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European Scrutiny Committee

Fifth Report of Session 2021–22

Documents considered by the Committee on 7 July 2021

Report, together with formal minutes

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Notes

Numbering of documents

Three separate numbering systems are used in this Report for European Union documents:

Numbers in brackets are the Committee's own reference numbers.

Numbers in the form "5467/05" are Council of Ministers reference numbers. This system is also used by UK Government Departments, by the House of Commons Vote Office and for proceedings in the House.

Numbers preceded by the letters COM or SEC or JOIN are Commission reference numbers.

Where only a Committee number is given, this usually indicates that no official text is available and the Government has submitted an "unnumbered Explanatory Memorandum" discussing what is likely to be included in the document or covering an unofficial text.

Abbreviations used in the headnotes and footnotes

AFSJ	Area of Freedom Security and Justice
CFSP	Common Foreign and Security Policy
CSDP	Common Security and Defence Policy
ECA	European Court of Auditors
ECB	European Central Bank
EEAS	European External Action Service
EM	Explanatory Memorandum (submitted by the Government to the Committee) *
EP	European Parliament
EU	European Union
JHA	Justice and Home Affairs
OJ	Official Journal of the European Communities
QMV	Qualified majority voting
SEM	Supplementary Explanatory Memorandum
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

Euros

Where figures in euros have been converted to pounds sterling, this is normally at the market rate for the last working day of the previous month.

Further information

Documents recommended by the Committee for debate, together with the times of forthcoming debates (where known), are listed in the European Union Documents list, which is published in the House of Commons Vote Bundle each Monday, and is also available on the parliamentary website. Documents awaiting consideration by the Committee are listed in "Remaining Business": www.parliament.uk/escom. The website also contains the Committee's Reports.

*Explanatory Memoranda (EMs) and letters issued by the Ministers can be downloaded from the Cabinet Office website: http://europeanmemoranda.cabinetoffice.gov.uk/.

Staff

The current staff of the Committee are Ravi Abhayaratne (Committee Operations Assistant), Joanne Dee (Deputy Counsel for European and International Law), Alistair Dillon and Leigh Gibson (Senior Committee Specialists), Nat Ireton and Apostolos Kostoulas (Committee Operations Officers), Daniel Moeller (Committee Operations Manager), Foeke Noppert (Senior Committee Specialist), Indira Rao MBE (Counsel for European and International Law), Paula Saunderson (Committee Operations Assistant), Emily Unwin (Deputy Counsel for European and International Law), Dr George Wilson (Clerk), Beatrice Woods (Committee Operations Officer).

Contacts

All correspondence should be addressed to the Clerk of the European Scrutiny Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is (020) 7219 3292/8185. The Committee's email address is escom@parliament.uk.

Contents

1 Protection of critical infrastructure[1]

This proposed EU Directive is legally and politically important because:

- it seeks to ensure that the operators of critical national infrastructure in 10 sectors (energy, transport, banking, financial market infrastructure, health, drinking water, waste water, digital infrastructure, public administration, and space) have robust plans to address natural and man-made risks which might significantly disrupt the provision of essential services;

- it may affect the operation of the single wholesale electricity market in Ireland and Northern Ireland and the laws applicable in Northern Ireland under the Protocol on Ireland/Northern Ireland (part of the UK/EU Withdrawal Agreement);

- it may also affect UK national critical infrastructure or operators where there are strong links to the EU or other interdependencies, such as highly connected supply chains; and

- it raises broader questions about the Government's approach to regulatory alignment and divergence after Brexit.

Action

- Write to the Paymaster General (Rt Hon. Penny Mordaunt MP) requesting further information on the potential impact of the proposed Directive in Northern Ireland, its wider implications for UK national critical infrastructure or UK operators with links to the EU, and the Government's approach to regulatory alignment and divergence after Brexit.

- Draw to the attention of the Northern Ireland Affairs Committee and the Public Administration and Constitutional Affairs Committee

Overview

1.1 As foreshadowed in its Security Union Strategy for 2020–25,[2] the European Commission has proposed two new EU laws ("Directives") which are intended to update the EU's existing framework for protecting the critical infrastructure on which we depend in our daily lives to ensure the delivery of essential services. We considered the first, a proposed Directive to ensure a high level of cybersecurity within the EU which focuses on countering cybersecurity threats, in earlier Reports.[3] This chapter concerns the second, a proposed Directive on the resilience of critical entities which addresses other natural or man-made threats. Both proposals seek to prevent or mitigate incidents which may disrupt access to a broad range of essential services provided by public or private bodies operating in 10 sectors: energy, transport, banking, financial market infrastructure, health,

1 Proposal for a Directive on the resilience of critical entities; COM(20) 829; Article 114 TFEU, ordinary legislative procedure, QMV; Cabinet Office; Devolved Administrations: consulted; ESC number 41751.

2 See the European Commission's Communication, COM(20) 605 published on 24 July 2020.

3 See our Fortieth Report HC 229–xxxv (2019–21), chapter 1 (17 March 2021) and our Second Report HC 121–ii (2021–22), chapter 3 (26 May 2021).

drinking water, waste water, digital infrastructure, public administration, and space. Our First Report of Session 2021–22 sets out the main elements of the second proposal on critical entities and the Government's position based on the information provided by the Paymaster General (Rt Hon. Penny Mordaunt MP) in her Explanatory Memorandum of 11 March 2021.

1.2 While the proposed Directive, if it becomes EU law, will not apply throughout the UK it could still have legal and policy implications because:

- it is unclear whether and to what extent it may affect the operation of the single wholesale electricity market in Ireland and Northern Ireland and the substance of the EU law applicable in Northern Ireland under the Protocol on Ireland/ Northern Ireland ("the Protocol");
- it may also affect national critical infrastructure or operators elsewhere in the UK where there are strong links to the EU or other interdependencies, such as highly connected supply chains; and
- the Government itself has expressed concern about the impact that "increasingly divergent regulatory approaches" in the EU and the UK may have on UK national critical infrastructure or operators.[4]

1.3 The Minister told us that legal teams within the UK Department for Business, Energy and Industrial Strategy and the Northern Ireland Executive Department for the Economy were seeking to clarify the relationship between the proposed Directive and the Protocol as well as any financial implications. She anticipated that the proposal would have "minimal direct impact" (other than in Northern Ireland) on the energy and transport sectors as they are already covered by a 2008 Directive on European critical infrastructures[5] which now forms part of retained EU law (EU law in force before the UK's exit from the EU which continues to have effect in the UK's domestic law under the European Union (Withdrawal) Act 2018). However, the scope of the new proposal is significantly wider (covering an additional eight sectors) and the Minister acknowledged the possibility that it might "indirectly affect" UK critical national infrastructure operators "through potential impacts on EU supply chains".[6]

1.4 In our letter of 12 May 2021 to the Minister, we noted that there was some uncertainty about the interaction between the proposed Directive and the Protocol. We sought further information on the outcome of the Government's legal assessment of the relationship between the proposal and EU law applicable in Northern Ireland under the Protocol, as well as a more detailed analysis of the broader policy implications of the proposal for the operation of the single electricity market (or other critical infrastructure) in Northern Ireland. We asked whether discussions on the proposed Directive had taken place or were envisaged in the Joint Consultative Working Group—the forum established by the EU/ UK Withdrawal Agreement to discuss the possible application of planned EU laws in Northern Ireland under the Protocol.[7]

4 See paragraph 27 of the Minister's Explanatory Memorandum on the proposed Directive.
5 Council Directive 2008/114/EC on the identification and designation of European critical infrastructures and the assessment of the need to improve their protection.
6 See footnote 4.
7 The JCWG was established by Article 15 of the Protocol on Ireland/Northern Ireland.

1.5 We noted that the Minister, while expressing concern about the impact that "increasingly divergent regulatory approaches" might have on UK national critical infrastructure or operators with strong links to the EU, did not indicate how significant these interdependencies were or what effect a substantial divergence in the rules applicable to EU and UK operators would have. Nor, it seemed, had the Government consulted external stakeholders in order to quantify and seek to mitigate any negative effects that the proposal as drafted might have for their operations. With this in mind, we requested further information on the Government's approach to weighing the costs and benefits of regulatory alignment and divergence after Brexit, both within the UK as well as between the EU and the UK. We asked how the Government intended to ensure that the interests and concerns of all relevant Government departments, regulatory bodies, devolved administrations and external stakeholders were taken into account in reaching an informed decision on alignment or divergence.

1.6 In her response dated 21 June 2021, the Minister tells us that "while a formal determination has not yet been made", the Government "deem the proposed Directive to be out of scope of the Protocol". She notes that Article 4 of the existing (2008) EU Directive on the protection of European critical infrastructures (which, for the time being, remains part of the retained EU law that continues to apply in the UK) includes a reference to Regulation 1227/2011 on wholesale energy market integrity and transparency, one of the EU laws that continues to apply in Northern Ireland under the Protocol. She adds:

> Our assessment is that [the 2008 Directive] would only be in scope were it to be considered necessary for joint SEM [single electricity market] operations.

1.7 The Minister concludes that "this limited scenario" does not apply and that the Commission's latest proposal (which would repeal and replace the 2008 EU Directive) is not within the scope of the Protocol. She notes that the Joint Consultative Working Group (JCWG) is the appropriate forum in which to discuss the implications of proposals amending or replacing acts listed in the Annexes to the Protocol. She makes clear that decisions on whether any "new" EU acts (those which do not amend or replace an existing act listed in the Protocol's Annexes) fall within the scope of the Protocol and should be added to it are to be taken by the Withdrawal Agreement Joint Committee:

> While the other Withdrawal Agreement structures, such as the JCWG, may be used in preparing for ultimate Joint Committee discussions, the decision there is rightly one to be made in the Joint Committee context.

Our assessment

1.8 As we stated in our earlier Report, the main issue of concern at this stage is to determine whether the proposed Directive (or certain provisions in it) may apply in Northern Ireland under the Protocol or, if not directly applicable, whether there are nonetheless implications for critical entities operating in or providing services to Northern Ireland. This concern arose in part from the information provided in the Minister's Explanatory Memorandum which stated that "there may be links to the Single Electricity Market through the Risk Preparedness Regulation (EU) 2019/941" which replaced an earlier EU law—Directive 2005/89/EC—listed in Annex 4 to the Protocol and so applies in Northern Ireland. The 2019 Regulation is referred to in Article 4 of the proposed Directive but the Minister makes no mention of it in her letter, nor does she indicate whether the explicit reference to the Regulation might bring some parts of the proposed Directive within the scope of the Protocol. She refers instead to a provision concerning the disclosure of sensitive information in a 2011 Regulation concerning wholesale energy market integrity and transparency which includes a cross-reference to the existing (2008) EU Directive on European critical infrastructure and says that it would not bring the proposed successor Directive within the scope of the Protocol.

1.9 Whether or not a new EU act (one which does not amend or replace an act already listed in the Annexes to the Protocol) is within the scope of the Protocol and should therefore be added to the relevant Annex so that it applies in Northern Ireland is a joint decision which has to be taken by the EU and the UK within the Withdrawal Agreement Joint Committee once the act has been formally adopted by the EU.[8] There may be important legal and practical consequences if the EU and UK are unable to agree whether an EU act is within scope. In particular, the EU may (after giving notice) "take appropriate remedial measures" if the UK is unwilling to agree that an act which the EU considers is within scope should be added to the relevant Annex. This is why early discussions in the Joint Consultative Working Group on planned EU acts (before they are set in stone once formally adopted by the EU) can be useful to understand whether and to what extent the EU considers them to be within the scope of the Protocol. It is also why we asked the Minister whether the Government intended to include the proposed Directive as an item for discussion in the agenda for a forthcoming Joint Consultative Working Group meeting. The Minister does not answer this question, nor does she provide the analysis we requested of the broader policy implications of the proposed Directive for the operation of the single electricity market (or other critical infrastructure) in Northern Ireland. We assume there may still be some impact even if the EU accepts that the Directive itself (should it become EU law) would not need to be added to one of the Protocol's Annexes.

