Business Tax Reform:

Fair for society and fair for business

This paper has been prepared by the Liberal Democrat Business Tax Working Group to provide background and support for the Business Tax Reform policy motion proposed at Autumn Conference 2019. It is not an official Federal Policy Committee paper, and so only the policy motion (and not the paper) is adopted as Party policy if the motion is passed.

Contents

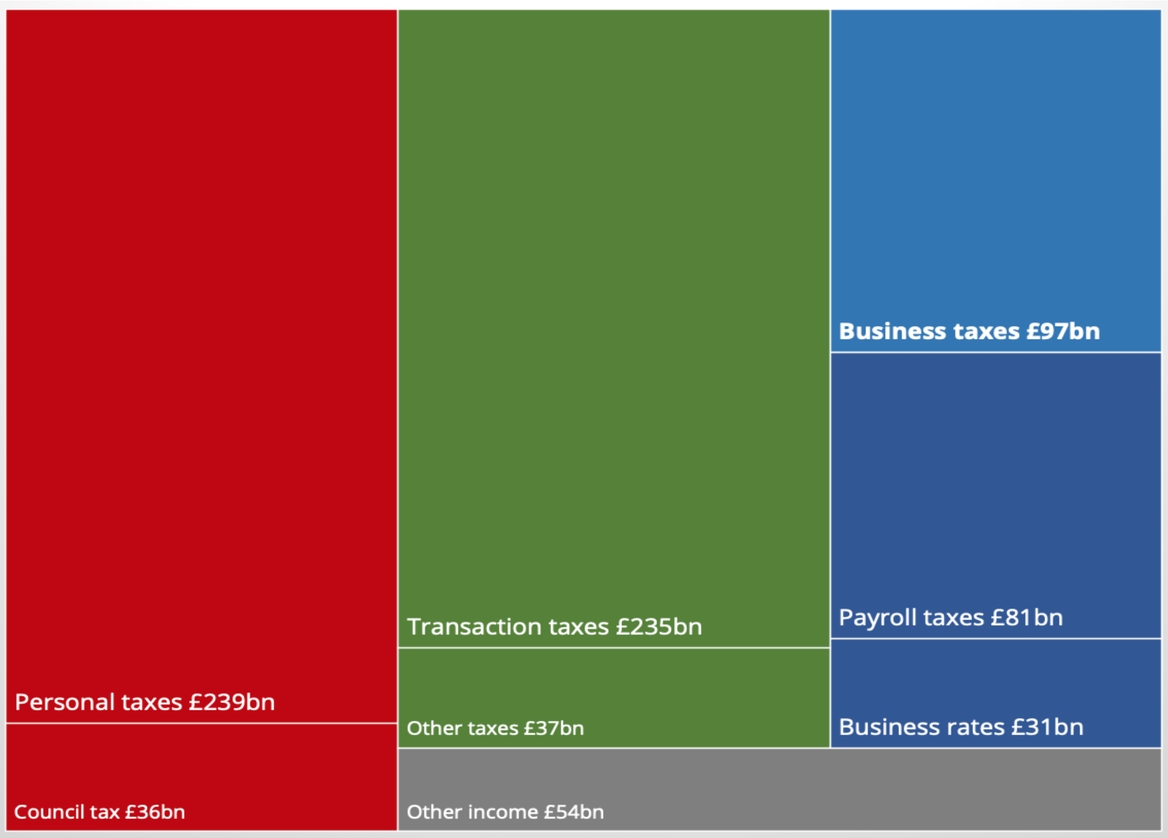
1. Executive summary

1.1 Introduction and scope

1.1.1 The purpose of this working group paper is to consider the best approach to taxing the earnings of businesses.

1.1.2 According to the Office for Budget Responsibility, businesses are expected to contribute £97bn in taxes on their earnings this year. This is 12% or just under one eighth of government income.

