

12. Business taxation

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Summary

- Finance Bill 2009 will move the UK to an exemption system under which most foreign dividends will be exempt from UK taxation. This is a welcome move that will put the UK more in line with other European countries and should help UK multinationals to make more productive use of their assets.
- The planned increase in the small companies' rate of corporation tax from 21% to 22% in April 2009 has been deferred by one year as part of a package aimed at supporting small businesses during the recession. This deferral is unlikely to be very effective, and maintains a greater artificial incentive for businesses to change legal form for tax purposes. The government would be better to settle on a small companies' rate and support small businesses by other means. In the long term, it is not clear that there should be separate tax rates for large- and small-profit firms.
- Empty properties with a rateable value of less than £15,000 will be exempt from business rates for the financial year 2009–10, but will be taxed again from April 2010. Neither regime is neutral towards the use of land.

12.1 Introduction

This chapter considers a number of announcements made in the November 2008 Pre-Budget Report (PBR) that are designed to provide additional support to businesses. Section 12.2 considers the taxation of companies' foreign profits and the ensuing move to an exemption system. Section 12.3 discusses the deferral of the planned increase in the small companies' rate of corporation tax from 21% to 22%. Section 12.4 covers empty property relief, which will exempt low-valued property from business rates for financial year 2009–10. Section 12.5 concludes.

12.2 Taxation of companies' foreign profits

At present, UK-resident companies are taxed on profits that are earned overseas, with a credit given for any taxes paid to foreign governments. In June 2007, the Treasury and HM Revenue and Customs (HMRC) issued a discussion document¹ that proposed moving to a system in which foreign dividends are exempt from UK corporation tax. The stated aims of the proposal were to simplify the tax treatment of foreign profits, make the rules more certain and straightforward, and increase the competitiveness of the UK's tax system.

¹ *Taxation of Companies' Foreign Profits: Discussion Document*, June 2007 (http://www.hm-treasury.gov.uk/consult_foreign_profits.htm).

Dividend exemption introduces an incentive for investors to move income abroad to countries with a lower corporation tax rate and then repatriate the returns as tax-free dividends. To protect the domestic tax base, the discussion document proposed moving away from the existing set of rules that define taxable income – known as the Controlled Foreign Companies (CFC) regime – to a new regime. This would have overhauled the ways in which tax avoidance is tackled.

These proposals proved controversial. In the November 2008 PBR, the government confirmed that a system of dividend exemption will be introduced in the 2009 Finance Bill. But the CFC regime will not be abolished – it will remain in place with additional new anti-avoidance rules. There will also be further consultation on future reforms to the rules that define taxable income.

The move to exemption

The move to an exemption system announced in the PBR means that when a multinational firm repatriates dividends into the UK, these will be exempt from UK corporation tax. Exemption will include shareholdings that represent less than 10% of a foreign company (portfolio shares). This moves the UK more into line with other European countries, most of which operate exemption systems.

A significant reason for moving towards an exemption system is that it reduces one way in which the tax system distorts firms' decisions over where to invest. Neutrality is one way in which tax systems are judged, the idea being that a well-designed tax system should not distort decisions over how much investment occurs, where it takes place and who undertakes it (unless there is a specific justification for doing so). There are different types of neutrality, and the extent to which any are realised depends not only on the UK tax system but also on the systems operated by other jurisdictions.

In theory, the current credit system taxes investments from the UK in the same way regardless of their destination. This adheres to the concept of *capital export neutrality* (CEN): investors in the UK face the same effective tax rate on foreign and domestic investments. Since competitive pressures should ensure cross-country after-tax rates of return are equalised, CEN ensures that pre-tax rates of return are also brought into line. In this way, a regime of CEN tends to equalise the marginal productivities of capital across countries, as required for maximisation of world income. In practice, the current credit system that is in place in the UK fails to achieve CEN because tax credits are limited to the level of the domestic tax and income repatriation can be deferred.

A particular asset or investment may be much more productive in the hands of one multinational than it would be in the hands of another, so it is important that the tax system does not distort the pattern of ownership. *Capital ownership neutrality* (CON) occurs when inward or outward investments are treated the same for the tax purposes regardless of who owns them. CON can be achieved if all countries exempt foreign income from domestic tax and apply the same rules for deducting financing costs. Under a pure exemption system, investments in any single location would be liable for the same tax regardless of their country of origin and, as a result, the assets invested in each country would be held by those companies that could earn the highest pre-tax (and hence highest after-tax) return on them. Moving to an exemption system would move the UK closer to CON, especially since many other countries (and almost all European countries) also operate exemption systems.

