

Impact case study (REF3b)

Institution: University of Oxford
Unit of Assessment: 19 – Business and Management Studies
Title of case study: Influencing Tax Policy in Europe
<p>1. Summary of the impact</p> <p>Since it was established in 2005, the Oxford University Centre for Business Taxation (CBT) has had significant and wide-ranging impact on several aspects of the formation of tax policy in Europe. Feeding into the current topical public debate on business taxation, the centre’s research on the design and effects of corporation tax and VAT has had impact in several ways, two of which are highlighted here: 1) on a proposal by the European Commission, and the response by member states, to harmonise corporation tax within the EU, in which the research has been partly responsible for the reform not being implemented; and 2) on a far-reaching reform to VAT in Portugal, where the research contributed significantly to the design of the revised VAT system.</p>
<p>2. Underpinning research</p> <p>The CBT is an independent research centre of the Saïd Business School which aims to promote effective policies for the taxation of business. The CBT undertakes multi- and inter-disciplinary research, drawing primarily on economics and law. It is funded roughly equally by donations from business and grants from the ESRC.</p> <p>Researchers involved in the research reported here include:</p> <ul style="list-style-type: none"> • Michael Devereux (Professor of Business Taxation and Director of CBT) • Simon Loretz, (Research Fellow of CBT from 2006 to 2011, now Assistant Professor, University of Bayreuth) • Rita de la Feria (Senior Research Fellow of CBT from 2008 to 2012, now Professor of Law at Durham University) <p>The taxation of business has recently become an important diplomatic, political and economic issue, internationally. For example, the G20 and the G8 have both discussed problems of tax avoidance and evasion in several meetings, and have supported the Organisation for Economic Co-operation and Development (OECD) in its efforts to reform the international tax system. The CBT is arguably the world’s leading centre for research in business taxation. It has been active and influential in these debates, and has been so since it was established - well before tax avoidance became a headline issue. Working with policy makers in a number of organisations, such as HMRC, HM Treasury, the OECD and the European Commission, the link between CBT research and its policy impact is two-way: its research informs its policy interventions, while its involvement in the policy debate shapes its research programme.</p> <p>1) Assessment of potential EU harmonisation of corporation taxes</p> <p>The CBT has undertaken several pieces of research on the European Commission’s proposals for what is known as a Common Consolidated Corporate Tax Base (CCCTB). The basic aim of the proposal is to remove the need for multinational companies to identify how much profit they earn in each member state, and to compute only their EU-wide profit. This aggregate measure of profit would be allocated to member states on the basis of a simple formula, and member states would tax their allocated profit at rates of their choosing.</p> <p>CBT research on this initiative has examined various aspects of the proposal to provide estimates of the impact of such a reform on corporation tax revenues in each member state [Section3: R2]; and to identify how the proposed system would allow companies to set losses in one country against profits made in another, something which is generally not possible under the existing system [R3]. Drawing on earlier work by Michael Devereux, this research introduced a new methodology for measuring the relevant effective tax rate in the presence of losses, and applied this methodology to assess the impact of the proposed reform on the incentive to invest for multinational companies, especially in new locations [R3].</p> <p>This underpinned a larger research project to evaluate the effects of the proposed system on macroeconomic factors. In collaboration with the CPB Netherlands Bureau of Economic Policy Analysis, the research constructed a computable general equilibrium model of the EU economy,</p>

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calibrated to the 27 EU member states. This model was designed to identify the impact of the tax on macroeconomic factors, such as investment, employment and financial flows between countries. The results indicated that the real economic benefits of the reform would be rather small; partly because the proposed system would, like the existing system, also create distortions to patterns of investment [R1].

2) Implementation of reform to Portuguese VAT

A further area of research by CBT Senior Research Fellow Rita de la Feria over the last decade has covered legal aspects of VAT, also drawing heavily on lessons from economic theory [R5, R6]. Her comprehensive monograph on EU VAT and the Internal Market [R5] argues strongly in favour of base broadening, and highlights the negative effects at both the legal and economic levels of the use of reduced rates of VAT and VAT exemptions. For example, she argues that applying different rates (including zero) to different goods is a poor way of attempting to meet distributional aims in the tax system, since these could be addressed more directly, while applying different rates also creates significant costs in terms of distorting private behaviour.

In later research, de la Feria continued to highlight the importance of base broadening, whilst also drawing attention to the inherent limitations that the economic and financial crisis imposed on the adoption of optimal tax policy [R6]. This research analysed the possibility of achieving base broadening by extensive limitation of the use of reduced rates, and elimination of some exemptions, whilst taking into account EU law limitations (namely VAT harmonisation rules, and state aid legislation), as well as financial constraints on the ability of governments to compensate low-income households for increases in VAT. This work was extensively used in the Portuguese reforms described below.

