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An Excess Profits Tax[1]

Michael Devereux

Executive Summary

The incoming UK government is committed to publishing a roadmap for business taxation over the new parliament. Amont other things, it aims to replace business rates, although it has not stated how it would replace the considerable foregone revenue. It also aims to boost economic growth, and has pressing demands for additional spending whilst meeting a number of commitments regarding tax and public sector borrowing.

This paper sets out one option available to the new government that could raise substantial revenue whilst not inhibiting economic growth. The additional revenue could be used to beneficially reorganise business taxes generally – such as reducing or replacing business rates or reducing corporation tax – or to support spending needs.

The option set out here is for an Excess Profit Tax (EPT) on businesses selling in UK markets. This differs from the existing corporation tax on profit in two important dimensions. First, it is designed to fall only on excess profit, or economic rent. Second, it is not a tax on the returns from production or more general economic activity taking place in the UK; instead, it would tax the excess profit of businesses selling in the UK, wherever their production or other economic activity takes place.

Theory and evidence suggest that such a tax, widely implemented, would be neutral with respect to business decisions on investment, location and finance. It would therefore not inhibit economic growth.

A number of detailed design choices are available for the implementation of the EPT, which are set out in the paper.

[1] I would like to thank Alan Auerbach and several CBT colleagues for helpful comments on this paper. The views expressed are entirely my own; they do not represent the views of the CBT, which has no corporate views.

1. Introduction

This Policy Paper sets out a potential contribution to business taxation for the incoming Labour government. It is intended to be able to raise considerable tax revenue while not having a negative impact on growth. It is a tax on excess profit earned by companies on sales in the United Kingdom.

The incoming Labour government made several statements in its pre-election manifesto with respect to business taxation.[2] The key elements included the following:

- to publish a roadmap for business taxation for the next parliament;
- to cap the main corporation tax rate at 25 per cent, retain a permanent full expensing system for capital investment (presumably for plant and machinery), and the annual investment allowance for small business;
- to replace the business rates system, raising the same revenue but in a "fairer way"; and
- to close the loopholes in the windfall tax on oil and gas companies.

The manifesto also said that the new government would seek "an enduring partnership with business to deliver the economic growth we need".[3] The need for economic growth was spelt out time and again in the election campaign.

The need to deliver higher economic growth seems to be a key factor as to why the new government will not seek to raise the corporation tax rate, or to eliminate expensing. Academic evidence suggests that both of these factors are important in determining the aggregate level of investment, a key contributor to growth.

Yet it is also clear that the new government would like to significantly increase spending on many areas of public spending. The constraints that it has already imposed on itself limits its opportunities to raise additional tax revenue; and raising revenue in ways that are likely to inhibit economic growth are unlikely to prove a long-term success.

Raising revenue from business rates has few, if any, supporters. For example, the Mirrlees Review said of business rates: "taxing non-domestic property is inefficient, and should not be part of the tax system".[4] But the Labour Party manifesto was silent as to how the approximately £25 billion in revenue collected from business rates could be replaced. HM Treasury's review of business rates in 2021 introduced specific reforms rather than a full replacement.[5] The Treasury went on to consult about the possibility of introducing an online sales tax, but after consultation decided in 2022 not to follow that approach – for convincing

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[2] Labour Party Manifesto, 2024.
[3] Ibid.
[4] James Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James M. Poterba (2011) Tax by Design, Oxford: Oxford University Press.
[5] Business Rates Review: Final Report, HM Treasury, 2021.

reasons.[6] The Mirrlees Review advocated a much wider reform, introducing a Land Value Tax. That is certainly worth considering, but is a much broader reform, and would need to be applied well beyond land and property owned or used by business.

An issue not addressed in the manifesto is the ongoing overhaul of the international tax system for taxing the profit of multinational companies. The UK has committed to introduce the various elements of the OECD's Inclusive Framework "Pillar 2", the Global Minimum Tax (GMT). Although the GMT has taken considerable time and effort to negotiate and deliver, it is unlikely to prove a game-changer in terms of raising considerable additional tax revenue.

