Why we focus on corporation tax

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Introduction

We are often asked why the Fair Tax Foundation (and our Fair Tax Mark accreditation standards) has Corporation Tax as a focal point of considerations[i] – given business pays many other taxes, and evasion and avoidance of these is also a pressing issue. Below we set out 'why' we have such a focus, as does much of the global tax justice movement.[ii]

Responsible businesses are proud to pay their fair share of tax and care about what they receive in return. As the World Bank points out:[iii]

- quality infrastructure is critical for the sound functioning of an economy and plays a central role in determining the location of economic activity and the kinds of sectors that can develop;
- a healthy workforce is vital to an economy's competitiveness and productivity; and
- a basic education increases the efficiency of each worker, whilst good-quality higher education and training allow economies to move up the value chain beyond simple production processes and products.

Companies pay many taxes to Government – both directly and indirectly.

- Direct taxes would include corporation tax, employer social security contributions and certain property taxes. These taxes are borne directly by business and constitute a bottom-line cost.
- Indirect taxes are those that are collected by business and passed on to government. They are not directly borne. This would include the value added tax / sales tax charged to customers, and the income and social security taxes of staff.

The focus of the Fair Tax Foundation's Fair Tax Mark accreditation scheme is corporate income tax – which is a tax on the profits of a business (which is, put simply, revenue minus costs). Read on for five reasons why corporation tax is the focus of what we do.

The Fair Tax Mark is the gold standard of responsible tax conduct. Accredited businesses include listed companies, co-operatives, social enterprises and large private businesses.

Some one hundred parent companies and 250 distinct trading businesses are currently Fair Tax Mark accredited, who between them employ over 250,000 and contribute more than US$1.5bn in corporation tax annually.

A Fair Tax Global Multinational Business Standard was launched end 2021, enabling multinationals headquartered outside of the United Kingdom to be accredited for the first time. Companies have now been certified in Denmark, Italy, Germany, the Netherlands and Sweden.

1. Corporate tax avoidance is a clear and present significant problem

Like many, we believe that profits should be taxed in the jurisdiction where underlying value is created (i.e., where the economic activities to generate those profits are carried out). However, as the OECD points out: "the current international tax rules still allow large multinationals to earn significant income in a jurisdiction without paying corporate income tax there. New business models that rely heavily on intellectual property have made it easier for multinationals to shift profits to low-tax jurisdictions. Globalisation has exacerbated unhealthy tax competition."[iv]

Researchers from the University of California and the University of Copenhagen estimate that **across the globe, close to 40% of multinational profits (US$970bn) are artificially shifted to tax havens each year, leading to a US$250bn reduction in corporate income tax revenue.**[v,vi] A recent OECD analysis of anonymised and aggregated country-by-country corporate tax disclosures by 7,000 multinationals to tax authorities confirms that there is still a significant misalignment between the location where profits are reported and the location where economic activities actually occur.[vii] Tellingly, revenues per employee tend to be higher where headline rates of corporation tax are zero, and in investment hubs.

Compared with other areas of corporate responsibility, responsible tax conduct has emerged as a priority relatively recently. Commitments and disclosures on tax significantly lag behind reporting on other sustainability issues (such as climate change and health and safety). A global analysis from FTSE Russell found that:

- over half (55%) of large and mid-sized companies make no material disclosures whatsoever;
- only a third (34%) have commitments or policies on tax transparency in place, compared to 87% for climate change and 98% for health and safety;
- barely 12% commit to comply with and follow the spirit of the law;
- just 7% disclose country-by-country breakdowns of taxes paid; and
- a miniscule 3% have a named position responsible for tax policy at board level.[viii]

Having said which, tax avoidance and evasion are by no means confined to large multinational enterprises. For example, the UK Government's Tax Gap analysis suggests that 'small business' is responsible for two-thirds of the UK's Corporation Tax gap.[ix]

2. Corporation tax is a crucial source of revenue to governments across the world

The OECD reports that across the world, average headline rates of Corporation Tax have been decreasing over the last two decades, from 28% in 2000 to 20% in 2022.[x,xi]

Nevertheless, corporation tax is still an important part of the tax contribution business makes in many parts the world, especially in developing countries.

