TOPIC GUIDE: TAX INCENTIVES (REVISED 2018)

"IT IS WRONG FOR COUNTRIES TO OFFER TAX INCENTIVES TO ATTRACT INVESTMENT"

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AUTHOR: ADAM RAWCLIFFE AND ROB LYONS

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INTRODUCTION

In December 2017, it was announced that the EU was investigating whether furniture giant Ikea - founded in Sweden but now headquartered in the Netherlands - had been given a 'sweetheart' tax deal by the Dutch government, enabling the firm to avoid €1 billion in taxes. Nor is this unusual: many EU countries offer tax breaks to attract wealthy individuals and companies [Ref: **Telegraph**]. EU Competition Commissioner Margrethe Vestager said that all firms "big or small, multinational or not, should pay their fair share of tax" she said. "Member states cannot let selected companies pay less tax by allowing them to artificially shift their profits elsewhere." [Ref: **Independent**] Yet it is also clear that some governments in the EU have used low-tax regimes to encourage foreign investment. Amazon Europe, for example, is based in low-tax Luxembourg, processing sales there to avoid higher taxes elsewhere [Ref: **Guardian**]. But it's not just European companies that avoid tax by changing the country they are legally based in, even when most of their business is done elsewhere. For example, in

November 2015, American pharmaceutical giant Pfizer announced a deal to buy Irish Botox maker Allergan in a deal worth $160 billion, that would have been one of the largest corporate mergers in history [Ref: **Reuters**]. Four months later, the deal collapsed after the US Treasury unveiled plans to wipe out the anticipated tax advantages [**FT**].

The Pfizer deal would have been the latest of a number of tax 'inversion' deals, where a larger company purchases a smaller company in order to relocate its headquarters to a new country with a lower corporate tax rate - Burger King bought Canadian coffee chain Tim Horton's in 2014, allowing it to relocate to Canada, where corporation tax rates are lower [Ref: **CNN**]. Opinion is split as to whether tax incentives are wrong both ethically and practically. Opponents argue that corporations that seek to pay less tax are avoiding their responsibility to contribute to the societies in which they operate, creating an unfair, unethical system which simply does not work. This view is contested by supporters, who suggest that tax incentives are just a logical component of a globalised free market and claim that big business is often portrayed unfairly, when in reality it benefits society - through investment, jobs and a competitive market - more than it harms it. Broadly speaking then, what are the ethics of tax incentives – are they a help or a hindrance?

For further reading use the menu bar on the right hand side.

DEBATE IN CONTEXT

This section provides a summary of the key issues in the debate, set in the context of recent discussions and the competing positions that have been adopted.

Are tax incentives ethical?

Tax incentives are defined as 'deduction, exclusion, or exemption from tax liability, offered as an enticement to engage in a specified activity (such as investment in capital goods) for a certain period' [Ref: **Business Dictionary**]. Tax incentives polarise opinion around the world: whilst tax avoidance is legal, many view it as ethically dubious. If "taxes are a social obligation" [Ref: **Guardian**], it could be argued that those who avoid paying an appropriate amount undermine tax as a moral responsibility - a question raised again by the so-called 'Paradise Papers' in 2017, which appeared to reveal international tax avoidance by big companies, rich celebrities and even the royal family [Ref: **Guardian**]. Critics argue that corporations take advantage of competitive tax rates internationally in order to make more money for their shareholders and themselves, not caring what impact these low tax rates have on the citizens of the countries they operate in. Within this context, many are now of the opinion that tax incentives are fundamentally unfair and unethical, because they mean that countries end up 'depleting the contributions of major corporations and leaving citizens to pick up the tab' [Ref: **Guardian**], to the extent that several EU countries, including Germany and France, have made moves to introduce a minimum rate of EU corporation tax in an attempt to avoid countries like Ireland and Luxembourg creating an unfair market [Ref: **Telegraph**, **Spiegel**]. Tax campaigners Ellie Mae O'Hagan and Nicholas Shaxson make the point that 'flighty financial capital does move; to find the most favourable tax arrangements' [Ref: **Guardian**]. In addition, it is claimed that tax competition gives big corporations an unfair advantage over smaller, local companies, because they can use complex offshore tax models to increase profits, which often leads to the smaller companies going out of business because they cannot compete [Ref: **Guardian**]. On the other hand, tax competition is largely supported by classical economic theory. In 1956, Charles Tiebout argued that in a globalised world, it would be logical for people to move to countries with the most efficiently run public services for the least amount of tax possible [Ref: **Journal of Political Economy**]. And on a practical level, advocates say tax competition is far from unethical, and is actually evidence of the free market at work: paying less tax allows multinationals to pass savings on to customers, pay higher wages to employees and ultimately invest more in to the societies in which they operate [Ref: **New American**]. For example, Pfizer CEO Ian Read claimed that the Allergan merger would give his company greater ability to invest in America and provide more money for its research and development department [Ref: **PR Week**]. Similarly, whilst Netflix paid very low rates of tax in the UK last year, it spent millions investing in the UK entertainment industry instead [Ref: **Guardian**].