The UK is also part of the negotiations to introduce the OECD's "Pillar 1" proposal, which would allocate some rights to tax the profit of multinational companies to the market country – broadly, where sales are made, or where users are. Like many countries the UK has not waited for the Pillar 1 proposal to be implemented, but has instead introduced a digital services tax (DST) as an interim measure.[7] The UK and others have agreed to replace the DST with Pillar 1 when – and if – it is finally agreed at an international level, as well as to give credit for any excess of the DST over what would have been due under Pillar 1. However, as the prospects for international agreement for Pillar 1 seem far off, a more immediate question for the incoming government is therefore whether to keep, reform, or scrap the DST. To the extent that DST is largely paid by foreign-owned multinational companies, it could be interpreted as a form of tariff, rather than a form of income tax. The prospect of a potentially disastrous trade war with the USA looms for the UK and for other countries which operate DSTs. Most clearly, though, the issues facing the incoming government are much larger in scale than the DST. Any tinkering with the DST would produce just a drop in the ocean in terms of the revenue sought by the government.

We therefore turn to considering a much broader alternative: a new excess profit tax. This in some ways builds on both Pillar 1 and the DST in aiming to tax profit earned by companies selling goods and services in the UK. But it aims to do so in a more comprehensive way. The concept of a tax on excess profit also underlies the windfall tax on oil and gas companies.

2. The Fundamentals

The Excess Profit Tax (EPT) is not a new idea, although its implementation in the form proposed here is innovative. There are two key elements of the tax: that the tax is levied only on excess profit (or economic rent), and that it is levied on a destination basis.

[6] Online Sales Tax: Response to the Consultation, 2022, HM Treasury.

[7] The UK's version of the DST was introduced in 2020 and is set at 2% of the UK revenue of in-scope digital activities of multinational companies, with a minimum threshold of £500m for total revenue and £25m of UK revenue. Around 90% of DST revenues for 2020-21 were provided by five business groups.

Note that the proposal is for the EPT to operate alongside the existing corporation tax (and its related elements, such as the GMT). It is intended to be an additional tax: there would be no credit of the EPT against corporation tax, for example.[8]

Basics

For the purposes of this paper, we define "excess profit" to be synonymous with economic rent – that is, profit made by a business over and above that which would be required to keep it in business. Economists usually assume that businesses aim to maximise economic rent. If this is the case, it follows that any tax that falls on only on economic rent would not affect decision as to whether, or how much to invest. Business choices that maximise pre-tax economic rent would be the same as those that maximise post-tax economic rent. This has long been recognised, and as a result a tax on economic rent has been proposed on numerous occasions, for example, by the Meade Committee in 1978.[9] The Meade Committee described in some detail how a tax based on the cash flows of the business would – in net present value terms – fall only on economic rent. The EPT is based on one of these approaches – the "R-base" – in which net cash flows arising from real (but not financial) activity would be taxed in each period.

But even a tax on economic rent might affect the international location of business. If a business chooses between locations for its activities where the tax regimes are different, then even taxes on economic rent can affect those location choices. The key difference of the proposed EPT compared to the Meade Committee approach is that the tax would be levied in the market country – that is, where the business makes sales to third party customers. This variation of the proposal has also been advocated as a destination-based cash flow tax (DBCFT); for a detailed analysis, see the Oxford International Group's book, Taxing Profit in the Global Economy, Devereux et al (2021).[10]

There are several rationales for levying the tax in the market country. The key factor is that the location of a third-party customer should be considerably less likely to respond to the tax. Businesses can change the location of their production, finance, marketing and management, but they cannot easily change the location of their customers. That implies that the location of the business real activities should be much less affected by the tax. Combined with the fact