Figure 1 – Forecast taxes and other income of £810bn in 2019-20



Personal taxes: income tax £160bn, employee national insurance £64bn, capital gains tax £9bn, inheritance tax £6bn.
Transaction taxes: VAT £156bn, fuel duties £28bn, alcohol and tobacco duties £22bn, property transaction taxes £13bn, other £16bn.
Profit taxes: corporation tax £60bn, self-assessment income tax £33bn, bank levy and surcharge £4bn.
Payroll taxes: employers' national insurance £78bn, apprenticeship levy £3bn.
Source: HM Treasury, Autumn Budget 2018.

1.1.3 Although not in the scope of this policy paper, we concur with the policy adopted at the 2018 Autumn Conference to abolish business rates and replace with a land value tax. Business rates discriminate against and are an unfair burden on many 'bricks and mortar' businesses and abolition cannot come too soon.

1.1.4 We have not addressed other aspects of the taxation system, including other taxes paid by businesses or personal taxes other than where they relate to taxing the earnings from business activities.

1.2 Reform is needed

1.2.1 We believe that the existing system of business taxation is not fit for purpose and needs significant improvement:

(i) It is too complicated, and is an unnecessary compliance burden that constrains enterprise.

(ii) It does not provide a level playing field, with businesses being taxed differently, and not always for rational reasons.

(iii) There are too many opportunities to minimise tax at the expense of citizens and society.

(iv) Tax incentives are frequently misdirected, rewarding the undeserving and often not having the intended economic effect.

(v) It distorts business decisions in ways that are not good for the economy.

1.2.2 A fairer and simpler tax system would ensure businesses are treated equitably and would save time and money for both businesses and the government.

1.3 Principles for a reformed system of business taxation

1.3.1 We believe that the business tax system should be reformed to be both fairer for society and fairer for business, with businesses contributing to the societies in which they operate: based on the following principles:

(i) Businesses should pay tax.

(ii) Businesses should be taxed on profits.

(iii) Businesses should be taxed equitably.

(iv) Taxes paid should be fairly allocated between jurisdictions, with businesses operating in the UK paying tax in the UK.

(v) Businesses should pay a single fair rate of tax on their profits.

(vi) Businesses should not be able to reduce their effective tax rate to zero.

(vii) The tax calculation should be straightforward.

(viii) The tax system should be stable, with sufficient time for consultation and implementation whenever changes are necessary

(ix) Productive investment should be encouraged.

(x) Incentives should be targeted and provide value for money.

(xi) Taxes should be transparent.

1.4 Policy proposals and implementation

1.4.1 We propose an international approach to business taxation:

(i) A global minimum rate of business tax.

(ii) A fair allocation of tax between jurisdictions – both internationally and between the regions and nations of the UK.

(iii) An end to businesses being able to shift their profits to low-tax jurisdictions to minimise tax bills at the expense of the societies in which they actually operate.

1.4.2 International reform will take time. In the meantime, we propose to:

(a) Reverse existing and planned cuts in the rate of corporation tax and adopt a long-term stable business tax rate of 20%. We will use the additional tax revenues raised to fund much needed investment in public services.

(b) Replace corporation tax with a new British business tax, in line with the principles set out in section 2.

(c) Require international businesses that operate in the UK to pay their fair share of tax in the UK.

(d) Eliminate tax breaks that enable businesses to pay less than their fair share and reform the system of incentives to ensure they are better targeted, simpler to administer and monitor, and cannot be used to reduce their effective tax rates to zero.

1.4.3 We will phase in our other proposed changes to ensure that businesses, individuals and HMRC all have time to prepare and adjust.

(i) We will gradually increase the annual investment allowance and the rates of capital allowances over at least five years.

(ii) We will gradually phase out existing business tax reliefs and replace them with more effective and better targeted tax incentives. This includes replacing the over-generous patent box and entrepreneurs' reliefs that favour global multi-nationals and wealthy individuals with new incentives that better support early stage businesses.

(iii) We will consult on how best to bring wealthy city partnerships and highly profitable unincorporated businesses into the scope of business tax, and will give three years advance notice before doing so.

2. Principles for a reformed business tax system

2.1 Businesses should pay tax

2.1.1 Businesses rely on and benefit from the physical, legal and social infrastructure in the jurisdictions in which they operate. They also depend on societies to provide public services to the customers they sell to, to the suppliers they buy from, and to the employees that do the work.

