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Briefing Note

WHY CORPORATION TAX CUTS WORK

DANIEL MAHONEY

SUMMARY

- From 2010-11 to 2016-17, the headline rate of corporation tax fell from 28% to 20%. Treasury analysis suggests that will cost the Treasury between £3.2bn and £4.3bn per annum. Yet onshore corporation tax receipts have exceeded initial expectations by the Office for Budget Responsibility and grown by 44% since 2011-12.
- Strong economic growth and higher profitability for companies are the driving force behind this rise – which themselves have been brought about by Government measures to boost competitiveness, including cuts to corporation tax.
- The decrease in corporation tax rate has supported growth and jobs. Treasury analysis shows that over the next 20 years they will increase investment by up to £6.2bn, GDP by up to £12.2bn and wage growth by up to £515 per household.
- A further cut in the corporation tax rate to 17% is now planned. The Labour party has publicly stated its intention to reverse the cuts and further increase the rate to 21.5%.
- At best, this would raise between £3.7 and £5 billion pa in the long term – although there is no clear historical evidence that higher corporation tax rates lead to more revenues. The main corporation tax rate has fallen from 52% in 1982, yet corporation tax receipts are now a higher % of GDP at a rate of just 20%.
- Labour has made pledges costing at least £15 billion pa linked to its planned hike in the corporation tax rate to 21.5%. These spending pledges are at least three times the maximum that could be raised from its planned increase in corporation tax rates.
- Overall, there is at least a £10 billion a year funding gap between Labour's current corporation tax plan and their directly connected spending pledges.
- To reconcile these without increases in other taxes or borrowing, Labour would have to increase the rate higher. Even if the corporation tax rate was reset at 28%, the gap is likely to remain. The maximum cost to the Treasury of the fall from 28% to 20% is between £3.2bn pa and £4.3bn pa – well short of the gap in Labour's plans.
- Such an increase would reverse the gains achieved from the cuts in the corporation tax rate, including in investment, GDP growth, wage increases, and jobs growth. A rise in the UK's corporation tax rate would damage competitiveness when other developed economies, including Canada and Japan, have been slashing their rates.



1. CORPORATION TAX POLICY SINCE 2010

From 2010-11 to 2016-17, the headline rate of corporation tax has fallen from 28% to 20%. Both the headline rate of corporation tax and small business rate were both set at 20% in 2016-17 and the rate has now fallen to 19%. The Government has also announced that the corporation tax rate will see further decreases over the course of this parliament, falling to 17% by 2020.

2. WHAT HAS BEEN THE IMPACT?

The modelled cost

£7.9bn per year based on static models, but £3.16bn to £4.35bn based on dynamic modelling

Table 1: Direct impact on Treasury in 2015-16 from corporation tax policies (2010 to 2015)

	Impact on Treasury revenues in 2015-16	
Main rate cut from 28% to 20% by 2015-16	-£7.6bn	
Small profits rate cut to 20% in 2011	-£1.4bn	Estimated long term policy cost (per annum):
Other measures	+£1.1bn	
Total:	-£7.9bn	-£3.2bn to -£4.3bn*

Source: Institute of Fiscal Studies [link](#)

*Based on HMRC analysis that 45 – 60% of tax loss is recovered over 20 years [1.d.p]

A static analysis suggests that the Treasury has lost £7.9 billion in revenue in 2015-16 as a result of the government's policy to reduce the corporation tax rate to 20% (see Table 1). However, over the longer term the net fiscal cost to the Treasury falls significantly. HMRC [analysis](#) suggests that 45 – 60 % of the tax loss is recovered after 20 years due to the dynamic positive effects on economic activity. This would suggest that, in the longer term, the cost in revenue for the Treasury from the fall in corporation tax rate from 28% to 20% is between £3.16bn and £4.35bn per annum.

But there have been increasing revenues...