Is all foreign income included?

Two forms of foreign-source income are excluded from the exemption system that will be introduced in the 2009 Finance Bill:

- First, income earned in foreign branches of UK firms, as opposed to foreign subsidiaries, will still be taxed under the old credit system. This means that the tax system retains an important non-neutrality with respect to legal form, with branch profits taxed differently from dividends paid from the profits of foreign subsidiaries.
- Second, small businesses – those with fewer than 50 employees and a turnover not exceeding €10 million – will not be subject to exemption, and will instead remain in the credit regime. In the original proposals, the main argument for not bringing small businesses into the exemption system was that the new anti-avoidance regime was deemed inappropriate for them. As highlighted in Green Budget 2008,² it is not clear why the same profits in different hands should be taxed differently. If there is a case for producing a more straightforward regime for large and medium business, then there is surely an equally strong case for doing so for small business. The government is continuing to consider the changes that would be best for small business.

Anti-avoidance rules and the definition of foreign-source income

The exemption system gives companies an incentive to shift income to lower-tax regimes and then repatriate them to the UK as tax-exempt dividends. There are a number of mechanisms through which a multinational may artificially shift income offshore. For example, a multinational could manipulate the price of intra-firm transactions (transfer prices) in such a way as to overcharge the part of the company located in the high-tax area and in doing so reduce the taxable profits in that country. Expenses that are shared across the group – for example, headquarters or other overheads costs – could be allocated to a high-tax area, again reducing taxable profits, or a multinational could shift income through the use of debt. For example, if a UK multinational has a subsidiary in a lower-tax country, the subsidiary could make a loan to the UK-based firm and the UK firm can then claim interest deductions against its profits.

Because of these incentives to shift income artificially for tax purposes, it is necessary that a number of anti-avoidance measures be introduced alongside exemption. The main measure, which aims to address income shifting via the use of debt, is a worldwide debt cap on tax deductions for interest claimed by UK members of a multinational group. The debt cap will be calculated by reference to the group's consolidated net external finance costs. This means that the extent to which a UK firm that borrows money from other parts of the company can then claim a tax deduction on the interest incurred will be limited by the amount the whole company has borrowed from outside sources. For example, if a UK multinational as a whole had borrowed £5 million from the external market, then the UK firm would be limited to claiming interest deduction on £5 million. If the UK subsidiaries of the multinational have higher finance costs than the overall external finance costs of the entire group, HMRC would see this as an indication that interest expenses have been allocated to the UK subgroup artificially with the purpose of reducing the entire group's worldwide tax bill.

² See M. Gammie, R. Griffith and H. Miller, 'Taxation of companies' foreign profits', in R. Chote, C. Emmerson, D. Miles and J. Shaw (eds), *The IFS Green Budget: January 2008*, IFS Commentary 104 (<http://www.ifs.org.uk/budgets/gb2008/08chap12.pdf>).

The most controversial aspects of the government's original proposals to move to an exemption system were the proposed anti-avoidance measures, which aimed to tax profits that are artificially shifted away from the UK. As a result, the current CFC rules (see Box 12.1) will not be scrapped but amended, with provisions added to limit the potential tax avoidance behaviour under an exemption system. Draft legislation released on 9 December 2008 details how the avoidance measures will operate initially.³ The government has emphasised that consultation will continue and that the draft clauses set out in December are likely to be modified.

Box 12.1. Controlled Foreign Companies regime

Under the current credit system, the UK normally taxes the profits of foreign subsidiaries only when they are remitted to the UK in the form of dividends. This means that UK multinational companies have the scope to defer UK taxation indefinitely by keeping the profits of their foreign subsidiaries offshore. To counter this, the UK operates a CFC regime that limits the extent to which companies can defer UK tax by retaining profits in a jurisdiction with a lower corporation tax rate.