2.1.2 For these reasons, we believe that society is entitled to a royalty on business activities. That royalty is best captured through a tax on business earnings to ensure that businesses contribute to the societies that enable them to trade and to create value for their owners.

2.1.3 We reject the notion that businesses should not be subject to tax or that tax rates should be significantly lowered from their current levels. While some commentators have argued that business taxes are an unnecessary friction to trade and should be eliminated or significantly reduced, we disagree. Even it did make economic sense to do so (which we doubt), other taxes would need to be increased to make up for the lost revenue, and such a move would potentially invite economic sanctions from other nations.

2.1.4 Other commentators have asserted that because businesses pay other taxes as well as collecting VAT and PAYE on behalf of the government, they have met their obligations to society even if they do not pay any or much tax on their profits. We reject this argument.

2.2 Businesses should be taxed on profits

2.2.1 There have been a number of suggestions for alternative tax bases to taxing business profits. These include proposals to tax revenue rather than profits or to tax other measures of business activity.

2.2.2 However, such alternatives have as many, or even more, problems than taxing profits, or would end up replicating taxes that already exist. For example, taxing revenue would discriminate against SMEs and lower margin businesses, and would in any case ultimately end up delivering a tax which looks very like VAT.

2.2.3 Such alternative taxes would also be counterproductive, entrenching the commercial advantages of highly profitable incumbents able to pay more, while penalising early stage businesses and other potential competitors.

2.2.4 The problems that arise with the current system have less to do with the basis for assessing tax, but are much more to do with its overcomplication, arbitrary rules and unfair application between different types of businesses. These problems need to be addressed rather than requiring a change in the underlying basis for assessing tax.

2.2.5 We believe that business profits are a reasonable basis for determining the tax to be paid:

(i) Business profits reflect the incremental value earned by businesses for their owners, recognised in accordance with standardised accounting principles.

(ii) Business profits implicitly provide a measure of ability to pay: larger more profitable businesses can and should pay more, while smaller and less profitable businesses are asked to pay less.

2.2.6 There have been a number of proposals for digital revenue taxes or digital value taxes, including one by the current government. Many of these proposals are unlikely to be ever implemented given the inherent contradictions of such tax arrangements, international legal difficulties, and the risk of reprisals from other countries. We believe that international tax reform is the best approach to addressing the problems in ensuring businesses pay their fair share of tax.

2.2.7 In the meantime, we believe enhanced place of establishment rules are required to ensure that multi-national and digital businesses operating in the UK contribute their fair share as set out in 2.5 below.

2.3 Businesses should be taxed equitably

2.3.1 The current business tax system is poorly designed. Structural inequities enable some businesses to pay much lower effective rates of tax than others, or even not to pay any tax on their profits at all.

2.3.2 Further unfairness and complexity is created by taxing businesses differently depending on their legal form. This creates opportunities for arbitrage and means that similar businesses pay different rates of tax for no sensible reason.

2.3.3 We also do not believe it is appropriate to re-introduce complexity by taxing businesses differently based on their size or level of profits in any one year.

2.3.4 A single rate of tax on all business activity is easier to administer, minimises compliance costs, and would avoid distortions that discourage businesses from expanding into higher tax brackets. The personal tax system is better able, and is better placed, to address differences in income and wealth.

2.3.5 We believe it is possible to reduce inequities in the current system, and we will consult widely on how to remove or reform unnecessary exemptions and deductions that mean that some businesses do not pay their fair share. Loopholes that benefit wealthy city firms and businesses with complex structures should be closed.

2.3.6 We will aim over time to bring highly profitable unincorporated businesses, such as wealthy city partnerships and consultancies, within the scope of business tax. Such businesses do not currently pay corporation tax and benefit from a lower effective marginal tax rate on business profits than other legal forms:

(i) Such a reform will require changes in the income tax and national insurance systems to ensure that individuals are treated equitably irrespective of whether they receive their earnings in the form of salary, drawings, dividends or otherwise.

(ii) Bringing highly profitable unincorporated businesses, partnerships and high earning sole traders into the scope of business taxation may result in some individuals paying higher taxes overall. For high earners, we believe that this is fair, removing the unfair structural advantages given to these firms and individuals by taxing them differently from other businesses.

