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5 July 2020

Dear Sir of Madam

Freeport Consultation

We thank you for the opportunity to comment on the government's proposals on the above issue.

This submission is in four parts. First, we provide background information to indicate why we have interest in this issue. Second, we provide some over-arching comments on the proposals made. Third, because as was explained in a Webinar hosted by various government officials on June 23 on this issue the consultation document is both ambitious in scope but also limited in detail in a great many areas, and most especially on tax matters, on which this submission focuses, we have been forced to provide most of our responses to this consultation in the body of this letter and not in response to the questions raised in the consultation document, which do not focus on our main areas of concern. As a result, this covering letter forms the main part of our submission. Fourth, in an appendix we provide a response to some of the detailed questions raised. You will note that we have not responded to most issues. That is either because we do not have relevant expertise, or it is because we do not intend to either operate a freeport or operate from one, or it is because we are not sure that there is sufficient link between the issue and freeports to think the

matter of concern.

We should add that the comments submitted are based on both the consultation document that was issued and comments made by representatives of various government departments and agencies during a webinar on 23 June 2020 on this issue.

Background information

Tax Research LLP runs the Tax Research UK think tank, which is directed by Prof Richard Murphy FCA. Since 2006 Tax Research UK has been extensively engaged in research on a wide range of UK and international tax related issues. Richard Murphy co-founded the Tax Justice Network in 2003 and the Fair Tax Mark in 2013. He was also a co-author of the original Green New Deal in 2008. He created the concept of country-by-country reporting, which was adopted in 2015 by the OECD as a mechanism to tackle international tax abuse. He is widely published on issues relating to tax abuse and the tax gap and co-authored one of the leading books on tax havens and the abuse that they have facilitated. He comments here based on experience obtained from this research and the resulting interactions with regulatory agencies and others on such subjects. Richard Murphy is currently Professor of Practice in International Political Economy, City, University of London.

Summary of submission

This submission details considerable concerns relating to that freeports that the UK government is proposing to create. These concerns relate in particular to:

- The significant money-laundering risks that they will create that are unavoidable without a comprehensive reform of the enforcement processes relating to UK company law;
- The extensive risk of tax avoidance activity because of the uncertainties that freeports will create with regard to a range of taxes including corporation tax, value added tax, income tax and social security;
- The inability of the freeport proposal to address the government's concerns with regard to stamp duty land tax, business rates, research and development credits and other related issues;
- The absence of any apparent economic need for freeports;
- The risk to UK tax morale that they will create;
- The threat to the UK's international tax relationships that they will pose;
- The challenge to the international consensus on ending the harmful race to the bottom in tax matters that they represent.

In our opinion none of these issues can be addressed by modification to the proposal made and as such we suggest that the proposal to create freeports should not be preceded with.

Background observations

The government has suggested in its consultation document that freeports are:

“secure customs zones located at ports where business can be carried out inside a country’s land border, but where different customs rules apply. They can reduce administrative burdens and tariff controls, provide relief from duties and import taxes, and ease tax and planning regulations.”

It has added that:

“The Government is considering a bespoke UK Freeport model which would include multiple customs zones located within or away from a port, to maximise flexibility for port operators and businesses, as well as an SEZ-style zone designated over or around the customs zones, to encourage the maximum number of businesses to open, expand and invest in our Freeports.”

As explanation it is noted that:

“Special Economic Zone (SEZs) ... can include tax incentives for investment within the geographical area of Freeports, regulatory flexibilities, and investment in infrastructure in the area.”

It is these comments that frame the response made here, having taken into account the relevant more detailed observations within the consultation document. In framing that response we note that government officials, speaking on its behalf in a Webinar on 23 June described the wide-ranging scope of the government’s ambition for freeports, and the freedom that the government wishes to provide to them. It was suggested that the consultation document may not be comprehensive as a consequence, most especially because it is light with regard to detail in some areas, including tax. As such we have had to presume in making our response that unless an issue is specifically excluded from consideration in the consultation document that it might be possible within the context of the proposed freeport arrangements and accordingly we address a range of issues not mentioned in that consultation document here.

Having noted this, we also note that the OECD, using language very similar to that in the

consultation document¹, suggested that there are four types of Freeport:

- **Free trade zones**, typically located near seaports or airports, mainly offer exemptions from national import and export duties on goods that are re-exported. Local services gain, though there is little, if any, value added to the goods traded.
- **Export processing zones** go a step further by focusing on exports with a significant value added, rather than only on re-exports.
- **Special economic zones** apply a multisectoral development approach and focus on both domestic and foreign markets. They offer an array of incentives including infrastructure, tax and custom exemptions, and simpler administrative procedures.
- **Industrial zones** are targeted at specific economic activities, say media or textiles, with infrastructure adapted accordingly.

As is apparent from the consultation document, the government is proposing to adopt the most comprehensive and complex form of freeport arrangement i.e. a special economic zone. As most commentators note, these also carry the greatest risk.

The OECD noted in 2010 that²:

"As a general rule, free zones provide regulatory incentives. In many zones, the authorities act as a onestop shop, cutting related red tape and simplifying administrative procedures. Similarly, labour market regulation can be eased. ... Free zones often offer programmes of fiscal incentives that go beyond those offered to investors in the wider economy.

