FISC Subcommittee of the European Parliament Public Hearing
The Impact of Brexit on the level playing field in the area of taxation

26 January 2021

Introductory Comments by Judith Freedman (University of Oxford): Brexit, cooperation or competition?

We have been invited to comment on corporate income tax, the digital services tax and the OECD negotiations from the UK's perspective post-Brexit.

We do not intend to comment on the pros and cons of Brexit - we do not speak for the UK Government or against it. In addition, we do not represent the views of Oxford University or any of the organisations we work with. All the views expressed today will be our personal views only.

We have no insider knowledge of the UK Government's future intentions and base our comments on public documents and statements and our analysis as tax specialists.

Background, timeline and speculation

There has been much speculation in the media about the direction in which tax policy will go in the UK following Brexit. It is notable that this speculation includes suggestions that corporate tax will be increased in the forthcoming Budget on 3rd March, and that the UK is moving towards a 'Singapore on Thames' with low tax rates. It is possible that there are different views on corporation tax and other tax rates in the UK Cabinet and that this is still being discussed.

Looking at corporate tax rates in isolation from everything else only tells you part of the story. In recent years the UK corporate tax rate has reduced but despite this there has been a growth in corporation tax receipts due to growth in company profits, growth in the number of firms paying the tax and base broadening changes to the corporation tax system, including restrictions on loss and interest deductions and anti-avoidance provisions. This revenue is important - £52 billion in £2019/20 out of £825 billion - the UK's 4th biggest tax. This is not revenue the Chancellor will lightly forgo in a year like this. What might happen in the future is less clear but radical change seems unlikely for now.

Further changes to the tax base might be preferred to reductions in the tax rate - for example the UK is non-competitive when it comes to deprecation for industrial buildings so that might be tackled and there may be further relaxation of depreciation rules on plant and machinery. This allows for what are effectively tax cuts to be more targeted at particular sectors. John will comment on this further below.

Other actions we could see might be the setting up of freeports or other regional zones with special tax regimes, which will need to meet the fiscal subsidy requirements of the EU-UK Trade and Cooperation Agreement (TCA). We have seen speculation but no details yet.

My final point before I hand over to John is that there have been no indications that the UK would want to relax anti-avoidance legislation. Implementation of DAC 6 has been cut down but only because the objectives are achieved already by the UK system or will be achieved in different ways. Some aspects of the OECD's Pillar II proposals that might be thought to contravene EU Freedoms might actually be easier for the UK to implement as a result of Brexit, should those proposals be accepted in the future.

Comments by John Vella (University of Oxford): Brexit, cooperation or competition? Corporate income tax, digital services tax and the OECD negotiations

I would like to start by making a comment on my general views on the issues we are discussing in this session.

I believe that the international corporate tax system is badly flawed. It is riddled with problems and needs fundamental reform. I do not believe that these problems have been caused by digitalisation. The problems stem from the very structure of the system itself. The system distorts economic activity, it is susceptible to avoidance, it is hugely complex, and it creates incentives for countries to compete with one another leading to a race to the bottom, as can be seen most clearly by falling corporate income tax rates across the world. These problems existed pre-digitalisation. Digitalisation just exacerbated these problems. For this reason, I would favour reforming the international corporate tax system in a way that is certainly more radical and fundamental than the reform currently being discussed in the OECD's Inclusive Framework, and that is favoured by the UK and many EU member states.

I will now turn to the issues I have been asked to discuss.

Corporate income tax

I will start with the corporate income tax.

The UK's statutory corporate income tax rate has fallen significantly in recent years. It fell from 30% in 2007 to 19% in 2017. Under previous leadership the government had announced that the rate would be cut further to 17%, but this planned cut was later cancelled. As Judith explained, it is hard to know what the UK will do on this front in the immediate future.

There are a few points worth noting here.

First, recent cuts to the UK's corporate income tax rate were part of a deliberate policy to have "the most competitive tax regime in the G20".

Second, as Judith explained, the attractiveness of a corporate income tax regime depends on the tax rate but also on the tax base. The UK's tax rate is attractive relative to that of many EU Member States. As of 2019, the UK's 19% rate was lower than that of 17 EU member states. But the UK's tax base is not as competitive. There are different measures which combine the tax rate and tax base. One is the Effective Average Tax Rate (EATR) and another is the Effective Marginal Tax Rate (EMTR). As the UK's corporate income tax base is not as attractive as its rate, the UK is not as competitive on these measures. In fact, as of 2019 – based on OECD figures[1] – the UK's EATR was lower than that of 16 EU Member States, but the UK's EMTR was lower than that of only 6 EU Member States.

Therefore, the take-away here is that while the UK has a very competitive statutory corporate tax rate, its base is not as competitive.

Third, corporate income tax rates have been falling around the world, including in EU Member States. This is partly due to the fact that under the existing system countries have an incentive to cut their tax rates to attract real activity and profit. These competitive forces are generated by the very structure of the existing system and threaten its viability in the long run. It is one of the main reasons why I favour fundamental reform that involves a shift to a system that is inherently less susceptible to these competitive pressures that lead to this race to the bottom.