(iii) Freelance workers and small unincorporated sole traders should continue to be taxed through the income tax and national insurance systems. These also need reform, but it is not the subject of this policy review.

(iv) This change to the tax system will require time to plan and will require extensive consultation before legislation is introduced. Once enacted, we envisage providing three years notice to give businesses time to prepare for the change.

2.4 Taxes paid should be fairly allocated between jurisdictions

2.4.1 The complex web of existing international tax treaties makes it impossible for any one country to unilaterally correct problems in the business taxation system.

2.4.2 The UK has been at the forefront of attempts to reform international business taxes, especially with respect to the global digital economy. The UK should continue to work with the Organisation for Economic Co-operation and Development (OECD) to address weaknesses in the current system. In particular, we need to design out the ability to shift profits to low-tax jurisdictions at will, stealing tax revenues from the societies that enable businesses to operate and generate value.

2.4.3 However, there is only so much that can be done through piecemeal reform. Ultimately, the current international system of business taxes needs to be replaced by a new approach suitable to an increasingly globalised economy. The UK should be at the forefront of driving this reform, pushing for a global system of business taxation based on the principles set out in this policy paper.

2.4.4 A new approach is needed to replace the existing 'origin' model that attributes taxable profits to a deemed place of value generation. This is no longer appropriate in the modern global economy, where businesses and their customers are located around the world, supply chains cross multiple borders, and value is created in more than country. Indeed, much of the value earned by modern business is generated by their users and is inappropriately treated as taxable in other jurisdictions by the origin approach.

2.4.5 We reject proposals to switch to a destination approach, where taxable profits are attributed to the jurisdiction of sale. This would be unfair in a different way, penalising many poorer countries that would be deprived of what little tax revenues they do earn in favour of attributing tax to wealthier jurisdictions.

2.4.6 Instead, we need an agreed international tax system that shares taxes on business fairly between the jurisdictions involved. This would recognise that businesses generate value from all the societies in which they operate and not just in their 'home' country (or adopted low-tax 'home'). Business taxes should be allocated between jurisdictions equitably, based on the principle that business activities involve more than one party – and where those parties are based in more than one jurisdiction, the tax paid attributable should be fairly allocated between those jurisdictions.

2.4.7 Even if other countries agree to reform the international system of business taxation, the reality is that reforming the global system will take years, if not decades. We should therefore not wait to make changes in our domestic business tax system, albeit there will some limits to the changes we can make within the constraints of international tax law.

2.4.8 In particular, we need to ensure that businesses operating in the UK pay tax in the UK, preventing multinational businesses from being able to structure themselves to minimise the tax they pay in a particular jurisdiction such as the UK.

2.4.9 This is not about penalising multinational businesses. We want to treat them fairly, while at the same ensuring that they contribute their fair share in taxes on business earnings from their UK operations.

2.4.10 For example, a retailer may be treated as based outside the UK even when selling goods from warehouses in the UK to customers in the UK. An online business may attribute to other jurisdictions its profits earned from selling advertising directed at UK consumers. Another online business may make money through the value generated by UK users, but claim that value is generated elsewhere. In each case, these companies pay substantially less in tax in the UK than might be expected given their global profitability.

2.4.11 These businesses are not to blame for a poorly designed tax system, and it is unsurprising that they take advantage of its weaknesses to maximise financial returns for their shareholders. While we might hope that they will change behaviour through moral pressure or a newfound sense of corporate citizenship, in practice this is unrealistic, especially where their loyalties are not to this country. The solution is to fix the flaws in our tax system.

2.4.12 Some have proposed new taxes to address this weakness in our current system of business taxation. For example, the EU has been discussing proposals to tax certain companies based on revenue rather than profits, while the UK Government is attempting to develop a digital user levy. However, these alternative taxes face many practical, legal and political difficulties and look likely either to be unsuccessful or, if implemented, unlikely to significantly address the 'lost' tax revenues.

2.4.13 We believe that rather than complicate the tax system by introducing new taxes, it would be better to address the weaknesses in the business tax system. We should ensure that the profits generated from economic activity in the UK are taxed in the UK.

