Consultation answers

Q1 to **Q17**

No response provided

Tax

Q18 In your view, do the specific tax incentives provided in existing English Enterprise Zones (Business Rates discount and Enhanced Capital Allowances) encourage increased business activity and employment in England?

Yes/**No**/Don't know

Q18.i: Please explain your answer and support your response with evidence where possible.

It is important to recognize that this question has asked whether these incentives increase business activity and employment in England. It has not asked whether these incentives increase business activity in the specific vicinity of the Enterprise Zone. It is undeniable that business activity does *shift* to enterprise zones (and no doubt freeports) where these are established. However, it is our view that in this situation all that is happening is that activity that would have taken place in some English location is now taking place in the particular locale of the zone. In other words, there is no significant net increase in business activity and employment across the whole of the country as a result of Enterprise Zones, and the same will be true of freeports.

Moreover, if the government response is to acknowledge that there is no net increase in business activity and that freeports are merely an exercise in local / regional equity as part of the 'levelling up' agenda, then there are more effective ways to encourage such regional growth, and ones that do not generate the significant disadvantages of freeports. In particular, ensuring that there is a highly skilled local workforce which attracts business investment would be a more obvious priority.

Centre for Cities analysed the impact on jobs of the 2011 creation of Enterprise Zones and found that at least a third (and likely many more) of the 'new' jobs apparently created were not new at all, but were simply moved from other locations. More telling was the fact that when these zones were analyzed in respect of their locality type (urban, suburban, rural) the vast majority of apparently 'new' jobs were in city centres. However, when they compared city centres with enterprise zones and those without they found no net difference in job creation between 2011 and 2017. In other words, the claim that Enterprise Zones create thousands of new jobs is almost certainly not true.

Perhaps more importantly, the number of jobs is not the relevant metric to be considering. More important is the income gained from those new jobs. If the new job is a zero hour contract, or very low paid, then it is questionable whether the government investment required to create the zones has genuinely created a worthwhile return on that investment. Again, the Centre for Cities report notes that over 90% of the new jobs were in low-skilled sectors and in fact the number of high-skilled local service jobs actually decreased in the relevant areas.

They conclude: "These findings should lead to greater caution over the creation of enterprise zones or any other area-based initiative, such as the free ports that have been suggested after the UK leaves the EU. Zones offering tax incentives or tariff reductions to relocate are likely to move activity around the locality or in from elsewhere in the country, rather than create new activity. And they are unlikely to attract in higher-skilled jobs that would change the fortunes of an economy." (In the Zone: Have Enterprise

Zones Delivered the Jobs they Promised, Centre for Cities, 2019)

Q19 How could the following policies be used to encourage employment and investment in business, infrastructure and innovation in a Freeport or surrounding area? Please explain your answer, and support your response with evidence where possible:

- facilitative solutions on VAT and Excise Duties for goods within Freeports (UK Wide)
- Stamp Duty Land Tax (England and Northern Ireland)
- Research and Development (R&D) Tax Credits (UK Wide)
- Employer National Insurance Contributions (UK Wide)

Q19i:

Of course, it is the case that amendments to some or all of those provisions could encourage business investment in a Freeport and surrounding area. However, we return to the point made in response to Q18. Either the purpose of this policy is to increase net business investment in the UK and the creation of additional income for British workers or the purpose is to improve local / regional equity. If the former, then the evidence for such net (as opposed to local) investment is sorely lacking. If the latter, then there are more effective solutions on offer, and in particular ones that do not incur the risk of fraud and money laundering associated with freeports, and the race to the bottom on taxes that are inevitably a zero sum game for the whole global community.

Q20: Is there any evidence to suggest that changes in these tax policies would be the deciding factor in investment decisions?

Yes/**No**/Don't know

Q20.i: Please explain your answer.

There is much UK evidence that tax incentives *alone* are never the deciding factor in investment decisions. Good infrastructure and a highly educated workforce appear to be far more relevant. Moreover, international studies which have been able to compare the different tax policies of different regions conclusively support this finding. Goetz et al analysed the economic impact of tax policies across a range of US states. They found that those states that engaged in a race to the bottom strategy of lowering tax rates experienced a negative economic impact while those states that pursued a race to the top strategy – investment in education and infrastructure – experienced a positive economic impact. They state "There was no evidence to suggest that states should enact broadly lower taxes to stimulate growth. The likely reason for the result is that, although taxes may directly increase firm costs or reduce household utility, they indirectly provide for government expenditures on valued services such as education and highways. In fact, evidence was found for positive growth effects of educational attainment and highway infrastructure. This suggests that state and local governments need to look more at increasing government efficiency, getting the maximum delivery of services per dollar of taxes, rather than simple reduction in taxes and the size of state and local government at the expense of valued services." Goetz et al, 'Sharing the Gains of Local Economic Growth: Race-to-the-Top versus Race-to-the-Bottom Economic Development' *Environment and Planning C: Government and Policy*, 29(3), 428–456.

Q21 In your view, are there any particular tax policies that could increase the risk of tax avoidance or tax evasion activity being routed through a Freeport? **Yes**/No

Q21.i: Please provide details.

It is clear from the consultation document that the government are intending to offer a range of tax incentives within their freeports. It would have been easier to respond to this question if the document had also outlined the precise nature of those proposals. In the absence of that detail, we have no choice but to speculate as to the likely proposals and provide comment on each of these.