UK competitiveness has improved and companies are now more profitable

Despite the fall in the headline rate, the Government's revenues from onshore corporation tax have increased by 44% since 2011-12, rising from £34.2bn to £49.4bn in 2016-17 (see Table 2). Total corporation tax receipts were slightly higher at £49.8bn. This has exceeded expectations. In 2013, the Office for Budget Responsibility (OBR) projected that total corporation tax receipts for 2016-17 would be just £38.2bn (see Figure 1 and Table 3).



Table 2: Headline rate of corporation tax and corporation tax receipts

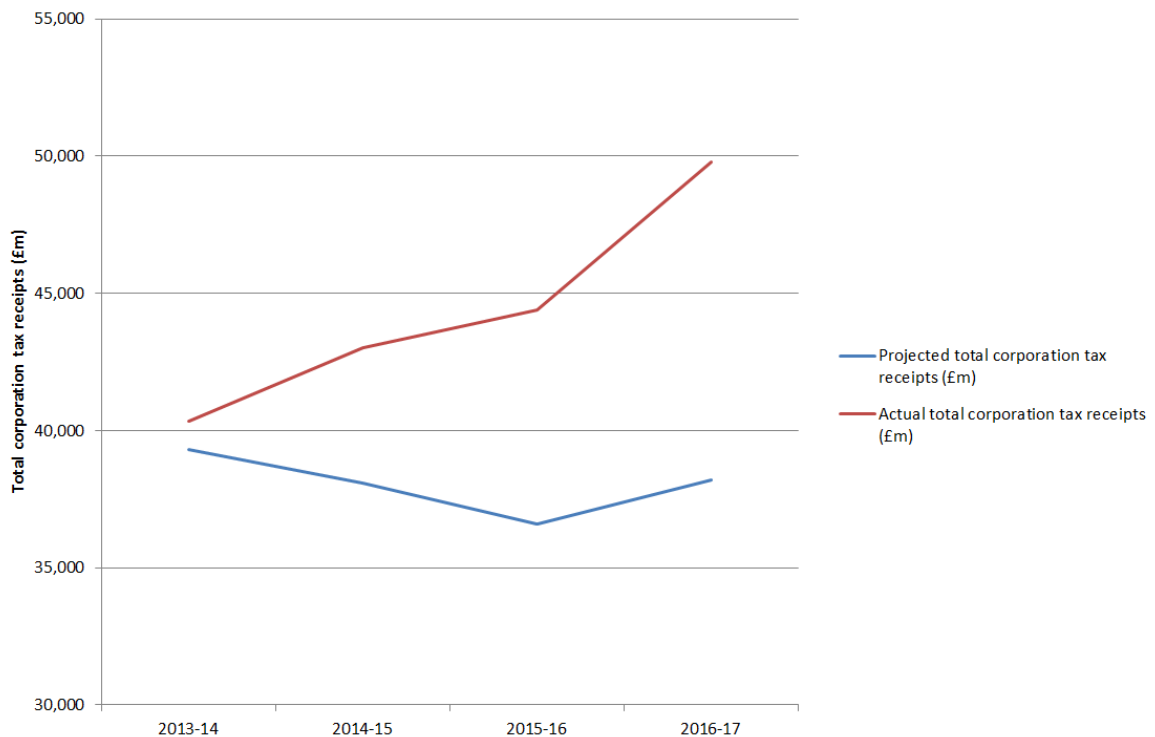
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Onshore Tax receipts (£m)	36,176	34,290	36,070	36,771	40,932	43,872	49,434
Total Corporation Tax receipts	43,040	43,130	40,482	40,327	43,005	44,410	49,772
	2010	2011	2012	2013	2014	2015	2016
Corporation tax rate	28%	26%	24%	23%	21%	20%	20%

Source: [HMRC](#)

Note 1: These figures exclude the Bank Levy and the Bank surcharge.

Note 2: Total tax receipts have seen a more modest rate of growth than onshore receipts due to the collapse in tax revenues from offshore North Sea oil and gas.