2.4.14 We also need to restrict the ability of multinationals to shift profits artificially out of the UK to low tax jurisdictions. We therefore propose that:

(i) Profits should be taxed where the business activity takes place following actual commercial reality and not legal form.

(ii) We will revise permanent establishment rules to capture online businesses that are operating in the UK, ensuring that businesses selling advertising aimed at UK consumers or generating value from UK subscribers are captured within the UK business tax system.

(iii) We should take such further steps as may be possible to restrict the ability of multinationals to avoid paying taxes anywhere or to shift profits to lower tax jurisdictions inappropriately. In particular, further work is needed on royalty charges and debt interest.

(iv) We will introduce changes to the tax system to prevent public utilities and outsourced service providers attributing profits made in providing public services within the UK to other jurisdictions.[1]

2.5 Businesses should pay a single fair rate of tax on profits

2.5.1 The right balance needs to be drawn between a tax rate that supports enterprise, and is a source of advantage to the country, as opposed to a rate where businesses are not sufficiently contributing to society.

2.5.2 Too low a rate risks turning the UK into a tax haven and damaging the country's standing in the world market. Too high a rate and we risk damaging business competitiveness and hence wider prosperity.

2.5.3 The average corporate tax across European countries is estimated to be in the order of 23% to 26%, although many of their tax systems feature deductions that enable many businesses to pay substantially less than the headline rate. A tax rate in excess of 20% combined with fewer deductions and fewer opportunities to unfairly minimise tax would likely be uncompetitive and disadvantage British businesses; it might also encourage businesses to locate elsewhere, reducing the overall tax take.

2.5.4 Labour's proposal to increase the rate of corporation tax to 26% would damage the UK's competitiveness, discouraging much needed investment. Labour's proposed would also reintroduce complexity by taxing businesses at different rates based on their size.[2]

2.5.5 However, there is also little justification for the reduction by the Conservatives in the corporation tax rate to 19% or the planned reduction to 17% in 2020 (still less the suggestion that it be reduced further). Any economic benefit is unlikely to outweigh the sacrifice of this revenue at a time when money is desperately needed to fund our very stretched public services.

2.5.6 We believe that business will benefit from the introduction of a stable long-term tax rate that enables them to plan ahead with confidence.

2.5.7 We recommend a long-term rate of 20% for taxing business activity. We believe this is fair for society, fair for business, and sensible for the economy.

---

[1] This would have prevented fiascos such as the sales and leaseback of military housing or of HMRC offices to companies based in tax havens. The Guardian, *How the MoD's plan to privatise military housing ended in disaster, 25 April 2017*.

[2] The Labour Party plan to raise the corporation tax rate to 21% from 2018-19, 24% from 2019-20 and 26% from 2020-21, while taxing smaller businesses (profits below £300,000) at 20% from 2018-19 and 21% from 2020-21. (http://labour.org.uk/wp-content/uploads/2017/10/Funding-Britains-Future.pdf).

2.6 Businesses should not be able to reduce their tax rate on their profits to zero

2.6.1 Currently businesses that make profits are often able to utilise tax reliefs and allowances to reduce their tax bill to zero, even when they have generated value for their owners.

2.6.2 We believe that it is right that if a business is generating profits that it can and should pay tax. As a consequence, where tax incentives are claimed they should be restricted so that they cannot be used to completely eliminate the payment of tax when a business is profitable.

2.6.3 This will be achieved through the design of the tax calculation, with standard tax incentives restricted to a maximum of 50% of taxable profits, meaning that no established profitable business should have an effective tax rate of less than 10%.

2.6.4 We believe strongly that there is a role for the tax system in supporting and encouraging early stage businesses. A reformed British business tax will retain cash R&D tax credits to support businesses as they develop and grow into the successful enterprises that we need for future prosperity.

2.7 The tax calculation should be straightforward

2.7.1 The way taxes are currently calculated is much too complicated. It results in excessive compliance costs for business, waste in public administration and leads to errors and disputes on the part of both taxpayers and HMRC.

2.7.2 A complicated tax calculation also means that the taxes paid diverge from the reported profits on which they are supposed to be based. This adversely affects public confidence in the tax system.