The claimed advantages having been noted the OECD then noted that:

But do free zones actually work? Some investments may have taken place anyway, though the existence of zones does spur governments to develop their investment policies, satisfy investors and promote opportunities for new businesses. They also [can] create job. But take a closer look and it is not hard to see how these zones can end up adding to the fiscal burden of governments, distorting the direction of investments in the wrong areas or creating complacency in extending economy-wide reforms.

They added:

¹ https://oecdobserver.org/news/archivestory.php/aid/3101/Free_zones:_Benefits_and_costs.html

² https://oecdobserver.org/news/archivestory.php/aid/3101/Free_zones:_Benefits_and_costs.html

The zones ... that have performed best over a long period tend to be in countries where the enabling environment is relatively favourable anyway, in terms of macroeconomic and exchange-rate policies, private property and investment laws, labour market regulations, productivity of human capital and rule of law. Incentives and economic zones supplement, but cannot replace, a good enabling environment. Zones should not be seen as a substitute for a country's larger trade and investment reform efforts.

It added to this comment in 2019, saying³:

"There are more than 3,500 free trade zones, often located at key ports, in 130 countries or economies in North and South America, the Asia-Pacific region, Europe and Africa, up from just 79 spread across 25 countries or economies in 1975. The special zones facilitate trade by offering businesses advantageous tariffs and lighter regulation on financing, ownership, labour and immigration, and taxes. They have helped emerging economies to attract foreign investment and generate jobs and growth."

It was, however, again compelled to add a note of significant concern at that time, saying:

"However, the gains from reduced customs presence in FTZs can offer opportunities for illicit trade. There is a risk that, without additional transparency and oversight, the economic benefits from FTZs could be jeopardised. To address this issue, the "[OECD Recommendation of the Council on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones](#)", is designed to ensure transparency in FTZs and is framed as part of the broader effort to counter illicit trade."

The fact that the OECD felt compelled to issue this document suggests that it is of the opinion that the risk in question is significant and systemic. It is hard, in that case, to imagine that the risk would be avoided in the case of freeports in the UK.

The OECD is not alone in having this concern. For example, the Financial Action Task Force has said of freeports, having noted the same broadly similar potential advantages that the OECD and the government do in their documents that⁴:

"Because the same characteristics that make [Free Trade Zones (FTZs)] attractive to legitimate business also attract abuse by illicit actors, FTZs are a concern that the

³ <https://www.oecd.org/governance/risk/recommendation-enhancing-transparency-free-trade-zones.htm>

⁴ <https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

Financial Action Task Force (FATF) should address. 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. “

These concerns are shared by the European Parliament. They carefully defined freeports in a 2018 report saying that⁵:

“It is important to make a distinction between free ports (free zones) and customs warehouses.

Free ports are warehouses, in free zones, that were – originally – intended as spaces to store merchandise in transit. They have latterly become popular for the storage of valuables, including art, precious stones, gold, antiques and wine collections – often on a permanent basis.

The new generation of free ports is tailored to the needs of high-end art collectors. These free ports are equipped with surveillance cameras, climate and humidity control and private showrooms. They have strong rooms and offices for galleries and art lenders where clients can view, buy and sell art, and they provide a wide range of services including transport and logistics. In addition, firms offering art-related services such as restoration, framing and financing set up shop on the grounds.”

Having made this distinction they noted that:

“Free ports are conducive to secrecy. With 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 or direct tax authorities. A value needs to be declared to store goods in a free port or customs warehouse. The value is generally declared by the owner or a representative ('self-declaration') and in most cases is not checked.

⁵ https://www.europarl.europa.eu/cmsdata/155721/EPRS_STUD_627114_Money%20laundering-FINAL.pdf

The goods in free ports or under customs warehousing procedures are technically 'in transit' even though in most free ports of this kind, there are no time limits. This system allows the stored goods to gain value and it allows for tax-free sales. Goods can enter a free port, stay there indefinitely and trade an unlimited number of times without ever having been taxed."

Their concerns are apparent and are consistent with those of the other organisations with experience in this area already noted.

We also note that the World Customs Organisation has long had concern about issues relating to the territoriality of freeports and the threat that they pose to the Kyoto Convention⁶, particularly with regard to who has jurisdiction for what issue within them.

We also note the report from the Financial Transparency Coalition on this issue, published in January 2020 under the title 'Use and Abuse of Tax Breaks: How Tax Incentives Become Harmful'⁷. In this the authors note:

There is no compelling body of evidence that strongly argues for the.. general effectiveness [of tax incentives], and their necessity in the Global South remains highly doubtful. Studies that have shown correlation between tax incentives and investment are true only for OECD countries. And even then, since they are usually offered along with non-tax perks, one cannot completely attribute the cause of investment flows solely to tax incentives.

Since they also show that freeports are rare in OECD countries (just 67 in total) even the conclusion for the OECD in general cannot be extrapolated to the case the UK is making for freeports.

We build on all these background concerns in this submission and believe that they all have validity in the case of the UK government's proposals. This is most especially the case given the lack of detail in the consultation proposal that has been issued. In our opinion that lack of detail when combined with the scope of the government's ambition seriously undermines the validity of this consultation process. We specifically ask the government to address this issue in its response to the submissions that are made.

Money laundering and illicit financial flows

⁶ http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/conventions/pf_revised_kyoto_conv/kyoto_new.aspx

⁷ <https://financialtransparency.org/wp-content/uploads/2020/01/How-Tax-Incentives-Become-Harmful-For-Web-Jan-24.pdf>

As the FATF, amongst other organisations notes, the opacity that freeports provide when combined with the 'light touch' and 'simplified' regulatory regimes that they make available make them hot-spots for organised crime and international money laundering activity. These are not the main focus of our submission, but we do express concern because we think that the UK's freeports will be especially vulnerable to this risk because of the exceptionally lax company regulatory environment within the UK.

