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Devolution of Corporation Tax

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This paper presents a critical analysis of the UK Government's consultation paper *Rebalancing the Northern Ireland Economy* and explores a number of issues related to the devolution of corporation tax powers to Northern Ireland. There is a particular focus on matters likely to be of interest to Members of the Northern Ireland Assembly, and especially to the Committee for Finance and Personnel.

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1 Key points

- Opinion is divided on whether reducing Northern Ireland's rate of corporation tax is likely to deliver a significant boost to the economy;
- The Treasury's figures for the amount of corporation tax receipts arising in Northern Ireland differ significantly from estimates published by the Department of Finance and Personnel last year;
- Some of the broader issues surrounding devolution – such as ethics and devolved-national government relations – have not, as yet featured widely in the debate;
- Some possible costs to Northern Ireland have not been estimated – possible administration costs for HMRC, or of Northern Ireland developing its own policy and enforcement capacity, for example – but these could potentially be significant;
- It appears that two of the three tests set out in European law (under the Azores judgement) for the legality of devolution can be met. It is not possible at this time to assess whether the third test might be met; and,
- There are a number of options presented without accompanying detail which may have impacts on business confidence, for example, that will need to be monitored if and when proposals are brought forward.

Executive Summary

The research presented in this paper confirms that there is still mixed evidence on the likelihood that devolving corporation tax to Northern Ireland will deliver significantly improved economic performance: some commentators say it probably will; some commentators say it probably won't. In its consultation paper the Treasury is somewhat cagey:

...increased investment, other things being equal, typically leads to increased growth and employment...

...the benefits of a corporation tax rate cut could be more substantial if other factors, such as infrastructure, skills or the state of the global economy, also encourage investment...

...opinions may vary about the expected benefits of a corporation tax rate reduction...

None of these statements is definitive but perhaps one should not expect definitive statements in economics. Indeed, the assumptions made by the Treasury about the proportion of UK corporate tax revenue that arises in Northern Ireland are very different from those presented by the Department for Finance and Personnel (DFP) last year.

And of course the potential impact of differences in measurement is significant. If the figure suggested by DFP is accurate, the direct cost to the Northern Ireland block could be in excess of £400m by year five. The two estimates presented by the Treasury puts it in the range of £225-270m by that year.

Over recent years there has been considerable debate, there have been detailed reviews, and consultations on this issue. These have focused mainly on whether cutting corporation tax will benefit the Northern Ireland economy. But in Scotland and Wales, well qualified and independent commissions have taken a wider approach – looking at what the best mix of devolved taxation might be and how devolution might be designed. Should it be income tax that is devolved instead? The difference in emphasis somewhat reflects the differences in motivation.

The paper does not attempt to rehash the arguments that have been made in the past. New evidence that has emerged recently has been highlighted where it seems to contribute to the overall question at hand: in principle, should corporation tax be devolved to Northern Ireland? The Economic Reform Group for Northern Ireland says very strongly that it should. The Northern Ireland branch of PricewaterhouseCoopers is much less convinced that this devolution alone is what is needed and that wider fiscal flexibility may be required.

The debate in Northern Ireland has rarely been placed in the context of devolved-national government relations. This paper presents the argument that either a shift in

relationships between the Northern Ireland Executive and the UK Government is required, or policy on the tax base should be devolved. Control over the *rate* of corporate taxation may be ineffective as a policy lever if the UK Government retains control over the tax *base*.

If indeed there is a commitment to more collaborative decision-making - so that one level of government's decisions don't undermine those of the other - it is argued that a shift in the centralisation of fiscal power is likely to be required. But the Treasury consultation does not propose, for example, that the Northern Ireland Executive would be given the power to borrow to manage volatility in tax receipts.

This is not the only way in which the public debate has been somewhat narrowly focused. Any discussion on the *ethics* of pursuing mobile international capital has been muted. Also, there has been little discussion of whether the Northern Ireland administration should develop, or indeed can afford to pay for, a capacity for policing transfer pricing and other potential manipulations of a devolved tax regime.

The Treasury consultation hints that this policy responsibility *might* be devolved, but at the same time presents discussion based on this function still being carried out by HMRC. This discussion is not supported by an estimate of the cost to Northern Ireland for those administrative functions. The costs might be significant, but may be bearable in the context of the potential benefits. At present, an interested observer is not really in a position to comment – the information on which to base an opinion is not there.

There remain other areas of uncertainty. Whilst the UK Government appears quite confident that devolution will comply with the requirements of EU law set out in the Azores judgement, it is unknown at this time whether it would be acceptable to other Member States under the Code of Conduct on harmful tax measures.

The research supports the Treasury's contention that at least two of the Azores criteria seem likely to be met. But it also found a difference in opinion about what impact a suspension of devolution, and return to direct rule from Westminster, might have. Further, it is argued that because detailed mechanisms for adjusting the block grant have not yet been presented, it is not possible to assess whether Northern Ireland would meet the criterion to demonstrate fiscal autonomy.

Devolution might present an opportunity to address to some degree Northern Ireland's reliance on other parts of the UK to fund its expenditure. Aligned with that, it would enhance the level of fiscal accountability at the local level – a matter that has not featured greatly in the debate to date in Northern Ireland but was a significant factor in the considerations in Scotland in particular for the devolution of tax powers to that administration.

Given that business confidence is of considerable importance in relation to investment decisions, what might be the impact of the suggestion in the consultation that a rate reduction could be phased in over time? The Treasury suggests it might be beneficial

in reducing the up-front cost to the Executive. It also presents some options for deferral or the exclusion of non-trading profits.

At the same time it also suggests that some deferral might be necessary in order for practicalities like the procurement of IT systems to be conducted and for evidence gathering in relation to adjusting the block grant. The paper does not address mechanisms for adjusting the block grant, nor indeed specific design issues for how the devolved tax might work. These will be subject to further development and consultation.

The research presented in this paper, therefore, is likely to need to be supplemented as – assuming a generally positive response to the current consultation – the steps towards devolving corporate tax powers are taken.

Throughout this paper a number of questions are posed. The Committee may wish to ask the Department to respond to some or all of them. It is intended that the questions raised may serve as a focus for members' consideration; it is recognised at the outset that there may be other issues of interest to the Committee which could form the basis of further research.

For ease of reference, all the questions posed in the paper are reproduced on the following page.

List of questions

1. Has the Department sought legal advice on the compliance with the Azores criteria of the outline proposals?
2. To what extent has the Department engaged with Europe or the UK's representation in Brussels – in particular in relation to the code of conduct group? Is acceptance of the proposed measure likely at European level?
3. What is the Department's view on the possible impact of the proposed EC Directive on a Common Consolidated Corporate Tax Base?
4. To what degree does the Department agree that the evidence to support devolution is 'compelling'?
5. Does the Department believe that full control over corporation tax should be devolved, or should devolution be restricted to setting the rate?
6. Given the relative importance of non-tax factors to FDI decisions, what is the Department's assessment of Northern Ireland's 'investment readiness'?
7. To what extent has the Department evaluated FDI flows in relation to the devolution of corporation tax? In particular, does the Department believe that devolved corporate tax powers will enable competition with BRIC countries?
8. Has the Department considered how to deal with fluctuations in revenue should corporation tax be devolved? Should a case be made for enhanced borrowing powers?
9. How does the Department account for the difference between its estimates and those of the Treasury?
10. Has the Department considered policies that could reduce or prevent profit shifting and/or tax-motivated incorporation?
11. Does the Department view the devolution of corporation tax as a means of addressing the fiscal deficit and of increasing local fiscal accountability?
12. Has the Department considered tax competition and transfer pricing? If the tax base were devolved, how would the Department set policy and rules?
13. Does the data that the Department holds on corporation tax receipts for Northern Ireland align with the assumptions presented in the Treasury's estimates?
14. Is the Department satisfied that the figures presented are a reasonable cost assessment of the expected 'behavioural response'?
15. Is the Department satisfied that the figures presented are a reasonable assessment of second-round tax effects?
16. Has the Department considered the composition of this high-level consultation group? By whom should Northern Ireland's interests be represented?

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1. Introduction

On 24 March 2011, the UK Treasury issued for consultation *Rebalancing the Northern Ireland economy*.¹ The consultation document considers the current state of the Northern Ireland economy, sets out the UK Government's strategy for rebalancing the UK economy, asks for views relating to the devolution of corporation tax, and presents other information in relation to strengthening the private sector in Northern Ireland.

The focus of this initial Research Paper is on the issues relating to the devolution of corporation tax. Particular attention is paid to legal issues and economic considerations. Following the Treasury's current consultation on the headline issues (and assuming a positive response from stakeholders), more detailed proposals will be developed on the specific mechanisms for devolving the taxation powers, costing and administering the tax collection, for example.

The primary purpose of the paper is to support the Committee for Finance and Personnel in considering the Treasury's consultation. Issues likely to be of interest to other statutory committees and MLAs generally are also explored in some detail.

¹ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011)

2. Background

In its June 2010 Budget, the UK Government committed to producing a paper on rebalancing the Northern Ireland economy, including consideration of enterprise zones, possible mechanisms for changing the corporation tax rate and other economic reform options.

2.1 ERGNI and Varney

The devolution of corporation tax powers returned to the political agenda² in May 2010 when the Economic Reform Group for Northern Ireland (ERGNI) published *The Case for a Reduced Rate of Corporation Tax in Northern Ireland* which observed that “twelve years after the Good Friday Agreement Northern Ireland remains the UK’s poorest region. It has the lowest average wages and the lowest productivity.”³

It was argued by ERGNI that lowering corporation tax was a means to address these problems. It stated:

NI would benefit from a much larger private sector, including 80-90,000 extra jobs over 20 years. Many of these jobs would have salary levels well above the average for NI. Unemployment should fall back much further than would otherwise be the case.

and

*The UK Treasury would gain from additional tax revenues from income taxes, national insurance, VAT etc. This would lead to a smaller subvention to NI.*⁴

The findings of the ERGNI report are rather different from an earlier report by Sir David Varney – *Review of Tax Policy in Northern Ireland* - commissioned by the UK Treasury. One of that review’s main findings was that, considering Northern Ireland in isolation, “a clear and unambiguous case for a 12.5% rate of corporation tax cannot be made.”⁵ Further details on these two reviews can be found in Assembly Research Briefing Paper 161/10 *A Comparison of the Varney Review and the ERGNI Report on Corporation Tax Reform*.⁶

² It had previously been considered in a UK Government sponsored review by David Varney in 2007.

³ ERGNI (2010) ‘The Case for a Reduced Rate of Corporation Tax in Northern Ireland’ available online at: http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011)

⁴ ERGNI (2010) ‘The Case for a Reduced Rate of Corporation Tax in Northern Ireland’ available online at: http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011) (see page 3)

⁵ Varney, D (2007) ‘Review of Tax Policy in Northern Ireland’ available online at: <http://webarchive.nationalarchives.gov.uk/20080205224421/http://hm-treasury.gov.uk/media/1/3/varney171207.pdf> (accessed 29 March 2011) (see page 4)

⁶ Available online at: <http://www.niassembly.gov.uk/researchandlibrary/2010/16110.pdf> (accessed 29 March 2011)

It is important to note at the outset that the earlier review conducted for the Treasury and published in 2007 was undertaken in a totally different economic context from the current consultation. Since the financial crisis and subsequent recession, the backdrop to reforming corporate taxation has changed. There may be, for example, a reduced level of investment for Northern Ireland to seek to attract from multi-national corporations.

2.2 The Calman and Holtham Commissions

Another important contextual point is that the current consultation on corporation tax in Northern Ireland should not be viewed in isolation from developments in the other UK devolved administrations.

The Calman Commission in Scotland had a remit to review the operation of devolution in its fullest sense, including the relationship between the Westminster and Scottish Parliaments. The Holtham Commission in Wales had a focus that was narrower, specifically on finance and funding. Further information on these commissions can be found in Assembly Research Briefing Paper 82/10 *Funding the UK's Devolved Administrations*.⁷

It is interesting to note that the recommendations of these commissions focus not on corporation tax but income tax.

The Calman Commission

In its final report *Serving Scotland Better: Scotland and the United Kingdom in the 21st Century*⁸ the Calman Commission proposed a new Scottish rate of income tax.

It also recommended that a number of other more minor taxes (stamp duty land tax, aggregates levy, landfill tax and air passenger duty, but not, interestingly, corporation tax) should be devolved to the Scottish Parliament (see Appendix 1 for the relevant recommendation).

The Holtham Commission

In its final report *Fairness and accountability: a new funding settlement for Wales* the Holtham Commission also recommended a devolution of powers in relation to income taxation.

It, too, recommended that stamp duty land tax be devolved, and that the Welsh Assembly Government undertakes an assessment of the usefulness of landfill tax, air

⁷ Available online at: <http://www.niassembly.gov.uk/researchandlibrary/2010/8210.pdf> (accessed 29 March 2011)

⁸ Calman, K (2009) 'Serving Scotland Better: Scotland and the United Kingdom in the 21st Century' available online at: <http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-12-csd-final-report-2009fbookmarked.pdf> (accessed 29 March 2011)

passenger duty and aggregates levy as policy instruments. These could then also be devolved (see Appendix 2 for the relevant recommendation).

In relation to corporation tax the Holtham Commission recommended that “the Assembly Government should seek discussions with the UK Government and the other devolved administrations about the feasibility of devolving corporation tax.”⁹

Summary remarks

Both the Calman and the Holtham Commissions expressed concerns about the volatility of corporation tax receipts and also possible distortion of competition within the UK. Volatility is considered further below in section 4.4.

It should also be borne in mind that Scotland or Wales may not face the same economic challenges as Northern Ireland. For example, Scotland has slightly higher productivity expressed in terms of Gross Value Added per employee.¹⁰ Also, both Scotland and Wales share a land border with England which introduces a set of challenges related to tax-induced migration which may be of less significance to Northern Ireland due to its geographical peripherality within the UK.

⁹ Independent Commission for Funding and Finance for Wales (2010) ‘Fairness and accountability: a new funding settlement for Wales’ available online at: <http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf> (accessed 29 March 2010) (see page 123)

¹⁰ ERGNI (2010) ‘The Case for a Reduced Rate of Corporation Tax in Northern Ireland’ available online at: http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011) (see Figure 2.2 on page 10)

3. Legal considerations

The proposal to devolve corporation tax to Northern Ireland raises some significant legal issues. This section presents the most important of those considerations.

3.1 Corporation tax is an ‘excepted matter’

Under paragraph 9 of Schedule 2 to the Northern Ireland Act 1998 (c.47) the following are ‘excepted matters’:

(a) taxes or duties under any law applying to the United Kingdom as a whole;

(b) stamp duty levied in Northern Ireland before the appointed day; and

(c) taxes or duties substantially of the same character as those mentioned in sub-paragraph (a) or (b).¹¹

If a matter is excepted, the Assembly does not have competence to legislate for it. It is, however, within the gift of the UK Parliament to amend the devolution statutes to give the Assembly that power.

The Scotland Bill

The Scotland Bill was introduced by the UK Government as the legislative means to implement the Calman Commission’s recommendations. It may be noted that following the elections to the Scottish Parliament and the strong performance of the Scottish National Party, the Bill may be subject to changes.

It may be of some interest to note that the Scotland Bill, whilst a piece of Westminster-based legislation, was subjected to scrutiny in the Scottish Parliament by a specially constituted ad hoc committee.¹² The Scotland Bill Committee reported on 3 March 2011.

Ultimately the Committee’s first and main conclusion was that the Scottish Parliament should support the Bill. But it should be noted that there was clearly a reasonably large element of political dispute about the contents of the Bill in relation to tax powers. Indeed, two Committee members dissented from the main conclusion, opting to suggest alternative paragraphs to the report:

Two members of the Committee (Brian Adam and Tricia Marwick) [...] proposed the following alternatives.

¹¹ Available online at: <http://www.legislation.gov.uk/ukpga/1998/47/schedule/2> (accessed 29 March 2011)

¹² See <http://www.scottish.parliament.uk/s3/committees/scotBill/index.htm> (accessed 15 April 2011)

They welcome more powers for this Parliament. They support many of the non-financial aspects of this Bill that deliver more powers for the Parliament, although believe that in many cases the Bill could and should go further. The tax proposals in the Bill, particularly those related to income tax, are flawed. They should be overhauled and replaced with full financial responsibility for the Scottish Parliament.

They recommend, therefore, that the Parliament gives its partial consent to this legislation dependent on the UK Government amending the legislation to include full financial responsibility and extension of the non financial powers in the Bill. Further, the Bill should not be passed by the UK Parliament without the express consent on its final provisions from the Scottish Parliament via a Legislative Consent Motion. In addition, the tax proposals should not be commenced without express consent from the Scottish Parliament via a Legislative Consent Motion.¹³

To date there appears to be a considerable degree of cross-party consensus over the devolution of corporation tax powers to Northern Ireland. It does seem, however, that similar discontent, perhaps along broadly similar lines, is entirely possible within the Northern Ireland Assembly in relation to a future Bill seeking to amend the Northern Ireland Act 1998.