Figure 1: Projected Total Corporation Tax Receipts Vs Actual Receipts



Notes: Projected total corporation tax receipts come from the 2013 Office for Budget Responsibility Economic and Fiscal Outlook [link](#)



Table 3: Projected corporation tax receipts in 2013 vs Actual Corporation tax receipts

	2013-14	2014-15	2015-16	2016-17
Projected total corporation tax receipts (£m)	39,300	38,100	36,600	38,200
Actual total corporation tax receipts (£m)	40,327	43,005	44,410	49,772
	2013	2014	2015	2016
Corporation tax rate	23%	21%	20%	20%

Note 1: Projected total corporation tax receipts come from the 2013 Office for Budget Responsibility Economic and Fiscal Outlook [link](#)

Note 2: HMRC [link](#)

The benefits from falling corporation tax rates

The increase in corporation tax receipts after the economic slowdown in 2011-12 is largely due to robust economic growth, with the UK being the fastest growing economy in the G7 group of nations in 2016. Furthermore, there has been growing profitability of UK companies since 2010. For example, according to the Office for National Statistics, the net rate of return on capital for UK private non-financial corporations was estimated to be 12.2% in Q3 2016, which is up from 10.2% in Q2 2010.

There is also evidence to suggest that the falling headline rate of corporation tax has supported growth and jobs. In 2013, the Treasury applied their peer reviewed Computable General Equilibrium model to the corporation tax rate reductions announced since 2010.

Table 4: Benefits from corporation tax falling from 28% to 20% over 20 years

Investment	£3.6bn to £6.2bn
GDP growth	£9.6bn to £12.2bn
Wage growth	£405 to £515 per household

Source: HMRC

The reduction in corporation tax rates has encouraged overseas businesses to invest in the UK and to earn profits here rather than elsewhere. This modelling suggests that the tax reductions will increase investment by between 2.5 per cent and 4.5 per cent in the long term (equivalent to £3.6 billion and £6.2 billion) and GDP by between 0.6% and 0.8%



(equivalent to between £9.6 billion and £12.2 billion). Lower corporation tax rates will also increase the demand for labour which in turn raises wages and increases consumption. The Treasury estimates that this benefits households by between £405 and £515.

Stronger than expected economic growth and larger than predicted tax receipts now mean that the Chancellor is expected to undershoot his borrowing target for 2016-17. This success has, at least in part, been driven by the UK's increasing competitiveness, which is partially due to the UK's cuts in corporation tax. The UK is now the 7th most competitive country in the world, according to the World Economic Forum's latest Global Competitiveness Index. This is up from being the 12th most competitive country in the world in 2010-11.

3. LABOUR'S PLANS ON CORPORATION TAX

Spending commitments do not match their plans on corporation tax

Jeremy Corbyn has previously called for a cancellation of the planned cuts in corporation tax rate from 20% to 17%, and in 2016 he announced that he wanted to increase the UK's corporation tax rate by 1.5 percentage points, which would leave the UK with a rate of 21.5%.

Table 5 shows that, when using a dynamic analysis, these changes could only raise a maximum of £5 billion per annum. However, the Labour Party has made commitments worth £15 billion per annum related pledges associated with a corporation tax rate increase to 21.5% (see Table 6). This means that the Labour Party has made pledges in excess of three times the maximum amount that can be raised from its stated policy on corporation tax rates.

It must be noted that these pledges relate to commitments that are linked to corporation tax rates, not on clamping down on tax avoidance or evasion.



Table 5: Maximum additional revenue derived from reversing planned corporation tax cuts and increasing the rate by 1.5%

Measure	Effective rate of corporation tax	2017-18	2018-19	2019-20	2020-21	Long-term annual estimate
1. Increase CT by extra 0.5% in 2020-21	21.5%				£1,205m ^a	£1,205m
2. Increasing CT by 1% ^b	21%	£750m	£2,030m	£2,410m	£2,410m	£2,410m
3. CT falling to 19% in 2017-18 ^c	19%	£605m	£1,600m	£1,870m	£1,870m	£1,870m
4. CT falling to 18% in 2020-21 ^d	18%				£605m	£1,870m
5. Reducing rate to 17% in 2020-21 ^e	17%			£120m	£945m	£1,870m
	STATIC MODEL	£1,355m	£3,630m	£4,400m	£6,035m	£9,225m
	DYNAMIC MODEL^f					£3.4bn – £5.1bn^g

^a Figure is half the estimate for the additional revenue arising from an increase in rate to 21% in 2020-21.

