Research and Information Service
Briefing Paper

Paper 42/15 | 12 March 2015 | NIAR 095-15

Public Finance Scrutiny Unit

Corporation Tax (Northern Ireland) Bill:
Key Provisions and Considerations

This Briefing Paper is compiled for the Committee for Finance and Personnel, to inform its discussion and debate about the Corporation Tax (Northern Ireland) Bill, which is currently progressing through the House of Lords. The Paper is not intended to be a comprehensive description or analysis of the Bill. It highlights key provisions and considerations arising from them, within the broader context of past, recent and on-going political, economic and budgetary developments. The Paper does not constitute professional legal or financial advice, nor should it be considered a substitute for such advice.

INTRODUCTION

Devolving corporation tax to Northern Ireland is to assist in rebalancing Northern Ireland's (NI) economy. This overarching aim is to be achieved by the Assembly setting a lower corporation tax rate for certain businesses, which presumably will benefit those businesses, increasing their profits. It is assumed that this will make NI a more attractive investment location, incentivising companies to invest for the first time in NI, or to invest further. Generating such economic activity is expected to genuinely expand NI's private sector, thereby helping to rebalance the economy. In January 2015, the Executive's Budget 2015-16 echoed this aim, when it stated:

> *[devolution of corporation tax would] provide the Executive with a significant additional lever to transform the Northern Ireland economy.*[1]

The United Kingdom (UK) Government maintains that European Union (EU) state aid rules will be satisfied if such devolution occurs and the Executive sets a lower rate for corporation tax for NI. It further states that the costs incurred by the Executive due to a lower NI rate will be proportionate and minimal.

On 4 March 2015, the Corporation Tax (Northern Ireland) Bill (the current Bill) advanced to the House of Lords for consideration; after moving through the House of Commons without amendment. If enacted, amongst other things, the current Bill will empower the Assembly to set a NI corporation tax rate - the NI rate - on specified trading profits, distinct from the UK main rate.

This Briefing Paper seeks to inform the Committee for Finance and Personnel's (CFP) discussion and debate about the current Bill. First the Paper sets out relevant information to explain the broader context in which the legislative proposals have been made. This is followed by an explanation of key Bill provisions and considerations arising from them due to recent and on-going political, economic and budgetary developments. Included throughout are scrutiny points for the CFP's consideration.

The Paper is intended to support MLAs, and is not intended to address the specific circumstances of any particular individual or situation. It does not constitute professional legal or financial advice, nor should it be considered a substitute for such advice.

1. CONTEXTUAL INFORMATION

This section outlines key information that helped shape the contents of the current Bill:

1.1 Current UK corporation tax legislation

1.2 NI economic context

[1] NI Executive (2015) *Budget* 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf

1.3 Key political, economic and budgetary developments

1.1 Current UK corporation tax legislation

The current Bill aims to amend existing UK corporation tax legislation and associated secondary legislation. Simply stated, the main provisions currently governing corporation tax in the UK are consolidated into the Corporation Tax Act 2009 and the Corporation Tax Act 2010, as amended, as well as the associated secondary legislation. Thereunder, corporation tax is charged throughout the UK on the specified profits made by specified companies, public corporations and unincorporated associations, such as industrial and provident societies, clubs and trade associations.

Exemptions from the payment of corporation tax include: the trading profits generated by charities; profits from fundraising activities for charitable purposes; agricultural exhibitions or shows where profits are used solely for an agricultural society; the sale of permanent health or sickness insurance by a friendly society; and, non-commercial activities connected with core health care delivery functions undertaken by NHS Foundation trusts.[2]

The present rate – called the "UK main rate" - is 21%. In 2012-13, it accrued the fourth largest level of revenue to the UK's Exchequer, after income tax, national insurance contributions and value added tax (VAT).[3]

In another month, the UK main rate will be lowered by the UK Government to 20%; following a downward pattern since 2010. In 2010 it was 28%; in 2013 23%; in 2014 21%; and, in April 2015 20%. Of note in this context is the forthcoming unification of the main rate with the small companies' rate. This is to occur in April 2015, and will result in a single UK rate for corporation tax on all liable profits in the UK.

However, if the current Bill is enacted, and if the NI rate is set at a different percentage to the UK main rate, then there will be two such rates – the NI rate and the UK main rate. This is highlighted in section 2, which explains key current Bill provisions.

1.2 NI economic context

Since 1921, NI's economy has been the weakest in UK.[4] In 2008, Treasury described the NI economy as:

> *…one of the UK's most disadvantaged regions on many measures. It has the lowest wages and one of the lowest labour productivity rates. It has a*

[2] HM Revenue and Customs (2009). *Who is Liable for Corporation Tax?* Online. Available at: http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/ct/new-company/who-is-liable.htm

[3] HM Treasury (2014) *Budget 2014.* Online. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf

[4] PricewaterhouseCoopers (2011) *Corporation Tax: Game changer or game over?* http://pdf.pwc.co.uk/ni-govt-futures-corporation-tax.pdf

weak private sector, with strong dependence on the public sector. These weaknesses reflect a number of unique factors, not least the legacy of 30 years of conflict, the demographic structure and the peripheral location of Northern Ireland, as well as issues surrounding deprivation and rurality. [5]

These structural and economic weaknesses and challenges were reiterated by the Treasury Minister on 4 March 2015 in the House of Commons at the Report Stage Debate:

…These include: its land border with the very low corporation tax environment in the Republic of Ireland; the fact that Northern Ireland is more dependent on the public sector than most other parts of the UK—estimates of the extent of this dependence vary, but it is generally accepted that about 30% work in the public sector, compared with about 20% in the rest of the UK; the claimant count in Northern Ireland in October 2014 was 5.9% compared to 2.8% in the UK as a whole, and the unemployment rates are reducing more slowly than the rest of the UK; and economic prosperity—GVA per capita—is persistently some 20% below the UK average and has been for a number of decades. To a large degree, many of these issues are the legacy of the troubles. [6]

In addition to the lowest wages and productivity rates, NI has consistently performed the worst in the UK across other economic indicators, such as Gross Domestic Product (GDP), unemployment rates and economic inactivity levels. Ulster Bank's most recent blog post (dated March 2015) shows recent economic output in NI is decreasing. It stated:

Beneath this headline figure, however, there were signs of improvement relative to the January report, when there was a simultaneous decline in output, new orders and employment, with only the services sector in expansion mode.[7]

For more detail regarding the above-discussed economic indicators, refer to Appendix 1 of this Paper.

1.3 Key political, economic and budgetary developments

Outlined below are a number of key political, economic and political developments leading up to the current Bill and throughout its passage in the UK Parliament. To a lesser or greater extent, they have influenced the current Bill's contents, as well as on-going deliberations in Westminster:

[5] HM Treasury *Rebalancing the Northern Ireland Economy* (2011) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[6] HC Deb 5 March 2015 cc968

[7] http://ulstereconomix.com/2015/03/09/six-years-of-inflation-comes-to-an-end-in-february/

- ***Varney Review*** – In 2007, the Varney Review, commissioned by the UK Government at that time, considered and rejected the case for devolution of corporation tax to NI.[8]

- ***Coalition's Programme for Government*** - Corporation tax devolution became part of the UK Coalition's Programme for Government (dated May 2010) inasmuch as it included a commitment to produce "a government paper examining potential mechanisms for changing the corporation tax rate in NI.[9]

- ***Initial UK Government Consultation*** - In 2011, there was a consultation on the proposal to devolve corporation tax rate-setting powers. It was part of HM Government's *Rebalancing the Northern Ireland Economy*[10] consultation paper. The Government published the summary of responses to that consultation on 20 December 2011. Around three-quarters of responses were in favour of corporation tax devolution; of which around two-thirds were from NI businesses or business owners.[11]

- ***Joint Ministerial Working Group*** - In October 2011, the UK Government announced the creation of a Joint Ministerial Working Group (JMWC), comprising of ministers from Treasury, the NI Office and the Executive. Topics explored included: potential costs to the block grant resulting from a reduction in NI's corporation tax rate; and, the associated administrative and legislative options. The JMWG concluded its work in October 2012, with and a report for the Prime Minister's consideration. At a meeting with the First Minister and deputy First Minister on 26 March 2013, the Prime Minister indicated that no decision on the devolution of corporation tax powers was to be made until autumn 2014, after the referendum on Scottish Independence. [12]

- ***Northern Ireland Economic Pact –*** The Pact was an agreement dated June 2013 between the UK Government and the Executive. It was entitled *Building a United and Prosperous Community.*[13] Amongst a range of policy proposals, it set out the timeline for a final decision on whether to devolve corporation tax

[8] *Review of Tax Policy in Northern Ireland*, Sir David Varney. October 2007

[9] HM Government (2010) *The Coalition: Our Programme for Government.* Online. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/78977/coalition_programme_for_government.pdf

[10] HM Government (2011) *Rebalancing the Northern Ireland Economy* Online. Available at: https://www.gov.uk/government/consultations/rebalancing-the-northern-ireland-economy

[11] HM Government (2011) *Rebalancing the Northern Ireland Economy* Online. Available at: https://www.gov.uk/government/consultations/rebalancing-the-northern-ireland-economy

[12] Office of the First and deputy First Minister (2012) *Rebalancing the Northern Ireland Economy.* Online: Available at: http://www.ofmdfmni.gov.uk/rebalancing-nieconomy

[13] https://www.gov.uk/government/publications/building-a-prosperous-and-united-community

rate-setting powers to the Assembly. It committed to a mechanism for taking forward the devolution of rate-setting powers before the UK General Election, if the UK Government decided to devolve these powers. It further stated that such devolution could be achieved through a stand-alone Bill in Westminster.

- ***Autumn Statement 2014*** - In the 2014 Autumn Statement, it was announced that legislation to devolve corporation tax would be introduced in the current Parliament, if the Executive demonstrated that it could manage any financial implications arising from such devolution, to the satisfaction of the UK Government. The Statement also noted that the introduction of legislation would be subjected to satisfactory progress on the issues raised by the cross-party talks, which eventually culminated in the *Stormont House Agreement.*
- ***Stormont House Agreement*** – After extensive negotiations, on 23 December 2014, political leaders concluded talks and produced an agreement, which stated that: "…legislation [would] be introduced as soon as Parliament returns to enable the devolution of corporation tax in April 2017."[14] However, progress of the draft legislation would be dependent on the Executive meeting agreed conditions, namely: (i) the Executive legislating for agreed changes to the social security system "with the Welfare Bill passing through Consideration Stage in the Assembly before the end of February [2015]"; (ii) the Executive setting a sustainable budget for 2015-16; and, (iii) the Executive making changes to stabilise its finances for the long-term.

The Financial Annex to the Agreement further stated that:

> *The block grant will be adjusted to reflect the corporation tax revenues foregone by the UK Government due to both direct and behavioural effects but it will not take into account second round effects on other taxes [emphasis added].* [15]

- **Secretary of State Statement** - On 7 January 2015, the NI Secretary of State (SOS) delivered a statement regarding the *Stormont House Agreement* to the House of Commons. She also stated that in addition to the agreed conditions, progress on "…efficiency measures and reforms to the public sector…" were to be achieved. She reaffirmed the UK Government's commitment:

> *If the Stormont Parties press ahead on agreeing their final budget and on delivering welfare reform legislation, the Government will use all*

[14] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390672/Stormont_House_Agreement.pdf

[15] Stormont House Agreement (2014). Online. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390672/Stormont_House_Agreement.pdf

their best endeavours to get the corporation tax legislation onto the statute book before Dissolution. [16]

- **Executive Budget 2015-16** – The Executive Budget 2015-16 contained serious cuts for the Executive departments' budgets, which is expected to result in reduced spending in, e.g., investment in education, higher education and skills development. This will inform the context in which a reduced NI rate may be introduced, which expectedly will impact on such a rate's potential for attracting investment.

  In addition, the Budget describes the NI fiscal deficit as follows:

  > *The taxes generated within Northern Ireland are considerably less than the level of funding received from HM Treasury. This shortfall is known as the fiscal deficit and in 2011-12 it was estimated to be £9.6 billion.* [17]

- ***Welfare Reform Bill*** – On 9 March 2015, the Minister for Social Development withdrew the Welfare Reform Bill at final stage in the Assembly, following the filing of a Petition of Concern to stop its passage in the Assembly. The Bill's withdrawal raised issues about the full implementation of the *Stormont House Agreement,* which – as highlighted above – includes, amongst other things, implementation of welfare reform and devolution of corporation tax.