Broadly speaking, a company is treated as a CFC if it is resident outside the UK, is subject to a tax regime with a significantly lower rate of tax than the UK (less than 75% of the tax rate applied in the UK) and is controlled by UK residents. In such cases, the UK-resident company is taxed on the proportion of the profits of the CFC that can be attributed to the UK by virtue of the size of its shareholding (provided that such profits account for at least 25% of the total profits of the CFC).

There will be new provisions added to the CFC regime when the UK moves to an exemption system in order to tackle avoidance behaviour.

What is the likely impact of the move to an exemption system?

How big an impact would the proposed exemption of foreign dividends have on after-tax returns to investment?

The move from a credit system to an exemption system may be seen as a move from residence-based taxation (based on the residence of the investor) to a source-based system (based on taxing income where it is earned). However, in practice, domestic taxes under the credit system are deferred until income is repatriated from the foreign subsidiary and, as a result, the system already tends to work like an exemption system. So to the extent that the current credit system is roughly equivalent to an exemption system, these reforms may not have a very big impact.

But, to the extent that the current system does not operate in effect as an exemption system, UK-based parent companies are at a disadvantage compared with firms located in countries that exempt foreign-source income (for example, most European countries). This disadvantage will be removed under the new system, thus increasing the after-tax return to some investments. However, the disadvantage is only relevant for investments into countries with lower tax rates than the UK, since (even with deferral) the net

³ A full description of all the provisions set out in the December legislation can be found in 'Taxation of the foreign profits of companies: draft provisions', December 2008 (http://www.hm-treasury.gov.uk/consult_foreign_profits.htm).

dividend income is the same in both the credit and the exemption systems when the subsidiary is based in a jurisdiction with the same or a higher tax rate.

The ownership neutrality implied by an exemption system could help UK multinationals make more productive use of their assets. The current UK taxation of foreign dividends discourages UK firms from investing in low-tax countries more than do the tax systems of the firms in exemption countries with which they compete. With a switch to exemption, UK multinationals may relocate some of their overseas activities from foreign high-tax to foreign low-tax countries to take advantage of increased after-tax profitability.

The move to an exemption system and the planned anti-avoidance measures are likely to keep the system as a hybrid between the source and residence principles. For example, foreign-branch income and interest received by UK companies will still be taxed in the UK.

12.3 Taxation of small companies

In Budget 2007, the government announced that the so-called small companies' rate of corporation tax – levied on businesses with profits below £300,000 – would be increased from 19% to 20% in April 2007, to 21% in April 2008 and to 22% in April 2009. The first two increases went ahead as planned, but the November 2008 PBR announced that the third would be deferred by one year (until April 2010) as part of a package aimed at supporting small companies during the recession. This decision was the latest in a long line of changes to corporation tax – and in particular the small companies' rate – since Labour came to power.

One of the stated aims of the staged increase in the small companies' rate was to reduce the tax 'differential between incorporated and unincorporated businesses'.⁴ The ability and willingness of individuals to exploit this differential was starkly demonstrated in 2002 when the introduction of a 0% 'starting rate' of corporation tax on profits up to £10,000 led to a spike in new incorporations, many of which seem to have been purely for tax purposes. In response, the government abolished the starting rate in 2006. The planned increases in the small companies' rate further reduce the incentive for tax-motivated incorporations. The temporary deferral therefore delays the time at which such incentives are reduced and adds yet more uncertainty to the future of the small companies' tax rate.

Organisational form

By switching organisational form, small businesses can change the regime under which their income is taxed. A self-employed individual (i.e. an unincorporated business) will be taxed under the personal tax system with profits liable to both income tax and National Insurance (NI). In contrast, an individual who forms an incorporated business can take part of his or her income as dividends, which are subject to corporation tax, and part as wages, which are taxed under the personal tax system.⁵ Since at least 1997, there has

