Companies are behaving in precisely the way that our international tax system incentivises them to behave

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*Government and business have generally sought to distinguish between the vast majority of companies, which engage in 'reasonable' tax planning, and a small minority, whose tax avoidance becomes 'aggressive'. **Martin Hearson** argues that if the government is committed to serious reform to address tax avoidance, it needs to abandon this distinction. The real problem is the incentives provided by the international tax system, and the real misconception is about what the system is designed to achieve.*

Last summer, I went to hear Treasury minister David Gauke speak at launch of the CBI publication Tax and British Business: Making the Case. The event, hosted by the think tank Policy Exchange, brought together the great and good of the tax profession to lament how the public debate on tax avoidance was getting out of control. Government and business, everyone agreed, needed to work together to counter the growing misconception that corporate tax avoidance was rife.

"It is important to get a sense of perspective," said the minister, because "there is reason to be more optimistic and more grateful than headlines suggest." The debate over corporate tax policy was "often obscured by unsubstantiated claims and wild accusations from the political fringes."

CBI Director General John Cridland agreed. "To read the comments and claims of some, you would think that business spends its time doing everything it can to dodge all and every tax it owes," he said. "The facts show how far from the truth this is."

All of that was before last autumn's public outcry over the tax affairs of Starbucks, Google and Amazon, after which executives from these companies were hauled in front of Parliament's Public Accounts Committee. The result of this moral panic does, at first sight, seem to have been the disruption of the cosy consensus between government and private sector. "Businesses who think they can carry on dodging that fair share, or that they can keep on selling to the UK and setting up ever more complex tax arrangements abroad to squeeze their tax bills right down, well they need to wake up and smell the coffee," said David Cameron in a speech at the World Economic Forum.

George Osborne and his German and French counterparts set out their stall in a letter to the Financial Times last month:

> *"International tax standards have struggled to keep pace with our changing economy. This has allowed some multinational companies to restructure their business to minimise the amount of tax they pay, shifting the taxation of their profits away from the jurisdictions where they are being generated, so that they pay less tax than smaller, less international companies."*

But has this really been a watershed moment for the government? Have Cameron, Osborne and Gauke accepted campaigners' view that corporations find the current system so easy to game that a really fundamental reform is needed? Or alternatively, is this more of a shift in rhetoric to accompany some routine updating of international tax rules? Here are three reasons to think the latter is more likely:

First, we can look at the smallprint. The government has asked the OECD, which is the main standard-setter in the global tax regime, to examine how the system needs to be fixed to deal with "base erosion and profit shifting" by multinational companies. Though the OECD's initial response does in principle leave the door open to fundamental reform, the Financial Times journalist Vanessa Houlder notes that it shows “no sign of going back to the drawing board” and instead a “lack of enthusiasm for a radical rethink.” We’ll know more when the OECD presents its action plan later this year.

Second, we can look at the rhetoric closely. Government and business have generally sought to distinguish between the vast majority of companies, which engage in ‘reasonable’ tax planning, and a small minority, whose tax avoidance becomes ‘aggressive’. But companies such as Starbucks and Amazon aren’t in an aggressive minority: they’re the majority, behaving in precisely the way that our international tax system incentivises them to do. So if the government is committed to serious reform to address these kinds of cases, it needs to abandon this distinction. It would be talking about substantially increased tax bills for household name companies.

The finance ministers’ letter to the Financial Times does seem to do that, noting that “some high-profile cases that have caused public concern have not related to complexity but rather quite simple tax concepts.” But in his Davos speech, Cameron was still drawing a line between “sensible tax planning” and “some forms of avoidance that have become so aggressive that I think it is right to say these raise ethical issues.” This will be an important point to watch as time goes on.

Third, what about the direction of travel? The government has cut the corporation tax rate from 28% to 21%, created a ‘patent box’ tax incentive that brings the rate down to 10% for come companies, and even brought in a rule that will allow companies using tax havens to enjoy a 5.25% rate in certain circumstances. Nick Shaxson argued against these changes on this blog a year ago. David Gauke recently boasted in the pages of City AM that the total tax giveaway to business stands at £7 billion a year.

Whatever position one takes on the wisdom of these reforms, it is hard to square them with the government’s apparent eagerness to reform the global system in a way that would significantly raise the tax burden on businesses. Cameron’s argument has been that cracking down on tax avoidance is the quid pro quo for lower rates, but that again implies that only a small minority will be affected.

The real problem is that, whatever the politicians say, international tax reforms are mired in such technical detail that an informed public or even parliamentary debate will be very difficult. I have argued elsewhere that what tax professionals dismiss as misunderstanding is often a fundamental disagreement about what the international tax system should be designed to achieve. Last month an industry magazine, outraged by the Public Accounts Committee’s style of questioning, crowned its chair Margaret Hodge as ‘tax prat of the year’. Proof, if it were needed, that we are still a long way off a debate that bridges tax technicalities and common sense understandings.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

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