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Fact Check: could Labour raise £19.4 billion by reversing Conservative corporation tax cuts?

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Raising revenue through corporation tax hikes won't be a piece of cake. Victoria Jones/PA Wire

> *The plans will be funded from the £19.4 billion that will be raised by reversing the Conservative Party's cuts to corporation tax.*

A Labour party press release on May 9, 2017, detailing how the party would fund its plans to increase school spending.

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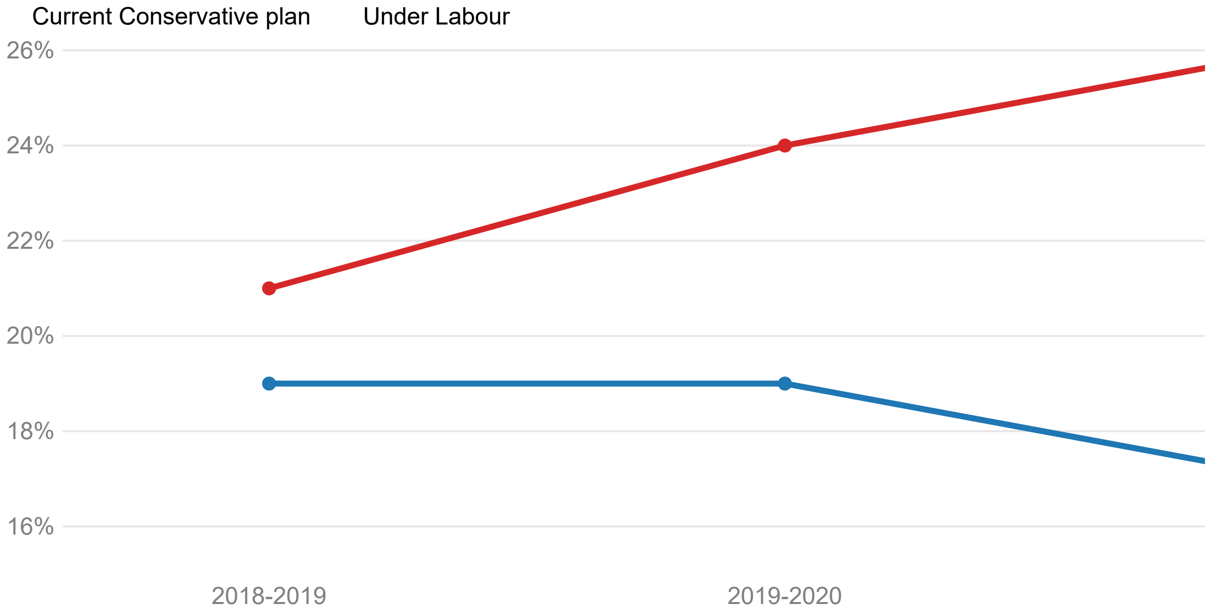
The Labour party has cited its pledged increase in corporation tax as a way to fund a number of manifesto commitments, including those on education.

Labour's assertion that they can raise £19.4 billion is founded upon HMRC's April 2017 estimates – known as a "ready reckoner" – that a 1% increase in the rate of corporation tax would raise an additional £2.6 billion a year in 2020-21 (and £2.7 billion in 2021-22 when accounting for growth).

Yet Labour plans to do more than simply reverse the Conservative plan to cut the main rate of corporation tax to 17% by 2020, from its current rate of 19%. Instead, Labour would increase the main rate to 26% by 2020-21 and reintroduce a small profits rate for small businesses of 21% by the same year.

This would mean that under a Labour government, the main rate of corporation tax would be 9% higher by the end of the next parliament than currently planned, and 4% higher for small businesses.

How main rate of corporation tax would differ under Labour



Source: Labour party & HMRC Get the data

The split between revenue raised through the main rate and the small profits rate was roughly 63%/37% in the last year when both rates existed, according to the Institute for Fiscal Studies. Applying this ratio to a calculation using the £2.7 billion figure from HMRC above would add an extra £4 billion for the 4% increase for small companies' profits, and £15.3 billion for the 9% increase for the main rate. This would mean that in 2021-22, the extra revenue would be £19.3 billion.

Changing behaviours

Based on this information, the £19.4 billion figure does seem reasonable. However, the increase in revenue would be dependent on the behaviour of companies not changing in the face of such a marked rate increase. Previous academic studies have shown how both individuals and organisations change their financial behaviour when relevant taxes are introduced, abolished or altered.

These changes in behaviour can take two main forms. Changes in tax planning could push companies to minimise their taxable profits in the UK. While changes in strategy and investment could make companies invest less in the UK, which would affect economic growth – and tax returns through corporation tax.

This means that the amount raised through corporation tax can be unpredictable and shows no immediate association with the underlying rate of tax. There is evidence of this in UK corporation tax receipts over recent years. While the main rate of corporation tax has continually decreased since it was introduced in its current form in 1973, the receipts generated have remained generally buoyant.

No tax exists in a bubble. Even if a company does not take any steps to counteract the change in tax rate and pays an increased amount of corporation tax, this will reduce its post-tax profits which will affect either its customers (in the form of increased prices), employees (through decreased wages), or shareholders (through decreases in dividends). Decreases in consumer spending, wages and dividends are then likely to result in decreases in tax receipts from excise duties, VAT, income tax and national insurance.

Verdict

While Labour claims that the Treasury will have an additional £19.4 billion to spend by increasing corporation tax to 26% by 2022 makes statistical sense, these headline numbers could only bear fruit if companies don't change their behaviour and there is no impact on other taxes. History teaches us that these are large assumptions to make, and so there can be no guarantee over future levels of corporation tax receipts.

Review

Eamonn Walsh, Professor of Accounting, University College Dublin

I agree with this verdict. If anything, it is too restrained. No change in corporate behaviour is probably untenable – all the more so when new administrations in France and especially the US are seeking to cut corporate tax rates to below 26%. Inevitably, international companies that can actively manage the geography of their profits will reconsider their internal arrangements and this will result in erosion of the UK corporate tax base.