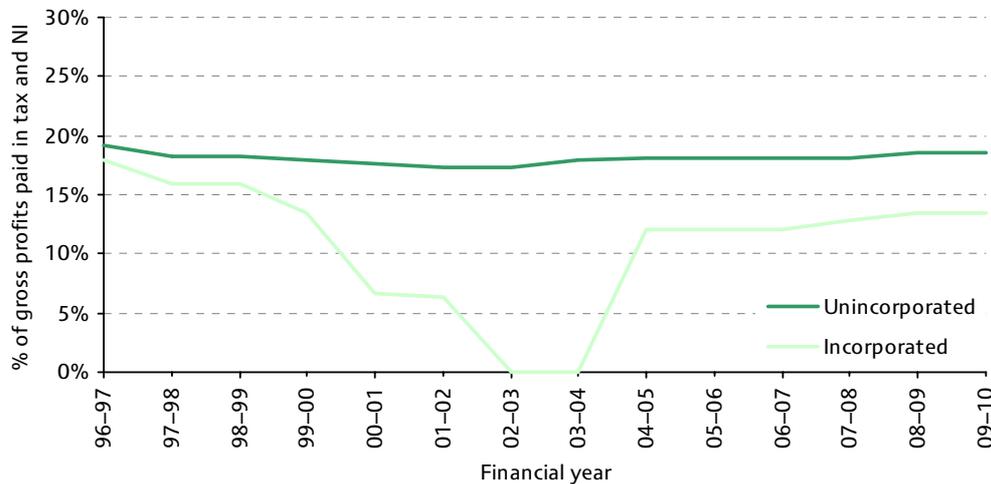
⁴ Page 49, paragraph 3.23 of HM Treasury, *Budget 2007*, March 2007 (http://www.hm-treasury.gov.uk/bud_bud07_index.htm).

⁵ For basic-rate income tax payers, dividends are effectively not taxed under the personal income tax system, while for higher-taxed individuals, they are taxed at a reduced rate. In both cases, dividends do not attract National Insurance. For further information, see C. Crawford and J. Freedman, *Small Business Taxation: a*

been a tax incentive to take the latter route: for the vast majority of profit-making small businesses, tax liability is minimised by incorporating, taking the income tax personal allowance as wages and taking the remainder as dividends.

Figures 12.1 and 12.2 illustrate the size of this incentive since 1996–97. Figure 12.1 shows the percentage of gross income that is paid in tax and NI for both unincorporated and incorporated businesses with profits of £15,000 a year. Figure 12.2 shows the same but for businesses making £25,000 a year. In both cases, the tax bill is lower for incorporated businesses than for unincorporated businesses. The incentive to incorporate increased during the 1990s and early 2000s as the government reduced the small companies’ rate of corporation tax and introduced a starting rate of corporation tax. The abolition of the starting rate and the increase in the small companies’ rate have reduced these incentives again. For the financial year 2009–10, the percentage of gross profits paid out in tax and National Insurance will be around 5 percentage points higher for unincorporated than for incorporated businesses.

Figure 12.1. Percentage of £15,000 gross profits paid in tax and NI over time, by legal form



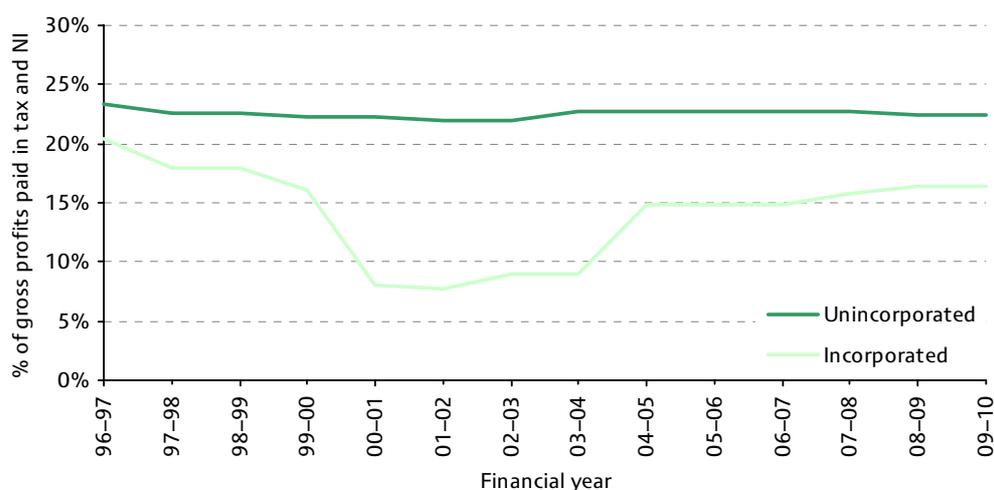
Notes: All allowances and thresholds used in these calculations are in 2008–09 prices. It is assumed that the incorporated individual pays themselves a salary equal to the personal allowance, with the remaining profits extracted in the form of dividends (on which corporation tax and income tax on dividend income must be paid).