[8] Except possibly in the case of a loss, as discussed below.
[9] Meade Committee (1978) The Structure and Reform of Direct Taxation, report of a committee chaired by Professor J.E. Meade, London: George Allen & Unwin.
[10] Devereux, Michael P., Alan J. Auerbach, Michael Keen, Paul Oosterhuis, Wolfgang Schön, and John Vella, 2021, "Taxing Profit in a Global Economy", Oxford University Press; see especially Chapter 7. The original proposal dates back to Bond and Devereux (2002) "Cash flow taxes in an open economy", *Centre for Economic Policy Research Discussion Paper Series,* Discussion Paper 3401. A theoretical analysis is provided by Alan Auerbach and Michael Devereux (2018) "Consumption and cash-flow taxes in an international setting", *American Economic Journal: Economic Policy* 10.3, 69-94. It was proposed also by the President's Advisory Panel on Federal Tax Reform (2005) "Simple, fair and pro-growth: Proposals to Fix America's Tax System", and by the Ways and Means Committee of the House of Representatives (2016), "A Better Way Forward: Our Vision for a Confident America".

that the tax base is economic rent, this implies that the tax would be neutral with respect to business investment, location and financial decisions: as such it would not be an impediment to growth.

Properties of a broad-based EPT

Devereux et al (2021) sets out a thorough analysis of the DBCFT. These properties are shared with the EPT – except where noted below – and the analysis will not be repeated in detail here. However, the basics of the tax are as follows. The tax base would be UK sales less UK expenses – all calculated on a cash flow basis. Relative to a conventional source-based tax, this implies that exports would not be taxed, but that imports would be taxed. This "border adjustment" is exactly the same mechanism as used successfully for VAT, which is also levied on a destination basis; the option of using VAT as an implementation mechanism for the EPT is discussed below.

The economic attributes of a full EPT, applying to all businesses in the UK, are well understood, and set out in Devereux et al (2021) – Section 4 considers the implications of applying the EPT to only a subset of all businesses. In the case of full implementation, the key to understanding the economic implications is to recognise that introducing such a destination-based tax in the UK would induce an appreciation of the sterling exchange rate.[11] This offsets distortions that would otherwise occur. For example, for imports into the UK from another country, the tax on imports would be offset by this currency appreciation. As a consequence there would be no effect either on the incentive of foreign businesses to export to the UK, nor on the incentive for UK purchasers to purchase from home or abroad. Equally, while UK exporters would gain from the zero tax on exports, the resulting incentive to export would be exactly offset by the appreciation of the currency. As a result, if introduced on a broad basis, the EPT would be neutral with respect to business decisions.

If the EPT were to replace the existing source-based corporation tax, then that would create an incentive to locate in the UK – but that effect would result from the abolition of corporation tax, rather than the introduction of the EPT. However, the intention here is that the EPT is introduced at a low rate in addition to corporation tax. If introduced on a broad scale, then this would not affect the incentive to locate in the UK. The EPT would therefore not be prone to competition with other countries for inward investment.

The appreciation of sterling would affect the effective incidence of the tax. Since nominal prices and wages would be unaffected, workers would not be affected by the tax. The rise in the exchange rate would also leave non-UK residents unaffected. Consequently, those consumers making purchases in the UK from economic rent would bear the tax burden. This

[11] Suppose that a country introduces an EPT/DBCFT. Goods and services that are produced domestically but exported would receive the benefit of a tax deduction for costs, but the income from sales would not be taxed. This would create a stimulus to exports. By contrast, the domestic cost of imports would increase, discouraging imports. Both of these effects would result in an increase in demand for the domestic currency – this would cause the domestic currency to appreciate on world markets. The appreciation would continue until its effects exactly offset the initial impacts of the tax.

suggests that the EPT would be a progressive tax, since the ownership of businesses is highly skewed towards the better off.

The EPT would not be subject to the same problems of avoidance as the existing system.[12] As demonstrated in Devereux et al (2021), the three main sources of international corporation tax avoidance are all absent for the EPT. There would be no incentive for a business to manipulate the prices at which it imports into the UK. As with VAT, a lower transfer price would induce a lower tax on the import, but this would be offset exactly by a higher tax on the eventual sale of the product. Since there is no deduction for interest payments, lending to the UK from a subsidiary in a low tax country would not affect the UK tax liability. The payment of a royalty to a subsidiary in a low tax country would receive a deduction, but that would be exactly matched by the tax on the value of the IP imported.