3. References to the research

R1] Bettendorf, L., M.P. Devereux, A. van der Horst, S. Loretz and R. de Mooij (2010) "Corporate tax harmonization in the EU", *Economic Policy* 63, 537-590.

<http://ezproxy.ouls.ox.ac.uk:3611/ehost/pdfviewer/pdfviewer?sid=986c7d7f-40ff-4e12-bc5f-996ddf5e2f45%40sessionmgr12&vid=5&hid=9>

R2] Devereux, M.P. and S. Loretz (2008a) "The effects of EU formula apportionment on corporate tax revenues", *Fiscal Studies* 29.1, 1-33.

<http://ezproxy.ouls.ox.ac.uk:4575/doi/10.1111/j.1475-5890.2008.00067.x/pdf>

R3] Devereux, M.P. and S. Loretz (2008b) "Increased efficiency through consolidation and formula apportionment in the European Union?," Working Paper 0812, Oxford University Centre for Business Taxation.

<http://www.sbs.ox.ac.uk/centres/tax/papers/Pages/PaperWP0812.aspx>

R4] Devereux, M. P., B. Lockwood, and M. Redoano (2008) "Do countries compete over corporate tax rates?," *Journal of Public Economics*, 92(5-6), 1210-1235.

http://ac.els-cdn.com/S0047272707001351/1-s2.0-S0047272707001351-main.pdf?_tid=ed90f6a0-2b43-11e3-aa81-00000aacb362&acdnat=1380705830_e8ab92231df19fd65ab14f85cfe2b335

R5] de la Feria, R. (2009) *The EU VAT System and the Internal Market*, Amsterdam: IBFD (382 pages).

<http://www.ibfd.org/IBFD-Products/EU-VAT-System-and-Internal-Market>

R6] de la Feria, R. (2012) "The 2011 Communication on the Future of VAT: Harnessing the economic crisis for EU VAT reform", *British Tax Review* 2, 119-133

<http://login.westlaw.co.uk/maf/wluk/app/document?&srqid=ia744d05e0000013e22f58ebed778acf8&docguid=IF87FA351A1E611E1A172E95B5E958901&hitguid=IF87FA351A1E611E1A172E95B5E958901&rank=2&spos=2&epos=2&td=19&crumbaction=append&context=5&resolvein=true>

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4. Details of the impact

1) Assessment of potential EU harmonisation of corporation taxes

The European Commission has for many years been considering its Common Consolidated

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Corporate Tax Base (CCCTB) proposal for establishing a form of harmonisation of corporation tax within the EU. In 2008, the Commission asked the CBT to undertake research to analyse the likely impact if such a proposal were implemented. The European Commission official currently in charge of this work commented: “Michael [Devereux] is accepted as a leading professional in taxation matters and the practical advantage of having his participation and name on a study will lend a lot of credibility to the analysis...he is also very objective.” [C2].

The work for this evaluation was published in a report, which is summarised in Devereux’s *Economic Policy* paper [R1]. The aim of the study was to evaluate the likely impact on the European economy and on individual member states. As noted above, this involved the construction of a detailed model of the European economy, combined with detailed modelling of the international corporation tax system. The results of the study suggested that the economic benefits of introducing the harmonised system are likely to be small.

Both in developing the study, and following the submission of an initial draft to the Commission, the researchers worked closely and collaboratively with officials of the European Commission. For example, officials asked for a number of additional scenarios to be considered, including a more detailed examination of compliance costs, and these were included in the final report. However, the broad conclusions did not change.

This evidence that the reform would not have a significant impact on the European economy had a direct and indirect impact on the subsequent decision made by the Commission to delay making a formal proposal for two years. The indirect impact arose through the fact that the report was influential in shaping the negative response of many EU countries to the proposal, including the UK and Ireland. During this period of delay, the Commission undertook a considerable amount of further work on the proposal, and produced its own impact assessment in 2011 [C1], which extensively quoted the results of the initial study [R1], and also cited several other research contributions by Michael Devereux, including [R4].

2) Implementation of reform to Portuguese VAT

In 2011, thanks to an awareness of her research on VAT within the Portuguese Government, Rita de la Feria was appointed Adviser to the Portuguese Government on VAT Policy. This was in the context of the terms of the International Monetary Fund / European Central Bank / European Commission (the so-called *troika*) May 2011 bail-out agreement, in which Portugal was required to perform an extensive reform of its VAT system. De la Feria was given responsibility for ensuring that the VAT reforms were in line with the terms of the bail-out agreement, as well as with best international practice in this area. She provided extensive advice, based on her research, for two State Budgets, in 2012 and 2013, working closely with Portuguese government officials [C8].