3.2 European law

The most important consideration in terms of European law is the European Court of Justice (ECJ) decision on the Azores Case.¹⁴ This case established three criteria or tests that must be satisfied for regional or sub-national variations in direct taxation not to breach European law and rules relating to State Aid:¹⁵

- The decision to introduce the regional difference in direct taxation must have been taken by the region which has a political and administrative status separate from that of the central government (institutional autonomy);
- The decision must have been adopted without the central government being able directly to intervene as regards its content (procedural autonomy); and,
- The full fiscal consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government (fiscal autonomy).

¹³ Scotland Bill Committee 1st report (2011) 'Report on the Scotland Bill and relevant legislative consent memoranda.' Available online at: <http://www.scottish.parliament.uk/s3/committees/scotBill/reports-11/sbr11-01.htm#1> (accessed 15 April 2011) (see paragraphs 2 to 8)

¹⁴ A helpful, non-technical summary of the case is available online at: <http://courtofjustice.blogspot.com/2006/09/case-c-8803-portugal-v-commission.html> (accessed 30 March 2011)

¹⁵ Article 87(1) of the EC Treaty states: "Save as otherwise provided in this Treaty, any aid granted by a Member State of through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market" see http://ec.europa.eu/competition/legislation/treaties/ec/art87_en.html (accessed 30 March 2011)

The purpose of these tests is to establish whether an ‘infra-State’¹⁶ body (in the present case, the devolved Northern Ireland legislature) which adopts a particular tax measure has done so in a manner “sufficiently autonomous vis-à-vis the central power.”¹⁷

In the consultation document, the UK Government states that it expects that Northern Ireland would meet these criteria. It argues that:

- *The [Northern Ireland Executive] already has institutional autonomy as the Northern Ireland Assembly is elected by a separate process to that of the UK Government and has autonomy over a wide range of spending and policy issues.*
- *The Northern Ireland Assembly would also have procedural autonomy, as the [Northern Ireland Executive] and Assembly would have the power to decide whether to raise or lower the rate of corporation tax. HMRC (the UK wide tax administration) could continue to collect receipts.*
- *In order to meet the fiscal autonomy condition, the [Northern Ireland Executive] would need to bear the full fiscal consequences of changes in tax revenues resulting from a new Northern Ireland corporation tax rate. This means that Northern Ireland’s block grant would be adjusted to reflect the fiscal costs of a reduction in the rate of corporation tax.*¹⁸

On the face of it, the first two of these points seem reasonable assertions. There are some issues that are worthy of further consideration which are discussed below. The third point is more problematic and it is on this criterion that the Azores case fell.

Under the Constitution of Portugal, the Azores formed an autonomous region with its own political and administrative status and its own self-government institutions. These had the power to exercise their own fiscal competence and adapt national fiscal provisions to regional circumstances.

But two aspects of the fiscal policy of the regional government - namely the decision to reduce the regional tax burden by exercising its power to reduce tax rates on revenue and the fulfilment of its task of correcting inequalities deriving from insularity - were inextricably linked and depended, from the financial point of view, on budgetary transfers managed by central government.¹⁹

¹⁶ ‘infra’ means ‘below or underneath’ the state level

¹⁷ Judgment of the ECJ 6 September 2006 available online at: <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&Submit=Rechercher&alldocs=alldocs&docj=docj&amp;amp;amp;docop=docop&docor=docor&docio=docio&numaff=C-88/03%20&datefs=&datefe=&nomusuel=&domaine=&mots=&resmax=100> (accessed 30 March 2011) (see paragraph 62)

¹⁸ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 25)

¹⁹ <http://courtofjustice.blogspot.com/2006/09/case-c-8803-portugal-v-commission.html> (accessed 30 March 2011)

Therefore, the ECJ determined that the disputed measures must be assessed in relation to whole of Portuguese territory, which implied that the Commission rightfully classified them as selective aid and incompatible with EU law.

Institutional autonomy

Both the Northern Ireland Executive and the Northern Ireland Assembly have political and administrative status which is separate from the UK Government. Members are elected on a separate mandate. Their respective roles and functions are set out in various sources – primarily the Northern Ireland Act 1998, the Belfast (Good Friday) Agreement and St Andrews Agreement.

Northern Ireland does however have a large fiscal deficit and is reliant on transfer payments from the UK Government to fund much of its expenditure. But the block grant that is paid from the UK is unhypothecated. In other words, the Northern Ireland Executive has complete discretion on the allocation to spending programmes and is not tied to UK Government priorities or policies in relation to devolved matters. This expenditure discretion reinforces the political autonomy of the Northern Ireland institutions.

Because, however, (and this is noted also below) the UK's devolved administrations are creatures of statute, it is within the power to the UK Parliament to suspend (or even permanently unpick) devolution. Indeed devolution in Northern Ireland has been suspended on a number of occasions, leading to periods of direct rule from Westminster.

ERGNI considered the impact of this point in its paper but argued that the devolution of taxation powers “would not necessarily be closed off, but the UK might need to apply for a derogation from EU tax rules, on the understanding that direct rule was intended to be temporary”.²⁰

But it should be noted that other commentators have reached slightly different conclusions. In evidence to the House of Commons Northern Ireland Select Committee's Inquiry on Corporation Tax Alan Trench²¹ stated that, in the event of suspension:

...the criteria of institutional independence and autonomy in decision-making would no longer be satisfied, and any differential in corporation tax would clearly be a selective state aid under the jurisprudence of the EU courts. One would therefore expect the European Commission to require

²⁰ ERGNI (2010) 'The Case for a Reduced Rate of Corporation Tax in Northern Ireland' available online at: http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011) (see page 47)

²¹ Alan Trench is honorary senior research fellow at the Constitution Unit at University College London and formerly research fellow in the School of Law at the University of Edinburgh. He was specialist adviser on devolution to the House of Lords Constitution Committee and to the Lords Select Committee on the Barnett Formula and writes 'Devolution Matters' a blog which frequently features devolution finance.

*the UK Government to put an end to the differential corporation tax within a short time.*²²

The potential economic considerations raised by this issue are discussed further in section 4.2 below.

Procedural autonomy

The UK's devolved administrations are creatures of statute – they are created by legislative acts of the higher tier of government (i.e. the UK Parliament). The legislative competence (or power to make laws) of the Northern Ireland Assembly is negatively derived. In other words, the Assembly can legislate for anything for which it is not prevented from legislating.

Sections 6(1) and 6(2) of the Northern Ireland Act 1998 (c.47) provide that:

Legislative competence.

(1) A provision of an Act is not law if it is outside the legislative competence of the Assembly.

(2) A provision is outside that competence if any of the following paragraphs apply—

(a) it would form part of the law of a country or territory other than Northern Ireland, or confer or remove functions exercisable otherwise than in or as regards Northern Ireland;

(b) it deals with an excepted matter and is not ancillary to other provisions (whether in the Act or previously enacted) dealing with reserved or transferred matters;

(c) it is incompatible with any of the Convention rights;

(d) it is incompatible with Community law;

(e) it discriminates against any person or class of person on the ground of religious belief or political opinion;

*(f) it modifies an enactment in breach of section 7 [entrenched enactments].*²³

From a non-legal reading of these provisions it is apparent that whilst s.6(2)(b) prohibits laws dealing with excepted matters it does not undermine or interfere with the competence of the Assembly to legislate on transferred matters. As corporation tax

²² Trench, A (2011) Memorandum to NI Affairs Select Committee, available online at: <http://devolutionmatters.files.wordpress.com/2011/03/trench-memo-to-ni-affs-cttee-re-corporation-tax-devolution.pdf> (accessed 31 March 2011) (see page 6)

²³ Available online at: <http://www.legislation.gov.uk/ukpga/1998/47/section/6> (accessed 30 March 2011)

would be transferred under an amendment to the devolution statutes, it might be hard for the European Commission to argue that the Assembly were not procedurally independent of Westminster – the legislature at Member State level.

Fiscal autonomy

The Azores condition for fiscal autonomy requires that the cost of the variable rate of taxation must be borne exclusively by the ‘infra-State body’. This means that there must be a transparent mechanism to calculate the cost, and also that it must be clear that transfers from the higher tier of government are not being used to offset the reduced revenue generated by a cut in corporate taxation.

The current Treasury consultation states:

The actual fiscal cost to the [Northern Ireland Executive] of reducing the corporation tax rate would depend on further analysis including outturn data on Northern Ireland corporate tax receipts.²⁴

The paper then presents estimated costs based on a series of statistical and economic assumptions. The estimates are considered in more detail below in section 5.

There are, however, a couple of points that are worth raising at this stage in the context of the Azores ruling. Firstly, a cut in corporate taxation is intended to stimulate greater economic activity in Northern Ireland; the purpose of devolving the power would be to give the Northern Ireland Executive an economic lever to improve the competitiveness of existing businesses, attract investment, improve productivity and create jobs.

ERGNI estimated that:

After a few years [corporation tax] revenues begin to rise as new companies move into NI and some of the lost public sector jobs can be restored. As new private sector jobs are created the net change in total employment becomes positive, building up to over 7,000 jobs a year by the 20th year. By the 20th year the cumulative change in total employment is a positive 86,000.²⁵

In its evidence to the Northern Ireland Affairs Committee’s Inquiry into Corporation Tax in Northern Ireland, the CBI noted that these new jobs would realise “a significant increase in other tax revenues (which will benefit the UK Treasury) and reduce the net subvention to Northern Ireland.”²⁶

²⁴ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 25)

²⁵ ERGNI (2010) ‘The Case for a Reduced Rate of Corporation Tax in Northern Ireland’ available online at: http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011) (see page 36)

²⁶ CBI Northern Ireland (2010) ‘Submission to the NI Affairs Committee’ available online at: <http://www.cbi.org.uk/pdf/20111123-cbi-corporation-tax-northern-ireland.pdf> (accessed 4 April 2011) (see page 3)

Other revenues that would be expected to rise include income tax and National Insurance contributions as well as indirect taxes – in particular VAT and excise duties. The Treasury consultation notes that:

These taxes are not devolved and would accrue to the UK Exchequer. However, indirect tax effects could be considered carefully when calculating the adjustment to the block grant as long as doing so complied with the Azores criteria and the UK fiscal framework. An initial estimate is that the effect of the dynamic responses of other tax revenue may yield £35 million to £55 million a year.²⁷

Any mechanism to pass back to Northern Ireland the benefits of increased VAT receipts would offset some of the reduction to the block grant that would be necessary to demonstrate fiscal autonomy. But it's also clear that it would have to be done in such a way that does not over-compensate Northern Ireland, or it could be viewed under European law as a subsidy in contravention of the Azores test.

The recent report by the Economic Advisory Group (EAG) emphasises the potential significance of yields from other taxes being transferred:

...net corporation tax receipts are expected to remain negative throughout the forecast period (up to 2030). However, when other tax yields (from sources such as income tax and national insurance contributions) are included then the policy is expected to break-even by 2021 on an Exchequer basis.²⁸

In other words, if the Northern Ireland Executive can receive transferred receipts from other taxes, it could shorten by nearly a decade the period in which yields offset the reduction in the block grant.

A second, broader point relating to the concept of 'fiscal autonomy' may be made. Heald and McLeod have noted:

Persuasive language figures prominently in fiscal debates; 'fiscal autonomy' clearly has a positive ring. This is one reason why it is used to characterise fundamentally different arrangements, blurring essential distinctions. For emphasis, there is often reference to 'full fiscal autonomy', a condition that is likely to exist only for independent states. For example, an independent Scotland [or Northern Ireland] would be in the same position as, for example, Denmark, with no connection to the UK Exchequer, except for indirect ones through European Union (EU) membership.

²⁷ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 29)

²⁸ EAG (2011) 'The Impact of Reducing Corporation Tax on the Northern Ireland Economy' available online at: <http://www.eagni.com/fs/doc/publications/impact-of-corporation-tax-on-ni-eag-report-final-report.pdf> (accessed 27 May 2011) (see page 9)

For a devolved Scotland [or Northern Ireland] to have full fiscal autonomy, there would be no grants or guarantees from the UK Exchequer. In relation to its devolved functions, [each devolved administration] would stand alone on its own resources, without right of access to UK resources to compensate for excesses in expenditure need or deficiencies in taxation bases; neither would it contribute to other parts of the United Kingdom.²⁹

Heald and McLeod note two attractions attributed to fiscal autonomy:

- the devolved administration would become more dependent on its own resources; and,
- fiscal decentralisation can be viewed as a vehicle for shrinking the total size of the public sector – there is an incentive to lower the tax rate to increase economic activity which would restrain the size of public sector that could be supported.

It is immediately apparent that what is under consideration for Northern Ireland is not ‘full fiscal autonomy’ but rather *increased* fiscal autonomy. If there were a transfer (in a way that was compatible with European law) of increased VAT receipts, for example, which mitigated the cost to Northern Ireland of reducing corporation tax, it might seem to undermine both the increased dependence of Northern Ireland Executive on its own resources and the incentive to shrink the public sector.

On the other hand, it might be possible to mount a convincing argument that any transfer of an increase in VAT receipts, for example, does not undermine self-reliance. It might be argued that such transfers could indeed justifiably be seen as the Northern Ireland Executive’s ‘own resources’.

The current Treasury consultation does not recommend specific mechanisms for implementing the devolution of corporation tax, and therefore it is not possible to assess compliance with the fiscal autonomy criterion. What the above discussion does highlight, however, is that there are wider issues that will need to be considered once more specific proposals have been developed, especially as it was this third criterion that the Azores case was determined not to satisfy.

Question: has the Department sought legal advice on the compliance with the Azores criteria of the outline proposals?

3.3 European Code of Conduct on harmful tax measures

In 1997 the European Council adopted a code of conduct concerning taxation policy. It stated that “coordinated action at European level is needed to reduce continuing distortions in the single market, prevent significant losses of tax revenue and help tax

²⁹ Heald, D and McLeod, A (2010) ‘The Taxation and Borrowing Powers of the UK Devolved Administrations’, conference paper presented to the Political Studies Association’s Specialist Group Conference on British and Comparative Territorial Politics, University of Oxford, 7-8 January 2010.

structures develop in a more employment-friendly way.”³⁰ The ultimate aim of the code is to prevent harmful tax measures arising from tax competition whilst acknowledging “the positive effects of fair competition.”

There are some relevant points worthy of noting in relation to the current Treasury consultation. In particular

*...tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question **are to be regarded as potentially harmful***³¹
[emphasis added]

Such measures are deemed to be covered by the code of conduct. It seems reasonable to assume that a corporation tax rate of 12.5% (or indeed lower) in Northern Ireland compared to 26% in the wider UK (falling to 23% by 2014) would be regarded as ‘significantly lower.’ Consideration of the code of conduct is therefore necessary.

Determining whether tax measures are harmful

In order to determine whether a tax measure is *actually* rather than just *potentially* harmful, the code of conduct sets out five criteria to be considered:

1. *The measure is reserved to non-resident entities;*

The criterion is whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents. This criterion contains two alternative elements: the first element is whether the measure is de jure only open for (criterion 1a) or in a majority of cases de facto used by (criterion 1b) non-residents, or transactions with non-residents.

2. *The measure has been isolated from the domestic economy (ring fencing);*

The criterion is whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base. Also for this criterion, a de jure and de facto distinction is applied. In practice this means that if all or a majority of beneficiaries are non-residents (or transactions with non-residents), the domestic tax base is completely or partially ring-fenced from the effects of the regime.

3. *The measure does not require real economic activity;*

³⁰ Official Journal of the European Communities (1998) ‘Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy’ available online at: http://ec.europa.eu/taxation_customs/resources/documents/coc_en.pdf (accessed 27 April 2011) (see page 2)

³¹ Official Journal of the European Communities (1998) ‘Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy’ available online at: http://ec.europa.eu/taxation_customs/resources/documents/coc_en.pdf (accessed 27 April 2011) (see page 3)

The criterion is whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages.

4. *The measure is not in line with internationally accepted (OECD) rules;*

The criterion is whether the rules for profit determination in respect of activities within a multinational Group of companies differ from internationally accepted principles, notably the rules agreed upon within the OECD (e.g. the OECD Transfer Pricing Guidelines).

5. *The measure lacks transparency.*

The criterion is whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way. In practice, it is assessed whether a measure has been fully set out in legislation or in regulations or guidelines, and it must be ensured that its application is not subject to any discretion at administrative level.³²

From these criteria it is immediately apparent that not only should any reduction in the rate of corporation tax in Northern Ireland be universal (i.e. not excluding or including specific groups or entities, such as non-resident businesses), require genuine economic activity and fit with other international rules but also that it **should be transparent** – in legal terms and also in terms of administrative discretion. Given that the current funding arrangements and the operation of the Barnett Formula are not always well understood, this criterion may need to be carefully examined.

