Northern Ireland Assembly

Committee for Finance and Personnel

OFFICIAL REPORT (Hansard)

Corporation Tax: Departmental Briefing

14 March 2012

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Conor Murphy (Chairperson)
Mr Dominic Bradley (Deputy Chairperson)
Mrs Judith Cochrane
Mr Leslie Cree
Mr Paul Girvan
Mr David Hilditch
Mr William Humphrey
Mr Ross Hussey
Mr Paul Maskey
Mr Mitchel McLaughlin
Mr Adrian McQuillan

Witnesses:

Mr Paul Montgomery	Department of Finance and Personnel
Mr Bill Pauley	Department of Finance and Personnel

The opening 10 minutes of audio recording were unavailable due to technical difficulties.

Mr Bill Pauley (Department of Finance and Personnel): Although they are separate, in some ways they overlap with each other, particularly towards what might, eventually, emerge as a final or revised cost or, indeed, a final analysis of what might be the expected benefit of the measure.

In that regard, there is a work stream on costing, and there is also one on corporation-tax design issues. Corporation tax design includes considering issues such as whether different trading or non-trading profits of companies would be included in what would be devolved to Northern Ireland. The original consultation document shows that that decision would be worth between £40 million and £50 million, depending on whether we included trading profits or non-trading profits in the rate that we reduced for corporation tax. That issue relates to the costings, and we have said previously in answer to Assembly questions that we do not have an overall update on the costs or a single cost estimate that the Treasury could have signed up to or that we could report to you separately to amend that.

However, I think that progress is being made in all the work streams, as we have reported. We are discussing every aspect of costs with the Treasury. We also pointed the Committee previously to a position where, at the autumn statement, the Government revised its projections of corporation tax for the UK as a whole. That would lead to a reduction in the costs to Northern Ireland because the methodology being used showed that we were 1·5% of the UK's corporation tax rate. If the level of corporation tax that the UK expects to collect over the next spending review period falls, our percentage of it falls. If the total amount falls, 1·5% of it also falls; however, I would be reluctant to translate that to a bottom line for the Committee.

It has not been done in the ministerial working group; however, the Treasury will again publish revised projections of corporation tax alongside the budget next week. It is also possible that the Government could take further measures on corporation tax in this budget. They have announced corporation tax changes in both budgets so far, and there may be further changes in this budget that would affect those calculations. You could look at individual items and say that they are going up or down week by week; however, I do not think that we have a number that would help to change the decision-making process to allow decisions to be based on it until we reached the end of the work in total.

The Chairperson: Just for our own clarity and scrutiny purposes, you said that paragraphs 7 to 13 of the report are a reflection of ongoing work.

Mr Pauley: The ministerial working group has six work steams: implementation, corporation tax design, costings, other tax options, economic impact and non-tax options.

The Chairperson: Were those paragraphs drafted before March 7, or have they been updated to reflect the meeting on that date?

Mr Pauley: We drafted those paragraphs before March 7, but they are based on the work that we were doing with Treasury colleagues in each of the individual work streams. The March 7 meeting reported to Ministers on the progress that officials were making. The papers for that were written by and commented on with Treasury colleagues prior to March 7 as well. I forget the actual date that we sent this paper to you, but it was sent approximately two weeks —

Mr Paul Montgomery (Department of Finance and Personnel): It reflected the comments and the outcome of the meeting on 7 March.

Mr Humphrey: Thank you very much for your attendance and your presentation. Paragraph 5 mentions that the First Minister and the deputy First Minister, the Finance Minister and the Enterprise, Trade and Investment Minister represent the Northern Ireland Executive on the joint ministerial working group. Who represents the national Government?

Mr Pauley: The Exchequer Secretary, David Gauke, represents the Treasury Minister, and Owen Patterson, Secretary of State, attends.

Mr Humphrey: I share some of the Chairman's concerns. You said that you are reluctant to translate to a bottom-line figure at this stage. For us in this place and the people outside to make a decision, it has to be simplified so that every one of us can understand, assuming that I am at the Dick and Dora stage of finance. People need to understand the benefits or disbenefits for them.

You are right that it is not just a case of what happens in Northern Ireland; there is a loss to the UK Exchequer with regard to any decision on corporation tax. Although Northern Ireland is a small place, there is, nevertheless, a loss. The key thing is that people have a figure so that they can make a decision on the benefits and disbenefits.

