The Independent
Fiscal Commission NI

More fiscal devolution for Northern Ireland?

Interim Report

December 2021

Contents

Preface

The Independent Fiscal Commission for Northern Ireland was established on 12 March 2021. The Commission was announced via Written Ministerial Statement in the NI Assembly from the Northern Ireland Finance Minister, Conor Murphy, MLA.

Our Commission is led by Paul Johnson, Director of the Institute for Fiscal Studies, and is expertly supported by Professor Cathy Gormley-Heenan, former deputy Vice-Chancellor of the Ulster University; Professor Iain McLean, Emeritus Professor of Politics at Oxford University; and Dr Lisa Wilson, Senior Economist at the Nevin Economic Research Institute.

The Commission is responsible for the content of this publication, however we would like to place on record our appreciation for the expert technical support provided by: David Phillips – Associate Director, Institute for Fiscal Studies; David Eiser – Senior Knowledge Exchange Fellow, Fraser of Allander Institute; and John Fitzgerald - Adjunct Professor, Trinity College Dublin.

The Commission would also like to place on record its appreciation for the dedication and expertise of the Secretariat: Aidan McMahon; Dr June Faccini; Alan Shannon; Darrell McCullough; and Debra Whyte. In addition, the Commission has received vital and informed comments from a range of stakeholders, and we thank them all for their valuable contribution. To note we have come under no pressure from any NI Executive or UK Government Ministers, advisers or officials to include, exclude or change any material.

Terms of Reference

The terms of reference are to:

> *"Review the case for increasing the fiscal powers to the NI Assembly, advising the Finance Minister on powers which could enhance the Assembly's fiscal responsibilities, increase its ability to raise revenues to sustainably fund public services, and provide additional policy instruments. As part of this, the Commission should consider the need for additional budgetary tools to manage any increased financial responsibility.*
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> *The Commission should carry out research and put forward recommendations to the Minister of Finance that are realistically implementable within the NI context and drawing from the experience of Scotland and Wales, including what has worked well, and where challenges have been encountered in those administrations. This should include the potential costs incurred and realistic timescales of any new powers proposed.*
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> *In addition, the Commission should also consider how the spending power of the NI Block can be protected if more powers are devolved."*

Our Approach

The establishment of our Commission prompted lots of initial questions directed to us and also by us. What's the purpose of fiscal devolution? How would it work? For what benefit? At what cost? We have learnt that the answers to these questions will often differ depending on the individual or organisation asked – and there is no doubt that our significant stakeholder engagement has provided a wide range of answers.

Our approach is not to instruct but to help inform the answers to these questions and to both stimulate and further progress the conversation on Northern Ireland's current fiscal devolution settlement and whether, why and how this could be rebalanced, taking into account the benefits, costs and practical implications of doing so.

The Commission is entirely apolitical. Devolution is, in some measure, a political project. However, it is our job to provide evidence-based and wholly independent advice on options for the possible devolution of taxes from Westminster. If Northern Ireland wishes to have increased fiscal devolution, which taxes are most appropriate to devolve and why? What would be the likely costs and potential benefits of doing so? ***In our analysis and in our conclusions, we do not seek preferential treatment for Northern Ireland, rather we aim to support balance and fairness, to all constituent parts of the UK, while basing our considerations in the present day Northern Ireland context.***

The Commission considers, in terms of existing fiscal powers, that the NI Assembly already enjoys a high level of spending autonomy. The majority of public spending in Northern Ireland is controlled by the NI Assembly. This remains true even when setting aside Social Security (welfare and pensions) spending where the NI Assembly broadly maintains parity with UK government policy despite having legislative powers.[i] As a consequence, we have concentrated our work on the consideration of potential changes to taxation powers, where the NI Assembly has much less autonomy.

Terms of Reference Interpretation

We understand that the first paragraph in the Terms of Reference, which discusses potentially increasing the Assembly's fiscal powers to 'increase its ability to raise revenues to sustainably fund public services', could be interpreted as being limited to tax rises to boost spending. However, the Commission also sees a more expansive interpretation which could result in increasing fiscal powers to reduce taxation to, for example, stimulate economic growth. The Commission will aim to consider taxation levels increasing or decreasing equally and without preference.

While paragraph two of the Terms of Reference can be more straightforwardly interpreted, the Commission notes that paragraph three which states that 'the Commission should also consider how the spending power of the NI Block can be protected if more powers are devolved' could be interpreted in differing ways. The Commission is clear that tax devolution does lead to an impact on the block grant. The Commission's view is that any further fiscal devolution will ordinarily result in a reduction to the NI block grant but with devolved tax revenues then flowing to the NI Executive. We will consider, however, how potential changes in the growth of those tax revenues and the design and operation of the block grant adjustments, to account for any fiscal devolution, might impact on the spending power of the NI Executive. We will also show how the Executive's spending power can be insulated, to a degree, through the deployment of additional budgetary tools. These tools could help the NI Executive absorb and cope with the inevitable fluctuations and risks as a result of fiscal devolution.

[i] Social Security, in legislative terms, is a devolved competency within the control of the NI Assembly and while the Assembly can choose an alternative welfare provision path than the rest of the UK, in practice it broadly maintains parity with the rest of the UK (with the exception on some relatively minor welfare mitigations) and so the level of control is less than might otherwise be considered to be the case. This position was formalised via the Northern Ireland Act 1998, which requires the NI Executive and UK Government to consult to try to achieve "single systems of social security, child support and pensions for the United Kingdom."

Reporting

We are reporting in two stages, beginning with this interim report, which aims to provide the Northern Ireland context to fiscal devolution, laying out the central issues as we see them and as informed by our invaluable stakeholder engagement. We describe the range of options available to Northern Ireland, and the different forms which enhanced fiscal devolution could take. We give the Commission's view on some of the fundamental factors for *successful* fiscal devolution, and other factors that should be considered ahead of securing any new fiscal powers. We assess individual taxes in the Northern Ireland context. We draw from the experience of Scotland and Wales, what has worked well, and where challenges have been encountered in those administrations, as they embarked on their own fiscal devolution journeys. We rule out a number of taxes for further consideration and bring forward others for more in-depth analysis in our final report. This interim report is designed to publicly air and test our emerging findings.

In our final report we will revise and add to our interim report, rather than start afresh. We will aim to delve into firmer conclusions on which taxes we believe are most suitable for devolution in Northern Ireland, in what form, and the gritty mechanics of how those powers could be operated. We will consider whether, and to what extent, the spending power of the NI block grant could be exposed to, or, insulated from volatilities in tax revenues if more powers are devolved. We will refine our consideration of those taxes brought forward into the final report and put forward proposals that are realistically implementable for Northern Ireland. We will do this for the beginning of the next political mandate.

Stakeholder Engagement

Over the last 8 months, the Commission has been actively engaging with stakeholders, carrying out research and digging deeper into specific issues. We have listened to what stakeholders have had to say. We have had honest and frank conversations about what the options are and what constraints there may be. We have had consistent requests for our report to be educational, to help inform the debate and to show a clear path forward.

Our interim report has prioritised the educational and contextual request particularly. With this in mind:

- Chapter 1 is an introduction to our report and sets out: the **starting point for our work**; **the theory behind fiscal devolution;** details of the current Northern Ireland **fiscal settlement;** and the **contemporary context** as informed by our stakeholders.

- Chapter 2 describes the Northern Ireland context in terms of its **economy, public spending and tax base**. It also describes the **Northern Ireland budget** and **how the NI Executive currently spends its resources.**

- Chapter 3 considers **fiscal devolution in the UK** and provides detail of the **economic and fiscal landscape in the Republic of Ireland**.

- Chapter 4 outlines the Commission's view on the **options and criteria** for assessing tax devolution in Northern Ireland and presents the **Commission's initial views on the suitability of UK based taxes for devolution in Northern Ireland.**

- Chapter 5 briefly outlines **our next steps**.

Before we complete and produce our final report, we are keen to gather as many responses to this interim report as possible. For all stakeholders, this is an important opportunity to really help shape local policy and the Commission welcomes further engagement with as wide a range of people as possible. Only through this engagement will a meaningful report with meaningful conclusions be completed, that will be of benefit to Northern Ireland. We hope we can count on your contribution and would ask that stakeholders consider and respond to the following Commission questions by 1 February 2022.

QUESTION 1 – Do you agree with our understanding and representation of why fiscal devolution might be considered important and the contemporary context of Northern Ireland, as described in Chapter 1?
If you disagree, can you explain where your analysis differs? Are there additional factors that we should also consider?

QUESTION 2 - Do you agree with our understanding and our representation of the current Northern Ireland context?
If you disagree, can you explain in relation to which aspects?

QUESTION 3 - Do you agree with our analysis of the suitability or otherwise for devolution of the individual taxes listed in Chapter 4?
If you disagree, can you explain where you own analysis may differ and how?

QUESTION 4 - Do you agree with our conclusions regarding the prioritisation of specific taxes to be carried forward for further consideration in the second phase of our work?
If you disagree, can you explain which taxes you believe should be treated differently and why? Can you provide information which would support or detract from the potential devolution of Excise Duties to Northern Ireland?

We will take your responses into consideration for the second stage of our work and inform the Finance Minister of them. Once this second stage has concluded, we will provide the Northern Ireland Finance Minister with a detailed final report, including our conclusions. It will then be for a new NI Executive and for the people of Northern Ireland to decide on next steps, in conjunction with the UK Government.

Further information on our work to date can be found at: www.FiscalCommissionNI.org and evidence and responses to the Fiscal Commission's interim report can be submitted to the Fiscal Commission via: Info@FiscalCommissionNI.org

We look forward to hearing from you.

Paul Johnson
Chair of Fiscal Commission NI

Professor Cathy Gormley-Heenan
Commissioner

Professor Iain McLean
Commissioner

Dr Lisa Wilson
Commissioner

Executive Summary

The NI Executive controls most of the spending on public services that happens within Northern Ireland – almost £9 in every £10 of 'identifiable' public spending. Other than rates on businesses and households it has no real substantive powers to vary taxes and raises less than £1 in every £20 of Northern Ireland tax revenue. In that it contrasts to the Scottish and Welsh governments which do have some, limited, tax powers. Our interim report, sets out to explore the case for additional powers over taxation. In doing so it considers the economic context, current fiscal powers, the possible reasons for additional devolution, and the potential risks and rewards from such devolution. It goes on to look at the whole array of UK taxes and reaches some preliminary conclusions regarding which taxes might be the best candidates for devolution and, importantly, those which are less suitable at this point in time.

Context

The NI Assembly, the devolved legislature of Northern Ireland, was established by the **Northern Ireland Act 1998**, in accordance with the principles laid out in the 1998 Good Friday/Belfast Agreement. As a Commission our starting point for considering the potential for additional fiscal powers is the Northern Ireland Act 1998, which outlines the powers of the devolved NI Assembly and NI Executive, operating within a wider UK framework.

Northern Ireland is significantly poorer than the UK as a whole – national income per head is about 25% lower than that of the UK, and even lower when compared to the Republic of Ireland (RoI). In that it is similar to Wales, though it has a population about 40% smaller than that of Wales, with a much smaller economy.

Public spending in Northern Ireland is about 20% higher, on a per person basis, than spending in the UK as a whole. Meanwhile, because (median) earnings are some 10% lower, combined with lower labour market participation, tax revenues per person are 15% lower. The result is a very large notional fiscal deficit. (Note, as we shall see, that is not in any sense an argument against some additional devolution of tax powers).

Around 90% of NI Executive-led public service spending in Northern Ireland is currently financed by the block grant – the c£14.8 billion a year which is paid directly to the NI Executive by the UK Government. There have in addition been irregular and significant "one off" top ups to this block grant, sometimes resulting from UK Government need for political support (e.g. the 2017 Confidence and Supply Agreement with the DUP) and sometimes payments made to bolster the power sharing arrangements at Stormont (e.g. the 2014 Stormont House Agreement).

As well as spending substantially more per head, **the NI Executive has also decided to forego substantial amounts of revenue by comparison with what it would have received had it matched policy in other parts of the UK**. For example, the fact that water rates are not charged cost the NI Executive £345 million this year alone, ongoing rates support to the manufacturing sector cost £57 million and mitigating welfare reforms £43 million. In total we estimate that the range of areas where the NI Executive charges less or provides more than in other parts of the UK (so called 'super-parity') cost around £600 to £700 million in 2020/21, or some 4% of the Northern Ireland Budget.

The NI Executive also has significant capital borrowing powers. These powers are distinct from the borrowing powers that Scotland and Wales obtained for tax devolution purposes. The NI Executive also has significant headroom for further borrowing from this source, circa £1.5 billion. This has the potential to be a significant economic lever if used effectively, although, it is also important to recognise that borrowing will have spending implications after the fact.

Why devolution?

Additional devolution of tax powers would, at root, be a political choice, a choice to provide the NI Executive with more power. With responsibility for raising tax as well as making spending decisions the NI Executive would become more accountable to its citizens. The citizens of Northern Ireland, and its Executive, may have different preferences to those of the UK as a whole. They may prefer different degrees of redistribution, for example, or different levels of spending. Under current arrangements they are not able to reflect that through different tax policies.

Tax can also complement policies in other areas where responsibility is devolved. For example, the NI Executive is responsible for public health, but has no control over taxes on alcohol, tobacco or soft drinks. It is responsible for education and skills policy, but not for the apprenticeship levy. Additional fiscal measures might help the NI Executive to incentivise, or disincentivise, certain behaviours to achieve policy goals such as improving public health, boosting skills or protecting the environment.

Sharing an island and a land border with RoI also means that taxes which are set with the UK as a whole in mind may not be appropriate for the Northern Ireland context. That could apply to corporation tax to the extent that Northern Ireland is competing with RoI for investment. It could also apply to excise duties given that the existence of a land border makes cross border shopping particularly easy.

Stakeholders made it clear to us that tax devolution should be seen as a potential tool to strengthen the economy, not just as a way of raising additional revenue for public services. Given that the Northern Ireland economy is different from, and significantly weaker than, that of the UK as a whole, the NI Executive might well be able to use devolved tax powers as one of its tools in implementing an economic strategy aimed at strengthening the economy.

What devolution?

We are not considering full fiscal devolution under which Northern Ireland would be responsible for funding all of its spending from its own revenues. Given the scale of the notional deficit that would clearly not be feasible. Neither Scotland nor Wales has anything approaching that.

We also do not consider pure tax assignment as a desirable way forward. That brings risks without the rewards gained from additional powers. Tax assignment occurs when the devolved government accepts that its revenues from a tax will depend on the amount actually raised there, but without the power to vary rates of the tax. In principle this could create the right incentives to improve economic policy so as to increase incomes and hence revenues. In practice, economic performance, and hence tax receipts, will vary for many reasons outside of the control of the devolved administration.

Rather, we are examining the case for devolving powers over individual taxes.

What risks and rewards might devolution bring?

Fiscal devolution does bring the potential for rewards, for example being able to spur economic activity, make different choices, or raise more money. Fiscal devolution could help local citizens, through their politicians, make those choices which suit them best.

However, with additional powers and the potential for additional reward would come additional risk. If taxes are devolved to the NI Executive then the NI Executive's budget will, in part, be determined by how much revenue those taxes raise in Northern Ireland. That could well lead to a more volatile budget. It could even lead to the budget falling, relative to what it might have been in the absence of further devolution and if Northern Ireland tax revenues grow more slowly than expected. Of course, things could pan out the other way, and the budget might increase relative to what it might have been, if Northern Ireland tax revenues grow more quickly than expected. But clearly tax devolution must and will increase risk.

Thinking historically… **the fiscal gap between Northern Ireland and the UK as a whole has been widening**, by 10% (in real terms) over the last 20 years. If substantial fiscal devolution had occurred 20 years ago and the block grant had not been adjusted to reflect that, then this additional fiscal devolution could have been difficult for Northern Ireland, as the gap between the level of spend relative to the level of tax generated locally increased.

Thinking to the future… **Northern Ireland's working age population is expected to decline in the years ahead**. This will impact on the Northern Ireland tax base, including the potential tax receipts coming from labour-based taxes. Higher proportions of children and those of pension age, relative to the rest of the UK, will also impact on public spending requirements and decisions. Ultimately, the amount of risk borne by the Northern Ireland Budget will depend significantly on how the block grant is adjusted in response to devolution – both the initial cost and how that cost is grown over time.

The exact way in which the block grant would be adjusted in response to tax devolution, and any additional budgetary tools made available to the NI Executive to manage any new powers, will matter enormously. We will come back to that in our final report.

Capacity to take on additional devolution

One important consideration for determining whether taxes should be devolved, and in what order, is the **administrative capability and capacity of the NI Executive and the Northern Ireland Civil Service to absorb and manage additional powers**. Understandably and by design Northern Ireland is not currently positioned to do so – it hasn't needed to be. However, as with Scotland and Wales this capacity can be developed over time. It is not a reason in itself to not consider devolution. We do note though the report of the Northern Ireland Audit Office (NIAO) which has raised some serious concerns about leadership and delivery capacity within the Northern Ireland Civil Service.[1] The NI Executive would have to ensure that appropriate structures and people were put in place before any devolution of tax powers.

There are two additional issues related to capacity that have been raised numerous times as part of our extensive stakeholder engagement.

One relates to the level of understanding of taxes in the Northern Ireland population. Much concern was expressed that this is currently low. Devolution is more likely to be successful if there is a good level of understanding and engagement from the populace. **We see our report as playing an important role in increasing public understanding of tax in Northern Ireland.**

Virtually everyone we spoke to also raised the issue of the political capacity of the NI Executive. Concerns were expressed over its stability, as well as its capacity to reach coherent and consistent policy decisions. Some saw this as a strong argument against further devolution. Others felt that devolving additional tax powers could help to improve capacity and stability. Enforced power sharing, and the need for cross party agreement, can bring significant benefits, but could also reduce the impact of devolution in terms of enhancing accountability.

It is not for us to make judgments on these essentially political issues, but we would bring to the attention of Northern Ireland's politicians the concerns that we encountered.

Mutual confidence and sustained engagement are also key for the success of fiscal devolution and, in particular, between the UK Government and NI Executive. In previous political agreements the UK Government has committed to examining the potential for devolving further fiscal powers, including, for example, the 2014 Stormont House Agreement. However, and despite these previous commitments, the UK Treasury has expressed scepticism regarding the readiness of the NI Executive to take on additional fiscal responsibility. In a recent letter (September 2021) to the Northern Ireland Finance Minister the UK Chief Secretary to the Treasury has said: "The Executive has not yet been able to demonstrate that its finances are on a sustainable footing for the long term – this is an agreed condition of proceeding with devolving the rate of corporation tax to the Assembly. In my view, before we start looking at the merits of increasing the fiscal powers available to the Assembly, the Executive needs both to devise a strategy for securing its fiscal sustainability and to execute it." Indeed this scepticism has led them to decide not to engage as fully with our Commission as they did with similar Commissions looking at fiscal devolution for Scotland and Wales.

Clearly, any progress on devolution will require the active participation of HM Treasury and the agreement of the UK Government. We have already commented on the number of occasions on which the NI Executive has gone to Westminster asking for additional resources. The NI Executive ought to expect, if it is given substantial additional fiscal powers, that there should be an end to any such requests (except in exceptional circumstances). It is also to be expected that the UK Government would want reassurance on the budgetary sustainability of the NI Executive before devolving any substantial fiscal powers. The UK Government should work with the NI Executive to agree what that means.

Devolving taxes

We have looked in some detail at around 20 different taxes. Starting with the biggest three: **value added tax (VAT) at £3.4bn; National Insurance contributions (NICs) at £3.1bn; and income tax at £3bn**. The three next biggest are **fuel duty (£864m); corporation tax (£810m); and alcohol and tobacco duties (£774m)**. The others, while significant, are much smaller in revenue terms.

We have had to prioritise a relatively small number of taxes for further investigation between this interim report and our final report, given the time and resources available to us. It is also our view that if Northern Ireland were to take on additional powers it should, like Scotland and Wales, take them on gradually so as to ensure administrative systems and the block grant adjustments essential to fiscal stability and sustainability are properly in place and functioning. So, we have prioritised. That said, in our view in the long term there is no reason in principle why a substantial fraction of current taxes could not be devolved. However, the decision on the balance of tax devolution would ultimately be a choice for politicians both local and national.

Much fuller explanations of why we arrived at the conclusions set out here are available in the main report. Here we provide just the briefest of summaries.

The big three

Income tax (£3bn), NICs (£3.1bn) and VAT (£3.4bn) account for close to two thirds of the Northern Ireland tax take. If the NI Executive is to have the capacity to raise serious amounts of revenue, or effect significant redistribution through the tax system, then it is likely to need some powers over one of these taxes.

There are good reasons to believe that (elements of) income tax would be the most appropriate of the big three to devolve. There is already experience of that in Scotland and Wales, so we know it is administratively possible. It is probably the most salient, or easily understood, of all the taxes. And it is the tax most suited to achieving redistribution.

We note that previous commissions for Scotland and Wales ruled out the devolution of VAT and NICs, because of EU rules in the former case and the relationship between NICs and benefit entitlements in the latter. These constraints may be less binding today and in the Northern Ireland context. Having exited the EU, we believe VAT devolution would be legally permissible. And Northern Ireland, despite broad parity with rUK, also formally operates its own benefit system, with contributory benefits also notionally funded by a separate Northern Ireland National Insurance Fund. Nevertheless, devolving each would be more complex than devolving income tax, not least in the case of VAT due to the remarkable lack of information on how much is collected at sub-national levels (a problem which has delayed assignment of VAT revenues to Scotland for over two years to date).

We therefore propose to focus on options for income tax devolution in our final report.

As an addendum, a relatively small tax that the NI Executive does not control is the **apprenticeship levy**. The arguments for devolving this are good, because it relates to the NI Executive's responsibility for economic growth and skills. But if devolved in isolation, this would involve excessive administration costs. We therefore wish to consider its devolution only in conjunction with the possible devolution of income tax (or NICs) which would help with administrative issues.

Corporation tax

Devolution of **corporation tax (£810m)** is already legislated for in the UK Parliament, but not 'commenced'. For a number of years there was a cross-party consensus in favour of devolution reflecting concerns about the difficulty of competing with RoI which has long had a 12.5% rate. Devolution did not actually occur. Firstly, because the NI Executive collapsed. But also the NI

Executive had still to get the UK Government's agreement that its finances were 'sustainable' – a condition to commence the power. Additionally, it had not proved possible, at that point, to reach agreement with Westminster over how the block grant should be adjusted.

We have heard different views about the case for devolution. There is economic modelling which suggests a lower corporation tax rate in Northern Ireland could be highly economically beneficial, and that it could impact foreign direct investment (FDI) decisions. The case for devolution may have been strengthened by the recent announcement that the UK corporation tax rate will rise to 25%. Even in the face of an increase in the RoI rate to 15%, that leaves a big difference between Northern Ireland and RoI.

On the other hand, the international environment has changed in recent years and continues to evolve. Competition on the basis of corporation tax rates has become less acceptable. We have heard economic evidence that other considerations, especially the skills and education of the population, are now much more important both for the actual success of the RoI economy and for the potential success of Northern Ireland's economy.

The case for corporation tax devolution is all about the opportunity to improve economic performance. In that respect it is rather different than the other taxes we have considered. We consider that there is a case for lower rates of corporation tax in poorer regions of the UK in general and, given the proximity of RoI, Northern Ireland in particular.

Devolution would, though, be complex. There are technical complexities around companies dealing with more than one rate within the UK, and HMRC ensuring the existence of different rates is not used as an opportunity for tax avoidance. There are also political complexities. The only reason for Northern Ireland to seek devolution of corporation tax would be to give the NI Executive the opportunity to implement a significant cut in its rates. That would result in an immediate loss of tax revenue in the expectation, though not the certainty, that future economic growth would be enhanced. So, a cut would need to be accompanied by one or more of tax rises elsewhere, spending cuts, borrowing, or additional support from the Westminster government. There would also need to be agreement with Westminster over whether and how the block grant should be adjusted not just in response to direct revenue losses resulting from devolving the tax but also from behavioural change; if profits move from Great Britain (GB) to Northern Ireland the UK Government may want compensating. A significant cut in Northern Ireland corporation tax could also lead to wider tax receipt benefits for the UK Exchequer. Even after initial agreement in principle on how these issues should be dealt with, robust processes would be needed to estimate effects, agree adjustments and arbitrate in the case of disagreement.

So, while in the Commission's view there is a case for devolving corporation tax, there is no value in the NI Executive simply asking for it again. It will need to demonstrate how it would use the powers, and how it would balance its budget: it would need to demonstrate the "sustainability" of its finances. It would need to work together with the UK Government on these issues. In our view the pre-requisites for devolution include:

- A clear statement of intent from the NI Executive on how devolved powers would be used;
- Agreement with HM Treasury over how the block grant would be adjusted in response to the mechanical effect of a cut in tax rate on revenue;

- A clear method for agreeing how, if at all, other effects on revenues would be taken into account, and a method for resolving disputes with HM Treasury;

- An agreement with HM Treasury over some limited additional borrowing powers to cover part of the short-term hole created by a tax cut;

- A clear commitment from the NI Executive over how it would fill the rest of the short-term hole in its revenues created by a tax cut and repay its additional borrowing.

As a Commission we believe that there is value in the NI Executive seeking devolution of corporation tax. Equally we see no value in them doing so unilaterally. We also recognise that this approach is different to our approach to other taxes and different to the approach taken in Scotland and Wales in respect of the taxes devolved there. However, corporation tax is different and the issues that need resolution are more complex. Should the NI Executive wish to pursue devolution we would urge them to develop their own plans for sustainability and we would urge HM Treasury to engage constructively on the block grant adjustment and borrowing powers.

Given the work already done, the scale and complexity of the issues, the need for action from the NI Executive and constructive engagement from HM Treasury, we as a Commission will not consider corporation tax any further.

Excise duties

Excise duties on petrol (£864m), alcohol and tobacco (£774M) raise around £1.6 billion in Northern Ireland each year. The Calman and Holtham Commissions, which examined tax devolution in Scotland and Wales respectively, ruled out consideration of their devolution. That reflected worries about the potential for cross border shopping: their land borders with England would have meant any differential in duty levels leading to residents crossing the border to purchase excisable goods in order to take advantage of tax differentials. Additionally, with respect to fuel duties, EU rules necessitated a single rate for each fuel type in Member States.

The situation in Northern Ireland is different, indeed arguably reversed. There is no land border with England, but there is with RoI. There is a case for allowing the NI Executive to set excise duties which are different from those in in the UK as a whole so as to be able to account for policy in RoI. For administrative reasons the existence of the NI Protocol could also make devolution easier than had it not existed (though it may also make the ‘scope’ of devolution more restrictive). In addition, taxation of alcohol and tobacco could support the NI Executive’s wider public health agenda.

For these reasons we will be looking further at the possibility of devolving excise duties. The big possible barrier relates to administration, compliance and enforcement as these goods move between Northern Ireland and GB. This is due to their structure as a tax, levied at the production and import stage rather than by retailers at the point of sale to final consumers. We will investigate these issues further for our final report.

Stamp duty land tax (SDLT)

While it only raises **£80 million** per annum, as a tax on property SDLT is well suited to devolution. It has been successfully devolved to Scotland and Wales, and significantly reformed by the Scottish Government. Given the lower values of properties in Northern Ireland relative to GB there could be a case for having different rates of SDLT in Northern Ireland. **We will be giving further consideration to devolution of SDLT in our final report.**

Other taxes on capital

While there might in principle be a case for devolving **inheritance tax (£43m)**, not least because of the very different levels of wealth in Northern Ireland, a combination of administrative complexity and the very small amounts of money involved means we will not be pursuing it further. We also see little case for prioritising **capital gains tax (£105m)**. **Stamp duty on shares** would be complex to devolve and achieve little. **We see no case for further analysis of these taxes.**

Environmental levies

Landfill tax (£24m) is a good candidate for devolution and we will look further at it. **Decisions on the aggregates levy (£18m) should be reserved until there is more evidence** on the experience of implementing a devolved aggregates levy in Scotland. **The climate change levy (CCL) (£23m) is best left as a UK wide tax**: carbon taxes should be set at the highest possible level of government with the widest possible application.

Other indirect taxes

Air passenger duty (APD) (£80m) is a good candidate for devolution, though there is likely a trade-off in the consideration of APD between environmental and economic factors, these issues should be considered ahead of pursuing this tax for devolution. We have also considered **betting and gaming duties (£75m), insurance premium tax (£144m), the soft drinks levy (£12m), and vehicle excise duty (VED) (£219m). Administrative costs and problems of implementation, set against relatively low revenue yield mean we don't believe the first three are priorities or strong candidates for devolution**. In the case of VED the fact that registered keepers of vehicles could be in GB as opposed to Northern Ireland, and difficulties with fleets would add to complexity and costs. **We therefore don't consider VED a priority for devolution**.

As a reminder, much fuller explanations of why we have arrived at the conclusions set out here can be found in Chapter 4 of our full report.

Chapter 1

An introduction to fiscal devolution in Northern Ireland

1.0 Overview

1.0.1 This chapter describes the starting point for our work, the theory behind fiscal devolution and an early example of the risks and rewards from fiscal devolution. It provides details of the current Northern Ireland fiscal settlement as well as recognising the contemporary context, as informed by our stakeholders. Finally the chapter briefly outlines the process for obtaining further fiscal powers.

1.1 Key points

1.1.1 **Fiscal devolution** refers to the transfer of a central government's responsibility for decisions on revenue raising and public spending to its devolved or sub-national administrations (in a UK sense fiscal devolution has generally focussed more on the devolution of revenue raising – through tax and borrowing powers).

1.1.2 In terms of **current fiscal powers,** Northern Ireland holds limited responsibility for revenue raising, while the devolution of its public spending powers is extensive, with the NI Executive responsible for the majority of 'identifiable' public spending (i.e. spending identified for the specific benefit of Northern Ireland) amounting to almost £9 in every £10 spent, including spending on social security.

1.1.3 The **benefits of fiscal devolution** can include improvements to tax and public service delivery through improved efficiency, the enhanced accountability of decision-makers and an increased flexibility to both implement specific policy goals and to meet the needs and preferences of the local population. There is evidence linking fiscal devolution with improvements in economic performance and a greater focus on public investment for those sectors with a role in promoting local economic growth.

1.1.4 The **risks of fiscal devolution** will depend largely on the design and implementation of the devolved powers (including associated financial arrangements), but can include the introduction of distortionary effects to local economies, negative effects on equity of provision across a country, added complication for individuals and businesses with respect to compliance under different tax regimes, and duplication of administrative effort and cost. There will also be risks in terms of revenue stability and predictability both at the local level and the national level.

1.1.5 There is therefore an element of both **risk and reward** with fiscal devolution. Any move to enhance fiscal devolution for Northern Ireland would be a move away from the insurance of the current system, with its reliance on the stability of block grant funding. It can, however, increase accountability and responsiveness of local policy makers, improve efficiency through the better targeting of services to meet the specifics of local need, and allow decisions to be made locally which seek to drive necessary economic, behavioural and social changes. The Commission fully recognises that gaining enhanced flexibility to realise rewards, comes with corresponding risks.

1.1.6 In addition to our criteria for assessing the suitability of individual taxes to be devolved in Northern Ireland, which we have presented in Chapter 4, we have reflected on other conditions and **issues raised with us by stakeholders** during our initial consultation process. It is clear that many of these issues could have the potential to impact on the successful implementation (or otherwise) of new fiscal powers or responsibilities within the Northern Ireland context. These issues include political and institutional resilience, as well as economic and administrative capability and capacity. In addition, as a Commission, we consider mutual confidence and meaningful engagement between the UK Government and the NI Executive to be key.

1.1.7 Stakeholders have expressed mixed and sometimes strong views both for and against enhanced fiscal devolution for Northern Ireland. Ultimately, the decision on whether any additional fiscal powers will be devolved, and indeed exercised, will be for political representatives both local and national.

1.2 Our Starting Point

1.2.1 Our starting point for Northern Ireland's devolved government is the ***Northern Ireland Act 1998***, which outlines the powers of the devolved NI Assembly and NI Executive, operating within a wider UK framework. It is from this starting point that we begin our work.

1.2.2 The Commission has been established to consider the case for *increasing the fiscal powers* of the NI Assembly. That is, to consider the case for increasing those powers which the Assembly currently has to:

i. raise revenues to support local public services;
ii. reduce or reform taxes to increase net incomes of selected groups;
iii. improve incentives to work or invest; or
iv. change societal behaviours for the greater good.

1.2.3 Ultimately, however, the decision on whether any additional powers are actually devolved, and indeed exercised, must be for political representatives both local and national and the citizens they represent.

1.3 What does 'fiscal devolution' mean?

1.3.1. Fiscal devolution usually means transferring certain responsibilities for taxation and/or public expenditure from central government to a devolved or sub-national administration.

1.3.2. Devolution settlements can vary with respect to the level of autonomy associated with the powers within the devolved competence. In respect of taxation, devolved powers can involve transferring varying levels of control over tax rates and/or tax bases of specific taxes levied in the devolved jurisdiction, as well as the ability to introduce new taxes and user charges for public services. In respect of public expenditure, devolved powers can range from the devolved administration having full control over determining spending allocations, to a situation where the central government mandates the terms of the spending, and the devolved administration simply executes payment (more accurately described as "decentralisation" than "devolution" in its truest sense).

1.3.3. Devolved administrations may seek to enhance their powers over tax and revenue raising for a number of reasons. Enhanced fiscal autonomy can support devolved governments in reforming and reshaping local public services, as well as addressing productivity gaps and promoting local economic growth and activity. Greater control over the tax base in their jurisdiction can allow devolved governments to plan more effectively in the medium to longer term, and to manage financial risks and investment decisions more efficiently.[2]

1.3.4. In the UK at present, the majority of taxes are set centrally by the UK Government. The way in which taxes raised are distributed across jurisdictions is also determined by central government. Since the beginning of the modern-era devolution processes from 1998, there have been a number of changes, with Scotland, Wales, Northern Ireland and local authorities in England all having experienced some degree of fiscal devolution, to a greater or lesser extent.[3]

1.3.5. Fiscal devolution remains at the discretion of the UK Government. As the HM Treasury's 'Statement of Funding Policy' (2020) makes clear 'overall funding policy and public expenditure allocation across the United Kingdom, as non-devolved or reserved matters, remain the responsibility of the UK Government'.[4]

1.4 Why might fiscal devolution be considered important?

1.4.1 All governments hold important economic and fiscal responsibilities and can be described as having three main objectives: delivery of public services; redistribution; and economic efficiency/management. In line with the first objective, taxation and expenditure can be used to realise a government's policies and strategic goals. The second objective involves the role of government in taking action to reduce fiscal inequalities in society, and the third covers a government's responsibility with regard to maintaining economic and market stability. There can, of course, be tension between the three objectives and the particular balance struck will be determined by the policy perspective of the government and specific needs of the society in question.

1.4.2 In a multi-level governance environment, the level at which economic and fiscal decisions are taken is important and can have a measurable impact on outcomes.

Efficiency

1.4.3 Devolution can improve the efficiency of service delivery by bringing decisions closer to those who know and understand local circumstances. Taxes can also be adjusted to reflect local economic particularities. On the other hand, devolving responsibilities can result in duplication of effort between the centre and the devolved region or nation and create distortions in the tax system which influence behaviour in unintended ways if people or firms move location or change behaviour in response to different tax rates or welfare systems.

1.4.4 Many studies of the economics of fiscal devolution have reported that increasing the fiscal responsibilities of devolved administrations has improved the economic performance for both national and sub-national economies.[5] It has been shown that most measures of fiscal decentralisation are positively correlated with the level of economic development (as measured by per capita income).[6] While it may be difficult to draw a direct link between enhanced fiscal autonomy and economic growth in all cases[7][8], fiscal devolution tends to lead to a greater focus on public investment and funding for those sectors with a role in promoting economic growth, such as education and health.[9] [10] [11] [12] [13] [14]

Accountability

1.4.5 Moving spending decisions closer to the citizen, typically makes local policymakers more accountable by increasing the pressure to manage public sector taxation and spending more efficiently. This incentive does not exist to the same degree where there is an overreliance on central grant funding.[15]

1.4.6 On the other hand, complex tax systems, where devolved governments may share the same tax base but hold the fiscal powers to vary rates, can lead to less transparency, meaning that local taxpayers may find it difficult to distinguish the tax policy of the devolved government from that of the central government. This can impact on accountability and therefore detract from some of the potential benefits offered by tax devolution. [16][17] Where tax devolution is intended to enhance the accountability of the devolved government, it is important that it is designed to be as transparent as possible, with clearly defined competencies for different jurisdictions to avoid conflicts arising.[18]

Local policy relevance and impact on outcomes

1.4.7 Fiscal devolution can offer devolved governments increased flexibility to incentivise and implement local policy goals, promote positive behavioural changes, and shape and support services that are specifically designed to target local need, or reflect local preferences. In this way, it can be seen that enhancing devolution is closely aligned with supporting devolved governments to better discharge their democratic functions.

1.4.8 Fiscal devolution typically results in individuals of the devolved administration(s) being treated differently to the rest of the population, thereby offering local decision makers the opportunity to improve policy and hence outcomes for the local community, however, it also offers the opportunity to make mistakes which can negatively impact local outcomes.

Resource Equalisation

1.4.9 Increasing fiscal devolution can have important implications for key central government policies as, in certain circumstances, it can conflict with equity of provision across the entire population, which may require the implementation of specific measures to address this i.e. “equalisation”. Even if equal access to services is not mandated, governments may seek to ensure that a level of guaranteed provision is available across all jurisdictions. Autonomous regions may spend up to their taxable capacity; thus rich regions can spend more than poor ones, although poor regions may have more demand for services.

1.4.10 Therefore, when considering increased fiscal devolution, a choice is often required as to the balance being sought between the two competing principles of: promoting fiscal autonomy of the local administration; and the extent of any mechanism required to address inequalities that exist in the fiscal position across jurisdictions.[19] Equalisation measures will differ depending on the policies and frameworks set by the central government in question.

1.5 Risk vs reward – an early example

1.5.1 Devolving taxes and gaining greater financial control comes with added responsibility. It is important that the individuals and institutions which administer those powers are able to do so effectively and that they are accountable for their choices. Accountability is a key theme in our report and often mooted as perhaps the most significant benefit from fiscal devolution.

1.5.2 The Commission recognises that it is appropriate that tax and spending decisions which impact on the daily lives of citizens are made by those who closely represent them. Indeed, that is the main argument for the devolution of spending on public services which already exists. Devolution of tax powers could allow decisions on tax which differ from those taken in Westminster if that is the preference of the local population. For example, the Scottish Government has used its powers to change the rates of income tax in Scotland, raising revenue for public services by increasing the contribution from those with higher incomes while cutting tax slightly for those on more modest incomes. Introducing these local changes can be seen as a benefit of fiscal devolution.

1.5.3 As well as demonstrating some of the benefits of fiscal devolution the Scottish experience also highlights some of the risks. The Scottish Government had expected additional revenues in its budget of £428m as a result of its tax policy changes. However, much of the additional revenue expected from higher taxes "has been offset by slower growth of the Scottish tax base compared to the rUK tax base (mainly reflected in slower earnings growth) between 2016/17 and 2018/19", so much so in fact that only a £119m increase in revenues materialised compared to the £428m expected.[20]

1.5.4 If tax revenues are devolved and they grow more slowly than in the rest of the UK then Northern Ireland's budget could suffer. Equally if they grow more quickly than the budget could benefit. In the language of economists, incentives are well aligned – at least to the extent that the NI Assembly has influence over economic growth and depending on the block grant adjustment method which is used to account for the devolved power.

1.5.5 Other risks have also materialised in the Northern Ireland context through the devolution of Long-haul Air Passenger Duty (APD). Long-haul APD rate-setting powers were devolved to the NI Assembly in 2012 by the UK Government, at the request of the NI Executive. The purpose of this fiscal devolution measure was to allow a policy response to attempt to save the direct air-link which Northern Ireland had to North America, with United / Continental Airlines. The power was devolved and the NI Assembly took the decision to zero-rate the tax on direct long-haul flights from 1 January 2013, thereby allowing ticket prices on those flights to be priced more competitively, in the hope that the route would become more sustainable in business terms.

1.5.6 This decision came at a cost to the NI Executive. A reduction to its block grant of c£2m was agreed with the UK Government, on an annual basis, to meet the loss in tax receipts to the UK Exchequer due to devolving this power. Given the NI Assembly's decision to zero-rate the tax from Northern Ireland airports, this also meant the NI Executive 'lost' the tax revenue it might otherwise have had as a result of devolution. By 2017 United / Continental Airlines had pulled out of its Northern Ireland operations. There is currently no scheduled direct air route to North America. The NI Executive does, however, retain the cost of this fiscal devolution measure. The agreed cost (block grant adjustment) continues to be deducted from the NI block grant and has actually increased over the period, to £2.3m in 2020/21 (though more recent estimates suggest a lessening of this cost to c£1.2m for 2021/22 given the impacts of COVID-19 on wider APD tax revenues).

1.5.7 The previous paragraphs help to demonstrate some of the potential benefits which increased fiscal devolution can bring but also help to illustrate some of the consequences when fiscal devolution does not go as planned. It is important that political decision-makers and the wider public are aware of these and can make informed choices and plan ahead. Our Commission aims to help articulate these issues in our interim and final reports.

1.6 The contemporary legal and lived context of Northern Ireland

1.6.1 The contemporary context in Northern Ireland is made up of the formal legal framework as well as the lived experience. Each will be considered in turn.

Legal Framework

1.6.2 The NI Assembly, the devolved legislature of Northern Ireland, was established by the ***Northern Ireland Act 1998***, in accordance with the principles laid out in the 1998 Good Friday/Belfast Agreement. The NI Assembly has the power to legislate on all competencies not explicitly retained by the Parliament at Westminster.

1.6.3 The Northern Ireland Act 1998 (as amended a number of times since 1998) provides the basis of the constitutional structure in Northern Ireland and sets out the respective responsibilities of the UK Government and NI Executive in relation to *transferred*, *excepted* and *reserved* matters (detailed in Table 1.1).

1.6.4 Schedule 2 of the Northern Ireland Act 1998 sets out matters of national importance which remain the responsibility of UK Government and Westminster, these are known as 'excepted matters', and the NI Assembly does not have competence to legislate on these. Schedule 3 of the Northern Ireland Act sets out many UK-wide issues where legislative authority rests with Westminster but where the NI Assembly could legislate with the consent of the Secretary of State - these are known as 'reserved matters'. As was the case in the Government of Ireland Act 1920 and repeated in the provisions of the 1973 Constitutions Act, anything that is not explicitly reserved or excepted in Schedules 2 or 3 is deemed to be 'transferred' or devolved and the NI Assembly has full legislative competence - it does not require consent from Westminster or UK Government to legislate.