- In 2021, it made up 31% of all taxes paid globally by the largest companies headquartered in Europe.[xii]
- The OECD reports that it makes up 15% of all tax paid globally, and accounts for a larger share in Africa (19%) and Asia and Pacific (18%).[xiii] In some countries – such as Bhutan, Chad, Democratic Republic of the Congo, Egypt, Equatorial Guinea, Ghana and Nigeria – corporate tax revenues make up more than one-quarter of total tax revenues.

3. Corporation tax is a progressive tax and has a major impact on a country's tax morale

Corporation tax has an importance way beyond the revenue it raises. As argued by the Tax Justice Network: "It holds the whole tax system together. It curbs political and economic inequalities and helps rebalance distorted economies".[xiv] In particular, corporation tax helps prevent the undue concentration of wealth and ensures a more equitable distribution of the tax burden among individuals and businesses.

The World Bank has observed that corporation tax acts as an important backstop to personal income tax, given it limits the scope for tax avoidance by individuals who might otherwise have a strong incentive to incorporate so as to escape personal income tax. It is also administratively simple to collect and is 'progressive' – as richer households will ultimately bear more payments than poorer households.[xv] This is important as people are more willing to pay taxes when their tax system is viewed as being generally progressive.[xvi] Where there is perceived tax inequity, individuals and businesses are less likely to act morally, and more likely to respond to taxation through noncompliance.

Which is why the development of a robust and substantial global minimum corporation tax is so important. The global decrease in headline corporate tax rates over the last two decades, combined with an almost daily reportage of corporate tax scandals, has eroded public trust in the fairness of the tax system in many parts of the world, with significant consequences for morale and compliance.

4. Corporate tax dodging reduces national productivity

Aggressive tax avoidance and evasion negatively distorts national economies and undermines the ability of businesses to compete fairly, both domestically and internationally.

An IMF Blog argues[xvii] that tax evading corporate 'cheats' enjoy a potentially large implicit subsidy that allows them to stay in business despite low productivity. As a result, these 'cheats' gain market share even if they are less productive, reducing the market share of more productive, tax compliant businesses. They go on to estimate that in emerging market and low income developing countries, closing the productivity gap between tax compliant firms and cheats would add ½ to 1 percentage points to aggregate productivity. Other researchers have similarly concluded that the productivity gaps between firms that comply with existing taxes and regulations and those which do not are significant, and that these large gaps can translate into low economy-wide productivity and growth.[xviii]

At the same time, keeping tax rates at a fair and reasonable level is crucial to the development of a thriving, diverse private sector and the formalization of business. Corporation tax reliefs can also be used to incentivize investment in public goods – for example, enhanced capital allowances and depreciation for renewable energy.

5. Corporation tax is 'red flag' issue for many investors

Institutional investors and asset managers are increasingly viewing corporation tax avoidance as a 'red flag' for an overly aggressive attitude to compliance in general and poor corporate governance. The Principles for Responsible Investment argues: "It is in investors' interest to ensure that corporate taxes contribute to stable, well-functioning socioeconomic systems that are conducive to achieving investment returns and the Sustainable Development Goals. Aggressive tax planning creates reputational, governance and earning related risks. Heightened scrutiny from tax authorities and policy makers around corporate tax following the

COVID-19 pandemic and global efforts to combat tax avoidance are only exacerbating those risks."[xix]

Uniquely, international financial reporting standards rightly urge that the overall corporation tax charge is detailed in financial statements, together with an explanation of its major components.[xx] Further demonstrating its widely considered importance for users of corporate financial statements. However, the Fair Tax Foundation, the Principles for Responsible Investment and many others believe that multinational enterprises should provide such transparency on a country-by-country basis in order that stakeholders can better determine that a business is paying the right amount of tax, in the right place and at the right time.[xxi]