Corporation tax – we assume that freeports will either other a reduced or even zero corporation tax rate. The potential problems associated with that are as follows:

- Decreased overall tax receipts as business activity that would have taken place outside the freeport is moved to within the freeport zone
- An unfair tax advantage accruing to those business that can move activity to within the freeport zone compared to those that cannot. This may weaken tax morale overall thereby increasing the already large UK tax gap
- Fostering a race to the bottom mentality in international tax arrangements. The UK is currently trying to reach an international agreement through the BEPS process and in the meantime implementing its own Digital Services Tax. Both of these initiatives are under pressure from the US, and the creation of low (or no) tax freeports will increase the chance of unilateral responses from the US and other countries. The global race to the bottom on tax helps no-one.
- Increased likelihood of abusive transfer pricing activities. If a large corporation has business activities both inside and outside the freeport then it is inevitable that we will we witness a shift of profits to freeports if they offer a favourable corporate tax rate. This problem is compounded by the absence of full registers of beneficial ownership.

Income and National Insurance – it is not clear whether those employed within freeports would enjoy differential income and NIC arrangements. If they did then the opportunities for abuse are rife. In particular, it is inevitable that both corporations and individuals would be complicit in claiming freeport employment status whether or not that was actually the case. In practice, it would create a whole new avenue for individuals to avoid paying tax on income.

Capital gains – existing experience has demonstrated that freeports have enabled transactions to occur that are not declared to the relevant tax authorities. The very nature of these areas has facilitated this form of tax evasion.

Q21.ii: If your answer is yes, then please suggest ways in which the Government could deter or prevent the tax avoidance or evasion risk you have identified.

The only way is not to offer differential tax rates within freeports.

Q22 In your view, would any of the potential tax policies set out in this document unnecessarily increase the administrative burden of business activity in the Freeport? Yes/**No**/Don't know

Q22.i: Please explain your answer.

In light of the fact that the UK experiences at least a £35bn tax gap every year, the regulatory tax burden on UK corporations is, if anything, too low already. The freeports proposals would make that even less.

Q22.ii: If your answer is yes, then please explain which of the tax policies could be modified to reduce administrative requirements and how they could be modified.

Q23 Please provide any other feedback you have relating to tax incentives for Freeports.

Q24 – Q46

No response provided

Preventing illicit activity

Q47 In your view, what is the level of risk of illicit activity in Freeports?

Very high/High/Medium/Low/Very low/None/Don't know

We do not think that the economic case for freeports has yet been made. Therefore, there is no prima facie justification for their creation. Nevertheless, even if an economic case could be made we feel that it would be undone by the significant risk of illicit financial activity that is known to take place in freeports. Our concerns here are based on the global experience of freeports and the analysis of them by a range of international bodies. In a highly critical report of the Luxembourg example, the European Parliament commented "Free ports are conducive to secrecy. In their preferential treatment, they resemble offshore financial centres, offering both high security and discretion and allowing transactions to be made without attracting the attention of regulators and direct tax authorities." Specifically, they noted the risks associated with high-value works of art. We recognize that the government intends to exclude works of art from their freeport plans, but the question remains how would they know whether trade in such works is taking place within the freeports. The European Parliament writes "Proceeds of sales of art or the possession of substitute goods such as art, antiques or jewellery do not fall within the categories for automatic exchange of information between tax authorities under DAC1. As free port operators are not financial institutions, they are not obliged to provide bulk data regarding their clients to tax authorities under the FATCA, CRS or DAC1 and therefore the exchange of such information between tax authorities is likely to be limited…Tax fraud and tax evasion have been considered predicate offences for money laundering since the entry into force of AMLD4 in June 2017. The effects of this remain to be seen as it is almost impossible for a free port operator to establish whether a client who has sold or inherited a piece of 'investment art' should have declared capital gains or inheritance or establish if this client actually did make a declaration to the direct tax authorities in the country of tax residence." (Money Laundering and Tax Evasion Risks in Free Ports, European Parliamentary Research Service, 2018)

In a similar vein, the Financial Action Task Force have written "Because the same characteristics that make FTZs attractive to legitimate business also attract abuse by illicit actors, FTZs are a concern that the Financial Action Task Force (FATF) should address." They continue, "The case studies included in this report illustrate ways in which FTZs are misused for money laundering and terrorist financing. In particular, the cases highlight the following systemic weaknesses that make FTZs vulnerable to abuse:

> •Inadequate anti-money laundering (AML) and combating the financing of terrorism (CFT) safeguards;
> •Relaxed oversight by competent domestic authorities;
> •Weak procedures to inspect goods and register legal entities, including inadequate record-keeping and information technology systems; and
> •Lack of adequate coordination and cooperation between zone and Customs authorities."
> (Money Laundering Vulenerabilities of Free Trade Zones, Financial Action Task Force, 2010)

Q48: What additional measures should be implemented to mitigate such activities?

Do not create freeports

Q49: Please provide any other feedback you have on the issue of preventing illicit activity within Freeports.

The British population are incredibly sensitive to issues of terrorism. If we go ahead with the creation of freeports then it is inevitable that at some point it will be revealed that freeports have been used either as conduits of terrorist financing or even as conduits for illegal arms trades. If the economic case for freeports was overwhelming then some might argue that is a risk worth taking. But the economic case is not overwhelming. As such, whichever government presses ahead with this policy is one whose own reputation could be severely damaged by accusations of facilitating terrorist finance.

Q50 – Q68

No response provided