at what other transparency measures might be necessary to assess whether companies and individuals are paying the right amount of tax in the UK, as well as how international transparency can help ensure a sustainable tax base in the UK and the developing world.

4. Domestic reform

This isn't just about individual companies. We are going to have to reform the current rules that allow companies to make profits in Britain but pay no tax. That means reform of our Corporation Tax system. In the 21st Century value is now often in brands, intellectual property, customer loyalty and ideas which can be traded globally between different parts of a corporate group. The rules need to be clearer, tighter and properly enforced.

Labour will examine the international lessons to be learned on how we can improve UK rules, particularly from countries where rules are more strictly applied. We will also consider whether transfer pricing rules can be improved and if there are better ways to assess the value of intangible assets being moved within corporate groups.

With the Coalition Government full of tough talk but still failing to act on tax avoidance, either at home or abroad, One Nation Labour will deliver the tax fairness and transparency required for a system that can support a recovery made by the many, not just for a few at the top.