1.10 Similarly, the Minister does not provide the information we requested on the Government's approach to weighing the costs and benefits of regulatory alignment and divergence after Brexit, even though she acknowledged in her Explanatory Memorandum that increasingly divergent EU and UK approaches to the protection of critical infrastructure could affect UK operators or service providers with strong links to the EU or other interdependencies, such as highly connected supply chains. Nor does she explain how the Government intends to ensure that the interests and concerns of all relevant Government departments, regulatory bodies, devolved administrations and external stakeholders are taken into account in reaching an informed decision on alignment or divergence. In his letter of 18 June 2021 to the Chair of the Northern Ireland Affairs Committee (Simon Hoare MP), Northern Ireland's Minister for the Economy (Paul Frew MLA) underlined the need to ensure that "policy development in Great Britain incorporates robust evaluation and impact assessment of the potential divergence a policy would create between Protocol-derived NI standards and those operating in Great Britain", as well as the importance of "identifying and acting upon risks of divergence". He highlights the need for "clarification centrally and with Whitehall Departments on strategic matters such as [….] the approach to the interpretation of and cross-referenced provisions under Article 9/Annex 4 instruments as regards the Single Electricity Market" and says clear arrangements are needed "to take full account of the market impacts that will result if there is unmanaged regulatory divergence".

8 See Article 13(4) of the Protocol on Ireland/Northern Ireland.

Action

1.11 We have written again to the Minister asking her to:

- inform us of any discussions which take place in the Joint Consultative Working Group on the proposed Directive and its possible application in Northern Ireland under the terms of the Protocol *before* its final adoption by the EU (under Article 15(3) of the Protocol), as well as any discussions which take place within the EU/UK Joint Committee *after* its adoption (under Article 13(4) of the Protocol);

- inform us when the Government and/or the EU have reached a "final determination" on the proposed Directive, including its relevance to any laws applicable in Northern Ireland under the Protocol; and

- provide further information on the significance of the cross-border supply chains and other interdependencies between the EU and the UK in the sectors covered by the proposed Directive and the steps the Government is taking to assess, manage and mitigate the impact that divergent regulatory approaches in the EU and the UK may have on UK national critical infrastructure or operators.

1.12 We have drawn this chapter to the attention of the Northern Ireland Affairs Committee and the Public Administration and Constitutional Affairs Committee.

Letter to the Paymaster General (Rt Hon. Penny Mordaunt MP), Cabinet Office

Thank you for your letter of 21 June 2021 in which you respond to some of the questions raised in our letter of 12 May 2021 concerning the legal and policy implications of a proposed EU Directive on the resilience of critical entities.[9]

You state that you "deem the proposed Directive to be out of scope" of the Protocol on Ireland/Northern Ireland while adding that "a formal determination has not yet been made". There remains in our view considerable uncertainty about the relationship between the proposed Directive and the application of existing, new or amended EU laws under the Protocol on Ireland/Northern Ireland as well as the impact that any changes to EU law may have on UK national critical infrastructure or on UK operators involved in EU supply chains in the sectors covered by the proposal. There is a broader question too about the Government's approach to weighing the costs and benefits of regulatory alignment and divergence after Brexit which your letter does not address. I would therefore be grateful if you could:

- clarify whether you mean that the Government, or the EU and the UK jointly, have yet to make a formal determination on whether the proposed Directive is within the scope of the Protocol and inform us when such a formal determination has been made;

- inform us of any discussions which take place in the Joint Consultative Working Group on the proposed Directive and its possible application in Northern Ireland

9 See also our First Report of Session 2021–22, HC 121–i (12 May 2021).

under the terms of the Protocol *before* its final adoption by the EU (under Article 15(3) of the Protocol), as well as any discussions which take place within the EU/UK Joint Committee *after* its adoption (under Article 13(4) of the Protocol);

- provide further information on existing cross-border supply chains and other interdependencies between the EU and the UK in the sectors covered by the proposed Directive and their significance;
- explain what assessment you have made of the impact that a divergence in the regulatory approaches taken by the EU and the UK to critical entities providing services which have a vital economic or societal function may have on UK national critical infrastructure or UK operators involved in EU supply chains; and
- indicate what steps the Government is taking to identify, assess, manage and mitigate the impact that divergent regulatory approaches in the EU and the UK may have for businesses operating across the UK.

We ask you to respond by the beginning of September.

2 Data adequacy[10]

These EU documents have not been deposited by the Government under the current interim scrutiny arrangements. These documents are, however, legally and politically important because:

- the decisions adopted on 28 June 2021 will now provide the EU legal basis for the transfer of personal data from the EU to the UK which is vital for the conduct of trade and law enforcement cooperation under the UK/EU Trade and Cooperation Agreement (TCA);
- they will expire after four years unless extended, be under constant review and monitoring by the EU Commission and may be subject to legal challenge; and
- effective Parliamentary scrutiny of the maintenance of adopted decisions and the corresponding UK data protection legal framework is a ground relied upon by the EU Commission and Government to support the adoption of the decisions.

Action

- To draw this chapter to the attention of the International Trade Committee; the Home Affairs Committee; the Digital, Culture, Media and Sport Committee; the Business and Industrial Strategy Committee; the Science and Technology Committee; the Health and Social Care Committee; and the Northern Ireland Affairs Committee.
- To write to the Government asking to keep the Committee updated on any developments, including any issues raised by the Commission with the Government regarding the decisions' continued application.

Overview

2.1 A data adequacy decision that a third country provides "essentially equivalent" personal data protection to the EU comprises the most comprehensive and seamless basis for the transfer of data from the EU to that country. Whether for the purpose of trade or cooperation on law enforcement, data adequacy decisions enable data to flow lawfully to third countries from the EU without the need for further safeguards.

2.2 The flow of personal data from the EU[11] to the UK is vital for the EU-UK future relationship, particularly in terms of trade and law enforcement cooperation under the

10 (a) Proposal for a Commission Implementing Decision;—; Article 45(3) of Regulation 2016/679 of the European Parliament and Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data and repealing Directive 95/46/EC (General Data Protection Regulation); Department: Digital, Culture, Media and Sport;—; 41796; (b) Proposal for a Commission Implementing Decision;—; Article 36(3) of Directive 2016/680 of the European Parliament and Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties and on the free movement of such data and repealing Council Framework Decision 2008/977 JHA; Department: Home Office;—; 41797.

11 Strictly speaking, the data adequacy decisions cover personal data transferred from EEA countries, not just the EU.

UK/EU Trade and Cooperation Agreement (TCA). From 1 January 2021 to 28 June, this flow of data has taken place by virtue of the bridging provisions in the TCA[12] which were due to expire by 30 June in any event.

2.3 On 19 February the Commission published both a draft General Data Protection Regulation (GDPR) decision and the Law Enforcement Directive (LED) draft decision. We are reporting to the House on the final texts of the GDPR and LED decisions, adopted and published by the Commission on 28 June, as noted by the Government and stakeholders.[13]

The decisions adopted on 28 June

2.4 Information and questions on the draft adequacy decisions were set out in our Fortieth Report of Session 2019–21 and our Report of 12 May, which also reported on the Government's letter of 19 April.[14]

2.5 In those Reports we highlighted key features of the draft decisions, including notably:

- The four-year sunset provision (now fixed as 27 June 2025), unless the decisions are extended under the GDPR and LED.

- The continuous monitoring by the Commission of the UK's legal framework which formed the basis of the Commission's "adequacy" or "equivalence" assessment which underlies the decisions. The UK is currently fully aligned with the GDPR and LED but that may change in future. If so, those changes will be monitored by the Commission to assess whether adequacy of data protection has been maintained compared to the EU's own laws and any relevant international legal commitments entered into by the UK under the ECHR[15] and Council of Europe Data Protection Convention[16] (see the Recitals to both drafts).

- If the Commission concludes that adequacy is no longer being maintained, then under the GDPR and LED, it may decide to suspend, repeal or amend the decisions and this is restated in the decisions themselves.

- If the UK does not cooperate with the Commission and that frustrates the Commission's ability to assess continuing adequacy, then the decisions explicitly state that this can be a ground for suspension, amendment or repeal of the decisions.

Amendments to the draft decisions in the final texts

2.6 There have been some changes to the draft decisions in the final texts. These may have been made by the Commission to take account of:

12 Article.FINPROV.10A of the Trade and Cooperation Agreement.
13 The Government also notes that "The UK must also now move to complete the development of its own international data transfer regime in order to allow companies in the UK not just to exchange data with the EU, but also to be able to access opportunities across the world."
14 First Report HC 121–i (2021–22), chapter 4 (12 May 2021).
15 European Convention on Human Rights, in particular Article 8 Right to respect for private and family life.
16 Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data.

- the EDPB[17] opinion which flagged issues of concern (outlined in our First Report of Session 2021–22);
- the EP Resolution of 21 May which claimed that the Commission was acting outside the scope of its implementing power if it adopted the drafts without changes sought by the EP;
- Judgments in the Big Brother Watch case[18] by the European Court of Human Rights (ECtHR) concerning bulk interception of data by UK intelligence services and in the UK Court of Appeal concerning the UK's immigration exemption in the Data Protection Act 2018 (the Open Rights judgment);[19] and
- the views of the expert national representatives sitting on the "comitology" committee which approved the decisions unanimously.

2.7 The main change to the operative provisions of the GDPR decision is the anticipated exclusion from the decision of data falling within the scope of the UK's immigration exemption. The exemption is set out in paragraph 4(1) of Schedule 2 to the UK Data Protection Act 2018. This is pending clarity on how the recent Open Rights judgment that the exemption is unlawful will be applied by the Court of Appeal to the relevant provisions of the DPA 2018.[20]

2.8 Another amendment provides that the Commission's monitoring will particularly focus on UK public authorities' access to data (including the intelligence agencies).

2.9 Additional changes to the Recitals of the GDPR decision include:

- more detail on UK safeguards relating to intelligence service access to data (including bulk interception) and references to the ECtHR's judgment[21] in Big Brother Watch; and

17 European Data Protection Board.

18 See Brother Watch and Others v. the United Kingdom, ECtHR, 25 May 2021. The ECtHR found some aspects of the UK's bulk interception of personal data regime under the Regulation of Investigatory Powers Act 2000 to be contrary to the ECHR.

19 R (Open Rights Group and the3million) v Secretary of State for the Home Department and Others [2021] EWCA Civ 800. Alternative lawful bases under the GDPR for transfer of data falling within this exclusion would need to be used.

20 Article 1(2) of the GDPR Decision reads "This decision does not cover personal data that is transferred for purposes of United Kingdom immigration control or that otherwise falls within the scope of the exemption from certain data subject rights for purposes of the maintenance of effective immigration control pursuant to paragraph 4(1) of Schedule 2 to the DPA 2018". Recital 6 explains "This conclusion does not concern personal data transferred for United Kingdom immigration control purposes or which otherwise falls within the scope of the exemption from certain data subject rights for purposes of the maintenance of effective immigration control (the "immigration exemption") pursuant to paragraph 4(1) of Schedule 2 to the UK Data Protection Act. The validity and interpretation of the immigration exemption under UK law is not settled following a decision of the England and Wales Court of Appeal of 26 May 2021. While recognising that data subject rights can, in principle, be restricted for immigration control purposes as "an important aspect of the public interest", the Court of Appeal has found that the immigration exemption is, in its current form, incompatible with UK law, as the legislative measure lacks specific provisions setting out the safeguards listed in Article 23(2) of the United Kingdom General Data Protection Regulation (UK GDPR). In these conditions, transfers of personal data from the Union to the United Kingdom to which the immigration exemption can be applied should be excluded from the scope of this Decision. Once the incompatibility with UK law is remedied, the immigration exemption should be reassessed, as well as the need to maintain the limitation of the scope of this Decision".

21 Big Brother Watch and Others v The United Kingdom, ECtHR, 25 May 2021.

- more emphasis on Commission monitoring of UK onwards transfer of data, including through new "adequacy regulations" it may grant to third countries for flows of data from the UK to third countries (which might be porous in terms of data transferred from the EU to the UK).

2.10 There do not appear to be any material changes to the operative provisions of the adopted LED decision or changes the Recitals which we would wish to highlight in addition to those flagged for the GDPR decision.

Action

2.11 We are writing to the Government to request that they keep us informed of any developments concerning the continued application of the adopted decisions.