We welcome the fact that the government has said in the consultation document that "the Government does not, however, intend to designate Freeports for the purposes of High Value Luxury Storage" (page 30). It is now widely understood that high-value art and other luxury items stored within freeports are readily available mechanisms for the transmission of illicit funds. The government commitment is, therefore, welcome, but there is no indication as to how UK freeport involvement in this activity can actually be prevented. Our particular concern is that whilst the storage of these items will be prohibited UK freeports will, nonetheless, become major conduit locations with regard to such assets and that the particular nature, and lax administration, of UK company law will facilitate this.

In particular we note that the mechanisms used for the facilitation of illicit financial flows relating to such high-value items property are particularly dependent upon the use of anonymous companies as mechanisms for either the ownership of such assets, or (of particular concern here) the layering of such ownership, as defined for money laundering purposes, as well as for the trade in them, which trade is critical to the money flows that such structures disguise. The UK is, at present, a particularly attractive location for the creation of such anonymous companies. There are a number of reasons for this:

1. It is very easy to form companies in the UK: they can be incorporated in less than a day and for well under £100;
2. If incorporation takes place directly with Companies House no proof of identity for money laundering purposes need be supplied by those incorporating the entity;
3. The UK has an exceptional number of companies in proportion to its population, meaning that suspicion rarely arises on incorporation;
4. Although there are more than 4.8 million companies in the UK at present only about 1.5 million of these companies do actually trade as indicated by the number corporation tax returns that indicate trading returned. There is, then, no culture of suspicion within the UK if a company claims to be dormant, whether it actually is or not;
5. Small companies within the UK have no audit requirement, meaning that no third-party verification on its activities ever takes place;
6. More than 400,000 companies a year do, on average, fail to provide legally required documentation to Companies House, either in the form of Confirmation Statements or annual accounts;

7. Research⁸ suggests⁹ a broadly similar failure with regard to the submission of corporation tax returns to HM Revenue & Customs, which authority is also very generous in granting exception to the obligation to make such returns;
8. Whilst there are penalties for failure to make all required returns the reality is that these are very rarely made the personal liability of the director of any company; few prosecutions are made; and the standard response of Companies House to such failure is to strike the company off the Register of Companies. This has the extraordinary consequence of removing any further obligation to comply with company law, including with regard to the submission of details of beneficial ownership, trading and potential tax liabilities.

The consequence of this approach to company and corporation tax law within the UK is that there are few environments more conducive to the creation of what might be described as 'throwaway' companies anywhere in the world, most especially when the very low-cost of such entities in the UK is taken into account.

The risk that these loopholes will be exploited by those seeking to pass the ownership of high value items through UK freeports so that the illicit the money flows relating to them become almost impossible to follow is very high indeed. The fact that the UK will not provide a storage space for those assets is, then, of little concern: what is of concern is that the UK will provide, through the combination of its freeports and readily available throwaway companies, the opportunity for much greater opacity within the illicit financial flows that are already of major concern. Unless UK company regulation is substantially reformed this risk cannot be eliminated. It will always be present in the UK's freeports, meaning they are bound to be used as centres for international corrupt money flows whatever the UK government might suggest.

Tax matters

The potential tax abuse of UK freeports is, however, our main concern. Tax abuse does, of course, represent an illicit financial flow in its own right.

We note that in the consultation document just two tax reliefs used in UK Enterprise Zones are referred to, but then note that the following is said (page 16):

Tax policy can help to stimulate economic growth by increasing investment and creating new jobs and economic activity in the Freeports. Our objective is to promote economic activity by creating an ambitious and attractive tax offer that

⁸ <https://www.taxresearch.org.uk/Documents/500000Final.pdf>

⁹ <http://www.taxresearch.org.uk/Documents/Intheshade.pdf>

makes our Freeports dynamic, innovative and growing hubs of global trade. At the same time, we must minimise the risk of increasing avoidance or evasion activity.

No further elaboration is provided as to what the Government has in mind. As previously noted, we think that this is a weakness in this consultation document. We suggest that a further public consultation take place when specific proposals with regard to freeport taxation are produced.

We also note that this brevity is typical of many of the issues addressed in the consultation document: what is not said is as apparent as what is said. In particular, the limited number of restrictions on permitted activity within the proposed freeports is very notable. The observations we make are as a consequence, in the main, in the body of this letter because the scope of the questions asked does not permit many of the issues that most concern us to be addressed because of this limitation in scope within the consultation document.

The comments that follow do, for the reason noted, presume that some of the commonplace tax incentives associated with Special Economic Zones, which appears to be the model for freeports that the Government is following, may be offered. These tax incentives often include:

- Low or no corporation tax;
- Modified tax bases, such as increased capital allowances;
- Low or no tariffs;
- Light touch value added tax regulation;
- Modified excise duties;
- Reduced income taxes for those employed in freeports or exemptions from usual conditions;
- Modified social security contributions;
- Low or no land taxation.

This submission presumes that some, or all, of these so-called tax incentives might be offered in UK freeports since we have had no option but think this. We raised this concern in a webinar with government officials on June 23 and were advised that the limited guidance was deliberate and that the government would welcome a note of our wide-ranging concerns, to which they then hoped that the government might be able to respond with more detail. We specifically request that response to the comments made in this letter.