Sources: C. Crawford, ‘Corporation tax and entrepreneurship’, in R. Chote, C. Emmerson, D. Miles and J. Shaw (eds), *The IFS Green Budget: January 2008*, IFS Commentary 104

(<http://www.ifs.org.uk/budgets/gb2008/08chap11.pdf>), updated using *Tolley’s Income Tax*, various years and *Tolley’s National Insurance Contributions*, various years; *Tolley’s Corporation Tax*, various years.

special study of the structural issues surrounding the taxation of business profits of owner managed firms, submission to the IFS Mirrlees Review, Institute for Fiscal Studies, 2008 (http://www.ifs.org.uk/mirrleesreview/press_docs/small_businesses.pdf).

Figure 12.2. Percentage of £25,000 gross profits paid in tax and NI over time, by legal form



Notes: As Figure 12.1.

Sources: As Figure 12.1.

A move in the right direction?

The tax incentive to incorporate is likely to encourage some individuals to change organisational form simply for tax purposes. But the incentive may also encourage new economic activity – specifically, entrepreneurship – which contributes importantly to economic growth. Indeed, this was the government’s original justification for introducing the starting rate in 2000.⁶ An incentive to incorporate may encourage individuals to start genuinely new businesses (and not just relabel existing activities).

But why is a tax incentive for entrepreneurship needed? Will the market not reward entrepreneurship appropriately by itself? The answer is probably not: entrepreneurship tends to produce returns that cannot be fully captured by the entrepreneur (*externalities*). For example, when an entrepreneur introduces a new product to the market, others may be able to learn from that experience and borrow ideas. If entrepreneurs cannot capture all the returns to their activity, they are likely to undertake less of it than would be optimal from the point of view of society as a whole.

The central question, therefore, is: ‘To what extent does the tax incentive encourage entrepreneurship, and at what cost (in terms of purely tax-motivated incorporations)?’. The literature on entrepreneurship and the effect of taxes provides mixed evidence over whether lower taxes on corporations encourage entrepreneurship. At best, the positive effects found are very small. The UK’s recent experience provides little indication that the incentive to incorporate has increased entrepreneurship.⁷ In contrast, anecdotal evidence suggests there were significant numbers of tax-motivated incorporations in response to

⁶ In 2002, the Paymaster General, Dawn Primarolo, explained the thinking behind the starting rate: ‘We believe that cutting corporation tax is an effective way of targeting support at small and growing businesses. ... We want to create growth and economic activity, and to sustain entrepreneurial activity’ (House of Commons Standing Committee F, 16 May 2002, cols. 114–115).

⁷ For more details, see C. Crawford, ‘Corporation tax and entrepreneurship’, in R. Chote, C. Emmerson, D. Miles and J. Shaw (eds), *The IFS Green Budget: January 2008*, IFS Commentary 104 (<http://www.ifs.org.uk/budgets/gb2008/08chap11.pdf>).

the zero starting rate of corporation tax. The costs of offering a tax incentive to incorporation, at least through the instrument of a lower rate of tax on companies with lower profits, thus appear to outweigh the benefits.

The increase in the small companies' rate reduces the incentive to incorporate for tax purposes and therefore appears to offer an improvement to the current UK situation.⁸

Temporary deferral

As outlined above, differential effective tax rates levied on unincorporated and incorporated businesses mean that the tax system provides an incentive for individuals to incorporate for tax purposes. The increase in the small companies' rate to 22% is a step towards removing this distortion. Temporary deferral delays the time at which the distortion is reduced, and adds to uncertainty about the future tax rate on small companies.