2.12 The decisions are of cross-cutting relevance to the work of many Committees across the House. We are therefore also drawing this Report chapter and the Government's letter to the attention of the International Trade Committee; the Home Affairs Committee; the Digital, Culture, Media and Sport Committee; the Business and Industrial Strategy Committee; the Science and Technology Committee; the Health and Social Care Committee; and the Northern Ireland Affairs Committee.

Letter from the Chair to the Minister for Media and Data (Rt Hon. John Whittingdale OBE MP)

Thank you for your letter of 19 April concerning the draft data adequacy decisions published by the EU Commission in February.

Once adopted, the decisions would provide the lawful basis for the continued flow of personal data from the EU to the UK for trade and law enforcement purposes. Adoption was required before the expiry of bridging provisions in the Trade and Cooperation Agreement (TCA) on 30 June.

In our Report of 12 May, we said we would next write to you when there had been further progress towards the adoption of the decisions. We are very pleased to be doing so now, in the light of the formal adoption of the decisions by the EU on 28 June.

As the Committee in the House tasked with scrutinising EU affairs, our main purpose in writing is to request that you provide us with timely information on further developments affecting the continued application and operation of the decisions. We make this request because the decisions are vital to the uninterrupted and unencumbered flow of data from the EU to the UK for both trade and law enforcement purposes. Developments might include (but are not limited to):

- Proposed or actual divergence from the current UK legal framework on data protection that might attract close monitoring of the adequacy decisions by the

Commission. We note for example the recommendation of the TIGGR[22] Report (see Headline Proposal 7)[23] on replacing the UK GDPR with a UK Framework of Citizen Data Rights.

- Proposed or actual divergence from the current EU legal framework on data protection by the EU itself, as this may also affect the initial adequacy assessment.

- Problems relating to cooperation between the Commission and the UK which could themselves lead to the Commission taking action to suspend, amend or repeal the decisions for lack of UK cooperation.

- As the four-year deadline of 27 June 2025 approaches, any indications that the Commission is not minded to extend the decisions by initiating the six month process preparatory to that (see Recitals 290 of the GDPR decision and Recital 174 of the LED decision).[24]

- Any indication that a legal challenge to the adequacy decisions has been launched in the EU Courts or indeed to UK "adequacy regulations" in the UK courts given their relevance to Commission monitoring of the onwards transfer of data to other third countries.

- Discussions raised within the Partnership Council or relevant Specialised Committees of the Trade and Cooperation Agreement (TCA) which are relevant to the adequacy decisions, particularly given their importance to the operation of the Law Enforcement provisions (Part 3 TCA).

In any event, we would be grateful for a yearly update on the operation and functioning of the decisions.

Given the cross-cutting nature of the decisions, I am copying this letter to the Chair (Julian Knight MP) and Clerk (Stephen McGinness) of the Digital, Culture, Media and Sport Committee; the Chair (Rt Hon Yvette Cooper MP) and Clerk (Elizabeth Hunt) of the Home Affairs Committee; the Chair (Rt. Hon Greg Clark MP) and Clerk (Danielle Nash) of the Science and Technology Committee; the Chair (Angus Brendan MacNeil MP) and Clerk (Eligio Cerval-Pena) of the International Trade Committee; the Chair (Simon Hoare MP) and Clerk (Stephen Habberley) of the Northern Ireland Affairs Committee; the Chair (Darren Jones MP) and Clerk (Dr Rebecca Davies) of the Business and Industrial Strategy Committee; the Chair (Rt. Hon Jeremy Hunt MP) and the Clerk (James Davies) of the Health and Social Care Committee; the Chair (Rt Hon Harriet Harman QC MP) and the Clerk (Lucinda Maer) of the Joint Committee on Human Rights; the Chair (the Earl of Kinnoull) and Clerk (Simon Pook) of the Lords European Affairs Committee; Rachel Marnick in the Department for Digital, Culture, Media and Sport; Alex Bernal in the Home Office; and Les Saunders and Donald Harris in the Cabinet Office.

22 Taskforce on Innovation, Growth and Regulatory Reform.

23 The Headline Proposal reads "Replace the UK General Data Protection Regulation 2018 with a new, more proportionate UK Framework of Citizen Data Rights to give people greater control of their data while allowing data to flow more freely and drive growth across healthcare, public services and the digital economy".

24 These Recitals state "Where in particular information resulting from the monitoring of this Decision reveals that the findings relating to the adequacy of the level of protection ensured in the United Kingdom are still factually and legally justified, the Commission should, at the latest six months before this Decision ceases to apply, initiate the procedure to amend this Decision by extending its temporal scope, in principle, for an additional period of four years".

3 Gender Equality: Commission Strategy and Stocktaking[25]

These EU documents are politically important because:

- they outline the EU's approach to gender equality over the next five years;
- they serve as an important marker for the UK Government's own plans as regards potential voluntary alignment with EU standards; and
- they raise the potential of there being further differences between the gender equality regime in Northern Ireland and that in Great Britain as a result of Northern Ireland Protocol obligations.

Action:

- Draw this Report chapter to the attention of the Women and Equalities Committee, the Joint Committee on Human Rights, and the Work and Pensions Committee.

Overview

3.1 The documents under scrutiny ((a) and (b)) were last considered by the Committee's predecessor in its Twentieth Report of Session 2019–21.[26]

3.2 The documents concern the EU's approach to the promotion and protection of equality. Document (a)—'A Union of Equality: Gender Equality Strategy 2020–2025'—sets out the Commission's policy objectives and key actions for the coming five years. Document (b)—'Report on the implementation of the EU Action Plan 2017–2019 on tackling the gender pay gap'—is an assessment of the EU's recent gender pay gap initiatives.

3.3 Taken together, these documents give a comprehensive overview of the EU's progress and ambitions to combat all facets of direct and indirect gender-based discrimination (in terms of employment, pay, care, power and pensions, and continuing violence, harassment and gender stereotypes).

3.4 As well as the EU being an important comparator for the UK in the equality field, the Ireland/Northern Ireland Protocol to the UK/EU Withdrawal Agreement lists six EU law equality Directives that must be complied with in Northern Ireland following the

25 Document (a)—Commission Communication: A Union of Equality: Gender Equality Strategy 2020–25; Council and COM number: 6678/20 and COM(2020) 152; Legal base:—; Department: Government Equalities Office; Devolved Administrations: Consulted; ESC number: 41124. Document (b)—Report from the Commission on the implementation of the EU Action Plan 2017–19 on tackling the gender pay gap; Council and COM number: 6648/20 + ADD 1 and COM(2020) 101; Legal base:—; Department: Government Equalities Office; Devolved Administrations: Consulted; ESC number: 41123.

26 Twentieth Report HC 229–xvi (2019–21), Chapter 8, (10 September 2020).

end of the post-Brexit transition period.[27] Any suggested revisions to these instruments will be trialled in EU documents like the Commission Communication and report under scrutiny.

3.5 A full analysis of both documents can be found our predecessor's Twentieth Report of Session 2019–21. In it, the Committee deemed the two documents politically important and, on 10 September 2020, wrote to the Minister (Baroness Berridge of the Vale of Catmose) requesting further information on the Government's views of the documents and the domestic actions that it is taking in the area. The Minister replied on 17 November 2020 and her response is considered below.

The Minister's letter of 17 November 2020

3.6 In our predecessor's letter, it was noted that the Commission's Gender Equality Strategy raised a number of questions concerning current equality policy in the UK and any future actions the Government might take following completion of the post-Brexit transition period. Specifically, the Committee requested further information on:

i) the Government's view of the EU's approach to gender mainstreaming and whether it has considered adopting a similar policy for its own legislative and economic agenda;

ii) the timetable that the Government is working towards for ratifying the International Labour Organisation (ILO) Violence and Harassment Convention on combating violence and harassment in the world of work;

iii) whether the Government will review the operation of The Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 and consider introducing new criteria such as reporting for organisations with fewer than 250 employees;

iv) whether the Government is considering, or will consider, legislating to ensure that women are represented on the corporate boards of large UK-based companies; and

v) whether the Government will commit to give effect to those parts of the Work-Life-Balance Directive and the Transparent and Predictable Working Conditions Directive that are not currently provided for in UK law.

3.7 In her response, the Minister addresses each of these questions in turn:

27 Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services; Directive 2006/54/EC of the European Parliament and of the Council of 5 July 2006 on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupations; Council Directive 2000/43/EC of 29 June 2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin; Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation; Directive 2010/41/EU of the European Parliament and of the Council of 7 July 2010 on the application of the principle of equal treatment between men and women engaged in an activity in a self-employed capacity and repealing Council Directive 86/613/EEC; and Council Directive 79/7/EEC of 19 December 1978 on the progressive implementation of the principle of equal treatment for men and women in matters of social security.

i) The Minister confirms that the Government supports the idea that a mix of both targeted measures and mainstreaming can help secure enhanced equality of opportunity for all, including women and girls, both domestically and in the UK's international work. She also states that the Government is bringing this work together to ensure that it has a more holistic picture of where individuals may be experiencing multiple barriers to opportunity, across but also beyond protected characteristics to include issues of social background and geography. The Minister notes that the Equality Act 2010 already places a proactive equality duty on public bodies, and those exercising public functions, to consider the potential effects of key decisions on groups with protected characteristics and flags to the Committee that, over the last two years, all ministerial departments have included a dedicated section on equality objectives in their 'Single Departmental Plans' to promote greater transparency and annual monitoring on progress.

ii) The Minister confirms that the Government strongly supported the adoption of the ILO Violence and Harassment Convention in 2019 and that the Department for Work Pensions is currently taking the steps necessary to ensure full cross-Government consideration of ratification, as well as consulting the Devolved Administrations. The Minister notes that the Government will make further announcements in due course regarding its position on ratification once this consultation activity has been completed.

iii) The Minister states that over 10,000 large employers complied with the regulations in the first two years of reporting before enforcement was suspended in the third year of reporting due to the burdens facing businesses as a result of the Covid-19 pandemic. The Minister notes, however, that over 5,500 employers still reported their gender pay gaps and that the Government is currently reviewing the effectiveness of the regulations, before reporting on the outcome of this review by 2022.

iv) The Minister states that the Government believes a voluntary approach is the best way to get more women into senior leadership positions in both the public and private sectors. She notes that, since 2011, the Government has supported the business-led voluntary Hampton-Alexander Review targets for 33% of all board and senior leadership positions across the FTSE 350 to be women and confirms that, while the FTSE 350 have already achieved their 33% women on boards targets, more needs to be done. The Minister states that, in order to maintain progress, businesses need to continue to be transparent and take effective evidence-based action.

v) The Minister states that the UK is not obliged to implement either the Work-Life-Balance Directive or the Transparent and Predictable Working Conditions Directive. She notes that, as the UK has now left the EU, it is for the UK Government and the UK Parliament to decide what rules should apply in the UK. The Minister does, however, confirm that the Government will deliver protections for workers that work best for the UK as well as bringing forward an Employment Bill, in due course, to deliver improvements to workers' rights.

3.8 More broadly, the Minister also touches upon the EU exit context of the two documents following completion of the post-Brexit transition period. She states that, as of 1 January 2021, no new or revised EU legal instruments or measures to strengthen the transposition, implementation or enforcement of existing EU equality instruments will have effect in Great Britain unless introduced by the UK Government and passed by the UK Parliament. The Minister does note, however, that the Government Equalities Office will maintain a broad awareness of changes in EU equality law, much like it does with other international partners and federations on which the UK has no legal dependence.

3.9 The Minister does acknowledge, however, that the situation in Northern Ireland is different as NI equality law is within the transferred competence of the Northern Ireland Assembly and already contains a number of differences from that in force across Great Britain. In addition, the Minister notes that Article 2 of the Ireland/Northern Ireland Protocol to the UK/EU Withdrawal Agreement requires that if the EU decides to amend or replace certain Directives setting out minimum standards of protection from discrimination (those listed in Annex 1 to the Protocol), then relevant domestic law in Northern Ireland would have to be amended, as necessary, to reflect any substantive enhancements to those protections.

Action

3.10 Draw this Report chapter to the attention of the Women and Equalities Committee, the Joint Committee on Human Rights, and the Work and Pensions Committee.