We summarise the concerns that we have, as follows:

1. Corporation tax

This is our primary concern in making submission. The areas of risk that we perceive to exist are as follows:

- a. That a differential tax rate might be offered with regard to UK tax. This has already been made possible within Northern Ireland, setting a precedent which it has not, however used because of the legal consequences of doing so whilst within the EU. If differential rates were now to be established in freeports the obvious consequences would be fourfold:
 - First, internal tax competition within the UK would be encouraged, which would be deeply prejudicial to the operation of fair trade within the country;
 - Second, the credibility of the UK tax system would be undermined, with tax morale being reduced and the incentive to both avoid and evade being increased at cost to the overall tax yield of the country;
 - The OECD's requirements on the removal of internal ring fences within the country to eliminate tax competition, laid down in its 1998 report on Harmful Tax Competition¹⁰ would have been breached in contravention to the UK's long-standing commitments on this issue;
 - International tax competition and the universally agreed harmful 'race to the bottom' in international tax rates would have been promoted at cost to international cooperation on this issue;
- b. That transactions will fall outside the scope of UK corporation tax, so reducing the overall yield from this tax, and providing an incentive for tax avoidance by encouraging the relocation of transactions in a way that cannot otherwise be economically justified, in the process removing the essential relationship between the making a profit within UK and the payment of tax in this country that underpins the social contract between the government and taxpayers in this country as well as its general tax morale;
- c. That transactions will be undertaken by entities located within UK freeports whose beneficial ownership cannot be identified, meaning that there is risk that consequent distributions of profits might go untaxed.
- d. Alternatively, there is risk that the information that is required for the purposes of automatic international exchange under the UK's international treaty obligations, including those created under the Organisation for Economic Cooperation and Development's Base Erosion and Profits Shifting programme, will not be available;
- e. That transfer pricing abuse will take place between entities within the rest of the United Kingdom and those located within UK freeports, the beneficial ownership of which may not be identifiable, with consequent cost to the UK Exchequer, and with resulting impact upon the level playing field that is essential for the operation of an

¹⁰ <https://www.oecd.org/tax/harmful/1904176.pdf>

effective free and open marketplace within the UK economy whilst undermining the credibility of the UK tax system as a whole;

- f. That similar transfer pricing abuse may take that place between entities located in UK freeports and entities in other countries with whom the UK has international tax treaty obligations, which the UK will not be able to monitor, control or report upon as a consequence of the 'light touch' regulatory regime within UK freeports, creating international tax stress between the UK and those other countries, whilst undermining efforts to eliminate international tax competition;
- g. That a different tax base for companies operating in freeports will be offered, including by offering enhanced capital allowances, although other options might also be available. This will create perverse incentives for excessive investment within freeports, whilst in all likelihood undermining the prospects of investment in the remainder of the economy, resulting in a disruption to rational decision-making, which should be based upon locating assets where they have best chance of making the most efficient use of capital without distortionary effects being created by the tax system. The consequence is, in effect, a distortion of any known economic model of efficient markets;
- h. That if companies wholly located within the freeport are not considered to be resident within the United Kingdom for corporation tax purposes then they will become stateless for the purposes of that tax, and will in the process recreate the opportunity for tax abuse arrangements once described as the 'Double Irish' but which might now be called the 'Double Middlesbrough' or suchlike, in the process undermining progress made on such issues to date by international tax authorities and those countries that have cooperated with them;
- i. The taxation consequences of investment income flows in the form of dividends out of freeports will not be known, and could add complication into the UK tax system.
- j. If a freeport was used as the location for a digital services operation e.g. a popular social media platform was to locate its fileservers within that area, it may not be possible to apply a digital services tax to that activity;
- k. Given that freeports will be on multiple sites the potential for goods to be smuggled from the freeports, increasing the risk of transfer pricing abuse amongst other issues arising, is high;
- l. Since it is planned that freeports be on multiple sites the chance that enhanced capital allowances will be claimed on assets not used exclusively in freeports will be very high;
- m. We make further observation with regard to transfer pricing risks in answer to detailed questions in the appendix to this letter and in the section regarding VAT below.

2. Tariffs

We accept that the bonded warehouses have permitted short and long term exemptions from tariffs on portside warehousing and related activities within the UK for a considerable period of time. The economic rationale for doing so has been established for a similarly long period of time and we are not seeking to question that. However, in that case the following questions that the consultation document does not address need to be asked:

- a. Why is it not possible to continue, and if necessary, expand the existing tariff and related VAT deferral arrangements? What requires the additional incentive that freeports supposedly offer? The consultation document does not make the case for change: when will it be available for comment?
- b. Will the existing arrangements for tariff deferral apply to freeports? If not, why?

Without this information the proposals on which comment is sought cannot be properly appraised.

3. Value added tax

Value added tax is charged when goods or services cross borders. Those borders may be geographic e.g. when goods or services pass between states. They can also relate to ownership i.e. when title passes from one person or entity to another. VAT can have an interaction in either case, and when the two are related issues the VAT consequences become more complicated.

The only direct reference to VAT within the consultation document is this:

No tariffs, import VAT or excise to be paid on goods brought into a Freeport from overseas until they leave the Freeport and enter the UK's domestic market.