Do tax incentives work?

American business magnate Warren Buffett once remarked that: 'I have worked with investors for 60 years and I have yet to see anyone… shy away from a sensible investment because of the tax rate on a potential gain', which calls into question the need for tax incentives at all. This is because: 'Above all, investors want good roads, a healthy and educated workforce, and the rule of law. All of which mean tax.' [Ref: **Guardian**] However, despite these misgivings, there are many who maintain that tax incentives do work: the recent competition between American cities to be the home of the second Amazon headquarters has shown how important tax incentives can be in a competitive market [Ref: **Reuters**]. They argue that rather than scapegoating big business, governmental bodies should focus on simplifying and lowering tax rates. This is vital due to the fact that economically prosperous countries must be attractive to foreign investors who look for competitive conditions with simple rules and minimal red tape [Ref: **City A.M.**]. And as columnist Alex Newman states, 'the benefits of tax competition, low taxes, and economic freedom are clear — liberty, prosperity, higher wages, more investment, more jobs, more growth, and a better society' [Ref: **New American**]. Advocates also point to success stories. Ireland exceeded tax revenue performance targets in 2015 by €800 million, 80 per cent of which can be attributed to money raised from corporation tax, with many crediting this to moves by a large American multinational to book certain profits in its Irish division that were previously booked offshore [Ref: **Irish Times**]. However, some observers have noted that the effect from the other side - that relatively high corporate taxes in the US have been the driver for firms declaring profits in other countries, benefiting low-tax states like Ireland at the expense of Americans [Ref: Big Think]. And politically, supporters of tax incentives note that national governments must be free to set their own rates as a matter of sovereignty, and suggest that if governments and organisations such as the EU had their way, taxes would always be set at the highest rates, which would drive business away [Ref: **City A.M**].

Tax incentives and the developing world

Favourable tax incentives have become commonplace in the developing world in recent years, sparking debate about whether it benefits or hinders economic growth in these countries. A damning report published by a group of NGOs claimed that in 2012 tax incentives for six firms amounted to 59 per cent of Sierra Leone's government budget. It concludes by stating that 'tax breaks for investors have done little to help the country's poorest people, draining resources needed for critical public services' [Ref: **Guardian**]. Moreover, it's not clear that such measures really work, with tax incentives ranked 11th out of 12 location factors in a United Nations Industrial Development Organization survey of 7,000 firms in 19 African countries. Investor Motivation surveys in Tanzania, Rwanda, Uganda and Burundi showed that over 90 per cent of investors would still have invested even if tax incentives were not provided [Ref: **OECD**]: countries like Zambia, with a corporation tax rate of 35%, have still managed to attract huge amounts of Chinese investment [Ref: **The South African**]. However, others are more sanguine, and say that without global tax competition, business would have no incentive to invest in new, perhaps poorer countries, and economic development would be stifled as a result [Ref: **Wall Street Journal**]. Without tax incentives, the economies of several 'tax haven' countries would likely collapse [Ref: **Guardian**]. In Kenya, an economic growth of 6-7% was projected in 2016 following the offer of exemption from corporation tax to companies new to the country, showing the potential positives of being able to offer competitive tax incentives [Ref: **Mail & Guardian Africa**]. So what are the pros and cons of tax incentives? Is it 'always harmful' [Ref: **Guardian**] for countries to offer tax incentives to attract investment – and who gains and who loses in such arrangements?

ESSENTIAL READING

It is crucial for debaters to have read the articles in this section, which provide essential information and arguments for and against the debate motion. Students will be expected to have additional evidence and examples derived from independent research, but they can expect to be criticised if they lack a basic familiarity with the issues raised in the essential reading.