Financial Services

The basic EPT as described would levy little, if any, tax on the economic rent of banks and other financial service businesses that trade in financial, as opposed to real, flows. That is because the base of the tax excludes financial flows. There are a number of options available for introducing an equivalent tax on such businesses.

The most theoretically pure tax would be to use a base for such companies that is based on real and financial flows, as opposed to just real flows. This tax base was initially proposed by the Meade Committee (1978) and is extensively examined in Devereux et al (2021). One factor in considering such businesses is that any transaction between two in-scope businesses essentially net out for tax purposes. Suppose, for example, that A sells a product or financial service to B. Then A would be subject to the EPT, but B would receive a deduction. If both businesses are subject to the same rate, the net tax effect is zero. In considering an additional element of the EPT to apply to financial businesses, this implies that such a tax would only be necessary with respect to transactions between the financial business and entities that are not subject to the EPT.[13]

Of course, a more ad hoc approach could also be used. For example, the bank tax surcharge introduced from 2016 could simply be extended as an approximation of the EPT to apply to businesses covered by the surcharge. The tax base lacks the border adjustment element of the EPT, but this approach would have the merit of easy implementation.

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[12] These issues are set out in more detail in Alan Auerbach, Michael Devereux, Michael Keen and John Vella, 2017, "International Tax Planning under the Destination-Based Cash Flow Tax", *National Tax Journal* 70.4, 783-802; and Michael Devereux and John Vella "Gaming Destination Based Cash Flow Taxes", 2018, *Tax Law Review*, 71.3, 477-514.

[13] This approach was first proposed with respect to VAT by Harry Huizinga (2002) "A European VAT on financial services", *Economic Policy* 17, 498-534.

Digital Services

The UK's DST (and the OECD's Pillar 1) aims to implement a tax in a slightly different location to VAT. Instead of being based on where a paying customer is located, it is based on where the user of a digital service is located. That is the DST charge in principle applies to the revenue received by a business in, say, Ireland, when that business receives a payment from a business in, say, France, as long as the payment reflects the provision of a service – such as an ad – that appears on the screen of a user in the UK. To the extent that an EPT might be thought of as a replacement for a DST, then the EPT could conceivably also be based on this principle, at least for digital services. However, such "revenue sourcing" rules would significantly complicate the tax. They would have the advantage of broadening the base which would depend on the relatively immobile location of the user. However, to the extent that the purchasing company aims eventually to make a sale of a good or service to a UK resident, then EPT would eventually be levied on that purchase, even if it were based on where payments are made.

Losses

One feature of the EPT, as with all taxes relating to profit, is the treatment of losses.[14] Theoretically, the tax would be neutral with respect to business decisions only if the system is symmetric: that is losses are rebated in the same way that profits are taxed. That is not generally a feature of corporation tax systems, where losses are typically required to be carried forward to set against future profits, without compensation for the time delay.

There are two options for EPT "losses", however. First, note that the EPT tax base would be negative if the firms makes less than economic rent; this is not the same as a conventional accounting measure of a loss. While noting that, one approach would be to sacrifice some element of neutrality to avoid making rebates for losses but requiring them to be carried forward. A second would be to take advantage of the fact that the EPT would run alongside the existing corporation tax regime; this allows the possibility that an EPT-loss could be credited against a positive corporation tax liability, in effect proving an immediate rebate for the EPT-loss.

Legal Issues

The EPT raises issues for two sets of international obligations: tax treaties, and commitments under the World Trade Organisation.

For the former, a key issue is whether the EPT would come within scope of tax treaties – which depends on whether it is regarded as a tax on income. Unfortunately, the OECD Model Tax

[14] Although it should be noted that the problem of losses can be more severe for a destination-based tax on economic rent. This is especially so for businesses that have domestic expenses but export their final product, which may have a permanent domestic taxable loss.

Treaty is unclear as to what is meant by a tax in income.[15] In practice, the scope of tax treaties is left to the countries entering into the treaty concerned in any particular case. If the EPT did fall within the scope of the treaty, then it would be in violation of a number of typical provisions. This may mean that the treaty partner may not be obliged to give a credit for the EPT. However, that would also be the outcome if the EPT were not regarded as subject to treaties. And since the EPT is designed as tax over and above other taxes – such as corporation tax – the lack of such a credit is not significant for its economic effects (although it would mean that the business – rather than foreign government – would bear the direct cost).