This gives rise to the following concerns that are not addressed within the consultation document:

- a. Is a freeport to be considered a part of the UK for VAT purposes, or not? If not, why not? And where might it be in that case?
- b. Are movements into and out of freeports to be considered imports and exports for VAT purposes?
- c. Are differential VAT rates to be permitted in freeports? If so, why? What will they be? How will they comply with international conventions on tax competition?
- d. Is an entity that only trades within the freeport to be registered for UK VAT? If not, why not? How else is the risk that it might export goods to the rest of the UK to be monitored if it is not compulsorily registered?
- e. If an entity trades both within and outside the freeport (i.e. it has operations in the rest of the UK as well as within the freeport) is one VAT registration to be

- maintained, or two? If one, how are flows into and out of the freeport to be monitored?
- f. If entities operating within the freeport are to be VAT registered is group registration with other entities within the UK, and even within other freeports, to be permitted? If so, why, and how are flows into and out of the freeport to be controlled in that case?
 - g. Is the freeport to be considered part of the UK, or outside it for the purposes of the export of services to it? In the situation that these services are supplied by other entities within the UK under common control to the entity operating within the freeport how are such services to be monitored? How will their export from the UK into the freeport be treated for VAT purposes? How are transfer pricing risks to be appraised?
 - h. If services are supplied from the freeport into the rest of the UK how are they to be treated and taxed? Who will have the liability to make payment? Where will the point of supply be?
 - i. Will the supplies of goods and services between related parties inside and outside the freeport be subject to transfer pricing regulation to ensure that VAT is paid on the appropriate value of goods and services supplied? Who will monitor such arrangements, and how?
 - j. Will distance selling arrangements for VAT apply to operations within the freeport? If so, how will they be monitored?

It will be very difficult to form an objective opinion on the impact of freeports on the operation of UK VAT without knowing an answer to these questions.

4. Income tax

The development of freeports does have an impact upon a number of areas of income tax which cannot be appraised on the basis of the information included in the consultation document because answers to the following questions are not available:

- a. The implication of the consultation document is that few, if any, people will actually live within the area of a freeport. But, presuming that they did, where would they be internationally resident for tax purposes, and would they be subject to UK income tax?
- b. Is the income to be paid to otherwise UK resident persons who will work within freeports to be subject to the same income tax as income from similar sources arising in the rest of the UK? If so, why?
- c. To restate the last question in another way; why is it that it is thought appropriate that tax incentives be provided to capital within the freeport area, but not to labour? Since some argue that the incidence of most UK taxes is upon labour (which is,

admittedly, a claim open to contestation, but is nonetheless widely made). In that case if labour working within the freeport is not offered a reduced tax rate then what is the overall economic advantage of the tax incentives to be provided, since on the basis of this widely made argument any such benefit would have been lost once labour was taxed at a rate consistent with the rest of the UK?

- d. How will investment income emanating from within the freeport be taxed in the rest of the UK? Is any differential to be applied? If so, why? If not, what is the enduring economic benefit that a freeport can deliver, because the tax advantage would appear to have been eliminated at that point?
- e. Are UK taxes to be applied to rents payable within the freeport?

5. Social security

The consultation document hints at the possibility that there may be changes to employer's national insurance liabilities within freeports but does not suggest what they might be. As such the following questions are appropriate:

- a. What changes to employer's national insurance are planned?
- b. What is the rationale for these changes?
- c. Why are these changes to be restricted to employer's liabilities? Why will they not be made available to employees working in the freeport, so increasing its attraction to them?
- d. Will the reduced contribution payable have any impact on the employee e.g. in terms of reduced benefits?
- e. Will the obligation on an employer to also make a contribution to a pension arrangement on behalf of their employees be waived, or will that be continued?
- f. If an employer has employees both within and outside the Freeport what arrangements will be made to ensure that appropriate national insurance charges are applied?
- g. If, as is entirely plausible, an employee might work both within and outside the report for the same employer how will national insurance liabilities be determined? How will potential abuses such arrangements be addressed? Will separate contract of employment be required? If so, how will the national insurance consequences of that be managed?

It will be very difficult to form an objective opinion on the impact of freeports on the operation of UK National insurance without knowing answers to these questions.

6. Land taxes

If, as seems likely, land taxes (business rates) are not to be charged within freeports how are the local authorities who will lose revenue as a result to be compensated? If, as will be necessary if the freeport policy is to be successful in redistributing economic activity within the UK, they are located in areas of high unemployment or lower than average national income, there will be considerable demand on local services supplied by councils in the same areas and those councils will not be able to deliver the services that their communities will require without a guarantee of continuing revenue, some of which will have been lost to the freeport. This issue is not addressed in the consultation document, but effectively shifts the cost of such freeports from central government to local authorities and so onto local communities and consequently needs to be addressed, most especially if there is to be the 'levelling up' that the government suggests will result from this policy.

7. Tax and money laundering administration

The consultation document says nothing about excluding lawyers and accountants from freeports although some excluded activities are mentioned. As a result a number of concerns arise in this area:

- a. Are such firms to be excluded from freeports?
- b. If a supplier of intermediate financial services, such as an accountant or lawyer, was to set up an operation within a freeport would they be subject to UK financial services regulation? If not, why not?
- c. Would such as financial services regulation be administered with a 'light touch' consistent with the stated approach towards regulation as a whole within the freeport area?
- d. Would such firms operating within the freeport need to report to UK tax money laundering authorities as if they were operating within the rest of the UK?

It will be very difficult to form an objective opinion on the impact of freeports on the operation of UK tax and money laundering regulation without knowing an answer to these questions.