Endnotes

[i] Corporation Tax is sometimes referred to as Corporate Income Tax.
[ii] Note, whilst the Fair Tax Foundation's Fair Tax Mark accreditation standards for business focus on corporation tax, if a business is known to have materially evaded or avoiding other taxes (such as sales taxes) then accreditation will not be an option. Furthermore, the Foundation operates a Fair Tax Councils declaration in the UK for public municipalities – this considers a broader range of taxes than corporation tax. See https://fairtaxmark.net/supporters/councils-for-fair-tax/
[iii] See https://subnational.doingbusiness.org/en/data/exploretopics/paying-taxes/why-matters
[iv] OECD (October 2021). Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. See https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf
[v] Within this, the UK was found to suffer a staggering US$110bn of profit shifting, leading to an estimated $21bn reduction in corporation tax revenues – which equates to £17bn of missing tax, or 32% of what is collected. See https://missingprofits.world/
[vi] The Fair Tax Foundation's list of tax havens (and their characteristics) is available here https://fairtaxmark.net/why-get-the-mark/faqs/#faq-4
[vii] OECD (November 2022). Corporate Tax Statistics (Fourth Edition)
[viii] Global trends in corporate tax disclosure (June 2021). FTSE Russell. Commissioned by PRI. See https://www.ftserussell.com/research/global-trends-corporate-tax-disclosure
[ix] Albeit, HMRC's Tax Gap Analysis effectively excludes consideration of the impact of profit-shifting by multinationals. The Corporation Tax gap for small businesses was estimated to be 19.1% of their total theoretical Corporation Tax liabilities in 2020 to 2021, which equates to £3.7 billion. It has been on an upward trend since 2012. See https://www.gov.uk/government/statistics/measuring-tax-gaps/5-tax-gaps-corporation-tax
[x] Corporate Tax Statistics: Fourth Edition (OECD, November 2022). See https://www.oecd.org/tax/beps/corporate-tax-statistics-database.htm
[xi] Note: the 'headline rate' of corporation tax does not give a full picture of the tax rates faced by corporations in a given jurisdiction. The standard CIT rate does not reflect special regimes or rates targeted to certain industries or income types, nor does it take into account the breadth of the corporate base to which the rate applies. In fact, corporation tax revenues contributed as a percentage of all taxes has increased over a similar timeframe, likely due to a broader tax base being introduced and some anti-avoidance measures. See https://www.oecd.org/tax/beps/corporate-tax-statistics-database.htm
[xii] €24.5bn CIT paid (cash basis) of €79.8bn total taxes borne. Relates to 2021. European Business Tax Forum (March 2023). Tax Transparency and Public Country-by-Country Reporting.
[xiii] Corporate Tax Statistics: Fourth Edition (OECD, November 2022). In 2019, the share of corporate tax revenues in total tax revenues was 15% on average across the 115 jurisdictions for which corporate tax revenues are available in the database. Average corporate tax revenues as a share of total tax revenues increased from 12.6% in 2000 to 15.0% in 2019.
[xiv] Ten Reasons to Defend the Corporate Income Tax (2015). See https://taxjustice.net/2015/03/18/new-report-ten-reasons-to-defend-the-corporate-income-tax/
[xv] Who exactly bears the cost of corporation tax is the subject of much debate. But many studies indicate that shareholders are impacted, and that these are often from higher personal income groups. CIT also acts as a backstop, ensuring that some tax is paid by business owners who otherwise might not pay income tax. See Poverty and Shared Prosperity 2022 (World Bank) at https://www.worldbank.org/en/publication/poverty-and-shared-prosperity
[xvi] Hoy, Christopher (2022). How Does the Progressivity of Taxes and Government Transfers Impact People's Willingness to Pay Tax?: Experimental Evidence across Developing Countries. Policy Research Working Papers; 10167. See http://hdl.handle.net/10986/37987
[xvii] Designed for Growth: Taxation and Productivity (2017). See https://www.imf.org/en/Blogs/Articles/2017/04/13/designed-for-growth-taxation-and-productivity
[xviii] Found that the labour productivity of informal firms is about one-fourth that of formal firms. Moreover, the labour productivity of formal firms that face competition from informal firms is about 75 percent of the average labour productivity of formal firms that do not experience informal competition. Amin, Mohammad, Franziska L. Ohnsorge, and Cedric Okou, "Casting a Shadow. Productivity of Formal Firms and Informality." (2019) World Bank Policy Research Working Paper 8945. See https://openknowledge.worldbank.org/server/api/core/bitstreams/f84f89aa-0e0f-5f09-a660-d7391c058d61/content
[xix] PRI (December 2022) How to consider tax in voting practices.

[xx] Reporting of income taxes under IFRS is subject to the accounting standard IAS 12. Income taxes include all domestic and foreign taxes which are based on taxable profits (plus withholding taxes). Only income taxes can be reported within the tax line in the income statement. Other taxes are reported elsewhere in the income statement, for example, in cost of sales or administrative expenses.

[xxi] See Public Country-by-Country Reporting - Why and how multinationals should lift the lid on their taxes https://fairtaxmark.net/why-get-the-mark/faqs/#1678724165766-530c1115-3d19

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