Corporation Tax

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Overall changes

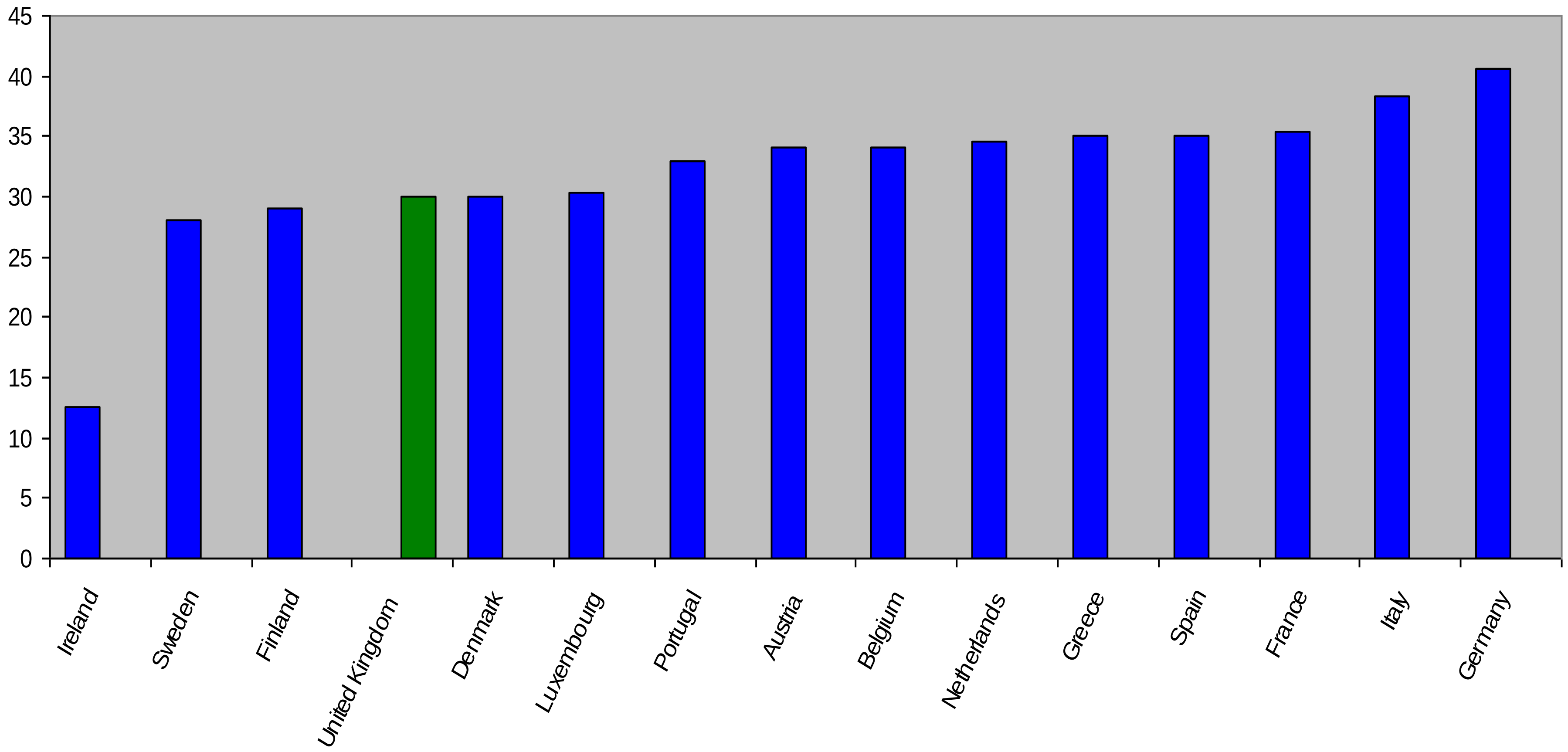
- Tax rate reduced from 30% to 28%
- R&D tax credits increased
- But a revenue neutral reform, paid for by
  - Reduction in capital allowances
  - Increase in small companies rate from 19% to 22%