Table 1.1 The respective responsibilities of the UK Government and NI Executive in relation to transferred, excepted and reserved matters

Transferred matters Issues on which the NI Assembly has full legislative powers:	**Schedule 2** **Excepted matters** HM government retains responsibility for matters of national importance, including:	**Schedule 3** **Reserved matters** These are issues where legislative authority generally rests with Westminster, but where the NI Assembly can legislate with the consent of the Secretary of State. These include:
• health and social services • education • employment and skills • agriculture • social security • pensions and child support • housing • economic development • local government • environmental issues, including planning • transport • culture and sport • the Northern Ireland Civil Service • equal opportunities • justice and policing	• the constitution • Royal succession • international relations • defence and armed forces • nationality, immigration and asylum • elections • national security • nuclear energy • **UK-wide taxation** • currency • conferring of honours • international treaties	• firearms and explosives • financial services and pensions regulation • broadcasting • import and export controls • navigation and civil aviation • international trade and financial markets • telecommunications and postage • the foreshore and seabed • disqualification from Assembly membership • consumer safety • intellectual property

Source: Cabinet Office and Northern Ireland Office - Devolution settlement: Northern Ireland. [21]

1.6.5 Any further changes to the constitutional arrangements or changes in the list of reserved and/or excepted matters requires primary or secondary legislation enacted by the UK Government at Westminster.

1.6.6 There can be a lack of clarity over excepted and reserved matters and devolved powers which can introduce complication. This lack of clarity is because of the inevitable overlapping, shared and interdependent nature of some of the powers. For example, social security does not appear on either the excepted or reserved lists, therefore social security is devolved, both officially and constitutionally. Practically however, parity with the rest of the UK had broadly always been maintained, until recently with the introduction of welfare mitigations in Northern Ireland in response to the UK's welfare reforms.[22] This can causes a tension between how these social security matters are both delivered and paid for.

Lived Experience / Stakeholder Views

1.6.7 There is a wide range of views about the contemporary context in which fiscal devolution may be considered in Northern Ireland. These views have been shared with us repeatedly in a variety of stakeholder engagement sessions held by the Commission over the last number of months. These views are often complementary to those expressed in the literature, albeit in a context not identical to that of Northern Ireland.

1.6.8 Firstly, from a Commission viewpoint, mutual confidence and meaningful engagement is key for the success of fiscal devolution. While much of the focus will be on the fiscal, reputational and political risks inherent for the NI Executive, it is important to recognise that devolution also creates additional risk for the UK Government. Devolving fiscal powers reduces the centre's ability to respond rapidly and act consistently across the UK, and can have reputational and political consequences where moves result in increased instability, or a marked deviation from central government policy. While commensurate with the relatively small scale of the NI economy, fiscal risks to the UK Government remain real as, given the number of past requests from the NI Executive for additional resources, it is clear that budget sustainability is a live issue in Northern Ireland.

1.6.9 It is also important that the NI Executive has confidence in the commitments made by the UK Government and in the effectiveness of the structures and processes established for intergovernmental working, particularly where they relate to dispute resolution. Our Executive Summary already references the previous commitments of the UK Government (Stormont House Agreement) to consider additional fiscal devolution for Northern Ireland and the more entrenched current position. In the context of the other devolved nations, there have been strong criticisms of existing structures and processes, most recently from the Welsh Government, with representatives describing current processes as "protracted and challenging" and claiming that current mechanisms have allowed HM Treasury to repeatedly "move the goalposts",[23] resulting in what the Welsh Government sees as an inappropriate attempt to determine devolved policy.[24] It is clear that intergovernmental working to deliver successful fiscal devolution will require a level of mutual confidence and engagement between the NI Executive and the UK Government, as well as mechanisms that are transparent and fit-for-purpose to enable the effective implementation of measures and appropriate management of risk.

1.6.10 In addition to this, stakeholders have identified a number of core issues to be addressed, to help ensure the efficient and effective operation of fiscal devolution within the Northern Ireland context. We have distilled these down to issues of political and institutional resilience, capability and capacity. It is clear that these important macro level factors will be key to decisions over the devolution of any tax powers especially where the substantial devolution of taxes is being pursued.

Political and Institutional Resilience

1.6.11 An appropriate level of political and institutional resilience is fundamental to realise those benefits offered by fiscal devolution.[25] Studies show that the positive effect of fiscal devolution on economic growth is tempered where countries lack strong institutions and/or political stability.[26]

1.6.12 The system of appointing Ministers to the NI Executive (the Executive Committee of the NI Assembly) uses the D'Hondt mechanism to determine the number of ministries each party is entitled to hold.[ii] This system of appointment roughly divides ministerial portfolios among parties in proportion to their strength in the NI Assembly, thereby

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[ii] With the exception of the justice portfolio, which is allocated on the basis of cross community support

creating a mandatory coalition, a form of power-sharing often referred to as *consociation.*[27]

1.6.13 In situations where there is a single party in government, it is more straightforward to hold the party responsible for government performance to account while, in coalition governments, it is more difficult for voters to determine which party to blame when mistakes are made, or which party to reward when government initiatives are successful. Scenarios where all (or almost all) of the parties are in government and there is no substantive opposition, as is currently the case in Northern Ireland, can make it extremely difficult for voters to hold decision-makers to account in any meaningful way.

1.6.14 Northern Ireland's inclusive approach to forming a devolved government sought to address the unique situation with regard to its divided society. Arguably, while there are undoubted advantages to operating this form of power-sharing, a drawback of such an approach is that it gives rise to a coalition of Executive Ministers with potentially diametrically opposing views on a wide range of issues. While multiparty agreements can offer considerable strength to the sense of *shared* accountability, multiparty negotiation can also be extremely challenging and time consuming, particularly with regard to reaching agreement on difficult fiscal issues.

1.6.15 Since its establishment in 1998, the NI Assembly has been suspended on five occasions (two of which for a period of 24 hours, and the longest period for 4 years, 7 months), during which period its legislative powers were exercised by the UK Government. Typically, on each occasion where an agreement was reached to re-establish the institutions, this has included an additional bespoke funding package made available to the returning NI Executive. During the most recent suspension (2017-2020), no local legislation could be passed meaning that the UK Government at Westminster had to legislate for annual budgets for Northern Ireland.

1.6.16 During this period, Northern Ireland had neither functioning devolved institutions nor direct rule. This has since been referred to as a period of "indirect rule",[28] and with no sittings of the NI Assembly over that time, there was no opportunity for local politicians to debate key issues and pass key legislation on a range of important social, economic and fiscal issues which impacted on the population of Northern Ireland.

1.6.17 The issue of the devolution of corporation tax exemplifies how instability can potentially limit the realisation of the benefits of fiscal devolution. Although the legislation was passed in 2015 to devolve corporation tax in Northern Ireland, the subsequent collapse of the Northern Ireland institutions in 2017, and the political hiatus between 2017 and 2020, meant that the power could not be formally transferred and commenced. When the institutions were re-established in January 2020, the NI Executive did not show an appetite to further pursue a lower rate of corporation tax from the rest of the UK.

1.6.18 Perhaps there is no reason to expect that the devolution of additional tax powers would operate any differently than other devolved powers in the absence of a local Executive and Assembly. While strong arguments in relation to a democratic deficit, the inefficient delivery of governmental functions, or the tempered impacts on economic growth can be made when there is political instability, there is little indication that fiscal powers would be any different than other devolved functions in such circumstances.

1.6.19 That said, we recognise the concerns around political resilience that have been raised with the Commission by many of our stakeholders, and we accept that the potential for additional suspensions in future remains live. In this context, we recognise the need to give due consideration to the implications of potential future political instability for any increased fiscal devolution, and will seek to ensure that our analysis is mindful of this possibility.

Institutional capability & capacity

1.6.20 Secondly, an appropriate level of capacity and capability is critical to the operationalisation of fiscal devolution. The 'Capacity and Capability in the Northern Ireland Civil Service' report, undertaken by the Northern Ireland Audit Office in late 2020, questioned the ability of the civil service to deliver complex programmes, such as the Renewable Heat Incentive (RHI) scheme, and noted that workforce planning has been inadequate, that the recruitment approach does not result in the 'right people, in the right post, at the right time', and that there is no record of the functional skills and experience of existing staff, among other things.[29] Against this backdrop, it is clear that the right people, in the right post, at the right time will be required to support the implementation of any new fiscal powers or responsibilities.

1.6.21 Indeed, the requirement to build capacity was necessary as part of the process of increasing fiscal devolution in Scotland and Wales, where changes were introduced to improve civil service capability to effectively administer and develop tax policy. This was complemented by the establishment of bespoke institutions set up to administer and collect the taxes at a devolved level, such as Revenue Scotland and the Welsh Revenue Authority. In Scotland's case, it also led to the establishment of a new Independent Fiscal Institution to forecast the economy, tax receipts and social security, the Scottish Fiscal Commission.

1.6.22 Any move to devolve additional fiscal responsibilities in Northern Ireland will require, by necessity, new skills and infrastructure within the public sector ranks to administer any new or devolved taxes. While recognising that capability can and will develop over time, we consider that it is important such institutions have the capability and competency from the outset to administer their taxation powers efficiently and with transparency. They will need to discharge their responsibilities in protecting and utilising what is very sensitive personal and corporate information to provide an essential function of government and economy, thus maintaining credibility and the trust of local taxpayers.[30]

1.6.23 We note that the capability and capacity of local institutions established for this purpose should be commensurate with the level and extent of the powers devolved.[31] Consideration should be given to economies of scale, and the effect on administrative efficiency, when decisions are made on the extent of powers being sought.

1.6.24 The establishment of local institutions to administer taxation has the potential to offer useful advantages with regard to facilitating better access to information which can be used to improve the accuracy of local policy development costing and forecasting, however, it also has the potential to create confusion in a highly complex area if the devolved and centralised institutions produce different forecasts. The assessment or estimation of the Northern Ireland tax base based on both data availability and confidence in its accuracy is an issue that has been raised repeatedly with the Commission.

1.7 What are the NI Executive's current fiscal powers?

1.7.1 Details on the broad powers that have been devolved (or not) to the NI Executive have already been outlined above. This includes the outline of transferred, excepted and reserved powers.

1.7.2 With respect to spending powers, the NI Executive is responsible for the vast majority of 'identifiable' public spending (i.e. spending identified for the specific benefit of Northern Ireland, most of which occurs within the region) - this amounts to almost £9 in every £10 spent. While this total includes spending on social security in Northern Ireland, for which the NI Executive is formally responsible, as stated previously, in practice, the Northern Ireland welfare system broadly mirrors the rules and rates in place elsewhere in the UK. Further detail of the NI Executive's spending responsibilities is provided in Section 2.11.

1.7.3 With respect to taxation, taxes or duties that apply to the UK as a whole – or that are "of the same character" as those applying to the UK as a whole – remain excepted matters in the hands of the UK Government, except where they are explicitly devolved.

1.7.4 At present, the NI Executive has only a small number of taxation powers at its disposal. The NI Executive has both Regional Rates and long-haul Air Passenger Duty devolved to it (with the latter now set to zero) and also primary legislation in place to devolve corporation tax should the NI Executive wish to pursue this and should the UK Government be receptive to this. Overall, the NI Executive raises less than £1 in every £20 of Northern Ireland tax revenue, almost all of it from Regional Rates on domestic and non-domestic property (this increases to less than £1 in every £10 of tax revenue if District Rates, set by local councils in Northern Ireland, are also included).

1.7.5 Table 1.2 outlines how Northern Ireland compares to the other devolved administrations in the UK in terms of what taxes have been devolved to date and also what taxes are currently under consideration for being devolved in future.

Table 1.2 Tax Powers and UK Devolved Administrations

Region	Devolved Taxes	Future Considerations
Northern Ireland	• Regional Rates (set by NI Executive) and District Rates (set by local councils for local expenditure) collected by Land & Property Services on both domestic and non-domestic properties • Long Haul Air Passenger Duty • Carrier Bag Levy (new tax)	• Corporation tax (commencement clause in legislation not yet triggered by HM Treasury) • Potential reconsideration post Fiscal Commission report.

Scotland	• Scottish Income Tax (partially devolved) with powers to vary rates and bands above the Personal Allowance for non-savings and non-dividend income, which is administered by HMRC; • Scottish Land and Buildings Transaction Tax and Scottish Landfill Tax (fully devolved), which are collected by Revenue Scotland; • Control over local taxation, including Council Tax and Non-Domestic Rates, which are collected and administered by Local Authorities for local expenditure.	• The Scottish Parliament has the power to introduce two further taxes devolved to Scotland, which have not yet been implemented: o Aggregates Levy o Air Departure Tax (Air Passenger Duty) • The assignment of approximately half of VAT revenues raised in Scotland to the Scottish Budget has also been delayed, and now paused, given challenges in reliably estimating Scotland's share of UK VAT receipts. • A new Scottish 'Tax policy and the budget: consultation' was launched on 31 Aug 2021 seeking views on overarching approach to tax policy, as well as using devolved and local tax powers as part of the Scottish Budget 2022 to 2023.
Wales	• Land Transaction Tax • Landfills Disposals Tax • Income tax – Partial Devolution through Welsh Rates of Income Tax • Control over local taxation, including Council Tax & Non-domestic Rates, which are collected and administered by Local Authorities for local expenditure.	• Aggregates levy (not devolved but UKG intention to do so) • 'Summary of Findings' of possible reforms to local government finance system was published in February 2021 with options including potential changes to council tax and non-domestic rates, and alternative approaches for raising local revenues such as local land value tax and local taxes based on income.[32] • Programme for Government 2021-26 committed to a consultation on legislation for a tourism levy in Wales. • Powers to introduce a Vacant Land Tax requested but not agreed.

1.8 How can the NI Executive obtain further fiscal powers?

1.8.1 The NI Executive can obtain further fiscal powers through:

a) the introduction of primary legislation at Westminster for the devolution of tax varying powers (and an NI Assembly vote to accept / use them);
b) satisfying the UK Government that the introduction of any new taxes are substantially different to those subject to UK wide taxation; and
c) via a request to the UK Government for a derogation of a particular tax or duty rather than seeking to have it devolved. These are explained in more detail below.

Tax Devolution

1.8.2 As UK-wide taxation is an Excepted matter, the devolution of tax varying powers requires primary legislation at Westminster. This has been the case previously in relation to Scottish and Welsh fiscal devolution.

New Taxes

1.8.3 Section 63 of the **Northern Ireland Act 1998**, '*Financial acts of the Assembly*', provides for a tax to be imposed or increased, thereby allowing the NI Executive to introduce new taxes. However, Schedule 2 constrains this significantly by indicating that the following matters are 'Excepted':

a) taxes or duties under any law applying to the United Kingdom as a whole;
b) stamp duty levied in Northern Ireland before the appointed day; and
c) taxes or duties substantially of the same character as those mentioned in sub-paragraph a) or b).

1.8.4 Therefore, any new tax imposed cannot contravene either a), b) or c) as outlined above. Item (c) is the major challenge given the broad range of activities already covered by UK-wide taxation, as the UK Government needs to be satisfied that any proposed 'new' taxes introduced in Northern Ireland are substantially different before they could progress. For example, the Welsh Government has been working to introduce a *Vacant Land Tax* (VLT) for the last three years and while a process for devolving new taxes has been agreed between the Welsh and UK Governments (and a similar process agreed for the Scottish Government) in line with the policy set out in the Wales Bill 2013-14 White Paper[33] the creation of VLT has yet to take place. The Welsh Government has been collaborating with the UK Government to agree on the management process for agreeing the competence for and how the new tax could be introduced. Engagement between the Department of Finance in Northern Ireland and the Welsh Government has indicated that this has been a challenging and protracted process with a range of barriers (including the information needed to support the proposal so that public consultation and legislation can take place) preventing its introduction.

Tax Derogation

1.8.5 There are also instances where, when a particular tax or duty would have had adverse economic consequences, a form of derogation has been sought by the NI Executive from the duty rather than seeking to have it devolved. Securing these derogations required the NI Executive to provide evidence to HM Treasury of the negative, disproportionate, and unintended consequences that the national policy change would have had in Northern Ireland. All derogations have also had to comply with EU State aid requirements to date, though this is clearly a developing situation given Brexit.

1.8.6 The advantage of tax derogation is that Northern Ireland can obtain the benefit of a differential tax treatment without an accompanying reduction in the block grant. There are two main examples of the use of this approach:

a) a reduction in the Aggregates levy was obtained through the Aggregate Levy Credit Scheme (ALCS) in April 2004 in order to reduce cross-border trade distortion with

RoI. The ALCS ran until it was suspended on 1 December 2010 following a legal challenge by the British Aggregates Association; and

b) an exemption from the Carbon Price Floor in April 2013 in view of the impact it would have had on Northern Ireland's electricity industry. (To note, these were policy choices with the effect of reducing tax take and/or mitigating against adverse environmental impacts.)

1.8.7 The introduction of any further fiscal powers will involve a negotiation process with the UK Government which may be challenging and both time consuming and resource intensive. The information likely needed as part of the negotiations between the NI Executive and the UK Government, and the associated timescales will be considered in more detail in our final report.

1.9 Conclusions

1.9.1 The ***Northern Ireland Act 1998*** outlines the powers of the devolved institutions in Northern Ireland, as operating within a wider UK framework. Any further evolution in this arrangement will need the consent of both UK and devolved governments.

1.9.2 Securing additional fiscal powers would provide the NI Executive with increased flexibility to achieve its policy aims. Additional fiscal powers can represent a useful policy instrument for local decision-makers in seeking to raise additional revenue, support policy priorities, incentivise economic reform and promote behavioural changes in the local population. But, moves to enhance the fiscal autonomy of Northern Ireland need to be balanced against costs and risks. There will be direct administrative costs, and there will be risks in terms of revenue stability and predictability, as well as potential risks to the UK Government if devolution creates distortions within the UK.

1.9.3 Any move to enhance fiscal devolution for Northern Ireland would be a move away from the insurance of the current system, with its reliance on the stability of block grant funding. The literature clearly demonstrates that there are potential rewards to be gained from fiscal devolution. It can increase accountability and responsiveness of local policy makers, improve efficiency through the better targeting of services to meet the specifics of local need, and allow decisions to be made locally which seek to drive necessary economic, behavioural and social changes. However, the counterbalance which the Commission fully recognises is that gaining the enhanced flexibility to realise these rewards, comes with corresponding risks.

1.9.4 These risks and rewards also need to be set within the context of the perceptions of the 'real politik' in Northern Ireland, including considering our stakeholders' concerns about Northern Ireland's political and institutional resilience, as well as capability and capacity issues and the need for mutual confidence and meaningful engagement between the NI Executive and the UK Government.

Chapter 2

The Northern Ireland context: economy, tax and spending

2.0 Overview

2.0.1 This chapter describes the Northern Ireland context in terms of its economy, public spending and tax base. This includes an overview of some of the key differences between the Northern Ireland and UK economies, the aggregate level of public spending and tax revenue generation in Northern Ireland and the region's corresponding fiscal balance. The chapter also provides insight into the narrower definition of public spending and revenue generation which is directly related to the NI Executive. A Commission assessment of areas of policy divergence (super/sub-parity) and their associated costs from other parts of the UK is also provided.

2.1 Key points

2.1.1 **Economy.** The Northern Ireland economy is fundamentally different in terms of its economic trajectory and industrial structure when compared to the UK as a whole, and also RoI. Output and income per head is significantly lower than the UK average, and is amongst the lowest ranked of the UK regions. The economy is slower growing and has persistent structural weaknesses, in particular in terms of its productivity levels and relatively small private sector. The Northern Ireland economy tends to feel the impacts of economic headwinds more deeply and for a longer duration than its closest economic partners. Across a range of economic metrics Northern Ireland performs similarly to Wales and the North East of England. Northern Ireland does score highly when it comes to measures of wellbeing and quality of life compared to other parts of the UK.

2.1.2 **Labour market**. Unemployment levels in Northern Ireland have been lower than many other parts of the UK in recent years, however, this masks the issue of participation in the labour market with the economic inactivity rate the highest of any UK region. This is driven in large part by poor long-term health or disability.

2.1.2 **Living standards and poverty.** Whilst overall average incomes are lower in Northern Ireland compared to the UK as a whole, they are higher than a number of other UK regions. There is also evidence that the cost of living in Northern Ireland is among the lowest of all the UK regions. It is also true that poverty levels are lower in Northern Ireland and the gap between the richest and poorest in Northern Ireland smaller than across the UK as a whole. State supports are key to insulating incomes, with proportionally higher levels of household income deriving from this source than across the UK.

2.1.3 **Demography.** Northern Ireland's working age population is expected to decline in future years. This will impact on the Northern Ireland tax base, including the potential tax receipts coming from labour-based taxes. Higher proportions of children and those of pension age, relative to the rest of the UK, will also impact on public spending requirements and decisions.

2.1.4 **Public spending & net fiscal position**. On a per head basis, overall (identifiable) spending per head is 21% higher in Northern Ireland than the UK average and higher than any other UK region. Relative spending varies considerably by function with a significantly higher amount spent on welfare (23% above the UK average) and a considerably lower amount spent on science and technology (57% below the UK average). Northern Ireland's net fiscal deficit per head (including public sector expenditure both identifiable and non-identifiable) is the largest deficit of all the regions in the UK.

2.1.5 **Tax revenues**. Northern Ireland has the lowest level of tax revenue per head of any UK region. Compared to the UK average, Northern Ireland raises a relatively higher proportion of its tax revenue from consumption-based taxes (e.g. VAT; fuel duty; alcohol and tobacco excise duties) and a lower proportion from labour and business-based taxes (e.g. income tax, NICs and corporation tax). Lower income levels, high rates of economic inactivity and the small private sector all contribute to this.

2.1.6 **Block grant adjustments**. (BGAs) are a part of the tax devolution process. They refer to the amount the block grant from the UK Government would need to be adjusted (reduced) following devolution of tax revenue to Northern Ireland. BGAs have two distinct elements. Firstly, the *initial deduction* – which is generally the revenues raised from the tax by the UK Government in Northern Ireland in the year immediately before devolution becomes operational. It will be expected that the NI block grant will be reduced by this amount to compensate the UK Government for its lost tax revenue which is now 'Executive-owned'. Secondly, the *indexation mechanism* which is a measure of the subsequent growth rate of the tax revenues in, for example, the rest of the UK from the tax that has been devolved to Northern Ireland. Block grant adjustments are both technical and highly contentious and carry significant risks. BGAs therefore require careful examination.

2.1.7 **Data issues**. Tax data reliability varies significantly across the taxes. Any move towards further devolution of fiscal powers to Northern Ireland should require careful consideration of the tax data that is available and its suitability in terms of providing reliable estimates of the tax base in Northern Ireland. This is because these estimates are a key element of the evidence base that will inform any decision-making process regarding devolution. Whilst not necessarily a straight forward issue to resolve, as data issues are often UK-wide, if Northern Ireland wishes to pursue further tax devolution early action should be taken to improve the robustness of current estimates where possible.

2.1.8 **The Northern Ireland Budget.** The NI Executive had a total budget of £16,610 million for 2021/22 which is made up of a number of funding sources. The most important funding source is the NI block grant which accounts for 88.8% of the NI Executive's budget. Any changes in the block grant are in general linked to changes in planned spending by UK Government departments and then applied via application of the 'Barnett formula'. Other sources of funding include income from Regional Rates; income from non-Barnett additions (often as part of political deals); EU Income and Borrowing.

2.1.9 **Policy divergence**. There are a number of specific examples of policy divergence (or 'super parity' issues) where Northern Ireland could raise additional revenue or reduce expenditure if policies matched other parts of the UK. While there are complex issues around all of these policy measures, their estimated cost is between £600m and £700m per annum. There are also some limited examples of 'sub-parity' issues where Northern Ireland policies are less generous than other parts of the UK.

2.10 **Understanding Northern Ireland's current economic, demographic and fiscal position**, relative to that of the UK as a whole, is vital for understanding the case for additional fiscal devolution. It is important to understand that Northern Ireland is poorer, receives less from most taxes and spends more on most public services than rUK. None of these facts is a barrier to devolving taxes. Indeed, the fact that Northern Ireland is quite different from rUK in its economic situation and the importance of different taxes, might in itself be a strong argument for allowing taxes to vary to take account of these differences. Similarly, having additional fiscal tools available to help in managing an economy which has been historically lagging behind rUK could be useful. What might give us pause, though, is the divergent trends between Northern Ireland and rUK. If Northern Ireland is becoming gradually poorer relative to rUK, or if relative tax revenues are falling, then devolution in and of itself could make Northern Ireland worse off over time unless the block grant is adjusted to account for that.

2.2 The Northern Ireland economy

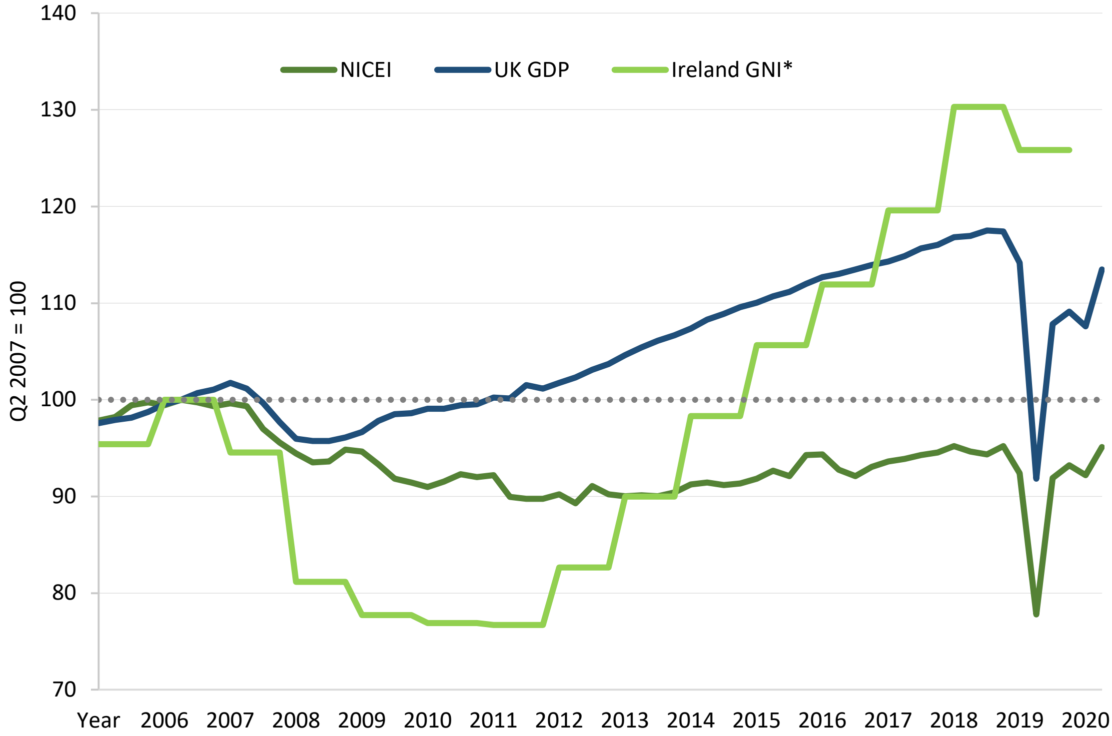
2.2.1 When considering the case for fiscal devolution it is important to provide the economic and fiscal context within which further devolution might occur. Northern Ireland is recognised as having undoubted economic strengths, notably its ability to attract Foreign Direct Investment; its thriving ICT clusters; and the high attainment levels of its students, to name a few. Northern Ireland also scores highly when it comes to measures of wellbeing and quality of life compared to other parts of the UK and other OECD countries. The Ulster University Economic Policy Centre (UUEPC) Competiveness Scorecard 2020 found that people in Northern Ireland are the most satisfied with their quality of life when compared to OECD countries. The same report also found that people in Northern Ireland reported greater levels of life satisfaction, happiness and feelings of worthwhile activity relative to other UK regions.[34]

2.2.2 Despite these attributes, the Northern Ireland economy is, and has consistently been, one of the UK's weakest performing economic regions, the historical details of which have been well rehearsed in many analyses of the economy over the last 50 years.[35][36][37][38][39] GDP per capita in Northern Ireland was 21% below that of the UK as a whole in 1998 and by 2019 this figure had risen to 23%. Between 1998 and 2019 the Northern Ireland figure has varied between being 17% and 23% lower than the UK-wide value. Compared to other UK regions over the same period, Northern Ireland has typically had the third lowest figure, above Wales and the North East.

2.2.3 Chart 2.1 shows the recent underperformance of the Northern Ireland economy post the 2007 global financial crisis, as measured by the Northern Ireland Composite Economic

Index[iii] (NICEI), alongside the performances of the UK and ROI economies.[iv] It highlights the dramatic fall in economic activity following the financial crisis, from which the Northern Ireland economy has still not recovered. Pre-COVID-19 (Q4 2019), the Northern Ireland economy remained some 5.1% smaller than its pre-2008 crisis level. COVID-19 has of course had a dramatic impact on the local economy over the recent period, however it is notable that as of Q2 2021, the Northern Ireland economy had returned to levels last seen during Q4 2019, i.e. pre-COVID-19 levels.

Chart 2.1 NICEI, comparison with selected GDP measures Q2 2007 – Q2 2021 index (Q2 2007 = 100)



Source: NICEI and UK GDP: NISRA - NI Composite Economic Index - April 2021. ROI GNI - Central Statistics Office. Fiscal Commission analysis.*

2.2.4 Whereas the Northern Ireland economy has struggled to regain its 'lost growth' since the financial crash, by contrast, the UK economy recovered to pre-crisis levels by Q2 2013, Scotland recovered its lost growth by Q2 2013[v] and the RoI economy recovered by 2016 (based on GNI*).[vi] Even in more recent times, the data preceding the COVID-19 pandemic

[iii] The Northern Ireland Composite Economic Index (NICEI) is broadly equivalent to the output measure of GDP produced by the Office for National Statistics (ONS) and is commonly used as a timely measure of the performance of the NI economy. NICEI is calculated using published quarterly indices (Index of Services, Index of Production, Quarterly Construction Enquiry), public sector employee jobs data from the Quarterly Employment Survey, plus unpublished agricultural output data from the Department of Agriculture, Environment and Rural Affairs, are weighted using the ONS Regional Accounts Gross Value Added (GVA) data and combined to provide this proxy measure of total economic output.

[iv] GNI* is used here to compare the economic performance of the RoI economy to that of NI and the UK. This is utilised because of known problems with using GDP or even GNI to compare the performance of the RoI economy. To alleviate the problems with Irish GDP data, the CSO have developed a modified Gross National Income (GNI*) series that removes the FDI related distortions, making it a more appropriate measure to compare against other national GDP measures. (CSO, 2017).

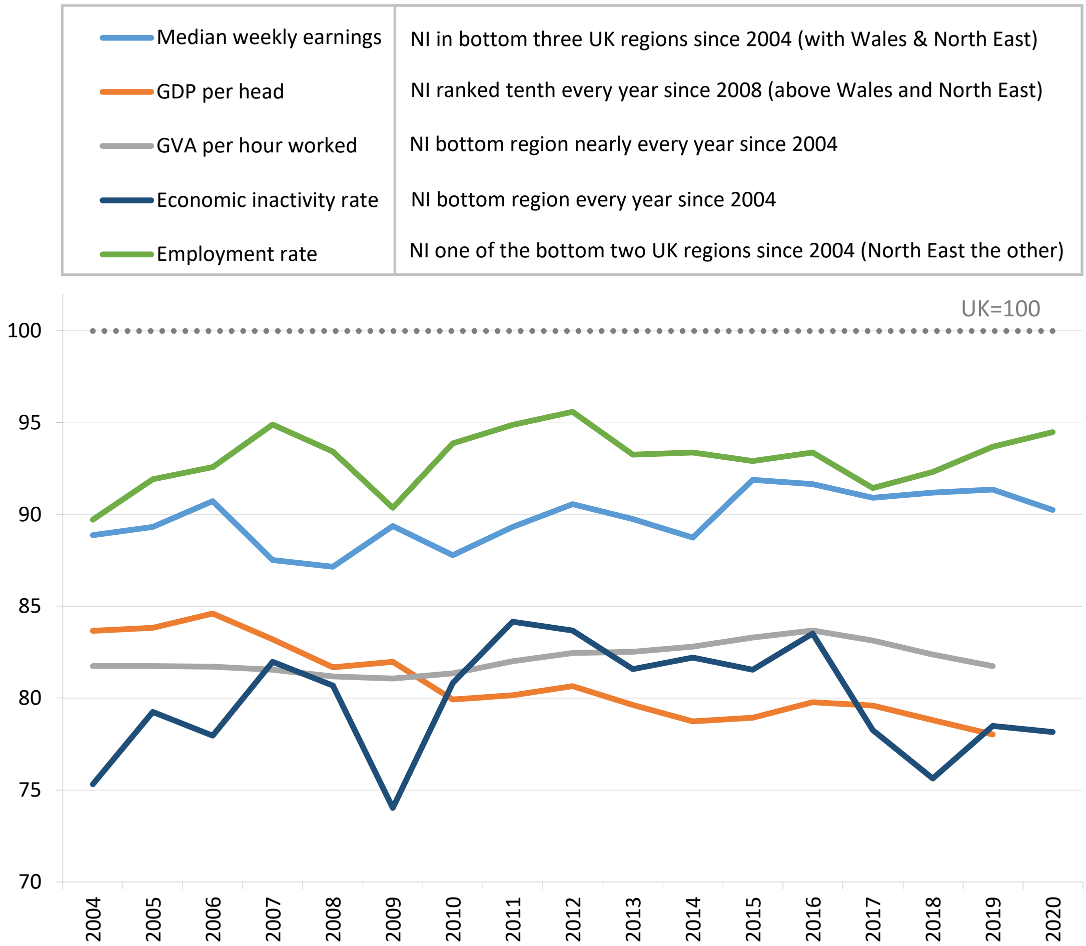
[v] Comparable data on Wales and English regions quarterly GDP not available prior to Q1 2012 – therefore comparisons are not included here.

[vi] GNI* for RoI is only available on an annual basis. In GDP terms, RoI peak pre-financial crisis value was in Q4 2007 which it recovered to by Q2 2014.

shows the Northern Ireland economy had been experiencing quarterly declines in economic activity throughout much of 2019. Despite the recent up-turn in economic growth, economic forecasters expect the economy to emerge from the COVID-19 pandemic less well than the UK and RoI economies.

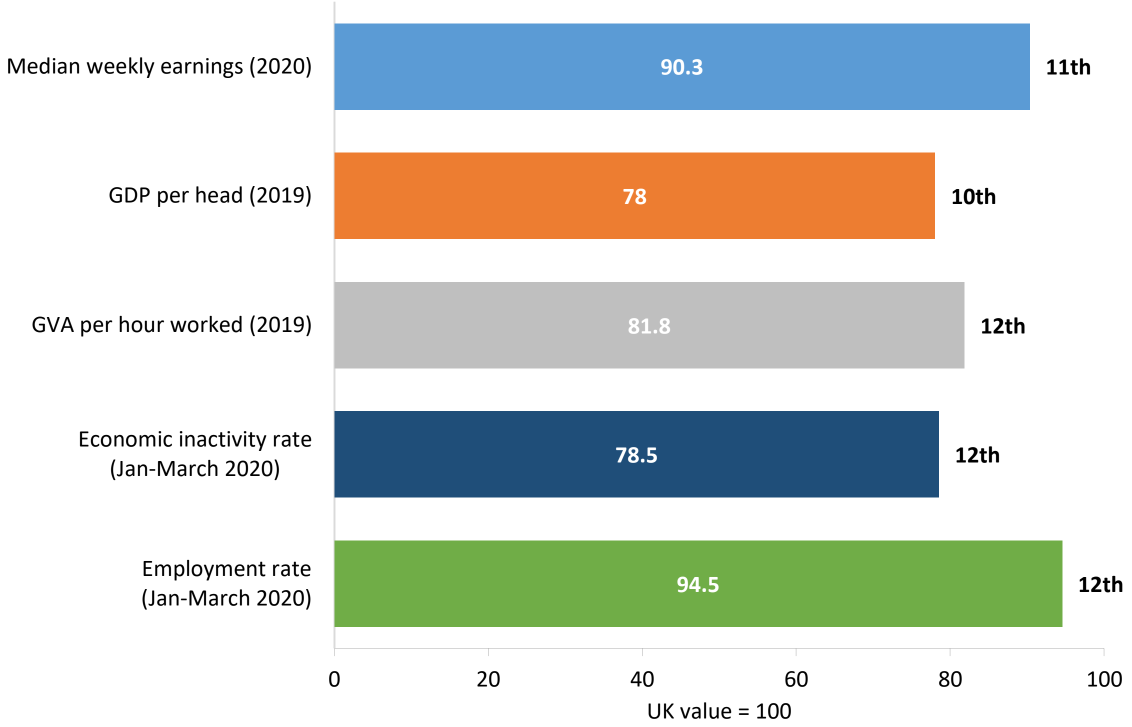
2.2.5 Chart 2.2 and Chart 2.3 below compare Northern Ireland's economic performance against the UK in a number of additional key economic metrics and provides a sense of its relative position to other UK regions. These metrics include: GDP per head, GVA per hour worked (i.e. productivity), the employment rate, median earnings and the economic inactivity rate. Compared to other UK regions, Northern Ireland has typically been in the bottom three performing UK regions on these metrics. Across most, Northern Ireland tends to perform at a similar level to Wales and the North East of England. As Chart 2.3 shows, NI ranks as the bottom UK region across three metrics (employment, inactivity rate and productivity) and one of the bottom three regions in the others (median earnings and GDP per head).

Chart 2.2 Comparison of selected measures, NI vs UK, 2004 -2020 (UK = 100)



Source: Nomis, ASHE, ONS Subregional Productivity and ONS Regional GDP

Chart 2.3 Comparison of selected measures, NI ranking vs UK regions, latest year (UK =100)



Source: Nomis, ASHE, ONS Subregional Productivity and ONS Regional GDP

2.3 Key differences in the Northern Ireland economy compared to the UK

Lower Productivity

2.3.1 **Northern Ireland's productivity figures have been persistently below the UK average**. **Between 2004 and 2019, NI GVA per hour worked was on average 82% of the UK value and generally the lowest of any UK region throughout this period.** Northern Ireland has a weaker industrial structure with an overrepresentation of low value-added sectors, such as retail and agriculture and underrepresentation of high value sectors, such as the financial and insurance sector, compared to the UK average.

2.3.2 The UUEPC identifies that Northern Ireland's low productivity is a factor of both what it does (its sectoral structure) and how well it does it (productivity within sectors) and that productivity is the main driver of Northern Ireland's income gap with the UK, with economic inactivity being the second biggest driver.[40] Other reasons cited for poor productivity performance include geographical peripherality; an infrastructure gap; levels of investment in research and development; and low levels of human capital as measured by educational achievement and skills.[41]

Lower Levels of Investment

2.3.3 **Lower levels of investment in R&D, technology, and its diffusion, physical infrastructure and human capital have also been identified as key to understanding Northern Ireland's underperformance.** Northern Ireland sees some of the lowest levels of investment in capital, both human and physical, relative to other UK regions.[42] Northern Ireland has long been highlighted as a region needing greater investment to help drive productivity growth, with underinvestment reflecting a long-run pattern that has harmed productivity levels.[43] [44]

Greater Economic Inactivity

2.3.4 Despite a strengthening labour market in the years directly preceding the COVID-19 pandemic Northern Ireland's labour market continues to be marked by a number of **persistent challenges including high rates of economic inactivity.** Northern Ireland has persistently had amongst the highest rates of economic inactivity of all UK regions. In January-March 2020, pre-pandemic, 26.1% of working age adults in Northern Ireland were classified as economically inactive[vii], compared to 20.4% across the UK as a whole.[45] The high rates of economic inactivity in Northern Ireland are driven in large part by poor long-term health or disability.[46] The greater rates of economic inactivity have been identified as the second biggest driver of Northern Ireland's income gap to the UK.[47]

Lower Wages

2.3.5 In 2020, Northern Ireland had the 2nd lowest wages of any UK region, with only the North East being lower in terms of median weekly earnings (NI £529 vs £586 UK average) and this underperformance has consistently been the case over time.[viii] Furthermore, in 2020 at 25.3%, Northern Ireland also had the highest proportion of jobs across all regions of the UK with earnings below the real living wage, as calculated by the Living Wage Foundation at £9.30 per hour.[48] However, in terms of cost of living, regional consumer price levels (for 2016) found that the relative price level of Northern Ireland was the lowest of all the UK regions, with prices on average 2.3% lower than the UK.[49]

High Skills Migration

2.3.6 **Northern Ireland has historically felt the effects of a 'brain drain' to other parts of the UK**. A large share of school leavers from Northern Ireland undertake full-time tertiary education at a university elsewhere in the UK. In 2019/20, 62,690 individuals from Northern Ireland were enrolled in UK higher education institutions, with 27% or around 17,000 of those leaving to study in GB,[50] this measure does not include students who leave to study outside the UK, including RoI. The data also shows that in 2019, only just over a third of graduates returned home for employment six months after their graduation. Northern Ireland also attracts limited student numbers from outside Northern Ireland for study and the retention rates for those who do attend, in terms of remaining in Northern Ireland, are low.

2.3.7 This outward mobility can, to a large degree, be explained by the Maximum Student Numbers Policy (a cap set by the Department for the Economy), which limits student recruitment in Northern Ireland, in addition to a variety of social and cultural reasons. Throughout the past decade, the cap on student numbers in Northern Ireland has remained at between 24,000 –25,000 places per year.[51] In contrast, in England and Wales where students pay their own tuition fees, there is no such cap on student numbers (there exists an unofficial cap on Scottish student numbers at Scottish universities, given the free tuition policy in place there for Scottish students).[52] **The loss of human capital from**

[vii] Figures used are the latest available pre-pandemic and before the impacts from COVID-19 have fully registered.
[viii] Annual Survey of Hours and Earnings (ASHE) has published its provisional 2021 data, however this data has not been used given impacts of COVID-19.

Northern Ireland to GB by students annually amounts to a 'fiscal drain'. Northern Ireland spends considerable public resources on school goers who go on to study and work outside of Northern Ireland. In this respect, Northern Ireland does not go on to reap the 'fiscal rewards' of these investments.

Lower House Prices

2.3.8 NI has **considerably lower house prices than the UK average.** Northern Ireland remains the cheapest UK country in which to purchase a property (North East England being the only region cheaper than Northern Ireland), with the average house price at £159,000 in September 2021. This compares to a UK average of £270,000.[53] This cost differential has consistently been the case, with the exception of the period 2005 to 2008 when house prices grew at an unsustainable level in Northern Ireland and outpaced the average growth in UK house prices. This growth was corrected following the 2007/08 financial crisis when house prices in Northern Ireland decreased sharply and by some 57% vs 19% in the UK. The Northern Ireland property market saw the largest correction of any UK region. While UK house prices recovered by August 2014, Northern Ireland's remain 30% below their peak as of September 2021. It is also worth highlighting that the housing market across the UK has been somewhat in flux throughout the course of the COVID-19 pandemic with rising prices seeing the UK average house price reach a record high in September 2021.