^b Figures from 2017-18 to 2019-20 come from HMRC. 2020-21 and long term annual estimate assumed to be the same as 2019-20 figure.

^c Figures come from *Summer Budget 2015*. Long term annual estimate assumed to be the same as 2020-21 figure.

^d 2020-21 figure comes from the *Summer Budget 2015*. Long term annual estimate is assumed to increase to £1,870m.

^e 2019-20 and 2020-21 figures comes from the *Budget 2016*. Long term annual estimate is assumed to increase to £1,870m.

^f The Dynamic model assumes that 45-60% of the revenue change is cancelled. This is based on HMRC's analysis.

^g Rounded to 1 decimal place.

Notes:

- Measures 1 and 2 look at the potential revenue raised from an increase in corporation tax by 1.5 percentage points.
- Measures 3, 4 and 5 show the potential revenue loss for the Treasury from corporation tax rates falling from 20% and 17%.
- The calculation for the maximum revenue raised by Labour's pledge to increase corporation tax to 21.5% is:
- The revenue raised by measures 1 and 2 + the change in revenue from measures 3, 4 and 5. A discount of between 45 and 60% is then applied to account for the dynamic impacts of the change.
- After three years, the fall in corporation tax rate from 20% to 19% raises £1,870m per year on the static model. The fall from 19% to 18% and 18% to 17% are also each assumed to raise £1,870 per year in the long term on the static model.



Table 6: Labour’s funding pledges from corporation tax

Expenditure type	Funded via	Amount needed (per year)	Amount from corporation tax (per year)
Reintroducing maintenance grants^a	Corporation tax	£3.0bn	£3.0bn
Public funding of universities^b	Corporation tax	£7.1bn	£7.1bn
Increasing public sector pay^c	Corporation tax / 50p rate	£1.25bn ^d	£0.6bn [assuming 50% from CT]
Reversing changes to universal credit^e	Corporation tax / tax avoidance	£3.4bn	£1.7bn [assuming 50% from CT]
Increasing social care spending^f	Corporation tax	£2.6bn	£2.6bn
Total in 2020-21			£15.0bn

^a Angela Rayner: ‘Today’s commitment to restoring both EMA and student maintenance grants shows that... When we can help improve the education of over a million young people with a small increase in corporation tax, it is an investment we would be foolish not to make’

- (LabourList, 17 August 2016, [link](#))

- Labour have said this will cost £3 billion (Guardian, 15 July 2015, [link](#))

^b Jeremy Corbyn: ‘At the moment what we’re doing is asking students to fund universities rather than the public to fund universities. I would rather move in to the other way around, with public funding of it... It would be largely on levels of corporate taxation’

- (Victoria Derbyshire Labour Leadership Hustings, 17 August 2016)

- Labour have said this will cost £7.1 billion (Guardian, 15 July 2015, [link](#))

^c ‘Jeremy Corbyn would fund pay rises for public sector workers partly through a 1 per cent rise in corporation tax and bringing back the 50p top rate of tax, the party has said.’

- (Observer, 7 August 2016, [link](#))

^d Public sector pay cap at 1% will save the Treasury £5 billion from 2016-17 to 2019-20 (Employee benefits, 2015 [link](#)). This comes out at an average of £1.25bn per year.