- ***Northern Ireland Office (NIO) Statement*** - On 9 March 2015, the NIO stated:

  > *Changes to the welfare system in Northern Ireland were a key part of the Stormont House Agreement and without these changes it will be extremely difficult for the Executive to deliver a balanced budget.* [18]

- ***NI SOS Statement to the Commons*** – On 11 March 2015, the NI SOS stated in the House of Commons that devolution of corporation tax would not occur until the welfare issue is resolved; there would be delayed use of the current Bill's commencement clause:

  > ***The corporation tax question is difficult. It is expressly linked with the resolution of welfare reform.*** *The Bill contains a commencement clause, and there is no question but that this welfare issue must be resolved. The Executive must fulfil their obligations under the Stormont House agreement before the commencement clause can be operated. In the interim, the Government proposes to continue with the legislation and to complete its parliamentary progress, because we are determined to implement the agreement fully and fairly.* ***Let me be clear: Northern Ireland will not get***

[16] HC Deb 7 January 2015 cc296-7
[17] NI Executive (2015) Budget 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf
[18] Northern Ireland Office (2015) *Villiers: Pivotal that all aspects of the Agreement are Implemented in full.* Online. Available at: https://www.gov.uk/government/news/villiers-pivotal-that-all-aspects-of-the-agreement-are-implemented-in-full

these devolved powers until the Stormont House agreement has been implemented.[19] [emphasis added]

2. THE CURRENT BILL – KEY PROVISIONS

The law governing corporation tax in the UK is complicated. It is grounded in technical statutory language and related rules and practices, where terms have specific and complex meanings. In addition, there are numerous classifications, as well as exceptions, and then exceptions to those exceptions.

With this in mind, this section is aimed at increasing CFP's understanding of key provisions contained in the current Bill. First it explains its parliamentary passage to date. Thereafter, as simply as possible, it explains the new Assembly power and what it entails.

2.1 Parliamentary passage to date

On 8 January 2015, the UK Government published and laid the Corporation Tax (Northern Ireland) Bill before the House of Commons, where it received its first reading. The accompanying Explanatory Notes explain that the proposed legislation does not require a Legislative Consent Motion, since it does not concern matters within the devolved legislatures' competence.[20]

The proposed legislation completed its passage through the House of Commons on 4 March 2015, without amendment.[21] That same day, it underwent its first reading in the House of Lords, a formality that signals the start of the current Bill's journey through the Upper House. The second reading is scheduled for 17 March 2015; it will address all aspects of the legislation.

As noted earlier, on 11 March 2015, the NI SOS stated in the House of Commons that devolution of corporation tax to NI would not occur until the on-going welfare issue is resolved; there would be delayed use of the Bill's commencement clause. [22]

2.2 What is the new Assembly power?

The current Bill (at Clause 1) aims to empower the Assembly from April 2017 to set or cancel the rate for corporation tax charged on certain trading profits. These profits include income for specified trades and activities in NI, with other sources of income remaining chargeable at the main UK rate (noted in sub-section 1.2 above).

[19] HC Deb 11 March 2015 Col 280 http://www.publications.parliament.uk/pa/cm201415/cmhansrd/cm150311/debtext/150311-0001.htm#15031163000006

[20] EN para 11

[21] In the House of Commons, an amendment was brought in relation to credit unions, but was unsuccessful. Refer to Appendix 2 of this Paper for more detail.

[22] HC Deb 11 March 2015 Col 280 http://www.publications.parliament.uk/pa/cm201415/cmhansrd/cm150311/debtext/150311-0001.htm#15031163000006

Throughout this Paper, the new rate for NI is referred to as the “NI rate”.[23] The current Bill does not apply to non-trading profits, such as income from property.

It does not remove control over the corporation tax base, including reliefs and allowances, from the UK Parliament. Rather, the current Bill allows for the co-existence of a NI rate and the UK main rate; authorising modification of prevailing UK corporation tax legislation and related rules to reflect this change.

Finally, the current Bill (at Clause 5) specifies that Treasury – by statutory instrument – must appoint the financial year in which the Assembly can set the NI rate.[24] This is the commencement clause. Until this is done, there is no devolution of corporation tax to NI. The NI rate remains at the UK main rate, and will remain so until the Assembly is empowered and exercises its power for the first time.

2.2 How is this new power exercised?

Under the current Bill (Clause 1), the Assembly is authorised to set the NI rate by a resolution, which is to be passed before the financial year in which the rate is to apply. It also specifies that the resolution can pass only if it is recommended by the Minister of Finance and Personnel and receives “cross-community support”, as defined under the *Northern Ireland Act 1998*.[25] When this does not occur, but a NI rate has been set for a previous financial year, then the Bill states that the previous rate is to continue to apply.

To cancel any rate set by resolution, the current Bill requires the Assembly to pass the cancelling resolution before the beginning of the financial year to which it is intended to apply.

2.3 What does the new NI rate apply to?

For ease of presentation, this sub-section first explains those trades and activities that are excluded under the current Bill. Thereafter it outlines relevant considerations to determine what the new NI rate applies to. This requires one to understand the “qualifying trades” and the specified conditions to be met under the current Bill, in order to qualify as a SME (Small and Medium-sized Enterprises) or a large company.

2.3.1 “Excluded trades and activities”

The current Bill (Clause 1) defines:[26]

- an *excluded trade* as:

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[23] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390672/Stormont_House_Agreement.pdf

[24] Explanatory Note, para 172.

[25] Section 4(5) states:

> *Cross-community support” in relation to a vote on any matter means either the support of a majority of members, a majority of the designated Nationalists and a majority of the designated Unionists voting; or the support of 60 per cent of the members voting, 40 per cent of the designated Nationalists voting and 40 per cent of the designated Unionists voting.*

[26] EN, paragraph 103

> *…a trade that includes trades of certain lending, investment and investment management, the long-term business of insurance companies, re-insurance trade or an oil or gas 'ring-fence trade'.*

- an *excluded activity* as:

> *…an activity of effecting or carrying out re-insurance contracts, or any activity carried on in connection with exploration or exploitation activity or in connection with exploration or exploitation rights in the UK sector of the continental shelf.*

It is important to note that Treasury is empowered under the current Bill (Clause 4) to amend the above definitions by regulation.[27] Treasury is afforded broad discretion to do so:

> *…[s]uch regulations may make different provision for different purposes and make incidental, supplemental, consequential and transitional provision and savings.* [28]

Issue: The current Bill includes the power to amend the definition of excluded trade by Treasury regulation.

Scrutiny Point: Does the Executive have any views about the scope of the present definition; is it too broad or too narrow?

2.3.2 "Qualifying trades/partnership trades"

Clause 1 of the current Bill defines qualifying trades as a trade that:[29]

- is carried on by a company (other than a partnership), which is not excluded as a trade under the current Bill; and,
- the company has responsibility for payment of the corporation tax on that trade.

The Bill's Explanatory Notes explain that the definition aims to enable a company/firm to make a one-off election (deduction), so that it can include profits attributable to "back-office" functions of certain trades that would have been excluded under the Bill, as introduced.30 The same applies where a qualifying partnership trade is at issue.[31]

Treasury explains that those trades and activities excluded under the current Bill are to protect against profit-shifting because profits from lending, investing and reinsurance can be easily moved to a different geographical area, without significant trading activity taking place in that area. However, some back offices' profits will qualify – see below.

[27] EN paragraphs 104-105
[28] EN paragraph 106
[29] EN paragraph 22-23
[30] EN paragraphs 23 and 31
[31] EN paragraph 97

Issue: Treasury is to be given power to make regulations that define back office activities.

Scrutiny Point: Given the challenges in defining this term, what are the Executive's views about a definition?

2.3.3 Specified conditions to qualify as a SME or a large company

Under the current Bill, to determine whether the NI rate applies to the profits of a qualifying trade/activity, the company must satisfy specified conditions so that it qualifies as a SME or a large company. This is explained below.

SME conditions

Under the current Bill, a company is a micro, small or medium-sized enterprise (SME) where:[32]

- The company - for the given accounting period, or for each given accounting period, any part of it fell within the 12-month period preceding the given period:
  - was an enterprise that has fewer than **250** staff (employees, owner-managers, employees on secondment or partners); and,
  - had an annual turnover of less than 50 million euros or a balance sheet total (gross assets) of less than 43 million Euros.

And

- The SME is a "NI Employer", i.e. the company's employee time and costs fall largely in NI, defined in the current Bill as:[33]
  - at least 75% of that company's UK workforce (employees, office holders and contractors) is present in NI, and,
  - at least 75% of the company's UK workforce expenses are attributable to time spent in NI.

In this context, HMRC has authority to specify deductions that are, or are not, to be regarded as workforce expenses.[34]

The UK Government believes the above provisions will help to ensure that nearly all SMEs currently active in NI will benefit from the NI rate.

[32] EN paragraphs 21-24
[33] EN paragraphs 25-26
[34] EN paragraph 26

Large company conditions

Under the current Bill, a company is a large company and has a "NI Regional Establishment" where:

- The company is not an SME;

And

- It has a NI Regional Establishment (NIRE), meaning:[35]
    - It has a "fixed place of business" in NI through which it wholly or partly carries out its business.

    "Fixed place of business" is defined as including a place of management, a branch, an office, a factory, a workshop, an installation or structure for the exploration of natural resources, a mine, an oil or gas well, a quarry or any other place of the extraction of natural resources or a building site or construction or installation project.

    Or

    - An agent acting for the company has authority in NI to carry out business on the company's behalf, and habitually has that authority.

      In this context, a company is not regarded under the current Bill as having a NIRE by reason of the fact that it carries out business in NI through an agent of independent status acting in the ordinary course of the agent's business.

2.4 How are profits and losses, as well as capital allowances and tax reliefs, treated when the NI rate applies?

Simply stated, the proposed legislation contains rules on the treatment of profits and losses, as well as capital allowances and tax reliefs, including those relating to the creative sector and in research and development. As noted earlier in this section, the law governing corporation tax is complicated, especially in this particular area of profits, losses, capital allowance and tax reliefs. If CFP wishes to closely scrutinise the proposed provisions in these areas, it may wish to secure expertise that specialises in this complex and technical area of law.

[35] EN paragraph 28

For purposes of this sub-section, a few high level observations can be made:

- The Bill's Explanatory Note explains that it is possible for a company or a partnership to make profits overall, but in certain circumstances it could make a NI loss in conjunction with a UK profit. Similarly, in certain circumstances a company making an overall loss could make a NI profit in conjunction with a UK loss or *vice versa*.[36]

- The Explanatory Notes explain that back-office profits are to be determined by imputing the profits on a percentage mark-up basis. Each back-office deduction is marked up at a rate of five percent.[37] Treasury's specified rate-varying power under the current Bill is to be used to determine the value of the imputed profits of back-office activities.[38]

- The current Bill specifies that the NI rate may apply to a corporate partner's share of the profits of a partnership trade if that company and partnership are both SMEs and the partnership's employee time and costs fall largely in NI. Treasury assures that internationally recognised principles will be used to attribute profits in this context.[39]

- Where – for purposes of the current Bill - the company is not a SME or a NI Employer, the NI rate does not apply to the company's trading profits; instead the UK main rate applies to all its trading profits. The same applies to a corporate partner's share of the profits of the partnership trade.

  In this context, the current Bill allows partnerships to apply the NI rate to profits from back-office functions that are exercised in relation to the stipulated trades. The Bill splits the company's trading profits or trading losses between those that are taxed and relieved at the NI rate, and those at the UK main rate.

- Where – for purposes of the current Bill - the company/corporate partner is not a large company/corporate partner with a NIRE, then the NI rate does not apply to the given trading profits; instead the UK main rate applies to them.

[36] EN paragraph 7
[37] EN paragraph 23 and 31
[38] EN paragraphs 33 and 97
[39] EN paragraph 5

3. KEY CONSIDERATIONS

This section outlines key considerations arising from the current Bill in relation to the following:

3.1 Anticipated future investment

3.2 Reductions to the block grant (including EU state aid considerations)

3.3 Cost implications

3.4 Potential impact on devolved administrations

3.1 Anticipated future investment

Generally speaking, a lower NI corporation tax rate would result in companies paying less tax, and expectedly increasing their profits. The Ulster University Economic Policy Centre (UUEPC) forecast that by 2033 such a reduction to 12.5% would:

- Increase in employment by 4.5% (37,500 jobs);
- Increase in productivity by 5.9% (£3,000);
- Increase in the size of the NI economy by 11%: and,
- Cost approximately £350 million per annum, increasing by 5% each year.[40]

The current Bill, however, does not proscribe how companies should spend this additional profit. Companies are under **no obligation** to reinvest any extra revenue in creating extra jobs in NI, or to purchase any additional plant and machinery that potentially would benefit NI supply-chain companies.

