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THE UK is losing out on up to £10 billion a year in taxes and a further £10 billion in wealth through private sector GDP spending and investment extracted and spent elsewhere in the EU, thanks to the perfectly legal abuse of the EU *Freedom of Establishment*. This is a core freedom of the Single Market that multinationals and the governments of smaller EU Member States – notably the Republic of Ireland and Luxembourg – are exploiting to their mutual benefit, and to the extreme detriment of other member states including the UK. This is one 'freedom' of the Single Market that the UK would be far better off without.

Single Market outflows hidden within the UK's total outflow of £115bn

The UK has an overall annual outflow of money of £114.8 billion per annum – the recorded balance of payments deficit, if the trend set of a £28.7 billion deficit for the period April-June 2016 is annualised (*Source: The Office of National Statistics*). This is a disastrous annual outflow and only possible due to a continuing build-up of borrowing, at government, business and private level in the UK.

This outflow is more than double the recorded outflow on Goods and Services. The UK's global trade deficit on Goods and Services, according to Trading Economics, was £4.7 billion in August 2016, or £56.4 billion annualised.

That global trade deficit approximates to 2.7% of UK GDP ($2.9 trillion, or £2.07 trillion at a 1.40 exchange rate), for the Full Year 2015 (*Source – World Bank*).

The UK's global trade deficit is slightly lower than the UK's trade deficit with the rest of the EU. The Office of National Statistics' figures for the

UK's trade deficit with the rest of the EU for 2014 were frequently quoted during the Referendum debate:

Category	**Amount - £ billions**	**Amount - EUR billions**
Goods	(77.0)	(96.3)
Services	+15.4	+19.3
Total	*(61.6)*	*(77.0)*

Single Market outflows estimated at the difference between Trade Deficit and Balance of Payments Deficit – £58.4 billion

The difference between the global Trade Deficit and the Balance of Payments Deficit is £58.4 billion. The hypothesis of this paper is that this figure equates to the UK sales of multinationals out of their bases elsewhere in the EU and is untaxed here, costing the UK £20 billion in lost tax and investment per annum.

Recording of these outflows in official figures

The nature of these outflows is such that they hover around the horizon of visibility in official Trade and Balance of Payments figures, partly above it as Goods and Services, partly below it as royalties and nebulous intercompany charges paid between different parts of the same multinational group.

For UK tax purposes it is irrelevant whether the flows derive from visible goods and services or invisible royalty payments and intercompany cost allocations. Either way the business models of these multinationals enable them to pay next-to-no Corporation Tax in the UK, and to run supply chains that involve low-value jobs in the UK, which deliver very little tax revenue for the UK compared to the cost of providing public services for those same UK workers.

Whether the flows appear in the trade figures or just in the Balance of Payments figures (or indeed in neither) is not the vital point at issue here: the vital point is how big the flows are, and secondly what the implications of these money flows are for UK taxation and for the funding of UK public services.

Plausibility of £58.4 billion being the outflows caused by EU "tax-efficient" structures

We can justify £58.4 billion as a ballpark figure by analyzing a small sample of 14 multinational companies (Fig 1, below) who have their European headquarters in one of the smaller EU Member States:

- Knowing that they are running a tax-efficient business model (not least because they have made presentations about it at Payments industry conferences); and
- Estimating the size of their UK sales.

To this last point, we can safely assume that the relationship of the company's UK sales to its global sales is not less than the relationship between the size of the UK economy and the size of the global economy. UK GDP in 2015 was 3.84% of global GDP (*Source: World Bank*).

FIGURE 1.

Company	Global Sales in $ billions	UK sales %	UK sales in $ billions	UK sales in £ billions
Cisco	49.2	6.84%	3.4	2.4
Symantec	1.5	6.84%	0.1	0.1
Google	75.4	6.84%	5.1	3.6
eBay	87.6	6.84%	6.0	4.3
Facebook	17.9	6.84%	1.2	0.9
LinkedIn	3.0	6.84%	0.2	0.1
Dell	58.1	6.84%	4.0	2.8
Hewlett Packard	56.4	6.84%	3.9	2.8
Yahoo	5.0	6.84%	0.3	0.2
Starbucks	16.5	6.84%	1.1	0.8
Twitter	2.2	6.84%	0.2	0.1
Amazon	107.0	6.84%	7.3	5.2
Microsoft	93.6	6.84%	6.4	4.6
Apple	233.7	6.84%	16.0	11.4
Totals	*806.1*		*55.2*	*39.3*

Notes:
- eBay figure is Q4 2015 Gross Merchandise volume x 4
- Dell figures are for the full year to 30/1/15: it is a private company and does not have to publish figures unless it applies to list specific securities on a US exchange
- Hewlett Packard figures are Q4 2015 revenues annualised

We can even make an uplift to cater for the UK market size for the goods and services involved being greater than the UK's share of global GDP, on the premise that the UK is an advanced economy, with a high level of education, public infrastructure and IT literacy, and thus punches-above-its-weight in terms of its demand level for these goods and services.