Status of the code of conduct

The code of conduct is not a formal instrument of the EU and isn't legally binding. It was, however, agreed collectively by the Member States and therefore has "political force".³³ Under the code of conduct a group was established which takes decisions in relation to the code. Decisions are then validated by Ministers, but do not end up in front of the ECJ.³⁴

Any proposal to change corporate taxation in Northern Ireland "needs to satisfy the delegations of the other Member States" when they consider that proposal against the

³² Written evidence from Algirdas Šemeta, Member of the European Commission, to the House of Commons NI Affairs Committee (2010) available online at: <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmniaf/writev/corptax/we16.htm> (accessed 27 April 2011)

³³ Source: European Commission website: http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm (accessed 27 April 2011)

³⁴ Evidence to the House of Commons NI Affairs Committee from Phillip Kermode, DG Taxation and Customs Union, available online at: <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmniaf/uc558-vi/uc55801.htm> (accessed 27 April 2011)

five criteria set out above.³⁵ Until the detailed proposals are developed, it is not possible to assess whether this satisfaction is likely to be achieved, although it may be noted that the Republic of Ireland has already indicated that it supports the change.³⁶

In terms of the views of other Member States, this might be an issue on which the Executive will need to engage both with the UK's Representation in Brussels (UKREP) and Northern Ireland's three MEPs.

Question: to what extent has the Department engaged with Europe or the UK's representation in Brussels – in particular in relation to the code of conduct group? Is acceptance of the proposed measure likely at European level?

3.4. Proposed EC Directive on a Common Consolidated Corporate Tax Base (CCCTB)

In March 2011 the European Commission published a proposal for a Directive that, if adopted, may have an impact on corporate taxation across Europe. The intention of the Directive would be to “ensure consistency in the national tax systems but would not harmonise tax rates.”³⁷

The Commission argues that the plan could eradicate the last fiscal obstacles for companies operating across borders: compliance costs linked to the existence of 27 different tax systems and rules concerning transfer pricing, double taxation of some revenues, as well as over-taxing caused by the current impossibility for a multinational group to consolidate profits and losses incurred by its different companies.

The CCCTB establishes eligibility criteria and a set of common rules to calculate the common tax base of these companies. The system would be optional: tax exemptions and tax deductibility of contributions would be authorised.

The CCCTB would allow companies to offset losses incurred in one country against profits made in another. It would be based on the principle of a one stop shop' (the tax return must be filed in the state where the parent company is based). Lastly, it would function according a system of sharing the consolidated common tax base between different countries where members of a group or company are active, and this

³⁵ Written evidence from Algirdas Šemeta, Member of the European Commission, to the House of Commons NI Affairs Committee (2010) available online at:

<http://www.publications.parliament.uk/pa/cm201011/cmselect/cmniaf/writev/corptax/we16.htm> (accessed 27 April 2011)

³⁶ NI Affairs Committee (2011) 'First Report: Corporation Tax in Northern Ireland' available online at:

<http://www.publications.parliament.uk/pa/cm201012/cmselect/cmniaf/558/55802.htm> (accessed 25 May 2011) (see paragraph 52)

³⁷ European Commission (2011) 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base' available online at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0121:FIN:EN:PDF> (accessed 19 May 2011) (see page 4)

according to three criteria: fixed assets, labour force and turnover. National tax rates would be applicable.³⁸

Response to the proposal

The Commission argues that the new measure would reduce compliance costs and bring other benefits to multinational corporations which would make Europe a more attractive place to do business. But there has been opposition to the proposal.

The Dáil committee has concluded that new draft EU directive for a common consolidated corporate tax base across all Member States does not comply with the principle of subsidiarity.³⁹

Subsidiarity is a legal requirement in the Lisbon Treaty to ensure that the EU only proposes common actions that are necessary to bring greater benefits which cannot be achieved at national level alone. If nine Member States raise objections to any proposal the Commission must rework it

The position of the Dáil committee concurs with that of the Netherlands which has sent a 'reasoned opinion' that the proposal breaches the subsidiarity principle.

A diplomat has recently been quoted as saying:

*We are very, very far from reaching a unanimous decision. France and Spain support the Commission. Germany has reservations, the UK and Ireland are more guarded still, and most countries from Central and Eastern Europe have serious objections.*⁴⁰

On this basis, it appears that the European Commission's proposal may be some way from being adopted into a Directive, and then it will have to be transposed into national law by each of the Member States. Nevertheless, it is arguable that an assessment of the likely impact of the proposed Directive upon the devolution to Northern Ireland of corporation tax powers would be useful.

Question: what is the Department's view on the possible impact of the proposed EC Directive on a Common Consolidated Corporate Tax Base?

³⁸ Verhoosel, T 'COMMON CONSOLIDATED CORPORATE TAX BASE : MEMBER STATES EXAMINE CCCTB PROPOSAL' in *Europolitics* 6 May 2011

³⁹ RTE News 'CCCTB breaches Lisbon Treaty – Committee' 13 May 2011, available online at <http://www.rte.ie/news/2011/0513/ccctb-business.html> (accessed 19 May 2011)

⁴⁰ Verhoosel, T 'COMMON CONSOLIDATED CORPORATE TAX BASE : MEMBER STATES EXAMINE CCCTB PROPOSAL' in *Europolitics* 6 May 2011

4. Economic considerations

The case made for the devolution of corporation tax powers to Northern Ireland centres on the rate of that tax being a useful lever for rebalancing, and ultimately growing, the economy. In particular it has been argued that lower corporate taxation could be an important driver of foreign direct investment (FDI).

The Treasury consultation estimates that a cut in the corporation tax rate to 12.5% could lead to increased domestic investment by £50-65m in the first year, rising to £110m in the tenth year. In terms of investment from outside Northern Ireland, the Treasury's mid-point estimate is £160m in the first year, rising to around £310m in the tenth year.⁴¹

On 26 May 2011, the Economic Advisory Group (EAG)⁴² published *The Impact of Reducing Corporation Tax on the Northern Ireland Economy*⁴³ which revised and updated the economic modelling supporting the ERGNI report. It found that a reduced rate of corporation tax "would bring major benefits to the Northern Ireland economy [...] which other combinations of policies would be unlikely to achieve."⁴⁴

This section reviews the evidence that has been provided to a number of recent inquiries in Scotland, Wales and Westminster as well the papers produced by ERGNI and other commentators in relation to Northern Ireland. In particular, some inconsistencies are highlighted. These may need to be considered as detailed proposals are developed.

4.1 Selective financial assistance

At present, Invest Northern Ireland can grant selective financial assistance (SFA) under Article 7 of the Industrial Development (Northern Ireland) Order 1982 (SI 1083 (N.I.15)).⁴⁵ Assistance may be given to projects likely to provide, maintain or safeguard employment in any part of Northern Ireland. SFA for individual projects is limited by ceilings imposed by EU rules on Gross grant equivalent (GGE).

These aid ceilings are reduced from 2011 onwards as shown in the tables below for different sizes of enterprise.

⁴¹HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 23)

⁴²The EAG provides independent advice to the Minister for ETI. See <http://www.eagni.com/> for more information

⁴³EAG (2011) 'The Impact of Reducing Corporation Tax on the Northern Ireland Economy' available online at: <http://www.eagni.com/fs/doc/publications/impact-of-corporation-tax-on-ni-eag-report-final-report.pdf> (accessed 27 May 2011)

⁴⁴EAG (2011) 'The Impact of Reducing Corporation Tax on the Northern Ireland Economy' available online at: <http://www.eagni.com/fs/doc/publications/impact-of-corporation-tax-on-ni-eag-report-final-report.pdf> (accessed 27 May 2011) (see page 11)

⁴⁵Available online at: <http://www.legislation.gov.uk/nisi/1982/1083/article/7> (accessed 20 April 2011)

(i) Aid Ceiling* 1 Jan 2007 – 31 Dec 2010

Area	Large	Medium	Small
All NI	30%	40%	50%

(ii) Aid Ceiling* 1 Jan 2011–31 Dec 2013

Area	Large	Medium	Small
Inner Belfast	10%	20%	30%
Outer Belfast & Rest of NI	15%	25%	35%

Source: Invest NI⁴⁶

For SFA to continue beyond the end of 2013 revised criteria must be notified to – and approved by – the European Commission. PwC has cited the reduced maxima for SFA as a factor “further complicating the creation of appropriate incentives for FDI that will operate in the high productivity/GVA/per capita sectors.”⁴⁷ This is one reason why the Northern Ireland Executive needs to consider other policy levers to help rebalance and grow the economy.⁴⁸

4.2 Drivers of foreign direct investment

ERGNI argued in *The Case for Reduced Corporation Tax – A Supporting Update* that:

*If policy is intended to be evidence-based, it is difficult to identify an economic policy hitherto adopted in Northern Ireland which is supported by more compelling evidence.*⁴⁹

This section surveys the evidence in relation to drivers of FDI and considers if this statement can really be supported in relation to a reduced rate of corporation tax alone.

Taxation - the headline rate

The Treasury consultation argues that:

A lower corporation tax rate would, on its own, be likely to have a positive effect on local private sector investment and foreign direct investment (FDI)

⁴⁶ Invest Northern Ireland ‘Guidelines on NI’s SFA Scheme’ available online at:

http://www.investni.com/selective_financial_assistance_guidelines.pdf (accessed 20 April 2011) (see page 12)

⁴⁷ PwC NI (2011) ‘Corporation tax: game changer or game over?’ available online at: <http://www.pwc.co.uk/ni/publications/ni-government-futures-corporation-tax.html> (accessed 6 April 2011) (see page 11)

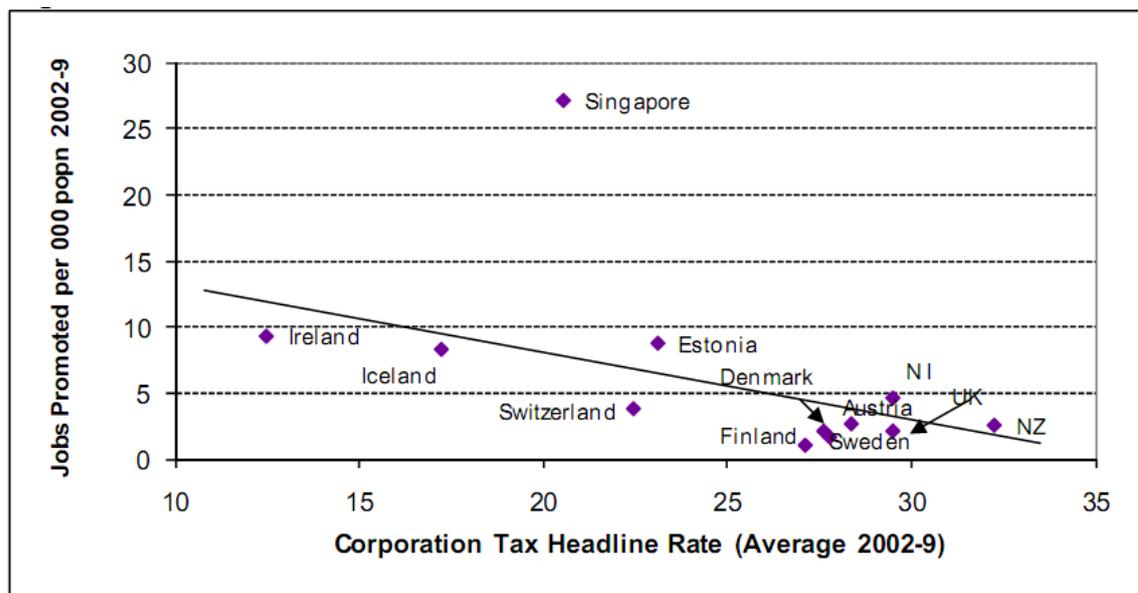
⁴⁸ There are several helpful summaries of the current state of the Northern Ireland economy. For example, chapter 2 of the Final Budget 2011-15 (http://www.northernireland.gov.uk/revised_budget_-_website_version.pdf) or chapter 2 of the ERGNI paper (http://ergni.org/reports/report_corporation_tax_may_2010.pdf). See also Assembly Research Economic Briefings (March 2011: <http://www.niassembly.gov.uk/researchandlibrary/2011/5111.pdf>)

⁴⁹ ERGNI (2011) ‘The Case for Reduced Corporation Tax – A Supporting Update’ available online at: http://ergni.org/reports/report_update_feb_2011.pdf (accessed 18 April 2011) (see page 8)

by increasing the return on capital to investors. In addition, a lower corporation tax rate means that businesses may have more post-tax profits available for internal investment. Increased investment, other things being equal, typically leads to increased growth and employment... [and]... in a world of increasingly mobile capital, business taxes are an important determinant of the attractiveness of a country to foreign investment.⁵⁰

It does, however, go on to acknowledge that research has also identified “a number of non-tax factors” which also contribute to investment levels across countries and regions.

The core relationship between FDI and the headline tax rate is illustrated in the following chart:⁵¹



Source: Oxford Economics

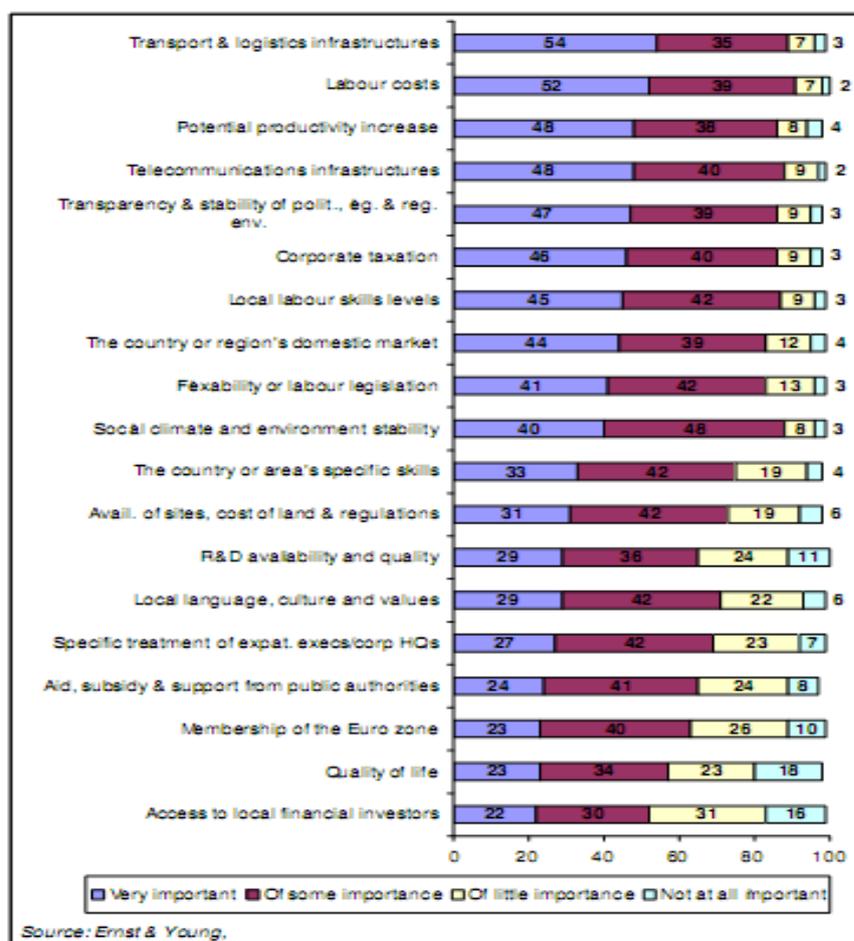
Essentially, this shows an increase in in jobs promoted as the headline tax rate declines and the EAG notes that a different and “significantly more optimistic” estimation by varying the equation or, to a lesser extent, by excluding Singapore.

The figure below shows how businesses rank certain factors in relation to the investment decisions they make. According to this ranking, corporate taxation is sixth most important after a number of non-tax factors – see also the section on non-tax factors on page 30.

⁵⁰ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 20)

⁵¹ EAG (2011) ‘The Impact of Reducing Corporation Tax on the Northern Ireland Economy’ available online at: <http://www.eagni.com/fs/doc/publications/impact-of-corporation-tax-on-ni-eag-report-final-report.pdf> (accessed 27 May 2011) (see page 27)

Figure 1: Ranking of the selection criteria for an investment location⁵²



A recent report by PwC noted that while London is the UK leader in attracting FDI, “Northern Ireland continues to perform remarkably well.”⁵³ Of course, it might be argued that Northern continues to perform well *despite* the current level of corporation tax, and that with devolved powers to vary the rate, the region could perform even better. On the other hand, it may be that a reduced rate of corporation tax would *not* make a significant difference to FDI levels.