It is also possible that the EPT could be inconsistent with WTO rules.[16] WTO rules expressly permit the border adjustment of a VAT. However, it has been argued that a DBCFT – and by implication an EPT – implemented in the style of a corporation tax, rather than as a VAT (see below for further discussion on this point) – would not be compliant. The argument is that the labour costs of a domestically-produced good are implicitly deducted in the EPT tax base, where the same is not true of foreign-produced goods. (Neither is deductible under a VAT). This makes no sense in economic terms: the tax treatment of domestic labour is the choice of the domestic government. It is perfectly within WTO rules for a government to tax labour income as it sees fit, and the fact this may be affected by the EPT has no economic consequence. Since a VAT is also consistent with WTO rules, this implies that an EPT based on raising the rate of VAT and making a corresponding reduction in payroll taxes (such as National Insurance) – as discussed in the next section - should be WTO-compliant.

3. Implementation Issues

The tax base for the EPT is similar to that of the existing corporation tax. However, there are three key differences. First, all expenditure, whatever its nature, would be immediately expensed. This is already true for the bulk of expenditure under the corporation tax, but some assets are still subject to capital allowance rates at less than 100%. Second, there would be no relief for interest payments. Third, the border adjustment – taxing imports and excluding exports – would need to be added to corporation tax.

As hinted above, this tax base is also very similar to the VAT tax base. VAT already has all of these three features – immediate expensing, no relief for interest payments, and the border adjustment.[17] The key difference between the EPT and VAT is that the EPT would also deduct

[15] See Richard Collier and Michael Devereux "The Border-Adjusted Tax and Tax Treaties", *Tax Notes*, 2018, December.

[16] See, for example Wolfgang Schön (2016) Schön (2016) "Destination-Based Income Taxation and WTO Law: A Note. In: H. Jochum et al. Practical Problems in European and International Tax Law - Essays in Honour of Manfred Mössner, Amsterdam: IBFD, 429-451; although others have argued the case for it being inconsistent is not conclusive, for example, Alice Pirlot, (2019) "Don't blame it on WTO law: An analysis of the alleged WTO law incompatibility of Destination-Based Taxes", *Florida Tax Review*, 23.1.

[17] Note that this treatment has applied to digital services since 2015.

the costs of labour, while these are not deductible for VAT. (This is why VAT is a tax on "value added", as opposed to "economic rent").

It follows that there are two routes to implementing the EPT. One would be to create a new tax, probably mimicking the collection mechanism of the corporation tax, but with the adjustments set out above. Since exports and imports are already recorded for VAT purposes, the additional implementation costs for making the border adjustment should be relatively small.[18] The other adjustments should also be straightforward.

The second route would be to use the VAT collection mechanism. Specifically, the EPT could in principle be implemented by raising the VAT rate and making a corresponding reduction on the tax levied on payroll costs. For example, a 1 percentage point rise in the VAT rate (preferably on all goods and services, though there may be political problems in doing so, meaning that only the main rate would be raised), and a 1 percentage point reduction in employer's national insurance contributions would amount (very approximately – see some caveats in Section 4) to an EPT levied at a rate of 1%.

The choice between these two approaches (or possibly a hybrid) should depend on administrative, legal, and possibly political issues. The administrative issues primarily concern costs of collection – for the government and for business. The legal issues relate to the discussion above as to whether one form of implementation is more in line with international trade and tax law than the other. Political issues include commitments already made by the new government such as not raising the rate of VAT; introducing an EPT is quite different from simply raising the rate of VAT, but that case would need to be made.

4. Scope, and Issues Arising

A key issue in developing an EPT is whether it would be intended to be a general tax on excess profit arising in the UK economy, or whether it would be focussed only on large businesses. There is no reason in principle why the EPT could not apply across all businesses. However, political acceptability of the tax may require it to be focused on a relatively small number of businesses. One possibility, for example, would be to limit the scope of the EPT to multinational businesses that are already in scope for the GMT: that is businesses with consolidated revenues of at least €750 million p.a..