The idea behind the deferral is to avoid increasing tax on business at a time when the economy is moving into a recession. However, it is not clear that this will be an effective way to stimulate economic activity in 2009–10. Businesses make investment decisions based on the expected tax rates for the duration of an asset's productive life and not just based on the current corporate tax rate. A one-year deferral of the small companies' rate increase might therefore be expected to have little effect on investment. It is also not clear that the temporary deferral will help credit-constrained firms in the near future, since it will be some time before they feel the financial benefit. Small companies do not pay their corporation tax until nine months after the end of the financial year, so the tax savings for financial year 2009–10 will not be realised until the end of 2010. Indeed, the Treasury's own estimates suggest that of the cumulative £610 million cost of this deferral over the three years from April 2009, only £20 million will be given away in 2009–10.⁹

Stability and a lack of uncertainty are important features of a good tax system. Rather than regularly tweaking the tax system, it would be better for the government to make a judgement about the small companies' rate and then stick to it. At the end of the day, we see no good economic rationale to have a different tax rate on small profits and large ones. One option, therefore, would be to align the small companies' rate with the main rate of corporation tax.¹⁰

12.4 Empty property relief

In Budget 2007, the government announced reforms to national non-domestic rates – commonly known as 'business rates' – that reduced the generosity of relief on empty property. In particular, starting in April 2008, relief enjoyed by empty property was

⁸ For discussion of changing incentives, see C. Crawford and J. Freedman, *Small Business Taxation: a special study of the structural issues surrounding the taxation of business profits of owner managed firms*, submission to the IFS Mirrlees Review, Institute for Fiscal Studies, 2008 (http://www.ifs.org.uk/mirrleesreview/press_docs/small_businesses.pdf).

⁹ Source: Page 10, table 1.2 of HM Treasury, *Pre-Budget Report 2008*, December 2008 (http://www.hm-treasury.gov.uk/prebud_pbr08_repindex.htm).

¹⁰ For discussion of aligning corporate tax rates, see C. Crawford and J. Freedman, *Small Business Taxation: a special study of the structural issues surrounding the taxation of business profits of owner managed firms*, submission to the IFS Mirrlees Review, Institute for Fiscal Studies, 2008 (http://www.ifs.org.uk/mirrleesreview/press_docs/small_businesses.pdf).

reduced. The idea was to encourage owners to relet or redevelop vacant properties, with the hope that this would help reduce property prices and encourage the more efficient use of land. In PBR 2008, as part of a package aimed at helping small businesses through the recession, the government temporarily amended the system, allowing full relief for low-valued property for the financial year 2009–10. The government claimed that this particular measure would assist small businesses manage short-term pressures arising from a distressed property market. This means that, since 2007, three different business rates regimes have been in place:

Regime 1: Before April 2008

- Vacant industrial property received 100% business rates relief (i.e. paid no business rates).
- Vacant commercial property received 50% relief after an initial three months of 100% relief.

Regime 2: From April 2008

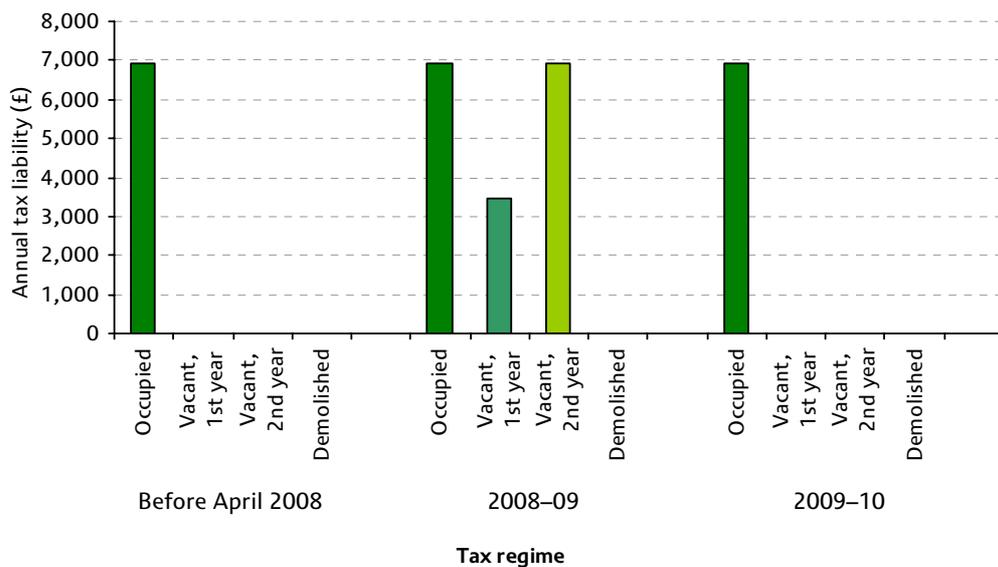
- Vacant industrial property became liable for full business rates after lying empty for an initial six months.
- Vacant commercial property became liable for full rates after lying empty for an initial three months.