Nonetheless, Treasury cite domestic and foreign investment as the main benefit of reducing the NI rate. Treasury also view a lower rate as a means of encouraging increased investment, stating:

> *Academic literature on corporation tax suggests that the most significant benefits of a reduction in the corporation tax rate in Northern Ireland would come through additional investment in both new foreign-owned firms and in existing firms. Increased investment, other things being equal, typically leads to increased growth and employment.*[41]

There is an implicit assumption by Treasury that companies benefiting from a lower rate tax will reinvest profits in NI, creating new employment in the region.

[40] UUEPC (2015) *An economic update on the Corporation Tax* (NI) Bill.

[41] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

Issue: A reduced NI rate does not necessarily translate into extra investment, creating extra jobs for the region. Companies are under **no obligation** to reinvest profits (gained as a result of benefiting from a reduced NI rate).

Scrutiny Point: Assuming the current Bill is enacted, and the Assembly does in fact set a lower NI rate, what measures could the Executive take to encourage those companies benefiting from the NI rate, to reinvest profits in NI?

3.1.1 Domestic Investment

In 2011, Treasury estimated increased domestic investment in NI following a corporation tax reduction to 12.5%, and assuming a UK main rate of 23% and a small profits rate of 20%. It stated:

> *It is estimated that domestic investment would increase by between £50 and £65 million in the first year (around 2 per cent of the total level of domestic investment in Northern Ireland). By year 10 the mid-point estimate is of higher annual investment amounting to around £110 million.*[42]

Issue: Treasury anticipate domestic investment in NI to increase following a reduction of the NI rate.

Scrutiny Point: Does the Executive have any targets for increased domestic investment following a reduction of the NI rate?

3.1.2 Foreign Direct Investment

Treasury view the lowering of corporation tax as having a positive effect on Foreign Direct Investment (FDI):

> *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) by increasing the return on capital to investors.*[43]

The Organisation for Economic Co-operation and Development (OECD) states that FDI brings substantial benefit to the host economy:

> *FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for*

[42] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[43] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

> *investment and, under the right policy environment; it can be an important vehicle for development.*[44]

Invest NI argue FDI would be particularly advantageous to the NI economy, stating:

> *Attracting and retaining Foreign Direct Investment (FDI) is an important means of promoting economic growth in a region such as Northern Ireland. Foreign-owned firms are associated with higher levels of productivity. They create wealth for Northern Ireland through exports and can introduce new skills and new technologies.*[45]

Generally speaking, increased FDI levels are expected to benefit a host economy in the following ways:

- Increases levels of productivity;
- Introduces new management techniques and practices;
- Introduces new markets;
- Attracts investment to areas of social disadvantage;
- Increases capital investment; and,
- Increases high skilled labour opportunities.[46]

In 2011, Treasury presented the following estimates for increased FDI investment in NI following the introduction of a lower NI rate:

> *It is estimated that net FDI (after taking account of the displacement of FDI from the rest of the UK of around 12.5 per cent of the total increase in FDI) would increase by between £105 and £175 million in the first year. A central estimate therefore represents around 50 per cent of the current level of estimated FDI in Northern Ireland. Not taking account of displacement, the gross effect on FDI would be an increase of between £120 and £200 million in the first year, with a mid-point of £160 million. By year 10 the mid-point estimate is of higher investment of around £310 million.*[47]

It is noteworthy that the above estimates date back to 2011. They are based on the assumptions of a 12.5% NI rate, a UK main rate of 23% and a small profits rate of 20%. Since coming to power in 2010, the UK Government have enacted changes to corporation tax, resulting in, amongst other things, the unification of the UK main rate and the small profit rate into a single 20% rate.

[44]OECD Factbook(2013): http://www.oecd-ilibrary.org/economics/oecd-factbook-2013/foreign-direct-investment_factbook-2013-34-en

[45]House of Commons Northern Ireland Affairs Committee (2011) *Written Evidence from InvestNI. Corporation Tax in Northern Ireland. First Report of Session 2010-12.*

[46]PricewaterhouseCoopers (2011) *Corporation Tax: Game changer or game over?* http://pdf.pwc.co.uk/ni-govt-futures-corporation-tax.pdf

[47]HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

Also important to note in this context is Treasury's cautionary note about FDI decisions:

> *Foreign direct investment decisions are influenced by a range of factors including skills, market access, and infrastructure. Consequently, it is difficult to isolate the exact impact of the corporation tax cuts from reform in other areas.*[48]

The 2007 Varney Report echoes this when it states that corporate taxation was **not** the most important factor to influence FDI location decisions:

> *Survey evidence such as Ernst & Young's annual 'European Attractiveness Survey' provides an indication of the relative importance of factors in influencing investment location. This gauges the opinion of international business executives across a range of industries, regions and business models. In the most recent survey, the level of corporate taxation was ranked sixth in importance as a criteria for investment location, behind transport and logistic infrastructure, labour costs, telecoms infrastructure, potential productivity increase and the legislative and regulatory environment.*[49]

This is evidenced below in Figure 1, which highlights the decreasing importance of the corporate tax rate as a determinative factor when companies make FDI location decisions.

[48] House of Commons (2014) *Foreign Investment in UK: Written question – 206722*: http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2014-07-21/206722

[49] Sir David Varney. (2007)*Review of Tax Policy in Northern Ireland:* *http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.178.3894&rep=rep1&type=pdf*

Figure 1: Key FDI location factors[50]

Key location factors

Factors that companies take into account when deciding on a location to establish operations

	2014	2012	2011
Stability and transparency of political, legal and regulatory environment	1	2	3
The country or region's domestic market	2	1	8
Potential productivity increase for their company	3	5	4
Labor costs	4	3	7
Transport and logistics infrastructure	5	4	1
Local labor skill level	6	6	6
Stability of social climate	7	7	5
Corporate taxation	8	8	9
Telecommunications infrastructure	9	10	2
Flexibility of labor legislation	10	9	10

Source: *EY's 2014 European attractiveness survey* (total respondents: 808).

Issue: Evidence suggests that a lower rate of corporation tax is only one of many factors that influence firms' investment location decisions in terms of FDI.

Scrutiny Point: What measures can the Executive take, outside corporation tax rate cuts, to improve the attractiveness of NI for potential FDI?

Republic of Ireland's FDI Experience

A 2014 report from the Republic of Ireland's Department of Finance appears to support the positive contribution FDI has made to its economy:

> *The headline rate of corporation tax is very important for FDI location decisions. If Ireland were to increase the 12.5 per cent corporation tax rate it would significantly reduce FDI flows into the country. Ireland should maintain a competitive corporation tax rate.*[51]

The 2014 report further states:

> *In 2011, a small number of sectors dominated by foreign-owned multinational enterprises (MNEs) accounted for 25 per cent of economy wide gross value added (GVA). Focusing on the somewhat narrower 'business economy', the foreign-owned sector accounted for 57 per cent of GVA in 2011. In terms of employment, foreign-owned enterprises account*

[50] Ersnt & Young (2014) *Attractiveness survey, Europe 2014.Back in the game*: http://www.ey.com/Publication/vwLUAssets/EY-2014-european-attractiveness-survey/$FILE/EY-2014-european-attractiveness-survey.pdf

[51] Department of Finance (RoI) 2014.*Economic Impact assessment of Ireland's Corporation Tax* Policy: Summary *Research Findings and Policy Decisions*: http://www.budget.gov.ie/Budgets/2015/Documents/EIA_Summary_Conclusions.pdf

> *for 22 per cent of private sector employment and are particularly important in manufacturing, where they account for almost half of employment.*[52]

In addition, the 2014 report acknowledges FDI's role in helping the Irish economy through the recession, explaining that:

> *The foreign-owned sector was an important source of strength for the economy over the period of the economic crisis, contributing five percentage points to economic growth in Ireland during […] 2008-11. The sector exhibits higher productivity levels which are reflected in higher wage levels than domestic firms. It also performs relatively strongly in terms of research and development and innovation.*[53]

Issue: Evidence suggests that FDI was an important factor in the Irish economy's performance during the recession.

Scrutiny Point: What lessons can the Executive learn from the Irish economy to improve FDI levels in NI?

3.2 Reduction to the block grant

A reduction to the NI corporation tax rate necessitates a reduction to the block grant, due to current EU state aid law and the financial arrangements of the prevailing devolution agreement. This sub-section outlines contextual information first, and then discusses a number of considerations relating to the reduction to the block grant.

3.2.1 Financial arrangements

Simply stated, the block grant is the money NI receives from the UK Government. In budgetary terms, it refers to Departmental Expenditure Limits (DEL): this is spending which is planned and controlled. The block is determined using the Barnett formula, which is based on changes in spending at a UK level in 'comparable services', e.g. health, education. In effect, the UK Government treats the Executive like a Whitehall department, so the block grant includes the initial allocation to NI from the UK Government for a given financial year, and subsequent Barnett consequentials for that year. Most spending within DEL can be used at the discretion of the Executive. (The block grant is **not** Total Managed Expenditure (TME), which includes the demand-led Annual Managed Expenditure (AME).[54])

[52] Department of Finance (RoI) 2014. *Economic Impact assessment of Ireland's Corporation Tax* Policy: Summary *Research Findings and Policy Decisions*: http://www.budget.gov.ie/Budgets/2015/Documents/EIA_Summary_Conclusions.pdf
[53] Department of Finance (RoI) 2014. *Economic Impact assessment of Ireland's Corporation Tax* Policy: Summary *Research Findings and Policy Decisions*: http://www.budget.gov.ie/Budgets/2015/Documents/EIA_Summary_Conclusions.pdf
[54] CIPFA (2015) *Resource Budgeting through Estimates to Accounts.*

3.2.2 EU State Aid Rules

Briefly explained, the decision of the European Court of Justice in the *Azores* Case establishes criteria to determine the lawfulness of regional taxation differences under EU state aid law.[55]

Azores establishes that:

- The decision to introduce the regional difference in direct taxation must be taken by the regional government, which has political and administrative status separate from the central government (institutional autonomy);
- The decision must be made and adopted without direct intervention from central government (procedural autonomy); and,
- The full fiscal consequences of a decision to reduce the regional tax rate from the national rate must not be offset by aid or subsidies from other regions or central government (fiscal autonomy).[56]

In 2011, Treasury took the view that NI would meet the above-stated, institutional and procedural autonomy conditions. However, in order to meet the fiscal autonomy condition, Treasury found a block grant reduction was needed:

> *In order to meet the fiscal autonomy condition, the NIE57 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.*[58]

In 2014, an academic providing evidence to the CFP about such a reduction and state aid rules noted:

> *The devolution of corporation tax would put you within the ambit of some very restrictive rules that would necessarily be quite tightly enforced, notably by the European Commission on the issue of state aid. That would mean that you would have to establish the amount of corporation tax that was attributable to Northern Ireland; make a cut in the block grant that related to that amount of revenue; ensure that that cut in the block grant was adjusted in subsequent years by a mechanism that satisfied state-aid tests; and ensure that the cut was sufficiently robust, and that the methodology for adjusting the cut was sufficiently robust to do that. I suspect that the Commission would keep quite a close eye on what*

[55]European Commission v Portugal C88/03.
[56]European Commission v Portugal C88/03.
[57]Northern Ireland Executive.
[58]HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

> *happened here. Then, assuming that a cut in the rate of corporation tax were made once you had obtained its devolution, you would have to apply an actual cut in spending to Northern Ireland Budgets.*[59]

Put simply, the academic states that the devolution of corporation tax will be affected by EU state aid rules on competition. This means the region (i.e. NI) must retain its fiscal autonomy; and any reduction in tax receipts must not be offset by additional aid or subsidies by the central government of the Member State (i.e. the UK). The extent of the reduction in tax receipts therefore must be measured, and the block grant adjusted accordingly.

In February 2015, on the matter of EU state aid rules and the formula for calculating any reduction to the block grant, the Financial Secretary to the Treasury stated:

> *…EU state aid rules—specifically, the Azores criteria, as I said earlier—mean that Northern Ireland's block grant must be adjusted to pay for the devolution of a corporation tax rate-setting power. There is no standard EU formula, because member states all have different tax systems and different ways of funding devolved Administrations, but the approach that we and the Northern Ireland Executive are working on is based on the arrangements agreed with the Scottish Government on the Scottish rate of income tax. I have already set out information about the Azores criteria and explained the key points. In terms of what is happening with the Commission, I can confirm that we are in discussions, which I hope to be completed later this year. As for state aid, let me be clear:* ***we are confident that the regime is within state aid rules****.*[60] [emphasis added]

Put simply, the Minister explained that the method for adjusting the block grant to NI would be based on the same approach and arrangements made between Treasury and the Scottish Executive during the negotiation of the Scottish rate of income tax.[61] Treasury appear to be confident that this approach would not be breaching EU state aid rules.