4 Public country-by-country tax reporting by multinationals in the EU[28]

This EU document is politically important because:

- it introduces EU legislation that will, from 2023, require large multinationals with operations in the EU to publish country-by-country (CbC) reports on where they pay tax, to facilitate public scrutiny; and
- although the Government has repeatedly said it would consider introducing CbC tax reporting requirements for large companies under UK law on a multilateral basis, it is unclear if Ministers would be willing to take that step in tandem with the EU following these latest developments.

Action

- Write to the Financial Secretary to the Treasury (Rt Hon. Jesse Norman MP) to request further information on the Government's views on the EU's new public country-by-country tax rules, and how this may affect UK policy in this area.
- Draw these developments to the attention of the Business, Energy and Industrial Strategy Committee, the Public Accounts Committee and the Treasury Committee.

Overview

4.1 One of the measures being introduced within the European Union to tackle aggressive tax avoidance by large multinational companies is to make them subject to mandatory public "country-by-country" (CbC) reporting, requiring them to disclose in which jurisdictions they are recording their profits and in which ones they are paying tax (and how much).[29] The logic is that increased public scrutiny of their tax affairs will put pressure on such companies to reduce their reliance on tax avoidance arrangements by booking profits through countries where they do not actually have substantial operations, although this is untested as no major jurisdiction anywhere in the world has implemented public CbC reporting to date.

4.2 In the EU, the European Commission tabled draft legislation in early 2016 to introduce public disclosure of CbC information for multinationals under the Accounting Directive. After several years of negotiations, the European Parliament and a majority of the EU's Member States in the Council of Ministers reached agreement on the text of the amending

28 Proposal for a DIRECTIVE amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches; Council number 7949/16, COM(16) 198; Legal base: Article 50(1); ordinary legislative procedure; QMV; Department: HM Treasury; Devolved Administrations: Not consulted; ESC number: 37663.

29 The proposed introduction of public CbC reporting requirements for multinationals is only one of various measures being pursued at EU-level (and internationally) to address tax avoidance and evasion. For example, separate discussions are on-going about the taxation of the digital economy, where base erosion and profit shifting is especially pronounced, and the EU recently announced that it would try to establish a joint approach with the United States on this issue. The European Commission is also due to publish an "Action Plan" on EU corporate taxation policy later in 2021.

Directive in early June 2021. In essence, this will require companies with operations in the EU, and a yearly turnover exceeding €750 million (£643 million), to publish annual reports showing how much tax they pay in each individual EU Member State, as well as in certain countries listed by the EU as not complying fully with international standards to combat tax avoidance.[30] For all other countries, the report would only have to include an aggregate, "rest of the world" amount for tax paid, not broken down by jurisdiction. The EU Directive will therefore not require a truly global country-by-country report.

4.3 Despite opposition from some Member States,[31] the new EU rules now await formal adoption in the coming weeks, and are expected to take effect from early 2023.[32] The US House of Representatives recently also approved a Bill for the introduction of public tax transparency requirements for multinationals, but it still awaits consideration by the Senate before it could become law.

4.4 The Government was supportive of the EU's public country-by-country reporting proposal while the UK was a Member State of the EU, but its views on the merits of the Directive following Brexit are unclear. In particular, although Ministers have said repeatedly they would be willing to introduce public CbC reporting as part of a multilateral effort (to avoid harming UK competitiveness by doing so unilaterally),[33] the Treasury told us in April 2021 that it needed to "wait to see the final version of the draft Directive before it considers any implications for the UK". It added that the UK's preference "remains for a genuinely global approach to public country-by-country reporting, which commands wide international support". Following agreement on the EU Directive in Brussels, and the developments in the US, the Government has not indicated whether the introduction of CbC disclosures for multinationals in these other jurisdictions could enable the UK to proceed with similar measures.

4.5 In the remainder of this chapter, we explore the substance of the new EU Directive on public country-by-country reporting further, as well as its possible implications for UK policy in this area.[34]

30 The country-by-country report will need to include information on the specific amount of tax paid in each country listed by EU Finance Ministers in Annex I to their bi-annual conclusions on "non-cooperative jurisdictions", which indicates that such jurisdictions "encourage abusive tax practices". The same will apply to countries in Annex II to those conclusions (indicating they "do not yet comply with all international tax standards but have committed to reform"), but only for those jurisdictions that have been listed in Annex II for at least two consecutive years.

31 Some EU countries, notably Ireland, have objected to the legal basis for the legislation, arguing it is an EU tax measure rather than accounting policy (which, under EU rules, would mean every EU Member State could veto the draft legislation, whereas an amendment to the Accounting Directive only requires the support of a qualified majority of EU countries). These procedural objections are in turn likely also driven in part by political concerns about the legislation, as noted in paragraphs 13 and 14.

32 Article 2 of the new Directive provides that the public CbC requirements must be implemented and enforced by all EU Member States starting 18 months after the legislation is published in the EU's Official Journal.

33 The concern is that the introduction of public CbC reporting requirements outside of a multilateral arrangement could encourage companies to relocate to a jurisdiction where they would not face such requirements.

34 We note that CbC measures are only a small part of current efforts to address shortcomings in the international tax system, as separate discussions are on-going about the introduction of new global rules on allocation of taxing rights and an effective minimum corporate tax rate. Those developments are beyond the scope of this chapter, but we may return to them in the future (in particular in the light of how the EU may implement such measures, and how these could affect the UK).

The new EU Directive on disclosure of country-by-country tax reports

4.6 In the field of tax policy, a key concern of policy-makers is that large multinational enterprises (MNEs) are able to exploit the gaps and mismatches between the tax rules of different countries. They can use these differences to artificially eliminate their profits, or shift them to low or no-tax jurisdictions where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

4.7 One of the measures recommended by the Organisation for Economic Co-operation and Development (OECD) to address such "Base Erosion and Profit Shifting" (BEPS) was for countries to introduce country-by-country (CbC) reporting by MNEs, to provide tax authorities with more information on where such companies pay their tax. However, in line with the recommendations made by the OECD, current CbC rules in the UK, EU and elsewhere[35] only require companies to provide this information solely to tax authorities, which treat it confidentially. Data on where companies pay corporation tax is not generally required to be made available for public scrutiny, although the EU's banking, extractive and logging industries[36] are already subject to a sector-specific requirement to disclose publicly where they pay tax.

4.8 In April 2016 however, in the aftermath of the Panama Papers tax evasion scandal, the European Commission tabled further draft EU legislation that would require large MNEs across all sectors to make their CbC tax information public.[37] After several years of negotiations, the European Parliament and a majority of the EU's Member States in the Council of Ministers reached agreement on the text of the amending Directive on 1 June 2021. The legislation will amend the EU Accounting Directive—which governs corporate reporting—to impose a public country-by-country tax reporting requirement on all large EU headquartered MNEs and non-EU headquartered MNEs operating in the EU, where they have a total consolidated annual group revenue above €750 million (£643 million).[38] Formal adoption is expected to take place in the near future, and the new disclosure rules would then take effect by early 2023.

4.9 More specifically, the new CbC Directive will require multinational companies to publish annual tax reports on their website describing, among other things, their net turnover; profits or losses before tax; and the amount of corporation tax due and already paid. Underlining the ultimate purpose of the Directive, this information will need to be broken down individually for a number of jurisdictions, so readers can see how much tax is paid in each of them. The geographical scope of the country-by-country reporting requirement was one of the key issues in the negotiations on the new legislation. In the end, the compromise that was reached is that CbC reports under the new EU rules will need to show tax paid in the following jurisdictions:

35 In the EU (and, at the time, the UK) the CbC requirements were implemented by means of a 2016 Directive that sets out the types of country-by-country tax information that all Member States must collect from companies operating in their territory, and how this data is shared—confidentially—with the tax authorities of other EU countries.

36 Article 89 of the Capital Requirements Directive (Directive 2013/36/EU) and Article 44 of the Accounting Directive (Directive 2013/34/EU).

37 The logic behind requiring disclosure of such information by these companies is that the increased scrutiny of whether they are paying tax where they earn their profits would put pressure on them to reduce their reliance on convoluted tax arrangements. As a new approach however, the effectiveness of public country-by-country reporting in that respect is not proven.

38 This is the OECD threshold in its CbC model, which it estimates—if rolled out globally—would cover MNEs controlling around 90% of corporate revenues, whilst excluding 85–90% of MNEs from the requirements.

- each of the EU's 27 Member States;[39]
- countries included in the EU's list of "non-cooperative jurisdictions" (in essence, countries listed by the EU as 'tax havens'), including Anguilla, Panama and the US Virgin Islands;[40] and
- countries listed by the EU as not *yet* complying with all international tax standards but that "have committed to reform". However, the CbC report would only have to show tax paid in these countries—which currently include Turkey, Barbados and the Maldives—if they have been listed as such for at least two consecutive years.

4.10 For all other jurisdictions, namely non-EU countries not included in the EU list of "non-cooperative jurisdictions", the tax transparency data would need to be reported only on an aggregated, "rest-of-the-world" basis. The EU Directive will therefore not require a truly global country-by-country report. At present, neither the UK nor any of its Overseas Territories or Crown Dependencies are listed by the EU as non-cooperative or non-compliant with respect to taxation of businesses. As such, multinationals within the scope of the new rules would not need to disclose their tax affairs for the UK or its associated territories on a country-by-country basis, but only as part of the aggregate section dealing with the "rest of the world".

4.11 By linking the public CbC reporting requirements to the EU's 'tax haven list', the substance of the former will change over time because the latter is not static. EU Finance Ministers review the list twice a year, in February and October, and usually make changes each time. The listing process itself has also been widely criticised for being flawed, with the Tax Justice Network arguing that the EU targets "economically smaller jurisdictions with less political power, and steer[s] well clear of major financial centres". Therefore, while companies in scope of the new Directive will always need to show how much tax they pay in every EU Member State, the contents of their tax transparency report for non-EU jurisdictions could vary year by year (based on tax haven listing decisions made by EU Finance Ministers). If the current EU list were to remain unchanged, the Directive would require country-by-country reporting for more than 20 non-EU countries (including Panama, Thailand and Turkey, but not the UK).[41] The next update of the EU's tax haven list is scheduled to take place in October 2021.[42]

4.12 The Directive also acknowledges that the EU's writ does not extend to companies' activities globally, in particular where multinationals are headquartered outside of the European Union.

4.13 Anticipating that companies outside of the EU's jurisdiction may in practice be unwilling to make disclosures about profits and tax that are commercially or politically sensitive, the legal responsibility for the public CbC reports falls to EU-based subsidiaries

39 The EU's Accounting Directive also applies in the three EFTA-EEA countries Norway, Iceland and Liechtenstein because they are part of the Single Market via the European Economic Agreement. As such, these countries are also expected to apply the new tax transparency requirements in due course as if they were EU Member States.

40 The list of jurisdictions included in Annex I of the EU's tax havens list which must be included in the CbC report will be as it stands on 1 March of the financial year to which the report relates.

41 The European Commission had suggested that it should have the power to establish a separate list of EU tax havens specifically to define the scope of the CbC Directive by means of a Delegated Act, a type of EU Statutory Instrument. This suggestion was not included in the final Directive.

42 The list is reviewed by EU Finance Ministers twice a year, in February and October.

or branches of multinationals based elsewhere. These daughter undertakings would have to try and obtain the necessary information from their parent company to comply with the Directive. However, if the latter is unwilling to disclose its profits and tax payments for inclusion in a public report, its subsidiaries and branches within the EU can instead "publish a report […] containing all information in their possession", accompanied by a statement "indicating that their ultimate parent undertaking has not made the necessary information available". This means for example that Amazon, as a US company, could not be required to publish a country-by-country report under EU rules, but its EU-based subsidiaries would have to do so using the information at their disposal. Depending on how a multinational is structured, this may limit the impact of the Directive on non-EU companies considerably.[43]

4.14 While the CbC Directive is now agreed in principle, some EU countries still oppose the new rules. In particular, certain Member States—notably Ireland[44]—have objected to the legal basis for the legislation, arguing it is an EU tax measure rather than accounting policy (which, under EU rules, would mean every EU Member State could veto the draft legislation, whereas an amendment to the Accounting Directive only requires the support of a qualified majority of EU countries).[45] This area of contention could render the EU's CbC requirements vulnerable to legal challenge before the EU Court of Justice.