An alternative approach would be to apply the EPT broadly, but – largely for administrative reasons – exclude relatively small companies. There is a very skewed distribution of businesses in the UK. For example, according to BEIS (2020)[19], of nearly 6 million businesses in the UK, only around 250,000 have at least 10 employees, and these account for nearly 80% of

[18] Although they would be much larger if the tax were based on the location of users, like the DST.
[19] Department of Business, Energy and Industrial Strategy (2020) "Business Population Estimates for the UK and the Regions", 2020.

aggregate turnover. So there would certainly be administrative gains to leaving domestic small firms outside the scope of the EPT.

There are four main considerations in this choice. First is clearly the ambition of the government in introducing the tax in terms of revenue. Limiting the tax to the very largest companies would diminish its potential to raise revenue. Second, and offsetting this, administrative costs of collection are likely to be lower the smaller the number of tax payers. However, offsetting this is the need to identify which foreign businesses are liable to a charge on their exports to the UK. The third and fourth factors are avoidance and economic efficiency, which we discuss in turn.

Avoidance

Applying the EPT to only a relatively small group of businesses would raise some technical issues of implementation.

Consider a transaction between an out-of-scope business, X, and an in-scope business, Y. Suppose, for example, that X sells an intermediate product to Y. From Y's perspective the cost of that purchase is a real cost and should be deductible for Y's EPT calculation. If X were in-scope there would be a corresponding tax on X's sale, and these two tax effects would net to zero. This is exactly what happens in the VAT system if both businesses are VAT-registered; it is also what happens under corporation tax (assuming that both businesses pay corporation tax).

But in this case, this netting of the tax would not occur, since X is out-of-scope. Under normal VAT treatment, since X does not charge VAT on the sale to Y, then there is no input VAT for Y to deduct against the tax levied on Y's output. Applying this in the EPT setting, with relief for labour costs as well, the net outcome would be that Y's EPT tax base would be, in effect, greater than economic rent. Instead of permitting this, it would be natural to allow a deduction for Y on the purchase from X, as would naturally arise under a corporation tax setting.

The importance of this point depends on whether the corporation tax or VAT route is chosen. It also depends on the scale of businesses that are out of scope of EPT. If, for example, all VAT-registered firms were treated as in-scope for EPT, then this problem would be relatively minor and could be largely ignored (as it effectively is under VAT). At the other extreme, if the EPT applies only to a small number of companies, then – at least under the VAT approach – care would need to be taken to allow purchases from out-of-scope businesses to be deductible.

A further problem arises that does not depend on whether or not implementation is through the VAT system or not. That concerns the treatment of imports and exports. As a general principle, the EPT should tax the value of imports and not tax exports.

Now suppose that Y asks X to import intermediate goods on Y's behalf, and sell them on to Y. Since X is out-of-scope, there would be no EPT charge on the import. Assuming, however, that

Y did receive a deduction for the cost of the purchase from X, the tax on the import would be avoided.

A similar problem arises with respect to exports. In this case, suppose that X redirects its exports via Y. X is not liable to EPT in any case, and so is not affected. But if Y receives a deduction on the purchase from X, and then exports, then overall Y would see a reduction in its tax.

The importance of these two avoidance opportunities depends on the cut-off point for deciding whether a business is within scope of the tax. The lower the cut-off point, the less problematic these factors would be; a very large company would still need a relatively large partner company to engage in such avoidance practices with. However, if there remained a significant incentive for such avoidance, then there would probably be a need for some form of tracing rules, or other anti-avoidance rules, to guard against such practices.

Economic Efficiency

A further issue in the choice of the scope of the EPT is in its neutrality properties. The analysis above claimed that the EPT would be neutral with respect to location and investment decisions. This is true as long the EPT is relatively widely applied. As noted above, the key to these neutrality properties is that the tax would induce an appreciation of the exchange rate. At the extreme, if all imports are taxed, and all exports untaxed, then theory suggests such an appreciation will take place.

However, if the tax applies only to a relatively small subset of the economy, then it is unlikely that a full appreciation of the exchange rate would take place. This has consequences for business decisions.