We can set that uplift at 3% and assume that the multinational companies derive 6.84% of their global sales from the UK. We can confirm the global sales figures as all these companies have to file 10K returns to the US Securities & Exchange Commission at one point or another, even if their shares are not listed.

Then, using an exchange rate of 1.40 for £/$ and the 6.84% ratio of UK sales/global sales, we can derive the UK sales that these multinationals are making from their European bases:

With 67% of the total derived from just 14 companies – what is the market total?

Applying the methodology to these 14 names leads to a figure of £39.3 billion of UK-derived revenues booked in European bases, 67% of the putative total of £58.4 billion. It is therefore quite plausible that the many other companies running such business models would be booking the remaining 33% or £19.1 billion. The basic Wikipedia listing of companies in Ireland shows another 32 multinationals with a base there in the IT sector alone.

One should add those into the mix, and other multinationals in Ireland in other business sectors, as well as all the multinationals across all business sectors using Luxembourg and the Netherlands as their European bases. Surely it is realistic, if our subset of 14 multinationals delivers a "missing UK GDP figure" of £39.3 billion per annum, that the entirety of the rest of the marketplace could be booking another £19.1 billion, if not more.

How and why is this money going out of the UK?

The money is flowing out because multinationals are, perfectly legally, exploiting the *Freedom of Establishment* to trade in the Single Market, and doing so out of companies incorporated in EU Member States with favourable tax regimes.

Three ‘business models’ are fairly common for how multinationals arrange this:

1. Direct sales of products over the internet, frequently from the Republic of Ireland;
2. A UK salesforce acting “on behalf of” its sister company – the European centre of a major internet company, also often in the Republic of Ireland – to sell advertising space, data, customer behaviour analysis etc., all of which is delivered through the centre in Ireland; and,
3. A UK company using the brand of its sister company – such as the European centre of a major internet company in Luxembourg – to generate sales, the fulfilment of which is organised by the Luxembourg company.

In each case the business relationships between the related companies are in the main for usage of intellectual property: that part of the business generates no movement of goods. Nor does the performance necessarily qualify as a “service”. This is the type of category that can fall below the horizon of the Office of National Statistics’ Trade and Balance of Payments figures.

There are other models that have more substance to them; for example a Starbucks-style business model involves cafes and coffee, an Apple-style business model involves shops and physical IT equipment. Nevertheless both of these also involve extensive usage of brands and licences, as well as large volumes of sales between one group company and another, such that many of the principles used to good effect in the substance-lite business models of software and advertising can also be applied to the substance-heavier business models of catering and IT hardware/devices.

Invisible outflow of money, not captured in any statistics

The substance-lite business models involve no shipments of goods, and money flows relate the usage of intellectual property as much to performance of services. Payment need involve no cross-border transfer of cash through a payments clearing system either:

- Accounts for receiving money from UK customers can be held in the UK, in GBP, either as a non-resident account or in the form of an account operated by the UK company but “on behalf of” the Ireland/Luxembourg company;

- Card-based sales to UK residents – which would be in GBP – would be switched through the Visa or Mastercard network and credited to a UK-domiciled GBP account;
- Frequently an American bank is used for holding these accounts, one that has operations in UK, Ireland, Luxembourg etc., so it can switch the money cross-border between accounts held in its branches via entries on its computer, not needing to make payments via CHAPS or SWIFT;
- All the same a bank deposit balance in the UK is reduced, and a bank deposit in Ireland or Luxembourg is increased;
- Since there is no statistical reporting of cross-border payments to the Bank of England, these movements of money will be invisible when they occur – but they deplete the total of bank deposits in UK banks and should therefore appear in the Balance of Payments figures.

Low-value work done in the UK; high-value work done abroad

The nature of the work done in the UK is important because all of the original - putatively missing - £58.4 billion starts off in the UK in the pockets or bank accounts of UK citizens or businesses. Then all of it leaves the UK and very little of it – the minimum possible for the multinational to fulfil its business here – comes back to be spent here.

The figures used are based on assumptions that are clearly stated, in order to provide a comprehensible illustration.

Many of these multinational businesses run on a very high gross profit margin: let's express that as a Cost-to-Income ratio of 30%. In other words, every incremental £1 of UK sales only requires 30p of cost to be expended to fulfil it (i.e. to create the goods, to deliver them, to download a copy of the software…).

That ratio, applied to £58.4 billion of revenues, results in:

- £17.5 billion of costs (30%)
- £40.9 billion of Profits before Interest and Tax (70%)

Where are the costs spent?

- The minority in the large EU Member States like the UK, where low- or medium-level jobs exist, and where the mass of the customers for the goods/service are based;

- The majority in the host EU Member State of the European centre;
- We can therefore posit that 33% of the costs are incurred in the UK, and 66% offshore;
- That means just £5.8 billion (33% of 30% of revenues) is spent in the UK, and £11.7 billion (66% of 30% of revenues) is spent offshore.

Thus, of the available revenues of £58.4 billion deriving from the UK, only £5.8 billion comes back into the UK economy, whereas 66% of costs (£11.7 billion) and all the profits (£40.9 billion) – totalling £52.6 billion and 90% of the original revenues – are attributable elsewhere.