Issue: The devolution of corporation tax to NI must comply with EU state aid rules. Under the current financial arrangements of the prevailing devolution agreement, this requires a reduction in the block grant.

Scrutiny Point: What measures can the Executive take to ensure that there would be no breaches of EU state aid rules, assuming the Bill's enactment in Westminster and the Assembly's subsequent enactment of a lower NI rate?

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[59] Committee For Finance and Personnel (2014) Oral evidence: *Barnett Formula: Professor Alan Trench and Professor Gerald Holtham*: http://www.niassembly.gov.uk/globalassets/documents/finance/barnett-formula/hansards/12-november-2014---hansard-evidence-from-professor-trench-and-professor-holtham.pdf

[60] House of Commons Public Bill Committee(5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

[61] The *Scotland Act 2012* introduces the Scottish rate of income Tax, which is expected to be implemented in April 2016.

Note: The issue of state aid is discussed in the following paragraphs in relation to industrial de-rating and the small business rates relief scheme. The discussion queries whether state aid issues would need to be revisited in future in light of these rate changes.

Manufacturing subsidies: industrial de-rating

A further consideration to be aware of in this area is the potential state aid issue arising from changes to NI subsidises in the manufacturing industry *via* industrial de-rating. Under the industrial de-rating scheme, manufacturing businesses occupying qualifying industrial properties can qualify to pay 30% of the normal occupied rates. Premises where manufacturing takes place and which are used mainly for retail purposes do not qualify.[62]

In 2011, the Finance Minister made a statement relating to this issue:

> *... Members will know that industrial de-rating provides relief to about 4,200 firms in Northern Ireland, ranging from one-man or one-woman operations right through to the likes of Bombardier. Industrial de-rating dates back to 1929. Although it is not a policy that is particularly well targeted because it pre-dates the common market, it is permissible under state aid rules. Therefore, it is one of the few ways in which we can provide direct financial assistance to the sector in these troubled economic times.*[63]

Put simply, it appears the Finance Minister does not believe the industrial de-rating scheme will fall afoul of EU state aid rules. However, the retention of the scheme in its present form is subject to legislation before the end of the 2015-16 financial year. The following extract from NI Budget 2015-16 notes the Executive's legislative intent:

> *In addition, the revenue forecasts associated with the Regional Rate for the Budget period assume that manufacturing rates will continue to apply at a level of 30 per cent liability until 31 March 2016. This will require the necessary legislation to be approved by the Northern Ireland Assembly in advance of the 2015-16 financial year.*[64]

Issue: Current and future industrial de-rating scheme changes, in the context of a future lower NI corporation tax rate, as well as current and future Small Business Rates Relief Scheme changes (see below), may necessitate further consideration of EU state aid rules.

Scrutiny Point: What are the Executive's present views about the above?

[62] https://www.nibusinessinfo.co.uk/content/industrial-derating

[63] NI Finance Minister (21 March 2011) NI Assembly Official Report: http://archive.niassembly.gov.uk/record/reports2010/110321.htm

[64] NI Executive (2014) *Budget* 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf

Small Business Rates Relief Scheme

Small Business Rates Relief Scheme (SBRRS) was introduced by the NI Finance Minister as a temporary measure in April 2010. It aimed to help alleviate pressures faced by small businesses during the economic downturn. The SBRRS supports the growth and sustainability of small business in NI by providing relief from business rates.[65] The Executive Budget 2015-16 proposes that SBRRS should continue to operate for the additional year of the budget period.[66]

In relation to EU state aid rules, the Explanatory Memorandum to Rates (Small Business Hereditament Relief) (Amendment) Regulations (Northern Ireland) 2013 states:

> *The 2010 Regulations provide that the reductions under the scheme apply only to the extent that they do not contravene the State aid rules of the European Community. The relief is being granted as de minimis aid in line with Commission Regulation (EC) No. 1998/2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid.*
>
> *There is currently a ceiling of 200,000 euros on the total de minimis aid that can be granted to any one business undertaking in the UK from all public sources over a rolling 3 year period.*
>
> *The removal of ratepayers with multiple premises in 2012/13 serves to reduce the likelihood of any breaches.*[67]

Issue: Current and future SBRRS changes, in the context of a future lower NI corporation tax rate, as well as current and future industrial de-rating changes, may necessitate further assessment about EU state aid rules.

Scrutiny Point: What are the Executive's present views about the above?

3.2.3 Calculating the block grant reduction

Some commentators have estimated that the economy must grow one-third in order to pay for an anticipated block grant reduction of £300 million:

> *Gerald Holtham estimates that, even if the cut were just £300 million, then compensating for that loss would require an additional £2.4 billion in private-sector profits. This translates into an additional £10 billion of Gross Value Added (GVA) (current figure £28 billion).*
>
> *According to these conservative calculations, breaking even on the budget would therefore require the Northern Ireland economy to grow by a third!*

[65] https://www.nibusinessinfo.co.uk/content/small-business-rate-relief

[66] NI Executive (2014) *Budget* 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf

[67] Explanatory Memorandum to the Rates (Small Business Hereditament Relief) (Amendment) Regulations (Northern Ireland) 2013: http://www.legislation.gov.uk/nisr/2013/46/pdfs/nisrem_20130046_en.pdf

> *Viewed in this light, cutting corporation tax looks like a considerable gamble with the existing budget and public services.*[68]

The Financial Annex to the January 2015 *Stormont House Agreement* reiterates the requirement to reduce the block grant subsequent to the introduction of a lower NI rate:

> *The block grant will be adjusted to reflect the corporation tax revenues foregone by the UK Government due to both direct and behavioural effects.*[69]

Using themed headings, this sub-section first explains both the direct and behavioural effects of introducing a reduced NI rate. Thereafter it sets out key considerations that have arisen about those effects, which are relevant to CFP's discussion about adjusting the block grant.

Direct Effects – Revenue raised

Estimating the share of UK corporation tax receipts accruing in NI is central to the calculation for adjusting the block grant. This is complicated by the fact that HMRC do not collect corporation tax receipts by location of activity; and therefore does not currently hold accurate data on the size of the NI corporation tax base.[70]

In 2011 Treasury noted that there is a degree of uncertainty with the estimates:

> *…with any estimate, there is a degree of uncertainty. Should the tax cut result in more investment than estimated here, then the extra corporation tax associated with this increase would be passed on to the [NI Executive]. Conversely, if the tax cut failed to attract as much investment, the [NI Executive] would need to make up the difference.*[71]

However, in October 2014, HMRC estimated that NI's suggested corporation tax revenue share was approximately 1.2% of UK onshore corporation tax receipts, excluding North Sea revenue.[72] The value of corporation tax receipts in NI in 2009-10 is estimated at around £465 million, rising to around £685 million by 2015-16.[73]

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[68] Andrew Baker and Richard Murphy (2013) *Corporation tax in Northern Ireland: the policy debate*: http://speri.dept.shef.ac.uk/2013/03/14/corporation-tax-northern-ireland-policy-debate/

[69] Northern Ireland Office (2014) *The Stormont House Agreement: Financial Annex*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390673/Stormont_House_Agreement_Financial_Annex.pdf

[70] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[71] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[72] HMRC (2014) *A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland*:https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/372565/disag-main.pdf .

[73] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

Issue: it appears that **c**alculating NI's share of UK corporation tax receipts is complex and exclusively relies on HMRC estimations.

Scrutiny Point: What measures can the Executive take to ensure that HMRC's estimation of NI's share of UK corporation tax receipts is robust, fair and accurate?

Behavioural Effects – Profit-shifting, brass-plating and tax-motivated incorporation

In addition to the direct costs discussed above, any block grant adjustment following the introduction of a NI rate requires an estimation of the costs increased by certain behavioural changes of companies, such as tax avoidance arising from profit-shifting, brass-plating and tax-motivated incorporation.[74] This was noted during the Bill's third reading in the House of Commons on 5 February 2015:

> *As set out in the Stormont House Agreement, the block grant will be reduced to reflect tax revenues forgone by the UK Government as a result of devolution, plus the additional tax revenue forgone due to the **behavioural effects** resulting from a lower corporation tax rate in Northern Ireland.*[75] [emphasis added]

Treasury explain profit-shifting and tax-motivated incorporation as follows:

> *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.*

And:

> *A lower rate of corporation tax would apply to the Northern Ireland profits of all companies, including small and medium sized ones. This would increase the tax differential between incorporated and unincorporated businesses, which would lead to more unincorporated businesses, with activity in Northern Ireland, incorporating to reduce their tax bill.*[76]

The Financial Secretary to the Treasury further stated the figures for tax-motivated incorporation were recently:

[74] **'Brass plating'**—where businesses move their address to a low tax jurisdiction without moving any meaningful economic activity.
Source: http://www.publications.parliament.uk/pa/cm201012/cmselect/cmniaf/558/55807.htm

'Profit Shifting' – (also referred to as Base Erosion and Profit Shifting) - tax planning strategies that rely on mismatches and gaps that exist between the tax rules of different jurisdictions. These strategies are designed to minimise the corporation tax that is payable overall by either making tax profits "disappear" or by shifting profits to low tax operations where there is little or no genuine activities. In general, BEPS strategies are not illegal but take advantage of different tax rules across different jurisdictions. The OECD and G20 are seeking to identify a method of standardising international tax rules.
Source: http://www.oecd.org/ctp/beps.html

[75] House of Commons Public Bill Committee(5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

[76] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

> *…revised significantly downwards since [originally] published. For 2019-20, the first year of the steady state, [tax motivated incorporation] is estimated to be only £5 million, presuming a 12.5% rate in Northern Ireland and a 20% rate for the rest of the UK. That revision has resulted in a significantly reduced figure.*[77]

In the same debate, the Secretary went on to assure the House of Commons that rules contained in the current Bill addressed the challenges of profit-shifting and tax-motivated incorporation. He explained that:

> *The new rules aim to target genuine economic activity in Northern Ireland, while limiting the risk of profit shifting. Those two issues came up on Second Reading and in the Committee's evidence session, and I know many Members of the House, understandably, feel strongly about them. They formed a core part of our guiding principles for the design of the new regime. The new rules will apply to trading profits only, which will more effectively target activity that encourages genuine economic growth and employment; profits from, for example, property income will not be included..*[78]

Issue: Estimating the direct and behavioural costs of a NI rate that is lower than the UK main rate is challenging. Calculations are based largely on assumptions of both NI's proportion of the total amount of UK corporation tax receipts and the amount of profit-shifting behaviour as a whole.

There are a number of uncertainties inherent in the estimation methodology used by Treasury, largely arising from the fact the HMRC does not collect corporation tax receipts by location of activity.

Scrutiny Point: What assurances can Treasury give that its estimation methodology for calculating the block grant adjustment is robust, and that it provides a fair and accurate estimation of the direct and behavioural costs of a NI rate that is less than the UK main rate?

Key government indications about Treasury's estimation methodology

Leading up to the Bill's introduction, there was discussion about both the method of adjusting the block grant and the degree to which it would be reduced. On 27 January 2015, the Financial Secretary to the Treasury stated:

> *On the block grant adjustment, the Stormont House agreement sets out that the block grant will be reduced to reflect the tax revenues forgone by*

[77] House of Commons Public Bill Committee(5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

[78] House of Commons Public Bill Committee(5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

the UK Government as a result of devolving tax powers. We will continue to work with the Northern Ireland Executive on the detailed mechanics to ensure that the Northern Ireland block grant is reduced appropriately.

An estimate of the cost to the Northern Ireland Executive of a 12.5% rate is in the region of £300 million by 2019-20, which is when the steady state will be in place. That will depend on a number of factors, not least the growth of the economy.[79]

Thereafter, during the third reading in the House of Commons on 5 February 2015, the Financial Secretary to the Treasury stated:

I stress again that the arrangements for calculating the block grant need to be agreed between the Treasury and the Executive, so I cannot provide more details here. Nor does the Azores judgment prescribe how the adjustment should be made, recognising the very different fiscal models in EU member states. However, our current estimate, assuming rates of 12.5% in Northern Ireland and 20% in the UK, is an adjustment of £325 million in 2019-20, assuming that that is the first steady-state year when compared to existing arrangements. As discussed on Tuesday, there will also be a process of reconciliation to compare forecasts with actual results once Northern Ireland corporation tax receipts are known.[80]

Following this, in response to an Assembly question in February 2015, the First Minister explained the block grant reduction as follows:

Previously, the fear was that we would be faced with a bill in the region of £325 million for the first year of its operation. The indications from the last briefing that we were given are, happily, that it is now clear that that will be phased in over three years, with a likely reduction from our block grant of between £100 million and £150 million in the first year. That makes it much more doable. It means that we would not face the final and larger figure until about 2019-2020.[81]

Issue: The methodology for calculating the block grant adjustment is not yet known**.** Key government indications suggest that an incremental approach will be taken, meaning that the Executive does not have to pay the full amount owed to Treasury in the first 3 years.