4.15 There are also substantive political concerns about the new Directive. For example, the German Government has previously argued that companies headquartered outside of the European Union will find it easier to withhold information on tax paid in non-EU jurisdictions, which the Directive itself explicitly acknowledges. This could therefore potentially put EU-based multinationals at a competitive disadvantage (by requiring them to disclose sensitive information that their competitors outside the EU can keep confidential).[46] Similarly, civil society groups have warned that, by requiring disclosure of tax paid in some specific non-EU jurisdictions but not others, the Directive could incentivise multinationals to artificially shift more profits to the latter, to avoid the new transparency requirements.[47]

4.16 The European Parliament's lead negotiator on the Directive (Green MEP Sven Giegold) has countered that most profit-shifting by multinationals "is between the EU's 27 Member States", and that the Directive could trigger "a positive dynamic that can encourage other countries to adopt similar initiatives". It is however likely that there will be further efforts in the future to expand the scope of the EU's country-by-country reporting requirements to MNE's tax affairs in more jurisdictions.[48]

43 See Recital 6 of the draft Directive.

44 The fact that the envisaged disclosures may also show certain EU countries account for a share of corporation tax paid by large companies disproportionate to the size of their domestic market may be part of their concerns.

45 The draft Directive as tabled is based on Article 50 TFEU, which allows the EU to set company law, rather than Article 115 TFEU, which covers EU tax policy such as corporate tax. The crucial difference is that new rules under Article 50 only need the support of a Qualified Majority of Member States in the EU's Council of Ministers, whereas Article 50 legislation requires unanimity, giving each country a veto.

46 In addition, the Directive's approach may incentivise multinationals to book more of their tax in jurisdictions not subject to the EU's country-by-country requirements.

47 Politico.EU, "NGOs blast EU tax transparency bill as 'almost meaningless'" (1 June 2021).

48 The European Commission will be required to publish an evaluation of the EU's CbC reporting requirements four years after they take effect, i.e. by early 2027.

Implications for the UK and the Government's position

4.17 The UK of course left the European Union on 31 January 2020, but the Government has maintained the requirement for companies to submit information to HM Revenue & Customs (HMRC) on their tax affairs in different jurisdictions on a confidential basis. The UK also continues to exchange this information with the tax authorities of certain other countries (including all 27 EU Member States).[49]

4.18 As it is no longer a Member State, the UK will not be required to implement any new EU legislation on country-by-country reporting of a company's tax affairs. Nevertheless, the Government has previously been supportive of international efforts to introduce public country-by-country reporting for multinationals.[50] Indeed, in 2016—before Brexit—the Treasury specifically noted that an EU-wide approach would allow the UK to introduce country-by-country reporting, because "EU agreement reduces the impact on the UK's competitiveness because the requirements for public CbC reporting would be introduced across all Member States".[51] Indeed, the then-Government believed that there was case for requiring MNEs "to publish breakdowns of both their EU and non-EU operations to allow the public to see the tax paid and profits made for each country in which a MNE operates", which would go further than the new EU rules (see paragraph 9 above) and would avoid the potential issue with companies shifting tax affairs to jurisdictions not caught by the EU's new country-by-country reporting requirements.

4.19 Ministers have previously said they would support the introduction of general public country-by-country tax transparency requirements for multinationals[52] on a multilateral basis (to avoid an impact on the competitiveness of UK businesses of doing so unilaterally),[53] and indeed already have the power to do so by means of regulations under the Finance Act 2016.[54] However, their enthusiasm appears to have waned more recently. In April 2021, when the EU was close to finalising its new rules, the Treasury told us that its preference was for a "genuinely global approach to public country-by-

49 The UK CbC regime is set out in s122 of the Finance Act 2015 and SI 2016/237, based on model legislation published by the OECD, as part of the BEPS project in Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 (5 October 2015). HMRC reviewed the financial implications of implementing the OECD CbC reporting model in the UK for the Autumn Statement 2014—the measure was estimated to yield £45 million over the five-year period, 2015–16 to 2019–20.

50 When the European Commission first published the draft CbC Reporting Directive in 2016, the Government told Parliament that the proposed EU approach was "appropriate and proportionate" to address aggressive tax planning by MNEs because "the nature of globally mobile firms and capital, a coordinated multilateral approach is necessary to effectively deal with the issue".

51 The Minister told us that the Commission's proposal was "in line with the Government's objective of further enhancing tax transparency by introducing public CbC reporting on a multilateral basis". In 2016, then Chancellor (George Osborne) pressed his EU and international counterparts at the ECOFIN Council and G20 meetings to push for the details of tax paid by MNEs to be made publicly available on a CbC basis.

52 The Government has maintained existing public country-by-country requirements for banks and the extractive industries that were initially introduced under EU law: see the Capital Requirements (Country-by-Country Reporting) Regulations 2013 and the Reports on Payments to Governments Regulations 2014.

53 For example, the Government said in November 2017 that a move to country-by-country reporting unilaterally "would certainly make the UK less competitive than other tax jurisdictions", although it would "continue to work towards bringing in […] public country-by-country reporting". Similarly, in December 2020, Treasury Minister John Glen MP told the House that "only a multilateral approach would be effective in achieving transparency objectives, and avoiding disproportionate impacts on the UK's competitors or distortions regarding group structures".

54 Paragraph 17(6) of schedule 19 to the Finance Act 2016 allows the Treasury, by regulations, to require a company's group public tax strategy to include a CbC report with the information that it is already required to submit confidentially to HMRC.

country reporting, which commands wide international support[55] The Treasury did acknowledge that negotiations on the substance of the EU's rules were still on-going at that point. Therefore, it was "following developments" but would "wait to see the final version of the draft Directive before it considers any implications for the UK".[56]

4.20 From the Treasury's correspondence, it is clear its focus in the field of international tax reform is on the work on-going within the OECD to establish new rules on the allocation of multinationals' taxable profits and on an international minimum corporate tax rate. These initiatives, it said, "would go to the root of concerns about the taxation of multinationals, both as to where these corporations are taxed and as to the level at which they pay tax". The OECD proposals do not, however, include measures requiring multinationals to publicly reveal where they pay tax. We note in this respect that the EU is nevertheless pushing ahead with its Directive, the US lawmakers are also still actively pursuing public CbC requirements under a draft "Disclosure of Tax Havens and Offshoring Act".[57]

4.21 Irrespective of the Government's position on introducing public CbC requirements in the UK, the new EU Directive can impact UK multinationals with EU operations. When the EU rules take effect, relevant multinationals will be required to disclose their tax payments on a country-by-country basis in line with the provisions of the EU's transparency rules, insofar as their subsidiaries and branches within the EU are authorised to publish this information by their UK parent undertaking.

4.22 In addition, the EU's push for tax transparency could also have ramifications for companies that shift their profits through certain jurisdictions linked to the UK that are often seen as tax havens, like the British Virgin Islands and the Channel Islands. As things stand, tax paid by multinationals in the British Overseas Territories and Crown Dependencies would not need to be disclosed separately under the Directive, because they are not listed on the EU's tax haven list.[58] However, as noted above, the substance of the EU list may have changed by the time the rules take effect in 2023. It is relevant in this respect that the offshore tax rules of several dependent territories linked to the UK are currently being reviewed by the EU.[59] If they are included on the EU Finance Minister's tax haven list, in the future the tax payments made by multinationals within the scope of the EU Directive in those jurisdictions may become available for public scrutiny, potentially triggering additional political pressure for these territories to alter their tax and transparency laws.

55 In previous correspondence with us, Ministers had referred to the desirability of a multilateral arrangement, rather than necessarily a "global" one, which is clearly a higher bar.

56 There is nothing in the new UK/EU Trade & Cooperation Agreement (TCA) that obliges the Government to introduce similar measures to the EU in that respect. The TCA reiterates both sides' support the OECD's 2015 BEPS Action Plan, on which the EU's public CbC Reporting Directive builds, but it does not specify any particular legal commitments or actions to be undertaken by the UK and EU jointly in this area.

57 The Bill was recently approved by the House of Representatives and is currently awaiting consideration by the Senate.

58 The territories currently being reviewed in relation to their tax treatment for partnerships are Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, the Isle of Man and Jersey, as well as Barbados.

59 In addition, it cannot be ruled out that the provisions of the EU Directive governing for which jurisdictions MNEs must disclose the amount of tax paid will be amended in the future to expand the scope of the country-by-country transparency requirements. A first review of the legislation is due in 2027.

Conclusions and action

4.23 This year, the EU is poised to become the first major jurisdiction to introduce public country-by-country reporting requirements for multinationals. The geographic scope of these new tax disclosure rules is somewhat unstable, because the list of non-EU countries for which tax payments must be publicly disclosed will be reviewed, and possibly changed, by EU Finance Ministers twice a year.

4.24 Despite recent momentum within the OECD and G7 towards substantive reform of the allocation of taxable profits and a global minimum corporate tax rate, a large majority of EU countries evidently believe transparency measures are still desirable. Indeed, it appears that substantive tax reform at international level does not preclude the need for or desirability of public country-by-country reporting rules, which would increase opportunities for scrutiny of the extent to which multinationals' tax affairs actually change and shift in response to the OECD's reforms, if agreed and once implemented. We accept, however, that the introduction of parallel public CbC reporting requirements developed separately by different jurisdictions may not yield optimal results, in particular with respect to the geographical scope of the country-by-country requirements given the EU's idiosyncratic compromise that will see the scope of its rules subject to change twice-yearly.

4.25 However, for the purposes of public and parliamentary debate, we believe it would be helpful for the Treasury to clarify the UK's position, having previously supported the EU's efforts and insisted on a multilateral approach. We have therefore written to the Financial Secretary to the Treasury for clarification of the Government's position on the need for public CbC reporting, and its assessment of the new EU rules in providing the basis for a multilateral approach to that effect. A copy of that letter is annexed below. While we await the Financial Secretary's response, we draw these developments to the attention of the Business, Energy and Industrial Strategy Committee, the Public Accounts Committee and the Treasury Committee.

4.26 The Committee notes that the EU has also announced a number of other policy measures related to corporate taxation and transparency, including proposals to implement any future agreement within the OECD on profit allocation and corporate tax rates, rules to "neutralise the misuse of shell entities for tax purposes", and further transparency measures on the effective tax rates paid by large companies. The Committee will consider the potential impact of these initiatives on the UK, where necessary, when more details are available in due course.

Letter from the Chair to the Financial Secretary to the Treasury (Jesse Norman MP)

Thank you for your letter of 20 April on the draft EU Directive to introduce public country-by-country tax reporting for multinationals.[60] You will be aware that the EU's legislators reached agreement on the final text of the Directive last month. Following formal adoption, it will require increased transparency from large companies about profits booked and tax paid in each EU country and in certain non-EU jurisdictions included on the bloc's tax haven list, starting in 2023.[61]

60 Document COM(2016) 198, 7949/17 (37663).

61 Council document 9547/21.

The Government has consistently said it would consider the introduction of public CbC transparency rules under UK law based on a "multilateral approach", to avoid "disproportionate impacts on the UK's competitors or distortions regarding group structures". In your latest letter, you appear to have gone a step further by referencing the need for a "global approach". However, you also noted that your Department was "following developments" in Brussels and would "wait to see the final version of the draft [EU] Directive before it considers any implications for the UK". We note that US lawmakers are also actively pursuing public CbC requirements under a draft "Disclosure of Tax Havens and Offshoring Act".

In your reply, you also drew attention to the separate OECD proposals for international rules on the allocation of taxable profits and corporate tax rates, which would "go to the root of concerns about the taxation of multinationals, both as to where these corporations are taxed and as to the level at which they pay tax". The implication appears to be that agreement on the OECD proposals may, in the Government's view, obviate the need for public CbC reporting.

In light of this, it would be helpful if you could:

- clarify if the Government is pushing for CbC transparency obligations for multinationals as part of the OECD talks referenced in your letter, and indeed whether it believes such disclosure requirements would still be necessary if there is an international agreement on "where these corporations are taxed and as to the level at which they pay tax";
- set out your Department's analysis of the final text of the EU Directive; and
- clarify the Government's position on introducing public CbC reporting requirements under UK law even if there is no reference to such a measure in a future OECD agreement, in light of recent developments in the EU and the US.

We look forward to receiving your reply by 31 July 2021.