FOR

Amazon Scammed America's Hurting Cities
Alex Shephard **The New Republic** 12 November 2018

Why Apple's low-tax deal is no blueprint for Brexit Britain
Fintan O'Toole **The Guardian** 4 September 2016

Another big corporation is flagrantly dodging tax. This must be outlawed
Simon Jenkins **Guardian** 24 November 2015

Protecting the tax base: why it's important to block tax inversions
Jared Bernstein **Washington Post** 19 November 2015

Tax evasion: the main cause of global poverty
Bella Mosselmans **Huffington Post** 28 February 2014

AGAINST

IEA announces Richard Koch Breakthrough Prize Winner
IEA 6 April 2017

In praise of tax havens
Oliver Riley **Adam Smith Institute** 3 March 2017

Tax Competition is good for Europe: Don't let Jean-Claude Juncker muddy the waters
Syed Kamali **City AM** 22 January 2015

Does tax avoidance really do evil?
Tim Black **Spiked** 20 May 2013

IN DEPTH

The New York Hustle of Amazon's Second Headquarters
Anand Giridharadas **The New Yorker** 17 November 2018

The challenges for developing countries in international tax justice
Martin Hearson **LSE Research Online** 2017

The Pfizer-Allergan Merger is a Disgrace
John Cassidy **The New Yorker** 23 November 2015

What's wrong with tax avoidance?
Mark Rowney **New Statesman** 20 April 2015

Multinational corporations, stateless income and tax havens
Sinclair Davidson **ACCA** 27 March 2014

KEY TERMS

Definitions of key concepts that are crucial for understanding the topic. Students should be familiar with these terms and the different ways in which they are used and interpreted and should be prepared to explain their significance.

Multinational

Tax competition

BACKGROUNDERS

Useful websites and materials that provide a good starting point for research.

From Seattle to Luxembourg: how tax schemes shaped Amazon
David Pegg **The Guardian** 25 April 2018

Peer Pressure: Tax competition and developing economies
Michael Keen **World Bank** 11 July 2017

Tax surge from multinationals 'not a one-off'
Irish Times 4 November 2015

Inequality will continue until corporations stop avoiding tax
Gabriel Zucman **The Guardian** 11 October 2015

Infrastructure projects, tax incentives present sweet opportunities in East Africa's largest economy
Johann Bernard **Mail & Guardian Africa** 11 September 2015

Where in the world can you pay the least tax?
Nic Cicutti **The Telegraph** 19 July 2014

New European data: when tax competition Is weakened, politicians respond by increasing tax rates
Daniel J Mitchell **Cato Institute** 2 May 2013

As companies seek tax deals, governments pay high price
Louise Story ***New York Times*** 1 December 2012

ORGANISATIONS

Links to organisations, campaign groups and official bodies who are referenced within the Topic Guide or which will be of use in providing additional research information.

Christian Aid: Tax Justice campaign

OECD

Tax Justice UK

IN THE NEWS

Relevant recent news stories from a variety of sources, which ensure students have an up to date awareness of the state of the debate.

EU announces plan to scrap member state veto on tax policy
Jon Stone **The Independent** 15 January 2019

Amazon halved corporation tax bill despite UK profits tripling
Mark Sweney **The Guardian** 3 August 2018

Faced with US tax cuts, France, Germany hasten harmonisation
Reuters 3 March 2018

Paradise Papers revealed 'commoditisation' of tax avoidance
Gareth Hutchens ***Guardian*** 15 January 2018

Ikea could face €1bn in back taxes as EU probes sweetheart deal
Leo Cendrowicz ***Independent*** 18 December 2017

Budget 2017: the truth about corporate tax cuts
The Week 21 November 2017

Billions in tax breaks offered to Amazon for second headquarters
Jeffrey Dastin **Reuters** 19 October 2017

OECD countries in bout of corporate tax competition

Vanessa Houlder ***Financial Times*** 13 September 2017

France and Germany planning assault on Ireland's corporation tax

Gavin McLoughin ***Irish Times*** 8 August 2017

The problem with corporation tax

Kamal Ahmed **BBC News** 10 May 2017

Riddle of UK's rising corporation tax receipts

Gavin Jackson and Vanessa Houlder ***Financial Times*** 26 April 2017

AUDIO/VISUAL

The moral purpose of tax

Moral Maze **BBC Radio 4** 8 November 2014

Taxing our way to a fairer society?

Battle of Ideas 20 December 2012

Tax avoidance

Moral Maze **BBC Radio 4** 24 March 2012