There are benefits if the package and timing are right, but that is a big if. I would welcome the devolution of corporation tax, but only if it does not adversely affect the money that Northern Ireland plc gets through the block grant. The key thing in negotiations is getting the best deal. However, there is also the opportunity cost of not doing it. Are those pieces of work being done alongside each other?

Mr Pauley: They absolutely are, and they are very much inter-related. One work stream is on the economic impact. The consultation document that the Government published gives their estimate of the economic impacts of the measure. Some of the responses to the consultation, including from the economic advisory group that advises the DETI Minister in particular, showed a very different estimate of the potential benefits of the measure. Other respondents commented on the issues in between.

As our update paper shows, there is a substantial difference between the estimates of the economic benefit. The Treasury estimate would lead to approximately a 1% increase in Northern Ireland's GDP; whereas the economic advisory group's paper would lead to an increase in GDP of just below a 14%. The difference is huge, and that work stream is to look at the economic issues about how the different models of the economies are showing such a substantial difference.

The inter-related nature of the work shows the Committee and others how that can affect costs. One aspect of the costs of the measure are the wider economic benefits that would accrue from changes and increases from revenue from other taxation, such as income tax or national insurance, and, potentially, many other taxes. You would have a much greater increase in revenue from income tax with a 14% increase in GDP than with the Treasury's latest estimate of a 1% increase in GDP.

That work is ongoing. We are looking at how the Treasury estimates have been produced in detail and how the different estimates that have come forward, for example from the economic advisory group, produce that much higher estimate, and to try to lead the ministerial working group towards a position where they can understand the differences even if they could not agree that one or other of the figures was precisely right.

Mr Humphrey: You will understand, Bill, the difficulty for politicians, particularly Ministers, on this issue. If the Treasury talks about an increase of 1% and the economic advisory group talks about 13·8%, this is all about instilling confidence and introducing certainty. This just does not do that.

Mr Pauley: That range of estimates of potential benefits is what exists at present. In the ministerial working group, Ministers will try collectively to give their view on the range of measures that has come forward; to try, at least, to narrow the gap or give as much certainty as possible on what the range of potential benefits might be.

Mr Humphrey: There is a considerable amount of work to be done.

The Chairperson: Does the ministerial working group, including the Department, have access to data that the Treasury is using to make those assessments in order to make its own assessment?

Mr Pauley: Certain data relating to corporation tax pertain to individual taxpayers; as such, they are covered by the Data Protection Act 1998, so we do not have data for every individual taxpayer. We have drawn conclusions from looking through the Companies Registry at companies' returns. Therefore, the precise answer is that we do not have every aspect of low-level detail; however, we have a range of data, split by sectors, that show corporation tax from different sectors of the economy.

We are much happier in this phase of work than we were when we worked with Treasury and other colleagues because there is greater sharing while respecting individual taxpayers' right that some of their data will remain confidential.

Mr McLaughlin: My question deals with precisely the same area, and William has addressed the pertinent issues. I suppose that I want to take an overview, as we have had this conversation previously. We could have that power and facility; however, we would need to have all relevant information in order to decide if, in fact, it is the right thing to do in the circumstances. The closest possible agreement on revenue flows between us and the Treasury would be required to enable us to agree on outcomes of any variation of corporation tax.

Under any proposed arrangements, would the corporation-tax contributions of companies that operate throughout Britain and here be differentiated, or will that always cause confusion?

Mr Pauley: They would be differentiated. Table 1 of the paper shows costs. The first estimates of costs that were published at the time of the consultation document did not include the very last item — the branch plant effect, as it is called. The £135 million was a figure that the Treasury produced after its consultation document. Just before summer 2011, the Exchequer Secretary wrote to the First Minister and the deputy First Minister to say that further analysis had been carried out of companies in Great Britain that had a branch plant in Northern Ireland. They estimated on the basis of either the employment or output of those companies and apportioned that with regard to either the employees or value of sales in Northern Ireland in order to reach an estimate.

The branch plant estimate will always be less robust than, for example, the precise return of companies based here with a BT postcode that file their tax returns from a Northern Ireland address and are solely based in Northern Ireland. For companies that report their tax mostly from some other part of the United Kingdom but which have a part of their activity in Northern Ireland, there will always be an element of apportionment of that activity.

Good estimates are made in other tax systems, such as in the United States of America between different states. There are ways of doing it. However, it is never as precise as the first element.

Mr McLaughlin: It can be done, because, as I understand it, they do it on mainland Europe. The vulnerability, which I thought William was addressing, was a concern that I had, and your responses did not entirely reassure me that we are not at a continuing disadvantage. For example, part of the arrangement will see us paying for a service that will continue to be provided by Treasury officials and revenue officials as opposed to our replicating what already exists. It sounds like a pragmatic solution.