The PwC report goes on to argue based on survey evidence that the level of corporate taxation and labour costs appear to be of less importance than other – and this echoes the point in the Treasury consultation – non-tax factors. PwC asks:

So what persuades investors to locate in the UK? It seems the ease of doing business, including language and cultural issues, communications,

⁵² DETI (2008) ‘FDI Research Project – Final Report’ available online at:

http://www.detini.gov.uk/fdi_in_tradable_services_8211_final_report.pdf (accessed 11 May 2011) (see page 12)

⁵³ PwC NI (2011) ‘Corporation tax: game changer or game over?’ available online at: <http://www.pwc.co.uk/ni/publications/ni-government-futures-corporation-tax.html> (accessed 6 April 2011) (see page 14)

*skills, an entrepreneurial culture and market proximity are the main drivers.*⁵⁴

Further, it argues that, while a region – such as Northern Ireland – that delivers on the cultural, communication and skills factors *and* a low sub-regional taxation regime *might* have real investment appeal, “it is difficult to see how low sub-regional tax alone could compete with London” and the greater south-east of England.⁵⁵

On the other hand, it should be noted that there *is* evidence in the literature that supports the contention that the level of taxation can be an important factor in the locational decisions taken by businesses. For example, the Institute of Chartered Accountants in Ireland stated in evidence to the Committee for Finance and Personnel that:

*Economic evidence points shows that factors such as host country size, per capita income and cost base minimisation policies such as corporate tax rate are the key factors to the stimulation of FDI and economic growth.*⁵⁶

Also, an econometric study of data from 19 OECD countries from 1983 to 1998, for example, found a “large and significant impact of the effective average tax rate” on the discrete location choices of capital stock owned by US multinationals in other OECD countries. The authors conclude that this suggests that “the decision as to where to locate seems to be a fine one, easily affected by differences in taxation.”⁵⁷

It may also be noted, however, that the study found that taxation did *not* have any impact on the *scale* of an investment once the location decision had been taken. This finding was in contrast to much of the literature which finds that the size of capital stock is influenced by the marginal tax rate – i.e. the tax payable on the next pound of income, rather than on your income or profit as a whole.

This finding led the authors to conclude that the more important part of the decision-making process therefore is the first part (when the location is decided) *is* affected by tax levels. The second part of the decision-making process (when *size* of investment is decided) is *not* affected so directly by taxation.

ERGNI supported its case for reducing corporation tax in Northern Ireland with specific reference to the Republic of Ireland. It argued:

The real reason for the Republic’s astonishing success has been a very low rate of corporation tax for most manufacturing sectors since the late 1950s.

⁵⁴ PwC NI (2011) ‘Corporation tax: game changer or game over?’ available online at: <http://www.pwc.co.uk/ni/publications/ni-government-futures-corporation-tax.html> (accessed 6 April 2011) (see page 14)

⁵⁵ PwC NI (2011) ‘Corporation tax: game changer or game over?’ available online at: <http://www.pwc.co.uk/ni/publications/ni-government-futures-corporation-tax.html> (accessed 6 April 2011) (see page 14)

⁵⁶ Written evidence to the Committee for Finance and Personnel (2008) available online at: <http://archive.niassembly.gov.uk/finance/2007mandate/varney/Institute%20of%20Chartered%20Accountants%20in%20Ireland.pdf> (accessed 4 May 2011) (see paragraph 1)

⁵⁷ Devereux, M and Lockwood, B (2006) ‘Taxes and the size of the foreign-owned capital stock: which taxes matter?’ available online at: http://www.ifs.org.uk/conferences/etpf_lockwood.pdf (accessed 15 April 2011) (see page 21)

This attracted a large in-flow of investment in plant and machinery, much of it by US multi-nationals in high value-added sectors.⁵⁸

Nevertheless, this assertion has been disputed, particularly in the PwC report. In particular, it noted that:

The Republic has had, in effect, relatively low tax on company profits (especially in the manufacturing and some other trading sectors) from as early as 1958. The fact that the Celtic Tiger did not really begin to roar until the late 1980s, three decades later, suggests either that the tax effect was a very slow burn or that Corporation Tax was mixed in with a range of other factors which (gradually) created the preconditions for sustained and rapid growth.⁵⁹

Indeed, PwC goes as far as to conclude that they could not find “any clear evidence of a simple correlation between low Corporation Tax *per se* and high levels of FDI.” So it may be that the rate of corporation tax could be reduced in Northern Ireland with a very long time lag before the benefits are realised in terms of growth. Or they might not be realised at all.

On the other hand, the cause of the time lag might be in part due to the fact that global FDI flows were probably much larger in the 1980s (as the pace of globalisation had started to increase) than they were in the 1950s.

A further set of evidence is presented by the EAG. It reports – based on evidence from Ireland, Estonia and Singapore - that:

...there exists evidence from other small open economies that reinforce that Northern Ireland should seek, and be granted, the powers to reduce the rate of corporation tax, and to do so in a manner that is affordable to the Executive / Assembly. Introducing a lower and more competitive rate of corporation tax is seen to help attract value added FDI and also boost indigenous business investment.⁶⁰

Question: to what degree does the Department agree that the evidence to support devolution is ‘compelling’?

Taxation – policy and the tax base

Beyond the headline *rate* of corporation tax there are other significant considerations relating to tax *policy*:

⁵⁸ ERGNI (2010) ‘The Case for a Reduced Rate of Corporation Tax in Northern Ireland’ available online at:

http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011) (see page 21)

⁵⁹ PwC NI (2011) ‘Corporation tax: game changer or game over?’ available online at: <http://www.pwc.co.uk/ni/publications/ni-government-futures-corporation-tax.html> (accessed 6 April 2011) (see page 19)

⁶⁰ EAG (2011) ‘The Impact of Reducing Corporation Tax on the Northern Ireland Economy’ available online at: <http://www.eagni.com/fs/doc/publications/impact-of-corporation-tax-on-ni-eag-report-final-report.pdf> (accessed 27 May 2011) (see page 51)

Tax policy also affects FDI financing decisions. For example, if a US company investing abroad finances the investment with equity, its active profits in this case are taxable in the host country but free from tax in the US until repatriated. Financing the investment through a loan from the parent company, on the other hand, gives rise to tax-deductible interest payments in the host country and taxable interest receipts in the US. Thus there is an incentive to finance investments in high tax countries through debt and in low tax countries through equity.⁶¹

Such decisions over the financing of investments “can greatly influence the amount of tax paid in a low-tax host country independent of the actual activity carried out there.”⁶² This suggests that the Northern Ireland Executive should be wary of believing that simply reducing the headline rate of corporation tax will indeed deliver much increased economic activity and the higher tax receipts that it is hoped it would generate.

The devolution of corporation tax powers to Northern Ireland will transfer some of the macro-fiscal risk from the UK Government to the Northern Ireland Executive (see also below in relation to volatility of corporate tax receipts). But the risk of volatility in receipts is not the only one that might be transferred; whether there is a transfer of risk relating to taxable capacity is also important.

The current Treasury consultation implies that one option for devolution is not just to allow the rate to be set in Northern Ireland but also decisions on the tax base:

If the whole tax base were devolved, the tax would become like the Northern Ireland regional rate where the [the Northern Ireland Executive] spends the taxes it raises. There would need to be an initial downward reduction in the block grant to reflect the existing level of tax receipts transferred to [the Northern Ireland Executive], which might be subject to subsequent review.⁶³

The ‘tax base’ is the ‘collective value of taxable assets’.⁶⁴ If the tax base were devolved, the Northern Ireland Executive would not only decide *how much* tax is to be paid, but also *what* constitutes taxable profits – i.e. the levels of allowances, exemptions and so on.

Heald and McLeod have argued that:

If the deduction from the block grant in year 1 is one-off, not subject to recalculation, then taxable capacity risk is fully transferred to the [Northern Ireland Executive]. If the deduction is recalculated in each subsequent

⁶¹ Barry, F and Healy-Rae, R (2010) ‘FDI Implications of Recent European Court of Justice Decisions on Corporate Tax Matters’ in *European Business Organization Law Review* 11: 125-145 (see page 126)

⁶² Barry, F and Healy-Rae, R (2010) ‘FDI Implications of Recent European Court of Justice Decisions on Corporate Tax Matters’ in *European Business Organization Law Review* 11: 125-145 (see page 126)

⁶³ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 33)

⁶⁴ Source: wordnetweb.princeton.edu/perl/webwn (accessed 15 March 2011)

year, then it is not transferred. The transfer of risk is seen as beneficial by those who wish the [Northern Ireland Executive] to be incentivised fiscally to grow [the economy]. Those who put a higher weight on equity or on the dynamics of UK territorial imbalance are likely to question the appropriateness of such risk transfer.⁶⁵

The current Treasury consultation uses the words “which might be subject to subsequent review” in relation to the reduction of the block grant. This suggests a less than full transfer of taxable capacity risk, but it also seems that this position is open to the views of consultees.

Separate (or at least partially separate) from taxable capacity risk is what can be called ‘policy risk’. If the full tax base were *not* devolved, the UK Government would retain the power to define what is taxable and what is not; the tax would then be levied on that base at whatever rate the Northern Ireland Executive determined as appropriate. A result of this would be that decisions taken by the UK Government would have an effect on the tax yield: a decision taken by the UK Government to raise the threshold for the small profits rate, for example, would have the effect of reducing the tax take.

In a situation where the *rate* of corporate taxation is devolved but not the tax base, it would seem appropriate that some mechanism for joint decision making by the Northern Ireland Executive and the UK Government is developed; if there is no joint decision, the Northern Ireland Executive would carry the policy risk for decisions taken at Westminster in relation to potential tax yields. Yet it has been observed that:

Both the principle and practice of decision-sharing would require a dramatic change in the centralised UK fiscal culture, particularly at the Treasury, with regard to substance, process and timing. It would also require a cultural adjustment on the part of politicians.⁶⁶

At present there is certainly a perception held by some that the Treasury’s attitude to engaging with the devolved administrations is less than satisfactory. In answer to a question about consultation during an evidence session before the Committee for Finance and Personnel, Minister of Finance, Sammy Wilson, stated:

The statement of funding policy is written in a way that allows the Treasury to interpret it as widely as possible. It always uses it as a justification. There is an obligation on the Treasury to consult us on some issues, although its definition of consultation seems to be fairly ropey. On some

⁶⁵ Heald, D and McLeod, A (2010) ‘The Taxation and Borrowing Powers of the UK Devolved Administrations’, conference paper presented to the Political Studies Association’s Specialist Group Conference on British and Comparative Territorial Politics, University of Oxford, 7-8 January 2010 (page 19)

⁶⁶ Heald, D and McLeod, A (2010) ‘The Taxation and Borrowing Powers of the UK Devolved Administrations’, conference paper presented to the Political Studies Association’s Specialist Group Conference on British and Comparative Territorial Politics, University of Oxford, 7-8 January 2010 (page 19)

*occasions, the policing issue, for example, there is no discussion with us at all.*⁶⁷

Certainly this view reinforces the point that a cultural adjustment will be necessary if the UK continues on a route of fiscal decentralisation – especially so, perhaps, on the current trajectory. Devolution within the UK is already asymmetric; the devolution of corporate tax powers to Northern Ireland but not to Scotland, and income tax powers to Scotland (and perhaps Wales) but not to Northern Ireland will only make it more so. In these circumstances, it seems possible that a forum for discussion and joint decision making between the UK Government and devolved administrations on fiscal matters may be appropriate.

Question: does the Department believe that full control over corporation tax should be devolved, or should devolution be restricted to setting the rate?

Non-tax factors

If the case for corporate taxation alone as the key driver of FDI is unproven, and devolution of decisions over the tax base is uncertain, then it is important to also pay some attention to non-tax factors in relation to Northern Ireland.

Further to the discussion above, the importance of non-tax factors has been highlighted in a recent academic publication:

*The evidence is unequivocal that in circumstances **where other locational factors** – such as the existence of a pool of well-qualified labour, reasonable infrastructure, business-friendly and robust political structures, and membership of wider economic unions such as the EU – **are similar**, a lower rate of corporate tax can serve as a powerful tool to attract mobile international capital.*⁶⁸ [emphasis added]

In the first instance, Northern Ireland is, as part of the UK, a member of the EU. The other factors listed above require more consideration.

- **a pool of well-qualified labour:** Northern Ireland does have some skills strengths. “Skills in the NI workforce have been improving steadily over the last decade with the percentage of the workforce with sub-degree, degree and postgraduate qualifications [...] increasing from just over 20% to almost 30%.”⁶⁹ But on the other hand, Northern Ireland has a lower employment rate than the UK as a whole partly because it has “a

⁶⁷ Official Report, 9 February 2011 available online at:

http://www.niassembly.gov.uk/record/committees2010/FinancePersonnel/110209_DraftBudget2011-15.pdf (accessed 15 April 2011) (see page 24)

⁶⁸ Barry, F and Healy-Rae, R (2010) ‘FDI Implications of Recent European Court of Justice Decisions on Corporate Tax Matters’ in *European Business Organization Law Review* 11: 125-145 (see page 126)

⁶⁹ Oxford Economics (2009) ‘Forecasting Future Skill Needs in Northern Ireland’ available online at:

http://www.delni.gov.uk/del_future_skill_needs_final_report_june_09_v4_no_links.pdf (accessed 18 April 2011) (see page ii)

higher share of its working age population with low level qualifications.”⁷⁰ Indeed in 2009, 22% of the Northern Ireland working age population were “without a qualification: this was some 10 percentage points higher than the UK average and 5 percentage points higher than the next “worst” [UK] region (West Midlands).”⁷¹ Based on survey data, it does seem that skills shortages are a problem in Northern Ireland. The NI Skills Monitoring Survey 2008 reported that 62% of ‘difficult-to-fill vacancies’ were due to skill shortages – a statistically significant increase of 28 percentage points from the 2005 survey. Over the same time period the number of employers reporting ‘skill gaps’ increased from 10% to 22%.⁷²

- **reasonable infrastructure:** Access to Northern Ireland has been improved in recent years with considerable investment in the Port of Belfast. But there are challenges, such as:
 - little incentive to move freight by rail. Freight is predominantly moved by road from the major sea ports and strategic road connections need to be upgraded;
 - lack of a cross-city public transit system in Greater Belfast;
 - average bus speeds in Greater Belfast are falling;
 - travel time between Belfast, Derry and Dublin needs to be reduced.⁷³

The reliance on road transportation leaves Northern Ireland vulnerable to shocks in the price of oil and petroleum products.

According to Intertradelreland:

*...a number of competitiveness surveys point to the significant infrastructure gap on the island of Ireland. Although Ireland’s relative investment in infrastructure compares well with other countries, it is still perceived by the business community to be inferior to that of competing countries as it is coming from a lower base.*⁷⁴

The figure below shows perceptions from businesses of the quality of infrastructure in comparisons with a number of other countries.

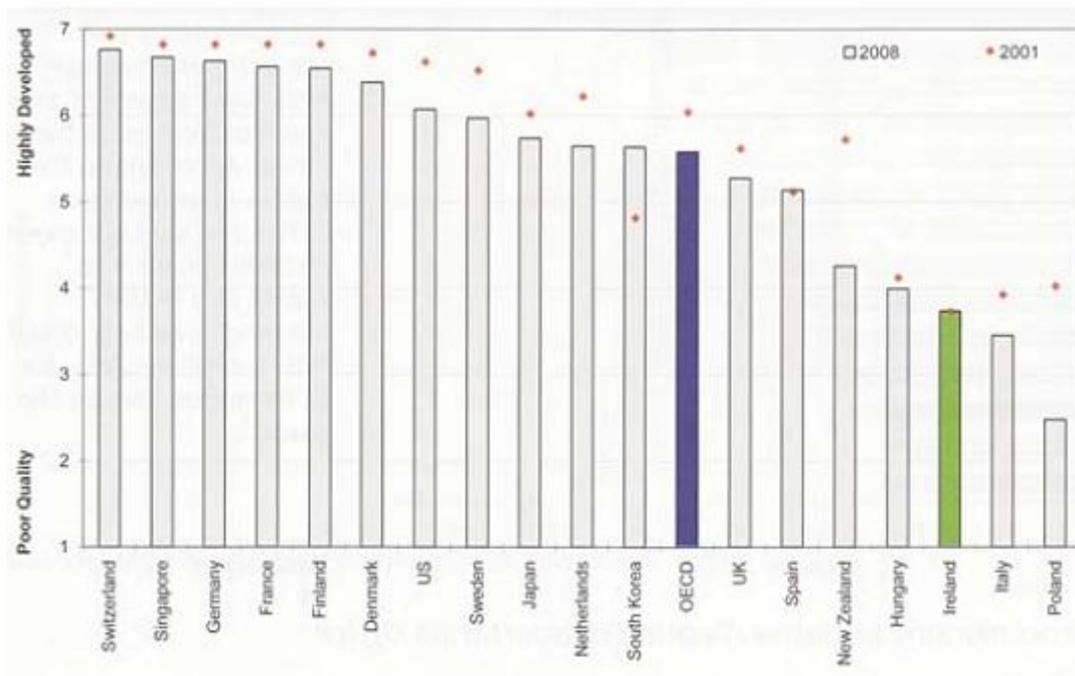
⁷⁰ Gibson, N (2011) ‘Growing the economy will require skills’ in *Labour Market Bulletin 23* available online at: <http://www.delni.gov.uk/lmb-23-web-version.pdf> (accessed 18 April 2011) (see page 14)

⁷¹ Rogers, D (2011) ‘Skills and the Northern Ireland Labour Market – an Overview’ in *Labour Market Bulletin 23* available online at: <http://www.delni.gov.uk/lmb-23-web-version.pdf> (accessed 18 April 2011) (see page 6)

⁷² McCartney, H (2011) ‘Skills Monitoring in Northern Ireland: Comparisons of the 2005 and 2008 Surveys’ in *Labour Market Bulletin 23* available online at: <http://www.delni.gov.uk/lmb-23-web-version.pdf> (accessed 18 April 2011) (see pages 49-53)

⁷³ Institution of Civil Engineers (2008) ‘State of the Nation Briefing Sheet, Northern Ireland: transport’ available online at: <http://www.ice.org.uk/getattachment/89f21ea9-7030-42d2-a745-f0534a226f13/State-of-the-Nation--Transport-briefing-sheet---No.aspx> (accessed 18 April 2011)

⁷⁴ Source: Intertradelreland (2010) ‘Infrastructure for an island population of 8 million’ available online at: <http://www.intertradelreland.com/media/intertradelrelandcom/researchandstatistics/publications/infrastructure/Infrastructure%20for%20an%20Island%20Population%20of%208%20Million%20Full%20Report.pdf> (accessed 20 April 2011) (see page 6)

Figure 2: Perception of Overall Infrastructure Quality, 2008

So whilst there have certainly been infrastructure improvements, it would seem that there is some distance to go before it can be argued that infrastructure on the island of Ireland is at an attractive level.