^e Universal Credit. We’re hoping on Wednesday the government will reverse that...If you had a fair taxation system, you weren’t giving the tax giveaways to corporations and to the rich, if you seriously tackle tax evasion and tax avoidance (50/50 breakdown assumed), if you grew the economy we’d be able to afford – we’d be able to afford our public services’

- (The Andrew Marr Show, BBC One, 21 November 2016)

- Labour have said this will cost £3.4 billion (Labour Party press release, 16 November 2016, [link](#))

^f Jeremy Corbyn: ‘Why does she [the Prime Minister] not do something really bold: cancel the corporation tax cut and put the money into social care instead’

- (Hansard, 14 December 2016, col. 787, [link](#))

- Labour have identified the social care ‘funding gap’ to be £2.6 billion (Labour Party press release, 15 December 2016, [link](#))

To reconcile this gap without other increases in tax or borrowing, the Labour Party would have to increase the corporation tax rate far in excess of the 1.5% planned rise. However, even if the corporation tax rate went back up to 28%, it is unlikely to fill the gap. The estimated long-term cost to the Treasury of the fall in the corporation tax rate from 28% to 20% is between £3.2bn and £4.3bn – well short of the gap in Labour’s plans. Moreover, such

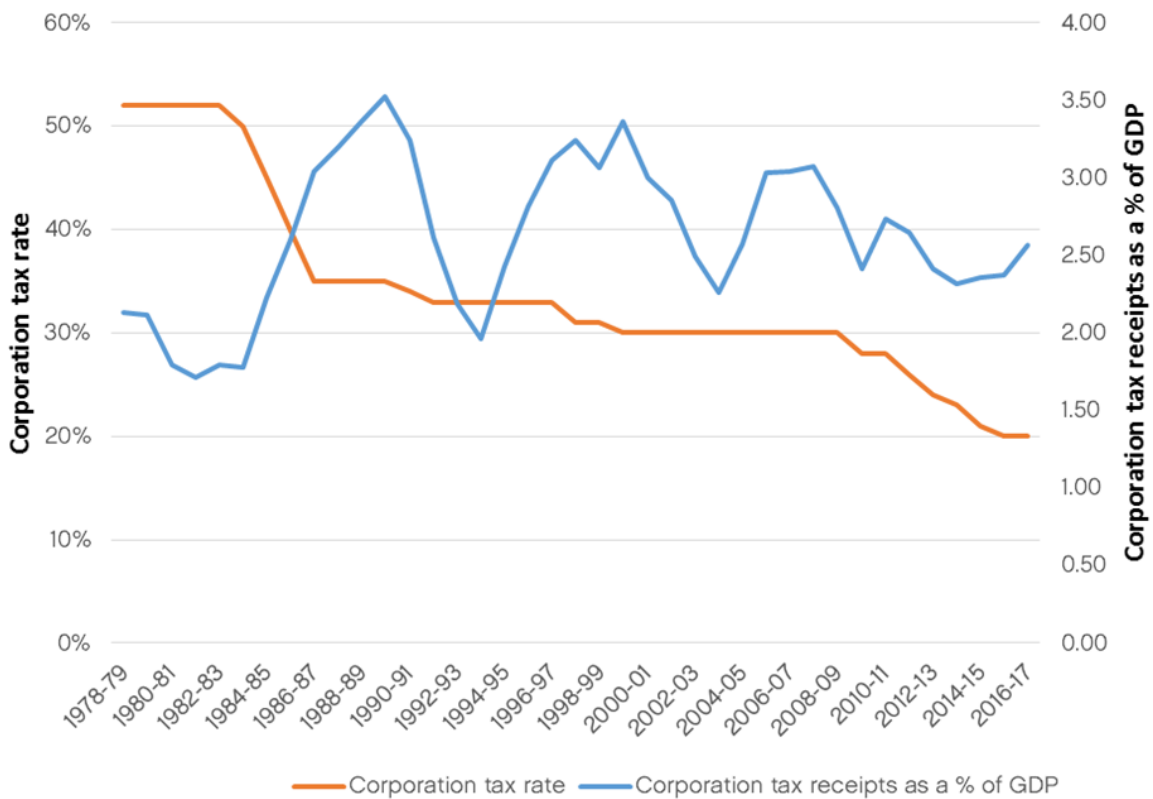


an increase would likely reverse the gains achieved in investment, GDP Growth and wage increases. There would also be an impact on employment. For example, analysis conducted by the CPS prior to the general election in 2015 suggests that a 4 percentage point increase in the corporation tax rate would lead to a reduction of employment by nearly 100,000. Furthermore, a rise in the UK's corporation tax rate would damage competitiveness at a time when other developed economies, including Canada and Japan, have been slashing their rates.