5 EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve[62]

This EU document is politically important because:

- it creates a €5.3bn (£4.6bn) support fund for EU Member States to help their regions, industries and public authorities adjust to the new, post-Brexit trading relationship with the UK. Ireland and the EU fisheries sector in the North Sea are singled out for particular assistance. Where the Reserve is used to provide EU-based companies with subsidies, this may raise competitiveness concerns for UK businesses under the new Trade and Cooperation Agreement with the EU.

Action

- Write to the Chief Secretary to the Treasury (Rt Hon. Steve Barclay MP) to clarify the Government's position on the EU's Brexit Adjustment Reserve and its implications for the UK.

- Draw the Brexit Adjustment Reserve to the attention of the Business, Energy and Industrial Strategy Committee, the Environment, Food and Rural Affairs Committee, the International Trade Committee, the Northern Ireland Affairs Committee, the Scottish Affairs Committee, the Treasury Committee and the Welsh Affairs Committee.

Overview

5.1 Following the UK's exit from the EU's Single Market and Customs Union at the end of the post-Brexit transitional period on 31 December 2020, the new trading relationship based on the new Trade and Cooperation Agreement (TCA) took effect. While the TCA retains tariff-free trade in goods between Great Britain[63] and the EU (subject to rules of origin requirements), many non-tariff barriers related to regulatory,[64] customs[65] and tax formalities[66] now apply to trade between the UK and the EU that were absent until the

62 Proposal for a REGULATION establishing the Brexit Adjustment Reserve; COM(20) 854; Legal base: Articles 175 TFEU and 322(1)(a) TFEU; ordinary legislative procedure; QMV; Department: HM Treasury; ESC number: 41771.

63 Special arrangements apply in and to Northern Ireland with respect to trade in goods with the EU under the Protocol on Ireland/Northern Ireland in the Withdrawal Agreement.

64 See for example guidance by the Department for Environment, Food and Rural Affairs, "Export or move food, drink and agricultural products" (January 2021). UK services providers like musicians, architects and lawyers have also broadly speaking lost their ability to offer their services freely throughout the EU, and must now meet the applicable rules and regulation in each individual EU Member State, including work permits.

65 British exports of goods to the EU now require customs declarations and other formalities. Making use of the tariff-free provisions of the UK/EU trade deal also requires companies to demonstrate compliance with the relevant rules of origin.

66 For example, in relation to import Value Added Tax: BBC News, "EU firms refuse UK deliveries over Brexit tax changes" (4 January 2021). See also the European Scrutiny Committee Report of 30 January 2019 on changes to EU VAT rules for online shopping and how these might affect UK-EU trade in a post-Brexit context.

end of 2020. Similarly, the Agreement gradually reduces the EU's quotas to fish in British waters, as the UK is no longer bound by the Common Fisheries Policy. These changes appear to have contributed to a decrease in UK-EU trade since the start of the year, although it is difficult in practice to disentangle the effects of Brexit in that respect from the impact of the Covid-19 pandemic and changes in trade patterns are highly variable across sectors.[67]

5.2 In June 2020, anticipating certain "unforeseen and adverse consequences" of the less integrated trading relationship between the UK and the EU as a result of our withdrawal, EU leaders agreed in principle on the establishment of a "Brexit Adjustment Reserve" ("the Reserve" or "BAR"). As we noted in our Report of 20 January 2021, this is a €5.3 billion[68] (£4.6 billion) funding programme, financed from the EU budget, to support Brexit-related policy measures in the 27 remaining Member States. In particular, countries are expected to use their share of the money—subject to EU State aid rules—to support to sectors and regions that are facing particular difficulties following the UK's withdrawal.[69] For example, France has announced its intention to use €100 million (£86 million) of its share of the Reserve to financially support fishermen and coastal communities along its western coast affected by quota reductions in UK waters after Brexit.[70]

5.3 The UK, naturally, will not be able to tap into the Brexit Adjustment Reserve nor contribute to it, as it is no longer an EU Member State. Instead, the Government has opted for sectoral Brexit-related support schemes rather than an overarching fund, for example for small businesses, fisheries and ports. Nonetheless, this EU funding programme may have implications for the UK. In particular, since EU countries could use their share of the €5.3 billion funding pot to grant subsidies to companies in the private sector, it could have an impact on the "level playing field" between the UK and the EU.[71] The UK Government has certain (limited) options under the TCA to challenge any subsidies to businesses financed from the BAR if it believes they have, or could have, a "negative effect on trade or investment" between the UK and EU.[72] The Government has not indicated whether it has any concerns about the Brexit Adjustment Reserve in that regard.

5.4 In the remainder of this chapter we have summarised the design of the Reserve as agreed in early June, followed by an assessment of its potential implications for the UK.

67 According to the Office for National Statistics, total trade in goods with EU countries decreased over 23% in the first quarter of 2021 compared to the same period in 2018, whereas trade with the rest of the world decreased by less than a per cent. The ONS chose 2018 as the comparator year in an attempt to address the impact of Covid-19 on trade patterns in 2020.

68 The Reserve's budget is set at €5 billion in 2018 prices. Using a 2% annual deflator, this amounts to approximately €5.3 billion in current prices.

69 The BAR financial support will be additional to EU funding Member States are due to receive from 'routine' European programmes like the Cohesion and Regional Development Funds in the coming years, as well as coming on top of their share of the special €750 billion EU Coronavirus Recovery Instrument. These could also be used for Brexit-related initiatives, provided they are in line with the objectives and requirements of these programmes.

70 Funding from the BAR can also be used by Member States for other purposes, for example to hand additional resources to public entities with Brexit-related tasks (such as their customs authorities). See paragraph 7 for more information.

71 For example, EU-based companies that receive financial support through the Reserve could compete more efficiently with their UK competitors in different markets, or become more attractive to investors if their operations are seen to be underpinned by taxpayer support.

72 In addition, normal EU State aid rules—although considerably relaxed in the context of the Covid-19 pandemic—still apply to any measures financed from the Reserve, which could limit any anti-competitive effects for the UK.

The EU's Brexit Adjustment Reserve

5.5 As noted, the Brexit Adjustment Reserve is a new funding programme under the EU budget. It is being established specifically in response to the UK's withdrawal from the European Union, to help the remaining 27 Member States address "barriers to trade flows, an increase in administrative and custom procedures and greater regulatory and financial burden" in trade with the UK. The European Commission tabled a formal proposal to establish the Reserve in December 2020, and talks took place throughout the first half of 2021 within the European Parliament and the EU's Council of Ministers—where its 27 national governments are represented—on the final design of the programme. On 17 June 2021, the two institutions announced they had reached agreement on the Reserve.[73] The legislation formally establishing the BAR is due to be approved by the Parliament and Council in September 2021, with the first payments to be made to the Member States shortly thereafter.

5.6 The objective of the programme is to give the 27 remaining Member States additional financial support to fund public spending on Brexit-related measures. The BAR's total budget is €5.3 billion (£4.6 billion).[74] Approximately 80 per cent of this amount—€4.2 billion (£3.6 billion)—will be distributed between the EU Member States in three annual instalments from 2021 to 2023, with the remainder held in reserve for the time being. Each country's initial national allocation is determined using a formula based on its overall volumes of trade with the UK, the population of its "maritime border regions" with the UK,[75] and the level of dependence of its fishing communities on access to British waters. Although no public overview of the exact breakdown of the Reserve between EU Member States appears available, in practice this means countries nearest to the UK will receive the lion's share of the support. Ireland is set to be the largest beneficiary, in line for more than €1 billion (£860 million). Other significant recipients will be France, Belgium and the Netherlands.

5.7 Given the rationale for its establishment, EU countries are expected to use their share of the Reserve to pay for measures to support their businesses, industries and others affected by the UK's withdrawal. The Regulation lists the following "eligible measures" for which the money can be deployed:

- support for private and public businesses, including SMEs and the self-employed, as well as, more broadly, local communities and economic sectors "adversely affected" by the UK's withdrawal,[76] in particular "businesses, regional and local communities and organisations […] dependent on fishing activities in the United Kingdom waters";[77]

73 The key issue in the negotiations appears to have been the formula for apportioning the available funds between the 27 EU Member States, which is one of the few areas where significant changes have been made to the Reserve compared to the original Commission proposal. Notably, the factor relating to the population of UK-adjacent maritime regions was absent from the original text.

74 The Reserve's budget is set at €5 billion in 2018 prices. Using a 2% annual deflator, this amounts to approximately €5.3 billion in current prices.

75 The factor linked to the maritime border regions is obtained by calculating the share of each Member State in the total population of maritime border regions with the UK, which have, or are near to, a coastline which is located no more than 150 kilometres from the UK coastline.

76 The Reserve itself will not be directly open to funding requests from businesses: all funds will be distributed to the national governments of individual EU countries, which then decide to what extent they want to pass it on in the form of financial support for the private sector.

77 This could include schemes for "job creation and protection", including "re-skilling and training in adversely affected sectors".

- measures to maintain or improve the capacity of EU public authorities that carry out "border, customs, sanitary and phytosanitary, security and fisheries controls" vis-à-vis the UK, as well as support for organisations that facilitate placing of EU goods on the UK market and vice versa (such as certification and authorisation of products, conformity assessments, labelling and marking);

- communication campaigns aimed at both EU citizens and businesses to inform them "about changes stemming from" Brexit; and

- support for EU citizens, and others with a right to reside in the EU, who have left the United Kingdom as a result of Brexit and the end of free movement of people between the EU and the UK.

5.8 The legislation establishing the Reserve does not allocate specific amounts to be spent on the different types of eligible measures listed above. However, EU countries with the fishery sectors most affected by Brexit are required to spend a certain proportion of their share on "coastal communities".[78]

5.9 Although the first funds from the Reserve will not be disbursed until September 2021, EU countries do not need to wait until then to begin implementing any measures that fall within the above categories. Rather, any relevant initiatives they fund from their national budget since January 2020 are retroactively eligible for financial support from the Reserve. Indeed, Member States will receive their allocation from the BAR in 2021, 2022 and 2023 without needing to submit plans in advance detailing how they intend to spend the money. Instead, they will retrospectively submit a report to the European Commission, in 2024, to demonstrate how they have used their share of the funding. Based on those reports, the Commission will consequently decide whether to request some of the money back (because it was not used for eligible Brexit-related purposes), or conversely provide additional financial support from the Reserve—using the remaining surplus—where necessary.[79]

5.10 It is important to note that the Reserve is meant to provide support for Brexit-related measures that EU countries may have chosen to implement in any event: the BAR is not a legal authorisation or precondition for governments to plan the types of initiatives described above. They would have been free to pursue such policies even if the Reserve had not been established, as the BAR functions only to provide EU financial support to reduce their cost to national budgets. It therefore acts as an incentive for EU countries to spend more on such measures than they would otherwise have done. It also follows that individual Member States are free to spend more than their share of the Reserve to address any Brexit-related policies at their own expense (provided they are, where relevant, compliant with EU State aid restrictions on subsidies to individual businesses, as

78 Article 4(4) of the Regulation establishing the BAR stipulates that EU countries whose allocation from the Reserve "includes an amount exceeding €10 million determined on the basis of the factor linked to fish caught in the waters that belong to the UK" have to "spend at least 50% of this amount [linked to fisheries] or 7% of their [total] allocated amount, whichever is lower, to support local and regional coastal communities, including the fisheries sector in particular the small scale coastal fisheries sector dependent on fishing activities".

79 More specifically, based on the EU Member States' formal reports in 2024, the European Commission will calculate an "accepted amount" of funding from the Reserve to which each Member State is entitled. Where this amount is less than what a country had already received, it will have to repay the difference. Conversely, where the amount exceeds the amount received from 2021 to 2023, that Member State can receive additional financial support from the remaining surplus of the Reserve

we discuss further below). As such, the full amount of public expenditure on preparations for, and adjustments to, the new realities of the EU's post-Brexit relationship on the EU side is likely to be higher than the €5.3 billion budget of the Reserve.[80]

5.11 Based on the decision to release funds from the Reserve in advance and only retrospectively check how the money was spent, it is not yet clear how individual EU countries intend to spend their share.[81] The only concrete example publicised by the European Commission is the aforementioned €100 million French support scheme for its North Sea fisheries sector to address the immediate impact of the UK's withdrawal from the Common Fisheries Policy.[82]

Implications of the Brexit Adjustment Reserve for the UK

5.12 Naturally, the support from the EU's Brexit Adjustment Reserve is not available to the UK, as it is now a "third country" vis-à-vis the European Union and no longer automatically entitled to access funding from the EU budget.[83] Instead, the provision of any support of a similar nature is the responsibility of the Government and the devolved administrations.