However, it means that information on strategic decisions on the economy and corporation tax variation is retained outwith the Assembly. We are relying on estimates, which is a word that always worries me, as opposed to receipts and the type of open-book examination that would satisfy people's legitimate concerns. However, the estimating would be done by those who supply the information to us, and they would be sending us the bill if there were an impact that we had not anticipated.

Mr Pauley: There are ways that we can double-check some individual companies for past performance by simply going to Companies Registry where such things are published for larger companies. Without wanting to leap ahead on our agenda, the draft legislation for air passenger duty has some clauses about the provision of information from HMRC to us as an Administration when it becomes our data through provisions in that draft legislation.

Mr McLaughlin: I had not thought of that.

Mr Pauley: In future, it would be our data about our tax base. HMRC is not working for us directly in that work. However, if we are making tax decisions in future, arrangements would be made to ensure that we have the best possible information on which to make them.

Mr McLaughlin: Are Treasury officials and revenue officials of the same mind as regards the interest of the existing revenue or tax take in that we both need to share that information? If there is to be profit shifting, which is something that they have to be concerned about, that conversation has to be completely transparent to us as well as to them. They may raise a legitimate concern that you would want to respond to; however, you would want to be convinced that it was in our interest as well as theirs to resolve it.

Mr Pauley: They understand that we need to be comfortable with the data. There are frictions at times between HMRC and Treasury with regard to individual corporate data that can be passed within the law as well as between us. In order to do analysis, parts of Treasury have to sign confidentiality agreements with HMRC. I expect that, in future, we would have to sign such agreements; however, sign them we would. When making decisions about our level of tax or about what amount of tax we expect to gather, we would need to have information that would allow us to make those decisions if, for example, we were basing our expenditure plans on it.

As regards the arrangements in Scotland, the Office for Budget Responsibility oversees or approves — I am not sure of the precise term — Treasury methodologies for forecasting tax revenues. That office will now have a role in separately forecasting such tax revenues for the tax incentives that have been devolved there. I imagine that, for an important tax such as this, there would be similar checks and balances and external views of the basis on which we were making key planning decisions.

Mr McLaughlin: Notwithstanding the language — I suppose that it belongs to that profession — there would be protocols that allow agreed baselines between them and us. Whether they are estimates that are 100% precise, they are agreed baselines between them and us, so that there would be no comebacks later, saying that you owe us this instead of what we said. Would there be agreed baselines on which we can inform ourselves before making policy decisions?

Mr Pauley: In the implementation work stream and in the different design options there are suggestions for how, even after we had made the first adjustment, it would be monitored, perhaps for a spending review period or for the early years at least. How we looked at what was actually received in taxation, even immediately after implementation, has still to be finalised.

Mr McLaughlin: Over a longer period you could —

Mr Pauley: Find an agreement on how we might make adjustments or allow for that. A key issue discussed at the ministerial working group was how we would manage the volatility of corporation tax receipts and what mechanisms might be put in place to allow the Executive and the Assembly to plan budgets on the basis of expected income from corporation tax when we know today that corporation tax receipts are very volatile. You might not get all that you expect —indeed, you might get more — but we do not want to breach public expenditure control rules or have to spend money very quickly on something that may not be the best thing to spend it on because —

Mr McLaughlin: There is some background here, in that it was hard to tie down what exactly the tax revenue outflows were from the economy, which is germane to the decision-making process. You could have the power to vary corporation tax and could decide for very good reasons and with full information not to vary it and to stay where you are; but it would be ridiculous if you could not do so because you did not know what the impact would be because there were gaps in the information necessary. That is what it boils down to. We were getting wildly different information, although I suppose that that reflected the temperature of the political discussion. At times it sounded as if they were trying to dissuade us, so we were getting hit with very alarming figures about impacts and cost to the block grant, et cetera. Then it moderated. Are we reaching agreed baselines on which to base strategic decisions?

Mr Pauley: The data are improving. To be fair to HMRC, and that is not my role, it never collected data separately for Northern Ireland. Estimates were made for the different examinations of the issue and then estimates were made for our consultation document at the time. Work since then has refined some of the estimates of Northern Ireland's share of the UK system as it has looked in more detail at what might be done. We will start to have precise data on exactly what was being paid in respect of Northern Ireland only when the computer systems are amended to extract such data. We are not there yet. That is being done as a special exercise for this work rather than as a natural, ongoing daily requirement for the planning of expenditure or the receipts that we might expect. It is improving, but we are not at the final data so that you could say what the actual precise level of receipts was. You mentioned profit shifting. There will always be an element of estimation in such behavioural impacts. No methodology will give a precise figure of take; it will have to be an element of agreed methodology and estimation.