- business-friendliness:** It has not been possible to locate information that compares the business friendliness of Northern Ireland with other sub-national locations. However, the Department of Enterprise, Trade and Investment (DETI) points out that “businesses in Northern Ireland benefit from the reputation that the UK has one of the best regulatory environments in the world.”⁷⁵ The latest World Bank *Doing Business* rankings show that the UK comes second (New Zealand is first) out of the thirty OECD countries in terms of ‘ease of doing business’. Of 183 countries globally, the UK is ranked fourth.⁷⁶

Political stability

In March 2011, the Northern Ireland Assembly completed its first full mandate uninterrupted by a period of suspension and direct rule from Westminster. Whilst this is an encouraging sign in relation to the stability of devolution, there are still challenges. In recent months the security situation has deteriorated and there have been high-profile bombings and alerts.

A possible impact of such incidents is an undermining of the confidence of business investors that Northern Ireland is a suitable location for significant commitments. The

⁷⁵ DETI (2010) ‘Better Regulation Annual Report 2009-10’ available online at:

http://www.detini.gov.uk/better_regulation_annual_report_2009-10_pdf.pdf (accessed 20 April 2011) (see page 3)

⁷⁶ World Bank/International Finance Corporation (2011) <http://www.doingbusiness.org/rankings> (accessed 20 April 2011)

issue of political stability was mentioned above in section 3.2: if it is indeed that case (and this is not certain) that a suspension of devolution and return to direct rule would require immediate action to restore an equal rate of corporation tax between Northern Ireland and the rest of the UK, then such a possibility will probably form part of the assessment that potential investors will make.

If investors are attracted by a low rate of corporate taxation, it is difficult to predict how much of an influence uncertainty about the robustness of Northern Ireland's political institutions is likely to have. But it does seem reasonable to assert that it will have *some* influence.

On the other hand, a reduced rate of corporate taxation could help provide a boost to the confidence of indigenous companies.

Question: given the relative importance of non-tax factors to FDI decisions, what is the Department's assessment of Northern Ireland's 'investment readiness'?

4.3 The availability of FDI: how much international capital is there?

Putting aside the discussion over the importance of corporate taxation in attracting FDI, it is also important in the context of the current consultation to consider current FDI flows; is there a significant level of investment globally that Northern Ireland could be seeking to attract?

Global competition

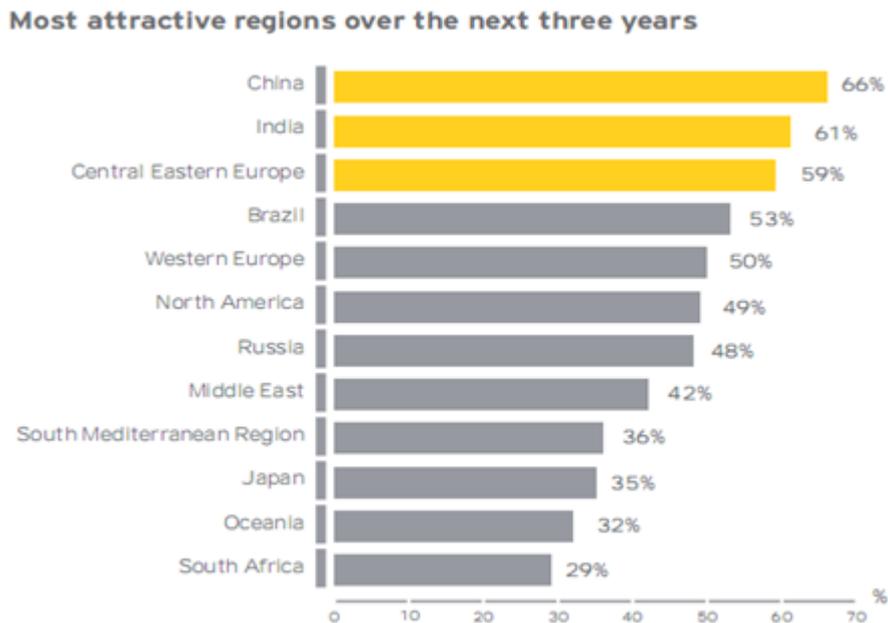
The global context for economic development has changed over recent years. In a recent report by Ernst and Young it was argued that:

Our global economy has turned into a multi-polar world in which China, India, Brazil and the Middle-East have joined the traditional players of North America, Europe and Japan as both the destinations and sources of global investment. Capital is now clearly flowing in multiple directions. New corporate giants are emerging to compete. Opportunities and challenges have grown as a consequence. Old assumptions have been found wanting but the new rules of competitive success have yet to be established.⁷⁷

This view is based on survey data from Ernst and Young's *European Attractiveness Survey*. The report highlights the regions likely to be most attractive over the coming three years (see chart below). This evidence suggests that Western Europe will generally be less attractive than China, India and Central Eastern Europe.

⁷⁷ Ernst and Young (2010) 'Waking up to the new economy' available online at:

<http://www.eyem.com/pdf/Ernst%20&%20Young's%202010%20EAS%20Waking%20up%20to%20the%20new%20economy.pdf> (accessed 10 May 2011) (see page 2)

Figure 3: most attractive regions for FDI over the next three years

Source: Ernst and Young⁷⁸

Having said that, of the FDI that came to Europe in 2009, the largest share (in terms of numbers of projects (21%) and job creation (16%)) came to the UK as a whole.⁷⁹

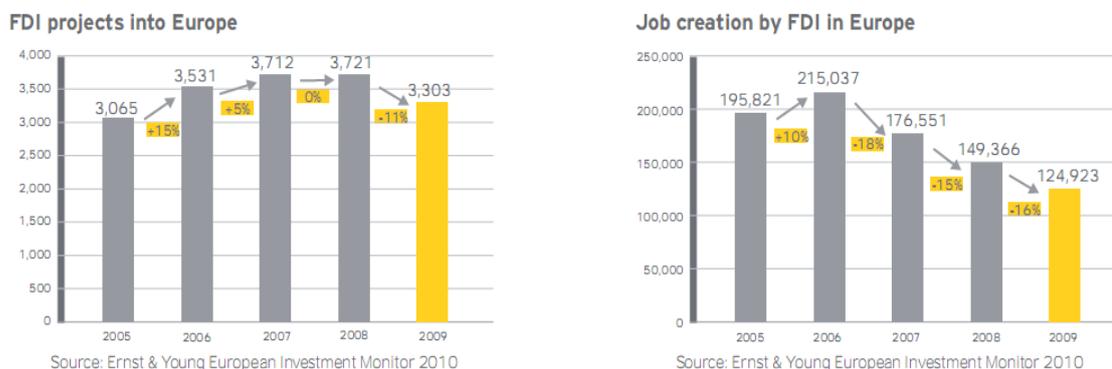
The level and nature of FDI

The emergence of India and China, in particular, as strong competitors for FDI over recent years has also been compounded by the global downturn which has seen levels of FDI decrease. In 2009, Europe attracted 3,303 FDI projects, a reduction of 11% from 2008.

In addition, the *nature* of investments has changed. On average, a new FDI project in Europe during 2009 created 69 jobs. In 2006, the average was 101 jobs created.

⁷⁸ Ernst and Young (2010) 'Waking up to the new economy' available online at: <http://www.eyeim.com/pdf/Ernst%20%20Young's%202010%20EAS%20Waking%20up%20to%20the%20new%20economy.pdf> (accessed 10 May 2011) (see page 13)

⁷⁹ Ernst and Young (2010) 'Waking up to the new economy' available online at: <http://www.eyeim.com/pdf/Ernst%20%20Young's%202010%20EAS%20Waking%20up%20to%20the%20new%20economy.pdf> (accessed 10 May 2011) (see page 20)

Figure 4 numbers of FDI projects and job creation in Europe 2005 to 2009

Source: Ernst and Young⁸⁰

The charts above illustrate that whilst numbers of FDI projects in 2007 and 2008 remained stable, the number of jobs that they created significantly reduced.

The origin of FDI

Another notable shift in FDI is not only the destination, but the origin.

Table 1: origins of FDI 2005-2009

Top ten origin countries of FDI into Europe (job creation)						
Rank 2009	Origin	% of jobs created				
		2005	2006	2007	2008	2009
1	USA	23%	23%	19%	22%	19%
2	Germany	17%	14%	13%	15%	17%
3	China	1%	1%	1%	2%	7%
4	France	8%	3%	7%	6%	5%
5	Switzerland	2%	3%	3%	3%	5%
6	United Kingdom	4%	6%	5%	4%	4%
7	Japan	4%	10%	4%	6%	3%
8	India	1%	2%	3%	4%	3%
9	Italy	3%	2%	4%	4%	3%
10	Sweden	3%	3%	3%	3%	2%

Source: Ernst & Young European Investment Monitor 2010

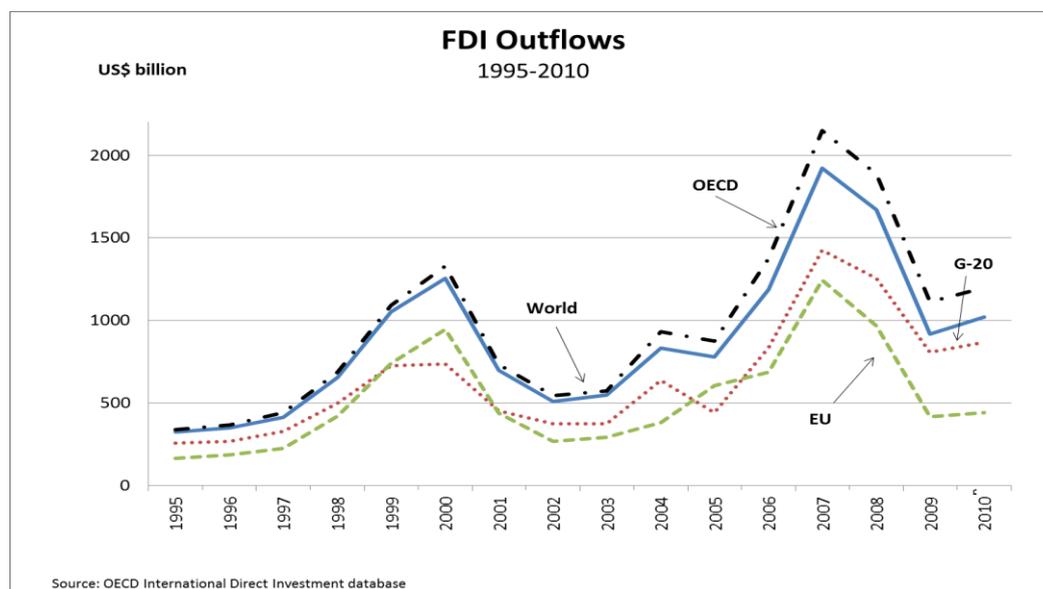
Source: Ernst and Young⁸¹

⁸⁰ Ernst and Young (2010) 'Waking up to the new economy' available online at: <http://www.eyeim.com/pdf/Ernst%20%20Young's%202010%20EAS%20Waking%20up%20to%20the%20new%20economy.pdf> (accessed 10 May 2011) (see page 18)

The table above shows that (in terms of jobs created) the USA has remained the top source of FDI coming into Europe over the last five years. But it is notable that both India and China are becoming more significant. Indeed, job creation in Europe in 2009 through FDI originating in BRIC countries (Brazil, Russia, India and China) grew by 34%.⁸²

The most recent OECD data for FDI flows⁸³ (Quarter Four of 2010) shows an increase in outflow (i.e. capital flowing outwards into other countries). But looking at the inflows for the same period suggests that the increase in flow (consistent with the findings of the Ernst and Young survey reported above) is heading not to OECD countries⁸⁴ but to other G20 states.⁸⁵

Figure 5: FDI Outflows 1995-2010



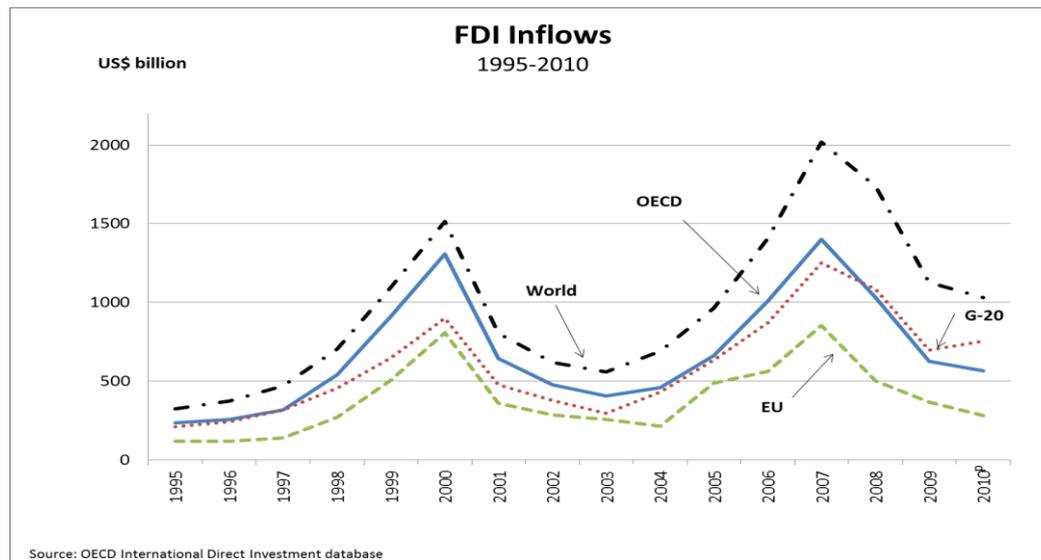
⁸¹ Ernst and Young (2010) 'Waking up to the new economy' available online at: <http://www.eyem.com/pdf/Ernst%20%20Young's%202010%20EAS%20Waking%20up%20to%20the%20new%20economy.pdf> (accessed 10 May 2011) (see page 24)

⁸² Ernst and Young (2010) 'Waking up to the new economy' available online at: <http://www.eyem.com/pdf/Ernst%20%20Young's%202010%20EAS%20Waking%20up%20to%20the%20new%20economy.pdf> (accessed 10 May 2011) (see page 24)

⁸³ OECD (2011) 'Foreign Direct Investment (FDI) Statistics' available online at: http://www.oecd.org/document/8/0,3746,en_2825_35728892_40930184_1_1_1_1,00.html (accessed 17 May 2011)

⁸⁴ OECD membership is at: http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1,00.html (accessed 17 May 2011)

⁸⁵ The current G20 makeup is at: http://en.wikipedia.org/wiki/G-20_major_economies#Member_countries_and_organizations (accessed 17 May 2011)

Figure 6: FDI Inflows 1995-2010

This data suggests then, that the flow of investments appears to be beginning to recover following the dramatic fall from the 2007 peak. If the growth destination is outside the OECD but within the G20, this tends to confirm the survey data because China and India, for example, are not OECD members, but are part of the G20.

Question: to what extent has the Department evaluated FDI flows in relation to the devolution of corporation tax? In particular, does the Department believe that devolved corporate tax powers will enable competition with BRIC countries?