5.13 Nevertheless, in our first Report on the Brexit Adjustment Reserve of 20 January 2021, we concluded that the BAR was "of interest to the UK, even if it will not benefit from it directly", because the financial support envisaged could help EU businesses overcome some of the initial hurdles for trade with British customers and suppliers, or help them diversify their supply chains or customer base away from the UK instead. Now that the legislation underpinning the Reserve has been finalised, we have undertaken a fresh assessment. Some of the possible impacts of the Reserve are tangentially positive for the UK, for example because they could help EU businesses and public authorities familiarise themselves more quickly with the new trade formalities that have arisen post-Brexit, and help mitigate any UK-EU supply chain issues.

5.14 It is concerning that a significant proportion of the Reserve's €5.3 billion budget could be channelled into private sector subsidies for EU businesses.[84] Given that the money has to be spent specifically to mitigate or address the implications of the UK's withdrawal, and the bulk of the Reserve is earmarked for countries with the closest economic links to the UK, it is possible that these subsidies could have an indirect impact on the competitiveness of British companies and sectors. For example, money from the Reserve could provide businesses in the EU with financial support to export their products more easily (either

80 For example, because any money spent on preparing for Brexit before 1 January 2020 is not eligible for support from the Reserve. Many Member States began their preparations well before that date, given the UK was originally due to withdraw from the EU in March 2019.

81 Aside from the detailed assessment of how individual Member States have used their allocation under the Reserve, the European Commission must also carry out a review of "the state of play of the implementation process" by summer 2024, followed by a formal evaluation report in 2028.

82 While this French scheme has been approved by the European Commission under EU State aid rules, whether it is eligible for financial support from the Brexit Adjustment Reserve will, as noted, only be verified by the Commission after France submits its BAR implementation report in 2024.

83 Although the UK still makes payments to the EU under the financial settlement set out in the Withdrawal Agreement, this is in relation to EU spending commitments made on or before 31 December 2020. Similarly, although the UK has negotiated access to certain specific EU research funding programmes—which must still be formally approved by means of a Protocol to the TCA—that arrangement does not include the Brexit Adjustment Reserve.

84 As noted, it is not clear at this stage how individual EU countries will spend their share of the Reserve but it seems likely a large proportion, if not the majority, of the funds will be used to support the private sector.

to the UK or elsewhere), or help EU businesses in financial difficulty because of Brexit stay solvent for longer than they would otherwise have done.[85] This may distort the ability of UK counterparts to compete with them on a "level playing field", particularly where British businesses do not have access to similar levels of financial support from UK taxpayers.[86] Northern Ireland may be particularly exposed in this regard, because Ireland is set to receive more than €1 billion from the Reserve, or approximately one-fifth of the BAR's entire budget.

5.15 However, any financial support provided by EU countries to their private sectors with support from the Brexit Adjustment Reserve will need to meet EU State aid requirements:[87] this means that in certain cases, where existing exemptions are not applicable, governments will need advance permission from the European Commission before subsidies can be granted. More generally, the broader set of EU rules that govern how Member States can subsidise their industries apply, for example in relation to transparency and recovery of unlawful subsidies. This may help to lessen any distortive effects on cross-border competition arising from the Reserve, although EU scrutiny of Brexit-related subsidies planned by its Member States will focus on the effects of competition within the European Union, rather than on competition with the UK.

5.16 Moreover, irrespective of whether particular subsidies funded from the Brexit Adjustment Reserve are cleared under EU State aid rules, the new UK/EU Trade and Cooperation Agreement (TCA) also contains specific subsidy control obligations. These impose constraints on both the UK and EU (and its Member States) when subsidising their respective private sectors.[88] Of particular relevance (in the context of the BAR) is that the TCA allows the Government to challenge the EU if it has concerns that a particular subsidy granted by the latter "has or could have a negative effect on trade or investment" between the UK and the EU. It may also ultimately be able to impose "remedial measures" where it considers that such a subsidy "causes, or there is a serious risk that it will cause, a significant negative effect" on trade and investment between the Parties, in a bid to neutralise the alleged unfair competitive advantage the subsidy confers directly or indirectly on businesses on the other side.

85 For example, as noted, France has already earmarked €100 million from the Reserve to support its fishing sector in the North Sea, notably to help it weather disruption caused by the new restrictions on access to UK waters. While the Government has already opened a Brexit-specific support scheme for the UK fishing industry (the £23 million Seafood Disruption Support Scheme), it is yet to publish details about its additional £100 million fund to help the sector which the Prime Minister announced in December 2020.

86 This is without prejudice to the State aid provisions under Article 10 of the Northern Ireland Protocol, under which certain subsidies provided by UK public authorities remain within the scope of EU State aid law rather than the subsidy control provisions of the TCA.

87 While the Regulation establishing the BAR does not explicitly state that EU State aid rules apply to measures implemented by Member States with support from the Reserve, Article 5(4) states that such measures "… referred to in paragraph 1 shall comply with applicable law", which is in turn defined as "Union law", including therefore EU State aid rules. The European Commission has also explicitly said that "EU State aid rules fully apply to BAR-financed support measures". It should be noted that EU State aid rules have been significantly relaxed until at least the end of 2021, in the context of the Covid-19 pandemic.

88 As part of a wider "level playing field" arrangement, the TCA sets out a number of principles that certain subsidies within the scope of the Agreement, whether granted in the UK or the EU, must adhere to. Subsidies are subject to various high-level legal principles, such as the need for them to be "proportional and limited". Certain subsidies may be prohibited altogether, while others may be permitted but subject to specific conditions. For the UK, these provisions are relevant only to the extent to which EU State Aid law does not already apply directly under Article 10 of the Northern Ireland Protocol. The Government set out its plans for the UK's new post-Brexit subsidy control regime on 30 June 2021.

5.17 Whether any subsidies financed from the Brexit Adjustment Reserve could give rise to concerns about the 'level playing field' is only likely to become apparent in the coming years, given that the funds are to be disbursed without detailed plans and the Commission will only check the eligibility of the initiatives financed in 2024. Transparency requirements under EU State aid law, which means certain information on subsidies granted by individual EU countries must be published online, should facilitate monitoring of the implementation of the Reserve in the meantime. However, detailed analysis may still be necessary to determine whether a particular subsidy funded from the BAR is harmful to the UK. Moreover, should the Government wish to initiate a formal challenge under the TCA to any such subsidies in due course, its ability to successfully address any concerns about fair competition would be limited by two characteristics of the "subsidy control" provisions in the UK/EU trade deal:

- first, some types of subsidies are outside the scope of the TCA's subsidy control provisions. In the context of the Brexit Adjustment Reserve, two exemptions are especially relevant.[89] First, a subsidy for a particular company must exceed the "*de minimis*" threshold of 325k Special Drawing Rights[90] (currently approximately £333k or €385k) over three years for it to fall within the scope of the TCA.[91] In addition, the subsidy control chapter does not apply to any "subsidies related to trade in fish and fish products". This is especially relevant because the EU fisheries industry is singled out as a particular beneficiary of support from the BAR, as shown by the €100 million French scheme; and

89 The TCA also contains certain other exemptions that are less likely to be relevant to the Reserve, namely for subsidies "of a social character that are targeted at final consumers" and for subsidies "related to the audio-visual sector".

90 Special drawing rights (SDR) are supplementary international reserve assets defined and maintained by the International Monetary Fund (IMF).

91 In this context, it is not the size of the Brexit Adjustment Reserve as a whole that matters, or the payment of funds by the Commission to the Member States, but the size of any subsidies subsequently provided to individual undertakings using this money.

- second, even insofar as subsidies provided with financing from the Reserve are in scope of the TCA, the Government cannot use the Agreement to *prevent* or *reverse*[92] a decision by the EU or its Member States to provide specific subsidies.[93] It can only impose "remedial measures" in an attempt to nullify any unfair competition[94] that could, in turn, trigger retaliatory measures by the EU.[95]

5.18 In summary, while the Reserve may have implications for the level playing field between the UK and the EU, the Trade and Cooperation Agreement does not provide any legal route for the Government to prevent an EU country from providing subsidies to its private sector, but it can challenge them and, in certain cases, if considered necessary, take remedial measures.

The UK Government's position on the Brexit Adjustment Reserve

5.19 On 9 February 2021, the Chief Secretary to the Treasury (Rt Hon. Steve Barclay MP) submitted an Explanatory Memorandum on the Brexit Adjustment Reserve, setting out the Government's position.[96] With respect to the potential impact of the subsidies from the Reserve for EU businesses on their UK competitors, the Minister only notes obliquely that the TCA allows the Government to "challenge EU subsidies which significantly harm the UK", including those "granted at the supranational level" (namely funding, such as the BAR, given by the EU institutions). The Minister did not indicate whether the Government is considering such action at that stage, given that the legal text underpinning the Brexit Adjustment Reserve was then still being negotiated.

5.20 We have not received an update from the Minister following the agreement reached at EU-level in June on the final design of the Brexit Adjustment Reserve and its imminent implementation in the coming months.

5.21 While the Government has of course spent significant sums on the UK's Brexit preparations, it has not set up a cross-sectoral fund analogous to the Brexit Adjustment Reserve. Instead, Ministers have opted to establish various support mechanisms for specific sectors, in particular the £23 million Seafood Disruption Support Scheme (to

92 Domestic courts in the UK or EU could order repayment, or "recovery", of the subsidy if it is found to be unlawful under the terms of the TCA. However, recovery is not required where the subsidy was granted on the basis of an Act of Parliament or an act "of the European Parliament and of the Council". The Regulation establishing the Brexit Adjustment Reserve would be an example of the latter, meaning the TCA does not require EU Member States to allow for recovery of subsidies funded from the Reserve, even if it had a "negative impact on trade and investment" between the UK and EU.

93 In particular, arbitration tribunals established under the Agreement in the context of a dispute resolution procedure over a subsidy are explicitly prohibited from assessing the compliance of an individual subsidy against the provisions of the TCA. Instead, the TCA largely relies on "vertical remedies": this is where interested parties, such as competitors of the beneficiary of a subsidy or trade bodies representing such companies collectively, can challenge subsidies before the courts of the UK or the EU Member States.

94 Such remedial measures could include, for example, tariffs on EU imports that the UK believes benefitted from a distortive subsidy.

95 If the UK imposed remedial measures under the TCA in response to a subsidy on the EU side, the EU would be entitled to ask an independent arbitration tribunal to assess these measures, in particular whether they are "appropriate" and "proportionate" based on the evidence that the EU's subsidy causes, or is likely to cause, "a significant negative effect on trade or investment". If the tribunal ruled the UK's counter-measures were inconsistent with the terms of the Agreement, the EU could ask for a further tribunal ruling setting out an equivalent suspension of its obligations vis-à-vis the UK under the trade agreement, for example to impose retaliatory tariffs on UK goods. If the tribunal decided that the UK's remedial measures were in compliance with the TCA, the EU could not seek a suspension of its obligations.

96 The Memorandum also notes the Commission proposal "has no direct financial implications for the UK" as it "will not be participating in or contributing to the Brexit Adjustment Reserve".

be supplemented by a further £100 million fund to "help modernise fishing fleets [and] the fish processing industry", which the Government announced in December 2020, but details for which are lacking at present). There are also, for example, Brexit-related funding pots for small businesses and ports. Therefore, a like-for-like comparison between UK Brexit-related support mechanisms and the EU's Brexit Adjustment Reserve is difficult.

Conclusions

5.22 The EU's new Brexit Adjustment Reserve has clear relevance for the UK. In particular, the granting of subsidies to EU businesses financed by the Reserve could make it easier for EU companies to navigate the new post-Brexit formalities when transacting with suppliers or customers. Conversely, the Reserve could have an impact on the competitiveness of UK businesses if used for subsidies that boost the position of specific EU sectors—like the fisheries industry—vis-à-vis their British counterparts, possibly justifying discussions between the Government and the EU to address any subsidies which could, in the Minister's words, "significantly harm the UK".