Rationale for reforms

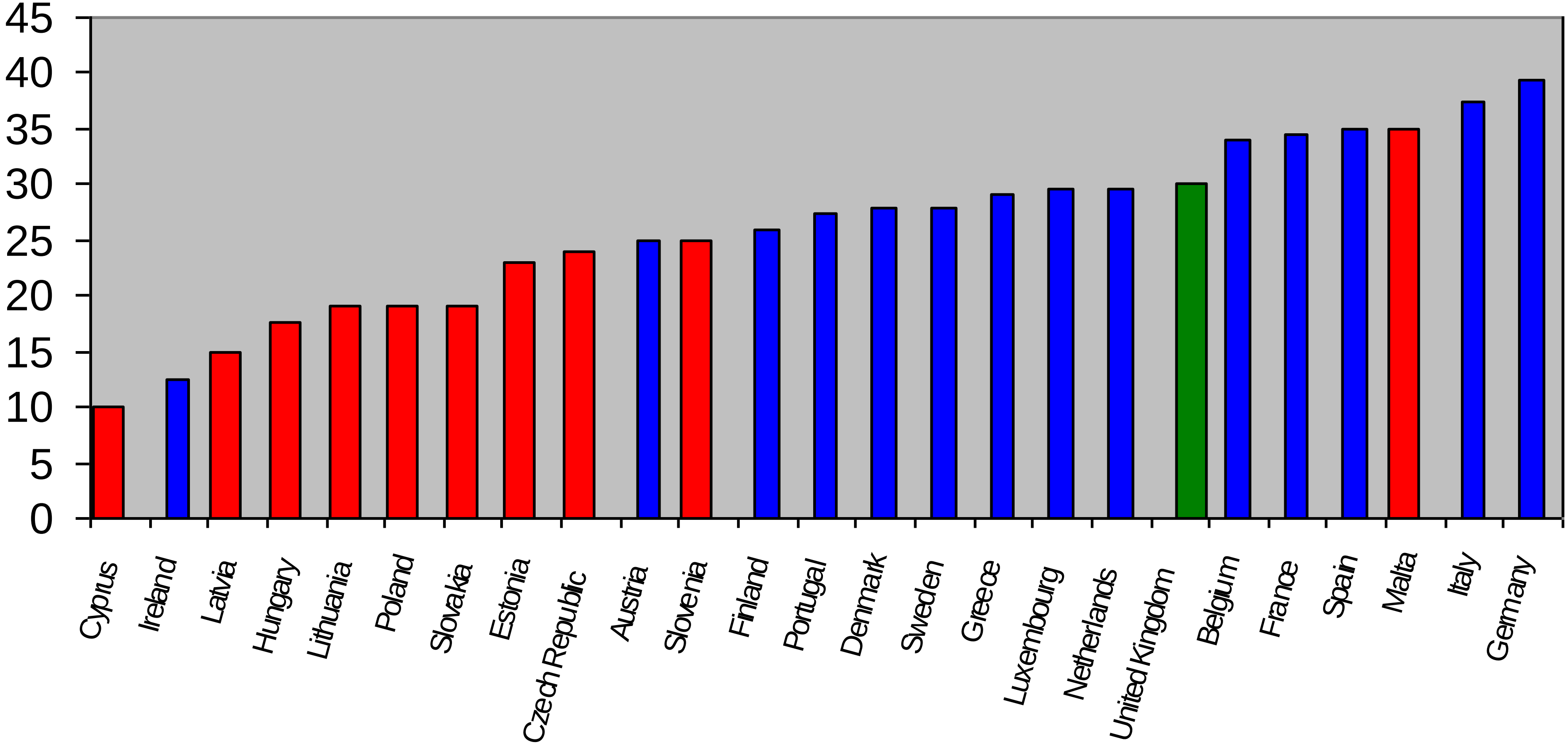
“to promote growth by enhancing international competitiveness, encouraging investment and promoting innovation”