4.4 Volatility of corporate tax receipts

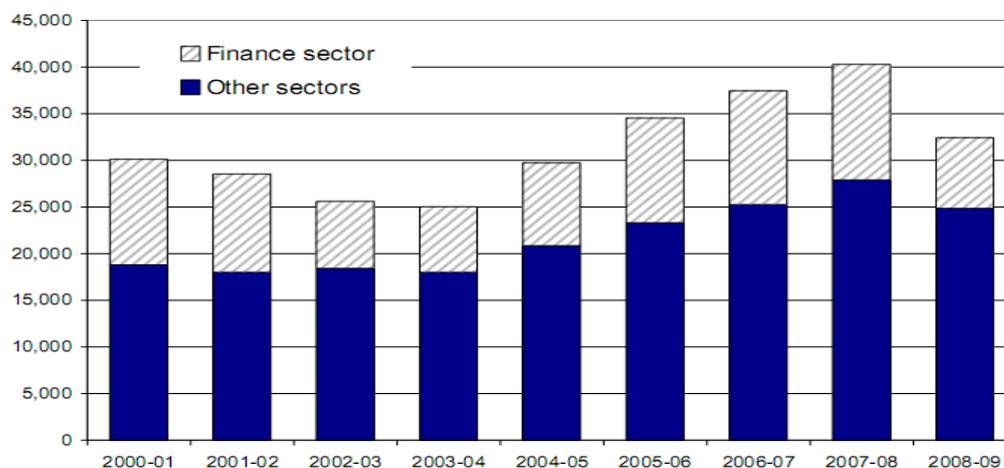
It has been argued by experts that one of the challenges with corporation tax is the volatility of receipts. Professor Anton Muscatelli (Chairman of the Independent Expert Group (IEG) that advised the Calman Commission) stated in evidence to the Scotland Bill Committee that “it is probably the most volatile of all the major taxes that could be devolved.”⁸⁶

The Independent Commission on Funding & Finance for Wales (the Holtham Commission) also considered the issue and concluded that devolution would “introduce substantial unwelcome volatility into the Welsh budget.”⁸⁷

The chart below illustrates this volatility at the UK level.

⁸⁶ Scotland Bill Committee (2011) ‘Report on the Scotland Bill and relevant legislative consent memoranda’ available online at: <http://www.scottish.parliament.uk/s3/committees/scotBill/reports-11/sbr11-01.htm#34> (accessed 5 April 2011) (see paragraph 494)

⁸⁷ ICFFW (2010) ‘Fairness and accountability: a new funding settlement for Wales’ available online at: <http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf> (accessed 5 April 2011) (see page 78)

Figure 7: UK non-North Sea corporation tax receipts (£million) 2000-01 to 2008-09

Source: HMRC⁸⁸

It is notable that the finance sector was responsible for a lot of the volatility over the period. As its financial sector is very small, it may be that corporation tax receipts are slightly less volatile in Northern Ireland than for the UK as a whole. On the other hand, this may not necessarily be the case because risks may be less diversified; this view is expressed by the Treasury in the consultation:

The risks that accompany such fluctuations are heightened in a region such as Northern Ireland with its relatively small corporate base.⁸⁹

Impact of volatility

It is worth considering why volatility in tax receipts is problematic. Currently, the Northern Ireland Executive does not have significant fiscal control. It is shown below in section 4.6 that the Executive raises in revenue only a small proportion of expenditure – the vast majority coming through the Northern Ireland block grant. This may have many disadvantages in terms of fiscal accountability, but it does mean the Executive has a substantial degree of certainty in its budgeting.

When the UK Government develops its expenditure plans (through multi-year spending reviews) it bases those plans on forecasts of tax revenue and planned levels of borrowing. If there is a shortfall in revenue it must either cut spending commitments or increase borrowing to make up the difference. In effect, the UK Government borrows on the devolved administrations' behalf: it is the UK Government that bears the risk of receipts being lower than forecast.

⁸⁸ Reproduced from ICFW (2010) 'Fairness and accountability: a new funding settlement for Wales' available online at: <http://wales.gov.uk/docs/icfw/report/100705fundingsettlementfullen.pdf> (accessed 5 April 2011) (see page 75)

⁸⁹ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 29)

The IEG that advised the Calman Commission stated:

Deviations in forecasts can derive from a number of factors, ranging from unforeseen changes in the economic conditions to the inherent volatility of tax receipts (annual UK Corporation Tax receipts, for example, have deviated by nearly 15% or £5.3 billion from forecast values in the past decade).⁹⁰

Even though corporation tax receipts do not constitute the largest proportion of overall UK tax revenues (forecast to be 8.13% in 2010-11) if revenues were 15% lower than the forecast it would lead to a reduction of £6.4 billion for that year.⁹¹

The consultation paper suggests that “it may be prudent to have an initial transitional phase in order to test the new system in which the UK Government bears the risk of differences between plan and outturn.”⁹² From the point of view of protecting the Northern Ireland Executive from economic shocks in the initial phase, such an approach seems likely to have a certain appeal.

Borrowing powers

The UK Government is able to borrow on the financial markets to smooth revenue over the economic cycle. At present the Northern Ireland Executive can borrow through the Reinvestment and Reform Initiative (RRI): this borrowing is only for the purposes of capital investment.⁹³ It has been argued that borrowing is especially important when a revenue stream is volatile:

There is an obvious link between taxation powers and borrowing powers, in that taxation revenues are subject to both economic trends and forecasting errors. The greater the revenue uncertainty, then greater the need for borrowing and reserve-holding powers to smooth revenue.⁹⁴

It should be noted – and this may appear like an obvious point – that borrowing does not allow for greater expenditure in total; it allows for expenditure to be rephased. Borrowing powers would, however, allow the Northern Ireland Executive an option for managing volatility in corporation tax receipts.

⁹⁰ IEG (2009) ‘Should Scottish Ministers be Able to Borrow?’ available online at: <http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-06-ieg-borrow.pdf> (accessed 5 April 2011) (see page 10)

⁹¹ Assembly Research calculations from HM Treasury (2011) ‘Budget 2011’ available online at: http://cdn.hm-treasury.gov.uk/2011budget_complete.pdf (accessed 5 April 2011) (see Table C.3, page 92)

⁹² HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 33)

⁹³ It should be noted that as part of the Spending Review 2010 settlement, the Executive has also been allowed to borrow £175m as part of the package to assist savers in the collapsed Presbyterian Mutual Society

⁹⁴ Heald, D and McLeod, A (2010) ‘The Taxation and Borrowing Powers of the UK Devolved Administrations’, conference paper presented to the Political Studies Association’s Specialist Group Conference on British and Comparative Territorial Politics, University of Oxford, 7-8 January 2010 (page 28)

This issue was touched upon by David Gauke MP, the UK Exchequer Secretary in evidence to the Northern Ireland Affairs Committee in the House of Commons. Mr Gauke was asked if the Treasury could compensate Northern Ireland for shortfalls in corporation tax receipts – particularly given the Azores judgment. In response he stated:

*...if corporation tax receipts were less than expected - of the devolved element or of its entirety, depending on which model we have used - then **that is something that the Northern Ireland Executive will have to deal with**, just as if corporation tax receipts turn out to be greater than anticipated, then clearly that is additional money for the Northern Ireland Executive to use as it sees fit and would not be coming back to the Treasury.⁹⁵ [emphasis added]*

In essence, the answer to the question appears to be 'no'.

On the other hand, the Scotland Bill currently before the UK Parliament does contain provisions on borrowing. The Scotland Act 1998:

...allows Scottish Ministers to borrow up to £500m for short term current spending, though this power has never been used. The Scotland Bill will replace this power with a more extensive one to reflect the increased financial accountability of the Scottish Parliament, and gives a substantial additional power that allows Scotland to be able to borrow for capital purposes.⁹⁶

This paper is not the place to debate whether the proposed borrowing facility is appropriate, but the very fact that the Bill contains a facility at all indicates that, in certain circumstances at least, the UK Government appears prepared to devolve borrowing powers.

Question: Has the Department considered how to deal with fluctuations in revenue should corporation tax be devolved? Should a case be made for enhanced borrowing powers?

Estimates of Northern Ireland corporation tax receipts

The current Treasury consultation states that:

The analysis of Northern Ireland postcodes implies that Northern Ireland corporation tax receipts excluding North Sea oil and gas, and also excluding branches, varied between 1.3 per cent and 1.6 per cent of UK

⁹⁵ Official Report (**uncorrected**) available online at: <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmniaf/uc951-i/uc95101.htm> (accessed 10 May 2011) (see Q.27)

⁹⁶ HM Government (2010) 'Strengthening Scotland's Future' available online at: http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland_Bill_Command_Paper.pdf (accessed 11 May 2011) (see page 37)

corporation tax receipts between 2002-3 and 2007-8, broadly averaging 1.5 per cent. In 2008-9 (the latest available data), the Northern Ireland tax base dipped to 1.1 per cent of UK corporation tax receipts. Given the historic data, on the basis of currently available evidence it is the Government's assessment that 1.5 per cent is the appropriate steady state percentage.⁹⁷

Calculations based on data published by the Department of Finance and Personnel, however, produce rather different figures for corporation tax receipts in Northern Ireland. These show variations between 2.36% and 2.44% in the period 2003-04 to 2007-08 (see the table presented at Appendix 3 for the source data) with an average of 2.4%.

The implication of the higher figures based on the DFP report is that the cost of devolving corporation tax powers to Northern Ireland is possibly understated in the Treasury consultation: the cost assumptions presented in the current Treasury consultation (and discussed below in section 5.) might be at the low end.

Question: how does the Department account for the difference between its estimates and those of the Treasury?

4.5 Behavioural responses to a reduced rate of corporation tax in Northern Ireland

Beyond the direct economic effects associated with a reduced rate of corporation tax in Northern Ireland, it is likely that there will also be *'behavioural'* effects.

Profit shifting or *'brass plating'*

One of the risks of introducing a differential rate of corporate taxation in Northern Ireland from the remainder of the UK is that multi-national corporations will relocate the profits of their operations to Northern Ireland to benefit from lower taxation, but the economic activity itself will not follow. This would benefit those corporations, but not the Northern Ireland economy.

In evidence to the House of Commons Northern Ireland Affairs Committee, the European Commission drew attention to the experience of another Member State:

A relevant lesson can be drawn from the experience in Germany from the abolition of trade income tax at local level. The small local community of Norderfriederichskoog in the German Land Schleswig Holstein applied a 0% trade tax rate in its area at the beginning of this millennium. In the year before 2004 there was a run of companies to choose this village as the

⁹⁷ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 26)

place of registration so that at the end 460 companies were registered in the village compared to 40 inhabitants. In 2004 Germany stopped this practise by introducing a minimum tax rate for trade income tax in Germany.⁹⁸

The current Treasury consultation acknowledges that profit shifting to Northern Ireland will occur, and seeks to estimate the extent that this will occur – these estimates are considered below in section 5 on costing. The documents states:

Profit shifting arises where companies artificially manipulate transactions so that their taxable profits arise in low tax jurisdictions, while the activities generating those profits remain in a high tax jurisdiction. The assumptions that are used to estimate profit shifting from the rest of the world into Northern Ireland are based on [Office of Budget Responsibility] approved methodology. This effect results in additional corporation tax being paid in Northern Ireland and serves to reduce the direct cost of the rate reduction. A similar methodology, consistent with the Varney Review, is used to estimate the effect of profit shifting from the rest of the UK to Northern Ireland. This cost is additional to the direct cost of the reduction in the corporation tax rate, because the overall level of corporation tax paid within the UK is reduced.⁹⁹

It is interesting that the Treasury seems to accept that this kind of behavioural effect will occur without explicitly suggesting that any measures could or should be taken in an attempt to mitigate against what could be considered to be tax tourism.

Tax-motivated incorporation

Given that a reduction in corporate taxation would apply to all company profits – including those of micro, small and medium-sized enterprises – a second potential behavioural response is ‘*tax-motivated incorporation*’ (TMI). Essentially, a low rate of taxation on profits gives an incentive to unincorporated businesses (such as sole traders whose profits are taxed as personal income) to incorporate to reduce their tax bills. According to the Treasury:

TMI would increase as the corporation tax rate falls and the differential between income tax and corporation tax rates increases. An increase in TMI results in higher corporation tax receipts although this will be more

⁹⁸ Written evidence from Algirdas Šemeta, Member of the European Commission, to the House of Commons NI Affairs Committee (2010) available online at:

<http://www.publications.parliament.uk/pa/cm201011/cmselect/cmniaf/writev/corptax/we16.htm> (accessed 27 April 2011)

⁹⁹ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 27)

than offset by falls in income tax and [National Insurance Contribution] receipts.¹⁰⁰

The cost assumptions related to falling tax receipts – which will probably result in an equivalent reduction to the Northern Ireland block grant – are considered below in section 5. Again it is interesting from a policy perspective that such a behavioural response is both predicted and modelled but that no policy intervention is proposed to mitigate against TMI.

In the 2007 Budget, the previous UK Government stated that:

The Government remains concerned that the corporation tax system is being used to achieve a reduction of personal tax and national insurance liabilities, through the extraction of labour income as dividends. The Government considers that this has eroded the balance between providing low rates of corporation tax to encourage business investment and maintaining a tax system that is fair for all.¹⁰¹

Indeed, in a section entitled 'Fairness', the same budget document contains the following observation:

Successive Governments have tried to encourage greater investment through low rates of tax for small companies with the Small Companies' Rate (SCR). However:

- *it has become apparent that the SCR can be taken advantage of by people incorporating with the main aim of reducing their personal tax and national insurance liability by extracting labour income as dividends. This results in an unfair difference between the overall tax and NICs paid by the incorporated and the unincorporated, even where they are engaged in the same economic activity. This tax-motivated incorporation, if left unaddressed, would pose a growing risk to the Exchequer; and*
- *the SCR is not well targeted. As companies qualify according to their taxable profits, not their size, around one third of taxpaying large companies benefit from the SCR.¹⁰²*

This illustrates a concern at the UK government level that TMI is to some degree unfair and perhaps harmful. It also underlines some of the difficulties associated with making

¹⁰⁰ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 28)

¹⁰¹ HMT (2007) 'Building Britain's long-term future: Prosperity and fairness for families' available online at: http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/media/0/6/bud07_chapter5_320.pdf (accessed 28 April 2011) (see page 129)

¹⁰² HMT (2007) 'Building Britain's long-term future: Prosperity and fairness for families' available online at: http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/media/5/D/bud07_chapter3_302.pdf (accessed 28 April 2011) (see page 49)

appropriate decisions over the tax base itself (see section 4.2 above for related discussion).

It is worth noting that from an economic perspective TMI can be explained in the following terms:

Tax motivated incorporations have been driven by the legitimate ability to arrange ones tax affairs to minimise tax liability. To businesses, tax is a cost and, in a competitive environment, business owners have to minimise all costs, in order to ensure survival and maximise returns. This fits with theories of rational economic man, where an individual will seek to maximise income. Tax avoidance¹⁰³ is a legitimate activity, that has been created either intentionally by government to promote certain activities, or inadvertently through tax policy changes that were intended for other purposes.¹⁰⁴

In the current discussion it is apparent from the 2007 Budget document that TMI as a result of reduced corporation tax was an unintended consequence of an attempt to find a means for encouraging greater investment by small companies. It also appears that the UK Government has not yet found a means of addressing the issue to its satisfaction – otherwise it seems unlikely that the Treasury would be modelling TMI effects in the current consultation. The Varney Review, for example suggested that:

...in the event of a significantly lower corporation tax rate in Northern Ireland, there would seem no obviously fair and proportionate way to level the playing field between incorporated and [un]incorporated businesses.¹⁰⁵

It might perhaps be argued that by shifting part of the cost of TMI from the UK to Northern Ireland through a reduction in the block grant, the UK Government is transferring some of the associated risk from the UK Exchequer. On the other hand, it may be that such a transfer of risk (and cost) would be necessary as part of the requirement to demonstrate Northern Ireland's fiscal autonomy in the context of the Azores judgement.

Question: has the Department considered policies that could reduce or prevent profit shifting and/or tax-motivated incorporation?

¹⁰³ Note tax *avoidance* is seeking to minimise tax bills through legitimate means; tax *evasion*, however, is illegal.

¹⁰⁴ Chittenden, F and Sloan, B (2007) 'The Chancellor's Last Budget Statement: Politics or Economics?' available online at: <http://research.mbs.ac.uk/entrepreneur/Portals/0/docs/MBSPostBudgetReportMay2007.pdf> (accessed 28 April 2011) (see page 5)

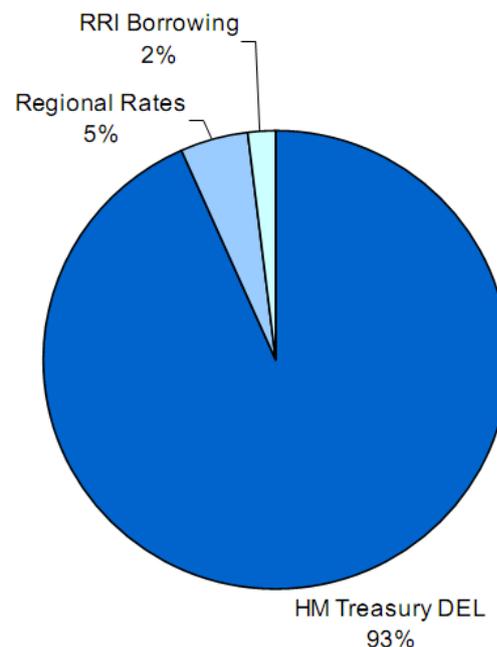
¹⁰⁵ Varney, D (2007) 'Review of Tax Policy in Northern Ireland' available online at: <http://webarchive.nationalarchives.gov.uk/20080205224421/http://hm-treasury.gov.uk/media/1/3/varney171207.pdf> (accessed 29 March 2011) (see page 46)

4.6 Reducing Northern Ireland's fiscal deficit

DFP estimated that Northern Ireland had a fiscal deficit of £7.3bn in 2007-08.¹⁰⁶ In other words, Northern Ireland's expenditure is subsidised to that amount by taxpayers elsewhere in the UK (predominantly the greater South East of England). There is an argument that the persistence of this fiscal deficit is not simply an economic issue but also a moral one.