Mr McLaughlin: Would that be an agreed process on which you sign off, or would we be given the impacts or estimates and told to take them or leave them?

Mr Pauley: We know how they have been calculated, and we have asked a page of questions about some of the issues.

Mr McLaughlin: Therefore it is ongoing.

Mr Pauley: Yes. It remains to be seen whether we agree on every aspect of the ministerial working group report when it is ready. However, it is on the table and being discussed.

Mr D Bradley: Good morning. You say in paragraph 9 that the most recent official estimate of the cost to the Executive of reducing corporation tax is £500 million per annum, as per table 1. Earlier, we heard various figures and costings. Are you saying that there is agreement among the stakeholders that that is the figure, or is there still work on that?

Mr Pauley: There is ongoing work on it. Those are the figures that were in the corporation tax consultation document from the Treasury, save, as I have already indicated, the branch plant £135 million that came later. All those figures are under discussion; we have queried different aspects of them all. The Minister has made it clear that he feels that the estimates that were made at that time were made by Treasury while making sure that it left nothing out.

Mr D Bradley: Is it correct to assume that that figure will be adjusted downwards?

Mr Pauley: We hope that we can reach a lower figure. The work was taken forward on the basis that we needed the figure to be affordable; that was stated in the draft economic strategy document. In our work in the ministerial working group we have interpreted that we want to arrive at a lower figure. Exactly what that might be will depend on negotiations on every line in that table. That is being discussed at the moment.

Mr D Bradley: In paragraph 10 you indicate three possible methods of scaling back the cost of reducing corporation tax: reducing the type of firms that can avail themselves of the lower rate, reducing the types of income chargeable to the lower rate, and increasing the compliance burden to reduce tax avoidance. How much detailed work has been done on those? Do you have any figures?

Mr Pauley: We have no final figures. There is some discussion of the different implementation options in the original consultation document. As for the type of income that is chargeable, I referred earlier to whether you include trading profits and non-trading profits as the profit base to which a lower rate would be applied. I indicated previously that the South's 12·5% corporation tax rate applies only to trading profits; a higher corporation tax of 25% applies to non-trading profits. In the UK tax system, the current rates of corporation tax apply to both in exactly the same way. If we were to reduce corporation tax here on non-trading profits only, it would save a considerable sum for the Executive. However, companies would not benefit from reinvestment. If we left that out, there would be a saving in the cost, but there is a potential impact on the benefits that could accrue if we expect all of what companies would gain by a reduction in corporation tax to be reinvested in the economy. There are trade-offs in both of those that we would like to see.

There are two aspects to the compliance burden and the type and scope of it. There is the administration cost of what we would have to pay HMRC to run the system for us; equally, however, if we had a very complex system, companies would have to fill out the forms, and the original consultation document estimated that, in round terms, the cost to companies of that additional compliance could be £50 million per annum across the UK. That is not a cost that we would have to pay as a reduction in the block grant, but it would need to be considered. The UK Government have perhaps been more concerned about that cost than we have. People here would benefit from a corporation tax reduction, and the cost of compliance of filling out an extra bit of a form would, presumably, be worth it. However, others may have to face more complex forms without necessarily benefiting from the measure. That is a big issue for HMRC in all its daily work; it is not just an issue here.

Mr D Bradley: There are great variances in the estimates of the increase in GDP from devolving corporation tax. HMT said that it will be only 1%, while the economic advisory group said that it will be 14%. Such variance does not inspire people with confidence when they have to make decisions. Why is there such wide variance?

Mr Pauley: Those issues are being looked at. I would not like to give you a precise reason, because if we knew that they would agree with us very quickly. The Treasury estimates are derived from a model that looks at the UK as a whole rather than at a regional economy. Under the Treasury's model, the effects of changes are quickly absorbed into the economy and people adjust their positions accordingly. For our regional economy, the work of the economic advisory group, for example, assumes that such a step change in the rate of corporation tax would have a much greater impact and would last longer. Therefore, it is about how long that benefit might last and the difference between dealing with a much larger national economy and a smaller regional one. It can be quite a complex issue.