5.23 At this stage, it is not clear what amount of the Brexit Adjustment Reserve is likely to be spent by individual EU countries on subsidies for their private sector, and in turn what proportion of such subsidies could raise concerns for the UK under the level playing field provisions of the TCA. However, the amounts of money involved are significant and the concentration of this financial support in the EU countries with the closest trade links with the UK means an impact on the competitiveness of UK businesses with competitors in those countries cannot be ruled out. The €100 million support package France has announced for the fisheries sector along its western coast, to be financed from the Brexit Adjustment Reserve, is an example of this.

5.24 More generally, the focus of the Reserve on support for the EU fisheries communities—the only industry singled out specifically for support—also highlights the particular disruption faced by that sector since the UK's exit from the Common Fisheries Policy and Single Market, both in the EU and the UK. The large level of support for Ireland is similarly striking: it will receive over €1 billion from the EU in the next three years specifically to help its economy adjust to the new UK-EU relationship. Given the integrated nature of the cross-border economy on the island of Ireland, this injection of financial support for Irish businesses may have a particular impact on their competitors north of the border.

5.25 To protect the UK's right to take remedial measures in relation to subsidies funded by the BAR in the future, if considered necessary, the Government will need to carefully monitor the planned and actual use of the Reserve by individual EU countries. It is not clear what resources are being deployed within Government to do so: even though the most significant subsidy schemes relating to the BAR must be approved by the EU under State aid rules and will be published online, they would still need to be analysed by Government to ascertain their actual or potential impact.[97] Irrespective of any action taken by the UK Government under the TCA, individual companies, including UK-based

97 Indeed, the Brexit Adjustment Reserve is only one example of a subsidy scheme on the EU side that may trigger the UK's rights under the level playing field provisions of the TCA. It serves as a useful demonstration of the fact that effective enforcement of the subsidy control provisions of the TCA is asymmetrical: while the European Commission and the 27 Member States only need to monitor for UK subsidies to assess whether to initiate any consultations and, potentially, remedial measures under the TCA, the UK Government needs to monitor the provision of subsidies by public authorities in 27 countries and by the EU itself.

ones, may also be in a position to legally challenge specific subsidies funded from the BAR before the courts of the relevant EU Member State, if they consider they breach EU State aid law and/or the subsidy control provisions of the TCA.[98]

5.26 Given the potential knock-on effect of the Brexit Adjustment Reserve on the competitiveness of UK businesses, the Committee has written to the Chief Secretary to the Treasury to clarify whether the Government has any concerns that the Reserve could be used to provide subsidies with a "material effect on trade or investment" between the UK and the EU; how it intends to assess the practical use of the Reserve in the EU-27, to establish whether there is a need for the UK to raise any issues of concern with the EU under the subsidy control provisions of the TCA; and whether the Government believes its support for UK businesses to address any changes or disruptions in the aftermath of the UK's withdrawal from the EU need to be adapted in light of the EU's support programme for their businesses and regions. A copy of that letter is annexed to this chapter.

5.27 In anticipation of the Minister's reply, we draw the latest developments around the EU's Brexit Adjustment Reserve to the attention of the Business, Energy and Industrial Strategy Committee and the Treasury Committee. We consider the Environment, Food and Rural Affairs Committee may also have an interest, given the specific support foreseen for the EU's coastal communities and fishing sector to address the implications of the UK's withdrawal from the Common Fisheries Policy. Similarly, and believe the Reserve may be of interest to the Welsh, Scottish and Northern Ireland Affairs Committees.

Letter from the Chair to the Chief Secretary to the Treasury (Jesse Norman MP)

You will be aware that the EU recently reached agreement on the establishment of its so-called "Brexit Adjustment Reserve" (BAR), a €5 billion (£4.3 billion) support fund that will be divided between the 27 remaining Member States.[99] It can be used by them to finance measures that aim to address the economic impact of the UK's withdrawal from the EU, with funding to be concentrated in sectors and countries most closely linked to the UK (and where the fundamental change in our trading relationship is likely to have been felt most keenly).[100]

We previously reported the BAR to the House in January this year, noting at the time that a proper assessment of its implications for the UK was not yet possible given that negotiations on its scope, design and implementation were still on-going in Brussels. Now that the finalised legal text underpinning the Reserve is available for public scrutiny, we have considered the matter again. We note, in particular, that the Reserve may be used to a significant extent by EU countries to provide subsidies to improve the financial position of private companies in the sectors most affected by Brexit, in particular the fisheries industry, potentially putting their UK competitors at a disadvantage.

The French Government, for example, has already announced—and received EU permission for—a €100 million scheme to support the fisheries industry and communities

98 The TCA provides for "vertical remedies": this is where interested parties, such as competitors of the beneficiary of a subsidy or trade bodies representing such companies collectively, can challenge subsidies before the courts of the UK or the EU Member States.

99 Document COM(20) 854, (41771).

100 The Irish Government, for example, has announced that it is set to receive more than €1 billion from the Reserve.

along its western coast, to be funded from the Reserve.[101] Therefore, there are indications that a significant proportion of the BAR will be channelled into subsidies for the EU's private sector, concentrated in a number of countries with which the UK is particularly closely linked economically, including Ireland, France, Belgium and the Netherlands.

We note in this respect that in your Explanatory Memorandum of 9 February, in which you set out the Government's initial views on the Reserve, you said that the Government can "challenge EU subsidies which significantly harm the UK", including funding given by EU institutions. In light of this, we would be grateful if you could write to us at the earliest possible opportunity to clarify:

- whether the Government has any concerns about the EU's Brexit Adjustment Reserve, in particular whether it could be used to provide subsidies with a negative effect on trade or investment between the UK and the EU under the Trade and Cooperation Agreement;
- more generally, how you intend to monitor how the funds provided to individual EU countries from the Brexit Adjustment Reserve are used, to establish whether there is a need for the UK to raise any issues of concern with the EU; and
- whether, in light of the amount of support the Reserve is likely to provide to affected sectors and communities in the countries closest to the UK, the Government believes it may be necessary to provide any additional support to UK sectors or businesses to match the support their EU counterparts may receive from the Reserve (in particular the fisheries industry).

We look forward to receiving your reply by the end of July.

101 EU State aid cases SA.62421, SA.62426 and SA.62427.

6 Documents not considered to be legally and/or politically important

Department for Business, Energy and Industrial Strategy

(41857) - -	Commission Implementing Decision (EU) 2021/845 of 26 May 2021 amending Implementing Decision (EU) 2019/1202 as regards determination of the spontaneous ignition behaviour of dust accumulations.

Department for Environment, Food and Rural Affairs

(41848) 8942/21 + ADD 1 C(21) 3285	Commission Delegated Regulation (EU) …/... of 17.5.2021 supplementing Regulation (EU) 2017/625 of the European Parliament and of the Council with regard to the cases and conditions under which competent authorities may designate official laboratories which do not fulfil the conditions in relation to all the methods they use for official controls or other official activities.
(41861) 6860/21 + ADD 1 C(21) 1442	Commission Delegated Directive (EU) .../… of 8.3.2021 amending, for the purposes of adapting to scientific and technical progress, Annex IV to Directive 2011/65/EU of the European Parliament and of the Council as regards the validity period of an exemption for the use of mercury in electric rotating connectors used in intravascular ultrasound imaging systems.

Department for Transport

(41849) 8880/21 COM(21) 254	Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1628 as regards the transitional provisions of certain machinery fitted with engines in the power range between 56kW and 130kW, and above 300kW in order to address the impact of COVID-19 crisis.

Annex

Documents drawn to the attention of select committees:

('SNC' indicates that scrutiny (of the document) is not completed'; 'SC' indicates that scrutiny of the document is completed)

Business, Energy and Industrial Strategy Committee: Public country-by-country tax reporting of multinationals in the EU [Proposed Directive (SNC)]; EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]; Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Digital, Culture, Media and Sport Committee: Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Environment, Food and Rural Affairs Committee: EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]

Health and Social Care Committee: Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Home Affairs Committee: Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Joint Committee on Human Rights: Gender Equality: Commission Strategy and Stocktaking [(a) Commission Communication, (b) Commission Report (SC)]

International Trade Committee: EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]; Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Northern Ireland Affairs Committee: EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]; Protection of critical infrastructure [Proposed Directive (SNC)]; Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Public Accounts Committee: Public country-by-country tax reporting of multinationals in the EU [Proposed Directive (SNC)]

Public Administration and Constitutional Affairs Committee: Protection of critical infrastructure [Proposed Directive (SNC)]

Science and Technology Committee: Data adequacy [Proposed Commission Implementing Decisions (SNC)]

Scottish Affairs Committee: EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]

Treasury Committee: Public country-by-country tax reporting of multinationals in the EU [Proposed Directive (SNC)]; EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]

Welsh Affairs Committee: EU financial support for regions and sectors affected by the UK's withdrawal: the Brexit Adjustment Reserve [Proposed Regulation (SNC)]

Women and Equalities Committee: Gender Equality: Commission Strategy and Stocktaking [(a) Commission Communication, (b) Commission Report (SC)]

Work and Pensions Committee: Gender Equality: Commission Strategy and Stocktaking [(a) Commission Communication, (b) Commission Report (SC)]

Formal Minutes

Wednesday 7 July 2020

Virtual meeting

Members present:

Sir William Cash, in the Chair

Jon Cruddas

Allan Dorans

Richard Drax

Margaret Ferrier

Mr Marcus Fysh

Mr David Jones

Craig Mackinlay

Anne Marie Morris

Document scrutiny

Draft Report, proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1.1 to 6 agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Adjournment

Adjourned till Monday 12 July 2021 at 1.30 pm

Standing Order and membership

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents and—

a) to report its opinion on the legal and political importance of each such document and, where it considers appropriate, to report also on the reasons for its opinion and on any matters of principle, policy or law which may be affected;

b) to make recommendations for the further consideration of any such document pursuant to Standing Order No. 119 (European Committees); and

c) to consider any issue arising upon any such document or group of documents, or related matters.

The expression "European Union document" covers—

i) any proposal under the Community Treaties for legislation by the Council or the Council acting jointly with the European Parliament;

ii) any document which is published for submission to the European Council, the Council or the European Central Bank;

iii) any proposal for a common strategy, a joint action or a common position under Title V of the Treaty on European Union which is prepared for submission to the Council or to the European Council;

iv) any proposal for a common position, framework decision, decision or a convention under Title VI of the Treaty on European Union which is prepared for submission to the Council;

v) any document (not falling within (ii), (iii) or (iv) above) which is published by one Union institution for or with a view to submission to another Union institution and which does not relate exclusively to consideration of any proposal for legislation;

vi) any other document relating to European Union matters deposited in the House by a Minister of the Crown.

The Committee's powers are set out in Standing Order No. 143.

The scrutiny reserve resolution, passed by the House, provides that Ministers should not give agreement to EU proposals which have not been cleared by the European Scrutiny Committee, or on which, when they have been recommended by the Committee for debate, the House has not yet agreed a resolution. The scrutiny reserve resolution is printed with the House's Standing Orders, which are available at www.parliament.uk.

Current membership

Sir William Cash MP (*Conservative, Stone*) (Chair)

Tahir Ali MP (*Labour, Birmingham, Hall Green*)

Jon Cruddas MP (*Labour, Dagenham and Rainham*)

Allan Dorans MP (*Scottish National Party, Ayr Carrick and Cumnock*)

Richard Drax MP (*Conservative, South Dorset*)

Margaret Ferrier MP (*Scottish National Party, Rutherglen and Hamilton West*)

Mr Marcus Fysh MP (*Conservative, Yeovil*)

Mrs Andrea Jenkyns MP (*Conservative, Morley and Outwood*)

Mr David Jones MP (*Conservative, Clwyd West*)

Stephen Kinnock MP (*Labour, Aberavon*)

Mr David Lammy MP (*Labour, Tottenham*)

Marco Longhi MP (*Conservative, Dudley North*)

Craig Mackinley MP (*Conservative, South Thanet*)

Ann Marie Morris MP (*Conservative, Newton Abbot*)

Charlotte Nichols MP (*Labour, Warrington North*)

Greg Smith MP (*Conservative, Buckingham*)