Scrutiny Point: What input will the Executive have in the calculations to adjust to the block grant?

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[79]House of Commons Public Bill Committee(27 January 2015) *Corporation Tax (Northern Ireland) Bill Second reading:* http://www.publications.parliament.uk/pa/cm201415/cmhansrd/cm150127/debtext/150127-0003.htm

[80]House of Commons Public Bill Committee(5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

[81] NI Assembly Oral Question (AQO 7565/11-15) Answered 16 February 2015

Noteworthy here is the Financial Annex to the *Stormont House Agreement*, which states:

> *The block grant will be adjusted to reflect the corporation tax revenues foregone by the UK Government due to both direct and behavioural effects but it will **not take into account second round effects on other taxes**.*[82] [emphasis added]

Second round effects include increased tax receipts from income tax and VAT. It has been noted during the current Bill's third reading in the House of Commons on 5 February 2015, that not using these tax receipts in the calculations for reducing the NI block grant is harsh:

> *May I go back to the second-round effect? There was a paper by HMRC or the Treasury in late 2013, which looked at the dynamic effects of corporation tax, and suggested that, over the long term, about 45% to 60% of the tax revenues were got back from income taxes and VAT. I suppose that by not giving those back to Northern Ireland, there could be a net cost, and actually it is really quite harsh on them. They have to pay all the downsides, but they get back none of the tax upsides. Is that really what is planned in the long term?*[83]

In the same debate the Financial Secretary to the Treasury commented on the difficulty in calculating second round effects:

> *The difficulty with the second-round effects is the uncertainty. It is difficult to include them. It is worth pointing out that, in the Stormont House agreement, all parties agreed that the second-round effects would not be included. The uncertainty there makes calculating the sums very difficult. I accept the point of the Treasury analysis that was done, but it had quite a significant range for what the second-round effects would be, and it is difficult to quantify that.*[84]

Issue: Treasury explains that any increases in income tax and VAT receipts arising as a result of increased economic activity due to a reduced NI rate are not to be included in the calculations to adjust the block grant. Treasury states it is too difficult.

Scrutiny Points: What is the Executive's view on Treasury's exclusion of these second-round effects?

What representations has the Executive made to the UK Government about them?

[82] Northern Ireland Office (2014) *The Stormont House Agreement: Financial Annex*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390673/Stormont_House_Agreement_Financial_Annex.pdf

[83] House of Commons Public Bill Committee (5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

[84] House of Commons Public Bill Committee (5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

In future does the Executive know if these second-round effects will be taken into consideration by Treasury when estimating future NI block grant allocations?

Importance of transparency

In its 2011 response to the NI Affairs Select Committee report, the UK Government noted the importance of transparency in the context of block grant reductions:

> *It is essential that the process of determining any reduction in the block grant is transparent, equitable to both the UK Government and Northern Ireland Executive and based on the best data available.*[85]

However, an academic's evidence to the CFP in January 2015 noted the potential need for greater transparency when determining the reduction, stating that:

> *There could be more transparency in the negotiations between DFP and Treasury civil servants about how much the block grant would be affected. If you were to have weekly reports, which stated that the Treasury is asking for this and DFP is suggesting that, you could put your views in and political pressures could be brought to bear.*[86]

As reduction calculations are considered, it should be noted that concern was also expressed in the same evidence session in January 2015 about the transparency of Treasury and HMRC calculations:

> *My experience is that Treasury tends to involve Revenue and Customs staff in the negotiations. They know their tax details well and are pretty tough on this. On the other side, when it comes to estimating the benefits of corporation tax, which is rather less important but is part of this, my own experience is that* ***the Treasury was just hopeless*** [emphasis added]. *It was just off the wall. We absolutely rejected its calculations. I do not know whether that will be relevant to you, but if you are faced with any figures from Treasury on the possible economic impact on Northern Ireland of lower corporation tax, do not start from the assumption that you are dealing with experts who know what they are doing. That is a strong thing to say, but that was my experience.*[87]

Issue: There appears to be a lack of transparency around Treasury's estimation methodology to calculate the block grant reduction.

Scrutiny Point: What measures has the Executive taken to secure greater transparency, and what will it do in future?

[85] House of Commons Northern Ireland Affairs Committee (2011) *Corporation Tax in Northern Ireland.Government Response to the Committee's First Report.*

[86] Dr Graham Gudgin Oral Evidence to the Committee for Finance and Personnel 28 January 2015.

[87] Dr Graham Gudgin Oral Evidence to the Committee for Finance and Personnel 28 January 2015.

Monitoring Tax Avoidance

On 5 February 2015, the HMRC Director of Corporation Tax gave details of how HMRC would monitor tax avoidance risks, in particular profit-shifting:

> *The rules are pitched to minimise the opportunities for profit shifting, but we will look at the approaches to routing profits taken by companies that have what we call Northern Ireland regional establishments, to make sure they are in line with agreed international principles. Larger companies will, in many cases, already be taking that sort of transfer-pricing approach and we will already have taken that into account in our risk working with those companies.*[88]

In September 2014, a UK Public Accounts Committee report on HMRC's tackling of tax avoidance concluded:

> *HMRC does not do enough to tackle companies which exploit international tax structures to minimise UK tax liabilities.*[89]

And:

> *International tax experts believe that the UK's tests for companies to gain tax residency are less rigorous than in other EU jurisdictions and research into seven companies who have recently relocated to the UK for tax purposes suggests that the economic benefits for the UK are minimal.*
>
> *We welcome the action HMRC has taken to address some of our concerns around tax avoidance, for example by proposing the accelerated payments scheme. But slow progress in other areas has put tax revenues at risk at a time when pressures on the public finances are acute.*[90]

And:

> *HMRC assured us that it has the right number and quality of staff to tackle tax avoidance. It explained that it had established a new counter-avoidance group, under an experienced director, to put its anti-avoidance work and resources in one place.*[91]

Issue: If there is devolution of corporation tax powers to NI, followed by the Executive's enactment of a lower NI rate, will HMRC have sufficient resources to tackle tax

[88] House of Commons Public Bill Committee(5 February 2015) *Corporation Tax (Northern Ireland) Bill Third reading:* http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/pm/150205s01.htm

[89] House of Commons Public Accounts Committee (2014) *HMRC's progress in improving tax compliance and preventing tax avoidance*:http://www.publications.parliament.uk/pa/cm201415/cmselect/cmpubacc/458/45804.htm

[90] House of Commons Public Accounts Committee (2014) *HMRC's progress in improving tax compliance and preventing tax avoidance*:http://www.publications.parliament.uk/pa/cm201415/cmselect/cmpubacc/458/45804.htm

[91] House of Commons Public Accounts Committee (2014) *HMRC's progress in improving tax compliance and preventing tax avoidance*:http://www.publications.parliament.uk/pa/cm201415/cmselect/cmpubacc/458/45804.htm

avoidance arising from the NI rate, given the likelihood of increased tax avoidance behaviour.

Scrutiny Point: What assurances can Treasury give that the capacity issues highlighted above will not affect the HMRC's ability to fully and fairly enforce the collection of NI corporation tax?

3.2.4 Public expenditure reductions – present and future considerations

The following sub-section highlights key considerations about public expenditure reductions at present and for the future. It discusses their impact on NI's potential investment and economic growth opportunities, which are anticipated to arise from a reduced NI corporation tax rate.

It discusses:

- Executive 2015-16 Budget;
- Future potential impact on the NI fiscal deficit; and,
- Future potential impact on the Barnett Formula.

Executive Budget 2015-16 cuts

Deductions are to be made to NI's block grant for 2015-16 due to austerity measures implemented by the UK Government and subsequent welfare reform financial penalties incurred by NI to date.

Such deductions consequently resulted in a 2015-16 Executive Budget that reduced public spending in a number of areas. This is expected to adversely impact on:

- Investment in education, higher education and skills development;
- Investment in promotion of NI; and,
- Investment in infrastructure.

Consequently this may adversely impact on NI's attractiveness as a FDI location destination, despite devolution of corporation tax to NI.

Investment in education, higher education and skills development

For a reduced corporation tax rate to have the maximum impact on the NI economy, any jobs created would need to be in high value sectors such as pharmaceutical telecoms and information technology services.[92] Employment in these sectors tends to be high skill/high wage. It therefore is expected to deliver higher levels of disposable income, which in turn is anticipated to provide a greater economic stimulus.

[92] Barklie, G. (2014). Talk on "Examining the importance of economic drivers- foreign direct investment". Delivered on 07/10/14 t the Northern Ireland Economic Conference 2014.

Skills and employability have long been linked to increased productivity, leading to a high value economy reflected in economic and wage growth. A high value economy is likely to require the education and skills essential to attract high wage employment. The Department for Employment and Learning's *Labour Market Bulletin 2013* found that:

> *It has been estimated that increasing the average level of education in the labour force by one year is associated, over time, with a substantial increase in labour productivity of between 11-15%.*[93]

In 2013, the Minister for Employment and Learning highlighted the importance of skills. He stated:

> *We have to intensify our investment in places in our universities, colleges and apprenticeships if we are to truly maximise the benefits of corporation tax.*[94]

In 2015, the Finance Minister highlighted the Executive Budget 2015-16 as providing investment in job creation and skills, in preparation and anticipation of the devolution of corporation tax:

> *It is a Budget that underpins the economic growth that Northern Ireland has been experiencing and prepares us for the devolution of corporation tax with sizeable investments in job creation and skills development.*[95]

And:

> *…even in a time when we are facing Budget reductions, we still continue to focus on that long-term objective of lowering corporation tax. That is why you will see a 10% increase in the DETI budget. That is to allow it to continue to do its work, a lot of which is about working now to ensure that investments are secured in future years. Additional money has been allocated specifically to skills development, while money has been given back to universities and colleges so that they can continue to create that pipeline of skilled workers that our economy needs now and will need in future, after the devolution and lowering of the corporation tax rate.*[96]

The Executive's Draft Budget 2015-16 proposed a 10.8% cut in the Department for Employment and Learning's non ring-fenced resource DEL budget.[97] This cut was revised to 6.4% in the final Budget 2015-16.[98] Colleges NI's response to the Executive's Budget 2015-16 states:

[93] Department for Employment and Learning.(2013) Labour Market Bulletin 24

[94] Minister for Employment and Learning (2015) NI Assembly Official Report: Monday 19 January 2015.

[95] NI Finance Minister (2015) Ministerial Statement. *Public Expenditure: 2014-15 January Monitoring and Budget 2015-16:*

[96] NI Finance Minister (2015) Ministerial Statement. *Public Expenditure: 2014-15 January Monitoring and Budget 2015-16:*

[97] NI Executive (2014) *Draft Budget* 2015-16: http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

[98] NI Executive (2014) *Budget* 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf

…while the Department for Employment and Learning is no longer facing cuts of 10.8% as initially anticipated – the cuts of 6.4% will still significantly impact on the role of the FE sector to deliver high quality education and training which is central to rebuilding and rebalancing the NI economy.[99]

Scrutiny Point: Does the NI labour market have the necessary skills to fill any potential high value employment opportunities that may be made available after a reduction in the NI rate?

Scrutiny Point: In the wake of the DEL budget cuts, e.g. cuts impacting apprenticeships and student places in further education colleges, how is the Executive planning to ensure that there is an appropriately skilled workforce to avail of those anticipated employment opportunities?

Investment Promotion

Invest NI's ability to maximise the impact of a reduced NI rate may be limited by public finance constraints that hinder its international promotional operations. In November 2014, the possibility of Executive's Budget 2015-16 impacting on Invest NI's promotional activity was raised by its Chief Executive. In his evidence to the Committee for Enterprise, Trade and Investment, he stated:

…when people look at the wider Budget position, they see that DETI is getting an additional 5%. I welcome what that means for us, but please do not be under any illusion that that is sufficient to deliver what we need to, if we continue to deliver as we are as an organisation.

