The UK's International Tax Competitiveness 2023 Update

By Tom Clougherty

- The UK ranks 30th out of 38 OECD countries in the 2023 edition of the International Tax Competitiveness Index, published annually by the US-based Tax Foundation. This is down three places from 2022.
- The UK ranks second for its cross-border tax rules, but comes 26th for individual taxes, 28th for corporate tax, and 35th for both consumption and property taxes.
- The most significant change since last year is in the corporate tax category: the UK has fallen 17 places, largely as a result of raising the headline corporation tax rate from 19% to 25%.
- Looking ahead, things will get even worse if the temporary 'full expensing' policy for investment in plant and machinery is allowed to expire. This would drop Britain to 31st place in the corporate category, and to 33rd place overall.
- By contrast, the rumoured abolition of inheritance tax would push Britain up to 26th place in the property taxes category, and to 28th place overall.
- This briefing outlines a revenue-neutral package of reforms that would catapult the UK to 3rd place in the tax competitiveness rankings, behind only Estonia and Latvia.
- That illustrative reform package – which consists of a complete overhaul of VAT, corporation tax, and all the UK's property taxes, as well as lower taxes on earnings and dividends – would be profoundly pro-growth.
- While a 'big bang' reform of this nature is not politically possible now, we could seek to move gradually and incrementally in such a direction by reforming and rebalancing the tax system over time.

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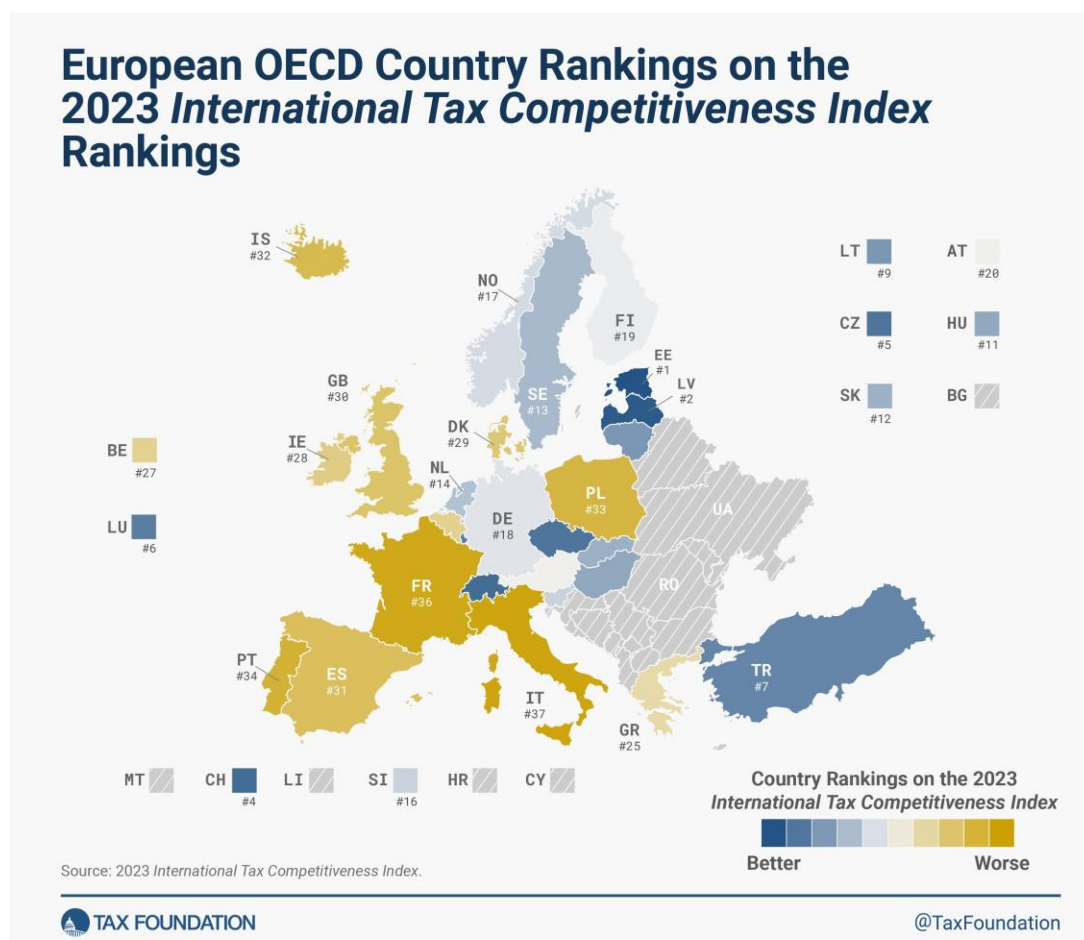
Introduction

The Tax Foundation's International Tax Competitiveness Index is an annual ranking of 38 OECD countries based on how pro-growth their tax systems are. It is not simply a comparison of marginal tax rates; it also puts a lot of weight on the underlying structure and quality of the tax system, examining more than 40 different tax policy variables to assess how supportive each country's tax system is of economic growth – or the reverse.