In other words only 10% of the £58.4 billion that was originally drawn out of the UK's economic product comes back into it.

UK Corporation Tax payable – what's that?

The typical profile of the individual UK subsidiary within such a business model is:

- The income of the company is steered towards equating to the tax-deductible costs of the company
- UK Profit = zero
- UK Corporation Tax at 19% = 0 x 19% = 0

UK staff costs and Employer National Insurance contributions

At an aggregate level this segment – UK subsidiaries acting on behalf of their European bases – will have the following characteristics regarding operating costs, staff costs and payroll taxes (such as Employer National Insurance contributions) based on the above segment-level assumptions:

- UK operating costs are taken to be 33% of total operating costs and thus to amount to £5.8 billion;
- The costs include the remuneration of low- or medium-level staff;
- Staff costs are taken to be 30% of total UK costs, and are therefore £1.75 billion;
- Payroll taxes accrue in an amount of £176 million; and,
- This cost and all other operating costs are tax-deductible for the employer.

Plausibility of the UK staff costs and resultant National Insurance contributions

We need to test the plausibility of a £1.75 billion staff costs bill and a £176 million bill for payroll taxes. This latter figure is based on each individual being paid £12,000, an amount selected because it is the approximate wage level at which the Employer and Employee National Insurance bills amount to £1,000 per annum and at which there is small surplus – subject to income tax – of the worker's wages over their Personal Allowance:

Payroll tax	Threshold	Wages	Subject to tax	Tax rate	Tax
Employer NI	£8,112	£12,000	£3,888	13.8%	£536
Employee NI	£8,060	£12,000	£3,940	12%	£473
Income Tax	£11,000	£12,000	£1,000	20%	£200
UK Direct tax-take per worker					£1,209
Employee take-home pay					£11,327
Total UK direct tax-take in terms of payroll taxes					£176 million
UK Direct tax-take as percentage of staff costs					10%

A £1.75 billion wages bill divided by £12,000 per staff member would work out to 146,000 employees in the UK, a figure which would comprise the entire UK staff of all the in-scope companies with European bases in Ireland, Luxembourg and the Netherlands, plus the UK employees of any third-party companies that are used to fulfil the business of these companies – such as the drivers employed by UPS and Fedex and needed here to fulfil Amazon's UK business. These people would not be on Amazon's payroll, but their jobs would not exist if Amazon did not exist.

In fact, judging from the UK business model adopted by Uber (who have a European base in Ireland), those workers might not be on the payroll of UPS or Fedex either, but be self-employed. In those cases the UK would not even be getting the Employer's National Insurance on their wages and the UK tax-take would be even lower.

Is a figure of 146,000 UK-based workers realistic for fulfilling the UK business models of the entirety of multinationals using an offshore European base, and is the total staff cost of £1.75 billion for those workers believable?

Trading Economics have stated the number of people in work in the UK in June 2016 as 30.6 million, across an economy that is 42% public sector and 58% private sector. The 58% are assumed to be discharging 100% of GDP i.e. 17.75 million workers, because the private sector generates the revenues out of which the public sector costs are met.

146,000 workers is 0.8% of that figure of 17.75 million, posited to be doing the local fulfilment work on revenue streams equating to 2.8% of UK GDP, but in business models where the high-value work has been stripped out to be done offshore. Business models carried out completely onshore for 2.8% of GDP would be expected to employ 2.8% of private sector workers as a median. Here we are looking at a minimalist onshore workforce of 28% of that median, where we have assumed that UK-based costs would be 33% of total costs. There is a 5% difference between the figures arrived at by these separate calculations. That is a tolerable margin of error and so we are within our rights to conclude that the figure of 146,000 workers is "in the ballpark".

The true figures, were they to be available, could be more akin to:

- More workers but not necessarily earning the imagined £12,000 per annum;
- Many Minimum Wage jobs at £6.70/hour, but not for the 48 hours a week averaged over 17 weeks which is the maximum hours under the Working Time Directive;
- Significant numbers of part-time workers, possibly on zero-hours contracts;
- A significant incidence of self-employed workers effectively on lower than the Minimum Wage per hour;
- Lower tax-take on Employer National Insurance in consequence; and,
- Almost no tax-take on Employee National Insurance and Income tax because few individual worker's wages exceed the annual thresholds.

Business models enabled by EU Member State domestic tax law – and by pushing the envelope

These business models rely on other, usually small, EU Member States exploiting their freedom to create a beneficial domestic tax regime along the lines of "I'd rather have 6% of something than 100% of nothing", as well as on companies' freedom to incorporate there, and lastly, on a seemingly inexhaustible supply of low-skill and cheap labour to carry out the fulfilment work over here.