The VAT reform, guided by de la Feria’s research, had two main objectives: fiscal consolidation, by increasing revenue accrued from the tax; and promoting economic growth by making the tax more efficient. Prior to the reform, the Portuguese VAT system was extremely inefficient, as measured by the OECD and IMF. This reflected two basic problems with the design of the tax: a narrow tax base (limited by exemptions and extensive use of reduced rates), and high levels of fraud and avoidance. The reform therefore also had to address these two features. As noted above, the first of these issues in particular has been addressed in detail in de la Feria’s research [R4, R5, R6].

The 2012 Budget was primarily concerned with base broadening, as well as anti-fraud and anti-avoidance measures. Based on her research over the previous decade, largely set out in [R5], de la Feria devised a set of criteria for broadening the base of VAT that took into account various challenges, in particular limitations under European law, and the potential impact of measures on low-income households, employment and economic growth. Apart from a small number of political concessions, de la Feria’s recommendations were applied and entered into force on 1 January 2012 [C8]. The Deputy Director of the IMF Fiscal Affairs Department, commented that “together these measures resulted in a big reduction in the goods and services with a reduced rate of VAT”.

As a result of these changes, Portugal experienced a very significant improvement in VAT

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efficiency, estimated at 30 points, whilst substantially increasing revenues and generating savings of 1.2 per cent of GDP [C6]. The EU Commission commented: “overall, the measures will help to significantly increase VAT efficiency”, (European Commission, 2012) [C5].

Other impacts:

CBT research has had a significant impact on several other areas of debate and reform, including: the following:

- The CBT Director of Legal Research, Judith Freedman, has pioneered research into the effects of a General Anti-Avoidance Rule (GAAR). Based on her research, she was appointed a member of an independent panel set up by the UK government to investigate introducing a GAAR in the UK. The panel’s recommendations were broadly accepted, and a GAAR was introduced in the 2013 Budget. This case is submitted to the Law Panel.
- CBT researchers John Vella and Anzhela Yevgenyeva made influential contributions on the proposal by the European Commission to introduce a new Financial Transactions Tax. Among other things, their research questioned the legality of the procedure of “enhanced cooperation” by a subset of member states; this was influential in the UK government’s decision to challenge the proposal at the European Court of Justice [C9].
- The OECD invited the Michael Devereux to undertake a project on transparency of reporting by multinational companies, chairing a group of representatives of business, NGOs, the OECD and other academics. This research was influential in the OECD’s decision not to pursue greater transparency [C10].
- Based on his research, Michael Devereux was appointed specialist adviser to the House of Lords Economic Affairs Committee for its 2013 enquiry in corporation tax [C11]. CBT researchers have also frequently provided oral and written evidence to select committees.

5. Sources to corroborate the impact

C1] European Commission (2011) “Impact assessment: Accompanying document to the Proposal for a Council Directive on a Common Consolidated Corporate Tax Base”, SEC(2011) 315 final.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/com_sec_2011_315_impact_assesment_en.pdf

C2] Head of Unit, Company Taxation Initiatives, DG Taxation and Customs Union, European Commission official currently in charge of CCCTB proposal, will confirm the impact of the CBT on the European Commission.

C3] Official announcement of appointment of de la Feria as adviser to the Portuguese Government (Despacho n.º 15297/2011) <http://www.dre.pt/sug/2s/diplomas-lista.asp>

C4] Portuguese State Budget 2012 (Lei n.º 64-B/2011 de 30 de Dezembro de 2011)

<http://www.dre.pt/util/getdiplomas.asp?iddip=20112035>

C5] European Commission (2012) “The Economic Adjustment Programme for Portugal – Third review-Winter 2011/2012”, *European Economy Occasional Papers* 95, April 2012

http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp95_en.pdf

C6] ESRC, “Reforming the Portuguese VAT system”, Impact Case Study, 2013

<http://www.esrc.ac.uk/news-and-events/features-casestudies/case-studies/25727/reforming-the-portuguese-vat-system.aspx>

C7] Deputy Director, Fiscal Affairs department, IMF, will confirm the impact of the Portuguese reform, and de la Feria’s role.

C8] Portuguese Secretary of State for Tax Affairs, Portuguese Finance Ministry, will confirm de la Feria’s role in the Portuguese reforms.

C9] QC who advised the UK government on its legal challenge will confirm the impact of this research on the UK’s decision to challenge the Commission’s FTT proposal.

C10] Director, Centre for Tax Policy and Administration, OECD, Paris; now Professor at the Vienna University of Economics and Business, will confirm the impact of this research on the OECD’s approach to greater transparency.

C11] House of Lords Select Committee on Economic Affairs report, “Tackling corporate tax avoidance in a global economy: is a new approach needed”, July 2013.

<http://www.publications.parliament.uk/pa/ld201314/ldselect/ldeconaf/48/48.pdf>