8. The regulation of banking

The consultation document says nothing about excluding banks from freeports although some excluded activities are mentioned. As a result a number of concerns arise in this area:

- a. Are banks to be excluded from freeports?
- b. If a bank was to operate from a freeport who would regulate it?
- c. Would that bank be subject to UK money laundering regulation?

- d. Would the bank be subject to the exchange information rules with HM Revenue & Customs that other banks in the UK are?

9. Company law

The creation of freeports in the UK might raise the question as to where the companies that might be incorporated in them (in the sense of having their registered office in such a location) and be resident in them (in the sense of having their locus of control within such a location) are located for international tax purposes. If this is to be the United Kingdom, then those companies must be subject to the whole range of regulation that applies to all other entities incorporated in the rest of the country. So, for example they must be subject to UK corporation tax. In addition, they must be subject to UK company law, and the requirement that they file their accounts on record. Importantly, neither should either of these conditions be waived in the event that the entity in question was registered (i.e. legally formed) in a country other than the UK. If that was to be the case then there would be an obvious incentive to, for example, use tax haven companies for freeport operations. That cannot, we presume, be the intention of the government and as such clarification on these issues is required.

10. EU and international relations

Through our association with the tax justice movement we have concern about international taxation issues and the way in which the UK cooperates on them.

By its very definition a freeport creates international tax competition, which has long been seen to be harmful in the international arena, where cooperation between states is necessary to ensure that each can collect the tax due to it in accordance with its own individual legislative mandate. There is no discussion of this issue in the consultation document, but we wish to make it clear that in our opinion the harm that might be caused to these international relationships, and the potential withdrawal of cooperation with the UK that might arise as a consequence, including the potential blacklisting of the UK as a tax haven by the European Union and other states as a consequence of the provision of preferential tax regimes contrary to the OECD's requirements and the provisions of the EU Code of Conduct on Business Taxation, would appear to impose significantly greater potential cost than any potential benefit that the creation of freeports might create. A full discussion on the true nature of the government's proposal, and its consequences, together with a cost benefit analysis of the resulting implications would appear to be necessary and we would therefore urge that such an appraisal be undertaken, and be published, a long time before any draft legislation is presented to Parliament for consideration.

11. Economic need

We understand that the Government's intention in promoting freeports is to encourage increased economic activity in the UK. It intends to do so by providing incentives through the tax system and by relaxing other regulation.

There is little evidence that freeports have ever achieved this goal for a government. There is quite strong evidence that, at best, freeports relocate activity at cost to a government.

In addition, there is no evidence at all at present within the UK that there is a shortage of capital available for investment purposes. There is, for example, regular and informed comment on the pages of the Financial Times and The Economist on the existence of a savings glut, which savings are not put to use by investors. What is more, that capital is available at incredibly low cost, meaning that the hurdles to be overcome before investment can take place have little, if anything, to do with the cost of finance, which is all that can be influenced by reduced taxation and a reduction in the cost of regulation within freeports. In that case there is very little economic evidence to suggest that freeport creation will address any known economic problem: it would seem that all desired economic activity in the UK is currently being funded at very little capital cost without the assistance of freeport arrangements. The economic rationale for such arrangement is, then, very hard to discern. The government has not stated what they are in the current economic environment. We would very strongly suggest that this be done before any legislation is presented to Parliament so that proper appraisal of the proposal can be made.

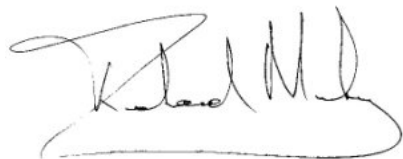
12. Regulatory need

We have one final observation to make. The logic of freeports is that there must be regulatory failings in the UK that requires that they exist. The consultation document does not specify these failings, but if they exist it is logical that the whole country enjoy the benefit of reform rather than just some selected areas. We would therefore suggest the government address this broader issue rather than introduce freeports if they think there are regulatory issues requiring attention.

As previously noted, we attached to this letter an appendix providing detailed answers to all the consultation questions to which we think we have the ability to contribute, but would ask that all the above matters be taken into account as well.

We shall be pleased to provide further information to elaborate the answers provided.

Yours faithfully



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and

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Appendix

Consultation answers

Customs Declarations

Q1 to Q2

No opinion offered.

Freeport operators and Freeport businesses

Q3 To Q6

No opinion offered.

Goods already in the UK

Q7

No opinion offered

Location of Freeports

Q8 What do you see as the advantages and/or disadvantages of an inland Freeport site compared to a Freeport site which is adjacent to a port?

Subject to the comments made more generally in our submission as to the desirability, or otherwise of freeports, we have particular concern with regard to the creation of inland freeports within the UK because inland freeports are usually located near airports. We are most especially concerned that this might encourage the handling of high value items at such locations. There is particular risk in this.

Firstly, this encourages the handling and storage of works or arts within freeports. As has been well documented (see Oddný Helgadóttir, <https://research.cbs.dk/en/publications/case-study-the-art-of-offshore-tax-avoidance-and-unseen-artworks->) freeports are widely used for money laundering, tax evasion and illicit financial flows using artwork as a medium of exchange. In our opinion the UK should not take the risk of becoming a location for such activities. We make further comment on this in our letter, above.