The proportion of Executive expenditure that is funded through locally determined means is around only 7% of the total:

Figure 8: Sources of funding available to the Northern Ireland Executive 2010-11¹⁰⁷



ERGNI has also argued that:

Devolving corporation tax to Stormont will provide an important boost to devolution. The UK currently has the most centralised tax system of any major economy, with just 5 per cent of taxes collected locally. A greater level of fiscal decentralisation is highly desirable for this reason alone.¹⁰⁸

This argument echoes points made in Scotland in support of fiscal devolution. Essentially the case is that devolved governments should be more accountable for their spending decisions to the taxpayers who foot the bill:

¹⁰⁶ DFP (2010) 'Northern Ireland Net Fiscal Balance Report 2007-08 (experimental)' available online at: <http://www.dfpni.gov.uk/northern-ireland-net-fiscal-balance-report-07-08-experimental.pdf> (accessed 13 May 2011)

¹⁰⁷ NI Executive (2011) 'Budget 2011-15' available online at: http://www.northernireland.gov.uk/revised_budget_website_version.pdf (accessed 13 May 2011) (see page 18)

¹⁰⁸ ERGNI (2010) 'The Case for a Reduced Rate of Corporation Tax in Northern Ireland' available online at: http://ergni.org/reports/report_corporation_tax_may_2010.pdf (accessed 29 March 2011) (see page 27)

This view argues that accountability for expenditure trade-offs is not sufficient and that there should be an explicit trade-off between expenditure and taxes raised [... which...] explains why some writers [...] have emphasised 'fiscal accountability at the margin'; a sub-national government should have a choice at the margin as to whether to spend £1 or reduce taxation by £1.¹⁰⁹

But under the current system, Northern Ireland does not have the power to reduce or increase taxation except through the regional rate, minor instruments such as prescription charging, or, water charging – until now unused. To some extent this means that Northern Ireland citizens are disconnected from the true cost of the services that are provided to them.

It also means that if the Northern Ireland Executive chooses to provide fewer services, at lower cost, through a smaller public sector, it has to hand back to the UK Government the unspent proportion of the block grant. Clearly, the Northern Ireland Executive has little incentive to do so, because it cannot deliver benefits to citizens through lower taxation; not spending the full block grant could be viewed effectively as an admission that Northern Ireland as a whole is overfunded by the UK Exchequer.

This situation also applies the other way around; the Northern Ireland Executive cannot have a larger public sector, or provide more services, than can be paid for from the block grant without increasing local taxation. There have been numerous examples of the Northern Ireland Executive rejecting this option in recent years – in particular exhibited by the reluctance to introduce water charging, the freezing of domestic rates from 2008 to 2011, and various 'giveaways' such as free prescriptions for all and public transport for pensioners.

Related to this:

...in industrialised democracies, there has traditionally been concern about the 'flypaper effect', a term reflecting the greater propensity to spend out of grant income than out of a corresponding increase in the local tax base.¹¹⁰

It is possible to argue that the devolution of corporation tax powers to Northern Ireland could have a potentially significant effect on the fiscal accountability of the devolved institutions. In one sense, obtaining the power to set corporation tax rates and/or policy locally might make local politicians and the wider public more aware of the trade-off between raising revenue and spending than having to justify spending £x million on service A, rather than on service B could ever have. In itself this may have benefits beyond the profitability of local businesses and the labour market.

¹⁰⁹ Heald, D and McLeod, A (2010) 'The Taxation and Borrowing Powers of the UK Devolved Administrations', conference paper presented to the Political Studies Association's Specialist Group Conference on British and Comparative Territorial Politics, University of Oxford, 7-8 January 2010.

¹¹⁰ Heald, D and McLeod, A (2010) 'The Taxation and Borrowing Powers of the UK Devolved Administrations', conference paper presented to the Political Studies Association's Specialist Group Conference on British and Comparative Territorial Politics, University of Oxford, 7-8 January 2010.

There is some research evidence that states behave in particular ways in response to the part of society or sector its revenue comes from. It is cheaper to trade services for revenue than purely to extort it. So, states effectively operate a 'fiscal contract' between themselves and their main taxpayers.¹¹¹ This might suggest that businesses in Northern Ireland may be brought more directly into a form of fiscal contract with the Executive. There is arguably already a contract based on business rates, but corporate taxation might generate a stronger linkage.

Question: does the Department view the devolution of corporation tax as a means of addressing the fiscal deficit and of increasing local fiscal accountability?

4.7 International considerations

Moving away from the economic and moral arguments surrounding accountability and Northern Ireland's fiscal deficit, there is another set of related issues that is worthy of attention.

Tax competition with the developing world

In a globalised economy, taxation in one country cannot be easily isolated from impacts on other countries. This is one very clear reason for the interest the EU has in preventing harmful tax competition discussed above in section 3.3. Also, taxation:

...often has unexpected consequences, and the tax system of one country can easily have an impact on economic or social behaviour in another. Since business is now international, it is important that taxes are designed not only with a domestic agenda in mind, but with a view to their consequences internationally, particularly for vulnerable economies in the [developing world].¹¹²

This is important to the current debate because the low corporate tax regime in the Republic of Ireland has been consistently held up by ERGNI, the Treasury, and many other commentators as a useful model for Northern Ireland's attempts to rebalance the economy. But the regime in Ireland has recently been criticised:

Ireland may pose an inadvertent threat to the tax capacity of [developing] countries if its tax system is used by multinational firms as part of capital flight, or international tax evasion schemes. Ireland has attracted considerable foreign direct investment (FDI) through tax competition using a low rate of corporation tax, a wide network of double tax treaties and incentives for intellectual property to encourage multinational firms to locate

¹¹¹ Timmons, J F (2005) 'The Fiscal Contract: States, Taxes, and Public Services' in *World Politics* vol. 57 pages 530-67

¹¹² Killian, S (2011) 'Driving the Getaway Car? Ireland, Tax and Development' available online at: http://www.debtireland.org/images/documents/driving_the_getaway.pdf (accessed 28 April 2011) (see page v)

in the country. Although Ireland has recently introduced new rules to counter transfer pricing abuse, these have significant weaknesses. There is a clear risk that without closing these gaps, [the Irish] tax system can become a vehicle for complex tax avoidance schemes used by multinational firms to reduce their global tax liability. This is neither in the interests of countries which lose revenue to these firms, or in the interest of Ireland as a legitimate destination for FDI.¹¹³

There is a risk that if Northern Ireland seeks to emulate the low corporate tax regime of the Republic of Ireland as a lever to stimulate growth, it may also pose a threat to developing countries' tax capacities. This point has been picked up elsewhere in academic literature:

While the importance of taxation as a means to implement domestic public policy and conceptions of justice is widely acknowledged – and indeed often taken for granted – the external effects that the interdependence of national tax regimes generates are mostly neglected. Tax competition between states puts pressure on domestic fiscal regimes. Mobile factors of production have the opportunity to “shop around” to minimize their tax burden, thereby undermining the de facto sovereignty of states. As a consequence, tax competition tends to exacerbate inequalities of income and wealth both within countries and across borders.¹¹⁴

This issue is not one that has featured widely (if at all) in the debate on the devolution of corporation tax powers to Northern Ireland.¹¹⁵ Nevertheless, there is evidence to suggest that it is at least worthy of some consideration.

Transfer pricing

It is worth devoting some attention to transfer pricing because of its importance in corporate taxation, particularly in the context of the criticism (quoted above) of the Republic of Ireland's transfer pricing rules.

When a product is sold on the open market, a price is fixed at a level that buyers are prepared to pay and sellers are prepared to accept – in other words, market forces. But when the parties to the transaction are connected (for example, different parts of a multi-national corporation), there are other factors beyond market forces that will determine the price. Where both the seller and the purchaser are companies owned by the same person the price charged will not of itself make their common owner any richer or poorer; it will merely serve to determine the extent to which the common

¹¹³ Killian, S (2011) 'Driving the Getaway Car? Ireland, Tax and Development' available online at:

http://www.debtireland.org/images/documents/driving_the_getaway.pdf (accessed 28 April 2011) (see page v)

¹¹⁴ Dietsch, P and Rixen, T (2010) 'Justice and International Tax Competition' available online at:

http://eis.bris.ac.uk/~plcdib/territory/papers/dietsch_justiceandtax.pdf (accessed 28 April 2011) (see page 1)

¹¹⁵ See Belfast Newsletter 'Ethics plea over corporation tax', 16 May 2011 for some coverage of the issue:

http://www.newsletter.co.uk/news/local/ethics_plea_over_corporation_tax_1_2684367 (accessed 16 May 2011)

owner's funds/profits/financial resources are transferred/shifted from one company to the other.

According to HMRC:

The transfer pricing issue mainly arises in cross-border transactions between two companies who are part of the same group. However, transfer pricing problems are not limited to company to company transactions; for example a transaction between an individual and an overseas company he controls can be manipulated through the transfer price.

Large multinational enterprises and their advisors are well aware of the opportunities to manipulate transfer prices. From the point of view of a large multinational group, it is better to structure the business so that profits are earned in a territory that taxes them at 10%, rather than a territory that taxes them at 35%. Tax planning to help bring about such a result is now very sophisticated.

Tax authorities around the world are increasingly aware that the transfer pricing of transactions between connected parties can affect their tax yield. Moreover, this is particularly so where the parties to a transaction are subject to different tax rules and rates.¹¹⁶

There is a considerable amount of academic and practitioner-related material dedicated to the issue of transfer pricing. For the purposes of this paper it is sufficient to note firstly that it is a significant issue for states and their tax authorities. Secondly, it is important to highlight *why* this is a consideration in relation to the current Treasury consultation.

If it were the case (see section 4.2) that the decision-making responsibility over the tax base were devolved, it would be likely that the Northern Ireland Executive would have to develop the policy and enforcement capability to police transfer pricing or pay for it under some kind of agency arrangement. At present, these matters are handled at the UK level by HMRC. Any new capacity to deal with such issues would have to be resourced but this has not featured widely (if at all) in the public debate surrounding the devolution of corporation tax powers.

¹¹⁶ HMRC 'INTM431010 - What is transfer pricing all about?: What is the transfer pricing problem?' available online at: <http://www.hmrc.gov.uk/manuals/intmanual/INTM431010.htm> (accessed 6 May 2011)

International reputation and policing tax avoidance

As noted above, the legal responsibility and the capability for policing and regulating taxation currently rests with the UK Government. Understanding why such a capacity is needed is illustrated by an example from the Republic of Ireland:¹¹⁷¹¹⁸

Example – Round Island One

Writing in the Wall Street Journal, Simpson (2005) describes how Round Island One Ltd., a little-known Irish subsidiary of Microsoft, was used by the group to save over \$500 million in US taxes, and to partially shield Microsoft's multi-billion dollar profits from worldwide taxes. Simpson describes how this structure impoverishes Southern countries as follows. "*Through a key holding, dubbed Flat Island Co., Round Island licenses rights to Microsoft software throughout Europe, the Middle East and Africa. Thus, Microsoft routes the license sales through Ireland and Round Island pays a total of just under \$17 million in taxes to about 20 other governments that represent more than 300 million people.*"

Following this report, the two subsidiaries cited, Round Island One and Flat Island applied to change their status from limited to unlimited companies, removing the requirement that they file details with the Irish Companies' Office. This move shows the importance of opacity to the tax schemes of multinational firms, and so indirectly demonstrates the potential of automatic information exchange between taxing authorities, or public country-by-country reporting as tools to combat them. It also shows the moral hazard created by Ireland's low tax rate, and the propensity of large multinationals to take advantage of this in unanticipated ways.

It was noted in section 4.2 above that the UK recently ranked second among OECD countries for 'ease of doing business' in the World Bank *Doing Business* rankings. It seems highly likely that the UK Government will be exceptionally keen to protect this reputation. As such, it will be interesting to see how willingly or otherwise it chooses to devolve control over such issues as transfer pricing – such a step may involve a degree of risk.

**Question: has the Department considered tax competition and transfer pricing?
If the tax base were devolved, how would the Department set policy and rules?**

¹¹⁷ Killian, S (2011) 'Driving the Getaway Car? Ireland, Tax and Development' available online at:

http://www.debtireland.org/images/documents/driving_the_getaway.pdf (accessed 28 April 2011) (see page 21)

¹¹⁸ For the original source article by Simpson go to: http://www.taxjustice.net/cms/upload/pdf/WJSJ_-_Microsoft_slashes_taxes_in_US_and_EU_through_Irish_subsidiary_-_7_NOV_2005.pdf (accessed 6 May 2011)

5. The cost of devolving corporation tax

It has been noted above that Northern Ireland must bear the fiscal cost of devolved corporate tax variation. While finalised costs are not available, the current Treasury consultation presents estimates of direct and indirect costs. This section of the paper considers the Treasury's estimates and raises some questions about the methodology and figures presented.

5.1. Direct costs

The first set of cost estimates presented in the consultation are those arising directly from the reduction in revenue that would follow a cut in both the main rate and the Small Profits Rate of corporation tax to 12.5%.

Small profits assumption

The Small Profits Rate (SPR) is levied on companies whose profits are below a threshold of £300,000. For 2011, the SPR is 20% compared to the main rate of 26%. For profits between £300,000 and £1,500,000, Marginal Relief is available.¹¹⁹ Marginal Relief provides a sliding scale rate of corporation tax for companies whose profits are between the profit thresholds for the SPR and main rates.

The figures presented by the Treasury (reproduced below) assume that **both** rates are reduced to 12.5%. As a result, there would be no Marginal Relief for companies based in Northern Ireland.

Northern Ireland's share of total UK corporation tax receipts

The Treasury has estimated that Northern Ireland's tax receipts from 2002-3 and 2007-8 varied between 1.3% and 1.6%. It also notes that for 2008-9 (the latest available data) this dipped to 1.1%.¹²⁰

On that basis, two sets of direct costs have been estimated. The first assumes a Northern Ireland tax base that is 1.5% of the UK total. The second assumes 1.25%.

It was noted above in section 4.4 that these assumptions are markedly different from data published by DFP in its *Net Fiscal Balance Report*. If the true level of Northern Ireland's corporation tax receipts is around 2.4% as would appear from these data (see Appendix 3 for the source data) then the annual direct cost to the Northern Ireland Executive would be nearly double that presented in Table 3 based on a 1.25% assumption.

¹¹⁹ <http://www.hmrc.gov.uk/rates/corp.htm>

¹²⁰ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 26)

DFP has confirmed that work is ongoing on an updated *Net Fiscal Balance Report* based on 2008-09 data but at the time of writing this has not been published. It is expected in the coming months.¹²¹

Table 2: 1.5% assumption – direct costs to the Northern Ireland Executive of reduced corporation tax rate¹²²

£ million	Year 1 ¹³	Year 2	Year 3	Year 4	Year 5
(National Accounts basis)					
Direct effect:					
a) Main rate	-105	-180	-185	-180	-180
b) Small profits rate (SPR)	0	-45	-65	-70	-75
c) Marginal SPR ¹⁴	0	-10	-15	-15	-15
Total Direct Effects ¹⁵	-110	-235	-265	-265	-270
per cent of NI block grant	1.0	2.3	2.5	2.6	2.6

Table 3: 1.25% assumption – direct costs to the Northern Ireland Executive of reduced corporation tax rate

£ million	Year 1 ¹³	Year 2	Year 3	Year 4	Year 5
(National Accounts basis)					
Direct effect:					
a) Main rate	-90	-150	-155	-150	-150
b) Small profits rate (SPR)	0	-35	-50	-55	-60
c) Marginal SPR ¹⁴	0	-10	-15	-15	-15
Total Direct Effects ¹⁵	-90	-200	-220	-220	-225
per cent of NI block grant	0.9	1.9	2.1	2.1	2.2

There are some points that should be noted in relation to these tables:

- The final row 'per cent of NI block grant' relates to the estimated cost to the Northern Ireland Executive's total Departmental Expenditure Limit – i.e. Resource DEL (excluding depreciation) plus Capital DEL. Annually Managed Expenditure (AME) is not included in the calculation;¹²³
- The SPR and Marginal SPR Relief are shown as zero in Year 1 because costs are given in receipt terms, which means that they show when '*payments would be made*' by companies rather than when they accrue. The majority of SPR/Marginal SPR Relief payments will be made 9 months after the end of the relevant accounting

¹²¹ Source: communication with DFP official.