In the 2023 edition of the Index, published this week, the UK ranks 30th overall, down three places from 2022.[1] Compared with other G7 economies, we fall well short of Canada and Germany (at 15th and 18th place respectively), somewhat behind the United States and Japan (21st and 24th respectively), but still ahead of France and Italy, which finish 36th and 37th out of 38 OECD countries.

Estonia tops the rankings for the tenth year in a row, followed by Latvia. New Zealand comes third, with Switzerland in 4th place. The highest ranked G20 country on the Index is Australia, which comes 10th. In total, 19 European countries score better than the UK in the 2023 Index – including famously high-tax Sweden in 13th place.



[1] Previous year rankings are updated with each new edition of the Index to reflect the latest data and methodology. This means that the 2022 rankings here may differ from the ones released last year.

The International Tax Competitiveness Index 2023

Overall	Corporate tax	Individual taxes	Consumption taxes	Property taxes	Cross-border tax rules
30th ↓ 3	28th ↓ 17	26th —	35th ↓ 1	35th ↓ 2	2nd —

A country's ranking on the International Tax Competitiveness Index is based on how it scores on 41 different tax policy variables, spread across five categories: corporate tax, individual taxes, consumption taxes, property taxes, and cross-border tax rules.

As usual, the UK scores well for its cross-border tax rules, finishing in second place behind Switzerland. This reflects the fact that the UK's network of tax treaties – which it has in place with 130 countries – is the broadest in the OECD.

The UK fares less well on the rest of the Index categories. Its individual taxes rank (26th) reflects a high top-rate of tax on earnings (62% thanks to the withdrawal of the personal allowance) and dividends (39.35%) relative to other OECD countries. Indeed, only among OECD countries, only Denmark, Korea, and Ireland tax dividends more heavily than we do. (Ireland mitigates this by having a very low corporation tax rate.)

The biggest change in the UK's rankings from last year is on corporate tax, where we have fallen 17 places from 11th to 28th – largely because of the headline corporation tax rate rising from 19% to 25%. As a result, we have gone from having the 4th lowest headline rate in the OECD to the 21st. The full expensing policy for plant and machinery has kept us from slipping further, but is currently only temporary (more on this below). Meanwhile, our corporate tax code is cluttered with various complications and targeted incentives (like the Digital Services Tax and the Patent Box) which further weigh on our overall ranking.

The UK's property and consumption tax systems are a significant drag on its international tax competitiveness. It ranks 35th in each category. For property taxes, this reflects three factors: first, our recurrent property taxes impose a heavier burden (measured as a percentage of the capital stock) than in any other OECD country; second, business rates are structured in a way that discourages investment; third, we rely more than most other countries on economically-distortionary transaction taxes like stamp duty.

For consumption taxes, the fundamental problem is that the UK has one of the narrowest VAT bases of any OECD country. Our VAT registration threshold is very high by international standards, and we exclude a wider range of goods and services from VAT than most of our competitors. This narrow tax base has two unfortunate consequences: first, it creates complexity and distorts economic decision-making (see the obvious bunching of firms just under the registration threshold); second, by undermining the efficiency of VAT, a relatively benign tax from a growth perspective, this narrow tax base means that other, more damaging taxes must be higher.

The Impact of Tax Reforms on the UK's International Tax Competitiveness

At our request, the Tax Foundation has been kind enough to simulate the impact of various potential UK tax changes on the International Tax Competitiveness Index 2023.

The future of full expensing

Perhaps the most important thing to note is that if the UK's temporary full expensing policy were allowed to expire – which is currently scheduled for the end of March 2026 – the UK's corporate tax ranking would drop from 28th to 31st, while its overall ranking would fall from 30th to 33rd. If Britain were to return to the *status quo ante*, there would be 31 OECD countries with more generous tax treatment of investment in machinery.

Previous research from the CPS and the Tax Foundation suggests that the expiry of full expensing, as currently instituted in the UK, would also reduce long-run GDP by 0.9%, investment by 1.5%, and wages by 0.8% – compared to a counterfactual in which full expensing is a permanent policy. As such, making full expensing permanent should be a priority for the government.

Indeed, if anything, the government should be looking to go further, and extend full expensing to a wider range of investments. For example, our research suggests that extending a similar tax treatment to *all* plant and machinery as well as structures and buildings would add an additional 2.5% to long-run output (over and above the impact of making current full expensing permanent).

Abolishing inheritance tax

There was a great deal of speculation a few weeks ago that the government would commit to abolishing inheritance tax, perhaps as part of its next general election manifesto. The government is yet to give any indication on whether this might actually be the case – but if IHT *was* abolished, it would have a small positive impact on the UK's standing in the International Tax Competitiveness Index.

If the UK were to join the thirteen OECD countries *not* to levy an estate or inheritance tax, its property tax rank would improve by nine places from 35th to 26th. Its overall rank would improve by two places from 30th to 28th.