The customary elements in the tax regime of the EU Member State hosting the European base are:

- A mainstream corporation tax rate that is low compared to those of the EU Member States with large populations and a large welfare bill;
- Specific localities which benefit from particular regimes such as, in the past, the Dublin Docks Financial Services Centre or the Shannon Airport Zone, the latter having been home to a predecessor enterprise of Ryanair called Guinness Peat Aviation, founded by Tony Ryan;
- Accelerated depreciation schedules for certain asset classes, allowing lower taxable profits – 66% of the world's commercial aircraft fleet is nominally owned in the Republic of Ireland in consequence of that country's depreciation schedule for aircraft;
- Special treatment for categories of revenue such as royalties on intellectual property;
- An asymmetric treatment of the revenues that can be said to derive from specific costs e.g. for revenues received as a result of Research and Development carried out in that country. Revenues are taxed at or near to 0% if they can be connected to that R&D, even if the revenue so sheltered is a major multiple of the original R&D spend;
- Network of Double Taxation Treaties with non-EU Member States; and,
- Exploitation of the vital distinction in international tax law between (i) there being no tax Corporation Tax at all in that country; (ii) categories of revenue being tax-exempt in that country; and (iii) categories of revenue being taxed at a rate of 0% in that country.

Who is in the frame?

EU Member States that do not have a large population and or a large welfare bill, such that the addition of high-value jobs is sufficient to keep the lights on.

There is no serious attempt to tax the company's profits, but instead to see the establishment of a large European centre with many graduate-level jobs in it for locals, as well as numerous expatriates. That throws off payroll taxes and expenditure in the local economy, and a few such large centres can make a big difference to a small country.

We are talking about Ireland and Luxembourg in the front rank, followed by the Netherlands, and with all three being assisted by Switzerland in the various "sandwich" constructions.

Three business models

Here we have simplified versions of the three 'business models' that are fairly common:

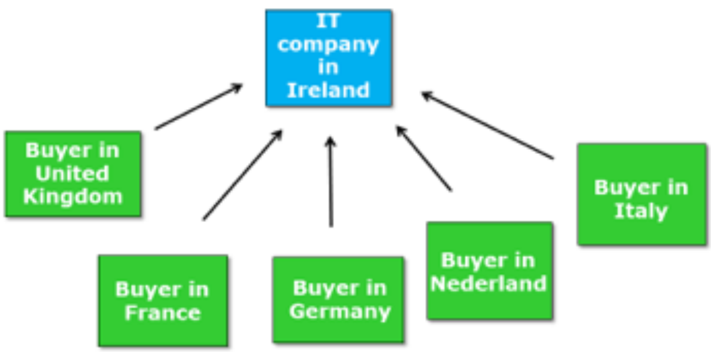
1. Direct sales of products over the internet: based on Norton Anti-Virus;
2. A UK salesforce acting "on behalf of" its sister company to sell advertising space, data, customer behaviour analysis etc, all of which is delivered through the centre in Ireland: based on Google; and,
3. A UK company using the brand of its sister company in Luxembourg to generate sales, the fulfilment of which is organised by the Luxembourg company: based on eBay.

Model 1: Direct sales of products over the internet

The software is advertised and sold on the internet. The owner of the source code vests a master licence for it in a company in the Republic of Ireland, which sells user licences to consumers throughout the EU from there.

All invoices would be headed "SoftwareCo Ireland" and have Irish VAT added in the case of a buyer who could not quote a VAT registration number of a different EU Member State.

Sales proceeds flow directly into accounts held by SoftwareCo Ireland at an American bank, in its branches or established through a mirror account structure at the bank's partner institutions (which is convenient for short-circuiting local Anti-Money Laundering procedures). The buyers are making their payments directly to SoftwareCo Ireland, wherever its accounts are held, and even if there are no cross-border payments into Ireland:

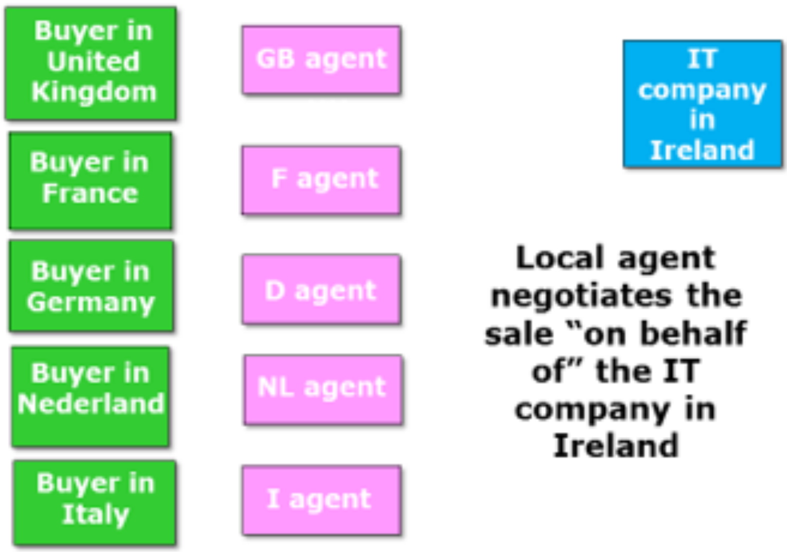


SoftwareCo Ireland would add up all its sales and costs, calculate its profits and pay 12.5% of them to the Irish revenue authorities, unless it could attribute some of the revenues to R&D carried out in Ireland, in which case a lower tax rate would apply.