A lesson from history: Lower rates do not necessarily mean less revenue

Historical evidence would suggest that raising corporation tax does not necessarily mean an increase in revenue for the Treasury. The main rate of corporation tax has been gradually falling in the UK, dropping from 52% in 1982 to just 20% currently. Despite the fall in the headline rate, corporation tax revenues have remained buoyant. In 1982-83 when the rate was 52%, corporation tax receipts yielded revenues equivalent to 2% of GDP. Corporation tax now raises over 2.5% of GDP when the headline rate is at just 20%. As shown in Figure 2, falling corporation taxes have been associated with higher proportional corporate tax receipts.

Figure 2: UK Headline corporation tax rate



Sources: HM Treasury and Bank of England



4. CONCLUSION

The policy of reducing the corporation tax rate from 28% to 20% has been very successful. It has helped improve the UK's competitiveness, contributing to robust economic growth over the past few years. Moreover, this robust economic growth has led to higher profits for companies and higher corporation tax receipts for the Treasury. Setting out a pathway to lower corporation tax to 17% will further boost the UK's competitiveness – although as this is below the basic rate of income tax it is important that issues around potential tax avoidance are addressed.

When looking at costs associated with corporation tax changes, it is estimated that traditional static models overstate the loss in revenue to the Treasury by around 45-60%. The static models do not account for long term dynamic changes. However, historical precedents suggest that it cannot be assumed that increases in corporation tax yield more revenue. The main rate of corporation tax has been gradually falling in the UK, dropping from 52% in 1982 to just 20% currently. Yet, despite this, corporation tax receipts now yield a higher % of GDP than previously.

In comparison to the Government's plans, the Labour Party's pledge to increase the corporation tax rate to 21.5% could raise a maximum of £5bn per annum. This policy is problematic in two key ways. The first is that it will damage the UK's competitiveness, reversing some of the gains over the past few years. The second is that the Labour Party has claimed that reversing the proposed cut in headline rate from 20% to 17% and increasing the rate to 21.5% will pay for over £15bn of annual spending pledges. Even assuming that this raises the maximum £5bn per annum, these funding pledges are underfunded by a ratio of 3 to 1. In any case, historical precedents suggest that you cannot guarantee that increases in corporation tax rates will lead to higher revenues for the Treasury.

To reconcile this gap without other increases in tax or borrowing, the Labour Party would have to increase the rate far in excess of the 1.5% planned rise. However, even if the corporation tax rate went back up to 28%, it is unlikely to fill the gap in Labour's plans. The estimated long-term cost to the Treasury of the fall from 28% - 20% is between £3.2bn and £4.3bn – well short of the gap in Labour's plans.

Such an increase would also lead to negative consequences for the UK economy and businesses, reversing the gains achieved in investment, GDP growth and wage increases, and also impacting on employment. Moreover, a rise in the UK's corporation tax rate would damage competitiveness at a time when other countries, including Canada and Japan, have been slashing their rates.

Of course, cutting down on tax avoidance and evasion could yield the Treasury more revenues. HMRC estimates that the tax gap is around £36 billion. However, just £5.2 billion of this is accounted for by tax evasion (which is illegal) and only £2.2 billion comes from tax avoidance. The Government has already taken steps to reduce avoidance opportunities, which includes introducing the anti-avoidance rule and engaging in the OECD Base Erosion and Profit Shifting project.



THE AUTHOR

Daniel Mahoney is Deputy Director and Head of Economic Research at the Centre for Policy Studies. He previously worked in research roles for a number of parliamentarians, including a three year posting as a senior researcher. He is author of *UK Manufacturing: How to Fix the Engine* (February 2017), *Who Will Fix London's Housing Crisis* (April 2016) and *The Great Overtake* (June 2016).

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