2.7.3 This complexity is added to by the current requirement to submit a profit and loss account for tax purposes to HMRC in a different format to that used for accounting purposes. This is unnecessary and leads to frequent errors in submissions.

2.7.4 We will introduce a simple tax calculation – starting from the profit reported in business accounts with a minimal number of adjustments.

2.8 The tax system should be stable

2.8.1 There have been hundreds of changes to the tax system in recent years, on occasion at as many as three fiscal events a year. These changes have resulted in significant compliance costs for both businesses and the tax authorities; and have created an environment where it is difficult for businesses to plan ahead and to make investment decisions.

2.8.2 In addition to the costs of implementing specific changes when they are introduced, an over-complicated tax system that is continually changing introduces costs over the long term.

2.8.3 Our recommendations for reform should reduce the need for future changes, which often reflect the need to fix flaws from tax legislation that has not been subject to sufficient consultation and is therefore poorly thought through and poorly implemented.

2.8.4 A different approach is needed that prioritises stability over continual tinkering with the tax system.

2.8.5 We therefore recommend that future governments should aim to implement changes to the business tax system no more than twice in any one Parliament, with extensive consultation and sufficient lead times to allow for businesses to prepare themselves.

2.9 Productive investment should be encouraged

2.9.1 We believe that capital investment that improves productivity should be encouraged and supported by the business tax system.

2.9.2 Unfortunately, the current system of capital allowances significantly disincentivises capital investment. This makes no sense when society needs businesses to be investing more in productive assets if the economy is to grow.

2.9.3 Attempts to address the faults inherent in capital allowances have given rise to range of constantly changing reliefs such as the annual investment allowance for smaller businesses, and first-year and other forms of accelerated capital allowances for larger businesses.

2.9.4 Because these reliefs change frequently, it is difficult for businesses to plan ahead – a key element to encouraging investment decisions. The complexity of capital allowances is also a significant burden on many taxpayers.

2.9.5 We propose to simplify capital allowances by establishing a single pool for capital expenditure on all tangible fixed assets other than land and buildings, as recommended by the Office for Tax Simplification.[3] This would significantly reduce the burden of record keeping and tax compliance for all businesses.

2.9.6 We also propose gradually Increasing the annual investment allowance to £2 million and making this increase permanent. This will mean that the overwhelming majority of businesses will receive immediate relief on capital expenditure, simplifying their tax affairs significantly and encouraging them to invest more.

2.9.7 To encourage larger businesses to increase investment too, we will gradually increase writing down allowances on productive assets from 18% to 25% a year.

2.10 Incentives should be targeted and provide value for money

2.10.1 Incentives can be helpful in encouraging economic activity and in developing new business sectors. For example, business enterprise zones have helped regenerate many parts of the UK, while tax relief for research and development has helped support the development of key industrial sectors.

2.10.2 However, tax incentives can often be a waste of taxpayers' money, outweighing any benefits to the economy. This is because they frequently compensate businesses for activities they were going to undertake anyway, while causing some businesses to make sub-optimal planning decisions in order to meet the requirements for an incentive. They also often provide opportunities for tax planning, enabling undeserving businesses to shelter profits from taxation.

2.10.3 In addition, the current ad hoc approach to incentives means that each one is designed separately, resulting in unnecessary complexity. Loopholes are created only to subsequently need fixing. Incentives have to be reformed when they prove not have worked. This approach is frequently unfair by providing some businesses or individuals with an undeserved competitive advantage, while depriving public services of much needed revenue.

2.10.4 Further, incentives lack transparency that would allow policy makers, parliament and citizens to properly assess whether they are providing value for money.

[3] Office for Tax Simplification, *Accounting depreciation or capital allowances: simplifying tax relief for tangible fixed assets,* June 2018.

2.10.5 We believe that the business tax system needs to allow for incentives, but in such a way that does not cause the tax system to become overcomplicated. We should therefore rationalise and simplify the current range of tax incentives, including research & development tax credits and the patent box systems.

(i) There should be a standardised approach for incentives, so that they do not need to be designed from scratch each time. This would reduce complexity and reduce the risk of continued changes to the tax system.