Regime 3: April 2009 to April 2010

- For financial year 2009–10, both empty industrial and commercial property with a rateable value of less than £15,000 will be exempt from paying business rates. (An estimated 70% of empty properties have a rateable value less than £15,000.)
- From April 2010, taxation of empty property returns to the way it was under regime 2.

Figures 12.3 and 12.4 illustrate the way in which empty property is treated relative both to occupied property and to property that is demolished or allowed to fall into a state of disrepair. Figure 12.3 is for industrial property and Figure 12.4 is for commercial property, with both graphs based on a property with a rateable value of £14,999. The dark-green bars represent the annual tax liability if the building is occupied, the mid-green bars represent the size of the liability if it is vacant but was occupied in the previous year, and the light-green bars represent the size of the liability if it is vacant and was vacant in the previous year, while in each case the tax liability if the building is demolished is zero.

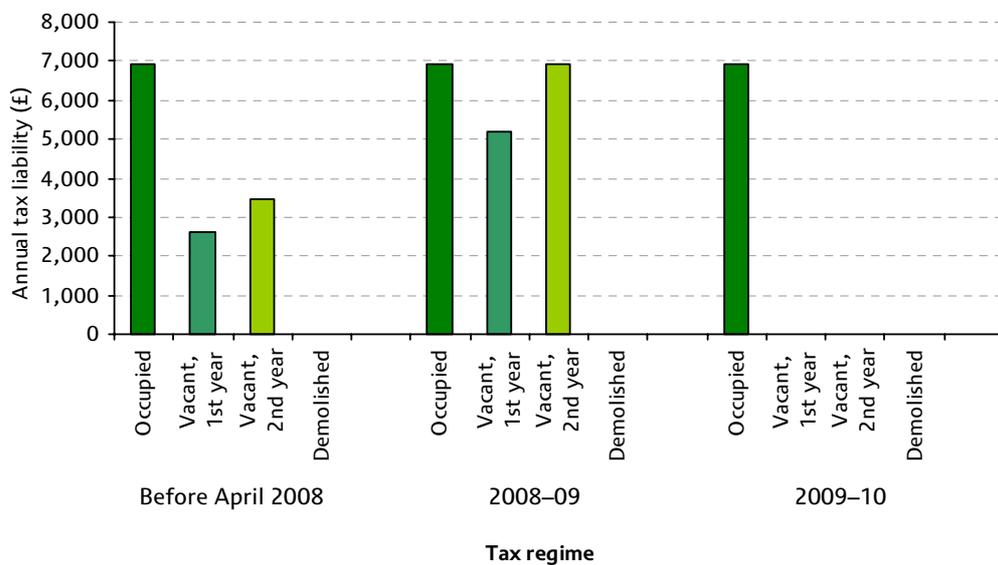
Figure 12.3. Three regimes of business rates by occupation status: industrial property



Notes: Figures are based on a property with a rateable value of £14,999. Tax liability is calculated, subject to relief, by multiplying the rateable value by the 2008-09 standard multiplier, which is 46.2p. In the City of London the multiplier is slightly higher, while for small businesses it is slightly lower. The multiplier used in Scotland and Wales is determined by the devolved administrations and differs slightly from that used in England, while the tax regime used in Northern Ireland combines a regional multiplier with locally-varying district multipliers.

Source: Authors' calculations using the multiplier and the relevant tax regimes.

Figure 12.4. Three regimes of business rates by occupation status: commercial property



Notes: As Figure 12.3.

Source: As Figure 12.3.

A number of points emerge from Figures 12.3 and 12.4:

- The effect of the Budget 2007 change was to increase the tax on empty properties; the annual tax levied on a newly-vacant property became closer to that levied on occupied property, while the tax levied on already-empty property became the same as that levied on occupied property. The results were a reduction in the tax incentive faced by property owners to allow occupied properties to become empty and the elimination of the tax incentive to keep already-vacant properties empty.
- But the Budget 2007 change also created a difference between the tax levied on a vacant property and that levied on the property if it were demolished. So Budget 2007 increased the tax incentive faced by owners of empty property to demolish it or allow it to fall into a state of disrepair.
- The temporary amendment made in PBR 2008 returns us to a system that is close to the pre-April-2008 regime, by exempting empty property with a rateable value of less than £15,000 from business rates. This slightly reduces the incentive to demolish empty property but increases the incentive to keep it vacant. However, the tax incentive to demolish empty property is not eliminated, as in April 2010 empty property will once again become liable for rates – a fact that owners of empty property will take account of when evaluating the case for demolishing their property.