IFS

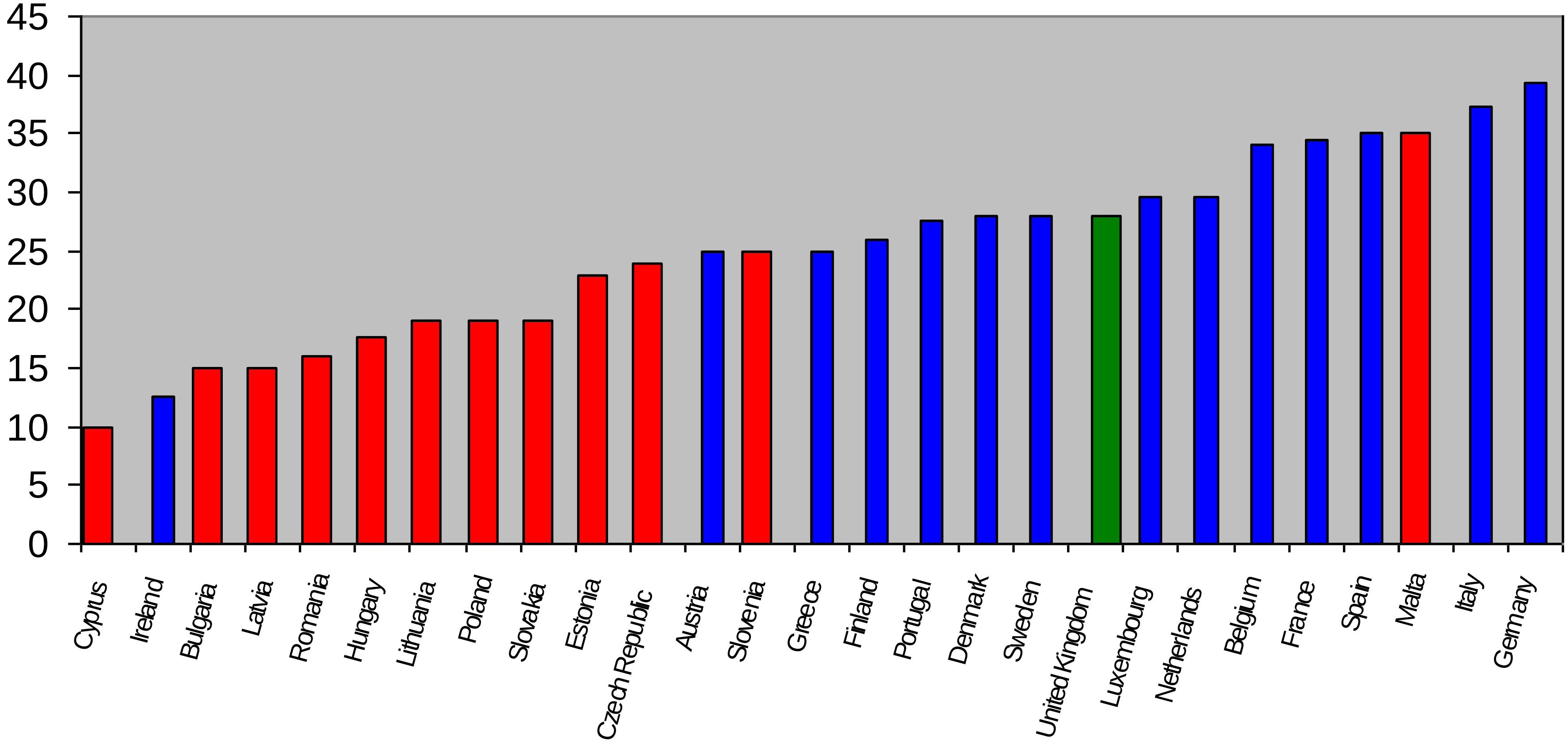
EU Statutory Corporation Tax Rates, 2003



EU Statutory corporation tax rates, 2006



EU Statutory corporation tax rates, 2007



R&D tax credits

- Increase in generosity
  - SME credit
    - Deduction increases from 150% to 175% of eligible expenditure from April 2008
  - Large firms' credit
    - Deduction increases from 125% to 130% of eligible expenditure from April 2008
  - Total cost £150m in 2009-10

Capital allowances

- Expenditure on plant and machinery
  - At present
    - Written down against taxable profits on 25% declining balance basis (6% for long-life plant and machinery)
  - From April 08
    - Writing-down allowance reduced to 20%
    - Long-life rate raised to 10%
    - New Annual Investment Allowance – first £50,000 offset immediately – final design subject to consultation

Capital allowances

- Industrial buildings
  - At present:
    - Written down against taxable profits at 4% on straight line basis
  - To be phased out by April 2011
    - Effective rate falls to 3% from April 2008, 2% from April 2009, 1% from April 2010
  - Exchequer gain £225m, 2009-10

Small companies rate

- At present: 19%
  - Applied to small profits, up to £300k, rather than small companies
- To be raised to
  - 20% in 2007-8, 21% in 2008-9, 22% in 2009-10
- Exchequer gain £820m, 2009-10

- Some irony here!
  - a rate-cutting, base-broadening reform for large companies
  - a base-reducing, rate-raising reform for small companies

Will reforms enhance international competitiveness?

Possible reasons:

1. Competition is for taxable income (ie. profit shifting), not for capital
   - Reducing the tax rate will reduce gains from shifting profit abroad
   - Purpose of rate cut would be to maintain or increase revenue
   - But rate cut to 28% will cost £2,230m in 2009-10

Will reforms enhance international competitiveness?

2. Reforms tend to favour more profitable companies
   - for whom allowance rates are *relatively* less important
   - They may undertake more investment and innovate more
   - They may be more internationally mobile
   - (though they may also be better at shifting profit)

Will reforms enhance international competitiveness?

3. Investment and location decisions may depend on tax rate, not on allowance rates
    - Maybe an element of truth in this, but evidence that *effective* tax rates affect location