Anatomy of a panic over corporation tax [1]

Written by **Tim Worstall** [2] | Sunday 30 June 2013

The current furore over who is and who isn't paying corporation tax is taking on the attributes of a moral panic. Not just that people arre panicking over the morals of it all, but that they're entirely ignoring the evidence as they do so. As examples I offer you two stories from the Mail on the subject. First up is Starbucks and the dastardly manner in which they pay no tax because they make no profit [3]:

> Starbucks? UK sales during the year rose 4 per cent to £413.4million ? the biggest increase since 2008. But the company made a loss of £30.4million ? after paying £26.5million to overseas subsidiaries in ?royalty payments?. It also paid £1.8million to other Starbucks companies as interest payments on loans made between divisions.

That the Starbucks brand has a value is easy enough to show: the company has franchisees around the world and they pay a royalty for the use of the brand. We can also consider the differencee in trade you'd get if you opened a caff called "Fred's" as opposed to one using the Starbucks brand. We all understand that traffice and trade are going to be different. That value of the brand should righteously be paid for. However, let's ignore that and also the intercompany loans. Add them back in: Starbucks UK is still making a £2.3 million loss.

Why Starbucks isn't paying the corporation tax due on its profits is thus explained: it's not making any profits that it has to pay corporation tax upon. But such is the moral panic that people are still shouting at them.

As to where the money is going that is simple enough. Try reading Ricardo on rent....or if that's too much for you, read Tim Harford's first chapter in "Undercover Economist". Which uses London coffee shops to explain Ricardo on rent. The competition for the land and or sites which get a lot of passing thirsty traffic is such that rents soar and the landlords get all the money. Which they are indeed taxed upon as rents are one of those things that you really cannot shift about in and out of a tax jurisdiction. Starbucks isn't paying tax this is true: but the economic activity of coffee shops is, it's just through the landlords.

The second is about the water companies [4]:

> Britain's privatised water firms have ?abused? loopholes in the law to dodge more than £1billion in tax since the election. A dossier of shame reveals nine water companies, seven of which are foreign owned, have racked up operating profits totalling £10billion since 2010 but paid just £541million in tax. This equates to a tax rate of just 5.3 per cent. Corporation tax on operating profit is normally 23 per cent.

The heinous crime they're accused of is to subtract interest on borrowings before calculating their tax bill. Which, given that interest is a specifically allowed expense isn't all that heinous a crime. They then apply the various rules that Parliament has passed to deal with the costs of investment (capital allowances and the like) and so they make no profit. Given that Parliament has specifically put these rules into law it's a little odd to claim that they are therefore shirking their tax duties. Most especially as everyone has been shouting to the skies that they must invest more in their businesses in order to upgrade the quality of the

water itself, treat the sewage more carefully, fix the century old leaky pipes and even, because of climate change, start building some more reservoirs. All of which is capital investment that they need to borrow money to do thus attracting the necessity of paying interest and having capital allowances.

They're doing exactly what everyone and the law tells them to do and yet people are still shouting at them.

> Richard Murphy, of Tax Research UK, said lax UK rules meant avoiding tax was ?as easy as taking candy from a baby? for multinationals. ?There are several serious problems with the system which leads it wide open to abuse,? he said.

Well, yes, obviously we were going to get a quote from that fabricator of this current moral panic. But look again at what the Mail seems to believe the tax system does:

> Corporation tax on operating profit is normally 23 per cent.

There is no world in which it is feasible to have a profits tax levied upon operating profits. It must be upon net profits, after the deductions of the cost of doing business. But here we have one of the leading newspapers of the country spouting nonsense to the population. This is indeed a moral panic, one in which all evidence is simply ignored. We'll be back to burning witches soon enoiugh, you mark my words.

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