Failing that, the existing system should become less susceptible to these competitive pressures if a robust and strict minimum tax were to be adopted by most countries world-wide. A minimum tax is being discussed under Pillar II in the OECD's Inclusive Framework, but it is not yet clear that most countries world-wide will agree to it and, in any event, it is unclear whether the minimum tax currently on the table is robust and strict enough to bring competition to a halt. For example, if a minimum tax rate of 12.5% is agreed, countries would still be under competitive pressure to reduce their rate to that.

To sum up on this final point, therefore, I would argue that there are reasons to believe that corporate income tax rates world-wide will continue to fall over the medium-long term.

Digital services taxes and the current OECD negotiations

I would now like to turn to Digital Service Taxes (DSTs) and the negotiations currently underway in the OECD Inclusive Framework.

Overall, thus far, the UK's position on these matters appears to have been broadly in line with that of the EU Commission and other EU Member States who have taken a prominent role in these negotiations. We can see this both in terms of the guiding principle and the reform proposals they have favoured.

We can start with the guiding principle. The UK, the Commission, and a number of EU Member States embrace the same guiding principle on international taxation. They believe that profit is and should be taxed where value is created. As an aside, I happen to think that this principle does not, should not, and actually cannot guide the design of the international tax system.

[1] These can be found here.

Be that as it may, the take-away here is that the UK, the Commission and many EU Member States embrace the same guiding principle on international taxation.

We can now turn to the actual proposals made thus far. The UK has for some time been clear in its view that the international corporate tax system needs to be reformed in response to the changes brought about by digitalisation. In March 2018, both the EU Commission and the UK put forward a short-term and a long-term proposal to address the challenges posed by digitalisation. The proposals put forward by the UK and the Commission were broadly along the same lines. The short-term proposals were Digital Service Taxes, and the long-term proposals basically involved a reallocation of taxing rights to countries where users are found. It is fair to say that the UK's proposals were more developed at this stage.

As people in this session will know, consensus could not be found among EU Member States on DSTs. But the UK and some other Member States went ahead and unilaterally adopted DSTs. The UK's DST came into effect in April 2020. As this is meant to be an interim measure, the UK is committed to repeal its DST if an "appropriate global solution is successfully agreed and implemented".

The long-term proposal put forward by the UK in March 2018 was known as the 'user participation' proposal. It was one of three proposals considered by the Inclusive Framework under Pillar I. These three proposals were eventually superseded by a compromise proposal, the Unified Approach proposal. This is the proposal that is currently being discussed under Pillar I in the Inclusive Framework. So, the UK has had a critical and leading role in the Pillar I negotiations. And as far as I can tell, the UK has also been broadly supportive of the Pillar II proposal.

I have concerns about the UK's DST – and DSTs more broadly. I also have concerns about the proposals being considered under Pillar I and II, although I think the move under Pillar I towards taxation in the market country is a positive step. But ultimately these proposals keep the existing system in place and simply try to patch it up so it can limp on into the future. I would have preferred bolder reform. I would have preferred reform that is comprehensive, coherent and principled. But, as I mentioned above, such reform is not currently favoured by the UK, a number of EU Member States and elsewhere.

Be that as it may, to sum up, as far as I can tell, the UK has been supportive of the negotiations in the Inclusive Framework aiming at a consensus-based multilateral solution. In fact, together with France and Germany and some others, the UK seems to have played a leading role in moving these negotiations forward. Public pronouncements made in recent months by UK officials involved in these negotiations have not given any indication that that is about to change.[2] On the contrary, they reaffirmed in strong terms the importance the UK attaches to this process and its hope that a consensus-based multilateral solution is reached by mid-2021. And this general stance is also reflected in the EU-UK TCA.

[2] See for example the comments made by Mike Williams (Director Business and International Tax, HM Treasury) at the conference "Pillar 1 and 2: Are we close to a deal?" organised by the Oxford University Centre for Business Taxation on 23 November 2020. The video of this session can be found here.

Bibliography

I have made brief reference to my views on a number of topics. These views are set out in full in the following publications.

- *Taxing Profit in a Global Economy*, OUP, (2021). With Alan Auerbach, Michael Devereux, Michael Keen, Paul Oosterhuis and Wolfgang Schön.
  NB This book, which has just been published by OUP, is also available for free in a digital format here and here.

- 'The UK's Digital Services Tax', *British Tax Review* 4 (2020) 469.

- *The OECD Global Anti-Base Erosion Proposal*, (2020) Oxford University Centre for Business Taxation Report. With Michael Devereux, François Bares, Sarah Clifford, Judith Freedman, İrem Güçeri, Martin McCarthy, and Martin Simmler.

- 'Digital Services Taxes: Principle as a double-edged sword', (2019) 72 (4) *National Tax Journal* 821.

- 'Taxing the digitalised economy: targeted or system-wide reform?', (2018) *British Tax Review* 387. With Michael Devereux.

- 'Implications of digitalisation for international corporate tax reform' in Sanjeev Gupta, Michael Keen, Alpa Shah and Genevieve Verdier (eds), *Digital Revolutions in Public Finance*, International Monetary Fund (2017). With Michael Devereux.

- 'Are we heading towards a corporate tax system fit for the 21st century?', (2014) 35 (4) *Fiscal Studies* 449. With Michael Devereux.