Let me give you two numbers. We put a very strong case and were very much supported by the Executive and Assembly. At the outset, I mentioned the figure of £50 million. If you allow that our old commitments are dropping off at the rate of about £17 million to £20 million a year and subtract that from the £50 million, we have a £30 million challenge, for the next five years, to pay for the jobs that we signed up. We bid for £30 million and got £30 million in the draft Budget settlement. However, the bit that is unseen is that we have been asked to take a £17·5 million cut at the same time. The challenge is that I cannot take the £17·5 million out of my commitments because that defeats the purpose of getting the £30 million. I need to take it out of everything else. That will represent a substantial challenge for the organisation.

And:

As we sit on the draft Budget settlement, 93% of my budget for next year is committed. It is signed up and contracts are agreed, and unless something

[99] Colleges NI (2015) Colleges Northern Ireland responds to the NI Executive's agreed Budget: http://www.anic.ac.uk/Colleges-NI-News-Item.aspx?id=199

changes with those contracts, 93% is committed. That leaves me 7%, which is about £6 million to £7 million of my budget. ***That is not only to write new business but to do other things that are not committed, such as the most important piece, which is to run our export and trade operation. Some members experienced just one of the 60 overseas exhibitions and trade missions that we run every year. They are uncommitted because there is no contract; we sign them up year-on-year. I fear that there is a substantial challenge that may not have been seen by looking at the headline numbers in the tables at the back of the draft Budget.*** [emphasis added][100]

Further emphasising the importance of this work, Invest NI's Chief Executive later added:

Despite what all of us may think, sitting here in Northern Ireland, there is a constant sales job to be done. Whether it is around the current proposition that is grant funded, or around a new proposition based on corporation tax, it will not fall off the shelves. You all know that there are a lot of people out there who do not even know where Northern Ireland is, never mind know that we might have an advantage in corporation tax, if that is delivered.[101]

Issue: The effectiveness of Invest NI in promoting NI as an investment destination location appears to be reduced, due to current pressures on its budget.

Scrutiny Point: Will Invest NI's budget be protected in future to help enable NI to achieve its potential in attracting FDI, assuming there is a reduced NI rate?

Investment in Infrastructure

Ernst & Young's 2014 European Attractiveness survey highlights the importance of a region's transport and logistics infrastructure and telecommunications infrastructure to attract FDI (as seen in figure 1 at sub-section 3.1.2). The following statement from the House of Commons consideration stage of the current Bill emphasises the importance of investing in NI's infrastructure to help attract investment:

..it is not just our communications infrastructure, but also our physical infrastructure, which requires investment. Companies doing due diligence before investing in a region will look at such issues. It is hugely important that we are able to invest in infrastructure in a way that will both encourage and benefit companies locally who are already involved in growing their businesses and attract new inward investment to Northern Ireland.[102]

[100] http://aims.niassembly.gov.uk/officialreport/minutesofevidencereport.aspx?AgendaId=10534&eveID=6647
[101] http://aims.niassembly.gov.uk/officialreport/minutesofevidencereport.aspx?AgendaId=10534&eveID=6647
[102] House of Commons (2015). *Corporation Tax (Northern Ireland) Bill, Consideration Stage:*http://www.publications.parliament.uk/pa/cm201415/cmhansrd/cm150304/debtext/150304-0002.htm#15030467000428

Public spending in infrastructure comes out of the NI Capital DEL budget, as explained in the following excerpt from the Executive's Budget 2015-16:

> *Capital DEL reflects investment in assets which will provide or underpin services in the longer term (for example, schools, hospitals, roads etc.).*[103]

The Budget further announced a 3.1% increase in Capital DEL from 2014-15 to 2015-16.[104] The *Stormont House Agreement* has pledged the following extra funding for infrastructure:

> *…up to an additional £350m borrowing for infrastructure projects with a profile over four years with £100m in 2015-16, £100m in 2016-17, £100m in 2017-18 and £50m 2018-19.*[105]

Part of the Department for Regional Development's (DRD) remit is to maintain and support infrastructure in NI, as reflected in the following DRD strategic objective:

> *Objective A –*
>
> *Supporting the economy by planning, developing and managing safe and sustainable transportation networks; setting the legislative and policy framework for harbour services; enhancing transport infrastructure links to airports and harbour gateway.* [106]

The Executive Budget 2015-16 allocated £328.3 million in Capital DEL to DRD. This represented an additional £2.5 million following negotiations, after an initial £325.8 million draft budget Capital DEL allocation.

Issue: The adequacy of current and projected levels of capital spending is an important consideration given NI needs to ensure it provides a level of infrastructure that will attract FDI if a reduced NI rate is to achieve its overarching aim of rebalancing the economy**.**

Scrutiny Point: What measures can the Executive take to improve the provision of infrastructure in an environment of public spending cuts?

Future Potential Impact on Fiscal Deficit

The Executive Budget 2015-16 describes the NI fiscal deficit as follows:

[103] NI Executive (2015) *Budget* 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf
[104] NI Executive (2015) *Budget* 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf
[105] Northern Ireland Office (2014) *The Stormont House Agreement: Financial Annex*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390673/Stormont_House_Agreement_Financial_Annex.pdf
[106] NI Executive (2014) *Draft Budget* 2015-16: http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

The taxes generated within Northern Ireland are considerably less than the level of funding received from HM Treasury. This shortfall is known as the fiscal deficit and in 2011-12 it was estimated to be £9.6 billion.[107]

It is possible that in the short to medium-term, a lower NI corporation tax rate could reduce tax receipts paid to Treasury from NI. But in the long-term, it would be expected that those receipts would increase.108 In addition, there would be anticipated increased receipts from VAT and new employment-related income tax (second round effects). All this raises a query about the impact of these receipts on the NI fiscal deficit.

In 2010, the NI Economic Reform Group modelled the predicted effects on the fiscal deficit following a reduction in the NI corporation tax rate to 12.5%. The following excerpt highlights a predicted narrowing of the NI fiscal deficit:

Total tax revenues initially fall, but subsequently build up rapidly, with a break- even point after only six years. Much of this revenue, in the form of income tax and VAT revenues, would accrue directly to the HM Treasury rather than to the NI Executive. The Treasury would thus be a net gainer of revenue after only six years. After this point the [fiscal deficit] would begin to reduce.[109]

Issue: A reduced NI rate is anticipated to have a positive effect on the NI fiscal deficit, as highlighted above.

Scrutiny Point: What is the Executive's view on this?

Future Potential Impact on Barnett Formula

A lower NI corporation tax rate could present problems in relation to the Barnett formula's future use. An academic's evidence to CFP in January 2015 noted this when he stated:

…given the potential devolution of corporation tax in Northern Ireland, longevity of the Barnett formula as a structure for allocating resources is a problem for the rest of the United Kingdom.[110]

In 2014, other evidence to the CFP raised the issue of the Barnett formula as a protective mechanism, stating:

[107] NI Executive (2015) Budget 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf

[108] HMRC and HM Treasury (2013*) Analysis of the dynamic effects of Corporation Tax reductions*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263560/4069_CT_Dynamic_effects_paper_20130312_IW_v2.pdf

[109] Northern Ireland Economic Reform Group (2010) *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*: http://www.ergni.org/reports/report_corporation_tax_may_2010.pdf

[110] Committee For Finance and Personnel (18 February 2015) Oral evidence: *Barnett Formula: Professor Colin Thain:*

> *From the point of view of devolved Governments and Finance Ministers, [the Barnett Formula] provides stable and predictable funding for three year periods and, indeed, on longer terms than that. That is very valuable; it insulates you from the risks of volatility of tax flows and the need to work out how you are going to finance public spending given the uncertainty of those tax flows. That is a significant advantage.*[111]

It seems that the devolution of corporation tax powers to NI may increase the tax flow volatility risks. This may necessitate greater scrutiny of future Barnett allocations to ensure NI gets its fair share.

Issue: Given the anticipated lower NI corporation tax rate than the UK main rate, it seems the future for the Barnett formula in its current form may be problematic.

Scrutiny Point: What is the Executive's view about the Barnett formula requiring adaptation to take into consideration future reductions in NI's block grant as a consequence of future increased corporation tax receipts in NI?

3.3 Cost Implications

The following paragraphs outline key cost implications arising from a lower NI corporation tax rate than the UK main rate, including impacts on:

- HMRC;
- Companies; and,
- Other devolved administrations

3.3.1 HMRC Costs

In 2011, Treasury stated the following in relation to the administrative costs arising from a NI corporation tax rate:

> *While HMRC does not breakdown administration costs on a regional basis, for illustrative purposes, corporation tax cost £340 million to administer across the UK in 2008-9, with just under 70 per cent of that cost relating to compliance activity. Northern Ireland would not be expected to bear the proportion of that amount that relates to administering the current system in the province, but would have to bear the extra costs above and beyond that relating to a new regime.*[112]

The report goes on to breakdown the potential costs into the following areas:

[111] Committee For Finance and Personnel (2014) Oral evidence: *Barnett Formula: Professor Alan Trench and Professor Gerald Holtham*: http://www.niassembly.gov.uk/globalassets/documents/finance/barnett-formula/hansards/12-november-2014---hansard-evidence-from-professor-trench-and-professor-holtham.pdf

[112] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

- *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*
- *Additional anti-avoidance compliance resource – ensuring that only "genuine" economic activity within Northern Ireland benefitted from any new regime.* [113]

In January 2015, HMRC published a *Tax Information and Impact Note* (the Note) describing the changes made in legislation to devolve the rate-setting power for corporation tax to NI. The Note *stated:*

> *The operational compliance impacts on HM Revenue and Customs (HMRC) of devolving the rate-setting power are estimated to be negligible. Further costs will depend on the rate of CT in NI set by the Northern Ireland Assembly (NIA).*

And:

> *The IT costs associated with the measure are estimated to be £3.4million, due to required changes to the CT600 form in order to identify NI trading profits separately from other UK profits. Other IT costs may be incurred e.g. to compliance systems, but it is not possible to assess these costs currently.* [114]

The Note further explained that a NI rate would affect 34,000 companies of all sizes, including 26,500 SMEs, HMRC, however, explained that the burden will vary greatly, depending on their size, existing tax arrangements, existing NI-based trading activity in a given year, and existing activity wholly based in NI.

3.3.2 Companies' Costs

In 2015, HMRC put the present value of total compliance costs for business at £35 million.[115] The Explanatory Notes accompanying the proposed legislation identify the following costs to companies:

- One off administration costs; and,
- Familiarisation with the new system costs.[116]

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[113] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[114] HMRC (2015) *Corporation Tax: devolution of rate-setting power to Northern Ireland*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/393521/TIIN_-_Corporation_Tax_-_devolution_of_rate-setting_power_to_Northern_Ireland.pdf

[115] HMRC (2015) *Corporation Tax: devolution of rate-setting power to Northern Ireland*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/393521/TIIN_-_Corporation_Tax_-_devolution_of_rate-setting_power_to_Northern_Ireland.pdf

This was echoed by various organisations. For example, in 2015 the Chartered Institute of Taxation commented on the administrative burden for companies to comply with the new legislation:

> *It may be that the new rules will place a significant compliance burden on some companies. For example, a large company with a presence in NI and in another part of the UK may need to treat its NI trading activity as if it were a separate business from its activities in the rest of the UK, and to apportion its profits accordingly.*[117]

Moreover, in written evidence to the Public Bill Committee in February 2015, the Association of Chartered Certified Accountants (ACCA) stated:

> *In order for the Bill to achieve its intention of enabling a differential tax rate to apply to profits chargeable to UK income tax which arise in Northern Ireland it must provide for identification of those profits. In order to comply with EU rules, the rate must apply in non-discriminatory fashion. The interaction of those rules will mean that even if the NI rate remains the same as the UK rate, large businesses will be required to identify the split between the two regions.*
>
> *The measure will inevitably add to the costs of business administration for those affected. Such costs will affect profitability, and it is therefore of course vital to the success of the measure that the benefit outweighs the costs.*
>
> *Take the example of a large business operating with comparatively low margin activities in Northern Ireland. The quantum of tax payable on the small amount of profit arising will be low. The benefit of the differential rate may very well be more than offset by the cost of complying with the regulations. The business may respond by attempting to increase the profitability of the NIRE, or if it is already confident that it is operating at maximum efficiency in NI it may simply decide that the effect of the additional administrative burden is to render the operation unprofitable.*
>
> *Overall, the problems posed by the Bill look set to be those of practical administration rather than difficulties with the principles set out in the clauses. Perhaps the most significant of these will be the requirement for all large businesses with both NIRE and UK taxable operations to maintain two sets of records for tax purposes (and tax purposes alone), a burden*

[116] Corporation Tax (Northern Ireland) Bill (2015) *Explanatory Notes (paragraph 156)*: http://www.publications.parliament.uk/pa/bills/cbill/2014-2015/0149/en/15149en.htm

[117] Chartered Institute of Taxation (2015) *Comments on Corporation Tax (Northern Ireland) Bill*: http://www.tax.org.uk/Resources/CIOT/Documents/2015/02/150218%20Corporation%20Tax%20(Northern%20Ireland)%20Bill%20-%20CIOT%20comments.pdf

which will be regarded as particularly onerous if the NIA does not in fact set a different rate.[118]

In March 2015, the Financial Secretary to the Treasury commented about reducing the administrative burdens on SMEs. He stated:

To reduce the administrative burdens on SMEs, a special regime will be put in place. A simple in/out test will mean that the majority of companies will be spared the burden and cost of proportioning profits. More than 97% of SMEs operating in Northern Ireland meet the 75% employment test threshold and will benefit from the Northern Ireland regime.[119]

In addition, with regard to SMEs, HMRC stated in 2015 that:

The NI CT regime includes specific rules to mitigate the impact on small and micro-businesses through a simple annual in/out test, which companies use to determine whether their trading profits are chargeable at the NI CT rate, or the main UK CT rate, without the need to apportion them between the two regimes. Over 99 per cent of affected small and micro-businesses have 100 per cent of their trading activity in Northern Ireland and so would not be affected by the thresholds applied in the test. The ongoing costs associated with this test are thought to be negligible.[120]

Issue: The devolution of corporation tax to NI will undoubtedly involve an additional administrative cost to both HMRC and companies wishing to avail of the anticipated lower NI rate.

