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Why corporations avoid tax [1]

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When you calculate the depressing effect of company taxes on incentives and economic growth, you can see why businesses resent them ? and indeed do their best to avoid them. The point was brought home to me when I re-read *Why Freedom Works* by Sir Ernest Benn (1875-1954), a successful publisher (and uncle of the Labour politician, Tony Benn).

One trouble with corporate taxes is that companies that make a profit see themselves taxed, while companies that make a loss have to bear it. Benn imagines three companies, each with a capital of ? let's make the numbers easy ? £100m. Two make a 10% profit of £10m, the other makes a 10% loss of £10m.

It is the 10% profits that politicians look at when thinking about the impact of corporate taxes. It seems a juicy enough return to be taxed. But just a moment: in reality, the £300m invested by the three companies actually produces total profits of just £20m ? a rate of return of just 6.66%. Taxing this rate of return seems rather meaner.

And it gets worse. The net profit of the three companies is actually just £10m (£10m+£10m-£10m = £10m). So in fact the £300m capital has produced a net return of only £10m ? just 3.33%. Taxing that looks positively perverse. After all, business does not guarantee anyone a job or a return for life. There are ups and downs, profits and losses all to be borne. If entrepreneurs figure they are likely to succeed just two-thirds of the time ? which is optimistic ? their successes will need to earn enormous profits for them to carry a tax burden like that and still have some reward left for their efforts.

Yet the entrepreneurs who stumped up the £300m capital for these three businesses actually get rather less than the £10m in total profit. By the time they have lost half their income to income tax and national insurance, their net return is £5m (£10m after tax)+£5 (£10m after tax)-£10m (untaxed), which is a total of...er, nothing. It makes you wonder why anybody does it, really.

So maybe it is not so surprising that entrepreneurial companies try to avoid the UK's corporate taxes. Or, which is easier, elect to move abroad and trade somewhere else.

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