Secondly, even if, as the government has indicated, it is not the intention that the long term storage of works of art within UK freeports will be permitted there remains a considerable risk. This is that UK freeports will become a point of conduit for works of art into and out of other freeports, and will as a result facilitate these illicit financial flows, which it is almost impossible to trace because almost every work of art stored in such locations is owned by an offshore entity whose real beneficial ownership is almost invariably exceptionally hard to prove. We note particular concerns arising because of the lax nature of UK company regulation in our letter, above.

Third, precisely because of the laxness of regulation in such territories, which is a deliberate feature of them, the smuggling of other products, whether they be counterfeit items, illegal products, firearms, or other goods considered harmful to society is much easier through these freeport locations than it is through normal customs channels, and as such freeports considerably increase risk in all these areas. For these reasons we think that the location of freeports inland, or by airports, contrary to the well-being and defence of society in the UK.

Excluded goods and excise goods

Q9 to Q12

No opinion offered.

Trade remedies and countermeasures

Q13 To what extent do you agree or disagree that trade remedies or countermeasures should be applied to goods exiting Freeports, whether or not they are processed in the Freeports? **Strongly agree**/Somewhat agree/Neither agree nor disagree/Somewhat disagree/Strongly disagree

Q13.i: Please explain your answer.

In this context trade remedies and countermeasures refer to the necessary steps required to prevent dumping in the course of protecting domestic industries from the threat of unfair international competition.

As we note elsewhere in this submission, the risk of transfer pricing abuse into UK freeports from other locations without such abuse being challenged because of the light touch regulatory regime of controls to be introduced in freeports means that there is a very high chance of concerted activity arising that would be intended to undermine the operation of free trade within the UK as a whole as a result of the use of that transfer

mispricing to secure a competitive advantage within domestic markets. As also noted elsewhere in this submission, this could only be addressed by the introduction of transfer pricing controls on all goods moving into and out of freeports in the United Kingdom.

It is already well known that many companies from outside the European Union, and most especially from China, have taken advantage of distance selling rules to avoid tax, and most especially VAT, through the use of Internet sales platforms such as Amazon and eBay. The estimated annual loss of revenue resulting from such fraud is estimated to exceed £1.5 billion per annum.

(<https://www.theguardian.com/politics/2017/oct/18/amazon-ebay-profiting-online-vat-hmrc-watchdog>). Fraud on this scale is systemic. It has had significant impact on the well-being of UK-based companies trying to trade from the same platforms, whose domestic sales opportunities have been substantially curtailed as a consequence because of the unfair price competition that this tax abuse has permitted. The unfair competition that freeports might permit that would similarly undermine the prospects of domestically based companies in the United Kingdom may not be of identical style, although the possibility that VAT abuse will take place cannot be precluded. Instead it is likely that direct price competition will take place through transfer pricing abuse taking place into the United Kingdom between related parties in UK freeports and a country of origin. As a result it would be essential the trade remedies and countermeasures be available to counter this threat to the operation of free trade within the United Kingdom, at cost to the domestic economy and those companies that operate within it.

Q14 To what extent do you agree or disagree that trade remedies or countermeasures should be applied to goods exiting Freeports, whether they are destined for consumption in the UK or exported to foreign markets? **Strongly agree/Somewhat agree/Neither agree nor disagree/Somewhat disagree/Strongly disagree**

The threat noted in our response to question 13 applies to all countries that might trade with UK freeports, and not just to the UK economy. If the UK is to be committed to free trade without distortion arising from unfair tax competition then it will have a duty to ensure that trade remedies and countermeasures should be applied to all goods leaving UK freeports whether their destination be in the UK or elsewhere.

General questions

Q15 to Q17

No opinion offered.

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.

As noted in paragraph 11 of our letter, we are not convinced that there is an economic case for freeports in the UK at present. With regard to the particular points raised here we comment as follows:

- a. There is an issue of concern with regard to business rates in England, which are in need of a radical overhaul. However, unless these issues noted in paragraph 6 of our letter are addressed freeports are not the way to deal with this issue;*
- b. In addition, the primary concern with regard to business rates refers to the differential between High Street retailers and online retailers and it is not, therefore, a matter likely to be addressed by freeports;*
- c. The above two points having been noted, a business rate discount is unlikely to provide an incentive for the relocation of businesses into freeport, or to encourage overall levels of economic activity;*
- d. Turning to enhanced capital allowances, the only economic purpose that these serve is to improve the cash flow of a business investing in assets eligible for such claims. Unless a capital allowance rate in excess of the amounts expended (i.e. overall reliefs exceed 100% of the cost incurred) is offered within a freeport the overall rate of capital allowance inside and outside a freeport will be similar, except as to timing. In that case the only factor to be taken into account is the cost of capital to a company investing in a freeport, and as is noted in paragraph 11 of our letter, current costs of capital to those companies likely to invest in freeports are at historically low levels, and are readily available if a business case can be made. As such enhanced capital allowances are unlikely to provide little incentive for relocation of activity to freeports at this time.*

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:

We address these issues as follows:

- a. *If goods arriving in a freeport are, in due course, to be sold into the UK almost no facilitative solution not already available in bonded warehouse and other such facilities is likely to be provided by the freeport, and as such the freeport provides no additional incentive to trade;*
- b. *There are already comprehensive arrangements in place to ensure that goods can transit through the UK without the operation of VAT and excise duties if none are net owing as a consequence of activity in the UK. As such Freeport are unlikely to provide any additional incentives to legitimate international trade flowing through the UK;*
- c. *If there are issues with regard to stamp duty land tax in England and Northern Ireland then they need to be addressed by generic reform to that tax, as has already been addressed, at least in part, within Wales and Scotland. Such reform might reduce the charges on properties of certain types, or leases of particular length, to encourage entrepreneurial risk. Research problems are known to exist then to restrict such reforms to freeports makes no sense: they should be made generally available as part of the government's levelling up programme, an investigation as to how they might be offered on regional basis should be undertaken as a matter of urgency to secure this objective;*
- d. *The real value of research and development tax credits is open to question. Indeed, there is a joke within the UK accountancy profession that more research and development activity has been undertaken by that profession in finding creative ways to make research and development tax credit claims than there has been in any other part of the UK economy. No doubt there will be R & D tax credit claims made from freeports if regulation permits these at higher rates than elsewhere, but whether they will actually result in new technical innovation within the freeport itself or will, instead, represent the relocation of the supposed activity into the freeport from that place where it actually took place will be very hard to determine. The likely real incentive value and impact on the real economy is, therefore, small.*
- e. *With regard to national insurance, please see paragraph 5 of our letter.*

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.

At many academic conferences and in many academic papers over many years the question has been asked as to whether tax determines the location of economic activity. Both research evidence and anecdotal reports suggest that tax is a factor in location decision-making but will rank far below other factors in influencing that process. More important factors are the availability of suitable premises and supported infrastructure; transport links; the availability of suitably skilled staff and the length of supply chains to and from the location. The supporting legal infrastructure is also of the importance on occasion, and the uncertainty that a freeport environment might create is not necessarily advantageous as a consequence. Tax will rarely come above any of those issues when considering this matter.

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.

Please see our covering letter.

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.

Please see our covering letter, and in particular the section on money laundering risk and paragraph 11. We consider tax avoidance and tax evasion to be illicit financial flows equivalent to money-laundering in the context of this answer. As we note in our letter, the risk of such activities arising is considerable, particularly with regard to the use of freeports as conduit locations (equivalent to tax havens) as a consequence of the easy availability of what we have described as throwaway companies in the UK. Without a complete overhaul of the UK's approach to company regulation we can see no way in which this risk can be avoided without cancellation of the freeport programme, which is what we would recommend as a consequence.

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.

The regulatory burden on UK businesses is persistently overstated despite the fact that it is already very light touch, is poorly enforced, and fails to protect many in society, including the creditors and employees of many companies, whilst permitting extensive tax evasion and avoidance activity at cost to society at large. The relaxation of these requirements that is proposed for freeports will only increase that cost to society and cannot be recommended as a consequence.

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.

Please see our many concerns detailed in our covering letter. Our concern is that the difficulties that the Freeport program will create are being seriously misunderstood by the government because the creation of many more boundaries within the UK will impose a considerable cost on society at large and business in particular.

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

Please see our many concerns detailed in our covering letter.

Planning

Permitted development rights

Q24

No opinion offered

Zonal planning

Q25

No opinion offered

National Policy Statement for Ports (NPSP)

Q26

No opinion offered

Additional planning freedoms

Q27

No opinion offered

Regulatory impacts

Q28

No opinion offered

Regeneration

Infrastructure

Q29 to Q31

No opinion offered

Business support

Q32

No opinion offered

Skills

Q33

No opinion offered

Q34

No opinion offered

Housing

Q35 to Q37

No opinion offered

Innovation

Challenge-based initiatives

Q38 to Q39

No opinion offered

Freeports and academic collaboration

Q40

No opinion offered

Regulatory sandboxes

Q41

No opinion offered

Data availability and usability

Q42 to Q43

No opinion offered

Contribution to the decarbonisation agenda

Q44 How could regulatory flexibility within Freeports help businesses to trial and implement new products and processes? [Free text box](#)]

No opinion offered

Q45 How could Freeports be used to test new ideas and support business and industry to decarbonise in line with the UK's Net Zero target? [Free text box](#)

No opinion offered

Q46 Please provide any additional feedback you have on the issue of innovation in Freeport policy not specifically addressed by any of the questions in this section. [Free text box](#)

No opinion offered

Additional policy considerations

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](#)

Please see our many concerns detailed in our covering letter.

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

Please see our many concerns detailed in our covering letter.

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

Please see our many concerns detailed in our covering letter.

Business impacts

Q50

No opinion offered

Equalities impacts

Q51 to Q54

No opinion offered

Q55 Please provide any other feedback on the impacts of the development of Freeports in the UK not specifically addressed by any of the questions in this section.

Please see our many concerns detailed in our covering letter.

Allocation and governance of Freeports in England Port modality

Q56 to Q58

No opinion offered

Objectives and criteria

Q59 to Q60

No opinion offered

Public and private sector partnerships

Q61 to Q65

No opinion offered

Measuring impact

Q66 How can the Government best monitor and evaluate Freeports?

There are two responses to this question:

- *The government cannot monitor freeports appropriately unless it can monitor the cost to society of the tax avoidance and tax evasion that they will facilitate, which at the micro level required has never been shown to be possible. Since any monitoring process that the government puts in places bound to ignore this issue, because it cannot be measured, it will be inherently flawed and as a consequence no effective evaluation of the Freeport process will be undertaken.*
- *More importantly, the questions to be asked are:*
 - *How will the government monitor freeport?*
 - *How will it publish its findings?*
 - *What will it do if the case for freeports is not proven by experience?*
 - *How will they be unwound if that is proven to be desirable?*

Q67 to Q68

No opinion offered