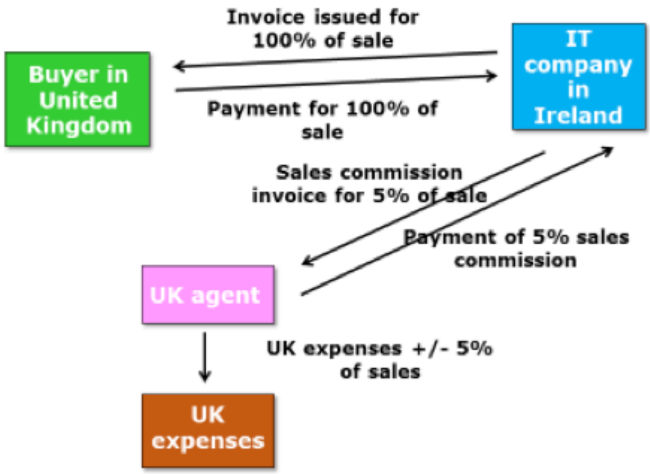
All the "added value" is being done in Ireland; there are no other legal entities in other EU Member States. SoftwareCo is operating 100% legally in the context of the set-up of the EU. While the UK is in the EU, there can be no UK tax imposed on such a structure.

"Commissionaire Sales Model" within the same company as Model 1

However, where the service requires a face-to-face sale or a software implementation locally, the common structure is the so-called "Commissionaire Sales Model". In this case the SoftwareCo has a subsidiary in each Member State that acts to sell, install and support its suite of products for business users:



When a sale is made by the agent to a local buyer, the invoice for the sale is issued by the Irish company as the principal, the owner of the product.



The buyer pays the invoice with a payment into a bank account opened by the Irish company, either in its own name or by the local agent acting "on its behalf".

Economics of the "Commissionaire Sales Model"

The agent is working on commission, a sales commission just like a person selling door-to-door under the Avon Cosmetics model.

If the commission is 5% of the face value of the invoice, 95% of the value remains as gross profit on the books of Ireland, to be taxed after deduction of any other expenses Ireland has.

5% is the sales income of the UK agent, and this pattern is replicated across all the other EU Member States.

If 5% is the sales income of the agent, the expenses of the agent (office, salaries, cars, phones..) miraculously turn out to be 4.99%. This leaves only 0.01% of the aggregate value of invoices as taxable profit in the other EU Member States, where the corporation tax rates can be expected to range from 20-30%.

How HMRC could challenge this version of the "Commissionaire Sales Model"

In consequence the UK is fully taxing the UK profits of this enterprise and could, while the UK is in the EU, only challenge the structure if the sales commission were considered to be too low e.g. if there were comparable structures in place but where the agent was a genuine third-party, appointed on competitive and arm's-length terms, and the market-standard commission rate was 10% or more.

Then the Inland Revenue could send the agent a supplementary Corporation Tax demand and ask the company to challenge that if they wished to.

Model 2: A UK salesforce acting "on behalf of" its sister company to sell advertising space, data etc.

This model is again the "Commissionaire Sales Model", but where the service always requires a face-to-face sale, and it usually goes hand-in-hand with a much larger office in the UK to make sales to a bigger audience. The UK "agent" is selling services like banner advertising on behalf of a search engine company based in Ireland, and so the place of delivery of the service sold is Ireland. Ireland pays a sales commission to the UK which is a percentage of the value of the sale.

This structure depends upon the contention that it is the service that contains most of the value, not the selling of it. Based on that contention, the sales commission can be kept low, such that the vast majority of the value of the sale comes to rest in the Irish company. If, on top of that, the capability being sold can be proven to have had R&D expended upon it in Ireland, the tax on that element of profit is below the 12½% mainstream rate.

How HMRC could challenge this version of the "Commissionaire Sales Model"

The only doubt against this model is that there is a well-developed industry rate card for advertising costs and commissions.

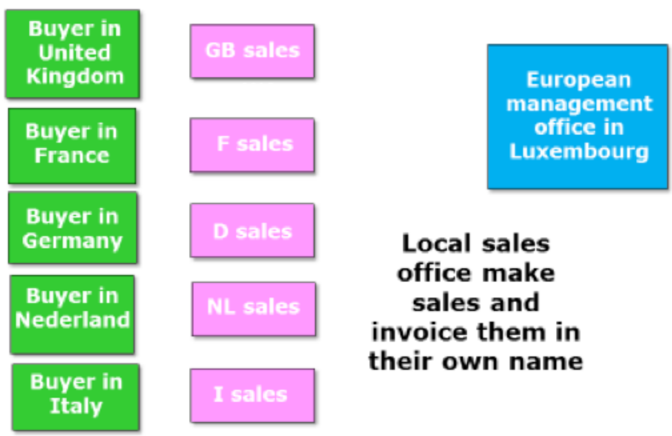
If this rate card indicated a 15% commission rate and the Irish company was only paying its in-house agent 7.5%, the Inland Revenue could challenge the tax return of the UK company on the basis that its dealings with its own sister company had not been conducted on “arm’s-length” terms: the terms upon which two unrelated businesses would have dealt with one another for the performance of the same services.