(ii) Incentives should be transparent, so that the cost of providing them is clearly visible to policy makers, parliament and citizens. This would make it much easier to assess whether incentives have added value to the economy or not.

(iii) There should be a basic litmus test that an established profitable business should not be able to use incentives to reduce the tax payable to zero. We therefore propose to limit the total incentives that may be claimed by any one business to 10% of business profits, i.e. a maximum of half of the tax due before incentives.

(iv) A more targeted approach will enable greater support to be provided in tax credits to early stage businesses, encouraging greater innovation and enterprise.

2.11 Taxes should be transparent

2.11.1 Transparency is essential to ensuring that businesses contribute fairly to society through the taxes they pay.

2.11.2 This is particularly important for businesses operating in multiple jurisdictions, especially where they can take advantage of the current system to minimise or eliminate the taxes they pay in some or all of the countries where they operate.

2.11.3 We therefore believe that businesses operating in the UK should be required to disclose the profits they make and the taxes they pay across the jurisdictions in which they operate. This is an OECD recommendation and will enable customers, shareholders, employees, suppliers, and the public more generally, to be able to judge whether businesses are paying their fair share.

2.11.4 These disclosure requirements should not just apply to listed companies: they should also apply to offshore companies bidding for public contracts, to all public utilities and to large private companies.[4]

[4] Labour's policy is to restrict this to the 'largest corporations' (https://labour.org.uk/press/labour-will-make-corporate-tax-returns-public/). Under a Liberal Democrat government all businesses will publish their top-line tax affairs.

2.11.5 Transparency will be enhanced if the required disclosures are not overcomplicated and are straightforward for businesses to prepare.[5]

2.11.6 Government contracts should require that large businesses providing public services on behalf of the government must disclose their tax affairs publicly.

3. Costings

3.1 Costings summary

	Yr 1 £bn	Yr 2 £bn	Yr 3 £bn	Yr 4 £bn	Yr 5 £bn	LR[1] £bn
Reverse cuts in corporation tax[2]	+8	+8	+8	+8	+8	+8
Permanent establishment[3]	+2	+2	+2	+2	+2	+2
Reformed tax incentives[4]	+1	+1	+1	+1	+1	-
Incentivise capital investment[5]	-3	-3	-3	-3	-3	-
Wealthy city firms[6]	-	-	-	-	-	*
Funds for public services[7]	**+8**	**+8**	**+8**	**+8**	**+8**	**+10**

1 LR = Long-run change in tax revenues, in 2020-21 values.
2 Increase corporation tax from 17% to 20% in year 1.
3 Strengthen permanent establishment rules to ensure businesses operating in the UK pay tax in the UK. We anticipate this could generate £2bn a year in new tax revenues.
4 Replace existing tax breaks over 5 years and replace with new, better targeted tax incentives to encourage investment in R&D, training and productivity improvements. These will be restricted so that taxes cannot be eliminated completely.
5 Widen scope of capital allowances to include all non-land and buildings capital expenditure on tangible fixed assets. Gradually increase over five years the annual investment allowance for small businesses to £2m and gradually increase writing down allowances for productive assets for larger businesses until they reach 25%.
6 Move wealthy city firms and very high earning unincorporated sole traders onto business tax, with consequential changes to income tax and national insurance payable on post-business tax profits attributable to owners. This would involve a two-year consultation on proposed new tax rules and a three-year lead time to allow businesses and HMRC to prepare. The amount of higher tax revenues is uncertain at this stage and so has not been included in the long-run estimate.
7 We will use additional revenues raised to provide much needed investment in public services.

[5] Labour's transparency policy is punitive and is likely to lead to aggressive tax planning (See http://labour.org.uk/wp-content/uploads/2017/10/Tax-transparency-programme.pdf)

3.2 A net gain to be used to fund priority areas

3.2.1 Overall, we expect the changes arising from these proposals to increase the amount received by the exchequer compared with current Conservative budgets.

3.2.2 This is principally because of the reversal of cuts in the rate of corporation tax. We intend to invest the additional tax revenues in public services, currently under severe pressure from almost a decade of cuts.