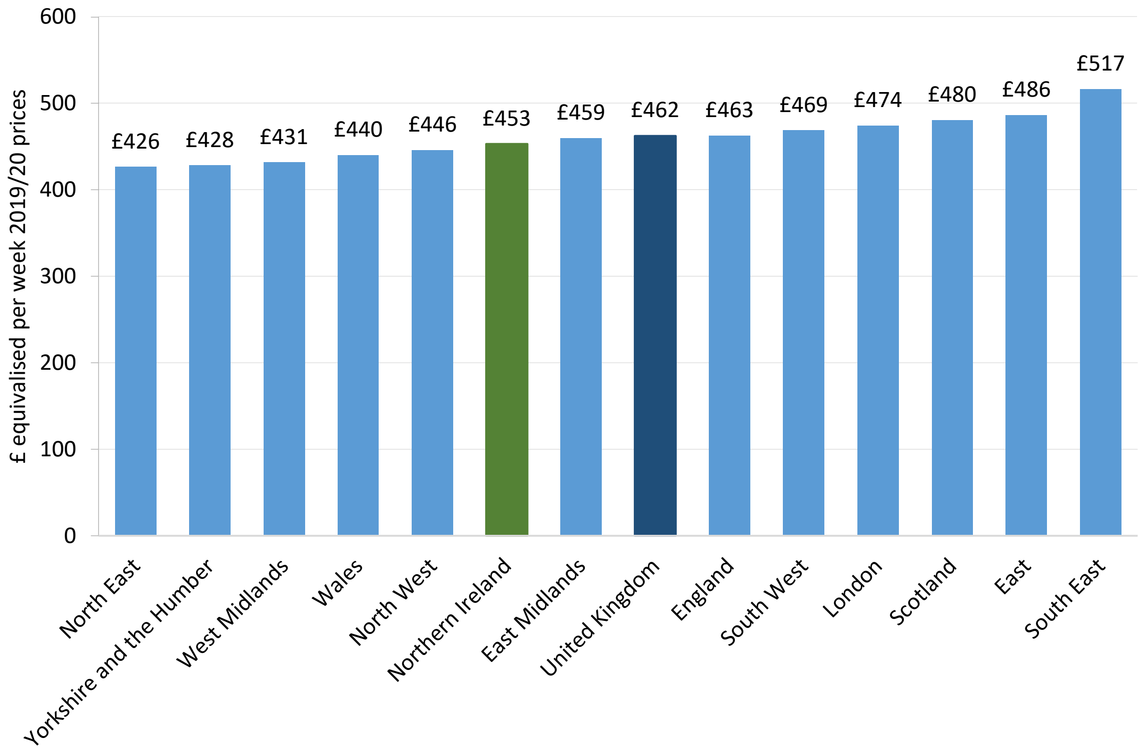
Smaller Private Sector

2.3.9 The **relatively large size of the public sector and small size of the private sector is a contributing factor in Northern Ireland's comparative economic underperformance**. Northern Ireland has a much higher percentage of its jobs in the public sector compared to the UK average, 25.5% vs 16.7%.[54] Scotland and Wales also have a higher percentage of public sector jobs than the UK average, but remain significantly below that of Northern Ireland. The relatively large size of the public sector has been suggested as a contributing factor in Northern Ireland's productivity gap by 'crowding out' private investment.[55]

Living Standards and Poverty

2.3.10 Average household incomes are lower in Northern Ireland than they are across the UK as a whole, however as shown in Chart 2.4, Northern Ireland performs better in terms of household income on a regional level than a number of other regions. The three-year average (2017/18 to 2019/20) median household income in Northern Ireland was £453 after housing costs (AHC), with median household incomes in the North West, Wales, West Midlands, Yorkshire and Humber, and North East regions below that of Northern Ireland.

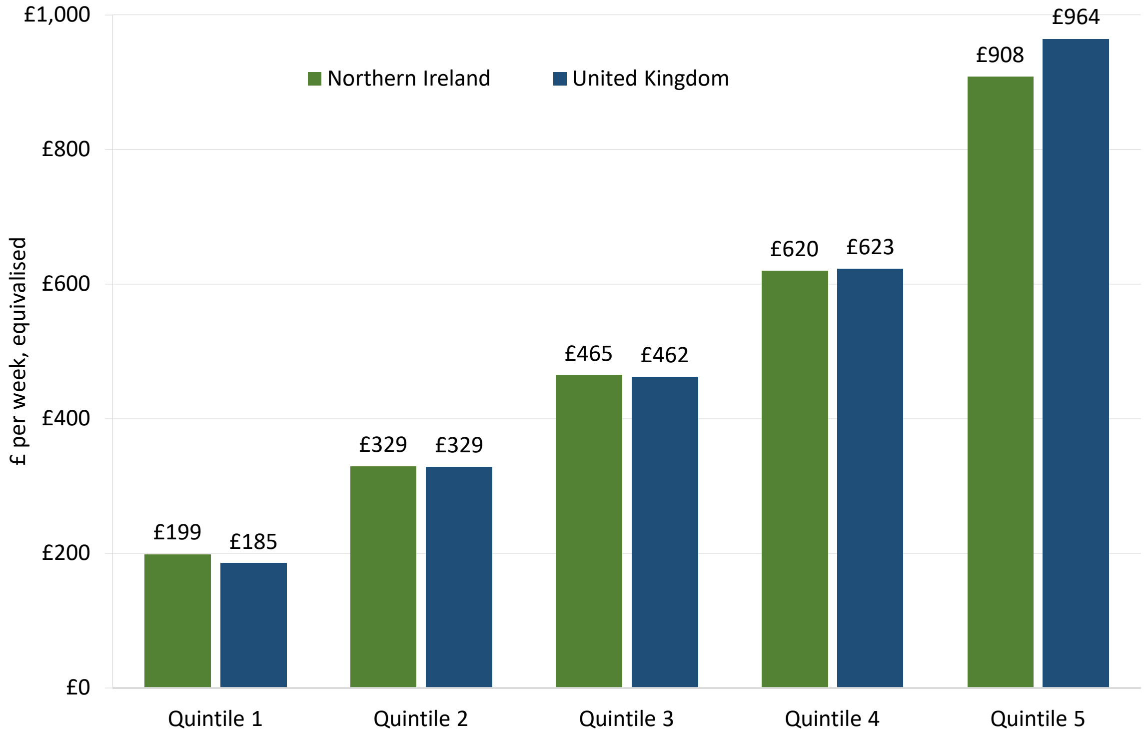
Chart 2.4 Median weekly equivalised household incomes (after housing costs) for all individuals by region, three year average (2017/18 to 2019/20) in 2019/20 prices



Source: Department for Work and Pensions: Households below average income: for financial years ending 1995 to 2020

2.3.11 In terms of the distribution of income, the most recent data show that **the poorest households in Northern Ireland are better off than the poorest households in the UK.** It is at the top of the income distribution, **in the top 2 quintiles, that households in the UK have a higher income than those in Northern Ireland** (see Chart 2.5).

Chart 2.5 Income distribution Northern Ireland and UK, Quintile group medians, weekly median equivalised after housing costs, three year average (2017/18 to 2019/20) in 2019/20 prices



Source: Department for Communities - Households below Average Income Northern Ireland 2019/20 and Department for Work and Pensions Households below average income (HBAI) statistics 2019/20.

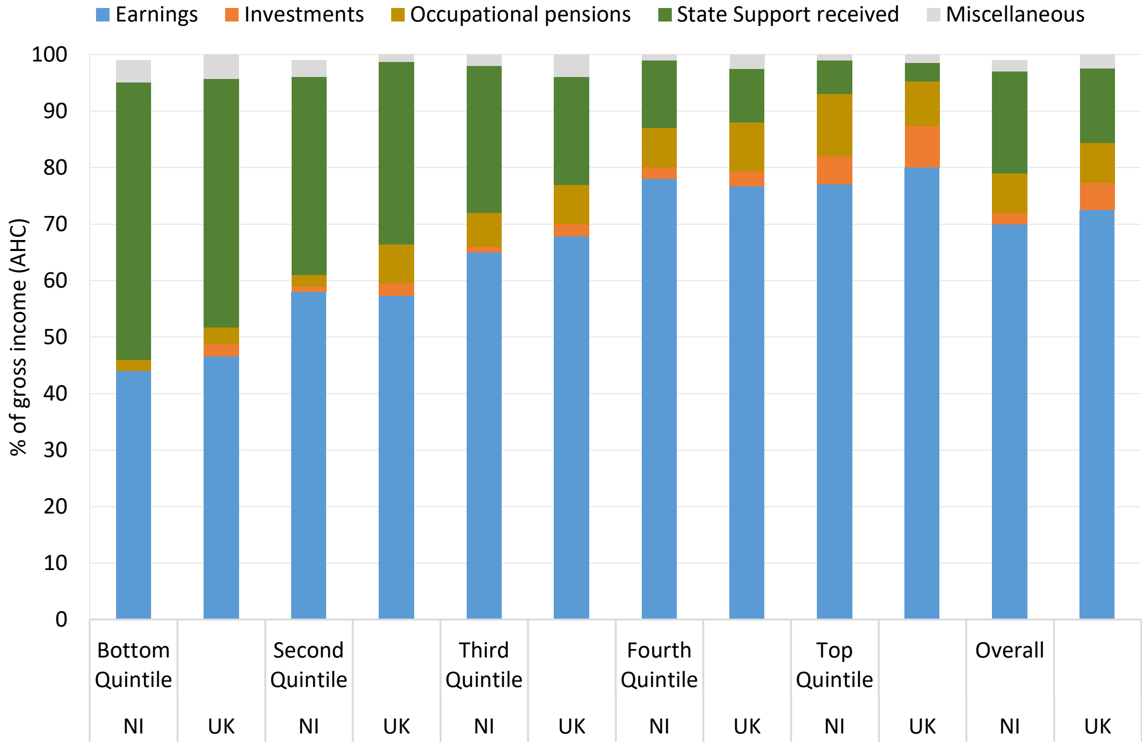
2.3.12 In terms of poverty, Northern Ireland has a lower percentage of people living in relative poverty before and after housing costs, than the UK. In 2019/20, 18% of individuals in the UK were considered to be in relative poverty before housing costs and 22% of individuals after housing costs.[56] This compares to 17% for Northern Ireland both before housing costs and after housing costs,[57] demonstrating that irrespective of housing costs Northern Ireland has lower poverty rates than the UK average, but that housing costs add to poverty levels at a UK level. Northern Ireland's more affordable housing costs, relative to other parts of the UK, is often cited as a key factor in its lower poverty rates.[58] It is also suggested that welfare reform mitigations have had an impact on poverty rates for those on income related benefits.[59]

Sources of Income

2.3.13 **Chart 2.6 illustrates that state supports make a significant contribution to total income in Northern Ireland, with 18% of total income on average deriving from this source. This is a significantly greater proportion than the UK where 13% derives from state supports and clearly has implications for public finances in Northern Ireland.** As the population moves from those in the bottom quintile to the fourth quintile the proportion of gross income made up by earnings increases and the level of dependency on state support decreases. Across all deciles, Northern Ireland is more dependent on state support than the UK and incomes from investments are less prominent in Northern Ireland. Income from earnings varies across quintiles with a greater share of income in Northern Ireland coming from earnings for the second and fourth quintiles, though only by one percentage point in each case.

2.3.14 Overall income from earnings makes up 70% of income in Northern Ireland compared to 73% in the UK. It also worth noting that Northern Ireland currently has the smallest proportion of people of pension age (16.5% compared to the 18.5% UK figure). This helps point to a higher proportional share of income coming from state support being driven by a higher proportion on welfare, not to a higher percentage of people of pension age.

Chart 2.6 Sources of gross income by income quintile, after housing costs, Northern Ireland vs. UK, 2019-20



Source: Department for Communities - Households below Average Income Northern Ireland 2019/20 and Department for Work and Pensions Households below average income (HBAI) statistics 2019/20[ix]

Demographic trends

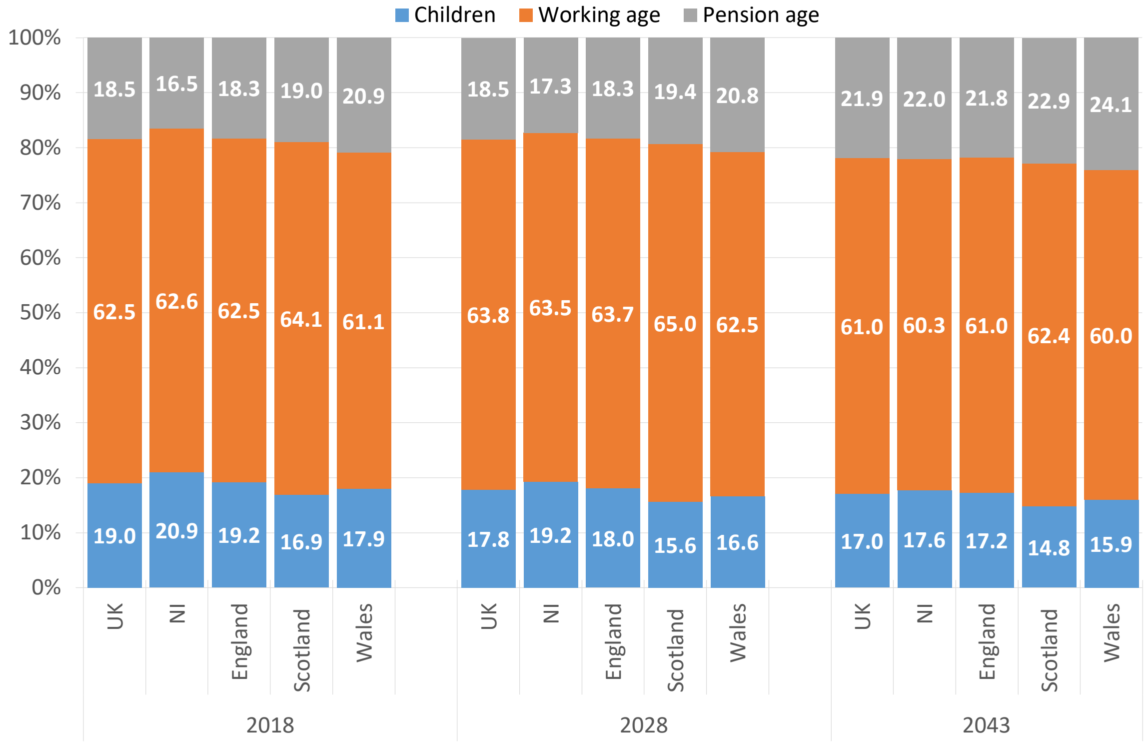
2.3.15 The Northern Ireland population stood at 1,896,000 by mid-2020 or 2.83% of the UK total.[60] Since 1971, Northern Ireland has had the highest average annual population growth rate of any UK country (0.43%) with Scotland the lowest at 0.09% and the UK average at 0.37%. Over the same period Northern Ireland has had, on average, a higher birth rate than any other UK country (15.3 per 1,000 on average compared to the UK value of 12.7 per 1,000). Between 2000 and 2019, Northern Ireland's population has increased by a total of 45,000 as a result of net international immigration.[61] More recently, between 2015 and 2020, Northern Ireland's annual average population growth was 0.5%, which was below the UK average of 0.63%, but higher than Scotland (0.37%) and Wales (0.42%).

2.3.16 In terms of demographic projections across the UK, between mid-2018 and mid-2043, England is projected to have the largest increase in population, at 10.3%. The projected increase over the same period for Northern Ireland is 5.7%, Wales is 3.7% and Scotland is 2.5%.[62]

[ix] These statistics are based on Households Below Average Income (HBAI) data sourced from the Family Resources Survey (FRS). This uses disposable household income, adjusted using modified OECD equivalisation factors for household size and composition.

2.3.17 As shown in Chart 2.7, by 2043, Northern Ireland is projected to go from having the smallest share of people of pension age amongst UK nations (16.5% in 2018) and having a share below the UK average value (18.5%) to having a share (22.0% in 2043) much more in line with the UK average and other UK nations. Across the UK, by 2043, there are projected to be many more people at older ages. This partly reflects the 1960s baby boomers now being aged around 80 years old but also general increases in life expectancy. Northern Ireland currently has the highest share of children (20.9%) and this is projected to remain the case in 2043. The UK is projected to have fewer young children by 2043 but more in their mid-teens; this is expected to be influenced by fertility rates in the 2020s and 2030s being lower than those around 2010 but higher than those around 2001 when UK fertility was at a record low. These changes also mean that Northern Ireland's working age population (62.6% vs UK value of 62.5% in 2018) is expected to decline to 60.3% by 2043, below the UK projected figure of 61.0%.

Chart 2.7 Changes in population makeup 2018-2043, by UK Country



Source: ONS: Principal projection - UK summary; 2018-based national population projections.

2.3.18 The differences in demographics will be an important consideration when looking at fiscal policy for Northern Ireland. The projections that Northern Ireland's population will grow at different rates and that its working age population will experience a greater decline between 2018 and 2043 will be expected to have an impact on the Northern Ireland tax base moving forwards, and the potential tax receipts coming from labour-based taxes in particular. Higher proportions of children and those of pension age will also impact on public spending requirements and decisions.

2.4 Public spending in Northern Ireland

2.4.1. Total public expenditure attributed to Northern Ireland amounted to £30,118 million in 2019/20, across all elements of the public sector. This includes both 'identifiable' expenditure that specifically and directly benefits Northern Ireland's population, and in addition Northern Ireland's population share of UK-wide 'non-identifiable' spending, to account for spending on national factors such as defence or the national debt. In terms of identifiable expenditure, £22,699 million was attributable to Northern Ireland in 2019/20. Table 2.1 presents a breakdown of public expenditure in Northern Ireland based on these definitions and Box 2.1 provides added detail on relevant public spending terminology.

Table 2.1: An overview of public expenditure in Northern Ireland, £ million

	2019/20
Total managed expenditure	**30,118**
Minus accounting adjustments*	4,106
Equals Total expenditure on services	26,012
Of which: Identifiable expenditure	**22,699**
*Of which: non-identifiable***	3,313

Source: ONS Country and Regional Public Sector Finances, FYE 2020
*Note: *Accounting adjustments are used to move from 'Total Expenditure on Services' to 'Total Managed Expenditure'. Accounting adjustments are mainly made up of capital consumption costs, i.e. depreciation. This is also captured on the 'income side' of ONS statistics under Gross Operating Surplus.*
*** Non-identifiable expenditure figure also includes spending across the UK as a whole allocated to Northern Ireland.*

Box 2.1: Public spending terminology

Since 1998, total spending by the public sector has been recorded as **'Total Managed Expenditure' or TME**. This expenditure is an aggregate derived from National Accounts and comprises all expenditure by the entire public sector - namely, the UK Government, NI Executive, local authorities and public corporations. This covers not only all cash spending but also relevant future liabilities and accounting adjustments.

Total Expenditure on Services (TES) represents actual spending undertaken by the public sector within a region and is used by HM Treasury (HM Treasury) as the basis for the reporting of functional, economic category and territorial spending across the Devolved Administrations.[x] **TES** can be further broken down further into **identifiable** and **non-identifiable expenditure**.

Identifiable expenditure relates to spending carried out by local and devolved governments and expenditure carried out directly by the UK Government that can be attributed to a particular country or region.

Non-identifiable expenditure refers to spending which cannot be attributed to a particular country or region and is deemed to be on behalf of the UK as a whole. Non-identifiable expenditure largely consists of defence spending and public sector debt interest payment. Northern Ireland is allocated its population share of UK expenditure on these items.

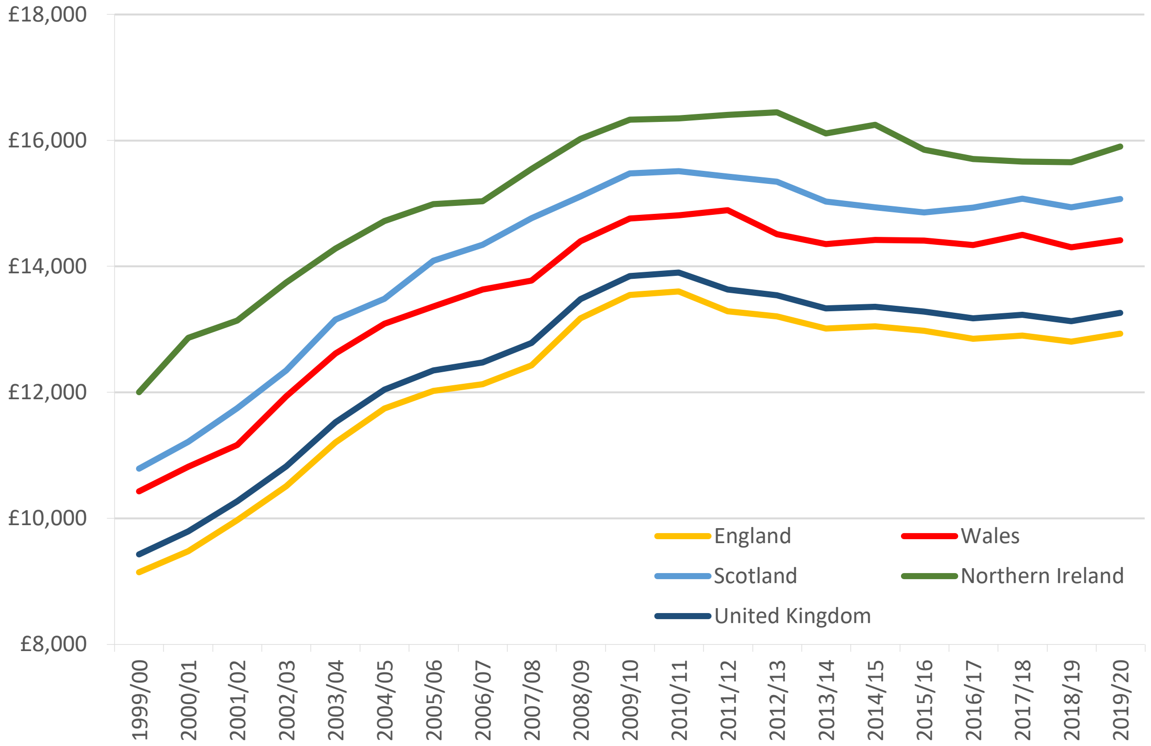
2.4.2. Translating the overall public expenditure figure of £30,118 million (Total Managed Expenditure, TME) into spending per head equates to a level of spend of £15,905 per

[x] The main difference between TES and TME is that TME includes accounting adjustments, which largely comprises capital consumption (depreciation) and does not reverse the deduction of certain VAT refunds. HM Treasury do not allocate accounting adjustments on a regional basis, and so TES allows for an analysis of public expenditure which excludes these. Public Expenditure Statistical Analyses (PESA) is the main document that publishes TES data.

person across Northern Ireland. This is the highest level of spend of any UK country or region and some 20% higher than the UK average of £13,263.

2.4.3. Chart 2.8 demonstrates that the high level of public spending in Northern Ireland has been an ongoing feature of the public spending environment with Northern Ireland spending per person consistently being some £2,500 higher than the UK average across the period, and consistently more than any other country (and region) of the UK.

Chart 2.8 Public spending, by country, TME per head, 1999-2020, in 2019/20 prices



Source: ONS Country and Regional Public Sector Finances, FYE 2020

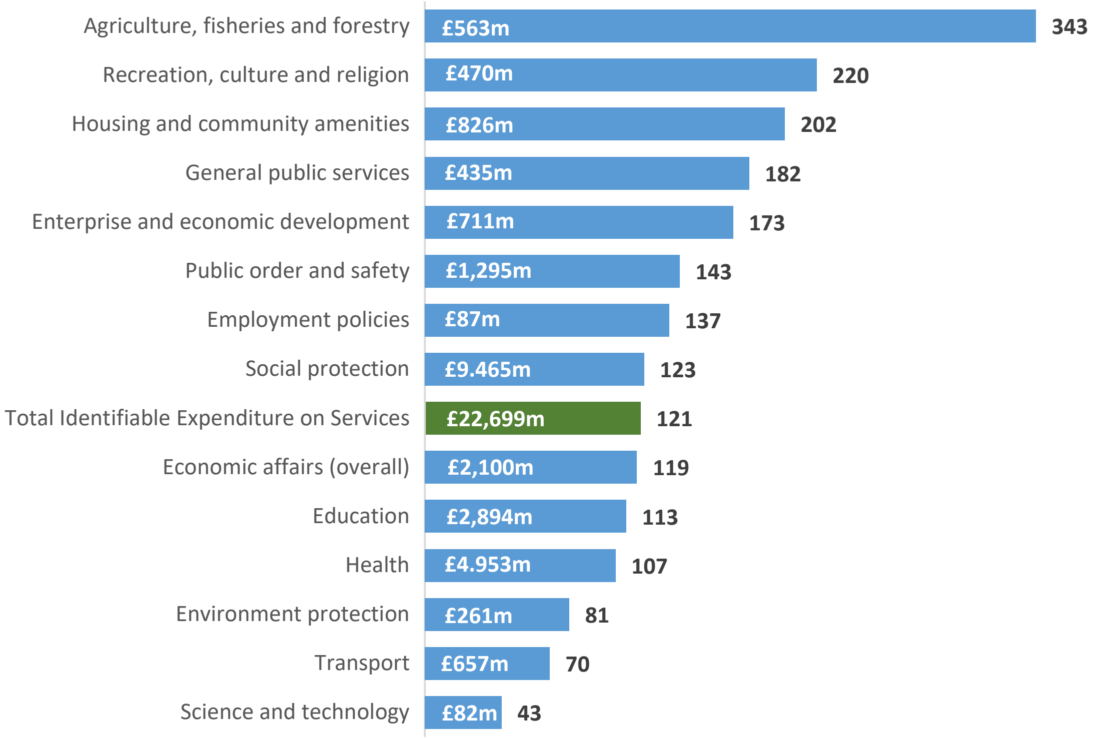
Box 2.2: 'Real terms' public spending and revenue

When comparing spending and revenue over time it is important to consider the impact of inflation and therefore present figures in 'real' terms where possible. Therefore, in this chapter **when comparing public spending or revenue figures over time, the values presented are not 'nominal' figures for each year but are instead values in 2019-20 prices**. To calculate the 'real' values we have adjusted for inflation using the whole-economy ONS GDP deflator with 2019-20 values indexed to equal 100.[63]

2.4.4. Examining the public spending figures in more detail, and focusing on the 'identifiable' expenditure element within Total Expenditure on Services (TES), it is clear that in the majority of expenditure areas[xi] Northern Ireland was (proportionally) significantly higher than the UK average in 2019/20[xii], with the exceptions of Environment Protection, Transport, and Science and Technology. Chart 2.9 highlights these figures. While the biggest differential in relative terms is in the Agriculture, Fisheries and Forestry area, the biggest spending areas for Northern Ireland include: Social Protection £9.47bn; Health £4.95bn; and Education £2.89bn, which all spend significantly more than the UK average by 23%, 7%, and 13% respectively.

[xii] Data for 2019-20 is taken from the HM Treasury Country and Regional Analysis November 2020 publication to ensure consistency with ONS published figures on identifiable expenditure for the same year.

Chart 2.9 Northern Ireland identifiable expenditure on services by function, £ and per head indexed, UK = 100



Source: NISRA, HM Treasury Country and Regional Analysis 2020
Note: Note these expenditure areas do not necessarily correspond to NI departmental spend.

2.4.5. Overall, the NI Executive is responsible for almost £9 in every £10 of identifiable spend across the region.[xiii] However, this amount includes social security spend. Setting aside the amount of spending on social security, the NI Executive broadly has direct control over some £16,610 million,[xiv] i.e. the NI Executive Budget (discussed further in section 2.9), which in turn equates to 73% of total identifiable expenditure attributable to Northern Ireland, or over £7 in every £10 spent.

2.5 Revenue raised in Northern Ireland

2.5.1 In 2019/20, £19,817 million was raised through revenues collected in Northern Ireland, either at the UK-wide level or by authorities in Northern Ireland, or by revenues attributed to Northern Ireland.[64] Of this total revenue, £15,668 million was tax revenue with the remainder made up of a combination of 'other revenue' (such as Gross Operating Surplus, interest and dividends).

2.5.2 The majority of revenue raised from Northern Ireland derives from taxes which are administered and collected at a UK-wide level by HMRC and which totalled £14,213 million in 2019/20. Domestic and non-domestic rates, which are devolved to the NI

[xiii] Data from HM Treasury Country and Regional Analysis 2020 indicates that the NI Executive was responsible for £20,264 million of expenditure out of a total of £22,699 of identifiable expenditure attributable to Northern Ireland in 2019/20.
[xiv] Most of the NI Executive (DEL) Budget is within the control of the NI Executive with some exceptions including UK government financial packages and security funding and farm and fisheries funding.

Assembly, and are collected by Land and Property Services, part of the Department of Finance, raised the largest tax revenue collected by Northern Ireland authorities. Rates raised a total of £1,455 million in 2019/20 - £717 million of which was raised from domestic rates and £660 million raised from business rates.[65] This rates revenue includes both the district element, used to fund local councils, and the regional element, used to fund the NI Executive's spending.[xv]

2.5.3 Table 2.2 details the specific UK-wide taxes which the Commission assesses in this, our interim report, for potential devolution. In 2019/20 three 'major taxes' collected the bulk of Northern Ireland tax revenue; VAT (£3.4bn), National Insurance contributions (£3.1bn), and income tax (£3.0bn). As percentages of total tax revenue in Northern Ireland, those three taxes contributed to 61% of total receipts for Northern Ireland (22%, 19.7% and 19.2% respectively). The dominance of these three taxes is a feature shared amongst most advanced economies, albeit it is worth noting that the proportion of tax revenue raised through VAT in Northern Ireland is comparatively high, whilst the proportion raised through income tax and National Insurance contributions (social security contributions) is internationally comparatively low.[66] Table 2.2 also shows that there are considerable differences comparing the share of total revenues between Northern Ireland and the UK, particularly for VAT and income tax.

2.5.4 A further three taxes tend towards major taxes in terms of their revenue generation. These moderately-sized taxes include fuel duties (£864m), corporation tax (£810m) and alcohol and tobacco excise duties (£774m). It is of note that, as a proportion of overall tax take, Northern Ireland generates less from corporation tax receipts and more from excise duties than the UK as a whole. The remaining taxes are relatively more minor in terms of tax revenues raised.

Table 2.2 Tax revenues raised in Northern Ireland, 2019-20

UK wide taxes	Description	Tax take 2019/20 £million	% share of total NI tax take	UK equivalent % share of total UK tax take
Value added tax	A tax on most goods and services.	3,442	22.0%	18.1%
National Insurance contributions	A tax on income from employment, levied on employers, employees and the self-employed.	3,094	19.7%	19.6%
Income tax	A tax on most forms of income.	3,001	19.2%	26.2%
Fuel duty	Levied on manufacturers and importers of oil products.	864	5.5%	3.7%
Corporation tax	A tax on the profits of limited companies and other organisations.	810	5.2%	6.6%
VAT refunds*	VAT refunds claimed by public sector organisations.	798	5.1%	2.6%

[xv] The values used here regarding rates revenue in Northern Ireland are taken from the ONS Country and Regional Public Sector finance statistics for 2019/20. These values may differ from those used by the Northern Ireland Department of Finance with regards to the NI Budget or from Department of Finance's Land and Property Services. This can be for a number for reasons including when rate exemptions are included in calculations.

Alcohol and tobacco excise duties	Levied on alcohol and tobacco products before release to the UK market	774	4.9%	2.9%
Vehicle excise duty	Payable by either the registered or actual keepers of vehicles.	219	1.4%	0.9%
Insurance premium tax	A tax on general insurance premiums, paid by companies and intermediaries	144	0.9%	0.9%
Capital gains tax	A tax on the gain or profit from selling or otherwise disposing of a possession, such as shares or property.	105	0.7%	1.3%
Stamp duty	Payable on the purchase or transfer of property or land, and on shares.	80	0.5%	2.2%
Air passenger duty	Charged on the carriage of passengers from UK airports.	80	0.5%	0.5%
Betting and gaming duties	Duty charged on net stake receipts and gross gaming yields.	75	0.5%	0.3%
Inheritance tax**	Paid on the estate of deceased persons and sometimes on trusts or gifts made by individuals during their lifetime.	43	0.3%	0.7%
Bank levy	Annual charge on certain equity and liabilities of banks, building societies, banking groups and building society groups.	36	0.2%	0.3%
Landfill tax	Charged on disposal of waste at licensed landfill sites, and paid by the site operators	24	0.2%	0.1%
Climate change levy	Chargeable on the industrial and commercial supply of taxable commodities for lighting, heating and power by business consumers.	23	0.1%	0.3%
Aggregates levy	A tax on the commercial exploitation of sand, gravel and rock.	18	0.1%	0.0%
Soft drinks industry levy	Applied to the production and importation of soft drinks containing added sugar.	12	0.1%	0.0%
Digital Services tax	A tax on the revenues of search engines, social media services and online marketplaces which derive value from UK users.	2	0.0%	0.0%
Other taxes	Includes taxes not listed above as well as taxes that are not specifically listed by ONS such as the apprenticeship levy and other taxes on production.	569	3.6%	3.5%
Non-Domestic and Domestic rates (or Council Tax in GB)		1,455	9.3%	9.1%
Total taxes only		**15,668**	100%	100%
Other revenue	*GOS, interest and dividends and rent and other current transfers*	*4,149*		
Total revenue		*19,817*		

Source: ONS Country and Regional Public Sector Finances, FYE 2020: Revenue Tables, geographical basis
** VAT refunds represent the refunds of VAT that some public sector bodies have paid in respect of contracted out services for non-business purposes and are therefore a revenue foregone as opposed to a revenue raised. However, they are noted here for completeness. **ONS includes inheritance tax as part of 'other taxes on capital' along with Swiss Capital*

Tax. As no values for Swiss Capital tax are applicable in 2019/20, the value of 'other taxes on capital' for that year is solely attributed to inheritance tax.

Box 2.3: Gross Operating Surplus An Explainer

'Other revenue' for Northern Ireland accounts for £4,149m or 23.8% of total revenues for Northern Ireland, whereas for the UK as a whole, this figure is only 13.9% of total revenue. The main component of the 'Other revenue' value is Gross Operating Surplus – which totals £3,250m in Northern Ireland in 2019-20. On a per head basis this is more than double the values for the UK average or for England (£1,716 per head in Northern Ireland versus £852 in the UK and £752 in England in 2019-20).

The Gross Operating Surplus values for Northern Ireland are a combination of the profits of public corporations and the derived Gross Operating Surplus for central and local government. For Northern Ireland, it is the derived Gross Operating Surpluses for central and local government that are higher than other regions and driving the overall higher Gross Operating Surplus value for Northern Ireland.

According to internationally agreed statistical definitions such as the UN's System of National Accounts 2008,[67] Gross Operating Surpluses for central and local government are assumed to be the same size as capital consumption costs**, i.e. depreciation. As noted previously this is also captured on the expenditure side (Total Managed Expenditure) in the ONS statistics under accounting adjustments. Given this, there is no impact from Gross Operating Surplus on general government net fiscal balance as a result.**

Apportionment to regions

The existing ONS methodology for sub-national estimates is to apportion capital consumption costs, as well as Gross Operating Surplus, using various methods based on the type of service that the capital assets are provided for – but in many cases values will be apportioned according to civil service headcount. **Therefore regions with a higher per-capita proportion of civil servants – as is the case in Northern Ireland – will end up with a higher amount of capital consumption compared to the proportionate share of services the population of that region might be consuming.**

ONS have indicated to the Commission that they are revising this methodology and there may be revisions to the Gross Operating Surplus value allocated to Northern Ireland in the future as a result. This improvement in the methodology does mean that Northern Ireland's government capital consumption will be more in line with other regions in future ONS Country and Regional publications.

Box 2.4: Tax revenue data reliability

Taxes in the UK are not generally levied or collected at a regional level but at a national level (domestic and non-domestic rates being the significant exception for Northern Ireland) and so it can be difficult to identify which country or region tax receipts should be allocated to. Therefore, there is no comprehensive source of administrative figures on the actual amount of tax revenue raised in Northern Ireland. The data sources capturing the tax base in Northern Ireland are a mixture of administrative and survey data sources. These are the best available estimates of what is raised, with varying degrees of reliability. The Commission is carrying out a more in-depth examination of the data and methods used to capture the tax base in Northern Ireland and in doing so, we will provide further insight into these issues in the second phase of our work.

However, what is clear is that if Northern Ireland aims to pursue devolution of additional tax powers, early action should be taken where possible to work toward better and more reliable estimates of the tax data to better prepare decision makers in making as informed decisions as possible. Reliable data will also be vital for calculating block grant adjustments. Without reliable information these calculations are more likely to be contested and more difficult to implement.

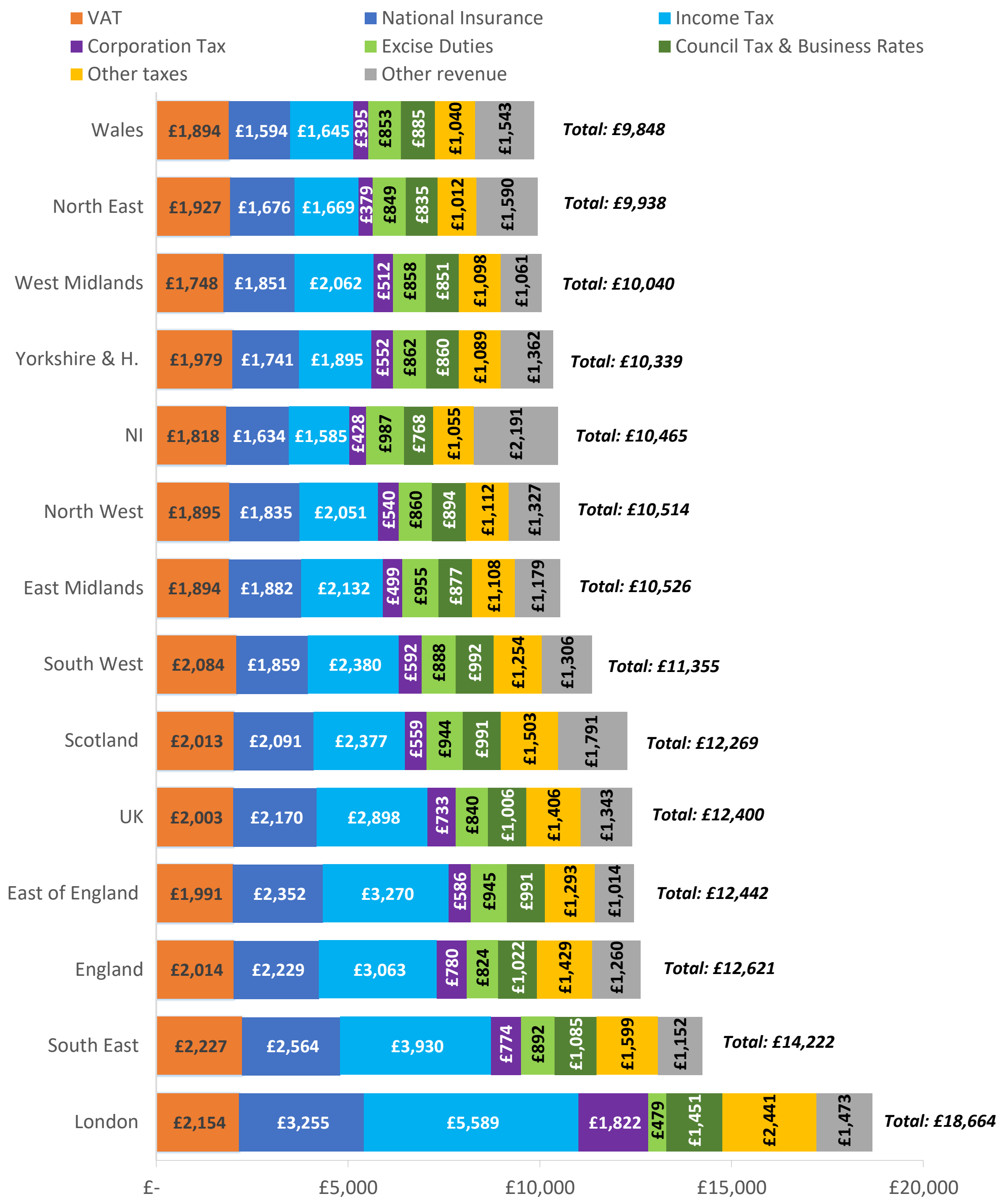
2.6 How does revenue raised per head in Northern Ireland compare to other regions of the UK?

2.6.1 Amongst UK regions, Northern Ireland is among the lowest contributors of 'total revenue' per head (as per Table 2.2, total revenue is total tax take plus 'other revenues'). Chart 2.10 highlights the figures for 2019/20 where Northern Ireland's total revenue per head was £10,465. The UK average was 18.5% higher, at £12,400 per head. However Northern Ireland is above Wales, North East, West Midlands and Yorkshire and Humber on this metric. On average since 1999/00, Northern Ireland total revenue per head has been £1,364 (14.5%) below the UK average.[68] This figure itself has been increasing in recent years, with an almost £800 increase in the difference (in nominal terms) since 2012/13, though there has been a small decline since 2018/19 (£124).

2.6.2 However, as referenced in Box 2.3, Northern Ireland has the highest 'other revenue' figure of any UK region. Tax revenue, excluding other revenues, would see Northern Ireland as the bottom region of the UK for tax contribution per head, closely followed by Wales.

2.6.3 In terms of revenue yields per head across specific taxes it is clear that, compared to the UK, Northern Ireland raises a relatively higher proportion of its tax revenue from consumption-based taxes and a lower proportion from labour and business-based taxes. Specifically, while VAT contributions per head in Northern Ireland are broadly comparable to the UK average, there exist significant differences between income tax and National Insurance contributions where the UK per head average is a huge 83% and 33% higher respectively. In 2019/20, at £1,585 Northern Ireland had the lowest yield of income tax per head, compared to all of the UK regions. At £1,634 per head, it had the second lowest yield from National Insurance contributions. Northern Ireland does contribute proportionately more revenue via excise duties at 18% above the UK average per head.