Benefits were forecast in both those sources over 25 to 30 years. That is extremely difficult, and you will all have heard the Minister's views on whether that can be done with any accuracy. The first years immediately after the measure's introduction will be very important in checking whether the responses and behaviours that we felt it would make to the economy actually happen. The economic strategy document deals with some of the things that we would do and would look for. Those would allow us to take actions to ensure that the benefits from the measure were towards the upper end of the estimates rather than not responding as well with our actions, which could leave it towards the lower end.

Mr Cree: There is certainly a grey mist around many of the figures. You mentioned the volatility of corporation tax, and that is for sure. The danger is that we will have to accept the arbitrary figures that you mentioned; for example, the 1·5% of the UK corporation take might be relevant. How do we protect ourselves against the clear assumption that all companies make the same profit in all parts of the United Kingdom in all sorts of businesses? How do we check that?

The second point also relates to calculations. With the reduction in corporation tax, we would hopefully see the economy and GDP growing. There would also be an increased revenue stream to the Treasury of income tax and superannuation. How will that be handled? How can we be sure that the cost to Northern Ireland will be amended by the extra revenue generated from it?

Thirdly, do you believe that Scottish intervention in corporation tax is slowing things down and that the Treasury and HMRC are more cautious?

Mr Pauley: The 1·5% estimate is an average over six years of what our share of the UK's total corporation tax would be. At that time, the range went from 1·1% in the most recent year to as high as 1·6%, although Treasury have subsequently revised that upwards to 1·7%. That range changes as some companies in Northern Ireland perform well or less well than others relative to the UK. We have data that show that some sectors of the economy perform differently relative to the UK, where the most important changes have been in the financial services sectors. Since the recession, the profits of local banks and financial services companies have been noticeably lower than they were in the earlier years in that period. It has changed. In one way, taking the average over the period deals with how we can be sure that it is different; but it is also adding up the actual corporation tax payments of companies with a BT postcode and taking that as a percentage of the total receipts of corporation tax. Therefore, it is a reasonably exact number, provided that the postcodes reflect the activity of the companies located here.

Mr Cree: Would that be reviewed annually to make sure that we are well on track?

Mr Pauley: Part of that work stream is looking at what we might expect that percentage to be in the next one, two or three years. As you go further out, it naturally becomes more speculative, but that is an issue as we look at that number. We are looking extremely closely at the 1·5%. When you look at the table of costings, it is the biggest part of the costs, so it is attracting proportionate attention. It is key to the decision and to the degree that we might have a lower percentage, and that number will be very important.

Mr Cree: Do you agree that it should be continually revised?

Mr Pauley: It would be continually revised, and any methodology or change to our block grant would need to have a mechanism in place that might take account of such changes. With regard to GDP growing and how income tax might be handled, the Treasury's consultation document indicated that those were costs that could be considered as a possible offset to the costs to the Executive. The Treasury has not yet confirmed or agreed formally that such costs can be offset against any final cost to our block, but it has certainly been a matter of discussion at official and ministerial level that we believe that those costs are relevant. Indeed, the EU Azores requirement that the full fiscal consequences of the measure should be taken into account is an important part of that consideration, and we would want an allowance to be made for the changes that would happen to those other, wider taxes.

The Scotland point is really a political judgement. My opinion would —

Mr Cree: You do not think that it is holding us back?

Mr Montgomery: The position of the Minister following the meeting on 7 March was that it should not have an impact on the Northern Ireland negotiations.

Mr Cree: I am pleased with that reassurance.

Mr McLaughlin: I think. *[Laughter.]*

The Chairperson: The data issue underpins all the questions. Even though we are moving towards data sharing, there is still uncertainty because of the Treasury's reluctance to go down to individual companies. Has there been any examination of what would be entailed cost-wise and logistically in collecting our own data so that we are not constantly at the mercy of the Treasury in trying to interpret data?

Mr Pauley: We have not precisely costed it. However, OFMDFM and DFP loaned DETI people to go to Companies House to go through the accounts submitted there by companies to confirm across the larger companies of Northern Ireland the trends that were being reported in those 1·5% and 1·6% so that the graph that we would draw up by extracting that data would be similar to the one from HMRC. We found close correlation.

By law, companies file data depending on their size and restrictions. We have looked at that, and, as others have intimated, no matter much we invested prior to the actual decision, after the decision we would, by law, have greater access to information that would enable us to see what we had and had not been charged for or what we may be charged for in future. We would look closely to make sure that the invoice that we received was accurate.

The Chairperson: Thank you for your evidence this morning, gentlemen.