3.2.3 HMRC estimates that a 1% increase in the corporate tax rate would bring in an additional £2.8bn in tax revenues in 2021-22.[6] On this basis, we expect that restoring the corporation tax rate from 17% to 20% would raise in the order of £8bn a year from 2021-22 onwards.

3.3 Re-investing other gains in productive investment and in small and growing businesses

3.3.1 Our plan to ensure all businesses pay their fair share of tax in the UK by eliminating existing tax breaks and introducing new rules over the place of establishment should result in higher tax revenues. However, we plan to introduce new tax incentives that are better targeted and more effective and to increase the level of support to early stage businesses through cash tax credits. We estimate that overall these respective changes will therefore have relatively modest effect on net tax revenues, generating £3bn a year in additional tax revenues once they are fully implemented.

3.3.2 We plan to use these gains to increase the incentives for businesses to invest in productive assets, by simplifying capital allowances, increasing the annual investment allowances and increasing writing-down allowances. This will affect the timing of tax payments over the period of implementation, reducing tax revenues in the short-term by an estimated £3bn a year over the period of phasing in these changes. In the longer-term the benefit will be positive, with higher investment benefiting the economy and hence overall tax revenues.

---

[6] Source: HMRC, https://www.gov.uk/government/statistics/direct-effects-of-illustrative-tax-changes.

3.3.3 We also plan to consult on how we can bring wealthy city partnerships and highly profitable unincorporated businesses into the scope of business tax, ensuring a level playing field with other businesses and business owners. We think this is right and that these individuals should pay their fair share, irrespective of the legal form that they select to conduct their business. This will have no effect on tax revenues in the first five years, after which we believe it should generate higher tax revenues overall, although the precise amount will depend on the final reform and the nature of consequential changes in the income tax and national insurance system. For costing purposes we have therefore not counted any gains to the exchequer from this reform.

3.3.4 Overall, we believe that a reformed business tax system that is fairer, simpler to administer and provides more targeted incentives will benefit the economy and improve our competitiveness, generating higher tax revenues over the long term. In addition, a simpler tax system will free up resources to pursue tax avoidance and tax evasion, thereby generating higher taxes.

3.3.5 We have not included the expected economic benefits of our proposals in our costings because of the difficulty of quantifying them, but they are likely to be significant over the long term.

4. Conclusion

4.1 A tax system that is fair for business and fair for society

4.1.1 Liberal Democrats believe in Responsible Business. Responsible Businesses that provide the goods, services and jobs that people need, that pay fair wages to their employees, that operate sustainably, and that look after the environment. Responsible Businesses contribute to society by generating prosperity and economic growth, and through the taxes that they pay.

4.1.2 The overwhelming majority of businesses do want to pay their fair share. They believe in the importance of contributing to the societies in which they operate and that provide the infrastructure on which they rely.

4.1.3 But at the same time, businesses deserve to be treated fairly and equitably. There should be a level playing field, without unfair competition from those who benefit inequitably as a consequence of a poorly designed tax system.

4.1.4 Our proposed reforms will establish a more stable tax system, with a stronger tax base and simpler administration. A business tax system that supports investment and economic growth. A British business tax that will provide the tax revenues that the country needs to ensure a just and equitable society.

Working Group on Business Tax Reform

Membership of the working group should not be taken to indicate that every member necessarily agrees with every statement or every proposal in this paper.

Ex-officio Chair

Vince Cable

Working Chair

Tony Harris

Members

Chris Davidson

Noel Davison

Serena Tierney

Alice Thomas

Martin Wheatcroft

Ex-officio member

Susan Kramer

Observers

Andrew Dixon (Land Value Tax working group)

Staff

Andrew Burrell

Max Von Thun

Thanks

Noel Davison: During the period that this paper was being developed Noel Davison sadly passed away. We all appreciated his help and his insights during his time on the working group and we offer our sincere condolences to his family.

Further copies of this paper can be found online at libdems.org.uk/policy-papers-autumn-19.

This paper has been prepared by the Liberal Democrat Business Tax Working Group
c/o Liberal Democrats, 8-10 Great George Street, London SW1P 3AE