Chart 2.10 UK region, composition of revenue per head (£), 2019/20, geographic basis



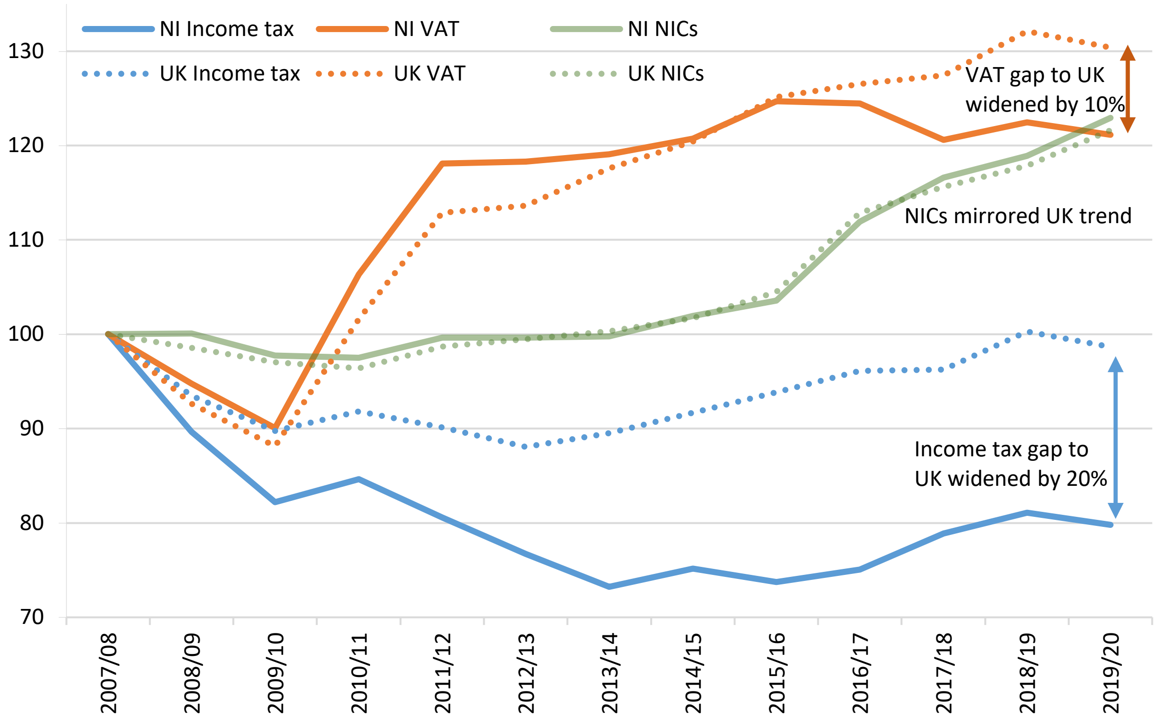
Source: ONS Country and Regional Public Sector Finances, FYE 2020: Revenue Tables.

2.7 How stable is Northern Ireland's revenue base and how correlated to the UK tax base?

2.7.1 A fundamental issue when it comes to decisions around fiscal devolution relates to the size, stability and volatility of the tax base, specifically locally but also when compared to national trends. Whilst there may be a case to devolve a tax which currently raises a considerable volume of revenues, that case may well weaken or strengthen if revenues are expected to decline or increase, or be highly volatile or stable over time. While these issues will be explored in more detail in our final report, with regard to individual taxes, a useful beginning is made in this section.

2.7.2 Chart 2.11 looks at trends in Northern Ireland's tax receipts from the major taxes since the 2007/08 financial crisis. National Insurance contributions in Northern Ireland have largely mirrored the UK trend since 2007/08, remaining steady before rising sharply from 2016/17 onward. Income tax revenues on the other hand have fallen dramatically in Northern Ireland relative to the UK since 2007-08. This impact has resulted in income tax receipts in Northern Ireland diverging some 20% below UK receipts over the period. As outlined in the previous section, Northern Ireland has a substantially lower yield per head from income tax, than across the UK as a whole and this has been the case consistently over the last two decades.

Chart 2.11 Northern Ireland and UK Tax receipts: Income tax, VAT and NICs comparison in real terms, 2007/8=100



Source: ONS Country and Regional Public Sector Finances, FYE 2020: Revenue Tables.

2.7.3 Looking at the income tax base provides some insight as to why income tax receipts in Northern Ireland have experienced a poorer growth rate since 2007/08 when compared to the UK average. Firstly, regarding the number of income tax payers in Northern Ireland relative to the UK. In 2019/20, there remained circa 12,000 fewer income tax payers in Northern Ireland compared to before the 2007/08 financial crisis. This is despite the employment rate having made a full-recovery and surpassed the pre-2007/08 crisis peak by early 2016. Part of the explanation for this is the big changes to income tax policy in recent years, which has seen a large increase in the level of the personal allowance since 2007/08 – this has had a greater impact in Northern Ireland than the UK as a whole given the larger proportion of low income earners in Northern Ireland. One of the key impacts of these changes is that the number of income tax payers as a percentage of the adult population in Northern Ireland has declined from 57% in 2007/08 to 52% by 2019/20.

2.7.4 Secondly, the significantly lower proportion of total taxes deriving from the number of higher and additional rate tax payers in Northern Ireland versus the UK. Since the mid-2010s, there has been a large rise in the higher-rate threshold (which had followed a large reduction earlier in the decade). Whilst both the UK and Northern Ireland experienced a sharp decline in the number of higher and additional rate tax payers in the years subsequent to the 2007/08 financial crisis, it took Northern Ireland until 2013/14 to recover to its 2007/08 level, compared to 2011/12 for the UK as a whole. The UK has also experienced faster growth in the number of higher and additional rate taxpayers than in Northern Ireland across the period, which has resulted in an overall widening of this gap (see Chart 2.12). As of 2020/21, Northern Ireland had the lowest proportion of higher or additional rate payers of any UK region – at just 8.0%. This compares to 14.2% in England, 15.7% in Scotland and 8.2% in Wales. Table 2.3 shows the breakdown by UK region and also highlights that London and the South East have the largest shares of higher and additional rate payers of any UK region.

Table 2.3 Percentage of taxpayers by band and UK region, 2020/21

	Basic rate	Higher rate	Additional rate
London	77.2%	19.1%	3.7%
South East	81.5%	16.3%	2.2%
East of England	83.9%	14.4%	1.7%
Scotland	84.3%	15.0%	0.7%
England	85.9%	12.7%	1.4%
South West	88.1%	11.0%	0.9%
East Midlands	88.7%	10.5%	0.8%
West Midlands	88.9%	10.3%	0.8%
North West	89.3%	10.0%	0.7%
Yorkshire and the Humber	90.0%	9.3%	0.7%
North East	90.7%	8.9%	0.4%
Wales	91.8%	7.8%	0.4%
NI	92.0%	7.5%	0.5%

Source: HMRC Number of individual income tax payers
Note: UK regions ordered by Basic rate, with the region with the lowest percentage of basic rate payers at the top and the region with the highest percentage of basic rate payers at the bottom of the table.

Chart 2.12 Index of number of higher and additional rate tax payers, 2007/08 = 100

Source: HMRC income tax payers by country[69]

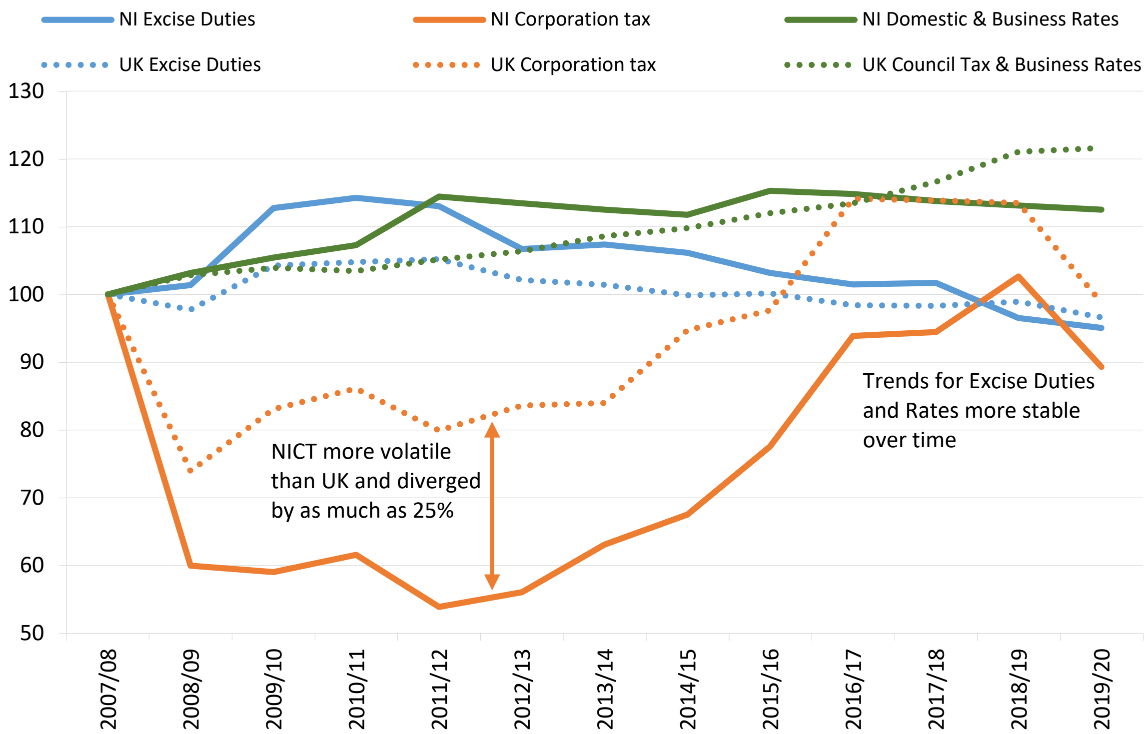
2.7.5 One peculiar trend of note is the divergence between Northern Ireland and UK income tax receipts, which is not mirrored by Northern Ireland and UK National Insurance contributions receipts. This is due to the increasingly progressive nature of income taxation compared to National Insurance which subsequently affected the relative revenue yield from income tax, with a widening of this gap between Northern Ireland and the UK. This has not been evidenced in National Insurance contributions, given this tax's less progressive nature.

2.7.6 In terms of VAT, ONS estimates of tax receipts show that following a decline in the 2007/08 to 2009/10 period there has been significant increases in VAT receipts in both the UK and Northern Ireland (note there was a temporary VAT reduction, from 17.5% to 15% between 1 December 2008 to 31 December 2009,[70] at which point the rate reverted to 17.5% and then a further increase to a 20% rate from 4 January 2011, following the 2010 Budget). In 2019/20, 22% of total Northern Ireland tax receipts arose from VAT receipts, compared to 18.1% for the UK as a whole. However, as outlined in Box 2.4, there are significant questions that need to be raised about reliability and precision of some tax estimates, especially those for Northern Ireland. In summary, estimates of VAT receipts for the household sector apportioned regionally derive from data from the Living Costs and Food (LCF) survey, which captures expenditure on goods and services. The current sample from the LCF for Northern Ireland is not sufficiently large enough to ensure a statistically sound estimate to enable accurate regional analysis of VAT receipts for Northern Ireland. Further to this, the LCF is faced with a number of long-standing known issues related to underreporting of expenditures which also present issues in terms of the accuracy and reliability of the data collected.[71]

2.7.7 In terms of the other taxes which bring in a relatively high yield, estimates show (Chart 2.13) reasonable overall stability in the tax receipts from excise duties, (i.e. fuel, alcohol and tobacco excise duties combined) although in real terms fuel duties have declined over the period since 2007/08, whilst alcohol and tobacco duties have increased. It should be noted that, similar to VAT, there is considerable uncertainty around the estimates of alcohol and tobacco excise duty apportioned to Northern Ireland as these estimates also derive from the Living Costs and Food survey.

2.7.8 The path of corporation tax receipts is more volatile, where Northern Ireland experienced a greater decline after the financial crisis and also took longer to recover to pre-crisis levels, only reaching 2007/08 levels (in real terms) again in 2018/19 (and then falling below again in 2019/20), compared to UK which exceeded pre crisis levels by 2016/17. It is also of note that there is evidence that the corporation tax revenue attributable to Northern Ireland is underestimated because companies' profits are often attributed to the location of their head office. This means it might be more appropriate to allocate corporation tax based on the share of profits earned in Northern Ireland, which would see higher revenue attributed to Northern Ireland.[72]

Chart 2.13 Other Northern Ireland and UK tax receipts, comparison in real terms, 2007/08 = 100



Source: ONS Country and Regional Public Sector Finances, FYE 2020: Revenue Tables.

Block grant adjustments (BGAs) – an introduction

2.7.8 A further reason to understand the level of Northern Ireland taxes and the growth of both Northern Ireland and rUK taxes relative to each other, relates to block grant adjustments (BGAs). In the case that further fiscal powers were to be devolved to the NI Executive, there would be adjustments (i.e. reductions) to Northern Ireland's block grant in future years to reflect the transfer of revenues from the UK Government. Without any such offsetting reduction to the block grant, the budget of the NI Executive would benefit from a windfall funding increase, whilst the UK Government would see a fall in its revenues without any offsetting reduction in expenditure.

2.7.9 But how should these block grant adjustments be made? In the Scottish and Welsh cases, the block grants have been adjusted to ensure two key outcomes. First, so that the devolved budget is not immediately better off or worse off simply as a result of the initial transfer of revenues. Second, that the future budgets of the devolved government capture the revenue impacts of their devolved tax policy choices, and of faster or slower growth in the underlying tax base.

2.7.10 Based on the Scottish and Welsh experiences, the calculation of the block grant adjustments for Northern Ireland will likely consist of two elements: an *initial deduction* and an *indexation mechanism*.

- The *initial deduction* is generally the revenues raised from the tax by the UK Government in Northern Ireland in the year immediately before devolution becomes operational. So if income tax, for example, is devolved to Northern Ireland in 2023/24, the initial deduction is simply the revenues raised by the UK Government from income tax in Northern Ireland in 2022/23.

- The *indexation mechanism* is a measure of the subsequent growth rate of revenues in rUK from the tax that has been devolved to Northern Ireland. So for example, imagine that income tax is devolved to Northern Ireland in 2023/24 and the initial deduction (the amount raised in Northern Ireland in 2022/23 by the UK Government) is £3bn. If income tax revenues in rUK subsequently grow by 5%, then *one way* to calculate the block grant adjustment would be to apply this 5% growth rate to the initial deduction, to give a figure for the block grant adjustment in 2023/24 of £3.15bn. This figure would be deducted from the NI Executive's block grant for the corresponding year.

2.7.11 Viewed this way, the block grant adjustment is effectively an estimate of the revenues that the UK Government is likely to have foregone as a result of transferring a tax stream to Northern Ireland. To make this calculation, an assumption is made that, in the absence of devolution, the UK Government's revenues from the tax in Northern Ireland would have grown at the same rate as in rUK after devolution occurred.

2.7.12 The approach to calculating the block grant adjustments, and especially how they are indexed post-devolution, makes a significant difference to the balance of budgetary risks and rewards that tax devolution implies. First, the BGA mechanisms determine the fiscal risks the NI Executive faces over the long run – for example, is it exposed to the fiscal risks of demographic change, or insulated from them? Second, the approach to calculating the block grant adjustment will also influence the degree of exposure of the Northern Ireland budget to short-term forecast error risks, and hence to the degree of borrowing and other cash management tools required alongside tax devolution.

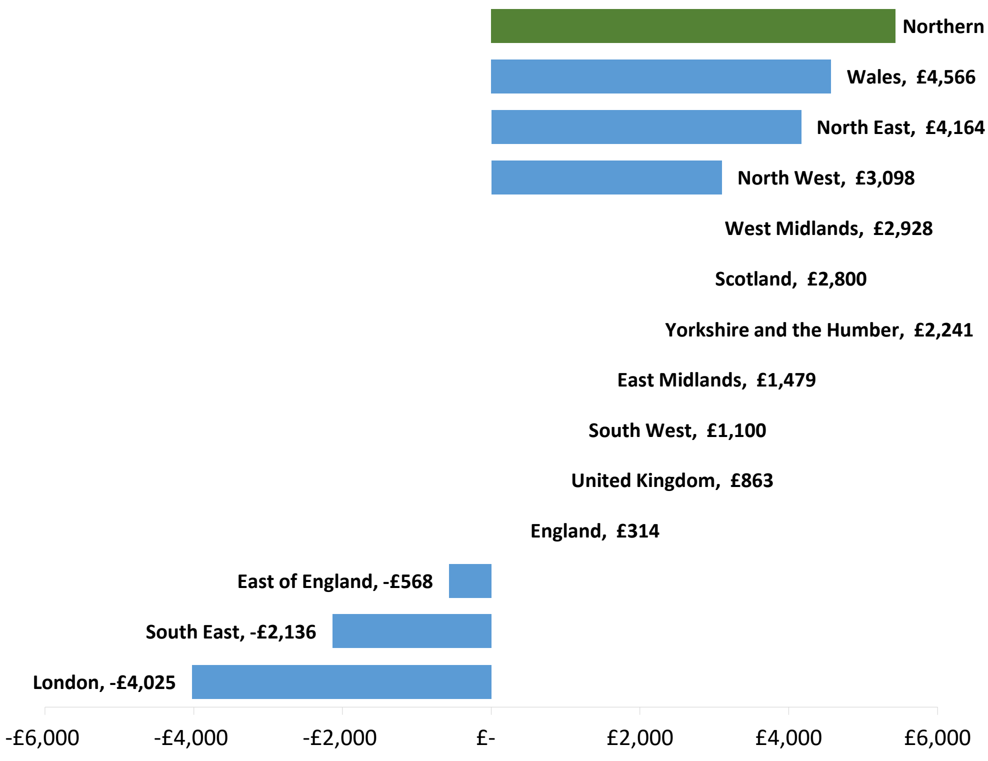
2.7.13 Block grant adjustments are therefore both technical and highly contentious issues. Annex B discusses in more detail our above example of how such block grant adjustments could be made. The second phase of work will consider the options and implications of different mechanisms for adjusting the block grant in further detail.

2.8 What can be said about Northern Ireland's net fiscal position?

2.8.1 Combining the figures for spending and revenues presented in the previous sections allows us to construct the 'fiscal balance' for Northern Ireland - in other words, what the difference is between all expenditure which is attributed to Northern Ireland (i.e. Total Managed Expenditure, TME) versus the total revenues raised or attributed to Northern Ireland (total tax take plus other revenue). TME includes, as it should, NI's population share of 'non-identifiable' expenditure on such items as UK debt interest and overseas representation. In overall terms, Northern Ireland's net fiscal deficit for 2019/20 was £10,301 million which equates to 21% of Northern Ireland GDP[73] or 52% of Northern Ireland's overall tax take.

2.8.2 As shown in Chart 2.14, in 2019/20, Northern Ireland's net fiscal deficit per head (including public sector expenditure both identifiable and non-identifiable) was £5,440[74] which was proportionally the largest deficit of all the regions in the UK. Only three sub-regions of the UK ran a surplus, those being London, South East of England and East of England.

Chart 2.14 Net Fiscal Deficit per head UK regions 2019/20, geographical basis

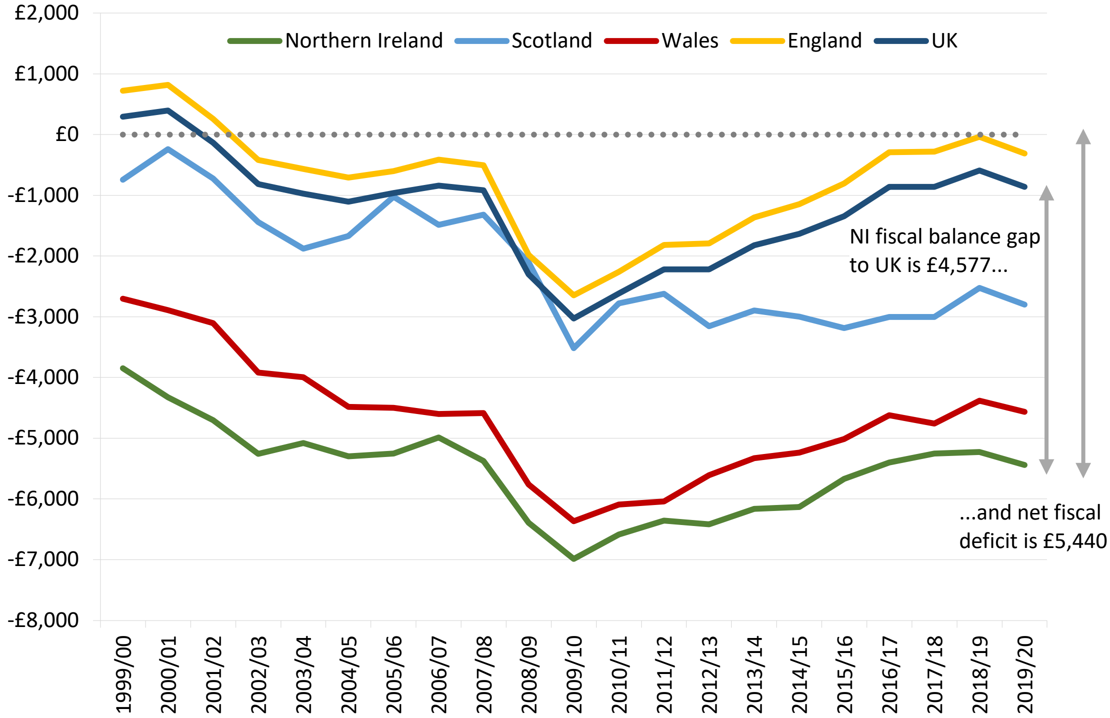


Source: ONS Country and Regional Public Sector Finances, FYE 2020.

2.8.3 Looking at changes in the countries of the UK's net fiscal position overtime (Chart 2.15) we can see that between 2010/11 and 2019/20, all UK countries and regions have seen an improvement in their individual net fiscal balance, i.e. either a decreasing deficit or an increasing surplus. Northern Ireland's net fiscal deficit per head in real terms has been as high as £6,990 in 2009/10 and has been increasing once again since 2017/18.

2.8.4 Over the longer term, Northern Ireland has consistently had the largest net fiscal deficit of any UK region since 1999/2000, with Wales and the North East being the regions with the next largest deficits. Only London and the South East have consistently had net fiscal surpluses each year since 1999/2000. Additionally, the gap in the fiscal balance between Northern Ireland and the UK as a whole has been widening over time. In real terms, in 1999/2000, there was a gap of £4,145 per head between Northern Ireland and the UK. By 2019/20 this gap had widened to £4,577 (i.e. the difference between the Northern Ireland deficit of £5,440 versus the UK deficit of £863 in 2019/20).

Chart 2.15 Northern Ireland Net Fiscal balances per head, since 1999/00, £, 2019-20 prices



Source: ONS Country and Regional Public Sector Finances, FYE 2020

2.8.5 It is not uncommon for sub-regions of an economy to run a fiscal deficit, for economically more productive areas to do more of the heavy lifting in terms of revenue raising, and for the less productive regions of the economy to be net beneficiaries from being part of the wider economy. Issues do emerge however when the size of the overall fiscal deficit grows over time and begins to put pressure on the wider country's public finances.[xvi]

2.9 What are the sources of funding for the NI Executive?

2.9.1 While Total Managed Expenditure (TME) discussed in the previous section represents the total public spending in its very broadest sense, it is not representative of the spending that the NI Executive has 'control' over. The expenditure which the NI Executive does have

[xvi] It is also of note that the application of the above methodology to accurately depict the balance of public finances in NI has been the subject of considerable dispute over many years. Whilst issues have been raised around the practical and theoretical difficulties of accurately capturing NI specific revenues, one of the most enduring aspects of this dispute relates to whether or not the fiscal balance should be calculated on the basis of total managed expenditure attributed to NI (which includes NI's population share of UK-wide 'non-identifiable' spending, to account for spending on national factors such as defence or the national debt) or 'identifiable' expenditure only, that is spending which can directly be attributed to NI.

control over is a subset of TME and is sometimes referred to as the NI Executive's Departmental Expenditure Limit Budget or 'DEL' Budget.

2.9.2 The funding available to the NI Executive that *is* under its control can be divided into the following main categories: the unrestricted 'block grant' from Westminster for programme spending and capital investments (otherwise referred to as 'Barnett-based grants' or DEL); Northern Ireland's own-source revenue (principally regional rates on houses and business premises); and income from other fees and charges (such as annual vehicle testing fees). These primary resources are further complemented by bespoke funding or 'non-Barnett additions', for example, funding in support of political agreements made in Northern Ireland such as the 2015 Fresh Start Agreement, as well as some grants from the EU and replacement EU funding for farmers/fisheries. The NI Executive also has established borrowing facilities, including through the Reinvestment and Reform Initiative (RRI).

2.9.3 The main sources of funding for the published 2021/22 NI Executive Budget include:

- NI block grant - £14,757m (88.8%)
- Regional Rates - £580.1m (3.5%)[xvii]
- Other income £923.4m (5.6%)
- EU income - £179.9m (1.1%)
- RRI borrowing - £170m (1.0%)
- **Total budget for 2021/22 - £16,610m**

Each source of funding is explained in further detail below.

It should also be noted that the Total Budget (£16,610m) above, differs from the total departmental planned spend for NI departments (£14,782.5m) outlined later in this chapter. This is because the NI Executive's DEL Budget is published on a net basis and is made up of planned departmental spend as well as several central items. These central items fall into three broad categories: financing items (such as Regional Rate income); funding that will be allocated to departments (such as Delivering Social Change funding or unallocated funding; and central costs (such as RRI interest repayments or the block grant cost of the zero-rated Air Passenger Duty policy). Full reconciliations between planned spend and overall DEL are set out in the NI Executive's Budget document.

Box 2.5: Public Spending Terminology

The DEL budget is separate from and does not include Annually Managed Expenditure or 'AME'. AME is spending that is administered by the NI Executive on behalf of HM Treasury, but it is not controlled by the NI Executive. While AME is briefly referenced here by way of context, it does not constitute the focus of our discussions here given the NI Executive's lack of control over this spending line.

Annually Managed Expenditure (AME) - Generally, programmes are funded in AME if they are demand-led and volatile in a way that could not adequately be controlled by the devolved administrations; and/or are so large that the devolved administrations could not be expected to absorb the effects of volatility within DEL. AME therefore covers programmes such as (most) welfare payments and public service pensions. Where a devolved administration offers broadly similar terms for an AME programme, the UK

[xvii] The Regional Rates value provided here refers to the value correct at the time of the 2021/22 Budget being published. There may be variations to this value from other sources, including for example Land and Property Services, depending on when the application of various reliefs and exemptions, including, for example, COVID rate reliefs are applied.

Government will fund the cost of this programme. Where a devolved administration wishes to offer more generous terms for an AME programme, then the excess over that implied by adopting broadly similar terms for that programme (and therefore broadly comparable costs) must be met by the devolved administration. In these circumstances, devolved administrations will generally need to fund any costs that are above a population share of the costs of the UK Government programme.[75]

Departmental Expenditure Limit (DEL) is a spending aggregate that sets firm net expenditure limits for a multi-year period. DEL includes that expenditure which is generally within the department's control and can be managed within multi-year limits. These limits are set at an NI Executive level by UK Spending Reviews. The NI Executive Budget then sets out individual Northern Ireland departments' DEL controls which have been determined through the local Budget process. DEL is split into Resource DEL (RDEL) which reflects the ongoing cost of providing services and Capital DEL (CDEL) which reflects investment in assets which will provide, or underpin, services in the longer term.[76]

The NI block grant from Westminster and applying Barnett

2.9.4 As referenced in HM Treasury's Statement of Funding Policy, the NI Executive's block grant funding is presented as the Total Departmental Expenditure Limit (DEL) within the budgeting framework. It is split between resource DEL and capital DEL.[77]

2.9.5 Resource DEL spending covers day-to-day costs (such as wages, purchasing goods and services, and grants and subsidies) as well as the ongoing depreciation of capital assets. Capital DEL spending covers longer-term investment (such as hospitals, roads, and research and development).

2.9.6 Any changes in UK government block grant funding for the devolved administrations in relation to public services are generally linked to changes in planned spending by UK government departments. This link is generally achieved through the application of the 'Barnett formula'.

2.9.7 Through the application of the Barnett formula, the Scottish Government, Welsh Government and NI Executive receive a population-based proportion of changes in planned UK government spending on services in England, England and Wales, or GB.

2.9.8 The Barnett formula therefore determines *changes* to each devolved administration's funding with reference to *changes* in DEL funding for UK government departments; it does not determine the *total* allocation for each devolved administration afresh each time it is applied.

2.9.9 There are three factors that are multiplied together to determine changes to each devolved administration's block grant under the Barnett formula:

(A) *the change in planned spending by UK government departments;*

(B) *the comparability factor* (this is the extent to which services delivered by UK government departments correspond to services delivered by the devolved administrations);

(C) *the appropriate population proportion* (for Northern Ireland, this is Northern Ireland's population as a percentage of England's (or England & Wales's or GB's if that is where the department delivers its services).

2.9.10 Changes to the NI Executive's block grant through the Barnett formula are also abated (i.e. reduced) in relation to VAT. This is not the case for Scotland or Wales. This reflects the fact that the NI Executive, unlike departments in the Scottish and Welsh Governments, has many of the responsibilities of local authorities in the rest of the UK so has more/all of its VAT refunded by HM Revenue and Customs. Barnett formula changes for the NI Executive are therefore abated (reduced) by 2.5%.

2.9.11 Therefore, the Barnett Formula calculation for Northern Ireland can be summarised as: **A** (change to planned UK government spending) **x B** (comparability factor) **x C** (appropriate population proportion) **x D** (VAT abatement factor, currently 0.975, i.e. a 2.5% reduction).

2.9.12 At Spending Reviews, the Barnett calculation is undertaken using changes to each UK government department's overall DEL budget, the population proportion, and the departmental comparability percentage. The product of these changes represents the aggregate net change to the funding for each of the devolved administrations. Resource and capital DEL changes are calculated separately.

2.9.13 These net changes are added onto the devolved administrations' existing block grant and are referred to as the 'Barnett Consequentials'. The existing block grant essentially reflects the devolved administrations' original baseline block grant plus all previous Barnett allocations, excluding allocations that are one-off or time limited, for example discrete COVID-19 funding.

2.9.14 The baseline block grant starts from the block grant set at the previous Spending Review.

2.9.15 Once allocated, the NI Executive must live within its block grant allocation (plus its own resources) and absorb unforeseen pressures. It is responsible for ensuring sufficient arrangements are in place for the planning and control of spending on devolved services to mitigate and manage the impact of emerging pressures.

Domestic and Non-Domestic Regional Rates

2.9.16 Aside from the block grant allocation for Northern Ireland, the most significant source of funding for central public services is the revenue generated locally through the Regional Rates.

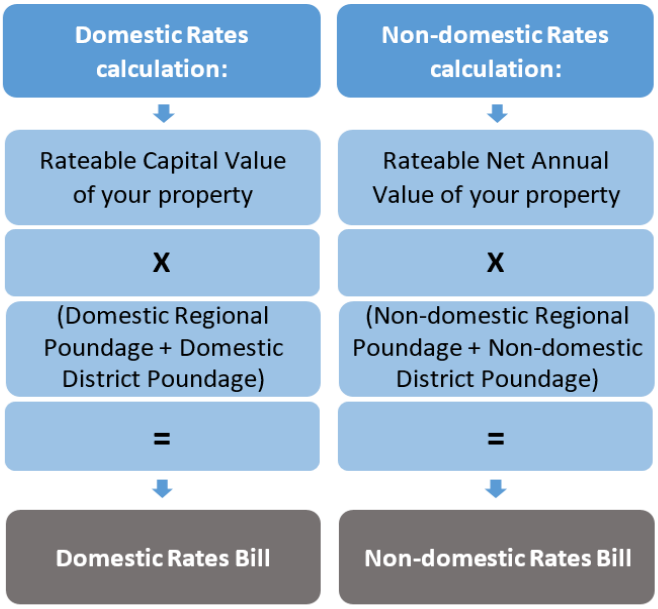
2.9.17 Rates are a property tax based on the valuation of a property. The rating system in place in Northern Ireland is unique. Neither Poll Tax nor its successor Council Tax, were ever introduced in Northern Ireland and, as such, the rating system is a separate local tax and has no direct links to property taxation systems in GB (such as Council Tax).

2.9.18 Two types of rates are levied in Northern Ireland – domestic rates for residential properties and non-domestic rates for business properties. There are also two elements to a rates bill – the district rate and the regional rate. The district rate serves to finance local government, i.e. local councils' expenditure and is set by each local council annually on their assessment of the amount needed to meet their expenditure requirements for that year.

2.9.19 It is only the regional rate that directly helps to finance the spending of the NI Executive and the regional rate is set annually by the NI Executive.

2.9.20 Domestic rates are based on the capital value of the property. The last general revaluation of domestic rates in Northern Ireland was carried out in 2007 and was based on January 2005 values. This differs from GB where valuation dates vary. In England and Scotland, Council tax is based on valuations from April 1991; and in Wales it is based on valuations from April 2003. Non-Domestic rates are calculated on the basis of the property's rental value known as the Net Annual Value (NAV). Rates bills are calculated by taking either the rateable capital value of a property (for domestic rates) or the rateable net annual value of a property (for non-domestic) and then multiplying that value by the sum of the domestic or non-domestic district and regional rates, as appropriate. Chart 2.16 summarises this calculation.

Chart 2.16 Calculation of Northern Ireland Rates bills



2.9.21 The general principle behind the rates in Northern Ireland is that all built property is taxed. Several reliefs, exemptions and allowances are applied (for example, the disabled persons allowance, lone pensioner allowance, and rate rebate scheme for people on universal credit and a range of reliefs for non-domestic property). These have been developed over many years reflecting the different policies and priorities of the NI Executive at that point in time and are at its discretion. Any change in reliefs, exemptions and allowances is a public expenditure choice taken by the NI Executive.

2.9.22 For example, the capital value cap of £400,000 on domestic properties which limits the current maximum regional rate to £1,829 per property is a policy choice which limits the progressive nature of rates and reduces the total yield. The cap was introduced to create a parity with the highest council tax bands in GB.[78] In GB, each domestic property is placed in a council tax band depending on the value of the property at the relevant valuation date. Each council sets the amount of council tax that is payable for properties that fall within each band; this effectively caps council tax bills. In England, the highest band is for properties valued in 1991 at more than £320,000, Scotland more than £212,000 and Wales more than £424,000.

2.9.23 A comparison of average (mean) rates bills in Northern Ireland with council tax bills of households in GB shows that bills for Northern Ireland households are lower than their GB counterparts, with GB households also facing additional, separate charges for water and sewage. Table 2.4 outlines the average household bills across the UK for 2021/22.

Table 2.4 Comparison of Northern Ireland Domestic Rates & GB Council Tax – 2021/22 values

	Average Bill (Council tax or rates)	Water and sewage	Total household bill
Northern Ireland	£1,036	£0	£1,036
England	£1,428	£408	£1,836
Wales	£1,544	£408	£1,952
Scotland	£1,198	£383	£1,581

Source: Department of Finance – Land and Property Services (LPS), Presentation to Fiscal Commission – May 2021

Note: Northern Ireland Average (mean) Rates Bill here is based on data from the Northern Ireland Capital Valuation List for domestic properties (which displays capital values as of January 2005, not current house sales) and the rates poundages published on the DoF website.[79] Council tax bills in GB are based on the value of the property at a set point in time (April 1991 for England and Scotland; April 2003 for Wales).

2.9.24 The valuation practice for non-domestic rateable properties is harmonised across the UK as far as legislation permits, apart from Industrial De-Rating, which has been retained only in Northern Ireland. The systems of reliefs and exemptions are similar in their policy intent but differ in the specifics of how they operate in practice, varying among the four jurisdictions.

2.9.25 When non-domestic rate reliefs in England are enhanced, Northern Ireland and other devolved administrations, receive equivalent funding via the Barnett formula and subsequent changes to the block grant.

2.9.26 There have been reviews of the rating system in Northern Ireland, most recently in 2016 and 2019. These reviews consulted on the options for changing the various reliefs, exemptions, and allowances for both domestic and non-domestic regional rates. For example, reducing the 100% exemption on charity shops, changing the amount of relief on vacant non-domestic premises, removing the capital value cap of £400,000 on domestic properties, amongst other things. These reviews have not resulted in any substantive changes to the rating system other than to implement more frequent general revaluations.

Other income

2.9.27 In addition to the above, funding can also be generated by charges (such as for MOT vehicle safety tests), the sale of assets, and the application of certain levies (like the carrier bag levy). There are certain restrictions to what departments can do locally to raise such additional funding. For example, the retention of income from licences and levies or fines and penalties is subject to HM Treasury agreement.

Non-Barnett additions[xviii]

2.9.28 The NI Executive receives various 'non-Barnett additions' to the block grant, which are typically ring-fenced for particular purposes. The NI Executive has received several such additions to reflect political developments, such as the New Decade New Approach (NDNA) agreement in 2020 (£900 million) and the Confidence and Supply Agreement between the DUP and the Conservative Party in 2017 (£1bn), as well as specific funding relating to the NI Protocol, shared education/housing and security funding. In addition, like the other devolved administrations, it has also received grant funding for 'City Deals' where the NI Executive matches that funding pound for pound (£617 million).

2.9.29 The NI Executive has received the additional funding from each of these deals in a 'drip-fed' manner over a number of years rather than via one-off lump sum amounts. We have commissioned the Department of Finance to provide further details of the funding levels that the NI Executive expected to receive in recent years and how much was actually drawn down from these sources. Tables 2.5 and 2.6 provide a high level summary by year for the initial funding profiles and the subsequent actual drawdowns. A full breakdown of each financial package is available in Annex C.

Table 2.5 NI Executive financial packages – original funding profiles 2015-16-2024-2025

Financial package	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	2021 22	2022 23	2023 24	2024 25	Total
Stormont House Agreement	£80m	£80m	£80m	£80m	£80m	£50m	£50m	£50m	£50m	£50m	**£650m**
Fresh Start Agreement		£42m	£42m	£42m	£42m	£42m					**£210m**
Confidence & Supply Arrangement				£455m	£455m	£30m	£30m	£30m			**£1bn**
New Decade New Approach					£30m	£519m	£174m	£69m	£54m	£54m	**£900m**
Sub total											***£2.76bn***
City Deals											**£617m**
NI Protocol						£30.3m	£35.6m				**£65.9m**
Total	***£80m***	***£122m***	***£122m***	***£577m***	***£607m***	***£671.3m***	***£289.6m***	***£149m***	***£104m***	***£104m***	***£3.443bn***[xix]

Source: DoF, Public Spending Directorate

[xviii] A note on *COVID-19 impact on 2021/22 Budget*: the NI Executive's DEL budget for 2021-22 was set as part of the UK Spending Review 2020. This included significant levels of funding for the COVID-19 response. The NI Executive viewed the funding as separate funding streams – COVID-19 funding and Core DEL funding. The working assumption is that COVID-19 funding will be for one year only. While the majority of the Core DEL funding will be rolled forward to form the baseline for the next Spending Review, this will be subject to some adjustment by HM Treasury when the actual baseline for the next Spending Review is set. As such, we do not consider COVID-19 funding in detail within our report.

[xix] Note the overall total here includes value for City Deals funding, however details of City Deals funding by year is not available, and therefore the yearly totals will differ to the overall total.

Table 2.6 NI Executive financial packages – actual drawdown, 2015-16-2020-21

Financial package	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	Total
Stormont House Agreement		£2.6m	£6.1m	£10.9m	£13.4m	£26.5m	**£59.5m**
Fresh Start Agreement		£38.3m	£38.8m	£41.7m	£42.8m	£45.1m	**£206.7m**
Confidence & Supply Arrangement				£410.0m	£330.0m	£50.6m	**£790.6m**
New Decade New Approach					£30.0m	£504.0m	**£534.0m**
Sub total		***£40.9m***	***£44.9m***	***£462.m***	***£416.2m***	***£626.2m***	***£1.591bn***
City Deals					£20m		**£20m**
NI Protocol						£22.5m	**£22.5m**
Total		***£40.9m***	***£44.9m***	***£462.m***	***£436.2m***	***£648.7m***	***£1.633bn***

Source: DoF, Public Spending Directorate

Grants From the EU

2.9.30 Pre Brexit, grants and funding from the EU to Northern Ireland included: Common Agriculture Payments (CAP); Common Market Organisation (CMO) Funding; Peace IV Programme; Interreg VA Programme; Structural Funds (European Regional Development Fund and European Social Fund); European Maritime Fisheries Fund (EMFF); and access to a wide range of funding competitions, such as Horizon 2020.

2.9.31 Post Brexit, there have been some changes. Funding for farmers and fisheries (replacing CAP and EMFF respectively) is now largely provided to the NI Executive by the UK Government, though the UK will continue to participate in programmes funded under the current 2014-2020 Multiannual Financial Framework (MFF) until their closure. In line with commitments from the EU and UK Government, the PEACE PLUS programme will provide replacement for PEACE IV and Interreg VA funding.

Borrowing

2.9.32 The issue of borrowing powers is important to consider, both as a source of current income and expenditure (given capital and interest repayments), but also in the context of the devolution of additional fiscal powers. If additional fiscal powers are devolved to Northern Ireland it can be expected that additional budgetary tools, including borrowing, will be required to operate these powers. This sub-section provides an outline of the 'base' borrowing powers of the NI Executive, Scottish and Welsh Governments, with Chapter 3 providing further detail on the additional borrowing which Scotland and Wales obtained as part of their fiscal devolution packages. We will explore what further fiscal tools may be may be required for Northern Ireland in our final report.

2.9.33 The NI Executive can borrow both to fund capital expenditure and also for a defined range of purposes not related to capital expenditure. Borrowing, like other spending within Departmental Expenditure Limits (DEL) or Annually Managed Expenditure (AME), affects the UK's fiscal position and is therefore subject to a range of legislative and administrative controls.

2.9.34 The **Northern Ireland (Loans) Act 1975**, as amended by the Northern Ireland (Miscellaneous Provisions) Act 2006, enables the NI Executive to borrow for capital purposes up to a cumulative maximum of £3 billion. Capital borrowing facilities are available through the Secretary of State of Northern Ireland from the National Loans Fund. Annual limits on borrowing are determined by HM Treasury.

2.9.35 The **Reinvestment and Reform Initiative (RRI)**, announced in May 2002, included a new borrowing power intended to support an infrastructure investment programme. This uses the powers under The Northern Ireland (Loans) Act 1975 as set out above. A formal borrowing limit, of £125 million in 2003-04 and £200 million per annum thereafter, was agreed by HM Treasury. This was amended for a limited period by the Fresh Start Agreement. For 2021-22 the borrowing limit is set at £200 million. The RRI was designed to address the major deficit in infrastructure and to modernise key services. The initiative targets services such as water, health, transport, and education and intends to reverse the damage caused to Northern Ireland's public services by 30 years of focus on security issues.[xx]

2.9.36 The **Northern Ireland Act 1998** also enables NI Executive Ministers to borrow for purposes other than capital expenditure, up to a maximum of £250 million. The sole purpose of this loan facility is to give the NI Executive the ability to borrow over the short-term for cash management purposes, in circumstances where it is necessary to provide a working balance or meet an in-year excess in expenditure over income within the Northern Ireland Consolidated Fund.

2.9.37 Borrowing for purposes other than capital expenditure is carried out by the Secretary of State on behalf of the NI Executive, from the National Loans Fund. To date, this power has not been utilised by the NI Executive. The Scottish Government has used its forecast error borrowing powers to manage forecast error risk on a number of occasions; the Welsh Government is yet to do so.