Scrutiny Point: What representations has the Executive made to Treasury to ensure that the cost implications outlined above for HMRC and companies will be proportionate and minimal?

3.4 Other devolved administrations

In 2011, Treasury outlined its rationale for devolving corporation tax powers to NI:

Northern Ireland has its own unique set of circumstances, not least a land border with the Republic of Ireland with one of the world's lowest

[118] House of Commons (2015) *Written evidence submitted by ACCA Corporation Tax (Northern Ireland) Bill*: http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/memo/ct02.htm

[119] House of Commons Debate (4 March 2015) *Corporation Tax (Northern Ireland) Bill Consideration of Bill, as amended in the Public Bill Committee*: http://www.publications.parliament.uk/pa/cm201415/cmhansrd/chan118.pdf

[120] HMRC (2015) *Corporation Tax: devolution of rate-setting power to Northern Ireland.* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/393521/TIIN_-_Corporation_Tax_-_devolution_of_rate-setting_power_to_Northern_Ireland.pdf

> *corporation tax regimes, and the implications of a lower Northern Ireland corporation tax rate need to be examined on their own merits.*[121]

In 2015, Treasury echoed this, stating:

> *..the [UK] Government's view as set out by the Chancellor at Autumn Statement 2014 is that Northern Ireland's particular economic circumstances mean there are strong arguments in favour of corporation tax devolution, which do not apply to other parts of the UK.*[122]

However, an academic raised the issue of regionalisation of the UK economy following the devolution of corporation tax powers to NI. In 2011, he argued:

> *…if corporation tax were to be devolved to Northern Ireland, there can be no good argument of principle for not devolving it to Scotland as well … If the UK Government were to decline to do so, it would be a reflection of sheer cussedness rather than a desire to maintain the integrity of the UK economy (for example). Such a decision would have profound implications for the regionalisation of the UK economy, and for such long-established principles as relating public spending to need. These are big decisions with wide implications.*[123]

Issue: Treasury views NI as uniquely placed among the devolved administrations for the devolution of corporation tax powers. This is largely due to the fact that NI shares a land border with an EU Member State (Republic of Ireland), and the fact that the Republic of Ireland has a corporation tax rate which is considerably lower than the UK main rate.

Scrutiny Point: In the Executive’s opinion, what is the potential for future devolution of corporation tax powers to Scotland and Wales?

Scrutiny Point: How would any future devolution of corporation tax powers to Scotland and Wales affect NI, especially given NI borders the Republic of Ireland, which has a 12.5% corporation tax rate?

[121] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[122] Treasury Committee, Letter from David Gauke to Andrew Tyrie, 12 January 2015.

[123] Alan Trench (25 May 2011) *Devolution Matters Blog.*

Conclusion

The *Corporation Tax (Northern Ireland) Bill* represents a comprehensive transferal of rate-setting powers from Westminster to the Assembly, without the burden of dismantling the intricate legislative architecture of the UK corporation tax system. The current Bill would allow the Assembly to set the corporation tax rate by resolution. This change is expected to affect an estimated 34,000 companies of all sizes, including 26,500 SMEs.[124]

Under the current Bill, different rules apply for small and medium- sized enterprises and large companies. The UK Government assures that the proposed legislative provisions provide a system to equip the Executive so that it can encourage genuine domestic and inward investment, whilst minimising tax avoidance opportunities *via* profit-shifting and brass-plating. For example, the ‘back office’ definition in the current Bill for excluded companies’ operations is intended to aid businesses in their long-term strategic decision-making.

Of course, the devolution of corporation tax to NI in itself does not guarantee future investment and employment. Companies are under no obligation to reinvest profits generated by their initial investment. They are not required to create additional new employment opportunities or to purchase additional plant and machinery that may benefit NI supply-chain companies. Nonetheless it is expected that some companies will re-invest profits into their NI based businesses for sound economic and business reasons, namely expanding output to increase profitability.

Devolution of corporation tax to NI is often hailed as a major instrument to rebalance the economy by attracting increased investment and employment opportunities, which is expected to promote genuine economic activity that expands the private sector. However, evidence suggests that a lower NI corporation tax rate is only one of many factors that influence firms’ investment location decision, in particular where FDI is concerned.

For FDI to have the maximum impact on the NI economy, the jobs created would need to be in high value sectors such as pharmaceutical telecoms and information technology services.[125] Employment in these sectors tends to be high skill/high wage, and therefore delivers higher levels of disposable income, consequently providing greater economic stimulus. If a lower NI rate leads to employment in low value sectors, e.g. business and professional services, the same multiplier effect is unlikely to occur. This is largely due to the low skill/low wage of those sectors, e.g. minimum wage in manufacturing, zero hours contracts in call centres.

[124]HMRC (2015) *HMRC Guidance Note: Corporation Tax: Devolution of Rate-setting power to Northern Ireland* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/393521/TIIN_-_Corporation_Tax_-_devolution_of_rate-setting_power_to_Northern_Ireland.pdf

[125]Barklie, G. (2014). Talk on “Examining the importance of economic drivers- foreign direct investment”. Delivered on 07/10/14 at the Northern Ireland Economic Conference 2014.

The revenue forgone as a result of a lower NI corporation tax rate necessitates a reduction to NI's block grant. This is due to prevailing EU state aid rules and the current financial arrangements of the present devolution settlement in NI. The adjustment must take into account direct and behavioural effects of reducing the NI corporation tax rate, so that the criteria in the *Azores* case are satisfied.

Behavioural effects include tax avoidance measures, such as profit-shifting, brass-plating and tax-motivated incorporation. Estimating the cost of these behavioural effects is challenging. Details on Treasury's methodology to calculate the block adjustments are not yet available. However, negotiations are on-going between Treasury and HMRC about the adjustment calculations. Most recent indications from the First Minister suggest that an incremental approach will be used, phased in over three years, with a likely reduction of between £100 million and £150 million in the first year.[126]

Treasury states that any increases in income tax and VAT receipts arising from the second-round effects of increased economic activity due to a lower NI corporation tax rate are not to be included in the block grant adjustment calculations. This has been described as harsh, raising questions as to whether NI will receive its fair share of future resource allocations.

The UK Government's austerity measures, and subsequent welfare reform financial penalties, have resulted in significantly reduced public expenditure in NI for 2015-16. Consequently the Executive's budget cuts to departmental spending are anticipated to adversely impact on, e.g., public spending on higher/further education, apprenticeships, investment promotion and infrastructure investment. This may be particularly important in terms of NI's labour market and the ability to fill any future high value employment vacancies. In addition, it may affect Invest NI's performance in promoting NI as an FDI location destination. It also may impact on NI's ability to ensure it has “fit for purpose” infrastructure.

Key cost implications for HMRC and companies arise out of implementation of the current Bill. These are expected to include: start-up costs; on-going costs such as maintaining IT systems; and, compliance costs to counteract tax avoidance measures.

Finally, it appears the current Bill – if enacted – raises an issue about the Barnett formula. The lowering of the NI corporation tax rate is likely to increase tax flow volatility risks. This will increase uncertainty in planning for future allocations of resources.

Issue: There may be compliance, technical and cost issues that arise over time as the nature of the economy (and thus the tax base) changes.

Scrutiny Point: Will there be a formal arrangement in place to review the NI corporation tax rate over time, both to assess its effectiveness and to enable reform of

[126] NI Assembly Oral Question (AQO 7565/11-15) Answered 16 February 2015.

those elements that are deemed to work less well than others? If so, who will undertake this?

Appendix 1: Northern Ireland's Poor Economic Performance

This appendix highlights how Northern Ireland (NI) has consistently performed the worst in the United Kingdom across the following:

1. GDP
2. Productivity
3. Unemployment rates
4. Economic inactivity levels
5. Wage levels

1. Gross Domestic Product

NI's Gross Domestic Product (GDP) *per capita* has consistently fallen below the UK average:

> *Over the entire period since 1921, Northern Ireland has failed to achieve sustained economic convergence relative to the UK average; levels of GDP per capita, for example continue to languish at 80 percent of the UK average.*[127]

PriceWaterHouseCoopers (PWC) maintains that NI's performance is among the weakest in the UK. Recently the Ulster University Economic Policy Centre (UUEPC) forecasted NI Gross Value Added (GVA)[128] growth at 2.2% in 2014.[129] The following table shows how UUEPC forecast less economic growth for NI from 2014-2018, when compared to the UK as a whole:

Table 1: NI and UK Economic Growth Forecast[130]

	GVA Growth				
	2014	2015	2016	2017	2018
NI	2.2%	1.9%	1.3%	1.3%	1.3%
UK	3.1%	2.7%	2.2%	1.8%	1.8%

2. Productivity

In terms of productivity,[131] NI has consistently underperformed, in comparison to the UK average. An analysis of regional economic performance in the UK between 1996

[127] PriceWaterhouseCoopers (2011) *Corporation Tax: Game changer or game over?*http://pdf.pwc.co.uk/ni-govt-futures-corporation-tax.pdf

[128]GVA is a measure of economic activity, similar to GDP, but excludes the impact of taxes and subsidies (most notably VAT).

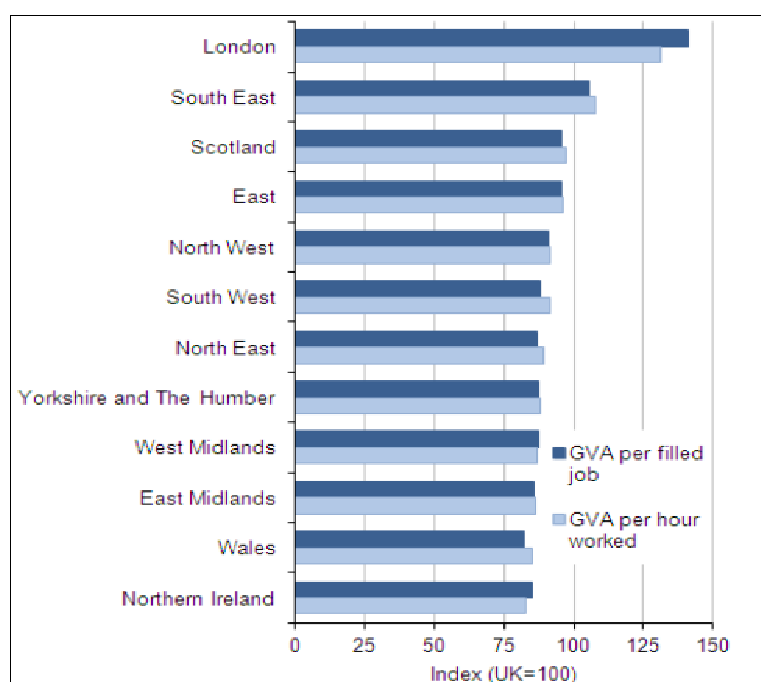
[129] Ulster University Economic Policy Centre (2014) Outlook: Autumn 2014: http://www.business.ulster.ac.uk/nicep/docs/NICEP%20Autumn%202014%20Outlook.pdf

[130]Ulster University Economic Policy Centre (2014) Outlook: Autumn 2014: http://www.business.ulster.ac.uk/nicep/docs/NICEP%20Autumn%202014%20Outlook.pdf

and 2003 found that NI exhibited the largest adverse productivity performance of all regions over this period.[132] In 2003, NI recorded the second lowest labour productivity level of all UK regions and the lowest hourly productivity level.[133]

By 2009, Gross Value Added (GVA) *per capita*[134] in NI remained significantly lower than most of the other regions of the UK. Only Wales and North East England had a lower GVA per head of population in 2009.[135] Treasury have attributed this, at least in part, to low levels of labour productivity, with GDP per employee in NI just over 85 % of the UK average, this was lower than all other regions other than Wales.[136] The figure below shows that in 2012. NI was estimated as the least productive region when measured by GVA per hour worked; 17.2% below the UK average.[137]

Figure 1. GVA per hour worked and GVA per filled job, 2012[138]



[131] Productivity is a measure of the efficiency of production. It is the ratio of output produced to the inputs required in the production process.

