Profiting from low pay

Proposal. As reported in the press, Labour may consider legislation to prohibit payment of dividends by companies who pay less that the "living wage".

My reaction. Highly desirable. A most worthy proposal. It is extremely distasteful for companies to be able to pass the benefits of excessively low pay on to their shareholders.

My vote. No. The motivation is good, but the envisaged legislation will be difficult to formulate, and it will be very difficult to stop a company finding ways to avoid its effects. And even where the legislation is effective the benefit of low pay remains with the company and hence the shareholders.

Old Labour acquired a much deserved reputation for legislation which was well meaning but ineffective, and sometimes even counter-productive. One of the few merits of NuLabor was that it avoided that trap. Let us not return to old ways of thinking.

Definition. It will not be easy for the envisaged legislation to define and provide for the effective monitoring of the pay requirement. Which government department will be responsible? How will they ascertain the rate of pay for each working hour? Will they receive a special return, in which case will it be reliable? Or will the information be provided through existing returns, possibly extended? And how will a "working hour" be defined? It could hardly include unpaid overtime, unless that were a contractual requirement. But some jobs are known to have a cruelly limited definition of hours which are "worked" and therefore paid for. Care workers, for example, are sometimes paid only for time with clients, and not for travelling between them, nor even for compulsory training courses.

It is possible that the simplest and most effective mechanism would be to have the necessary information included on the form used to claim Working Tax Credits (WTC). Indeed, even simpler would be to take any payment of Working Tax Credits as a definitive indication of low pay, and all by itself to constitute sufficient grounds for denial of the right to pay dividends.

Avoidance. If the envisaged legislation is enacted, companies may be expected to immediately seek ways to avoid its effect. For example, they might contract out all underpaid jobs to a deliberately unprofitable subsidiary, if allowed. Or they may, as many do now, develop a beneficial definition of what are deemed to be working hours.

Should such manoeuvres fail, there may prove to be other ways to deliver cash to shareholders. There may be expected to be no limit to the willingness of tax accountants and other "professionals" to use their imagination in devising clever schemes to pay money to shareholders other than by the payment of dividends.

Retained profit. And if, as may be hoped, they fail in such endeavours the benefit of low pay nevertheless remains with the company and hence the shareholders. So all the shareholders would lose from a ban on dividends is a modicum of liquidity, and even that they can readily recover by selling some of their shares, at what would be a value increased by the forcible retention of profits.

So what will the company do with the extra cash which it would have paid as dividend? One silly but plausible option would be to pay staff adequately one year in five, and thus pay a 25% dividend that year rather than the annual 5% it would have paid. Or it might use the spare cash to buy up companies which are less profitable because they pay staff adequately, and then quickly correct that uncommercial fault in them. But whatever happens, the shareholders will not lose out.

Subsidy or loan? Working Tax Credits are often represented as being benefit payments to low-paid workers. But it is widely accepted, which is obviously true, that they are really subsidies to low-paying employers. Which is in any case justifiable as a way of encouraging enterprise and stimulating employment. However, such a subsidy should be provided only if needed and should therefore perhaps be treated as a conditional loan, repayable from profits if there are any. And that repayment necessarily takes precedence over dividend payments, which achieves the effect which would presumably be the aim of the envisaged legislation.

To discourage use of the tax credit system as a means of obtaining cheap credit, and in keeping with the current policy of having people pay for services they receive, it might be found expedient to add a small charge to the loan when it is repaid, to cover administration costs and a small amount of interest. Perhaps 10% of the loan would be appropriate.

On the other hand, those who actually need the subsidy, because they fail to make a profit, are not gong to be asked to repay it. In which case it might be decided to consider actually reducing the minimum wage, and thus further increasing the potential subsidy, if it were deemed desirable to increase its effect in encouraging enterprise and stimulating employment. Which is a concession which would presumably be greatly welcomed by charities and other non-profit organisations.

Trading profit. Unfortunately, there can be a large difference between the true trading profit of an enterprise, the surplus directly generated by its trading activities, and the nett profit calculated for the purposes of taxation and dividend payment. It is from this true trading profit that any refund of tax credits should be made, and any legislation to that effect needs to specify clearly the payments and provisions which are to be excluded from the calculation of trading profit.

Items which really should be considered for exclusion include

- staff bonuses
- remuneration packages in excess of (say) £200K
- payments to individual staff masquerading as consultants
- voluntary contributions, e. g. to political parties and charities
- profits which are currently disreputably exported by means of tribute money such as franchise fees, interest on unnecessary loans, or overpriced purchases from, or other contributions to, parent companies and other associated companies.

Corporation Tax. At which point it seems obvious to consider making Corporation Tax payable on the revised trading profit as contemplated above. Because all the largely voluntary non-trading expenses listed are arguably as much a distribution of profits as are dividends, and therefore equally worthy of being excluded from the calculation of taxable profit.

Conclusion. We should do this. Arrangements such as those discussed above would

- avoid the current abuse of the tax credit system in the interests of shareholders and senior managers
- provide a valuable stimulant to commerce and highly desirable support for start-ups, charities and other socially desirable non-profit organisations
- afford a much more justifiable way of raising extra revenue than simply increasing the rate of Corporation Tax.

Bill Waghorn
01 Feb 16, rev. 28 Aug 17