If HMRC determined that the revenues were set at too low a level in the shape of a shortfall of 7.5%, HMRC could send the UK agent a supplementary Corporation Tax demand for 19% of 7.5% of UK invoices on the basis that the UK company should have received commission at 15% and not 7.5%.

Model 3: a UK company using the brand of its sister company in Luxembourg to generate sales, the fulfilment of which is organised by the Luxembourg company

In this example the UK sales offices is selling advertising space on a website using branding materials, upon which the European headquarters company owns the licence. The UK company is also collecting sales proceeds for sales made on the site, and paying Luxembourg for the fulfilment of the sales (invoicing, tracking, warehousing, despatch, delivery of goods, accounting, reporting, cash management etc).

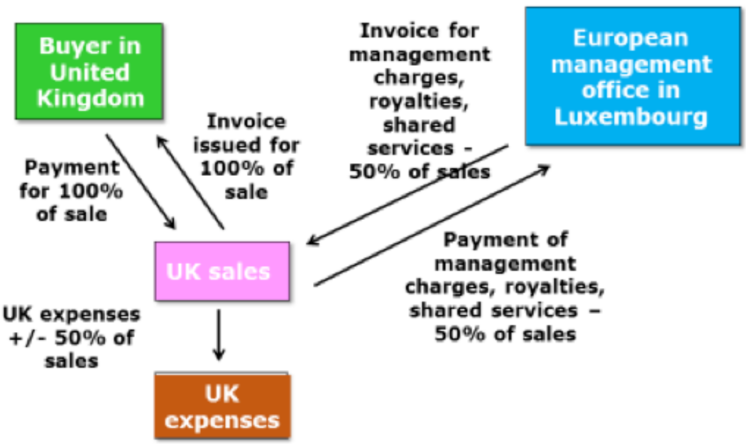
The critical difference between this model and Numbers 1 and 2 is that, in this one, the UK buyer is directly invoiced by the UK subsidiary, and then the UK subsidiary is subject to several lines of charge-back by the European headquarters company:



The European headquarters company construes the usage of the branding materials as meriting a standing royalty payment from each sales subsidiary. It also construes the right conferred on the sales subsidiary to sell advertising space on the European's site as meriting a royalty payment, such that each sales invoice sent to a customer by a sales subsidiary triggers a royalty invoice payable by the same sales subsidiary to Luxembourg.

In addition to the royalty payments, the European Management entity will send further invoices for:

- Fulfilment of sales;
- Management services; and,
- Provision of shared services such as R&D, advertising and marketing



All these invoices will be tax-deductible in the P&L accounts of the local companies, and taxable in Luxembourg's (that is, if there were a payment of any substance due).

The UK activities of this company are assumed to have a greater physical element so its Cost-to-Income ratio is 50% rather than 30%. Since it is itself invoicing its customers, that would leave 50% of sales proceeds as its profit, if nothing else were done.

In order to extract this 50%, the European headquarters generates streams of invoices on the UK company, for royalties and for services rendered. It is still in principle obliged to determine the pricing in its invoices to its sister companies on an “arm’s-length” basis, fairly reflecting the prices at which the sister companies could have contracted the same services from unrelated companies.

Royalties as against services rendered

But here the royalty element demonstrates its value. Royalty payments are notoriously nebulous, because it can be very difficult to identify a precise equivalent to the product or service to which the royalty pertains: for example, Nestle have a global royalty stream from their manufacturing subsidiaries for the usage of the recipe for the condiment mix called Maggi which, thankfully, has no common equivalent.

The tendency in this model is to pad out the royalty payment element, and reduce the payment-for-services element, but still have the two add up to 50% of sales.

How HMRC could challenge this model

The danger for the company in this model is where Luxembourg charges its sister companies for services that they could buy themselves, in their own country, in local currency, and at wages related to the their local cost-of-living rather than the cost-of-living in Luxembourg, which is notoriously high.

In these cases it is possible both to make a direct price comparison, and also to make a high-level sense check:

- What are the average wages in the country of the European headquarters?
- What type of work is it that the European headquarters is doing for the UK and how do the UK wages of a person suitably qualified to do that work compare to the UK average wage – higher or lower?
- Apply the same wage inflator/deflator to Luxembourg average wages, and divide that into what Luxembourg is charging to work out how many Luxembourg-based Full-Time Equivalent staff of the correct level of qualifications equate to the charges paid by the UK sister company for the services concerned;

- How large a building is the European headquarters, and how many actually people work there?
- How many other sister companies are serviced from there by the staff in the building?
- Is it plausible that Luxembourg really is employing the correct number of suitably qualified people indicated by the size of their charges, or are they over-invoicing?
- If the resources to do the work are available in the UK and cheaper, why are the Directors of the UK company not discharging their duty to get the best deal for the company of which they are a Director, and buying the services here?

