SMF Mentor30Engineers Competition

Name: Ben Kelley
Degree course: MEng Civil Engineering
University: University of Southampton
Year of graduation: 2015 (First class honours)
Current role: Graduate tunnel engineer, Arup (London)

5. How can government/regulators ensure that major corporations pay their fair share of taxes?

The starting point in this highly topical question is to examine **why** major corporations don't (or aren't considered to) pay their 'fair' share of taxes as a matter of course. Firstly, we must acknowledge that the vast majority of companies fulfil their obligations and pay their legally owed taxes to the UK government. Secondly, 'fair' is highly subjective – it is therefore to be expected that a capitalist firm wishes to maximise profits by legally minimising their tax bill (a practice known as tax avoidance), whilst a government wishes to maximise tax receipts (to pay for public expenditure such as infrastructure). This clear tension between major corporations and governments regarding taxation is often exasperated by a feeling from major corporations that they are being over-taxed, given that their products may already generate value-added tax (vat), produce GDP and employ a population that pay income taxes.

The "ensure" aspect of the question leads us to consider compliance with tax regulations, so we will explore **how** major corporations avoid tax. Without discussing tedious details of tax law, the most significant impact on UK tax receipts is that of 'tax residency', where a corporation (legally) exploits their global nature to transfer profits between interlinked subsidiaries/parent companies/legal entities across multiple countries. As the UK government taxes corporations based on their <u>profits</u> (with corporation tax), the corporation is thus able to minimise their tax bill by transfering profits to a country with lower taxation. Assuming that this method is currently legally compliant, we must infer that the real question our client (the UK government) is asking us is how they can increase tax revenues by making new regulations that are as 'fair' as the original tax regulations were for national (rather than international) corporations.

The simplest solution is for the UK government to tax firms based on their UK profits, calculated by multiplying UK revenues by global profitability, rather than a self-declared UK profit. For example a global furniture maker that builds chairs in India, runs the business from the USA and sells them globally, would pay UK corporation tax based on a UK revenue of £10m multiplied by a global profitability of 10%, i.e. UK corporation tax due on £1m assumed UK profits. Given this solution has not yet already been adopted (and that governments have access to significant expert advice!), there are clearly some drawbacks to this concept. Notably, it could result in inequality for a firm whose profitability (e.g. perhaps due to labour costs etc.) varies significantly across their global business, perhaps leading to a business removing itself from the UK marketplace. Nonetheless, I argue it is a transparent, simple and easy to implement solution that could also provide a government with both a tax revenue and political windfall, that could be used to pay off national debts, invest in infrastructure and support public services.

The above method I have postulated of taxing profits calculated based on UK revenue and global profitability (a percentage rather than monetary number), works very well for firms that sell a physical product, whereby the physical sale of the product can be accurately assigned to a specific country. However, the rapid growth of technology companies in our increasingly digital economy are far harder to assign revenues to a geographic region. This is especially important given that in 2017 over 50% of the top 20 corporations by market capitalisation were technology companies. An example of the difficulties; a customer uses a social media platform in the UK, the social media company (US based) interprets the data and notices the customer likes cats, so promotes a French cat food retailer's products to the customer. The US social media firm may have sold this UK collected data to the French retailer, but where is the revenue actually generated? I would argue the revenue is generated wherever the 'value' is added, which in this case might be the US firm using US staff and US servers to process the data. However, what if the value is added using Irish servers with an algorithm developed in Germany? This creates a far more complex situation to assess for taxation purposes, allowing confusion to reign and tax residency to be exploited. A potential extension to my proposed method is to consider data as a raw material, which is 'mined' in the traditional sense, the same as oil and gas. Perhaps therefore, the data might be 'mined' in the UK under a paid 'license' from the UK government based on the population that are contributing to the data-source, and the revenue is then assigned to where the value is added by the residency of the servers processing the data. This might however have the unintended consequence of creating a tax haven rush for data centre residency!

In conclusion, I have suggested a method for increasing the 'fairness' of corporation taxation for the UK government that assigns UK profits based on UK revenues and global profitability (rather than the current self-declared UK profits). Furthermore, I have noted that the digital economy makes assigning revenues to a geographic region even more difficult, and I have proposed a method of treating data as a raw material that is licensed by a government on behalf of the population, to generate additional revenues. The additional corporation tax and data licensing revenues that could be generated for UK government could be used to invest in national infrastructure, reduce debt and improve public services, as well as providing government with a political advantage that may be highly popular amongst the electorate.