Comprehensive tax reform – pro-growth, but revenue-neutral

The International Tax Competitiveness Index does not just reward low tax rates. What really matters is the *neutrality* of the tax system – that is, how much it distorts incentives and affects economic decision-making. As a consequence, it is possible to design a package of tax reforms that would significantly boost the UK's competitive standing, and make its tax system much more supportive of economic growth, *without* reducing government revenue. Take, for example, the following set of reforms:

- Abolish council tax and (residential) stamp duty land tax. Replace with a proportional property tax – a simple annual levy on the current value of a property.
- Abolish business rates and (non-residential) stamp duty land tax. Replace with a commercial landowner levy – a flat tax on the land value of commercial sites.
- Abolish stamp duty on shares and inheritance tax, while eliminating the uplift in capital gains tax basis at death.
- Replace the UK's existing corporation tax regime with a 'distributed profits tax' modelled on Estonia's, but levied at 25%. This would essentially eliminate all the complexity of the current corporation tax system, in favour of a straightforward levy on money paid out to shareholders (no tax would be payable on profits that were retained and reinvested).
- Remodel UK VAT based on the Estonian version. This would likely mean halving the registration threshold, scrapping zero and reduced rates, and taxing a much broader range of consumption at the standard rate.
- Raise the income tax personal allowance and the National Insurance primary threshold to £15,000 a year. Scrap the withdrawal of the personal allowance and have the additional (45p) income tax rate kick in at £100,000. Reduce the top rate on dividends to 29%.

If such a reform package were adopted in the UK, it would have a significant effect on the country's tax competitiveness, as the table below suggests.

Overall	**Corporate tax**	**Individual taxes**	**Consumption taxes**	**Property taxes**	**Cross-border tax rules**
3rd ↑ 27	3rd ↑ 25	16th ↑ 10	15th ↑ 20	8th ↑ 27	2nd —

The UK would leapfrog every G7 and G20 country that currently leads it on the International Tax Competitiveness Index. The only European countries left ahead of the UK would be Estonia and Latvia, in first and second place. More fundamentally, the UK would be left with a much more rational, neutral, and pro-growth tax system:

- Highly distortionary transaction taxes (stamp duties) would be eliminated.
- Business taxes would no longer create any bias against investment.
- Residential property taxes would no longer be regressive or based on 1991 values.
- The high deadweight costs associated with inheritance tax would be eliminated.
- The distortionary 'lock in' effect of capital gains tax would be reduced.
- The first £1,250 people earned each month would be completely free of direct tax.
- The effective marginal tax rate on earnings would no longer spike arbitrarily at £100,000, before falling again at £125,140.
- The effective top rate on business income (corporation tax plus dividend tax) would be the same as on ordinary earnings (income tax plus employee National Insurance).[2]
- VAT would be simplified and would apply evenly across different types of consumption. Fewer businesses would be able to cluster just under the registration threshold.

[2] Admittedly, if you factor in *employers'* National Insurance contributions too, labour income still ends up being taxed at a higher rate than business income.

From a technical and economic perspective, moreover, there is nothing particularly outlandish about this set of reforms. The UK would simply be copying best practices from other countries around the world and applying them in a British context.

That said, it should be stressed that this is *not* a suggestion for the forthcoming Autumn Statement, or indeed for any election manifesto. The politics of such a reform would be difficult for a variety of reasons. For one thing, while replacing stamp duty land tax, council tax, and business rates in a revenue neutral way would produce many winners (especially in the North and Midlands) there would inevitably be lots of losers too – particularly in London and the South-East where property values are highest.

Meanwhile, the tax *cuts* within the package are 'funded' by a significant broadening of the VAT base. The economics of this stack up: traditional corporate income taxes are the worst way to raise revenue in terms of the impact on GDP per capita; broad-based consumption taxes, by contrast, are relatively benign.

On the other hand, the distributional consequences would need careful handling, since the poorest households could end up paying more in VAT but not gaining anything from income tax and National Insurance cuts. Moreover, broadening the VAT base would deliver a one-off boost to inflation – and particularly to consumer food and energy prices. Clearly that is not what anyone wants right now.

The point of this reform scenario, then, is not to propose an immediate set tax policies for the government to adopt, but rather to show that it *is* possible to have a highly competitive, pro-growth tax system that raises just as much money as the current one, and to indicate a possible future direction of travel. Even if a 'big bang' reform is not feasible, property taxes could be reformed incrementally as properties change hands, and the burden of taxation could gradually be shifted away from income and investment and towards consumption over time.

Conclusion

Ultimately, the UK tax system is not very competitive internationally. This unquestionably holds back economic growth, and makes Britain less prosperous and dynamic than it ought to be.

Our cross-border tax rules are among the best in the world, but on every other front – personal taxes, corporate taxes, property taxes, consumption taxes – we have a deeply flawed tax system that is crying out for comprehensive reform.

As much as we would like to see *lower* taxes, pro-growth reform need not mean reduced revenues and bigger deficits. On the contrary, we could develop one of the most competitive tax systems in the world *without* giving up revenue. We just need to learn the right lessons from around the world.

Radically improving our tax system is not the work of a single Budget or fiscal event, but it must be the longer-term ambition. Instead of making tax policy piecemeal to suit the political calendar, we should set a clear direction of travel and work coherently towards it over time. Putting full expensing on a permanent footing as soon as possible would be a good way to begin that process.