2.9.38 Any borrowing in excess of £200 million is due to HM Treasury approved access to previously undrawn borrowing, or new borrowing under the 2013 Together: Building a United Community (T:BUC) Strategy, or the 2014 Stormont House Agreement (for example when additional powering was deployed to assist the NI Executive to support the Presbyterian Mutual Society).

2.9.39 There are, of course, implications to such borrowing. The interest payments on borrowing are treated as a direct cost to the NI Executive's Resource DEL and must be found from within the budget. It is only the principal repayments that are treated as non-Budget costs to avoid a double count with the borrowing itself. However, these principal repayments are a first call on the NI Executive's Regional Rates income and as such, this reduces the Regional Rates income that remains available to fund other expenditure through an agreed budget.

2.9.40 In summary, the National Loans Fund is the 'mechanism' for the NI Executive to borrow capital money. It does this by using the Reinvestment and Reform Initiative (RRI) arrangements – which outline the agreement between the NI Executive and HM Treasury

[xx] See the Strategic Investment and Regeneration division explanations online at https://www.executiveoffice-ni.gov.uk/articles/about-strategic-investment-and-regeneration#toc-5 for further information.

on the parameters around which capital borrowing can take place. The Northern Ireland Act 1998 is, in effect, an 'overdraft' or cash management facility to smooth expenditure as opposed to boost spending.

2.9.41 Since the introduction of the RRI borrowing facility in 2003-04, RRI Borrowing budgetary cover will have been used to *cover* £3,205.2million of RRI borrowing by the end of 2021-22. The *actual cash borrowing* from the National Loans Fund over this time period will be £2,628.9 million by end of 2021-22. The RRI Principal that will be repaid by the end of 2021-22 will total £1,060 million.

2.9.42 This means that the *net borrowing position* of the NI Executive will be £1,569 million by end of 2021-22. Leaving borrowing 'headroom' of £1,431 million. The value of repayments made by the NI Executive (covering principal and interest) in the latest budget year alone - 2021-22 - is £175.8 million.

2.9.43 The NI Executive's capital borrowing powers can be compared to those in Scotland and Wales. The 2012 and 2016 Scotland Acts allow the Scottish Government capital borrowing power of up to £450m per annum, with a total cap of £3 billion. This equates to £549 per capita. The Wales Acts 2014 and 2017 allow the Welsh Government capital borrowing power of up to £1 billion. This equates to £317 per capita. As above, the NI Executive can borrow for capital purposes up to a cumulative maximum of £3 billion, equating to £1,584 per head of population in Northern Ireland. While the NI Executive has relatively more capital borrowing powers than the Scottish or Welsh Governments, this partly reflects the fact the NI Executive has many of the responsibilities of local authorities in Scotland and Wales. Chapter 3 provides further detail on the additional borrowing powers which the Scottish and Welsh Governments obtained as part of their fiscal devolution packages and which the NI Executive may require as part of any fiscal devolution process.

2.10 How is the NI Executive's budget agreed?

2.10.1 Under the 1998 Northern Ireland Act, a budget must be agreed by the NI Executive and presented to the NI Assembly before the start of the new financial year. The funding available and the timespan for the NI Executive's Budget process will be influenced by the control totals set through the UK Spending Review process.

2.10.2 The Northern Ireland (Stormont House Agreement and Implementation Plan) Act 2016 also places a statutory duty on the Finance Minister to lay before the NI Assembly a statement showing that the amount of UK funding required by the draft budget does not exceed the amount (notified to the Finance Minister by the Secretary of State) for that year.

2.10.3 It is difficult to estimate with certainty what the actual Budget timetable will be. Relevant factors include, timing of the Spending Review and time needed for political agreement at the NI Executive. Over recent years, the process has been delayed, resulting in shorter time periods for consultation.

2.10.4 Clearly it is preferable for Spending Reviews and Budgets to be set over a longer time horizon, providing greater certainty to all stakeholders over funding allocations, facilitating better planning and management of public expenditure.

2.10.5 There has been much political debate surrounding the desire for the NI Executive to move to multi-year budgets, and all devolved administrations have made clear their desire for multi-year budgets to be delivered. New Decade New Approach (NDNA) also emphasised the need for a multi-year Programme for Government to be supported by a multi-year budget. The 2021 Spending Review, announced in October 2021, sets out multi-year budgets for UK government departments and the devolved administrations' block grants from 2022-23 to 2024-25.[80]

2.10.6 Our understanding is that the experiences in Scotland and Wales, following the devolution of tax powers, has meant that their own budget processes are even more reliant than before on the UK budget process being completed in a timely manner. This is in order for the devolved governments in Scotland and Wales to have a better understanding of the spending envelope available to them, which is now more volatile given additional fiscal devolution and their increased exposure to varying tax bases. This is particularly true given the limited borrowing powers they both have available to them to cover any funding uncertainties.

2.10.7 Following agreement of a Budget, the NI Executive has an established process for managing the in-year management of the budget. Full details of that process are published annually by the Department of Finance as In-Year Monitoring Guidelines.[81]

2.11 How does the NI Executive spend its resources?

2.11.1 The NI Executive is responsible for the majority of public spending in Northern Ireland, such as spending on health, education, roads, and law and order. Table 2.7 outlines the breakdown of the NI Executive's spending by department, according to the 2021/22 Budget.

Table 2.7 Resource, Capital spend planned - draft 2021/22 NI Budget, by department, £million

Department	Resource Spend	Capital Spend
Agriculture, Environment and Rural Affairs	553.8	95.5
Communities	876.3	224.8
Economy	821.3	89.8
Education	2,345.1	158.3
Finance	172.1	45
Health	6,451.9	326.5
Infrastructure	429.9	722.5
Justice	1,125.3	96.4
The Executive Office	120.5	15.3
Food Standards Agency	11.7	0.1
NI Assembly Commission	45.8	1
NI Audit Office	8.6	4.5
NI Authority for Utility Regulation	0.2	0
NI Public Services Ombudsman	3.6	0.1
Public Prosecution Service	35.3	0.6
Total Planned Spend	**13,001.5**	**1,781.0**

Source: DoF, Northern Ireland Budget 2021-2022

2.11.2 The figures from the 2021/22 Budget show that Health takes up almost half - 49.6% - of the Resource spend of the NI Executive, significantly more than any other department, with Education the next highest, taking up 18%. In terms of Capital spend, Infrastructure with 40.6% has the highest share of the budget, with Health next with an 18.3% share.

2.11.3 The Total Planned Spend outlined in Table 2.7 above (£14,782.5m) does not match the NI Executive's DEL Budget (£16,610m) as outlined earlier in this chapter (a difference of £1,827,5m). This is because the NI Executive's DEL Budget is published on a net basis and is made up of planned departmental spend as well as several central items. These central items fall into three broad categories: financing items (such as Regional Rate income); funding that will be allocated to departments (such as Delivering Social Change funding or unallocated funding; and central costs (such as RRI interest repayments or the block grant cost of the zero-rated Air Passenger Duty policy). Full reconciliations between planned spend and overall DEL are set out in the NI Executive's Budget document.

2.11.4 In terms of how the NI Executive chooses to spend its resources, like all governments, this is based on the policy choices that they deem most appropriate on behalf of their citizens. Frequently these policy choices have revenue implications and can either boost or reduce the level of expenditure available for other public spending priorities. Northern Ireland is no different to other jurisdictions in this regard.

2.12 Policy divergence in Northern Ireland ('super- and sub-parity' issues)

2.12.1 The imprecise term '*super parity*' is often used in Northern Ireland's policy circles to describe policy divergence in respect of policies which confer an element of benefit or differentiation with the wider UK population. This differentiation generally comes from reduced costs and charges for local citizens and businesses, which have a resultant public expenditure impact. In other words, there are a number of specific examples of policy divergence where Northern Ireland could raise additional revenue or reduce expenditure if policies matched other parts of the UK.

2.12.2 In order to understand the extent of the various exemptions and mitigations in place relating to existing policies, the Commission requested, through the Department of Finance, that all NI Executive departments provide an overview of areas of policy divergence ('super-parity') and the associated costs within their departmental remit. Table 2.8 provides an overview of the responses received by each department.

Table 2.8 Super-parity measures identified by NI Executive departments, Summer 2021, £million

Department & measure	Description of Measure	Value of measure
Department for Communities		
Existing welfare mitigations	This includes payments related to certain welfare reforms including the Benefit Cap, the "Bedroom Tax" and Personal Independence Payment	£42.8m

Housing Benefit Rates	In 2013/14, the UK Government decided that Housing Benefit Rates should be moved from the AME budget to the DEL budget and applied a cut of 10%. NI Executive continues to 'compensate' for this cut each year	£12m
Department for Economy		
University Tuition Fees*	NI has not introduced higher tuition fees for students, as seen in England. Currently DfE provides funding directly to Northern Ireland universities from the NI block grant to help subsidise part of the cost	£14.2m to £90.5m
Department of Finance		
Industrial De-Rating**	Properties which are occupied and used for manufacturing purposes receive 70% reduction in their rates bill	£59m
Low Income Rate Relief**	A supplement to Housing Benefit to help with rates charges	£6.6m
Vacant property rate relief**	In general, once a non-domestic property becomes vacant, it will receive 100% exemption for the first three months, after that it will then only have to pay 50% of the occupied rates liability	£35m
Freight/transport rate relief**	Properties occupied for the purpose of freight transport receive 75% rates relief	£2.2m
Landlords Allowance**	10% allowance for landlords who make lump sum payments for several properties at the same time	£13m
Department of Health		
Prescription Charges	The NI Executive abolished all prescription charges in Northern Ireland in April 2010	£20m
Domiciliary Care Charges	Domiciliary care is provided free of charge in Northern Ireland	£17.8m to £32.5m
Department for Infrastructure		
Concessionary Fares	The Northern Ireland Concessionary Fares Scheme (NICFS) offers free bus and rail travel for Northern Ireland residents aged between 60 and 64	£29.2m
Domestic Water Charges	The NI Executive has extended the power for DfI to pay a subsidy to NI Water in lieu of domestic water charging since 2007. Water charges are currently in place elsewhere in the UK where it is either added to a property's Council tax bill or charged on a usage basis	£344.5m

Non Departmental measures		
Air Passenger Duty	Long-haul Air Passenger Duty has been devolved since January 2013 and since then there has been a zero-rate policy in place for long-haul flights from Northern Ireland	£2.3m
	Total Super Parity measures	**£599m to £690m**

Source: Commission calculations from Northern Ireland Departmental returns via Department of Finance, Summer 2021

Note: Minor measures under the value of £1m are not included in the table above. Figures provided in Summer 2021 but do not necessarily correspond to figures for that year but the latest available.
** The issue of fee funding and replacing grant funding with increased loans involves many nuances and DfE have indicated to the Commission that significant analysis would be required to arrive at exact estimates. The estimates presented here reflect whether or not the additional costs associated with the write offs of loans would be met by the UK Treasury or would be met by the NI Executive from its own DEL Budget.*
*** For a number of rating reliefs, revenue foregone is split between the NI Executive and the district councils, therefore not all additional revenue raised by removing these reliefs would go to the NI Executive.*

2.12.3 While not necessarily a comprehensive assessment, and there may be differences between how other countries of the UK have implemented policies in the areas detailed, the total estimated cost of policy divergence, and all various relief and exemption measures is estimated to be between £600m to £700m or approximately 3.8-4.2% of the total annual NI Executive DEL budget available.

2.12.4 There are of course significant and complex issues behind each of these measures and there is no guarantee that alignment with other parts of the UK would bring the full fiscal benefit as detailed, given, for example, the mitigations required in the system for those who cannot afford to absorb additional costs. There would also likely need to be detailed assessments and public consultations before any proposed change in policy position could be taken and, of course, the NI Executive would have to support any change. However, while the Commission recognises that any changes to these measures are likely to be controversial, and also the limitations of our exercise, it remains of note that these measures exist and their significant revenue impacts represent, in effect, a degree of opportunity cost to other public spending measures.

2.12.5 Conversely, there are also 'sub-parity' policies, where provision is less generous in Northern Ireland than in other parts of the UK, although there are relatively fewer examples of this. Two such examples are childcare support and, arguably to a lesser degree, apprenticeships. England offers 30 hours per week of free childcare to eligible working parents of three and four year olds. The same provision is not available in Northern Ireland despite costs being estimated as the second highest amongst 24 European countries reviewed in 2019.[82] The apprenticeship levy operates on a UK-wide basis; however, although Northern Ireland businesses pay the same levy, they are unable to access apprentices through government vouchers in the same way. The NI Executive does, however, receive a Barnett consequential as a result of UK government spending on apprenticeships in England.

2.12.6 A more detailed overview of each example of policy divergence, as understood by the Commission, and as identified by the respective NI Executive departments is provided in Annex D.

2.13 Conclusions

2.13.1 Understanding Northern Ireland's current economic, demographic and fiscal position, relative to that of the UK as a whole, is vital for understanding the case for additional fiscal devolution. It is important to understand that Northern Ireland is poorer, generates less from most taxes and spends more on most public services than rUK. None of these facts is a barrier to devolving taxes. Indeed, the fact that Northern Ireland is quite different from rUK in its economic situation and the importance of different taxes, might in itself be a strong argument for allowing taxes to vary to take account of these differences. Similarly, having additional fiscal tools available to help in managing an economy which has been historically lagging behind rUK, could be useful.

2.13.2 What might give us pause, though, is the divergent *trends* between Northern Ireland and rUK. If Northern Ireland is becoming gradually poorer relative to rUK, or if relative tax revenues are falling, then devolution in and of itself could make Northern Ireland worse off over time *unless* the block grant is adjusted to account for that. Block grant adjustments are both technical and highly contentious issues which will need to be explored in much greater detail in our final report.

2.13.3 It is important to note the existing powers that the NI Executive currently has and how it makes use of them. There are a number of specific examples of policy divergence where the NI Executive has existing powers that would allow it to raise additional revenue or reduce expenditure, if it made the choice to follow policies that matched other parts of the UK. It is also the case that Northern Ireland, in terms of 'base borrowing' (i.e. borrowing powers, broadly capital, and separate to those for tax devolution purposes), has the ability to borrow more per capita than the Scottish or Welsh Governments. Furthermore, there is significant remaining headroom left for further borrowing, circa £1.5 billion, which has the potential to be a significant economic lever if used effectively. Although, such borrowing will have future revenue implications, as interest and capital repayments must be found from within the NI Executive's budget. These are policy choices for local politicians.

2.13.4 The NI Executive has also benefitted from additional funding from a number of bespoke financial packages that have been agreed as part of various political agreements. The nature of this funding means it is unreliable and that the amount of funding available to the NI Executive can fluctuate significantly over a number of years. Substantive devolution of fiscal powers might well change the context of this additional funding. The NI Executive needs to be cognisant of the fact that a Westminster government might be less inclined to provide support in this way going forward following the devolution of additional powers.

Chapter 3

Wider devolution considerations: UK and Republic of Ireland

3.0 Overview

3.0.1 This chapter provides context on fiscal devolution across the UK, describing the tax devolution settlements of Scotland and Wales, and provides insights into key aspects of the RoI economy and its tax structure relative to the UK and Northern Ireland.

3.1 Key points

3.1.1 **Fiscal devolution in the UK.** Fiscal powers in the UK are more centralised than most other comparable countries globally, in part due to a longstanding emphasis on meeting needs equitably across the UK but also given the lack of devolution in England. With regard to the devolved nations specifically, there is a high degree of spending autonomy but a much more limited degree of tax autonomy. Devolution within the UK is also asymmetric with the three devolved nations having different levels of legislative, administrative and budgetary autonomy, and England having none. The fiscal journeys of Scotland and Wales, with regards to tax powers, have gone further than Northern Ireland, while Northern Ireland has (legislatively) more control over spending than Scotland and Wales, in practice, this is less the case given the broad adherence to the wider UK welfare system.

3.1.2 **The Republic of Ireland** (**RoI) economy** is wealthier and faster growing than the Northern Ireland economy and has benefitted from significant investment in education, market access to the EU, and successful FDI policies over the longer-term, becoming one of the most globalised economies in Europe. Increases in productivity, population growth and labour market participation over time have all helped secure this.

3.1.3 **The RoI tax base.** The level and composition of RoI tax revenues differs significantly from those in NI, with the amount of revenue collected on a per head basis much higher in RoI. The total amount of revenue raised in 2020 in RoI was €16,799 per head (approx. £14,933), compared to £12,400 per head in the UK and £10,465 per head in Northern Ireland. This should be understood within the context of the higher price levels and higher incomes in RoI relative to Northern Ireland and the UK. Proportionally RoI generates much more in tax revenues than the UK or Northern Ireland from taxes such as income tax, social contributions and corporation tax. RoI also has significant differences in its tax structure than the UK and Northern Ireland, including a more progressive income tax structure; a (current) 12.5% corporation tax rate; a lower hospitality VAT rate; differing excise rates; and no air travel tax equivalent.

3.1.4 **The RoI and UK labour markets** are highly integrated. Changes in the UK labour market impact RoI. The RoI and Northern Ireland labour markets appear less integrated. Levels of cross-border commuters in either direction between RoI and Northern Ireland are lower than might be expected with evidence of a greater tendency for RoI residents to commute to Northern Ireland than *vice versa*.

3.1.5 **The RoI economy is significantly influenced by the existence of a number of large multi-national enterprises** to the extent that it has been argued there is a 'dual economy'. One with a large foreign controlled multinational enterprise (MNEs) element, which is mainly export-orientated, operating alongside a more domestic focused element, which is more labour intensive and dominated by small and medium sized enterprises.

3.1.6 **The differences between the RoI and Northern Ireland economies and their tax structures have implications for the devolution of fiscal powers to Northern Ireland**. The ability of RoI to take fiscal decisions appropriate for its own economy and social circumstances allows it to tailor policies to suit its needs. These decisions can lead to economic impacts and competitiveness issues between Northern Ireland and RoI.

3.2 Fiscal Devolution in the UK

3.2.1 The OECD document: *2019 Report World Observatory on Subnational Government Finance and Investment – Key Findings,* ("SNGWOFI Report")[83] draws attention to a trend for increasing decentralisation across the world over the past seventy years; one which has intensified over the last twenty years in particular.[xxi] The report also draws attention to some areas where *recentralisation* has occurred, partly attributable to political changes, but also to the fact that decentralisation, when not designed and implemented appropriately to take account of the local context, can result in unforeseen outcomes which work *against* the benefits sought.

3.2.2 Devolution within the UK is asymmetric with the three devolved nations having different levels of legislative, administrative and budgetary autonomy. When compared to other EU countries, the UK has had a lower than average degree of decentralisation of its spending functions, because there is no devolution within England, which contains 85% of the UK population. However, the Barnett Formula, as described in Chapter 2 of this report, gives the three devolved administrations remarkable freedom to spend their block grants. There is no ring-fencing, nor even an obligation to allocate spending to the functions of government in the same proportions as in England. Compared to other OECD countries, while the UK is very centralised for tax revenue generation, Scotland, Wales, and Northern Ireland all have relatively high discretion on how to spend the block grants they receive from the centre.

[xxi] The World Observatory on Subnational Government Finance and Investment database covers indicators for 120+ countries (including 103 unitary countries and 19 federations and quasi-federations) accounting for 86% of the world population and 89% of world GDP.

Overview of devolved spending across UK

3.2.3 Public expenditure in the devolved regions of the UK is carried out by the UK Government, the devolved governments and local government in addition to all their affiliated agencies and public bodies. Chart 3.1 below, derived from analysis performed by the Institute for Government, highlights the differences in devolved spending across Northern Ireland, Scotland and Wales.

3.2.4 A significant difference for Northern Ireland when compared to Scotland and Wales is that almost all of the Department for Work and Pensions (DWP)'s spending responsibility is devolved, however, as referenced earlier in our report, parity in terms of payment rates and the wider welfare system is broadly maintained and so in practice control is less than might otherwise be considered to be the case[xxii]. Northern Ireland is also notably similar to Scotland in terms of Transport, Justice and Home Office spending that is devolved.

Chart 3.1 Percentage of UK government departments' spending responsibility that is devolved

Department	Scotland	Wales	Northern Ireland
Education	100%	100%	100%
Housing, Communities and Local Government	100%	100%	100%
Health and Social Care	100%	100%	100%
Environment, Food and Rural Affairs	97%	97%	97%
Transport	92%	37%	95%
Digital, Culture, Media, and Sport	68%	68%	70%
Justice	100%	1%	100%
Home Office	74%	2%	74%
Work and Pensions	20%	0%	98%
Business, Energy and Industrial Strategy	7%	7%	7%
HM Revenue and Customs	4%	4%	3%
HM Treasury	0%	0%	0%
Cabinet Office	0%	0%	0%
Defence	0%	0%	0%
Foreign, Commonwealth and Development Office	0%	0%	0%
International Trade	0%	0%	0%

Source: Derived from Institute for Government analysis of HM Treasury, Statement of Funding Policy, updated 26 November 2020

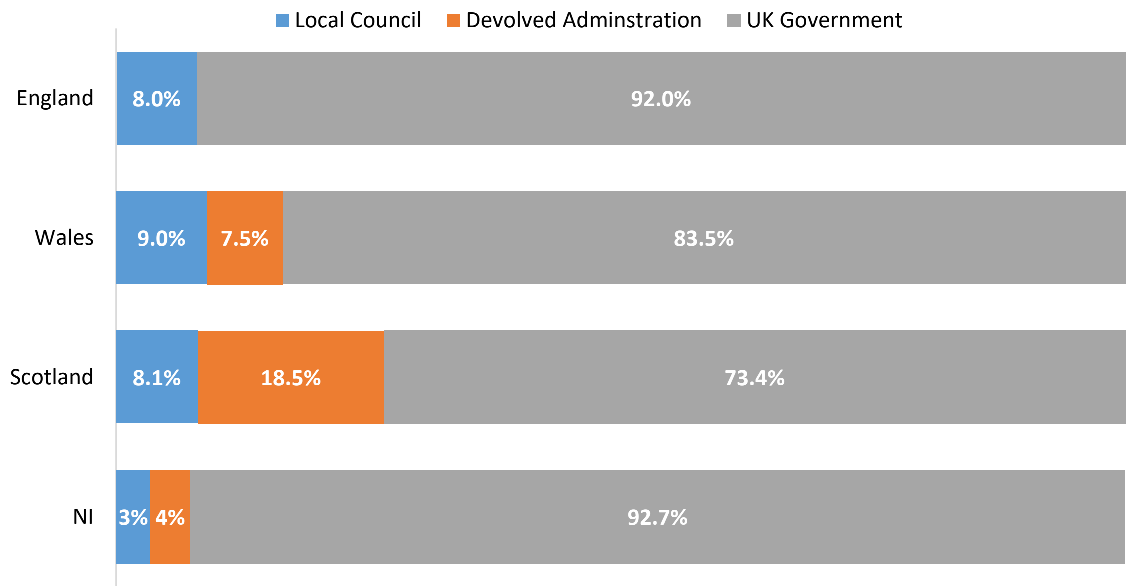
Proportion of tax revenue raised at subnational level across UK

3.2.5 In 2019/20, devolved tax revenue and local council taxes represented the following percentages of total revenue raised across the countries of the UK: 27% for Scotland (not including assigned VAT revenue); 17% for Wales; 8% for England[xxiii]; and 7% for Northern Ireland. The key difference between the proportion of revenue raised at devolved administration level in Scotland (19%) and Wales (8%) is mainly attributable to the differing degree of devolution of income tax in each case. This is described in more detail in the following sections.

[xxii] Social Security, in legislative terms, is a devolved competency within the control of the NI Assembly and while the Assembly can choose an alternative welfare provision path than the rest of the UK, in practice it broadly maintains parity with the rest of the UK (with the exception on some relatively minor welfare mitigations) and so the level of control is less than might otherwise be considered to be the case. This position was formalised via the Northern Ireland Act 1998, which requires the NI Executive and UK Government to consult to try to achieve "single systems of social security, child support and pensions for the United Kingdom."

[xxiii] Council tax and business rates, local government in England operate within a nationally-controlled system.

Chart 3.2 Identifiable revenue by layer of government in 2019-20



Source: Office for National Statistics / IFG

Note: UK regions have different fiscal arrangements relating to rates, in terms of: the bodies responsible for setting the tax rate (the UK Government in England, devolved governments in Scotland and Wales, and a mix of councils and NI Executive in Northern Ireland); the body responsible for collection (councils in England, Scotland and Wales, and the NI Executive in Northern Ireland); and the bodies formally receiving the revenues (councils in England, Scotland, and Wales and split between the NI Executive and councils in Northern Ireland). The chart above reflects this formal assignment of rates revenues.

Note: VAT revenue 'assigned' to the Scottish Government is attributed here to the UK Government. Air Passenger Duty and Aggregates levy also included in UK Government values for Scotland as these powers have not been implemented by the Scottish Government to date.

3.2.6 The devolution context of Northern Ireland is discussed in Chapter 1, and a brief description of the devolution of fiscal powers in Scotland and Wales is provided below.

Scotland

3.2.7 Scotland voted for the creation of a devolved parliament with tax-varying powers via referendum in September 1997, which led to the passing of the ***Scotland Act 1998*** and the establishment of the Scottish Parliament in 1999. Under the 1998 Act, the Scottish Government had the **power to vary the standard rate of income** tax up or down by up to 3 pence in the pound. This power was never used.

3.2.8 Subsequently, two further Scotland Acts, passed in 2012 and 2016, devolved additional fiscal powers to Scotland. The ***Scotland Act 2012*** enabled the Scottish Parliament to **set part of the rate of income tax** applicable to Scottish taxpayers from 6 April 2016 (except on interest and dividends, where income tax rates, bands, and collection all remain with the UK Government). The basic, higher and additional rates of income tax levied by the UK Government were reduced by 10 pence in the pound and the ability to set a new *Scottish Rate of Income Tax* was conferred. The tax was administered by HM Revenue & Customs, with the Scottish Government making a contribution to those costs.

3.2.9 The 2012 Act also provided for the devolution of **stamp duty land tax** and **landfill tax** from April 2015. These were subsequently replaced by *Land and Business Transactions Tax* and *Scottish Landfill Tax*. When designing the *Land and Business Transactions Tax*, the Scottish Government introduced a higher starting point for the tax, increased the level of tax on higher value transactions and abolished the 'slab structure' of assessing property tax, whereby a higher rate was payable on the entire purchase price when a threshold was reached, opting instead to assess tax liability on the portion of the total value falling within each band.[xxiv] The 2012 Act also conferred the power to the Scottish Parliament to create new taxes, and for additional taxes to be devolved.

3.2.10 The new power in relation to income tax gave the Scottish Parliament control over 10 points of the income tax revenue raised in Scotland, but the level at which income tax became payable (the personal allowance) and the structure of income tax (including reliefs) remained under the control of the UK Government. Further, the Scottish Parliament could only increase or reduce all the rates of income tax simultaneously.

3.2.11 The ***Scotland Act 2016*** went further. It gave the Scottish Parliament the power to set the rates and thresholds of income tax on non-saving, non-dividend income, and power to introduce new rates and bands of income tax above the UK-wide personal allowance. The 2016 Act also included the **assignment of the first 10 percentage points of the standard rate of VAT** and the first 2.5 percentage points of the reduced rate of VAT applicable to Scotland, to the Scottish Government's budget (currently on hold), and provided for the devolution of the **aggregates levy**, which is due to be devolved in future, and devolved powers over setting **air passenger duty** (due to be replaced by air departure tax, but currently on hold).[84]

3.2.12 A Fiscal Framework Agreement between the Scottish and UK Governments, setting out the arrangements required to operationalise the devolution of the tax and welfare powers, was published in February 2016. The fiscal framework sets out arrangements for adjusting the Scottish block grant, the scope of new budget management tools to manage forecast error and volatility associated with the taxes and social security payments being devolved, and rules around the treatment of spillover effects (where the policy choices of one government affect the revenues or spending of the other).

3.2.13 The fiscal framework commits to the use of the 'Indexed Per Capita' (IPC) method for adjusting Scotland's block grant following tax and social security devolution. Under this arrangement, if devolved tax revenues in Scotland grow at the same per capita rate as the equivalent revenues in rUK, the Scottish budget is no better or worse off than it would be without tax devolution. If devolved Scottish revenues grow relatively faster per capita than the equivalent rUK revenues – either because of tax policy changes or faster growth in the tax base in Scotland – then the Scottish budget will be better off. We will discuss block grant adjustments in more detail in our final report. [85]

3.2.14 Scottish income tax policy has diverged from rUK since it was first implemented in April 2017. Scotland now has a five-band structure of income tax (as opposed to the three band UK structure). The basic rate band is split in three, to include a 19p starter rate and a 21p intermediate rate. The higher and additional rates are each one percentage point higher in Scotland than rUK. Perhaps most significantly, the higher rate threshold is set significantly lower in Scotland (£43,662 in 2021/22) compared to rUK (£50,270). The

[xxiv] Subsequently, in December 2014 *(and before LBTT was introduced in April 2015)*, the UK Government made changes to UK residential Stamp Duty Land Tax, also moving away from the 'slab structure' to one applying different rates to different bands within the total price.

implication is that Scottish taxpayers with incomes below the Scottish median income (£27,000) pay marginally less income tax in Scotland than they would in the rest of the UK, while those with above median incomes pay more tax than they would in the rest of the UK. The additional tax liability for a Scottish taxpayer with income of £50,000 is around £1,500 annually – equivalent to 3% of gross income.

3.2.15 As a result of these policy changes, Scottish income tax revenues are estimated in 2019/20 to be around £500m (4%) higher than they would be if the rUK policy prevailed. However, the Scottish budget is only around £150m better-off than it would be without tax devolution. This is because the income tax base has grown more quickly in rUK than in Scotland. Without income tax devolution, Scotland would have received a share of this faster growth in rUK tax revenues via the Barnett Formula. But after tax devolution, growth in rUK income tax revenues are no longer pooled and shared across the UK. Thus the Scottish budget has benefited from the policy decision to vary income tax policy, but some of this revenue benefit has been offset by the fact that the Scottish budget no longer receives a share of the (relatively faster) growth in rUK revenues.

3.2.16 One implication of the Scottish Government's decision to set the higher rate threshold of income tax below the equivalent rUK threshold is that some individuals in Scotland face high marginal tax rates on earnings when income tax and National Insurance contributions are considered in combination. The Upper Earnings Limit in National Insurance (which applies across the UK, and where the marginal rate falls from 12% to 2%) is tied to the prevailing rUK income tax higher rate threshold. Individuals in Scotland whose earned income falls between the Scottish higher rate threshold and the UK's higher rate threshold thus pay a 12% NICs rate on that band of income on top of the 41% income tax rate that they are liable for, a combined marginal rate of 53%. This illustrates the challenges that arise when elements of different taxes are linked, but only certain parts are devolved.

3.2.17 In terms of social security payments in Scotland, most benefits remain the responsibility of the UK Government, however, some powers are in the process of being devolved to the Scottish Government including: Disability benefits, Carer's allowance and various occasional benefits e.g. winter fuel payments and maternity grants. In addition, the Scottish Government has some limited powers to vary elements of universal credit (such as the payment frequency), can fund top-ups to UK benefits (it has funded a top-up to Carer's Allowance, in advance of that benefit being formally devolved), and can introduce new benefits (such as the Scottish Child Payment, introduced in February 2021).

3.2.18 While the main disability and carer benefits are currently being operated in line with UK government rules, the Scottish Government is in the process of designing its own schemes to replace these, and indeed, some of the smaller UK benefits have already been replaced by new Scottish schemes e.g. *Best Start* grants replacing the UK *Sure Start* maternity grants.[86]

3.2.19 In relative terms, Scottish tax policies tend to show more generosity to taxpayers in the lower part of the distribution of the relevant tax base, and levy relatively higher tax rates on taxpayers in the upper part of the distribution of the tax base. For example, *Land and Business Transactions Tax* levies a slightly lower tax rate on most properties in Scotland than the equivalent Stamp Duty would imply, but a higher rate on transactions of the most expensive homes. Council tax rates are lower in Scotland than England, but Scottish homes in bands E-H pay more tax relative to those in bands A-D than is the case in England (i.e. the tax is more progressive with respect to band than in England). Business rates reliefs for low-valued properties are slightly more generous in Scotland than England (and Scotland has levied a further supplement on the highest value properties). Further, income tax, as described above, is more progressive in Scotland than in England. That said, most changes introduced by the Scottish Government do not represent a major departure from policies in place elsewhere in the UK.[87]

3.2.20 Looking forward, the issue of enhancing fiscal devolution remains live in Scotland, with the current Scottish Government having called for the devolution of National Insurance, capital gains tax and control over the savings and dividends element of income tax.[88] The current Scottish Government committed to pursuing the devolution of VAT in their 2021 manifesto,[89] following the UK's departure from the EU, and the removal of the requirement to comply with EU VAT rules.

Wales

3.2.21 In 1998, the UK Parliament passed the ***Government of Wales Act 1998***, which led to the establishment of the National Assembly of Wales in 1999. The Welsh Government was not initially granted any power to vary taxes, however, following the ***Wales Act 2014*** and the ***Wales Act 2017***, powers over stamp duty land tax and landfill tax were devolved to the Welsh Government and were subsequently replaced by *Land Transaction Tax* and *Welsh Landfill Disposals Tax*, respectively from April 2018. When designing *Land Transaction Tax,* the Welsh Government adopted the same approach to assessing property tax as Scotland (and subsequently the UK Government) had done, applying different rates to different bands within the total price, and made the tax more progressive, increasing effective tax rates on higher value transactions. The Welsh Assembly already has powers to legislate in respect of non-domestic rates and council tax.

3.2.22 Under the 2017 Act, income tax was partially devolved to Wales and replaced by the *Welsh Rates of Income Tax* which apply to the non-savings and non-dividend income of Welsh taxpayers, from April 2019. The associated block grant adjustment, which accompanied devolution, is described in Section 3.2.25. In practice, the basic, higher and additional rates of income tax levied by the UK Government were reduced by 10 pence, with the Welsh rate then being added to this. In relative terms, there are fewer high-earning individuals residing in Wales, less income tax is raised per person on average, and a much smaller share of income tax is raised at the higher and additional rates. Based on the Welsh Budget as of May 2021, devolved Welsh tax revenues represented 17% of the Welsh Government's budget for 2021-22 (some £20.5bn), of which 10.2% (some £2.1bn) was attributable to Welsh income tax.[xxv] [90] To date, the Welsh Government has not used its tax-varying powers over income tax. It has always replaced the UK tax poundage vacated by the same amount, with the effect that income tax levels are the same in Wales as in England.

3.2.23 Recently, however, research published by the Welsh Parliament has acknowledged that, given the economic challenges faced by Wales as a result of the COVID-19 pandemic,

[xxv] Devolved tax revenues include: £2.1bn from Welsh Rates of Income Tax (10.2% of Welsh budget); £1.1bn from non-domestic rates (5.4% of Welsh budget); and £0.3bn from Land Transaction Tax and Landfill Disposals Tax (1.5% of Welsh budget)

pressure is likely to increase on the Welsh Government in future to use the tax-varying powers over income tax paid in Wales. [91] It is also acknowledged that the porosity of the Wales-England border may act as a constraint on the level of divergence that is possible between UK and Welsh income tax rates, as taxpayers could simply migrate across the border, with a corresponding impact on Welsh income tax revenues. Nearly 48% of the Welsh population live within 25 miles of the border.[92]

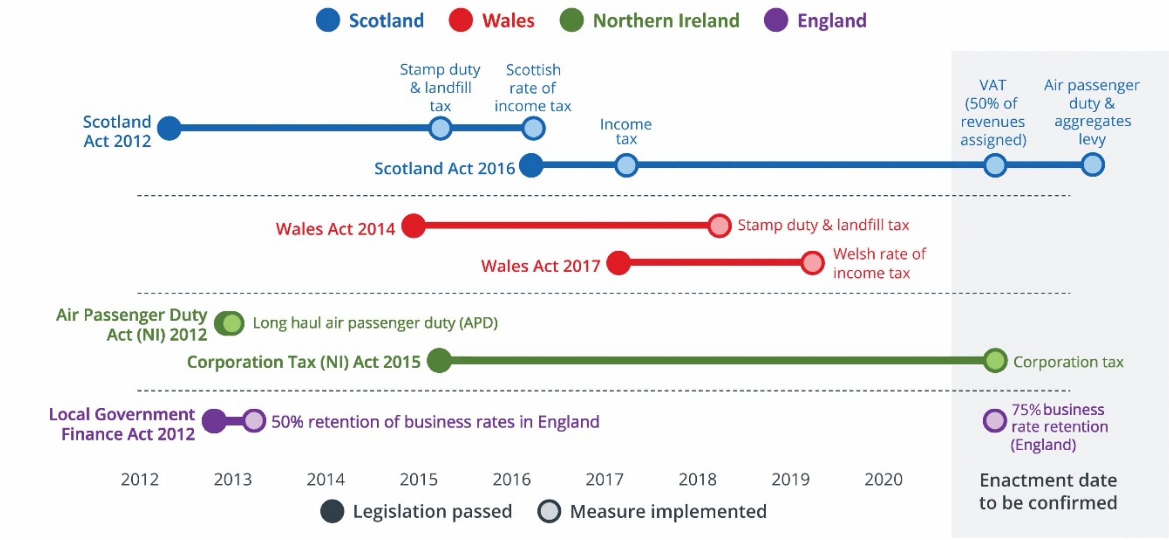
3.2.24 Under the ***Wales Act 2014***, the Welsh Government was given the power to seek competence from both Houses of the UK Parliament and the National Assembly of Wales to introduce *new taxes* in Wales. In March 2020, the Welsh Government formally requested devolution of further tax competence relating to a 'vacant land' tax and is carrying out investigations into other potential new taxes, including a disposable plastic tax and a tourism tax.[93] The formal request in March 2020 was the first time that the mechanism in the 2014 Act had been used and we understand the process has proved challenging to date, attracting criticism from the Welsh Finance Minister, and with Senedd Research, the research body of the Welsh Parliament, reporting in October 2021 that discussions with the UK Government had reached "an impasse".[94]

3.2.25 Following the fiscal framework agreed in 2016, devolved revenues from income tax became the largest source of tax revenue for the Welsh Government, followed by council tax and non-domestic rates (both local government taxes).[95] As with the position in Scotland, under the fiscal framework, the Welsh block grant is adjusted downward in line with the assessment of the revenue forgone by HM Treasury after tax devolution, meaning that differential growth in the Welsh tax base will have a significant and direct impact on the size of the Welsh budget.[96] The nature of block grant adjustment is somewhat different than in Scotland and we will discuss this in more detail in our final report (also see Annex B). Recent projections by Cardiff University's Wales Governance Centre of the net effect of tax devolution from 2018-19 to 2024-25 have estimated a positive net effect on the Welsh budget, as a result of faster growth in revenues in Wales. They predict that, inclusive of projected positive reconciliations with respect to Welsh Rates of Income Tax, the net effect of tax devolution could amount to more than £200 million by 2024-25;[97] projected gains being largely attributable to growth in the Welsh tax base.[xxvi]

3.2.26 An overview of the progression of tax devolution across Scotland, Wales and Northern Ireland in the last decade is outlined in Chart 3.3 by way of illustration.

[xxvi] Note that the £200m figure in 2024-25 includes positive reconciliations, as authors of the report consider that gains from tax devolution in 2021-22 will have been under-estimated, and under forecasts are reconciled 3 years later. The projected underlying gain (stripping out reconciliations) is somewhat lower.

Chart 3.3 Tax devolution across Scotland, Wales and Northern Ireland in the last decade



Source: Derived from Institute for Government analysis of legislation.gov.uk, the fiscal frameworks for Scotland and Wales, and the House of Commons Library briefings.
Note: Recent statements from the UK Government Communities Secretary suggest that plans for 75% business rate retention have since been shelved.[98]

3.3 Budgetary Management Tools for fiscal powers – Scotland and Wales

3.3.1 In Chapter 2 we outlined the 'base' borrowing powers of the three devolved administrations. In this section we highlight the additional budgetary tools which Scottish and Welsh Governments obtained alongside their recent additional fiscal powers.[99] If the NI Executive is to get additional fiscal powers, it will also likely need additional budget management tools. What these should be exactly will depend on what fiscal powers are devolved (and the outcome of any negotiations with the UK Government).

Scotland

3.3.2 Under the Scottish Government's Fiscal Framework, agreed by the UK and Scottish Governments in February 2016, the Scottish Government can borrow up to **£300m each year to address forecast errors**, and up to **£500m each year for in-year cash management**. However the total annual limit, across these two purposes, is limited to £600m (i.e. if £300m is borrowed to address forecast error, only £300m could be borrowed for in-year cash management).

3.3.3 The borrowing limit for forecast error borrowing increases to £600m annually when there is, or is forecast to be, a Scotland-specific economic shock.[xxvii] However, this does not alter the total annual borrowing limit, which remains £600m in such circumstances (i.e. if there is a Scotland-specific economic shock, the Scottish Government could borrow £600m for forecast error; but that would leave it no capacity to borrow for cash management).

[xxvii] A Scotland specific economic shock is defined as a period when (on a rolling 4-quarter basis), Scotland's GDP grows (or is forecast to grow) by less than 1% and is also more than 1 percentage point less than growth in UK GDP growth.

3.3.4 In addition to these annual limits, the Scottish Government faces a statutory overall cap on resource borrowing of £1.75 billion.

3.3.5 The Scottish Government's Fiscal Framework also makes provisions for **a cash reserve** – *the Scotland Reserve* – which can be used to smooth spending and manage tax revenue volatility. The Scottish Government will be able to pay into reserves up to a total of £700 million and draw these down at a rate of up to £250 million a year for resource spending, and £100 million a year for capital spending. These draw down limits are removed where there is a Scotland specific economic shock.

Wales

3.3.6 In Wales, the scale of revenues being transferred to the Welsh Government is somewhat lower, both in terms of the absolute size of the revenues, and the revenues as a proportion of total Welsh government spending. As a result, the budget management tools are somewhat more constrained.

3.3.7 For resource borrowing, the Welsh Government **can borrow up to £200m each year for forecast errors (within an overall £500m cap)**. Furthermore the Welsh Government Fiscal Framework allows for the creation of a **Wales Reserve**. The Wales Reserve, like the Scotland Reserve, can be 'built-up' as a result of underspends, or when tax revenues are higher than forecast. The Wales Reserve will be capped in aggregate at £350m, with annual drawdowns limited to £125m for resource and £50m for capital. The annual withdrawal limit from the Wales Reserve, at £125m, is proportionately higher (in the context of the scale of revenues being transferred) than it is for Scotland. In part this compensates for the fact that the Welsh Government has no facility to borrow to address revenue shortfall when there is a Welsh specific shock.

3.3.8 The budget management tools available to the Scottish and Welsh Governments, as distinct from the capital borrowing powers already outlined in Chapter 2, are shown in Table 3.1 below.