¹²² HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 27)

¹²³ Source: communication with Treasury official.

period, which would fall in Year 2 in almost all cases; this means that the cost in Year 1 is zero;¹²⁴

- The direct cost of a reduced main rate, however, does begin to show in Year 1. This is because main rate payers will pay through the Quarterly Instalment Payment system. Under this, companies pay in four equal instalments, the first of which is due six months and 13 days after the first day of the accounting period. This means that receipts costs start to arise in the year in which the rate cut is made, but at a lower (pro-rata) level than in subsequent years;¹²⁵
- If the previous DFP data is used and a 2.4% assumption is made, the direct costs to the Northern Ireland Executive would be nearer to £180m in Year 1, rising to well over £400m in Year 5.

Question: does the data that the Department holds on corporation tax receipts for Northern Ireland align with the assumptions presented in the Treasury's estimates?

5.2. Indirect costs

As discussed in section 4.5 above, all other things being equal, a so-called '*behavioural response*' can be expected to a reduction in corporate taxation in Northern Ireland.

As with the direct costs, the Treasury has presented two sets of estimates, again based on 1.5% and 1.25% assumptions which must be added to the estimated direct costs.

Table 4: 1.5% assumption – behavioural response

£ million	Year 1	Year 2	Year 3	Year 4	Year 5
Behavioural Response:					
a) Profit shifting from the rest of the world to NI	20	35	40	35	35
b) Profit shifting from GB to NI	-40	-75	-75	-70	-70
c) Tax Motivated Incorporation	-10	-25	-35	-45	-50
Total behavioural effect	-30	-65	-70	-80	-85

¹²⁴ Source: communication with Treasury official.

¹²⁵ Source: communication with Treasury official.

Table 5: 1.25% assumption – behavioural response

£ million	Year 1	Year 2	Year 3	Year 4	Year 5
Behavioural Response:					
a) Profit shifting from the rest of the world to NI	15	30	30	30	30
b) Profit shifting from GB to NI	-35	-60	-65	-60	-55
c) Tax Motivated Incorporation	-10	-25	-35	-45	-50
Total behavioural effect	-30	-55	-70	-75	-75

Again, there are some points that should be noted in relation to these tables:

- Tax-motivated incorporation (TMI) was considered above in section 4.5. The Treasury expects that TMI will result in reduced income tax and NICS receipts for the UK as a whole. For Northern Ireland to demonstrably meet the full cost of a reduction in corporation tax as required by the Azores criteria, the Executive will have to bear an equivalent reduction to the block grant;
- The same principle must apply in relation to any profit-shifting that occurs with companies currently located in other parts of the UK artificially manipulating transactions to generate their profits in Northern Ireland to benefit from the lower rate. As discussed above, this activity would be of little benefit to the local economy, but would result in a loss to the UK Exchequer;
- Where profits are shifted from outside the UK, however, there is no cost to the UK Exchequer (although the issues raised in section 4.7 apply) and so the Azores criteria are irrelevant. The Treasury has estimated the impact of this kind of response that would be of some limited fiscal benefit to Northern Ireland.

Question – is the Department satisfied that the figures presented are a reasonable cost assessment of the behavioural response?

5.3. Dynamic impacts on tax receipts

If the corporate tax rate in Northern Ireland is reduced and the policy is successful, an increase in corporate tax receipts should flow from additional investment. In turn, the associated increase in economic activity and corporate income may lead to increased consumption (i.e. spending by consumers on goods and services) which would raise VAT and excise duty receipts. These effects would result in a benefit to the UK Exchequer.

It was noted above (in section 3.2 on fiscal autonomy) that the Treasury has stated that these effects could be taken into consideration when the adjustment to the block grant is calculated – as long as compliance with the Azores criteria can be achieved.¹²⁶ If

¹²⁶HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 29)

this can indeed be achieved, then it would reduce the overall cost to the Northern Ireland block grant. The Treasury has produced the following estimates:

Table 6: Estimated second-round tax effects

£ million ¹⁷	Year 1	Year 2	Year 3	Year 4	Year 5
Second-round corporation tax effect	10	10	20	20	20
Second-round effects on other tax receipts	20	40	50	50	50

Question – is the Department satisfied that the figures presented are a reasonable assessment of second-round tax effects?

5.4. Administrative costs

The Treasury states that in 2008-9 the administration costs of HMRC relating to corporation tax across the UK were £340m. This will increase with devolution and Northern Ireland will bear the additional administrative costs. The additional elements of cost are identified as:

- *Start-up costs – e.g. changes to HMRC IT and operational systems and online filing services to enable a new regime to commence;*
- *Ongoing costs – costs arising from maintaining new systems and procedures (both IT and operational) to administer a new regime; and,*
- *Additional anti-avoidance compliance resource – ensuring that only “genuine” economic activity within Northern Ireland benefitted from any new regime.¹²⁷*

The current consultation does not attempt to estimate what these additional costs might be.

Whilst the administrative mechanisms for income tax and corporation tax must inevitably differ to some degree, it may be instructive to consider the estimates prepared by the Scotland Office for the impact assessment for the Scotland Bill; the Bill contains provisions for a devolved income tax.

The Scotland Office has estimated one-off ‘transition’ costs to HMRC at £45m over seven years.¹²⁸ On top of this it estimates a recurring annual cost of £4.2m. Both of these estimates are subject to the caveat that they may change subject to outstanding policy decisions – this may especially be the case following the recent elections to the

¹²⁷ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 31)

¹²⁸ Scotland Office (2010) ‘Impact Assessment of the Scotland Bill’ available online at: http://www.scotlandoffice.gov.uk/scotlandoffice/files/Impact_Assessment.pdf (accessed 12 May 2011) (see page 3)

Scottish Parliament which look to have strengthened calls for greater devolution of fiscal powers to Scotland.¹²⁹

5.4. Costs to business

Changing the corporate tax regime in only part of the UK is likely to lead to compliance costs to businesses which operate both in Northern Ireland and other regions. The Treasury states that:

*...additional administrative burdens on businesses might be up to £50 million a year or more, although exact figures are uncertain and will depend on the policy design. Sufficiently profitable firms in Northern Ireland stand to gain more than this from lower corporation tax rates and would be net beneficiaries. Some companies of course may not be sufficiently profitable to offset the additional cost of compliance.*¹³⁰

As the policy is further designed, there will be a requirement for the Government to produce a regulatory impact assessment (RIA) to quantify these compliance costs. This issue will be returned to, then, at a later date. At this stage, it might simply be observed that an annual cost to business of £50m or more is not insignificant.

5.5. Total costs – immediate rate cut to 12.5%

Given the various uncertainties highlighted in the preceding sections, it is not yet possible to determine a hard-and-fast figure for the cost that would be attached to devolving corporation tax powers. The table below brings together the estimates published by the Treasury. It should be noted, however, that these estimates may well be developed as part of the current consultation and as decisions are subsequently taken.

Table 7: Total estimated cost of devolving corporation tax (£m)

	Year 1	Year 2	Year 3	Year 4	Year 5
Direct costs	90-110	200-235	220-265	220-265	225-270
Indirect costs	30	55-65	70	75-80	75-85
Second-round tax effects	-30	-50	-70	-70	-70
Administration costs*	10	10	10	10	10
Total	100-120	215-260	230-275	235-285	240-295

¹²⁹ See for example 'Alex Salmond in quick victory on powers' in *The Scotsman*, 8 May 2011, available online at: <http://www.scotsman.com/sectionhome.aspx?sectionID=6985> (accessed 12 May 2011)

¹³⁰ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 32)

***note** for the purposes of illustration, estimated administration costs for HMRC based approximately on those identified for the Scotland Bill have been applied.

6. Other consultation issues

The consultation document briefly introduces three options for reducing the upfront cost of a one-off reduction in corporation tax rates to 12.5%. These options are:

- Deferral of the reduction;
- Phasing the reduction; and,
- Excluding non-trading profits.

As such, these options relate more to the implementation of a reduction rather than having a considerable impact on the principal decision of whether or not the powers *should* be devolved. More research on these options can be undertaken as the process unfolds.

Similar considerations apply to options for adjusting the Northern Ireland block grant. The current consultation outlines main principles but does not make any specific proposals. The principles are that:

- *[The Northern Ireland Executive] would bear the fiscal consequences of devolution including upside and downside risks if tax receipts were more or less than forecast. Given the volatility of corporation tax in a relatively small private sector base like Northern Ireland this may be a significant risk;*
- *[The Northern Ireland Executive] and the Government would need to develop and agree both an Northern Ireland corporation tax forecasting and outturn tax receipts identifying capacity, liaising with the [Office of Budget Responsibility] as appropriate;*
- *Appropriate adjustments would need to be considered to ensure that Northern Ireland met the full fiscal costs of this measure including profit shifting and TMI which would decrease overall UK receipts. In addition, careful consideration would need to be given to any dynamic effects on other tax receipts when determining the adjustment to the block grant, subject to complying with the Azores criteria and the UK fiscal framework; and,*
- *There would need to be a reconciliation between forecast and outturn receipts. This could potentially be quite complex given the gap between corporation tax rate setting and capture of corporation tax receipts data.*¹³¹

Possible devolved tax scenarios are also presented:

¹³¹ HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 32)

- *A tax varying power up or down by 11 per cent from the 23 per cent UK rate (somewhat similar to the Scottish Variable Rate of income tax in Scotland);*
- *Setting the UK rate in Northern Ireland at 12.5 per cent and allowing [The Northern Ireland Executive] to vary the rate upwards; or,*
- *Setting the UK rate in Northern Ireland at zero and allowing the [The Northern Ireland Executive] to vary the rate upwards.*¹³²

These scenarios in themselves are based - at least in part - on the work done by the Calman Commission. There are potentially very significant implications from such design issues that will need to be considered in detail in the future.

¹³² HMT (2011) 'Rebalancing the Northern Ireland economy' available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 32)

7. Next steps

The current consultation closes on 24 June 2011.

The consultation paper states that the UK Government proposes, in conjunction with the Northern Ireland Executive, the establishment of high-level consultation group. This group will consider the issues raised in the current consultation and, presumably, the responses to it. The group will comprise “representatives from the private sector and others in Northern Ireland.”¹³³

The remit of this group will doubtless depend upon the responses to the current consultation. But to some degree it will presumably need to be involved in the development of the detailed mechanisms for adjusting the block grant, the measurement of indirect benefits and policy on the tax base, among other things.

Question: has the Department considered the composition of this high-level consultation group? By whom should Northern Ireland’s interests be represented?

¹³³ HMT (2011) ‘Rebalancing the Northern Ireland economy’ available online at: http://www.hm-treasury.gov.uk/consult_rebalancing_ni_economy.htm (accessed 29 March 2011) (see page 6)

8. Concluding remarks

Although there has been a level of public debate over the potential costs and benefits of the devolution of corporation tax to Northern Ireland for some time, there is still a lack of certainty about the tax as a policy lever; there is still some disagreement about whether the rate of corporate taxation is really the factor that will kick start the Northern Ireland economy. There are a number of issues as yet to be resolved:

- what is the current corporation tax take in Northern Ireland?
- will policy relating to the tax base be devolved? If not, will there be a mechanism to the Executive to discuss issues of mutual concern with the UK Government in a more meaningful way than current arrangements?
- will the Executive be allowed to borrow to manage volatility?
- how will the Executive/UK Government manage behavioural responses from businesses?

Further, there are some issues that do not have appeared to have featured in the debate at all:

- from a moral perspective, does Northern Ireland want to position itself as a tax competitor to the developing world, for instance?
- how will the Executive/UK Government manage tax avoidance and transfer-pricing manipulation?

But, if it *is* accepted that the powers should be devolved there are some strong positive notes:

- the UK Government appears confident that the legal hurdles can be overcome;
- devolution offers an opportunity to tackle Northern Ireland's fiscal deficit and increase fiscal accountability; and,
- the UK Government appears prepared to pass back to Northern Ireland the secondary benefits of increased VAT and other receipts – this will reduce the upfront cost.

One thing that can be said with certainty is that the issue of devolved tax powers will be live in Northern Ireland – and the wider UK – for the foreseeable future.

Appendix 1: The Calman Commission's proposals

- a. [...] the Scottish Variable Rate of income tax should be replaced by a new Scottish rate of income tax, collected by HMRC, which should apply to the basic and higher rates of income tax.
- b. To make this possible, the basic and higher rates of income tax levied by the UK Government in Scotland should be reduced by 10 pence in the pound and the block grant from the UK to the Scottish Parliament should be reduced accordingly.
- c. Income tax on savings and distributions should not be devolved to the Scottish Parliament, but half of the yield should be assigned to the Scottish Parliament's Budget, with a corresponding reduction in block grant.
- d. The structure of the income tax system, including the bands, allowances and thresholds should remain entirely the responsibility of the UK Parliament.¹³⁴

¹³⁴ Calman, K (2009) 'Serving Scotland Better: Scotland and the United Kingdom in the 21st Century' available online at: <http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-12-csd-final-report-2009fbookmarked.pdf> (accessed 29 March 2011) (see page 111)

Appendix 2: The Holtham Commission proposals

The Assembly Government should acquire limited powers to vary income tax rates in Wales.

i) The basic and higher rates of income tax in Wales should be reduced by ten pence, 20 pence and 25 pence. The block grant should be reduced by an equivalent amount in the first year of the new system. In subsequent years, the size of the block grant reduction should be recalculated to reflect the growth of the relevant income tax bases across the UK as a whole.

ii) The National Assembly should vote annually to set Welsh income tax rates, which would be additional to the reduced UK rates that would apply in Wales.

iii) Welsh Ministers should ideally be able to vary separately all rates of Welsh income tax. Income tax rates in Wales should be allowed to vary by no more than three pence relative to the prevailing rate in the UK. If this recommendation is not accepted, a second best alternative would be to devolve powers to vary only the basic rate.

iv) The UK Government should retain responsibility for income tax on savings and distributions, and for designating income tax bands, allowances and thresholds¹³⁵

¹³⁵ Independent Commission for Funding and Finance for Wales (2010) 'Fairness and accountability: a new funding settlement for Wales' available online at: <http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf> (accessed 29 March 2010) (see page 123)

Appendix 3: Estimated Revenue Trend for UK and Northern Ireland 2003-04 to 2007-08

Revenue Stream £ Million	UK					NI				
	2003-04	2004-05	2005-06	2006-07	2007-08	2003-04	2004-05	2005-06	2006-07	2007-08
Income tax (net of tax credits)	113,969	122,924	130,478	143,322	147,326	2,176	2,342	2,513	2,788	2,816
Corporation tax (excluding NS revenues)	25,020	29,810	34,522	37,599	40,288	597	717	841	903	952
Capital gains tax	2,225	2,278	3,041	3,812	5,265	51	52	70	88	121
Inheritance tax	2,521	2,931	3,276	3,618	3,890	26	28	33	29	52
Stamp duties	7,544	8,966	10,918	13,393	14,123	220	263	247	365	435
National Insurance Contributions (NICs)	72,457	78,098	85,522	87,274	100,411	1,530	1,674	1,822	1,866	2,069
VAT	69,075	73,026	72,856	77,360	80,601	1,861	1,967	1,963	2,235	2,328
Fuel duties	22,786	23,313	23,438	23,585	24,905	753	780	852	865	926
Tobacco duty	8,091	8,100	7,959	8,149	8,094	349	349	343	352	350
Alcohol duties	7,565	7,876	7,861	7,913	8,302	186	190	190	196	222
Betting & Gaming duties	1,347	1,421	1,421	1,391	1,481	28	30	30	39	41
Air Passenger duty	791	864	905	971	1,994	23	25	26	28	58
Insurance Premium tax	2,294	2,359	2,343	2,314	2,306	66	67	67	67	67
Land fill tax	607	672	733	804	877	21	23	26	30	32
Climate Change Levy	832	764	744	712	688	15	13	13	13	13
Aggregates levy	339	334	326	321	339	8	9	8	8	8
Customs Duties & levies	1,941	2,195	2,258	2,325	2,456	53	60	62	65	68
VED	4,689	4,737	4,950	5,139	5,393	129	127	135	143	155
Business rates (non-domestic rates)	18,415	18,739	19,845	20,962	21,413	357	400	437	469	461
Council Tax (domestic rates)	18,747	20,017	20,884	22,208	23,469	312	347	379	432	443
Other taxes & royalties ¹	11,497	12,553	13,181	14,011	14,684	287	319	342	380	403
Interest & dividends	4,581	6,142	6,847	6,521	9,076	145	186	202	192	257
Gross operating surplus & rent	19,968	19,747	22,909	23,805	24,452	625	597	679	705	704
Other receipts & accounting adjustments ²	912	-427	43	2,789	-918	21	-10	1	64	-21
Current receipts (excluding NS revenues)	418,213	447,439	477,260	510,298	540,915	9,839	10,556	11,282	12,322	12,958
North Sea revenues (per capita basis) ³	4,294	5,195	9,641	9,015	7,775	123	148	276	259	225
Current Receipts (including NS revenues)	422,507	452,634	486,901	519,313	548,690	9,961	10,704	11,558	12,582	13,183

Source: DFP <http://www.dfpni.gov.uk/northern-ireland-net-fiscal-balance-report-07-08- experimental .pdf> (see page 1)