For example, in the absence of an exchange rate appreciation, the absence of tax on exports would create an incentive for UK businesses to raise exports. This should not directly affect their incentive to supply the home UK market. However, depending on the nature of their business, it is possible that some business with fixed capacity would aim to substitute exports for domestic sales.

Also, without any offsetting affect of a currency appreciation, the tax on imports would bite on foreign producers exporting to the UK. The tax would then no longer be neutral with respect to investment abroad for sales into the UK market. In that case, multinationals may respond by attempting to pass some of the tax on in higher prices – though the extent to which they would be able to do so would be limited to the extent that there were competing with purely UK operations. Also, though, this would favour UK producers over foreign producers in the UK market, since the former would receive EPT relief on their costs, while the latter would not. It would therefore also give an incentive for those supplying the UK market to produce in the UK. Arguably, this would provide a double benefit to the UK – not only would it generate additional revenue, it would also make the UK more attractive for real economic activity (although at the expense of neutrality). Note though, that this would probably strengthen the case that the EPT would not be WTO-compliant.

Another implication is for the effective incidence of the tax, which in the absence of the currency appreciation would be borne by shareholders, wherever they reside, as opposed to only UK residents.

5. Revenue Estimates

The likely revenue from introducing an EPT in the UK is uncertain. The best way of estimating the effects would be to combine tax return data from corporation tax, income tax and VAT on a business-by-business basis. That would enable an estimate – based on historic data – to be computed, taking into account the main features of the EPT. However, that would be a time-consuming exercise which has not yet been carried out. Revenue collected would also depend on a number of detailed design choices – for example, the scope of the tax and the treatment of the financial sector and of losses.

However, a back-of-the-envelope calculation can be made to give a very rough idea of the likely scale of the tax. That approach takes the second implementation strategy above, based on VAT. As noted there, an approximation of the EPT base is value added (roughly the base of VAT) less labour costs (roughly the base for Employer's National Insurance).

The Institute for Fiscal Studies offers a number of helpful ready-reckoners for tax reforms on its "Be the Chancellor" website. Specifically, that website shows that a 1 percentage point rise in the main rate of VAT would raise £10.1 billion p.a.. Since that would fall both on economic rent and labour costs, it needs to be offset by a reduction in the tax on labour costs. Approximating this by the reduction in revenue from a 1 percentage point reduction in the rate of Employers' National Insurance, the latter has a cost of £4.9 billion p.a.. The net gain in revenue from both of these measures is therefore slightly over £5 billion p.a.. An EPT at, say, 5% could in principle therefore raise something of the order of £25 billion p.a..[20]

Of course, such an estimate must come with considerable caveats. For example:

- It assumes that all VAT-registered businesses would become liable to EPT. The further the scope of the tax is reduced, the lower the potential revenue gains.
- It ignores the fact that the main rate of VAT does not apply to financial services; applying the EPT to financial services would rise additional revenue.
- It considers only a rise in the main rate of VAT; if the EPT were applied to all goods and services, this would further extend the tax base and raise further revenue.
- Employers' NI applies only to income for each employee over £9,100 p.a. Extending the relief for labour costs to include this income would reduce overall tax revenue.

[20] A rough sanity check on these numbers can be provided by consideration of corporation tax receipts. The corporation tax base differs from the EPT in a number of ways, notably in the border adjustment, but can provide a very rough check. In 20022/23, the main corporation tax rate was 19%, and revenues were around £71 billion, implying revenue of a little under £4 billion per percentage point. This revenue per percentage point falls a little in 2023/4.

There is therefore some uncertainty over the precise total revenue likely to be raised by an EPT – which depends on part of the details of how it is introduced. More detailed calculations could, of course, be carried out in order to produce more precise estimates. However, these simple calculations do suggest that the incoming government has scope to raise a considerable sum in additional revenue. The use of that revenue is, of course, a political decision. Within the context of the reform of business taxation, it could be used to move the system away from business rates, as announced in the manifesto, or to reduce the corporation tax rate, leaving total taxes on business relatively unaffected.