Incentives

As discussed in Section 12.2 on the taxation of companies' foreign profits, the government should avoid introducing artificial distortions to the tax system without clear justification. To remove such distortions from business rates, the government would have to adopt a system that was neutral with respect to the use of land – that is, one that taxes occupied, vacant and demolished property at the same rate. By doing so, it would ensure that the decision of how to use land would be unaffected by the prevailing tax regime. A land value tax – a tax levied on the value of the land ignoring the buildings that stand on it – would achieve this goal. A land value tax has the added benefit that land is an immobile asset in relatively fixed supply, meaning that taxing it would lead to minimal distortions. So while the current system affects land-use decisions, a land value tax would simply lead to a fall in the price of land, without distorting incentives to invest in and improve what stands on it. While international experience of a land value tax is limited, the obstacles impeding its implementation do not seem insurmountable.¹¹

Policy

Regardless of whether the government elects to move towards taxing land, it is clear that it should avoid making frequent adjustments to the tax system. Businesses make investment decisions factoring in their expected future tax liability. If the government continually alters the tax regime, it increases uncertainty, making an assessment of the after-tax returns to an investment more difficult, ultimately deterring businesses from investing. While the most recent business rates reforms, by temporarily introducing empty property rates relief, are aimed at assisting small businesses, it is far from clear that this is an effective, well-targeted policy. Instead of tinkering with the tax system, the

¹¹ R. Boadway, E. Chamberlain and C. Emmerson, *Taxation of Wealth and Wealth Transfers*, submission to the IFS Mirrlees Review, Institute for Fiscal Studies, 2008 (http://www.ifs.org.uk/mirrleesreview/reports/wealth_transfers.pdf).

government should select a business rate regime that minimises distortions and refrain from altering it unless there is good justification for doing so. Implementing a land value tax is the first-best solution. However, a useful start would be to remove any relief for empty property, whilst designing a tax avoidance regime that minimises the opportunities to avoid liability through allowing empty property to fall into a state of disrepair. The Budget 2007 reforms moved us in this direction by reducing empty property relief; however, they did not contain provisions for tackling tax avoidance.

12.5 Conclusions

The move to exemption of foreign-source income from UK corporation tax is welcome, as is the fact that the government has decided not to pursue its original proposal to replace the CFC regime with an entirely new regime. This was possible due to the fact that the government chose to consult on the measures, and then to act on the responses to that consultation. That is not to say further improvements could not be made in this area. Another step towards neutrality could come from also applying this improved regime to those firms with fewer than 50 employees as well as larger firms.

Other developments – on which the government chose not to consult – are less welcome. In particular, the decision to defer the planned increase in the small companies' corporation tax rate will come at the cost of increased uncertainty in the tax system, and is likely to deliver very little additional entrepreneurship relative to the cost of the policy. It is far from clear why low-profit companies should be rewarded with a lower rate of corporation tax than high-profit firms.

The temporary reduction in business rates for those owning empty properties in 2009–10 is also difficult to justify. It will do little to reduce the incentive to demolish property and again the change comes at the cost of added uncertainty in the tax system. In the longer term, a shift towards taxation of land values rather than property values is likely to be more efficient. In the meantime, the government should fix a rate of tax for unoccupied property and, unless there are very good reasons not to, stick to it.

That is not to say that temporary policies can never be justified. For example, targeted support for those likely to face credit constraints during the current turmoil in financial markets could improve economic efficiency and welfare. But those owning unoccupied properties might not be relatively likely to face credit constraints. And a policy of reducing the corporation tax bill payable in 2010–11 for those companies making small profits in 2009–10 seems very difficult to justify on economic grounds.

The main lesson with these reforms is, to misquote Elvis Presley, 'A little more conversation, a little less action please'.