[132] IparraguirreD'Elia, Jose Luis (2006) *Decomposition of Regional GVA per Capita Gap by UK Region* http://eservices.afbini.gov.uk/erini/pdf/EriniMon7.pdf

[133] IparraguirreD'Elia, Jose Luis (2007) *The Five Drivers of Productivity: How Much Does Each One Contribute? Causal Analysis of Regional Labour Productivity in the UK.*

[134] The ONS cautions that GVA per head is not the most appropriate productivity indicator when assessing regional economic performance. This is because the input measure used in GVA per head (residential population) is not a good measure of the actual labour input involved in the production of a region's output (GVA). Office for National Statistics *Regional Economic Indicators, July 2014* (2014) p.12 http://www.ons.gov.uk/ons/dcp171776_369754.pdf

[135] HM Treasury *Rebalancing the Northern Ireland Economy* (2011) p.8 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[136] Office for National Statistics *(2010)Labour Productivity Statistical Bulletin Q3 2010.*

[137] Office for National Statistics (2014) *Regional Economic Indicators*: http://www.ons.gov.uk/ons/dcp171776_369754.pdf

[138] Office for National Statistics (2014) *Regional Economic Indicators*:http://www.ons.gov.uk/ons/dcp171776_369754.pdf

Although there has been some improvement, the most recent data available shows GVA per employee in NI remained the second lowest of the twelve UK regions in 2012.[139] In terms of GVA per hour worked, NI was 82.8% of the UK average.[140]

While NI had the lowest productivity of all UK regions on this measure, GVA per hour actually increased by 1.7 percentage points relative to the UK average in 2012.[141] Reflecting on the most recently published statistics, the Department for Enterprise, Trade and Investment (DETI) expressed the belief that this slight convergence towards the UK average represented the reversal of a long-established trend.[142] Treasury further stated:

> *Low productivity is largely due to under-representation of high productivity sectors in Northern Ireland, including finance and business services. Northern Ireland tends to be over represented compared to the UK average in low productivity sectors such as agriculture and food processing.*[143]

3. Labour market

In 2010, the NI Economic Reform Group described the effect of the recession on the NI labour market relative to other UK regions as follows:

> *Despite having proportionately the smallest private sector, it has suffered the largest percentage loss of jobs of any region during the current recession. Its unemployment rate has risen to the third highest of any region, and a higher percentage of […] working-age population are inactive than in any other region.*[144]

3.1 Unemployment in NI

Latest available unemployment figures estimate the NI unemployment rate for the period October - December 2014 at 5.7%. This was down 0.3% over the quarter and down by 1.6% over the year. The latest available NI unemployment rate was the same as the UK average of 5.7%. The table below presents UUEPC's forecast of NI and UK unemployment rates[145] from 2014 to 2018.

[139] GVA per job filled in Northern Ireland was 85 % of the UK average. Office for National Statistics *Labour Productivity, Q2 2014* (2014) Table 9 http://www.ons.gov.uk/ons/dcp171778_374636.pdf

[140] Office for National Statistics *Labour Productivity, Q2 2014* (2014) Table 9 http://www.ons.gov.uk/ons/dcp171778_374636.pdf

[141] Department for Enterprise, Trade and Investment(2014) *DETI Economic Commentary* page 9.http://www.detini.gov.uk/february-2014-deti-economic-commentary.pdf?rev=0

[142] Department for Enterprise, Trade and Investment(2014) *DETI Economic Commentary* page 9.http://www.detini.gov.uk/february-2014-deti-economic-commentary.pdf?rev=0

[143] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[144] Northern Ireland Economic Reform Group (2010) *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*: http://www.ergni.org/reports/report_corporation_tax_may_2010.pdf

[145] Calculated as claimant count rate as a % of the 16-64 age population.

Table 1: NI and UK Economic Forecast Data[146]

	Unemployment Rate				
	2014	2015	2016	2017	2018
NI	5.3%	5.1%	5.2%	5.3%	5.5%
UK	3.5%	3.0%	2.7%	2.7%	2.8%

3.2 Economic Inactivity

The "Economically Inactive" is defined as:

> *People who are not in work, but who do not satisfy all the criteria for ILO147 unemployment such as those in retirement and those who are not actively seeking work.*[148]

Economic inactivity has been a historic problem for NI's economy. As stated by the Minister for Employment and Learning:

> *This level of economic inactivity has been a persistent feature of our economy over the past thirty years, within the range of 26% and 32%, irrespective of the changes within the economic cycle.*[149]

In NI, figures for the last quarter of 2014 show that 28% of the working age population (16-64) are classed as economically inactive. NI remains above the UK average Economically Inactive rate of 22.3%, which is the highest of all twelve UK regions.[150]

It should be noted that not all forms of economic inactivity have negative consequences. For example, students pursue qualifications which may have long-term benefit to both themselves and the NI economy (assuming they join the NI labour force on graduation). The *NI Economic Inactivity Strategy* notes that:

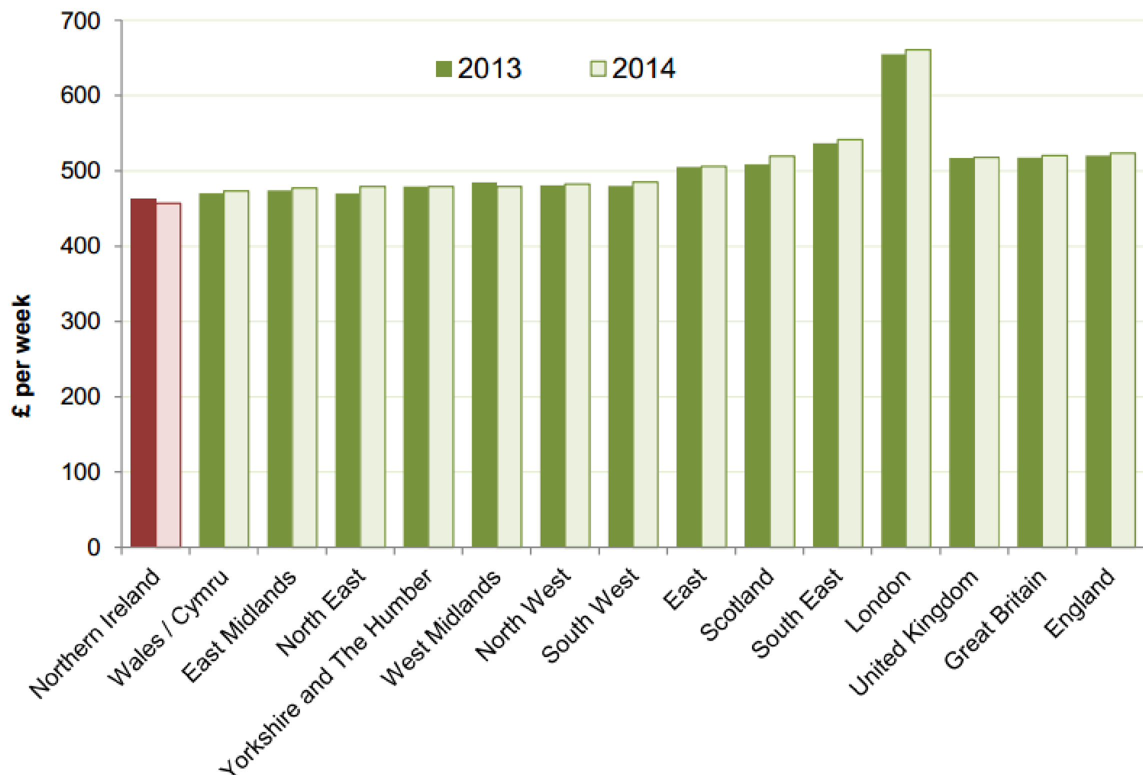
> *Northern Ireland, for example, has a higher proportion of students contributing to our inactive total than any other region of the UK. Equally, those who avail of early retirement have worked hard over the course of their careers and in many cases make a vital contribution through volunteering and other activities in their community.*[151]

[146]Ulster University Economic Policy Centre (2014) Outlook: Autumn 2014: http://www.business.ulster.ac.uk/nicep/docs/NICEP%20Autumn%202014%20Outlook.pdf
[147]The International Labour Organisation.
[148] Office for National Statistics, February 2002, Barham, C, Economic inactivity and the labour market, http://www.ons.gov.uk/ons/rel/lms/labour-market-trends--discontinued-/volume-110--no--2/economic-inactivity-and-the-labour-market.pdf
[149] Minister for Employment and Learning, 3 December 2013, Oral Statement to the NI Assembly, http://www.delni.gov.uk/del-oral-statement-economic-inactivity-strategic-framework
[150]Department for Enterprise, Trade and Investment, (18 February 2015), *Labour Market Statistics*:http://www.detini.gov.uk/labour_market_press_release_-_february_2015__final_.pdf?rev=0
[151] DEL, Enabling Success: Driving social change through economic participation: a strategic framework to tackle economic inactivity, http://www.delni.gov.uk/economic-inactivity-strategic-framework.pdf

3.3. Wages

NI wages are the lowest in the UK, as highlighted below, using data from the Annual Survey of Hours:

Figure 2: Earnings Full-time employees in NI had the lowest median gross weekly earnings (£457) across the UK regions at April 2014[152]



Unlike other UK regions where wages increased from 2013 to 2014, NI continued to experience downward pressure on wages. Consequently, NI continued to be:

> *A low wage region able to generate employment growth, mainly in low wage activities, but with productivity and wages consistently falling further behind the UK average.*[153]

[152] ONS (2014) *Northern Ireland Annual Survey of Hours and Earnings* http://www.detini.gov.uk/ni_ashe_2014_bulletin-2.pdf?rev=0

[153] NI Economic Reform Group (2011) The case for a reduced rate of Corporation Tax in NI: http://ergni.org/reports/report_corporation_tax_may_2010.pdf

Appendix 2: Credit Union Amendment

The following highlights key developments regarding the failed credit union amendment in the House of Commons.

- On 5 February 2015 the issue of excluding credit unions from the Bill's general exclusion arose during the committee stage (third sitting) in the House of Commons in relation to a MP's question concerning his proposed amendment to the Bill. The Minister opposed the amendment, arguing it was unnecessary.[154]

  He stated that credit unions currently do not pay corporation tax on their income from loans made to their members because they have a specific exemption under the applicable prevailing legislation in this area. He explained that to charge them at the Northern Ireland corporation tax rate, if the Bill was enacted in its current form, would actually place them in a less favourable tax position than they currently enjoy.

  He further clarified:

  > *Credit unions pay corporation tax on investment income and on capital gains, but those are not covered by the Northern Ireland regime. As credit unions do not have a trade of lending money for corporation tax purposes, they are therefore neither explicitly included nor excluded from the Northern Ireland rate and as such are in no worse position because of it.* [155]

- On 4 March 2015, in the House of Commons, it was stated that:

  > *Credit unions do not pay corporation tax on their trading profits, so this Bill does not impact on them.*
  >
  > *I felt that the amendment tabled by the hon. Member for Foyle (Mark Durkan) did not take care of the scope for profit shifting within the financial services sector. We are all alive to that threat, but I am afraid that the amendment did not deal satisfactorily with the problem that the good work of the Progressive in Northern Ireland could slip through and be accounted for, whereas everything else that could result in profit shifting would be excluded.* [156]

[154] http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/am/150205s01.pdf, at p12
[155] http://www.publications.parliament.uk/pa/cm201415/cmpublic/corporationtax/150205/am/150205s01.pdf, at p12
[156] Hansard 4 March2015, at Column 973