International Tax Competition and Corporate Taxation in the Wake of Brexit

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1. Motivation

• Increasingly fierce tax competition has led to a sharp decline in corporate taxes.

• Brexit will, if anything, cause further downward pressure on corporate taxes.

• This is potentially bad news for public spending and immobile income sources (labour, ‘local’ businesses).

• This is potentially bad news for the South West.
2. International Tax Competition and Coordination

• International tax competition:
  – In the last decades, increasing mobility of capital and companies has led to a ‘race to the bottom’, with median statutory tax rates in high-income countries dropping from about 50% in the 1980s to less than 30%. Average worldwide corporate tax rates have declined similarly (see figure).
  – Tax competition leads to inefficiently low taxes and thus to insufficient revenues and inefficiently low public spending.
2. International Tax Competition and Coordination

Top Marginal Corporate Tax Rates Have Declined Since 1980


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2. International Tax Competition and Coordination

- Fundamental problem:
  - Mismatch between the limited geographical reach of individual countries and the global activities of multinational enterprises.

- International tax coordination:
  - Various measures, e.g. minimum tax rates, limiting preferential tax regimes, formula apportionment.
2. International Tax Competition and Coordination

• EU Initiatives:
  – VAT harmonisation.
  – EU savings directive.
  – EU Code of Conduct Group: limiting ‘harmful’ tax practices (e.g. phasing out preferential tax regimes).
  – Initiative on the Common Consolidated Corporate Tax Base.
3. Potential Implications of Brexit

- Brexit and corporate taxation:
  - British exporters and FDI suffer from leaving the single market (at least in the short run).
  - Likely UK government response: reduction in corporate tax burden, as stressed by Philip Hammond.
  - UK tax cuts would put pressure of EU member states to lower tax rates too.
  - This would sound the bell for a new round of fierce international tax competition.
3. Potential Implications of Brexit

• Brexit and tax coordination in Europe:
  – Beneficial tax arrangements between the UK and the EU will be, in principle, still possible, but will be more difficult to be negotiated.
  – Issue linkage, which can facilitate agreements, will become more difficult.
3. Potential Implications of Brexit

• To summarise, Brexit will, if anything, intensify international tax competition and thus lower tax revenues for two reasons:
  – Governments are under pressure to ‘compensate’ exporters for the potential disruption of international trade and supply chains in the wake of Brexit.
  – Tax coordination will become more difficult.
3. Potential Implications of Brexit

• Potential implications:

  – Further cuts in public spending (education, infrastructure, etc.).

  – Shift of tax burden from more mobile to less mobile income sources (e.g. to labour and small and medium-sized ‘local’ business).
3. Potential Implications of Brexit

- This is potentially bad news for the South West:
  - Relatively heavy reliance on public spending (NHS, MoD).
  - Dominance of small and medium ‘local’ enterprises.
  - Strong representation of sectors that are relatively dependent on state support (agriculture).
4. Recommendations

- The UK and the EU should maintain their current level of economic integration as far as possible.

- The UK and the EU should maintain a strong partnership and should continue to coordinate their tax policies and initiatives.

- To safeguard the competitiveness of the UK, the British government should focus on productivity enhancing measures (e.g. improving infrastructure and skills) rather than on cutting corporate taxes.
Many thanks for your interest.