Why aren't the UK directors concerned about the UK subsidiary's performance?

But the UK directors in these circumstances frequently appear unmotivated to shop around for the best deal, and seem surprisingly relaxed about the elimination of their company's taxable profit.

By the looks of the UK profit-and-loss accounts of these companies, the UK is not a very interesting market at all for their goods/services: the UK is delivering a zero profit. Surely either a new salesforce should be brought in to shake the bushes and get some more sales in and at higher prices, or else the group would be better off investing its money elsewhere.

As it is, the typical Profit and Loss account of the UK operation follows the generic model:

- Revenues are expended (in this case) 50/50 on local costs and charges from the European headquarters
- Profit before Interest and Tax is 0
- Corporation Tax is 19% x 0 = 0

The European headquarters likewise has a minimal local tax liability. Nevertheless no changes are made to UK management in order to improve this abysmal local performance, no doubt because UK management are remunerated under an EU-level bonus scheme, behind which the results are very positive indeed. "Positive" means expanding EU revenues and making the maximum percentage of those revenues available to the owners, i.e. booked in Luxembourg and then made available to the shareholders of the Luxembourg company, without regard to profits at a national level.

This is what is meant by a “tax-efficient” business model.

What is the UK’s tax take out of all this?

100% of sales are derived from UK wealth, but the contribution back into the costs of the infrastructure needed to create a market for the company’s products and services, and to pay for the related social costs, are just:

- 13.8% Employer National Insurance, Employee income tax and National Insurance, all subject to thresholds;
- Indirect taxes of perhaps as low as £278 million, calculated at 5% of UK operating costs less all payroll taxes.

Since it is the low-wage jobs that are being created in the UK, the income tax and National Insurance thresholds will kick in in many cases and reduce the UK direct tax-take from each job to perhaps as little as £1,200 – that is compared to the average cost of providing UK public services of approximately £10,500 per capita per annum.

If, on top of all of this, the workforce within the UK supply chain is partially self-employed, the UK’s tax take on Employer National Insurance will fall away. Engaging drivers on a self-employed basis was recently shown to be core to the business model of Uber.

Impact on the UK of this exploitation of the EU Single Market

All of the above procedures are having a devastating impact on UK wealth.

In our putative but plausible model £58.4 billion per annum of UK wealth is going out of the UK, £5.8 billion is coming back. That £5.8 billion is creating low-wage jobs that give very little tax-take to HMRC.

Some 66% of the costs of these businesses and all the profits are being attributed to *other EU Member States* – to pay salaries, deliver social taxes, and add to the Retained Earnings of major multinationals – that is £52.6 billion per annum.

Post-Brexit Policy and Finance Models

Since the current, detrimental situation is enabled by the EU Single Market, the UK's exit from the EU presents a golden opportunity to put a stop to these practices. The UK's policy stance in the Brexit negotiations on this issue must start from the following premises:

- If multinationals want to take a slice of UK wealth they must do it from a UK base;
- If their UK business requires high-value jobs to run it, those jobs must be based in the UK;
- If their UK business requires there to be a customer base that is well educated and IT literate, the multinational needs to make a reasonable contribution to the costs of furnishing them with such a customer base;
- If their business requires there to be modern and developed physical infrastructure in place in the UK, the multinational needs to make a reasonable contribution to the costs of that as well.

This is demonstrably not the case now: the UK bears all the infrastructure, educational and social welfare costs and gets the low-value jobs with very low tax returns, while other EU Member States get the high-value jobs and a far larger tax-take.

Instead our model post-Brexit, expressed in £billions, must be made to look more like this:

Category	Now	Future	Difference
Revenues	58.4	58.4	0
Cost-to-income ratio	30%	30%	0
UK-incurred costs	5.8	17.5	+11.7
Salary costs – in future 50% of costs, on higher value jobs	1.8	8.7	+6.9
NI & payroll taxes on salaries – in future 20% of salary costs	0.2	1.7	+1.5
Other costs spent in the UK	3.8	7.1	+3.3
Total of money spent in the UK net of payroll taxes	5.6	15.8	+10.2
Indirect taxes on total money spent in the UK @average 5%	0.3	0.8	+0.5
Company's Profit before Interest and Tax	40.9	40.9	0
Corporation Tax @0% now, @19% in future	0.0	7.8	+7.8
Profit attributable to business owners	40.9	33.1	-7.8
Direct tax take for the UK (payroll & corporation)	0.2	9.5	+9.3
Indirect tax take for the UK	0.3	0.8	+0.5
Total tax take for the UK	0.5	10.3	+9.8

The main impacts would be:

1. More and better paid jobs in the UK;
   - Meaning higher payroll taxes; resulting in,
   - Private sector spending and investment on wages and other costs up by £10.2 billion from £5.6 billion to £15.8 billion;
2. ...Leading to more indirect taxes in the UK;
   - estimated to increase by £522 million, from £278 million to £800 million; and,
3. ...Leading to more direct taxes in the UK;
   - estimated to increase £9.32 billion from £176 million to £9.5 billion; a total tax take of £10.3 billion, and,
4. …To that wealth being recycled around the UK rather than siphoned off into other EU Member States and then, through their bilateral tax treaties with non-EU Member States, into Netherlands Antilles and other tax havens.
5. To summarise:
   - An increase in total of private sector money spent or invested in the UK of £10.2 billion;
   - An increase of indirect UK tax-take by £522 million;
   - An increase of direct UK tax-take by £9.32 billion; and,
   - A <u>combined</u> increase in tax-take by £9.85 billion.