Table 3.1: Budget Management Tools in Scotland and Wales

	Scotland	Wales
Reserve:		
annual payments in	Unlimited	Unlimited
aggregate limit	£700 million	£350 million
annual drawdown limit	£250 million (resource) £100 million (capital)	£125 million (resource) £50 million (capital)
Resource borrowing		
Aggregate cap:	£1.75 billion	£500 million
Resource borrowing for forecast error: annual limit	£300 million	£200 million
Resource borrowing for cash management: annual	£500 million	£500 million
Resource borrowing for economic shocks: annual	£600 million	n/a
Resource borrowing: total annual limit	£600 million	£500 million
Context		
Resource DEL budget 2021/22*	£36.2bn	£16.2bn
Full value of devolved and assigned revenues 2019	£18.8bn	£2.3bn

Source: Fiscal Commission analysis using Scottish[100] and Welsh[101] Fiscal Frameworks; ONS Country and regional public sector finances; HM Treasury Block Grant Transparency: June 2021
**Resource DEL budget for Wales is after block grant adjustments. DEL budget for Scotland is before block grant adjustments*

3.3.9 Note also that neither the Scottish nor Welsh Governments can borrow to offset the effects of forecast revenue volatility. For example, if forecasts suggests that revenues may be subdued relative to the rest of the UK this year and next but more robust in subsequent years, neither government can borrow to achieve a smoother budget profile. Borrowing is only in respect of forecast errors.

3.3.10 In our final report we will consider in more detail the likely requirements for budget management tools for the NI Executive in relation to the taxes that we propose as being suitable for devolution.

3.4 Republic of Ireland: economy and taxation

Introduction

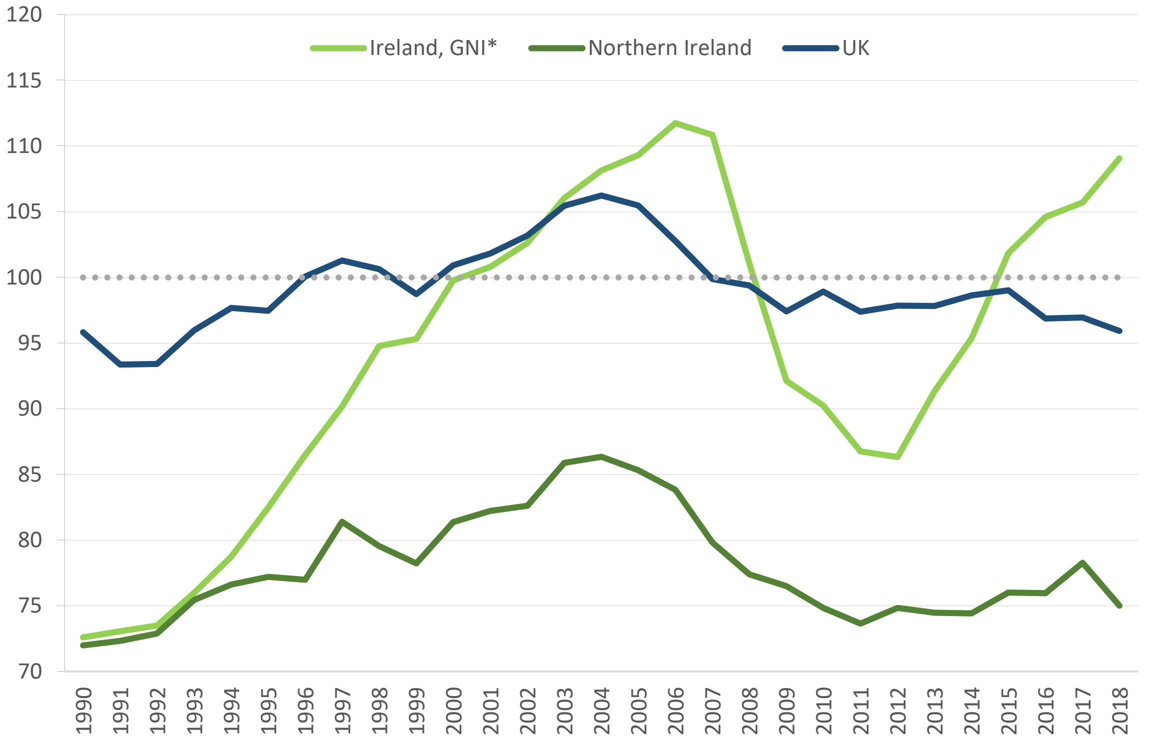
3.4.1 In the context of fiscal devolution within the UK, Northern Ireland is in a unique position. Northern Ireland shares a land border with another country and therefore tax jurisdiction, the Republic of Ireland (RoI). This sets the context for fiscal devolution in a differing light from that of Scotland and Wales and it is important to have an understanding of the economic and fiscal environment of RoI when considering fiscal devolution in Northern Ireland. This section provides some insight; added detail can be found on the Commission website.[102]

Key drivers of economic growth in RoI

3.4.2 Chapter 2 showed the recent economic growth trajectory of RoI compared to the UK and Northern Ireland economies (from 2006 onwards). Looking at a longer time horizon, and considering the growth trajectory of RoI, UK and NI relative to the average growth levels of the EU from 1990, as in Chart 3.4 below, it is clear to see the success of the RoI economy over the last 30 years, with the notable exception of the significant impact of the financial crisis from 2007/08. The RoI economy has progressed from some 30% below the EU15 in terms of GDP/GNI*[xxviii] per head and at similar levels to Northern Ireland to an economy significantly exceeding the EU15, including the UK.

[xxviii] While Gross Domestic Product (GDP) measures output in RoI, over time, a growing proportion of that output has been the profits of non-resident multinationals, which flows out of RoI, and leads to GDP estimates which do not give an appropriate indication of genuine RoI output which would be comparable to other nations. To deal with this problem, and the impact of depreciation, on national accounts, the Central Statistics Office (CSO) have developed an indicator referred to as Modified Gross National Income or GNI*. The RoI Department of Finance notes that as GNI* is a better approximation of the size of the Irish economy, it is an important indicator for fiscal purposes. Further information as to how the CSO calculates GNI* can be found on the CSO website – https://www.cso.ie/en/releasesandpublications/in/nie/in-mgnicp/ or at: https://assets.gov.ie/4910/181218123252-71a2c297f26b419fa3696d7349e3e788.pdf

Chart 3.4 GNI/GNI* per head, adjusted for PPS, (100= EU15 average) 1990-2018



Source: EU commission AMECO database; GNI from CSO; Northern Ireland GNI based upon UK GNI which is then adjusted for Northern Ireland based on ratio Northern Ireland to UK GDP per head relative ratio.*

3.4.3 The full range of factors underlying RoI's economic success have been well rehearsed[103] [104] and include access to the EU Single Market; significant investment in education; and successful FDI attraction policies over the long-term. These successes have helped the RoI economy become one of the most globalised and successful in Europe. To better understand the drivers of growth of the RoI economy over the last 30 years Table 3.2 shows growth in GDP/GNI* and a decomposition of the growth in GDP/GNI* per capita into a series of components - productivity; employment rate, labour market participation rate and the working age population rate (or inverse dependency rate) across two periods, from 1990-2005 and 2005-2019.

Table 3.2: Contribution to growth in UK/NI GDP or RoI GNI* per capita, percentage points

	1990 2005 Average annual rate			2005 2019 Average annual rate		
	ROI	UK	NI	ROI	UK	NI
UK/NI GDP / ROI GNI*	5.7	2.6	3.3	1.6	1.3	0.8
Population	1.1	0.4	0.5	1.3	0.7	0.7
UK/NI GDP/ROI GNI* per capita	4.5	2.3	2.8	0.3	0.6	0.1
Components of Growth in GNI* per capita:						
Productivity (GNI*/Emp)	2.2	2.1	1.8	0.7	0.4	0.1
Employment rate (Emp/pop15-64)	0.5	0.2	0.6	0.0	0.1	0.0
Participation rate (Labour Force/ pop 15-64)	1.0	-0.1	0.0	0.0	0.4	0.3
Inverse of Dependency rate (Pop15-64/total pop)	0.7	0.1	0.3	-0.3	-0.3	-0.2

Note: Some values in columns may not sum due to rounding

Source: Constructed from CSO National Income and Expenditure 2020 and Historical National Accounts 1990-1995; NISRA, ONS Regional GDP, Eurostat GDP data; and EU Commission AMECO database[xxix]

3.4.4 A significant factor in RoI's higher growth rate than the UK or Northern Ireland over the last 30 years has been its more rapid growth in **population**. This growth in population between 1990 and 2005 owed much to a large influx of people, mainly from the Eastern European EU accession states. There was also a reversal in migration from RoI compared to previous generations, where significant numbers had previously emigrated from RoI for economic reasons.[105] The rapid growth in population has been maintained in RoI since 2005, with the population growing by 1.3% a year on average compared to 0.7% a year in Northern Ireland and the UK with this higher growth being driven by substantial immigration.

3.4.5 The rate of growth in **productivity** (output per person employed) in RoI in the 20 years leading up to 1990 had been higher than the UK and much stronger than Northern Ireland. From 1990 to 2005 performance was similar to the UK and remained significantly higher than in Northern Ireland. In the 2005-2019 period, the effects of the financial crisis significantly dented the rise in productivity, but growth in RoI remained higher than in the UK or NI on average throughout this period with strong growth in productivity in the years post the financial crisis.[106] RoI has seen productivity growth in both absolute and relative terms, across both foreign and domestically controlled sectors and has seen its productivity gradually pull ahead of the EU15 since 2000. Even when the effect of non-resident owned firms are removed from RoI's productivity figures, the remaining domestic sector still outperforms Northern Ireland.[107]

3.4.6 The RoI **labour market** performed strongly between 1990 and 2005. In 1990 the **unemployment rate** in RoI was 13% and it fell rapidly in the late 1990s. By 2005 it was 4.6%. This reduction in the unemployment rate (and increase in the employment rate) was in significant part driven by individuals who were previously inactive finding work and contributing significantly to output growth in RoI - by around 0.5 percentage points a year.[108] A similar process in Northern Ireland also contributed significantly to NI growth to 2005. For the UK, with much lower unemployment in 1990, there was a more limited increase. In the latest period since 2005, the unemployment rate rose in all three economies to a peak during the financial crisis, but had, once again, returned to high levels of employment by 2019. This meant that changes in the employment rate made little contribution to growth in the three economies between 2005 and 2019.[109]

3.4.7 In RoI an increase in **the participation rate** between 1990 and 2005 contributed a very large 1.0 percentage point a year to growth. This exceptional contribution was largely driven by rising female labour force participation. In 1990 Irish female participation rates were very low by European standards, despite the fact that women were, on average,

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xxix $$\underbrace{\frac{GNI*}{Pop}}_{\text{GNI* per capita}} = \underbrace{\frac{GNI*}{Emp}}_{\text{Productivity}} \cdot \underbrace{\frac{Emp}{LForce}}_{\text{Employment Rate}} \cdot \underbrace{\frac{LForce}{Pop1564}}_{\text{Participation Rate}} \cdot \underbrace{\frac{Pop1564}{Pop}}_{\text{Dependency Ratio (inverse)}}$$

Pop1564 refers to population aged 15 to 64 years better educated than men. However, a combination of wider cultural changes and greatly increased labour market demand for skilled labour saw a dramatic increase in female employment as women remained in the labour market or re-entered it. For the UK, female participation rates were already high in 1990 so that there was much more limited scope for further increases in the participation rate. Therefore, for both the UK and Northern Ireland, between 1990 and 2005 the participation rate changed little and did not affect overall growth in the economy. From 2005 onwards however, there has been no growth in the RoI employment rate or labour market participation rate, in contrast to both Northern Ireland and UK experiencing small levels of growth.[110]

3.4.8 The period 1990-2005 also saw a major contribution to growth from a **falling dependency rate** in RoI resulting from a falling birth rate, growth in the population of working age, and low levels at older ages (as high numbers of those born in RoI, now in older age groups, had previously emigrated). However, more recently, since 2005, the rate of old age dependency has begun to rise. A very similar pattern is seen in the UK and Northern Ireland post-2005.[111]

3.4.9 While not referenced in Table 3.2 it is also notable that a major factor in the high rate of productivity growth, in the period from 1990-2005 was the rising **educational attainment** of the population. This played a major role in the rise in labour force participation, for example as women with tertiary level education were much more likely to be part of the labour force. The rising educational attainment also better matched the supply of labour, by level of education, to the demand for labour in the RoI economy.[112]

3.4.10 Looking beyond some of the hard economic data it is of note that, in present day terms, Northern Ireland does score more highly than RoI when it comes to many quality of life measures such as life satisfaction.[113] Additionally, in terms of household expenditure patterns, there are differences between Northern Ireland and RoI, with RoI households spending a higher share of their expenditure on healthcare, education and housing (32% versus 26% in NI) and Northern Ireland spending proportionally more on recreation and retail[114]. This suggests that the 'lived experience' for citizens in both jurisdictions may be more similar than the hard economic data sometimes suggests.

RoI - A tale of two economies?

3.4.11 Many commentators on RoI have referred to it as having two distinct economies or pointing towards evidence of a **'dual economy'**. First, the large foreign controlled multinational enterprises (MNEs) element which is mainly export-orientated; secondly, a more domestic focused element, which is more labour intensive and dominated by small and medium sized enterprises.

3.4.12 There is little doubt that the RoI economy has developed strongly in recent decades by attracting and retaining significant investment from MNEs.[115] A number of economic indicators highlight the differences between these two sectors of the economy, domestic and foreign owned. For example, looking at national income statistics, shows that RoI was the only EU economy to have positive GDP growth in 2020 despite the impact of COVID-19. When using GNI*, the economy decreased in size by 3.5% in 2020,[116] however this was still a much smaller decrease than experienced by many other countries (for example UK GDP fell by 9.8% in 2020). These figures were driven by strong export growth (from the large foreign controlled multinational enterprises sector) whilst domestic demand slumped much like in every other EU country and the UK.

3.4.13 The difference is also evident in productivity statistics such as gross value added, labour productivity, and company productivity where the foreign controlled sector outperformed domestic sectors of the economy. Key metrics also point to a very high degree of concentration with respect to large MNEs – a small number of companies are generating high productivity growth. This is not to discount the role of the domestic economy in RoI but helps demonstrate the significance of foreign owned MNEs.[117]

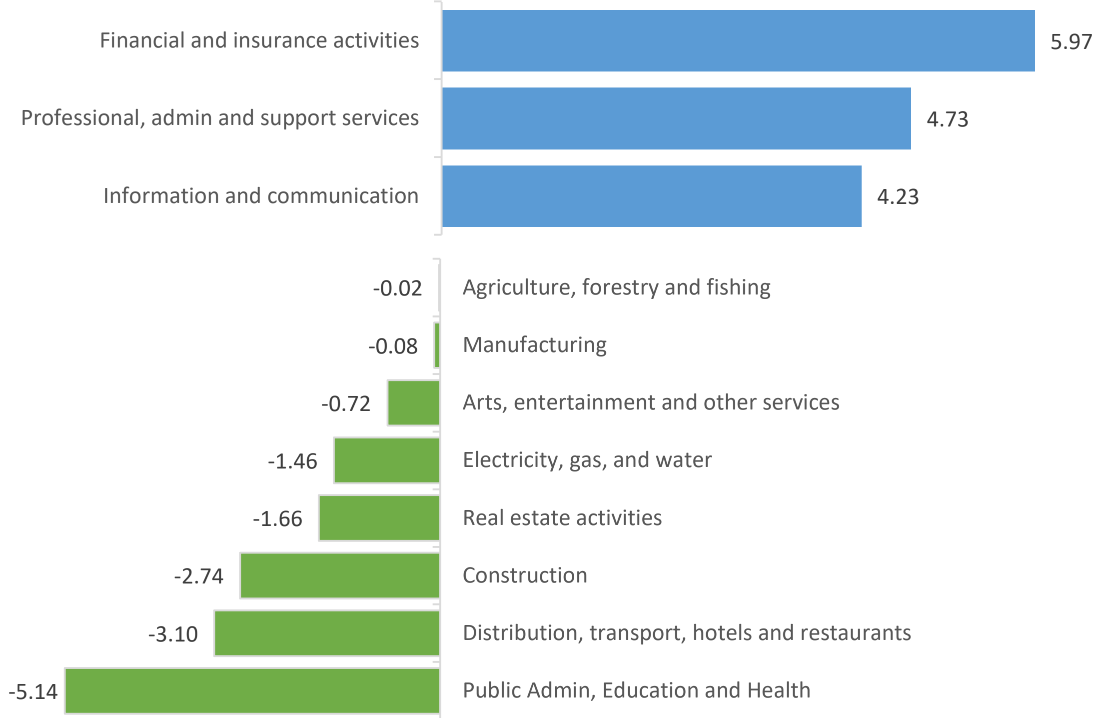
Structural differences between the RoI and Northern Ireland economies

3.4.14 We outlined in Chapter 2, the industrial structure of the Northern Ireland economy and how it compared to the UK economy. This section briefly highlights some of the differences in structure between the Northern Ireland economy and the RoI economy.

3.4.15 Chart 3.5 shows the difference in structural make-up of the RoI and Northern Ireland economies by looking at the contribution of different sectors to the total share of Net National Product (NNP)[xxx] for RoI and the total share of GVA for Northern Ireland. While Northern Ireland is more closely correlated to RoI than UK in terms of its structural make-up, it is also clear that a significantly larger proportion of the RoI economy, as measured by NNP, is derived from three broad sectors, namely 'Financial and insurance activities'; 'Professional, admin and support services'; and 'Information and Communication' These same sectors would also be typically seen as being higher value-added sectors, with high levels of wages and productivity relative to other sectors.

[xxx] As highlighted previously in this chapter, there a number of issues in measuring RoI economic output, which results in indicators such as GNI* being used. Another useful measure is Net National Product - which excludes all depreciation - and allows analysis by industrial sector, which GNI* does not.

Chart 3.5: RoI Economy sector share of total NNP, difference versus Northern Ireland share of total GVA, percentage points, 2019



Source: Analysis of CSO Institutional Sector Accounts Non-Financial and Financial 2019 and ONS Regional GVA 2019

3.4.16 There is also some difference in the public sector versus private sector make-up of the two economies, with the RoI economy less reliant on the public sector than Northern Ireland. RoI employment figures for Q1 2020 also show that 21.4% of employment came from the public sector[118], lower than Northern Ireland at 25.5% (but significantly higher than UK average of 16.7%[xxxi]).

Government Revenue raised in RoI

3.4.17 The total amount of government revenue raised in 2020 in RoI was €83,616 million or €16,799 (approx. £14,933) per head.[119] This compares to NI where in 2019/20, total revenue was estimated at £19,817m or £10,465 per head or in the UK where the total revenue per head was £12,400.

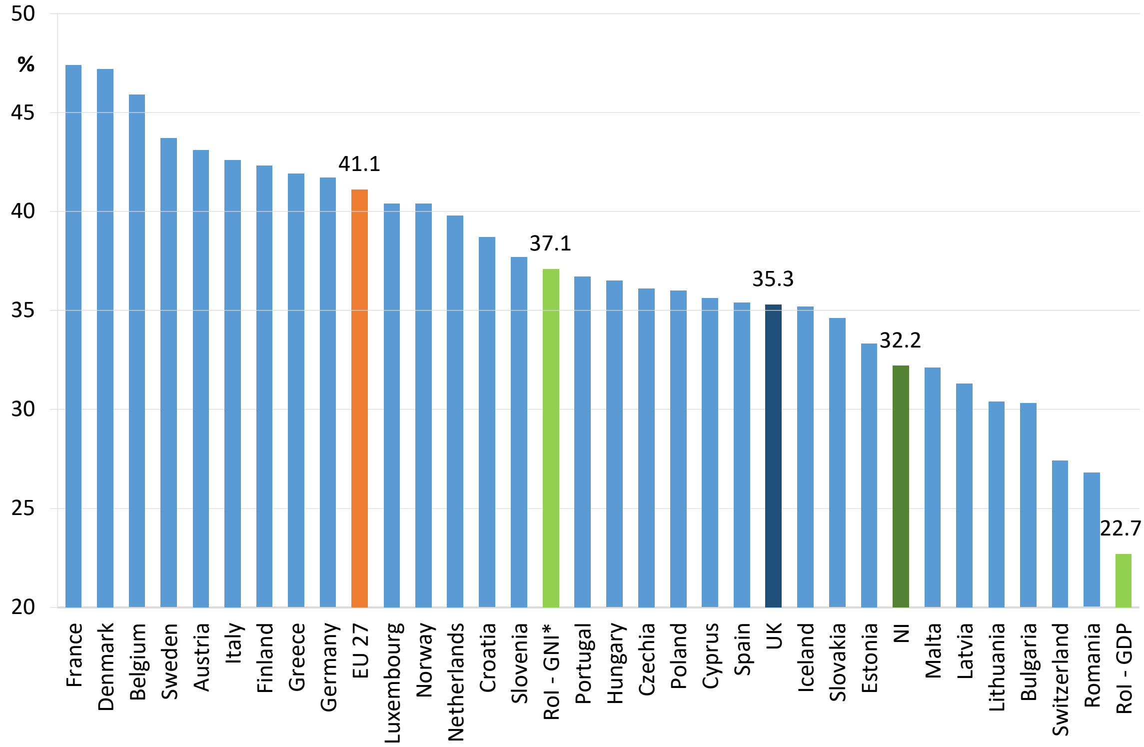
3.4.18 The amount of total revenue collected on a per head basis is therefore much higher in RoI than in the UK or Northern Ireland. However, this message should be caveated given that income and price levels are also higher in RoI and looking at tax revenues in isolation does not factor this in. For example amongst EU countries, RoI is second to only Denmark in terms of comparative price levels of consumer goods and services, 36% above the EU average price level (whereas the UK was 19% above the EU average).[120]

3.4.19 Looking more specifically at the total tax take element of government revenue, Chart 3.6 assesses the tax take relative to the size of the economy. For RoI we use GNI* to provide

[xxxi] Note that ROI public sector employment is based around Labour Force Survey data. Labour Force Survey data is also available for NI and UK for public sector employment, which for Q1 2020 suggests public sector employment of 32.6% and 21.8% for NI and the UK. ONS note that for NI and the UK, the public and private sector employment estimates from the 'Public sector employment' datasets provide more reliable estimates than the figures from the Labour Force Survey.

a more suitable picture for comparing to other countries. GDP is used as a measure for all other countries. Looking at the most recent year for when data is available for EU countries, we see that RoI ranks in the middle of EU nations with tax take 37.1% of GNI* and above both UK and Northern Ireland (note how this position would be reversed if RoI GDP were used).

Chart 3.6 International comparison of tax take as a percentage of GDP/GNI*, 2019



Source: Eurostat, ONS CRPSF Northern Ireland, CSO for RoI GNI value. Note: Data for Northern Ireland/UK is FYE 2020, other data is from 2019.*

Note: Chart 3.6 uses Eurostat figure for UK for comparative purposes. However elsewhere in the report, the UK figures for taxes as % of GDP are calculated using ONS CRSPF.

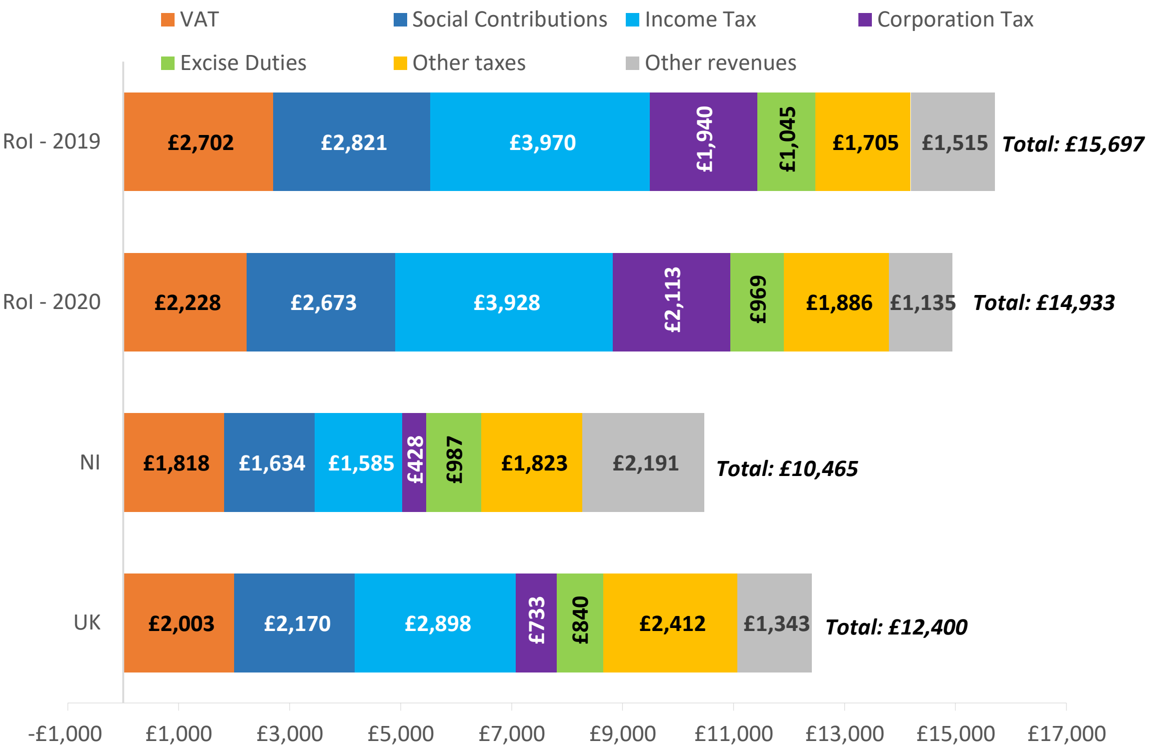
3.4.20 A further point of note, is that both the UK (as referenced previously) and RoI are heavily centralised in terms of tax revenue collection, with most other European countries being much more decentralised with significant local or regional government tax yields. However, RoI is even more centralised than the UK with only 2.2% of its taxes being collected at local level in 2019 compared to 5.4% being raised in the UK at the local level (or 11.1% when taxes collected by devolved administrations in the UK are also included, based on Commission calculations).[121] Of course, RoI has a much smaller population and economy than that of the UK and so it might be expected that the level of decentralisation may be less as a result, for administrative efficiency purposes for example.

Government Revenue raised per head in RoI, Northern Ireland and UK

3.4.21 Chart 3.7 shows the composition of government revenues across RoI, Northern Ireland and UK on a per head basis, split by the main forms of tax. To note, total revenue is a more expansive measure than tax revenue and includes 'other revenues' to give a complete picture of government revenues per head. This comparison illustrates both the extent of differences in total revenues per head between Northern Ireland, the UK, and RoI, and where differences arise. For RoI both 2019 and 2020 values are shown to highlight the latest figures pre-COVID-19 in 2019 and to highlight any impacts that COVID-19 may have had on revenues in 2020. For Northern Ireland and UK, we use 2019/20 financial year data (as we have done elsewhere in this report and which broadly excludes COVID-19 impacts).

3.4.22 In terms of income taxes Chart 3.7 shows that revenue from income taxes and social insurance contributions are far higher on a per head basis in RoI and that they held up remarkably well during the pandemic. Revenue from corporation tax even more so, with RoI having higher revenues in 2020 than in 2019 and some three times as high as the UK's per head value and almost five times higher than the per head value in Northern Ireland. VAT revenue saw a large decline in 2020 in RoI, largely due to consumption reductions and the VAT exemptions in response to COVID-19. However, across both years VAT yielded a higher amount of revenue per head than in the UK or Northern Ireland. In terms of a proportion of total revenues per head, VAT yields a significantly lower proportion in RoI than it does in either Northern Ireland or the UK. Interestingly excise duties are broadly comparable, in absolute terms, between Northern Ireland and RoI.

Chart 3.7 Government Revenue per head, 2019 / 2020, by tax / revenue composition



Source: UK and Northern Ireland - Country and Regional Public Sector Finances, FYE 2020; ROI – Irish Revenue 'Revenue net receipts by tax head' and CSO Government Finance Statistics April 2021[xxxii] *Exchange rate taken from ONS: Average Sterling exchange rate: Euro.*

[xxxii] Note that 'other taxes revenue' here includes other taxes and revenues listed in the respective ONS and CSO data that make up total revenue. For UK and Northern Ireland this includes taxes listed as part of the ONS Country and Regional Public Sector Finances Revenue Tables that are not explicitly included in the chart (e.g. business rates, council, stamp duty land taxes). It also includes values for other current receipts attributed to Northern Ireland such as: Taxes on capital; Gross operating surplus; Interest and dividends; and Rent and other current transfers. For RoI it includes other taxes such as stamp duty, local property tax, and other items of revenue attributed to general government as listed in CSO Government Finance Statistics April 2021 - Table 3.

A comparison of current taxes and their rates in the UK / Northern Ireland and RoI

3.4.23 A comparison of current taxes and their rates in the UK / Northern Ireland and RoI is provided in Table 3.3. A fuller version of this table across all taxes is presented at Annex E.

3.4.24 In terms of the consideration of fiscal devolution in Northern Ireland, and building on the evidence presented above, it is of note that RoI has significant differences in a number of its taxes. These differentials can have considerable impact on the relative share of the tax base which derive from the different tax components, which we explore in more detail in the rest of this chapter. These differences also have the potential to impact on the competitiveness position of the Northern Ireland economy on the island of Ireland and in a distinct way to elsewhere in the UK. For example, while there are similar rates of income tax, there is a tax-free allowance in UK/NI but not in RoI; married RoI citizens have the ability to aggregate their income for tax purposes; the difference in corporation tax rates where RoI has much more competitive rate that UK/NI; and the differing rates of excise duties which can encourage cross border shopping in either direction.

Table 3.3: Comparison of UK and RoI tax rates

Taxes	UK rates	RoI rates
Income tax	**20% basic rate** (£12,571 to £50,270) **40% higher rate** (£50,271 to £150,000) **45% additional rate** (£150,000+)[122] The standard Personal Allowance in the UK is £12,570, where tax is not paid on income below that amount.	**20% lower rate and 40% higher rate.**[123] Different bands apply for the higher tax rate dependent on marital status or number of children **RoI operates a system of tax credits** that means in effect anyone earning €16,500 or less does not pay any income tax.[124] There is an additional tax on income in ROI –the **Universal Social Charge (USC)** - From 2022 - First €12,012 - 0.5%; Next €9,283 - 2%; Next €48,749 - 4.5%; remainder - 8%; Self-employed income over €100,000 – 11% [125]
National insurance contributions	**Employers contribution – 13.8%** on earnings above £170.01 per week. **Employees contribution – 12%** rate on earnings between £184.01 and £967 per week and 2% on earnings above £967 per week[126]	Pay Related Social Insurance (PRSI) – typically **4% employee contribution.**[127] **Employers then pay 8.8%** Class A employer PRSI on weekly earnings up to €398.or pay 11.05% Class A employer PRSI on weekly earnings over €398. From 1 January 2022 higher rate of employer's PRSI will increase from €398 to €410 [128]
Value added tax	**Standard rate – 20%;** Reduced rate – 5%; Zero rate for certain goods, e.g. children's clothes/food[129] Temporary reduced rate of VAT of 5% for hospitality until 30 September 2021, then 12.5% until 31 March 2022.[130]	From 1 March 2021- **Standard rate -23%;** Reduced rate -13.5%; Second reduced rate – 9%[131] [132] The reduced rate for tourism and hospitality from 13.5% to 9% remains in place until the end of August 2022.[133]
Corporation tax	Currently **19% but will rise to 25%** by April 2023 (with an exception for	**12.5%** for trading income. 25% for non-trading or excepted trade[135]

	smaller businesses to stay at the 19% rate)[134]	From 2023 12.5% up to €750m turnover; 15% over €750m in line with OECD tax agreement.[136]
Fuel duty	**57.95 pence** per litre for petrol/diesel[137]	From 1 May 2021, **63.7c per litre** of petrol and **53.5c per litre** of diesel.[138]
Alcohol and tobacco excise duties	Cigarettes - 16.5% of the retail price plus £5.26 on a packet of 20 Beer duty- typically 19.08 pence per litre for each % of alcohol. Spirits - £28.74 of Spirit Duty per litre of pure alcohol. [139] An overhaul of UK alcohol taxes was announced in the October budget. Changes are proposed for 2023[140]	Cigarettes - €383.42 per thousand together with an amount equal to 8.83% of the price at which the cigarettes are sold (alternatively €434.19 per thousand) Typical €22.55 per hectolitre per cent of alcohol in the beer. €42.57 per litre of alcohol in the spirits[141]

Direct taxes and the labour market

3.4.25 Taxes on income and social insurance contributions[xxxiii] were estimated to have raised €36,965 million or 47.8% of total tax take and 17.8% of GNI* in RoI in 2020. This compares to similar taxes in Northern Ireland/UK (i.e. income tax and NICs), which account for 38.9% of total tax take and 12.5% of GDP in Northern Ireland and 45.8% of total tax take and 15.2% of GDP in the UK[xxxiv] in 2019/20. These taxes are therefore proportionally more valuable to RoI than the UK and Northern Ireland.

3.4.26 The RoI labour market has arguably been part of a wider British Isles labour market for an extended period. Evidence suggests that for most of the last 70 years migration between RoI and GB has been driven by differentials in the unemployment rate and differentials in the real after-tax wage rate. These studies indicate large changes in labour supply in RoI because of the potential for large labour movements to and from the GB labour market. They also suggest that there has generally been a close relationship between wage rates in RoI and the UK, albeit this relationship does not necessarily result in the same wages across the jurisdictions.[142] [143]

3.4.27 In 2019 employees' average (or mean) gross hourly earnings at £21.23 (€23.88)[144] were significantly higher in RoI than they were in Northern Ireland (£14.90) or the UK (£17.27). Median weekly earnings data for all employees in 2018 also shows that wages in RoI were significantly higher using this metric, with a value of £524 (€593), compared to £420 in Northern Ireland and £460 in the UK. Given the resultant gap with RoI earnings, it might be expected that there would also be significant flows of labour from Northern Ireland to RoI. However, there is evidence that the opposite is true, with the level of cross-border commuters in either direction lower than might be expected and a greater tendency for RoI residents to commute to Northern Ireland than vice versa.[145] [146]

[xxxiii] For the UK and NI this includes income tax and National Insurance contributions. For ROI this covers income tax, professional services withholding tax, universal social charges and PSRI.

[xxxiv] Taxation figures for UK and NI are from - Country and Regional Public Sector Finances, FYE 2020; for ROI – Irish Revenue 'Revenue net receipts by tax head' and CSO Government Finance Statistics April 2021. NI GDP values taken from ONS Regional GDP dataset – May 2021; UK figure from -Country and Regional Public Sector Finances, FYE 2020. GNI* figures taken from CSO National Income and Expenditure Annual Results

3.4.28 While the wages of those employees with secondary education across the UK and RoI have remained broadly stable and in line with each other over the last 20 years those with a third level education have reversed. RoI graduates earned 80% of their potential UK wage in 2002 but twenty years later there is a RoI premium over the UK wage of some 15%.[147] This reversal may, in part, be explained by an increase in the personal tax rate of RoI employees over UK employees after 2010, with higher wages compensating for a higher tax burden.

3.4.29 As detailed previously, it is also of note that the RoI income tax system allows couples to aggregate their income, as indicated in Table 3.3 above, allowing married couples to maximise household benefits (though there is evidence that 'non-individualisation' is a barrier to second earner employment in RoI).[148] In the UK/NI couples cannot aggregate their income in the same way (although there is a Marriage Allowance which allows for a transfer of £1,260 of Personal Allowance to a husband, wife or civil partner).

3.4.30 Table 3.4 below compares the values of income tax (and USC) and social contributions paid on a range of salaries in RoI against the UK. We can see that at the lower end of salaries, take-home pay as a percentage of overall pay is higher in RoI, but at higher salary levels, the gap closes and then falls below UK levels. This helps to demonstrate the more progressive nature of the income tax system in RoI.

Table 3.4 Comparison of RoI and UK income taxes across range of salary levels, 2021/22

£20,000/€20,000 salary	**UK**	**RoI**
Income tax paid	£1,486	€700
Universal social charge (in RoI only)		€220
Social contributions paid	£1,252	€459
Take home pay	£17,262	€18,622
Take home pay %	*86.3%*	*93.1%*

£40,000/€40,000 salary	**UK**	**RoI**
Income tax paid	£5,486	€5,640
Universal social charge (in RoI only)		€1,103
Social contributions paid	£3,652	€1,600
Take home pay	£30,862	€31,657
Take home pay %	*77.2%*	*79.1%*

£80,000/€80,000 salary	**UK**	**RoI**
Income tax paid	£19,432	€21,640
Universal social charge (in RoI only)		€3,251
Social contributions paid	£5,479	€3,200
Take home pay	£55,089	€51,909
Take home pay %	*68.9%*	*64.9%*

Source: Fiscal Commission analysis[149]

Indirect taxes

3.4.31 The two main indirect taxes in RoI are excise taxes and VAT. Together they accounted for €17,901m or 23.2% of the total tax take in 2020 and 8.6% of GNI*. In 2019, VAT and excise taxes yielded £21,033m or 26.1% of the total tax take.

3.4.32 These taxes make up proportionally less revenue in RoI than in Northern Ireland or the UK. In 2020 VAT and excise taxes accounted for 33.9% total tax take and 10.9% of GDP in Northern Ireland and 25.7% of total tax take and 8.5% of GDP in the UK.

3.4.33 With the exception of recent COVID-19 easements, the basic VAT rates and regime in ROI has changed little in recent decades (see Table 3.3 above for current tax rates), though there have been some alterations of the regime affecting the hospitality sector, where the sector enjoyed a temporary 9% rate between 2011 and 2018 before a return to the standard hospitality rate of 13.5%. This is significant in a Northern Ireland context given the potential for cross-border trade in this sector and where the VAT rate in Northern Ireland has remained at 20% since 2011 (again with the exception of recent COVID-19 easements at a UK level).

3.4.34 While evidence on the effects of differential tax rates on levels of cross border shopping is somewhat mixed, a useful example to highlight in the Northern Ireland context is evidence from the period 2013 to 2015 which examined the extent of 'fuel tourism' from Northern Ireland to RoI, driven by the higher rates of tax on motor fuels in Northern Ireland. The combined excise duty, carbon tax and VAT contribution to the RoI Exchequer associated with fuel tourism was estimated at €202 million for diesel and €28 million for petrol based on 2015 levels.[150] This also represents a loss to the UK Exchequer.

Corporation tax

3.4.35 Corporation tax was estimated to have raised €11,833m or 15.3% of total tax take and 5.7% of GNI* in RoI in 2020. This compares to 5.2% of total tax take and 1.7% of GDP in Northern Ireland and 6.6% of total tax take and 2.2% of GDP in the UK. Corporation tax is a really significant contributor to the total RoI tax take and proportionally far exceeds the total tax take from corporation tax receipts in both Northern Ireland and the UK (over 3 times more than in Northern Ireland and over twice as much in the UK as a percentage of GDP).

3.4.36 This revenue is heavily dependent on a small number of large companies. The top ten companies accounted for 40% of net corporation tax receipts in 2019.[151] And some 80% of revenues came from foreign MNEs compared to 20% from domestic companies, with around half of the foreign revenues coming from US companies.

3.4.37 Recent changes to the international tax regime have led the RoI Government to provide for a €2bn drop in corporation tax revenue by 2025 as a possible result of international reforms in the 'not-too-distant future'.[152] These reforms include the OECD (Base Erosion and Profit Shifting, 'BEPS') process; a global minimum corporate tax rate (15%); and changes to US corporate tax rates for US firm's overseas income. In October 2021, the RoI Government announced that it too will support a global deal to set a global minimum tax rate for large firms. From 2023, RoI will have a minimum rate of 15% for large companies (those over €750m).[153] The 12.5% rate is expected to continue for smaller companies. Despite the proposed changes in RoI there is still a considerable difference when compared to the UK rates (19% rising to 25% by April 2023) and by extension Northern Ireland, as detailed in Table 3.2.

3.4.38 There is strong evidence that the very low corporate tax rate in RoI has played an important part in attracting large amounts of FDI, has pushed up tax receipts and significantly contributed to the economic growth of RoI. [154] [155] [156] Research also suggests that RoI might not have experienced the same rate of growth during the 'Celtic Tiger' period (i.e. in the 1990s and early 2000s) if it had not adopted such a 'corporation-tax-driven industrialisation strategy'.[157] Research commissioned by the RoI Department of Finance suggests that the level of corporation tax rate has a significant influence on firms' FDI decisions. This research indicates that on average across the EU, corporation tax has the largest impact on the decision of where to locate FDI. It also suggests that higher RoI corporation tax rates would lead to a significant reduction in the number of new foreign firms entering RoI.[158]

3.4.39 However, it may be that the role of a low corporation tax rate has diminished more recently. While low corporate tax rates have attracted firms to set up some form of entity in RoI, over the last 20 years (and perhaps beyond) the low corporate tax rate may not have been as important as it once was in attracting firms or FDI to RoI with the resultant benefits of extensive employment. A wider range of factors may underlie RoI's recent economic success including more appropriate fiscal and monetary policies compared to pre-1990, external global factors, English speaking graduates, a suitable regulatory regime, a degree of certainty regarding tax policy and an expansion in tertiary education and an improvement in skills.[159] [160]

3.4.40 Whatever the views on the corporation tax policy of RoI, it is clear that when the original policy was conceived in the 1950s it was aimed at stimulating employment growth at the expense of tax revenue. Today it has, arguably, been transformed into a huge source of tax revenue which is a very important revenue stream for the RoI Government – and one which, given the changing global environment, is at significant risk going forward.

3.5 Conclusions

3.5.1 While a trend for increasing decentralisation is observable in many countries across the world, in relative terms, the UK is much more fiscally centralised than many other comparable countries. That said, devolution within the UK is asymmetric with the three devolved nations having different levels of legislative, administrative and budgetary autonomy. Devolved nations have significant autonomy in terms of their spending but much less autonomy in terms of taxation.

3.5.2 The fiscal devolution of tax powers in Scotland and Wales is currently further advanced than in Northern Ireland. While, legislatively speaking, Northern Ireland has more control over spending, in practice, adherence to the rUK welfare system's rules and rates is broadly maintained meaning that Northern Ireland remains quite closely correlated to Scotland in terms of spending control and less so Wales. Scotland and Wales have used their enhanced taxation powers to varying degrees and have experienced some of the benefits and risks which can come with fiscal devolution in terms of implementing localised policies choices as well as more volatile budgets. There is a question over whether the balance to Northern Ireland's current fiscal arrangement is the right one. What is clear is that if Northern Ireland does enhance its fiscal powers it will require additional budgetary management tools to manage them.