No-brainer

The UK's future trade relationship with other EU Member States needs to put a stop to this drain which can be valued at around £10 billion a year in lost taxes and another £10 billion in private sector money spent or invested elsewhere that should add to our GDP. The extra taxes received, taken together with the cessation of our cash contributions into the EU Budget of another £10 billion net per annum, would reduce our annual public spending deficit by 33%: it is currently £60 billion per annum and could be cut to £40 billion. This really is a no-brainer. We cannot afford to remain either as part of the EU, or associated to the structure of the Single Market in its current form, when these are the impacts.

Bob Lyddon 5 December 2016

Summary of
The UK's lost GDP and tax revenues

How Single Market tax dodges
cost the UK £10bn a year and make us all the poorer

- Up to £10 billion per annum in taxes and another £10 billion per annum in private sector spending and investment are disappearing out of the UK thanks to a perfectly legal abuse of the *Freedom of Establishment* within the EU Single Market;
- Multinationals are working in tandem with the governments of the smaller EU Member States – such as Ireland and Luxembourg – to book their UK sales revenues into European bases in those countries, so as to pay next-to-no-Corporation Tax here;
- The high-value jobs and the majority of the spending goes to the Member State where the European base is located, while the UK supply chains are staffed mostly with low-skilled, low-wage labour;
- Those Member States have constructed aggressive tax regimes to attract multinationals, whose business models major on nebulous royalty and intercompany charging, and on construing their UK operation as being an agent, acting "on behalf of" their European base to sells its goods and services;
- The UK operation then receives a sales commission under the so-called "Commissionaire Sales Model", as if they were selling cosmetics door-to-door;
- 90% of sales revenues land in the European base; 10% come back to the UK to pay for the UK supply chain, and what does that supply chain cost? Miraculously the same amount as the UK agent's revenues, eliminating any UK profit and corporation tax;
- While we are in the Single Market the UK can do nothing to oppose this, apart from examine the detail of the intercompany relationships between the European base and its UK agent;
- But it is plausible that the entire difference between our already-bad Trade Deficit of £56.4 billion and our disastrous Balance of Payments deficit of £114.8 billion is disappearing out of the door in this way;
- That is £58.4 billion per annum being conduited out to be taxed

and spent elsewhere in the EU, while we are left with an estimated 146,000 jobs that each yield approximately £1,200 in payroll taxes per annum or £175 million in total, and perhaps another £278 million in indirect taxes on the money spent here: these taxes come nowhere close to paying for the public services for the workers involved;

- There is a clear case here for leaving the Single Market, and onshoring the revenues and cost base of these businesses back into the UK: that would involve more jobs, higher-value jobs, far higher payroll taxes, more money spent by the businesses and employees in the UK, and higher indirect taxes;
- The same business models that have been assessed as yielding only £500 million in UK taxes now and £5.6 billion in spending, could in future yield £10.3 billion in taxes and £15.8 billion in spending – increases of approximately £10 billion each in taxes and GDP spending; and,
- The taxes equate to 17% of the UK's public spending deficit of £60 billion and the same amount as our annual net cash contributions into the EU of £10bn – so that when we leave the EU we can cut the deficit by 33% straight away. This argument against the Single Market is a real no-brainer.

About the author...

Bob Lyddon

Bob Lyddon is an experienced management consultant both privately and with PwC. Recent engagements include running an international banking alliance, advising small payment providers how to access UK payment systems, and advising a major player in global payments as to the opportunities and threats arising from the establishment the UK's Payment Systems Regulator.

With PwC Bob managed several Euro implementation programmes. Prior to that, he had a diverse 17-year career in international banking, encompassing Transaction Banking, syndicated loans, export finance and derivatives.

Bob holds a First Class degree in Modern Languages from the University of Cambridge.

THE BREXIT PAPERS

Global Britain was founded twenty years ago to provide the positive business case for the UK to leave the European Union and published a wealth of research briefs and papers to that end.

Now that the argument for an outward-facing, sovereign, democratic UK has been won Global Britain is committed to ensuring that our politicians do not betray the 17.4 million that voted for it.

The Brexit Papers is a series of detailed essays designed to ask questions and provoke debate about the policies and strategies required to ensure the UK enjoys as optimal and clean a Brexit as possible. In this, the third, Bob Lyddon exposes the failure of it Payments regulations, which the UK needs to escape.

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Why our financial services need a clean Brexit
Only leaving the Single Market can deliver greater opportunity for UK financial services

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