3.5.3 Overall, RoI is a wealthier country than Northern Ireland, with a faster growing and more successful economy. The RoI economy has experienced increases in productivity; high population growth; increased labour market participation and high levels of educational attainment that have not been matched by Northern Ireland in recent decades.

3.5.4 Northern Ireland does score more highly than RoI when it comes to many quality of life measures such as life satisfaction. RoI households also appear to spend a higher share of their expenditure on healthcare, education and housing with Northern Ireland spending a higher proportion on recreation and retail, this suggests that the lived experience for citizens may be more similar than the hard economic data suggests.

3.5.5 The tax structure in RoI differs significantly to that in Northern Ireland and the UK with the amount of revenue collected on a per head basis much higher in RoI (notwithstanding the context of the higher price levels and higher incomes in RoI relative to Northern Ireland and the UK). Proportionally RoI generates much more in tax revenues via income tax, social contributions and corporation tax.

3.5.6 Historically the 12.5% corporation tax rate and regime in RoI has been seen as an important contributor to its economic success by attracting FDI, driving economic growth and attracting employment in foreign MNEs to RoI. However, there are questions over how much of a role the low corporation tax rate has in contributing to the growth in today’s RoI economy and how secure the tax revenues and benefits are in the changing global environment.

3.5.7 The different economic and geographical environment within which Northern Ireland exists has implications for considering further fiscal devolution, particularly when compared to Scotland or Wales. The RoI and its economic landscape and tax structure will have significant implications on the priority of taxes for devolution to Northern Ireland. Increased tax devolution to Northern Ireland would influence how Northern Ireland could react in terms of promoting tax efficiencies across the island and in protecting its competitiveness with respect to the RoI, when deploying tax as an economic lever. This is a consideration which Northern Ireland is not able to make currently.

Chapter 4

Tax assessment: model, criteria and appraisal

4.0 Overview

4.0.1 This chapter outlines the Commission's view on the possible models of fiscal devolution for Northern Ireland and the criteria that the Commission has used in assessing the suitability of individual taxes for devolution. The chapter presents the Commission's initial appraisal on the suitability of existing UK-based taxes for devolution in Northern Ireland – identifying those taxes prioritised for further consideration, as part of the second stage of the Commission's work, and those taxes deemed not suitable for further consideration.

4.1 Key points

4.1.1 There is no one 'model' for fiscal devolution and it is helpful to consider the different options, or types, of fiscal devolution as points on a continuum beginning with the status quo or a 'do nothing' approach moving toward increasing fiscal responsibility and/or full fiscal autonomy over tax revenue generation.

4.1.2 While the potential flexibilities and benefits of fiscal devolution may increase along the continuum, the risks associated with each of the models may also increase in line with the extent of the autonomy sought and how the fiscal powers are used. In other words, through gaining more control over its fiscal powers Northern Ireland would lose some of the stability and security of the current block grant funding arrangements and inherit new risks through the volatility of the tax base.

4.1.3 While devolution offers local politicians and decision makers the opportunity to improve policy and hence outcomes for the local community, it also offers the opportunity to make mistakes and hence damage outcomes. It is important that both political and policy making capacity is adequate and appropriate to the level of devolved powers that are enjoyed. With this in mind, there could be an optimal level of fiscal devolution for Northern Ireland which balances both the risks and rewards within its unique context.

4.1.4 A **Key Objective** for our Commission is to: ***"provide advice to the Finance Minister, on the options and implications of enhanced fiscal devolution by setting out the balance of barriers and opportunities as well as the risks and rewards from the devolution of different tax powers."***

4.1.5 To help do this, we identify a **set of five key criteria** to inform our deliberations on the taxes most appropriate for devolution in Northern Ireland. Our criteria are: *economic and policy context; legal constraints; accountability; administrative efficiency; and economic efficiency and risks to the UK tax base*.

4.1.6 We have considered each of the UK-based taxes levied in Northern Ireland against our five key criteria. We have prioritised a smaller list of those taxes that, in our view, represent the strongest candidates for devolution at this time. As part of the second phase of our work, we will carry out further investigation into each of these 'priority' taxes. This will entail carrying out analysis of the operational aspects of implementation as well as the impact on the NI block grant, the additional budgetary management tools required and, where appropriate, a consideration of the optimum scope/mechanism of devolution (i.e. which elements of the tax base should be devolved and what degree of control over rates/bands should be devolved).

4.1.7 Importantly, and in view of the significance of appropriate design and sequencing of fiscal powers, it is our view that Northern Ireland should not seek the devolution of more than one 'major tax' (VAT, National Insurance contributions or Income tax) at this time. Arguably, the pursuit of smaller taxes in the first instance is likely to be a more prudent and appropriate path to allow the development and embedding of capability and capacity ahead of further devolution.

4.1.8 The taxes that we consider to be the strongest candidates for devolution, or sufficiently strong to merit further investigation to confirm suitability for devolution in Northern Ireland, and therefore those **taxes that *will* advance for further consideration**, include:

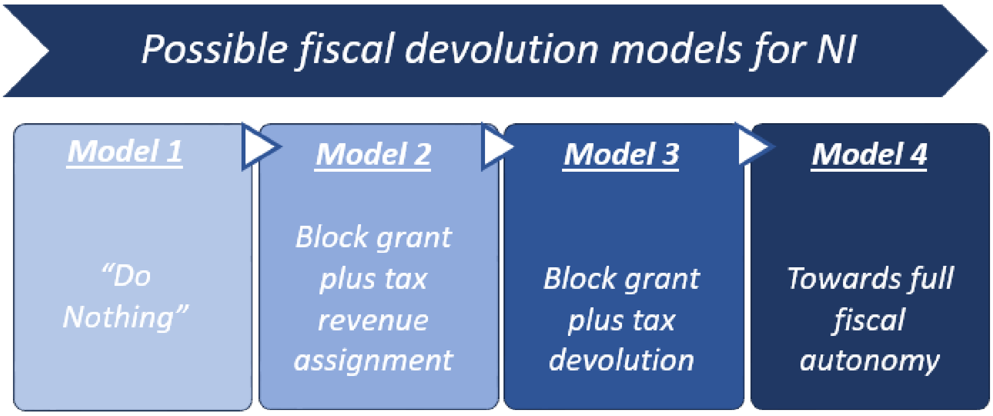
* **Income tax (and apprenticeship levy if income tax is devolved)**
* **Fuel duty**
* **Alcohol and tobacco duties**
* **Stamp duty land tax**
* **Air passenger duty**
* **Landfill tax**

4.1.9 The taxes for which we consider there is not a strong case for devolution, or for which there is a case, in principle, for devolution but where surrounding issues lessen their priority, and therefore are those **taxes that will *not* be advancing for further consideration**, include:

* **Value added tax**
* **National Insurance contributions**
* **Corporation tax**
* **Vehicle excise duty**
* **Insurance premium tax**
* **Capital gains tax**
* **Betting and gaming duties**
* **Inheritance tax**
* **Climate change levy**
* **Aggregates levy**
* **Stamp duty on shares**
* **Soft drinks levy**
* **Taxes on specific business activities** (diverted profits, banking levy, digital services)

4.2 What type of fiscal devolution might be appropriate?

4.2.1 Fiscal devolution can take many different forms. The 2010 Final Report of the Independent Commission on Funding & Finance for Wales (the "Holtham Commission") identified four main models for funding for devolved government. The models represent four points on a spectrum describing ever-increasing fiscal autonomy. The most appropriate model for Northern Ireland at this time may sit anywhere on this spectrum, and could evolve further over time. It is also possible that one of the models may be more appropriate for an individual fiscal power and another model may be more appropriate for a different fiscal power. We agree that these models can be used to helpfully inform the consideration of options regarding the differing types of fiscal autonomy which the NI Executive and Assembly may wish to pursue.



Model 1 – Status quo

4.2.2 The current situation in Northern Ireland represents a high degree of fiscal autonomy with regard to public spending but only limited fiscal responsibility for revenues raised. Revenue is provided following the pooling of tax revenues at a UK level. This revenue is made up of **block grant** funding supplied by the UK Government, determined by the Barnett Formula, **alongside a small number of devolved taxes** (for example, domestic and non-domestic rates). This situation represents the most 'stable' of the different funding arrangements which could be proposed, as the Northern Ireland budget has low exposure to any fluctuations in locally generated tax revenues. The ability and accountability of local decision makers to use fiscal policy to promote positive change or stimulate growth in the local economy is however limited with this model. UK government Ministers control the broad level of spend in Northern Ireland and the vast majority of tax generation, while local Ministers primarily control how that spend is utilised.

Model 2 - Block grant plus tax revenue assignment

4.2.3 A more graduated option would see the **block grant** reduced and remainder of the budget available to Northern Ireland made up of **revenue raised by certain taxes** in Northern Ireland. This option strengthens the link between revenue raised in Northern Ireland and the level of public spending, relating spend more closely to the performance of the Northern Irish economy. The revenue can be calculated in line with actual tax receipts in Northern Ireland, or an estimation of these, or alternatively by formula apportionment[161].

4.2.4 For example, under the Scotland Act 2016, the UK Government agreed to assign revenues from the first 10 percentage points of the standard rate of VAT and the first 2.5 percentage points of the reduced rate of VAT applicable to Scotland to the Scottish Government. This step was seen as a way to empower the Scottish Parliament and improve financial accountability by strengthening the link between public expenditure and the Scottish tax base. The implementation of the VAT assignment was to have occurred in 2019/20 but has been paused due to challenges in identifying the methodology to be used to estimate the Scottish share of UK VAT receipts.

4.2.5 Tax reassignment does not involve the devolution of policy (it is perhaps more accurately described as tax decentralisation). Local politicians would have no power to change the assigned taxes, as the power to vary both the tax base and tax rates would be retained by the UK Government. Additionally, any fluctuations in the tax revenue raised over time would impact on the budget available to the NI Executive and Assembly.

4.2.6 For these reasons, tax revenue assignment models are not often considered to be an attractive option, and we do not consider pure tax assignment as a desirable way forward for Northern Ireland, as it effectively replaces a more stable funding stream (i.e. a portion of the block grant) with one subject to volatility, without devolving tax varying powers. Assignment would seem only to be an attractive option if it were felt that there were other actions that the NI Assembly could take which would significantly enhance growth and hence tax revenues from a particular tax, in this case assignment would give it sharper incentives to do so. In practice, however, economic performance will vary for many reasons which are outside of the NI Assembly's control.

Model 3 - Block grant plus tax devolution

4.2.7 **Block grant plus tax devolution**, would see a proportion of the Northern Ireland budget made up of tax revenue raised by certain taxes in Northern Ireland, and the block grant reduced by an equivalent amount. The key difference between tax assignment and tax devolution is that with tax devolution the power to vary the specific devolved taxes would also be conferred. The NI Assembly would have the option to vary the tax rates and potentially the tax bases of the devolved taxes to increase or reduce the funding available for delivering public services in line with local policy aims and objectives. In our view, this is the most appropriate model for Northern Ireland to adopt if additional fiscal devolution is to be implemented.

4.2.8 With numerous taxes, big and small, there are numerous choices over which taxes could be devolved, and indeed over the degree of devolution of each tax.

4.2.9 Differing degrees of devolution are possible within this model, whereby the NI Assembly could seek the full or partial devolution of certain taxes, for example allowing them to vary the rates (as was the case with the anticipated devolution of corporation tax 'rate-setting' powers in 2015), but with control of the tax base, i.e. the definition of what is "taxable"[162], being retained centrally by the UK Government. The ability to adopt a varied approach under this model allows a balance to be struck between securing the additional flexibility and accountability to implement local fiscal policy while balancing the administrative efficiency burden of devolving taxes in their entirety.

Model 4 – Towards full fiscal autonomy

4.2.10 This model represents the same type of fiscal powers devolved as in model 3 but where they are employed to their fullest extent, aiming to confer the strongest and most wide-ranging powers over the local economy and, in turn, carries the highest level of risk to the stability of the funding arrangements.

4.2.11 **Fiscal autonomy** would see full devolution of the majority, if not all, Northern Ireland taxes and expenditure. Northern Ireland would be wholly responsible for taxation revenue and the Northern Ireland budget would be fully exposed to any fluctuations in Northern Ireland's tax receipts and broader fiscal shocks. In our view, net payments could still be received from the UK Government for 'equalisation grants'. That is, the remainder of the block grant once devolved taxation deductions have been made. Given the scale of the notional deficit in Northern Ireland, it is clear to us that full fiscal devolution – complete devolution of fiscal powers and no block grant – is not a feasible option for us to consider.

4.2.12 It is our view that the optimal level of fiscal devolution for Northern Ireland will be that which strikes a balance between the risks and rewards offered through the enhanced flexibility and autonomy. Any potential benefits resulting from enhancing devolution will vary depending on the overall degree of devolution and the circumstances around the individual tax or fiscal power, meaning that different levels of fiscal devolution may be considered more appropriate for different taxes or fiscal powers. Our views on the suitability of individual taxes in line with the different models of fiscal devolution are set out in more detail later in this Chapter and will be explored further in our final report.

4.3 What criteria could be used to assess the feasibility and desirability of fiscal devolution?

4.3.1 The extent to which a particular tax is appropriate for devolution is likely to depend on a number of factors. In common with the Commission on Scottish Devolution (the "Calman Commission") and the Holtham Commission for Wales, we propose to consider the suitability of all existing UK taxes for devolution in Northern Ireland, against a number of specific criteria.

4.3.2 Our proposed criteria are listed in Table 4.1 and are based on those developed initially by the Calman Commission, and adapted further by the Holtham Commission, to appraise the suitability of tax devolution in Scotland and Wales respectively.

4.3.3 Our criteria differ only slightly from those used by the Holtham Commission in that we have merged two behavioural criteria into one, and we propose to give more explicit consideration to the policy and economic context. That said, whilst the criteria are very similar, the context for tax devolution in Northern Ireland in 2021 is, in some aspects, very different from the context for tax devolution in Wales in 2010.

Table 4.1 - Criteria used to assess suitability of fiscal devolution of UK taxes to Northern Ireland

Criteria		Rationale
i	Economic and policy context	any policy-relevant factors that might influence the appropriateness of a tax for devolution, including the links between the tax and existing devolved competencies, any compelling evidence as to why policy-makers might want to set tax policy differently in Northern Ireland (for example, due to policy in RoI, or the different distribution of the tax base in Northern Ireland as compared to rUK), and any relevant learning from recent Scottish and Welsh experiences.
ii	Legal constraints	the extent to which tax devolution would be consistent with existing UK law and any international agreements, including the EU Withdrawal Agreement and NI Protocol.

iii	Accountability	the potential of a tax to raise the accountability of the NI Assembly. The ability of a tax to raise accountability is likely to be a function of the size of revenues raised; the visibility of the tax to taxpayers, the proportion of Northern Ireland residents who are taxpayers, and the extent to which the tax is understood by the electorate.
iv	Administrative efficiency	the extent to which tax devolution would create additional administrative burdens or costs for tax authorities or taxpayers themselves.
v	Economic efficiency and risks to the UK tax base	the extent to which tax devolution – if it resulted in divergent tax policy between Northern Ireland and other parts of the UK – could induce behavioural responses by individuals or firms to change the physical location of their activities (profits, purchases, etc.) in order to reduce their tax burden.

4.3.4 Clearly, no tax will wholly meet all criteria and, therefore, decisions to pursue the devolution of specific taxes should be based on a consideration of the different factors.

4.3.5 The Calman Commission based its argument for greater fiscal powers for Scotland primarily on, and gave greatest weight to, the argument for accountability.

4.3.6 The Holtham Commission stated their objective was to: "*identify taxes that would, if devolved, have a beneficial impact on the accountability of the Assembly Government to its citizens, while having either a net gain in efficiency or only a small potential to create economic distortions*."

4.3.7 Within a Northern Ireland context, the principle of accountability is arguably more complicated due to the different form of government in place, i.e. the mandatory coalition. This point is discussed further in Sections 1.6.12 and 1.6.13. Therefore, having considered from a Northern Ireland perspective, and following significant stakeholder feedback, we consider our overall objective in using our tax assessment criteria to be to ***"provide advice to the Finance Minister, on the options and implications of enhanced fiscal devolution by setting out the balance of barriers and opportunities as well as the risks and rewards from the devolution of different tax powers."***

Design and sequencing of devolved powers

4.3.8 To ensure the success of fiscal devolution measures, careful consideration must be given to the design and implementation of any new powers or responsibilities, with close reference to the local economic context. Studies have shown that, in addition to the *content* of policy reforms, the *speed* and *order* of such reforms have a measurable impact on the likelihood of a successful outcome following implementation.[163]

4.3.9 It is not sufficient, therefore, to consider the pros and cons of each tax or fiscal power in isolation. A consideration of the *concentration* of powers and appropriate *sequencing* of their devolution is very important. Firstly, in terms of ensuring the local administration is able to manage the new responsibilities successfully, and is given the opportunity to build capacity where necessary. Secondly, in view of the interaction of different taxes, the appropriate sequencing of reforms will ensure that fiscal powers are used to best advantage, avoiding a situation where measures may work against each other, and instead, benefitting from the interactions between the impact of any changes, leading to beneficial outcomes for the local economy.[164]

4.3.10 Decisions over fiscal devolution in Northern Ireland need to balance the risks and rewards, taking account of its unique context, and political and institutional capacity and resilience. It is our view that if Northern Ireland were to take on additional powers it should intentionally and purposefully implement them in a phased approach to ensure that the administrative systems and the block grant adjustments essential to fiscal stability and sustainability are established and functioning well. Much in the same way as has unfolded in Scotland and Wales, even if not quite planned in this way.

4.3.11 Therefore, while there may be a case, in principle, for the devolution of a substantial number of the taxes levied in Northern Ireland, for the second phase of our work we have *prioritised* a smaller list of those taxes that, in our view, represent the strongest candidates for devolution at this time. Additionally, and perhaps our most important conclusion when considering the implications of appropriate design and sequencing of powers, it is our view that Northern Ireland should not seek the devolution of more than one 'major tax' (VAT; National Insurance contributions; or income tax) at this time. Arguably, the pursuit of smaller taxes in the first instance is likely to be a more prudent and appropriate path to allow the development and embedding of capability and capacity ahead of further devolution. We will return to the issue of sequencing in our final report.

4.3.12 Prior to publishing our final report, we will carry out further investigation into each of the taxes that we have prioritised including analysis of the operational aspects of implementation. We will look at how devolution might impact on the NI block grant, additional budgetary management tools required and, where appropriate, a consideration of the optimum scope/mechanism of devolution (i.e. which elements of the tax base should be devolved and what degree of control over rates/bands should be devolved).

4.4 Income tax

4.4.1 Income tax is paid by individuals on income from employment, self-employment, pensions (including the State Pension), some state benefits, rents from property, and savings and dividends. In UK terms, income tax is the largest revenue raiser. It is also the main 'redistributive' tax. It is estimated that income tax raised £3.0bn or 19.2% of the total tax take in Northern Ireland in 2019/20.

Economic and policy context

4.4.2 Income tax is partially devolved in both Scotland and Wales. In both cases, income tax was deemed an appropriate tax for raising the accountability of the devolved legislatures, given the scale of revenues raised and the visibility of the tax to residents.

4.4.3 In both Scotland and Wales, income tax is now a shared tax between the UK Government and each of the devolved governments. In both cases, the UK Government remains responsible for determining all reliefs and allowances (including the Personal Allowance, tax reliefs on pension contributions, and reliefs on contributions to charity, childcare vouchers, and so on).

4.4.4 But the scope of income tax devolution in Scotland differs from the position in Wales. In Scotland, all revenues from non-savings, non-dividend income tax have been transferred to the Scottish budget. The Scottish Government can vary income tax rates and thresholds, and create new tax bands (as it did do in 2018/19). In Wales in contrast, revenues from ten percentage points of each band have been transferred.[xxxv] In practice this means the Welsh Government can vary income tax rates, but not thresholds, and therefore changes in rates set by the UK Government continue to apply in Wales, but do not in Scotland.

4.4.5 Full transfer of revenues from non-savings, non-dividend income tax, as per the Scottish case, maximises the benefits of accountability. But it also maximises budgetary risks. Furthermore, the Scottish Government can vary income tax rates and thresholds (though not the personal allowance threshold[165]) without constraint. Even if income tax is deemed appropriate for devolution in Northern Ireland, questions around the scope of devolution will also need consideration.

4.4.6 In both Scotland and Wales, tax on income from savings and dividends remains taxed by the UK Government at UK rates. The reason for this relates to the fact that, when income tax devolution in Wales and Scotland was considered, a significant share of tax on savings and dividend income was collected at source by banks and building societies. This

[xxxv] The UK Government reduces the tax rates on each band of income tax by 10p in Wales. So the UK Government levied basic rate becomes 10p rather than 20p, the Higher Rate becomes 30p rather than 40p, and the additional rate becomes 35p rather than 45p, and the UK Government retains the revenues raised from these rates. It is then up to the Welsh Government to decide whether to add back the 10p rate, or to add back more or less than 10p. In the first year of income tax devolution in Wales, the Welsh Government levied a 10p rate on each band, meaning that income tax rates faced by Welsh taxpayers are identical to those faced by rUK taxpayers, but the revenues are split between the Welsh and UK Governments so that the Welsh Government retains revenues equivalent to 10p from each band.

arrangement created administrative challenges to devolution of tax on savings and dividend income. If the income tax rate in a devolved nation were to diverge from the UK rate, then banks and other institutions would have to identify which of their customers was liable to pay tax at the devolved rate and account for it separately. This was felt by the Calman Commission to impose a disproportionate administrative burden given that income tax on savings and dividends yields only about one tenth of the total of income tax.

4.4.7 However this position has since changed, following the introduction in 2016 of the Personal Savings Allowance and Dividend Allowance. As a result of this, UK financial institutions no longer deduct the tax at source. Instead those liable declare through self-assessment. This change may have material considerations for deliberations on the extent of income tax devolution in Northern Ireland.

Legal constraints

4.4.8 We are not aware of any legal constraints to the devolution of income tax.

Accountability

4.4.9 Income tax scores well in terms of our accountability criterion, although not unanimously so. With regard to coverage, HMRC's Survey of Personal Incomes estimates that there were some 761,000 income tax payers resident in Northern Ireland in 2019/20. This represents 51% of the 16+ population (53% of the 18+ population). The fact that the tax is paid by approximately half of adults implies that a rather large proportion of adults would not be directly impacted by devolved income tax policy decisions. Arguably, this may limit, to some degree, the extent to which income tax devolution raises the accountability of the NI Executive to all in society but overall a significant proportion do pay the tax in Northern Ireland.

4.4.10 ONS estimates that £3bn was raised from Northern Ireland-resident income taxpayers in 2019/20 accounting for 19% of the total tax take in Northern Ireland. As such, income tax raises less than VAT (22% of total tax take) and is on a par with National Insurance. Nonetheless, income tax raises substantially more than any revenue outside of these 'big three'.

4.4.11 In terms of visibility to tax payers, some argue that income tax is not visible, in the sense that it is deducted from most people's salaries before entering their accounts. However, it is much more visible than most other taxes, in that it is relatively easy for taxpayers to find out how much income tax they pay, by consulting payslips or P60. It may not be quite as visible as rates, but it is certainly more visible than any of the indirect taxes or duties.

4.4.12 The basic principles of income tax – that there is a tax-free allowance, with income above this being taxed at different rates by band – is relatively simple to understand. In principle it should be relatively straightforward for taxpayers to assess how much additional tax they might pay if their income increased by a certain amount. Moreover, tax 'ready reckoners' are frequently published (by both the UK and Scottish Governments) to outline how revenues are likely to change for a given change in income tax policy. However, for some income taxpayers, additional complexity is added through the operation of reliefs and allowances, which can complicate these calculations substantially – accentuated further by the interaction with social security benefits such as Universal Credit and Child Benefit.

Administrative efficiency

4.4.13 The lesson from Scotland and Wales is that, where HMRC continues to have responsibility for revenue collection and enforcement, income tax can operate in a devolved setting reasonably efficiently from an administrative perspective. (As a shared tax where devolved governments have some ability to vary rates and thresholds it makes sense for HMRC to retain the administrative role; the allocation of these responsibilities to a new revenue collection authority would be costly both fiscally and for employers and taxpayers in navigating their tax affairs).

4.4.14 The key administrative issue would be the identification of 'NI taxpayers'. HMRC has established a set of rules for determining taxpayer residence. This includes detailed guidance on interpretation of the residence rules in cases where people have more than one residence, or spend varying amounts of time in a given year in different parts of the UK.

4.4.15 In Scotland's case, HMRC's costs for setting-up processes and systems to enable different tax rules to apply to Scottish taxpayers cost £24 million. Annual operating costs of £1-£3 million are also incurred. Small costs are also incurred by DWP. These financial costs are very small in the context of the revenues generated (over £12 billion). HMRC estimates the overall cost of implementing the Welsh Rate of Income Tax were between £8m and £9m. Operating costs are estimated to be in the region of £700,000 for 2020-21.[166]

4.4.16 Income tax devolution has raised other administrative issues. For example, the introduction of new rates and bands in Scotland did require some legislative changes at UK level to ensure that consistent treatment of some allowances and reliefs. The changes were made through the *Scottish Rates of Income Tax (Consequential Amendments) Order 2018*, and approved by the UK Parliament on 26 March 2018, in order to take effect before the start of financial year 2018/19, when the Scottish Government's tax changes were due to take effect.[167]

4.4.17 Income tax devolution may also impose additional costs on payroll service providers.[xxxvi] We currently lack evidence on these costs in the Scottish case – and any analysis of the extent to which additional costs were passed on to Scottish based firms, though they are likely to be very small on the whole.

Economic efficiency and risks to the UK tax base

4.4.18 Taxpayers can and do respond to changes in income tax in a myriad of different ways. They can choose to work more or less; alter their demands in relation to pre-tax pay settlements; change the way they use income tax reliefs; potentially in some cases reclassify income as profit; and ultimately, migrate.

[xxxvi] Payroll service companies process employees' pay and PAYE tax return on employers' behalf. Those companies are likely to face additional costs in adapting their systems to accommodate different income tax structures in different parts of the UK.

4.4.19 All of these potential responses would apply to Northern Ireland taxpayers if income tax was devolved and rates in Northern Ireland were varied.

4.4.20 But what is also particularly important to consider is the extent to which income taxpayers in Northern Ireland might be responsive to tax policy differences with rUK, and the extent to which this creates additional scope for economic distortions.

4.4.21 In this part of the appraisal we are interested in the extent to which tax devolution – if that led to differences in income tax rates in different parts of the UK – could influence the behaviour of UK taxpayers in a way that was detrimental to the UK Government or NI Executive. Of course taxpayers will also be sensitive to differences in income tax policy between Northern Ireland and RoI, and some individuals in theory could choose to relocate on the basis of differences in tax policy. This risk already exists of course, but tax devolution would provide the NI Executive with the autonomy to influence the degree of tax policy divergence with RoI. Currently, income tax policy in RoI has similarities to that in the UK, with a basic rate of 20% and a higher rate of 40%. Though this higher rate in RoI 'kicks-in' at a lower level of income than in the UK, meaning that mid-to-higher income individuals are taxed more heavily in RoI than in Northern Ireland.

4.4.22 There are of course a number of different ways that taxpayers might respond to inter-UK tax policy differences. In the Welsh case, the Holtham Commission was particularly concerned about the risk that income tax policy differentials could incentivise taxpayers to relocate on one side of the England-Wales border, without needing to rupture working or socialising arrangements in any significant way. This concern is clearly less significant in Northern Ireland's case, as regular commuting between GB and Northern Ireland will not be an option for many (although the prospects of permanently increased rates of home-working post-COVID-19 do increase the possible risks here).

4.4.23 Nonetheless, it is possible that permanent differences in income tax policy could influence taxpayers' decisions in the long-term over where to live and work. Further, for those who have properties in both Northern Ireland and GB, they may be able to achieve a change in taxpayer status through only a relatively small change in behaviour.

4.4.24 In addition to these questions of residence, income tax differentials in Northern Ireland could incentivise taxpayers to respond in other ways. For example, if income tax rates were increased in Northern Ireland, the self-employed would have greater incentives to incorporate and pay corporation tax; and this incentive may be increased if, as in Scotland and Wales, savings and dividend income remains taxed at UK rates.

4.4.25 The Scottish Fiscal Commission is required to estimate the behavioural responses of UK taxpayers to differences in tax policy between Scotland and rUK. Their approach is informed by existing empirical studies of taxpayer responses in the UK and other countries, adjusted for the Scottish context. The Scottish Fiscal Commission argues that behavioural responses to tax changes will be higher in Scotland than in the UK as a whole. This is because:

- *The opportunities for migration from Scotland, particularly to the rest of the UK, are greater than opportunities for migration from the UK to other countries*

- *In Scotland, behaviour that shifts income from NSND income to another form such as dividends will mean a total loss of tax revenue in Scotland.*

4.4.26 Note however that there is no quantitative evidence to-date on the actual response of Scottish taxpayers to the differences in income tax policy relative to rUK that have opened up since 2017/18. HMRC has begun analysis to assess these effects, and this is expected to be published in November 2021.

4.4.27 The evidence from other states as to whether taxpayers are responsive to within-country differences in income tax policy is mixed. The Scottish Fiscal Commission recently hosted a workshop drawing on evidence of the impacts of within-state divergence in income tax policy in Switzerland, the US and Spain. Some key findings were:

- In Spain, differential tax policy does have an impact on the tax locations of the rich. But the effect on the stock of high-income taxpayers is relatively small, so that income tax cuts do result in falls to the budgets of sub-national government budgets (i.e. the impact of capturing in-migrating high-income taxpayers is not sufficient to outweigh the direct revenue losses from lower tax rates).
- Evidence from Switzerland suggests that the income tax base is responsive to cantonal differences in tax rate, but only for high income households without children; and the responses are much stronger when the tax differences exist at a small scale, within particular labour markets or urban areas.
- For the US, the conclusion was that millionaire tax flight between states *does* sometimes occur, but the magnitude is small, it has little impact on the stock of millionaires in a state, and is too small to matter for current tax policy.

Of course, these results are not directly transferable to the Northern Ireland case.

4.4.28 In reality we know little about the likely scale of responses of UK taxpayers to divergence in income tax policy between Northern Ireland and rUK. It seems reasonable to assume that the migratory response of Northern Ireland taxpayers to within UK divergence in tax policy would be somewhat lower that it would be for Scottish or Welsh taxpayers. But other forms of response such as reclassifying income to avoid Northern Ireland rates should Northern Ireland rates increase relative to those in rUK is likely to be just as strong.

Income tax - summary

4.4.29 Income tax raises substantial revenues from approximately half of adults in Northern Ireland, and is visible to those who pay it. Income tax devolution in Scotland and Wales has demonstrated that partial devolution of income tax - where the devolved government can set rates and potentially thresholds, but the UK Government continues to determine reliefs and allowances – can be operationalised at relatively low administrative cost and disruption. A more comprehensive devolution of income tax – giving the devolved government the ability to determine reliefs, allowances, and the definition of income that is taxed, would be much more challenging administratively and has not yet been tried in other parts of the UK.

4.4.30 Whilst differences in income tax rates in Northern Ireland relative to other parts of the UK could induce some behavioural responses, the scope for such responses is likely to be somewhat lessened in Northern Ireland relative to Wales and Scotland.

Conclusion

4.4.31 **Income tax is a sufficiently strong candidate for devolution in Northern Ireland, and we will consider it further as part of the second phase of our work. A key issue for consideration will be the scope of devolution, that is, if devolution was agreed which elements of the tax base should be devolved and what degree of control over rates and bands should be devolved.**

4.5 Value added tax

4.5.1 Value added tax (VAT) is estimated to be the largest single source of tax revenue in Northern Ireland, raising £3.4bn or 22% of the total tax take in Northern Ireland in 2019/20.[xxxvii] This means that each 1 percentage point change in the standard rate of VAT would be expected to yield or cost around £170 million, just over 1% of the NI Executive's Departmental Expenditure Limit and just over 2.5% of its spending on health and social care services. Devolution of VAT would therefore provide the NI Assembly with the power to meaningfully vary overall funding levels.

4.5.2 VAT is a proportional tax charged on the sales of businesses with turnovers of £85,000 a year or more.[xxxviii] However, businesses can deduct the VAT that was charged on their input purchases from the amount of VAT they must charge on their sales when calculating how much tax to remit to HMRC. Hence the tax base for VAT is sales minus the cost of goods and services purchased from other VAT-registered businesses. This can be considered the amount of value added to the goods or services sold by the business in question (hence the name of the tax) and is effectively the sum of its labour costs (the share of the value-added going to its workers) and profits (the share of the value-added going to its owners).

4.5.3 The standard rate of VAT in the UK is 20%. However, 0% and 5% rates apply to a range of goods and services including all exports, most food, construction of new houses, public transport, children's clothing and domestic fuel and power. To support businesses following the lifting of the COVID-19 lockdown, the UK Government temporarily applied a reduced rate of 5% to certain supplies relating to hospitality, hotel and holiday accommodation and admission to certain attractions. This rate was revised to 12.5% from 1 October 2021 and will end on 31 March 2022. A number of goods and services, including rent, education, health and financial services, are exempt from VAT, meaning that no VAT is charged in their sale, and businesses producing them cannot reclaim VAT paid on their inputs.

[xxxvii] Gross VAT revenues before refunds are estimated at £4.2 billion for NI in 2019/20 by ONS, with refunds of £0.8 billion included within that figure. However throughout this report when considering VAT, we refer to the VAT net of refunds value.

[xxxviii] Firms with turnovers over £85,000 are required to register for VAT; those with turnovers below £85,000 can voluntarily register if they wish.

4.5.4 In what follows we assume a model of partial devolution would enable the NI Assembly to vary the VAT rates applied to different goods and services, but where exemptions and other VAT rules (such as registration thresholds) would remain reserved. Devolving only the power to vary the existing rates of VAT (rather than the goods and services subject to them) would, in our view, only modestly reduce the challenges posed by devolution but would prevent a number of policy changes that the NI Assembly might want to have the flexibility to implement, such as more closely aligning VAT structures with those in RoI. On the other hand, devolving power over exemptions and other VAT rules could significantly increase the administration and compliance challenges posed by devolution, while providing little genuine additional flexibility to the NI Assembly given EU rules governing many of these areas of VAT policy.

Economic and policy context

4.5.5 As a tax which applies to most goods and services, VAT has relevance to a range of devolved policy competencies. Its devolution would mean that the NI Executive's funding would depend to an extent on the size of the VAT tax base, which broadly speaking equates to household consumption plus input purchases of businesses and organisations unable to reclaim VAT. This would provide the NI Executive with a fiscal incentive to increase a relatively broad measure of economic activity, aligning with its responsibility for promoting general economic development. Powers to vary rates for different types of goods and services could also align with powers over, for example, transport, tourism, housing, health and education. However, it is worth noting that economists typically do not recommend varying rates of VAT across goods and services given the administration and compliance costs and risks entailed, potential for economic distortion, and weak link between prices and many of the social 'goods' or 'bads' that one might want to promote or discourage with lower or higher taxation.[168]

4.5.6 We are not aware of any evidence of whether preferences over VAT policy differ in Northern Ireland relative to the rest of the UK. However, the policy context in Northern Ireland does differ somewhat given its land border with RoI, where the structure of VAT differs from the UK. For example, RoI permanently levies a lower rate of VAT (generally 13.5% compared to 20% in the UK) on tourism and hospitality services,[xxxix] as well as a range of repair, maintenance and cleaning services. In contrast, it levies a higher standard rate of VAT (usually 23% compared to 20%).[xl] These differences may affect competition between Northern Ireland and RoI-based businesses, particularly in border areas. Devolution of the power to set the VAT rates applying to different goods and services would allow the NI Assembly to reform VAT in light of these impacts if it so wished.

Legal constraints

4.5.7 The Calman, Holtham and Smith Commissions ruled out the devolution of VAT to Scotland and Wales due to the fact that EU rules generally prohibit sub-national variation in VAT

[xxxix] However, the rate on these services is temporarily 9% in RoI as part of efforts to support economic recovery from the COVID-19 pandemic, higher than the 5% temporary rate applicable in the UK.

[xl] However, the standard rate is temporarily 21% in RoI as part of efforts to support economic recovery from the COVID-19 pandemic.

rates and rules.[xli] Following the UK's exit from the EU and the end of the transition period, however, there have been renewed calls for the devolution of VAT to Scotland.[169]

4.5.8 In Northern Ireland's case the NI Protocol requires the continuing application of EU's rules on VAT on goods (but not services), except to the extent that RoI has exemptions from those rules. No reference is made in relation to whether this includes the requirement for uniform VAT rules and rates to be applied across a state. However, one can see scope for conflict if this rule were deemed to apply. For example, the UK Government could change VAT in such a way that is incompatible with both EU rules and RoI's exemptions from those rules. If these changes were applied to goods in Northern Ireland, it would be in breach of the NI Protocol. For this reason it seems likely that variation in VAT rates and rules between Northern Ireland and rUK is feasible (and could potentially be necessary) under the NI Protocol. However, there would be constraints on how any devolved VAT powers could be used to ensure consistency with EU and RoI rules and rates. These rules prohibit setting a standard rate of VAT below 15%, and limit the application of reduced and zero rates to certain goods and services, among other things.

Accountability

4.5.9 As highlighted above, VAT is the single largest source of revenues in Northern Ireland. This means that its devolution would provide a meaningful fiscal incentive, increasing the accountability of the NI Executive for economic performance, as well as a meaningful ability to change overall levels of taxation and spending at the margin.

4.5.10 To the extent that VAT is passed on in the form of higher prices, a devolved VAT would be paid by all residents of Northern Ireland, as well as visitors buying goods or services in Northern Ireland. The fact all residents and hence voters would pay would help ensure political accountability for tax policy decisions. If a large proportion of the tax were paid by visitors who cannot vote in devolved elections, then the NI Assembly would have an incentive to set tax rates higher than they otherwise would (as Northern Ireland voters and residents would pay only part of the tax but would receive all of the benefits in the form of higher public expenditure). There is limited evidence on the share of the VAT tax base in Northern Ireland that relates to sales to visitors, but it seems very unlikely to be high enough to cause significant accountability concerns.

4.5.11 In terms of visibility to taxpayers, unlike sales tax in the US, VAT is subsumed within quoted prices rather than being added on separately. When combined with complex rule about what goods and services are subject to what rates of VAT it seems unlikely most people have a good sense of how much VAT they actually pay. However, while VAT is not very visible to voters, VAT rate policy is politically salient and widely covered in the media. This includes discussion of the scope of reduced rates of VAT – e.g. on tampons,[170] on pasties and other hot bakery products,[171] hot meals in cafes, pubs and restaurants,[172] and for the wider hospitality industry[173] – as well as the overall rate of VAT.[174] Such media coverage would help voters hold the NI Assembly accountable for their VAT policy decisions.

[xli] Some exceptions (termed 'derogations') to these rules have been granted for particular territories such as Ceuta and Melilla (Spanish exclaves in North Africa) and Campo D'Italia (an Italian enclave in Switzerland).

Administrative efficiency

4.5.12 We are not aware of any quantitative estimates of the scale of the compliance and administration costs and risks that could arise from devolving VAT to the NI Assembly. However, a qualitative review of the evidence suggests that devolution would create important new compliance and administration costs and challenges. This is because in order to determine the tax base to which Northern Ireland rates and rules apply to, businesses and tax authorities would need to distinguish between sales to and purchases from Northern Ireland and GB.

4.5.13 Broadly speaking there would be two approaches that could be taken. The first would be to treat the Northern Ireland / GB border as an international border for VAT purposes. This would mean that for business-to-business transactions, exports from Northern Ireland to GB and vice versa would be subject to a zero-rate of VAT. The full rate of VAT in the importing jurisdiction would then be payable by the importer.[xlii] From a fiscal perspective, this would mean that full taxing rights would lie with the importing jurisdiction. Because of this, the NI Executive would not have a fiscal incentive to promote business activity that led to exports to GB. From an administrative perspective, the zero rating of exports provides a stronger incentive and greater opportunity for VAT fraud. For example, missing trader frauds involve an importing business that goes missing before it remits the tax due on the goods it imports. The incentive to do this is greater as all the VAT due up to that point in the production chain is due at the import stage (because of the zero-rating of exports). In addition it is possible for cycles of imports and exports (termed 'carousels') to lead to substantial losses to the tax authorities, as refunds are claimed by exporters and VAT liabilities of importers go unpaid. Estimates of the scale of losses across the EU vary a lot depending on methodology, but are all large, at between €20 and €100 billion as of 2018.[175]

4.5.14 The second approach would avoid this problem by continuing to charge VAT on exports from Northern Ireland to GB and vice versa. In this case though, businesses would need to either charge or reclaim different amounts of VAT depending on where in the UK their business customers or suppliers were based. This would increase VAT compliance costs for businesses, especially the more complex the differences between VAT rates and rules in Northern Ireland and GB became.[xliii] Businesses would also have an incentive to either declare business-to-business sales as being to the jurisdiction with the lower VAT rate, or declare input purchases as being from the jurisdiction with the higher VAT rate, to minimise net VAT liabilities. Greater enforcement activity would be required by HMRC to reduce this risk.

4.5.15 It is worth noting that the NI Protocol to the EU Withdrawal Agreement requires businesses moving goods from GB to Northern Ireland to formally charge output and reclaim input VAT on this internal transaction, although no net VAT liability is generated. However, such rules do not apply when goods are moved from Northern Ireland to GB, or on intra-business provisions of services, which would likely need to be the case if VAT

[xlii] The 'exporter' and 'importer' could in fact be the same business if it has operations in both Northern Ireland and GB.
[xliii] In order to avoid providing a fiscal incentive to the NI Executive to favour export transactions involving separate businesses, and import transactions involving a single business, businesses operating on a UK-wide basis would also have to apportion their value added between their operations in Northern Ireland and GB so that they their tax liabilities could be split appropriately between jurisdictions. This would also be costly to comply with and administer.

were devolved. Moreover net VAT liabilities could arise on such transactions if VAT policy differed between Northern Ireland and GB.

Economic efficiency and risks to the UK tax base

4.5.16 Differences in VAT rates across jurisdictions can lead to consumers to change where they purchase their goods and services from, and hence affect the location of businesses serving consumers. This is particularly true when people live close to 'borders' between different tax rates, and when transaction values are high, as the monetary and time costs involved in travelling to the low-tax area are then relatively low compared to the savings available.[176] Northern Ireland's geographic position on the island of Ireland, should therefore minimise the potential for significant impacts on the tax base of the rest of the UK via cross-border shopping.

4.5.17 There are two main areas where distortion could potentially occur. First is tourism. If Northern Ireland were to set a lower rate of VAT on tourist accommodation and hospitality and leisure services, the reduction in prices relative to the rest of the UK may encourage some foreign and domestic tourists to holiday in Northern Ireland as opposed to the rest of the UK. A recent review of evidence for the Scottish Government, for example, suggested that a reduction in tax equating to a 1% fall in the price of inbound tourists' cost could increase the number of tourists by 1.25% - although with significant uncertainty and no breakdown of where these tourists would otherwise have gone to (the rest of the UK or elsewhere).[177]

4.5.18 Second is that e-commerce could provide a low-cost form of cross-border shopping from a distance. In the 2000s, for example, a number of e-commerce retailers (e.g. Play.com) set themselves up in the Channel Islands to take advantage of rules allowing VAT-free import of items with a value of less than £15, until this rule was changed specifically for the Channel Islands. As of July 1st 2021, new EU rules require all but the smallest firms engaging in e-commerce to charge VAT on the basis of the country where a customer is located for transactions within the EU and between the EU and UK. Similar rules might need to be applied on business-to-consumer sales between Northern Ireland and GB if VAT were devolved to Northern Ireland and a substantially lower rate of VAT applied to certain goods.

VAT summary

4.5.19 VAT is a large and politically salient tax that has relevance for a range of devolved policy responsibilities, and for which the economic and policy context differs somewhat from the rest of the UK, given Northern Ireland's land border with Ireland. Devolution would now be legally possible, and the NI Protocol means that some of the information needed for the operation of a devolved VAT is already collected, although it would also limit the flexibility the NI Assembly would have in setting rates and rules.

4.5.20 However, devolution would still involve potentially significant additional compliance and administration burdens and challenges for firms transacting or operating on both sides of the Irish Sea, and would require the scaling-up of enforcement activity to manage increased risk.

Conclusion

4.5.21 **There is a case, in principle, for devolution of VAT to Northern Ireland. However the uncertainty regarding the significant additional compliance and administration burdens relative to income tax are sufficient that, in our view, further work at this stage should prioritise consideration of options for devolving income tax, rather than VAT. At this stage, therefore, we will not be carrying this tax forward for consideration as part of the second phase of our work.**

4.6 National Insurance contributions

4.6.1 National Insurance contributions (NICs) is a tax levied on the earnings of employees (with separate employee and employer contributions) and the profits of unincorporated businesses (i.e. the self-employed). Currently, employees pay a rate of 12% on earnings between £184.01 and £967 per week and 2% on earnings above £967 per week; employers pay 13.8% on earnings above £170.01 per week; and the self-employed pay a rate of 9% on profits between £9,569 and £50,270 per year, and 2% on profits above £50,270, as well as a flat £3.05 a week.

4.6.2 The revenues raised in Northern Ireland in 2019-20 are estimated to be £3.1 billion (19.7% of the total tax take), making it the second largest revenue generator, behind VAT and just ahead of income tax.

4.6.3 The UK Government announced in September 2021 that there will be a rise in both the main and additional rates (of Class 1, Class 1A, Class 1B and Class 4) NICs by 1.25% from April 2022 and that this extra payment will become a new tax from April 2023 onwards - the Health and Social Care Levy.[178] The levy will be applied to all earned income above the Class 1 and Class 4 thresholds, including for those over state pension age, whilst dividend tax rates will also rise by 1.25%. This new levy is a separate tax to NICs, so if NICs was to be considered for devolution in future, a decision would be required as to whether to devolve the Health and Social Care Levy alongside it.

Economic and policy context

4.6.4 NICs were originally introduced in 1911, were consolidated and expanded in scope in 1948, and moved from a flat-rate to an earnings-related system in 1975. Originally envisioned as part of a contributions-based system of benefits (including unemployment, invalidity and pension benefits), the link between individual contributions and benefits has been much weakened over time and is now virtually non-existent.[xliv] In this regard, NICs is better thought of as a second income tax, payable only on income from employment and self-employment, and with contributions from employers, rather than a true social security contribution.

4.6.5 However, there remain both formal and perceptual links between NICs and the benefit system. After a certain proportion is allocated to the National Health Service, remaining

[xliv] Employees for example, do not need to earn enough to pay NICs in order to qualify for the new flat-rate state pension (because the earnings threshold to accrue pension rights – the lower earnings limit – is lower than the threshold at which employee NICs become payable). The self-employed do though, as they are liable for a small flat-rate NICs contribution once profits reach the equivalent lower profits limit.

NICs revenues are paid into the National Insurance Funds, which fund benefits which are formally contributions-based such as the State Pension, and new-style Jobseekers and contributory Employment and Support Allowance. Fund surpluses cannot be used directly for other areas of government expenditure, but do so indirectly as they are invested in UK Government's Debt Management Account.

4.6.6 NI has a separate National Insurance Fund into which an estimate of the share of UK-wide NICs that are from Northern Ireland-based employed and self-employed individuals are paid. This reflects the fact that Northern Ireland's system of benefits is also legally separate from that in GB – although it is funded on the basis of spending needs by the UK Government if Northern Ireland policy matches than in GB, which it does apart from a few top-ups to counteract the effect of recent UK government welfare reforms (which the NI Executive pays for). The Northern Ireland Act 1998, however, requires transfers to be made between the GB and Northern Ireland National Insurance Fund such that their respective fund surpluses are maintained "as far as possible" in relation to their population.

4.6.7 Devolution of NICs would therefore require changes to the operation of the National Insurance Funds, more fully separating the GB and Northern Ireland funds and their investments. But the context for devolution is different from Scotland and Wales which share a single National Insurance Fund with England and a formally integrated contributory benefits system.

4.6.8 It is worth noting that RoI's system of social security contributions, termed Pay-Related Social Insurance (PRSI) differs significantly from the NICs system in place in the UK. Employer contributions apply from the first euro of income but are levied at a lower marginal percentage rate (8.8% or 11.05%) than NICs are. Employee contributions are levied above a high threshold of €398 per week (equivalent to £340, compared to £185 for employee NICs in the UK) and then at a rate of 4%. Although income tax thresholds are lower for single adults and couples with two earners, these low rates of social security contributions contribute to RoI having among the lowest tax wedges on labour income in the OECD (though UK has an ever lower tax wedge than RoI). Devolution of NICs (and/or income tax) would allow the NI Assembly to make different decisions on tax levels and structure, potentially taking account of levels and structures in RoI if it so wished.

Legal constraints

4.6.9 There are no legal constraints to devolving NICs to the NI Assembly.

Accountability

4.6.10 As discussed above, NICs are the second largest source of tax revenue in Northern Ireland. This means that its devolution would provide a meaningful fiscal incentive, increasing the accountability of the NI Executive for economic performance, as well as provide a meaningful ability to change overall levels of taxation and spending at the margin. However, the fact that NICs are only paid on income from employment and those over the state pension age are exempt from paying employee NICs entirely means that a substantial proportion of the population pay either no NICs or no NICs on a substantial proportion of their income.

4.6.11 It is also worth noting that while the taxes are formally separated into employee and employer contributions, this does not mean that these two elements are ultimately incident on employees and employers, respectively. In the short-term, one would expect them to have different economic incidences. However, in the longer-term, market wages should adjust such that the incidence of both is shared between employees and employers in the same way – with most of both probably incident on employees. A lack of understanding of this process of adjustment by the electorate may reduce the scrutiny the NI Assembly faces for NICs policy relative to income tax policy, for example.

4.6.12 The formal and perceived contributory nature of NICs may mean that taxpayers are more willing to pay higher rates of NICs than they would higher rates of income tax. Indeed, while the basic rate of income tax has not been increased since the 1970s, the main rate of NICs has been increased several times over the last 20 years (both transparently, in 2003 and 2011, and less transparently with the ending of lower rates for those previously 'contracted out' from the state second pension).

Administrative efficiency

4.6.13 HMRC collects NICs for the entire UK, with those levied on the earnings of employees collected via the PAYE system and for the self-employed via self-assessment. As discussed above, after a certain proportion is deducted to help fund the National Health Service, the remaining NICs are paid into separate GB and Northern Ireland National Insurance Funds.

4.6.14 In order to do this, the postcode of each employee or self-employed individual is extracted to estimate the share of individuals who have paid NICs that reside in GB and Northern Ireland. These shares are then rounded to the nearest percentage point and then applied to UK wide NICs revenues to apportion them between the GB and Northern Ireland National Insurance Funds. Thus the apportionments are based on rough estimates of the NICs from GB and Northern Ireland, rather than a precise calculation using the actual NICs paid on the earnings of specific employed and self-employed individuals.

4.6.15 The devolution of NICs would, however, require HMRC to identify the specific employees and self-employed individuals to which Northern Ireland NICs should apply. To do this, a decision would have to be taken as to the basis of assignment, with location of residence (like in the first stage of the existing rough estimate of NICs revenues attributable to Northern Ireland, and the Scottish and Welsh rates of income tax) probably most sensible. As with the case of income tax, discussed above, this would entail additional administration and compliance costs – both one-off set-up costs, and ongoing operation costs – although these would be small in the context of the NICs revenues. Administrative issues are therefore unlikely to be a particular obstacle to the devolution of NICs, at least if powers were restricted to rates and bands and they continued to be administered by HMRC.

4.6.16 Devolution of powers over the tax base – i.e. the types of income that are subject to NICs – would allow broader and potentially beneficial reforms, such as better integration with income tax (especially if powers over the income tax base were also devolved). However, this fuller devolution would entail a bigger increase in administration and compliance costs, especially if managed by a separate Northern Ireland-based revenue authority as opposed to HMRC.

Economic efficiency and risks to the UK tax base

4.6.17 Employees, the self-employed and employers can and do respond to changes in NICs in a myriad of different ways. They can choose to change their labour supply and labour demand; change the wages that they are willing to work for and pay; potentially reclassify earned-income as types of income, such as profits, to which NICs do not apply; and ultimately, migrate.

4.6.18 All of these potential responses would apply to Northern Ireland taxpayers if NICs were devolved and rates in Northern Ireland were varied.

4.6.19 But what is also particularly important to consider is the extent to which employees and employers in Northern Ireland might be responsive to NICs policy differences with GB, and the extent to which this creates additional scope for economic distortions.

4.6.20 There are of course a number of different ways that taxpayers might respond to inter-UK tax policy differences. In the Welsh case, Holtham was particularly concerned about the risk that tax policy differentials could incentivise taxpayers to relocate on one side of the England-Wales border, without needing to rupture working or socialising arrangements in any significant way. This concern is clearly less significant in Northern Ireland's case, as regular commuting between GB and Northern Ireland would not be an option for many (although the prospects of permanently increased rates of home-working post-COVID-19 do increase the possible risks here).

4.6.21 Nonetheless, it is possible that permanent differences in NICs policy could influence individuals' decisions in the long-term over where to live and work, and employers' decisions on where to locate. Further, for those individuals who have properties in both Northern Ireland and GB, they may be able to achieve a change in taxpayer status through only a relatively small change in behaviour.

4.6.22 In addition to these questions of residence and location, NICs differentials could incentivise individuals and employers to respond in other ways. For example, if NICs rates were increased in Northern Ireland, the self-employed would have greater incentives to incorporate to avoid NICs and instead pay corporation tax and dividends tax. Depending on which taxes were devolved to the NI Assembly, this could either increase or decrease UK government revenues.

4.6.23 As with income tax, discussed above, we do not currently have evidence on how responsive individuals and employers are to within-UK variation in NICs. There is also relatively less evidence internationally for social security contributions and taxes purely on earned income than for income tax. That evidence which does exist is mixed and focuses on effects on wages and employment in areas subject to lower contribution rates, rather than any migratory or other spill-over effects on other jurisdictions.

4.6.24 Ku et al (2020)[179], for example, find that when EU rules forced Norway to abolish regional variation in employer payroll taxes, wages and employment fell in those areas which had previously benefited from lower payroll tax rates. Bennmarker et al (2009)[180] find similar but smaller employment effects for a similar scheme in Sweden, driven by the entry and exit of employers. On the other hand, Korkeamaki and Uusitalo (2009)[181] find little evidence of employment effects for a similar scheme in Finland, and Cruces et al (2010)[182] find little evidence of employment effects of regionally-varying changes in contribution rates in Argentina.

4.6.25 Of course, these results are not directly transferable to the Northern Ireland case. In reality we know little about the likely scale of responses of taxpayers to divergence in NICs policy between Northern Ireland and GB. However, evidence from analysis of sub-national income tax differentials suggests that it is more likely that changes in NICs levied on high-earners (who currently pay a lower marginal rate of employee NICs) would have larger migratory and other effects than changes in NICs levied on low-to-middle earners. It also seems reasonable to assume that the migratory response of Northern Ireland taxpayers to within-UK divergence in tax policy would be somewhat lower that it would be for Scottish or Welsh taxpayers. But other forms of response (such as reclassifying income to avoid NICs should Northern Ireland rates increase further relative to taxes on unearned income) are likely to be just as strong.

National Insurance contributions (NICs) summary

4.6.26 NICs raises substantial revenues from a majority of employed and self-employed individuals in Northern Ireland and their employers. Its devolution would therefore provide the NI Assembly with a meaningful ability to vary its budget and greater financial accountability to its electorate – although those with only unearned or pension income or over the state pension age do not pay NICs.

4.6.27 Experience with income tax in Scotland and Wales suggests that a devolved NICs could be operationalised at relatively low administrative cost and disruption (assuming the HMRC continues to administer the tax, and that the definition of the NICs tax base remains determined by the UK Government). Whilst changes in NICs rates in Northern Ireland relative to GB and tax rates imposed on other forms of income could induce some behavioural responses, the scope for such responses is likely to be somewhat lessened in Northern Ireland relative to Wales and Scotland.

4.6.28 Northern Ireland also formally operates its own benefit system, with contributory benefits notionally funded by a separate Northern Ireland National Insurance Fund – unlike the situation in Scotland and Wales.

Conclusion

4.6.29 **There is arguably a slightly stronger case for devolving NICs to Northern Ireland than for Scotland or Wales. However, there remain additional complications relative to income tax, sufficient that, in our view, further work at this stage should prioritise consideration of options for devolving income tax, rather than NICs. If the NI Assembly wished to prioritise NICs over income tax or subsequent to any decisions to successfully devolve some or all income tax revenues to Northern Ireland, there may be a case to reconsider the devolution of NICs. At this stage, however, we will not be carrying this tax forward for consideration as part of the second phase of our work.**

Analysis of UK taxes levied in Northern Ireland – Medium-sized taxes

4.7 Fuel duties

4.7.1 Fuel duty is levied on petrol, diesel and other fuels used in vehicles or for heating. The tax rate depends on the fuel type. Petrol, diesel, biodiesel and bioethanol is currently taxed at 57.95 pence per litre (and has been frozen since 2011), whilst Liquefied petroleum gas (LPG) is taxed at 31.61 pence per litre. The tax is levied on fuel producers and importers.

4.7.2 There is a Rural Fuel Duty Relief which rebates 5 pence per litre in some rural areas with high road fuel prices; however the relief applies to very few areas, and none in Northern Ireland. There are also rebates for diesel and biodiesel used mainly for off-road purposes (e.g. in the construction industry), although the government announced in Budget 2020 plans to remove the entitlement to use red diesel and rebated biodiesel from most sectors from April 2022 to help meet its climate change and air quality targets. From April 2022, rebated diesel and fuel oil will only be available to the agriculture and rail transport sectors.

4.7.3 Fuel duties are estimated to have raised around £864 million in Northern Ireland in 2019-20 according to the ONS, accounting for 5.5% of the total tax take in Northern Ireland.

Economic and policy context

4.7.4 There has generally been reticence to devolve fuel duty within mainland GB given the scope that differential rates might create around cross-border substitution. This concern is less likely to apply to the same extent between Northern Ireland and GB.

4.7.5 Indeed the policy case for devolving fuel duty may hinge in part on the perceived economic risks to Northern Ireland of differential fuel tax policy in RoI. Currently, fuel duty on petrol is slightly lower in RoI, although duty on diesel is significantly lower.

4.7.6 As a result, there is evidence of 'fuel tourism' whereby Northern Ireland consumers buy fuel in the south. One recent study for example found that fuel tourism from Northern Ireland contributed tax receipts in RoI of about €28 million from petrol and €202 million from diesel in 2015 rates, taking VAT into account along with excise and carbon taxes.[183]

4.7.7 In principle, a case can be made that the optimal rate of fuel duty might be somewhat lower in Northern Ireland than in rUK. Fuel duty's primary purpose is to raise revenue. It also has secondary impacts such as on congestion, and since congestion is less of a problem in Northern Ireland than in rUK (on average), the in-principle case for variation in rates across the UK can be made.

4.7.8 Nonetheless, the resulting trade-off between environmental objectives on the one hand and the need to secure revenues on the other hand would raise some interesting challenges to the NI Executive as a result of devolution. Might a fuel duty cut in Northern

Ireland increase tax revenues if it recaptured some of the impacts of 'fuel tourism', and at what price in terms of environmental targets?

4.7.9 In addition to the primary purpose to raise revenue, the duty could potentially be used as a tool to tackle problems of congestion or incentivise use of other transport modes, although it may not be the most direct or efficient tool for achieving objectives in these areas.

4.7.10 In addition, Northern Ireland has experienced long-standing problems with fuel laundering and smuggling, particularly concentrated along the border with RoI. Tackling these issues is made more difficult due to the involvement of organised paramilitary groups, for whom fuel fraud has been a key source of funding.[184][185]

4.7.11 A final point to note which is material to the decision to devolve is that revenues from fuel duty are expected to decline over time given policy commitments to replace fuel based vehicles with electric vehicles.

Legal constraints

4.7.12 The Holtham Commission noted that, under the EU Energy Products Directive, member states must set a single rate of fuel duty for each fuel type. As far as we are aware, this constraint no longer applies, and we are therefore not aware of any legal constraints to devolving fuel duties to the NI Assembly.

Accountability

4.7.13 Fuel duty impacts a majority of households resident in Northern Ireland, and in principle the duty is straightforward to understand. It is not directly 'visible', but it is straightforward to estimate what proportion of a fuel bill is accounted for by duty. The tax is also highly salient to voters with fuel prices and the role of taxes in them regularly discussed in the media – the duty is levied on producers and importers of oil, though costs are largely passed on to consumers. The links and trade-offs around tax rates, environmental objectives, fuel poverty and cross border shopping ensure that debates around fuel duty will have wide salience.

Administrative efficiency

4.7.14 As with other excise duties, a key challenge in relation to devolving fuel duty is that the tax is levied on producers and importers of fuel. It is not levied at the point of final sale to consumers.

4.7.15 In principle, if a large proportion of fuel consumed in Northern Ireland was either produced in Northern Ireland or imported directly into Northern Ireland from a non-UK country, and if very little of the fuel produced in Northern Ireland was sold in GB, then a devolved fuel duty in Northern Ireland could be operationalised relatively straightforwardly by applying it to fuel produced in or imported directly into Northern Ireland.

4.7.16 But in reality, the majority of petrol, diesel and liquefied gas is imported into Northern Ireland from elsewhere in the UK.[xlv] This means that to be meaningfully effective, imports of fuel into Northern Ireland from elsewhere in UK would need to be exempted from UK fuel duty so that the Northern Ireland Duty could apply.

4.7.17 In this context, the NI Protocol to the EU Withdrawal Agreement treats excisable goods moving from GB into Northern Ireland similarly, but not identically, to goods moving across an international border. This means that excise duties are formally levied on the import of excisable products into Northern Ireland from GB. However, the importing party is able to offset any excise duty already paid at the point of production in or import into GB, to both avoid double taxation and the exporting party having to claim back duties via the 'excise drawback' scheme which applies to international exports. This special regime could continue to be used if excise duties were devolved to Northern Ireland, although whereas presently the offsetting of duty already paid nearly always leads to a zero liability at the point of import into Northern Ireland,[xlvi] any differences in tax rates would mean either extra tax payments or refunds would need to be made. This would increase the administration and compliance costs involved, albeit to a lesser extent than if the NI Protocol regime did not already exist. These costs would be higher the greater the difference in duty structure and rules in GB and Northern Ireland. Moreover, a system would need to be put in place for reconciliation of duties on 'exports' from Northern Ireland to GB, which does not currently exist, also entailing additional costs.

4.7.18 Note, that it would be desirable to allocate revenues between the NI Assembly and UK Government as if exports were subject to zero duties and full duties payable at import stage. This would ensure that both receive duty revenues based on consumption of fuel products within their jurisdictions, rather than revenues based largely on what is produced in their jurisdictions.

4.7.19 It is also worth noting that if there was a desire for higher fuel taxation in Northern Ireland, it might theoretically be possible to devolve the ability to add on a fuel duty supplement in Northern Ireland at the point of sale. But this would bring its own administrative problems, given the diverse number of vendors and the lack of infrastructure to collect tax from those vendors currently.

Economic efficiency and risks to the UK tax base

4.7.20 As noted previously, there has traditionally been reticence to devolve fuel duty to Wales in particular, but also Scotland, given risks of cross-border substitution of fuel sales.

4.7.21 This concern is much less likely to apply between Northern Ireland and GB, but cross-border shopping between Northern Ireland and RoI is a real issue as discussed above. Furthermore, fuel duty is in part designed to tackle externalities around local congestion (which may be lower in Northern Ireland than in rUK). There is a case for devolving rate setting to the NI Assembly, in order that these trade-offs between revenues, congestion

[xlv] Data from NISRA indicates that 81% of purchases made by Northern Ireland's refined petroleum industry are sourced from GB – see https://www.nisra.gov.uk/publications/overview-northern-ireland-trade-great-britain. Much liquid gas is imported via a pipeline from Scotland.
[xlvi] The only time when this offsetting is not exact is when excise duty policy is changed between the time of production and payment in GB and the time of import into Northern Ireland.

and other environmental objectives can be more effectively balanced within the specific context.

4.7.22 It is worth noting that the issue of cross-border shopping in RoI could create real risks for the NI Assembly. If the UK Government decided to increase fuel duty rates across the UK, then under current arrangements those increases would apply in Northern Ireland, leading to an increase in the proportion of fuel purchases made by Northern Ireland consumers in RoI. The UK Government would bear the risks of resulting revenue losses from Northern Ireland.

4.7.23 If, on the other hand, fuel duty was devolved, then a UK government increase in duty would not apply in Northern Ireland. But under the 'standard' mechanisms for calculating the 'block grant adjustment' the block grant adjustment would increase in line with the increase in rUK revenues. The NI Assembly may then find its budget penalised however it reacted. If it didn't increase its fuel duty rates, then its budget would decline as a result of the increase in the fuel duty block grant adjustment. But if it increased duty in Northern Ireland to match the situation in rUK it is likely to find that its revenues would not increase by as much as the block grant adjustment, given revenue leakage to RoI. This is an example of why the question of block grant adjustment is just as important as the question of tax devolution itself. See further discussion on block grant adjustments at Annex B.

4.7.24 A final point to note is that, in deciding whether or not to devolve fuel duty, a decision would need to be taken on the scope of devolution. For example, would the ability to vary headline rates only be devolved, or would devolution be fuller in scope, with the NI Executive able to determine rates on different fuel types, as well as the scope of fuel reliefs. Devolution of the power to determine reliefs may increase the scope for behavioural distortions, in part because the decision whether or not to apply a relief for particular users could result in substantial differences in liabilities for those users in NI relative to rUK.

Fuel duty summary

4.7.25 Fuel duty is a moderately-sized and salient tax paid by a relatively large share of Northern Ireland's residents. It also has links with devolved responsibilities in relation to the environment and transport, and has a potential (though somewhat indirect) role in managing localised congestion problems and issues of fuel poverty. Concerns around cross-border substitution of fuel sales within the UK are much less relevant than was the case for Scotland and Wales, and devolution may also be important in managing issues associated with cross-border fuel purchases with RoI.

4.7.26 However, the main factor militating against devolution of fuel duty is its structure as a tax on production or importation, rather than at point of sale. The infrastructure of the NI Protocol would help somewhat with the administration, compliance and enforcement issues that arise from this, but these could still be significant.

Conclusion

4.7.27 **We consider the case for devolution of fuel duty to Northern Ireland is sufficiently strong to merit further investigation as part of the second phase of our work. We will**

carry out additional research, and identify the likely additional administration and compliance checks as far as is possible within the period before the publication of our final report.

4.8 Corporation tax

4.8.1 Corporation tax is a tax levied on the profits of incorporated businesses. Currently, it is levied at a rate of 19% on all profits, having progressively been reduced from 30% for medium and large companies between 2008 and 2017 (although the tax base was also broadened at the same time). The main rate for medium and large companies is set to rise again in future though to 25% in April 2023, with companies with profits below £50,000 facing a rate of 19%, and those with profits between £50,000 and £250,000 facing a rate of between 19% and 25%.

4.8.2 Corporation tax is estimated to have raised £810 million from profits generated in Northern Ireland in 2019-20, making it a moderately-sized revenue-raiser (at an estimated 5.2% of the total tax take in Northern Ireland, roughly one quarter as large as income tax, VAT or NICs, and roughly the same as fuel duties or alcohol and tobacco duties combined).

Economic and policy context

4.8.3 Corporation tax is not devolved in principle or practice to any other part of the UK currently. The Calman Commission decided it should not be devolved to Scotland because it would "create economic inefficiencies as firms react to tax considerations rather than commercial factors" and entail "significant" administrative impacts. The Smith Commission also concluded that corporation tax should not be devolved to Scotland, and while the SNP previously argued for the devolution of corporation tax to Scotland,[186] it now highlights NICs and VAT as its priorities for further tax devolution.[187] In the case of Wales, the Holtham Commission recommended that the Welsh Government seek discussion with the UK Government and other devolved governments on the feasibility of devolving corporation tax, with constraints on the ability to lower tax rates linked to relative levels of economic performance (measured by GVA per capita). This was framed as a regional economic development policy, providing poorer parts of the UK with an additional tool to boost economic performance, while limiting the potential for full-scale tax competition between different parts of the country. However, the Welsh Government has not viewed the devolution of corporation tax as a priority, with senior politicians expressing concerns about the potential for tax avoidance and tax competition.

4.8.4 However, corporation tax has been at the heart of debates about tax devolution in Northern Ireland. This reflects the fact that RoI has, for many years, had a much lower (12.5%) rate of corporation tax than the UK, and has seen high levels of foreign direct investment (FDI), inwards profit-shifting (to take advantage of the lower rate) that boosts revenues despite the low rate, and strong economic performance. In contrast, Northern Ireland's economic performance is relatively poor, with the third-lowest level of output per person and the lowest share of private sector employment of any UK nation or region.

4.8.5 In this context, the devolution of corporation tax and subsequent reduction in tax rate (for example, to 12.5%) has been seen as a potentially very powerful tool to improve Northern Ireland's economic performance. An influential report by the Economic Research Institute of Northern Ireland (ERINI) in 2006 suggested the impacts could be transformational: doubling the rate of economic growth and eliminating the productivity gap with GB within a decade, boosting wages and creating 184,000 jobs (over one-third of the contemporaneous number of private-sector employee jobs) in the space of 20 or so years.[188] Over a similar time horizon, the cut in corporation tax would more than pay for itself – several times over if revenues from other taxes (such as income tax, NICs and VAT) were also accounted for. This analysis was cited in many submissions by industry bodies and political parties to the Varney Review of Tax Policy in Northern Ireland commissioned by the then Labour UK Government. However, the Varney Review criticised the methodology used – which effectively assumed differences in corporation tax rates were the only factor underlying differential FDI and employment trends and projections between RoI and Northern Ireland – and conclusions drawn by ERINI. [189] Following its own analysis, which used an alternative methodology, it concluded that the effects on investment, output and employment would be smaller, and that cutting corporation tax would have a sizeable cumulative net cost to the NI Executive's budget over a period of 20 years – although if additional revenues from other taxes were accounted for, the cumulative impact would be positive after 17 years. However, a proportion of the FDI and profits shifted into Northern Ireland would come from the rest of the UK and the effect on UK government revenue was therefore estimated to be negative over the same time span. The Varney Review itself received criticism for its approach. The then Labour government however decided not to devolve the power to vary the rate of corporation tax to the NI Assembly.

4.8.6 The Coalition government (2010) decided to revisit the issue though, stating in its founding agreement that it would "work to bring Northern Ireland back into the mainstream of UK politics, including producing a government paper examining potential mechanisms for changing the corporation tax rate in Northern Ireland". In March 2011 it published a consultation paper outlining options to grow Northern Ireland's private sector, including by a devolved and lower corporation tax rate. This highlighted both the potential benefits of a lower rate of corporation tax and the caveat that corporation tax (and specifically the corporation tax rate) is unlikely to be the only factor explaining differences in recent economic performance between RoI and Northern Ireland. It also provided indicative estimates of the revenue effects of cutting corporation tax in Northern Ireland, suggesting that induced investment and profits shifted into Northern Ireland from the rest of the world were likely to recoup only a proportion of the costs of the corporation tax cut in the long-term.

4.8.7 However, a Northern Ireland Affairs Committee inquiry in 2011 concluded the case for devolution was "convincing" and that a lower tax rate could be a "game-changer" based on discussions with stakeholders in RoI (although the Varney Review noted that corporation tax for inward investors were actually lower prior to the 'Celtic Tiger' period of rapid growth starting in the 1990s). It suggested distinguishing between trading-profits (on which the lower Northern Ireland rate could apply) and non-trading profits (on which the main UK rate could apply) in order to reduce the risks associated with profit-shifting. At a similar time, the locally based Economic Advisory Group, led by Dame Kate Barker, former member of the Bank of England's Monetary Policy Committee, published its report calling for the devolution of corporation tax rate-setting powers to Northern Ireland, citing the potential for some 58,000 additional jobs over the following 20 years and higher levels of economic growth, productivity and exports.

4.8.8 Noting a range of arguments for and against devolving corporation tax, the UK Government's official response to its consultation, published in 2012, kept its options open. However, in December 2014, the UK Government committed to legislation to devolve corporation tax to Northern Ireland if agreement on a range of other issues could be reached in the then ongoing cross-party talks in Northern Ireland. The so-called Stormont House Agreement was subsequently reached on 23rd December 2014, confirming that "legislation will be introduced as soon as Parliament returns to enable the devolution of corporation tax in April 2017".

4.8.9 Following this commitment, the *Corporation Tax (Northern Ireland) Act 2015* was passed and provides for the devolution of powers to vary the main rate of corporation tax charged on most corporate profits generated in Northern Ireland. In particular, if these powers are commenced, the NI Assembly would have the power to set a Northern Ireland rate of corporation tax applying to the qualifying profits of, broadly:

- Micro, small or medium-sized enterprises (SMEs) for which 75% of staff time and costs relate to work in Northern Ireland and some corporate partners.
- The trading profits of large companies that are attributable to Northern Ireland if they have a "Northern Ireland regional establishment" for which they must use separate accounting to divide income, costs and profits between Northern Ireland and GB, in a manner similar to how they divide income costs and profits between the UK and the rest of the world.[xlvii]

4.8.10 The standard (GB) rate rather than Northern Ireland rate would apply to certain trades and activities:

- Lending and investing activities;
- Asset management;
- Long-term insurance (mainly life insurance)
- Reinsurance of both general and long-term insurance; and
- Profits subject to the oil and gas regime ring-fenced and activities of oil and gas contractors working on the UK continental shelf.

4.8.11 However, the legislation also provides for companies undertaking such excluded trades and activities (except those relating to oil and gas or long-term insurance) to make a one-off decision as to whether the back-office functions related to those trades or activities should be subject to the Northern Ireland rate or not.

4.8.12 This regime has been designed so as to reduce the scope for companies to shift their profits between Northern Ireland and GB to take account of differences in tax rates. For example, by restricting the scope of devolution to trading profits and excluding lending and investing activities, the model would seek to prevent companies from shifting profits

[xlvii] SMEs for which less than 75% of staff time and costs relate to work in Northern Ireland would also be able to opt to use this regime too.

via loans between their GB and Northern Ireland subsidiaries. In addition, and as per the Stormont House Agreement (2014), Northern Ireland's block grant funding was to be adjusted to account an estimate of the revenue that the UK Treasury would forgo from Northern Ireland as a result of the devolution of corporation tax (also a consequence of the 'Azores ruling),[190] but also an estimate of the revenue that would be forgone as a result of any 'first round' behaviour effects that reduce the UK Government's revenue as a result of tax rate differences – such as profit shifting. This 'compensation' to HM Treasury would make it financially costlier to reduce the corporation tax rate.

4.8.13 Importantly, the Stormont House Agreement, reached between Northern Ireland's political leaders and the UK Government, 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 <u>but it will not take into account second round effects on other taxes.</u>[191]"* Therefore if a reduced corporation tax rate Northern Ireland led to improved employment and wage levels in Northern Ireland, which in turn led to improved tax generation for the UK Exchequer from taxes such as income tax, National Insurance contributions and VAT, these improved tax revenues – or fiscal '*spillovers*' – from Northern Ireland would not be considered in helping reduce the costs of corporation tax devolution to the NI Executive.

4.8.14 A key issue is how large such an adjustment should be, which was something HM Treasury and the NI Executive (through the Department of Finance) were negotiating prior to the collapse of the NI Executive in early 2017 (the proposed date of devolution having already been pushed back to April 2018).[xlviii] Perhaps unsurprisingly, HM Treasury was arguing for a larger adjustment than the NI Executive felt was justified. In this context it is worth noting that there is a high degree of uncertainty about the scale of behavioural response (e.g. profit-shifting from the rest of the UK or Tax Motivated Incorporation as a result of the measure) that would take place and these costs, as a proportion of the overall cost, were estimated to be particularly high – potentially one third of the overall cost. Moreover, even *ex post* it would only be possible to estimate (not know for sure) what the behavioural responses had been.

4.8.15 Following the collapse of the NI Executive, plans to commence the devolution of corporation tax were put on hold. A NI Executive was reformed in January 2020, but as yet no policy on whether to commence devolution has been agreed or voted on by the NI Assembly. In part, this may reflect the preoccupation as a result of the COVID-19 crisis, which has understandably absorbed policy and political capacity, and put a premium on funding for public services (which even in the most optimistic scenarios would fall initially). But also the political will does not appear to be what it once was. Finance Minister Conor Murphy stated, in January 2020 and prior to COVID-19, that the devolution of corporation tax was 'not something I'm actively pursuing', that it could only happen if it was affordable and that its significance had receded given Brexit and the changed economic and political circumstances. That said, the Finance Minister more latterly also noted that he remained open to consider corporation tax in conjunction with the broad suite of powers which could enhance the NI Assembly's fiscal responsibilities, as being considered by the Fiscal Commission NI.[192] It is also worth noting that, while we have

[xlviii] Official-level discussions continued following the collapse of the NI Executive but were put on hold when it became clear the NI Executive would not be back in place before April 2018.

heard calls from both sides of the debate, with a limited number of exceptions, we have noted less enthusiasm than we might have expected for pursuing devolution of corporation tax from the wide range of stakeholders with whom we have engaged to date.

4.8.16 The planned increase in the UK rate of corporation tax rate from 19% to 25% (twice the prevailing RoI rate) in April 2023, which was announced in March, has prompted some renewed calls from business groups and others for the devolution of and reduction of corporation tax in Northern Ireland. At the same time, international agreement has been reached by countries accounting for 90% of GDP for a minimum 15% effective corporation tax rate, although with deductions (or 'carve outs') based on payroll and tangible assets in a country to allow rates below this when real economic activity (not just paper profit-shifting) is involved.

4.8.17 The RoI Government, in October, and after intensive discussions with the OECD, made the announcement that it too will sign up to a global deal on corporate tax reform that will set a minimum rate of 15%, for large companies (those over €750m turnover).[193] Under the deal the long-standing 12.5% rate that has been a cornerstone of RoI's industrial policy will no longer be available as part of bids to attract investment from larger multinationals. It is expected to be implemented in 2023. The 12.5% rate is expected to continue for smaller companies.

4.8.18 It is not yet clear how exactly this will affect the attractiveness of RoI as a destination for tax-motivated FDI and profit-shifting; on the one hand, an increase in the headline tax rate due on shifted-profits may reduce the attractiveness of shifting profits in to RoI to some extent; on the other, a 15% rate would raise more from each euro of reported profits than the current 12.5% and would also affect other countries currently setting lower rates. What is clear is that the RoI Government, even prior to the announcement of a 15% minimum rate, had recognised the potential for a decline in revenues given the surrounding global changes. The Department of Finance's Stability Programme Update, published in April 2021, provided for a €2bn drop in corporation tax revenue by 2025 as a possible result of international reforms in the 'not-too-distant future'.[194] This demonstrates the vulnerable nature of this tax source to international changes. The global minimum tax will also have a bearing on the optimal structure of a devolved corporation tax in Northern Ireland – not just in terms of the rate that should be set, but in terms of how the substance-based 'carve outs' that will be allowed, and which could reduce effective tax rates well below 15%, would be incorporated into the rules.

4.8.19 Given recent policy changes at both the UK and international level, it is therefore not clear whether existing analysis or indeed the existing model of devolved corporation tax set out in the *Corporation Tax (Northern Ireland) Act 2015* are still appropriate. Updated detailed analysis may therefore need to be commissioned and other models of devolution considered. These additional models include:

- *Fuller devolution on the basis of separate accounting*, including a wider definition of profits (including from lending and investment activities, and from excluded sectors), and powers over the tax base.
- *Devolution on the basis of formula apportionment*, where profits would be allocated between Northern Ireland and GB on the basis of a mechanical formula accounting for factors such as the location of payroll costs and/or tangible assets and/or the

destination of sales. This is the approach used to apportion corporate income tax bases between US states, Canadian provinces, Italian regions and German municipalities, among others. The aim is to proxy where profits are generated, while avoiding the administration and compliance costs and scope for profit shifting associated with the separate accounting model.

4.8.20 We discuss the administrative and economic efficiency implications of both the model legislated for in the *Corporation Tax (Northern Ireland) Act 2015*, and these alternative models in the following sections.

Legal constraints

4.8.21 There are no legal constraints to devolving corporation tax to the NI Assembly and as discussed, existing legislation provides the right (not yet exercised) for the NI Assembly to set a rate of corporation tax applying to certain trading profits. Devolution is already legislated for in the UK Parliament, though not 'commenced'.

Accountability

4.8.22 Corporation tax is a moderately-sized tax, and as such its devolution would provide the NI Assembly with some ability to vary its funding at the margin. As discussed above, it would also provide it with both a new, potentially important economic policy tool and an additional financial stake in the performance of the Northern Ireland economy, increasing its financial accountability.

4.8.23 Corporation tax is relatively high profile in Northern Ireland. This reflects the lower rate of tax and stronger economic performance in RoI, the political consensus that a lower rate in Northern Ireland would help improve its economic performance, and the fact that devolution is already legislated for. This high profile, if sustained, would help the electorate and other stakeholders hold the NI Assembly to account for its corporation tax policy decisions.

4.8.24 However, corporation tax is formally levied on companies as opposed to individuals and therefore only a small proportion of the population of Northern Ireland have direct experience of it. Moreover, all taxes, including corporation tax, are ultimately incident on real people – whether owners, employees or customers. The (mis)perception that this corporation is a tax that does not affect real people – or only affects very rich people – may hinder the ability of the electorate to properly hold the NI Assembly to account.

Administrative efficiency

4.8.25 Devolution of corporation tax to the NI Assembly would require companies to apportion their profits into elements subject to the Northern Ireland regime and that subject to the standard (GB) regime. HMRC's systems would also need to be updated accordingly. This would entail additional administration and compliance costs. In addition, if the Northern Ireland rate differs from the standard (GB) rate, companies would have an incentive to try to shift their profits between Northern Ireland and GB so that more are taxed at the lower rate (and similarly shift losses so more can be offset against profits at the higher rate). Doing so would entail some cost to the taxpayer, and counteracting such behaviour would entail additional costs for HMRC as well.

4.8.26 HMRC estimated the administration and compliance costs associated with the model of devolution currently legislated for in 2015.[195] They suggested relatively modest costs relative to the likely yield of the Northern Ireland rate of corporation tax:

- *One-off compliance costs of £14 million, associated with companies and their agents familiarising themselves with the devolved regime and setting up new systems to comply with it.*
- *Ongoing compliance costs of £4 million per year, on average, over the first five years of devolution.*
- *One-off IT-related administration costs of £3.4 million.*
- *Ongoing administration costs estimated to be £1 million in the first year of devolution.*

4.8.27 Importantly, these figures were estimated on the basis of the Northern Ireland rate of corporation tax being the same as the main UK rate, and exclude any additional compliance or administration costs associated with tax avoidance activities that would likely result from differing rates of corporation tax. It is difficult to assess what scale these costs could be, but it would not be unreasonable to expect them to be larger than the basic costs of apportioning profits into Northern Ireland and GB elements if there were no incentives to game this system.

4.8.28 Significant work to develop these administration and compliance systems had been taken forward in the lead up to the expected devolution of corporation tax to Northern Ireland. For example, HMRC, working with the Department of Finance, had developed a new IT system to accommodate the new Northern Ireland regime and HMRC had published detailed draft 'guidance notes'[196] which set out how the Northern Ireland corporation tax legislation would operate once a separate rate was set. However, similar to the corporation tax legislation itself, all of these systems would need to be reconsidered given the passage of time and the changed corporation tax environment though they would nonetheless provide a significant base.

4.8.29 There is little evidence on what administration and compliance costs would be under alternative models of devolving corporation tax. It is reasonable to assume that if the NI Assembly had power to vary the tax base as well as the tax rate, the administration and compliance costs would be substantially higher though, given the additional complexity and scope for tax avoidance. It is also reasonable to assume that if the Northern Ireland rate of corporation tax applies to trades and activities excluded from its scope under current legislation, costs would be higher, given these trades and activities were excluded to reduce the scope for tax avoidance.

4.8.30 If formula apportionment was used to allocate profits between Northern Ireland and GB, the compliance and administration costs would depend on whether the data required for the formula was already routinely collected by companies and the ease with which it could be verified by HMRC. Without analysis of specific options it is not possible to say whether these would be higher or lower than under the currently legislated model.

Economic efficiency and risks to the UK tax base

4.8.31 Changes in corporate tax rates could affect company behaviour and in turn the wider economy in several ways. Corporate taxation policy could affect for example the quantity and location of investment and associated economic activity, the location that companies report profits in, the use of debt versus equity financing, and whether firms incorporate.

4.8.32 All of these potential responses would apply to firms in Northern Ireland if corporation tax was devolved and the rate in Northern Ireland were varied. But what is particularly important to consider is the extent to which firms' behaviour may respond to differences in tax rates compared to GB, and the extent to which this creates scope for impacts on the GB economy and UK government tax revenues.

4.8.33 The model of corporation tax devolution legislated for in Northern Ireland was designed to minimise these effects by excluding certain types of profits and types of activities, as described above. However, it was nonetheless recognised that a noticeably lower corporation tax rate in Northern Ireland compared to GB could result in some profits and some activity being displaced from GB to Northern Ireland. The Stormont House Agreement stated that the cost to the NI Assembly in terms of the adjustment to the block grant would reflect the corporation tax revenues forgone as a consequence of 'behavioural effects' as well as the direct effect on the tax base. The scale of these effects is uncertain, and HM Treasury and the NI Executive held different opinions and had not reached agreement on their likely scale.

4.8.34 A range of studies suggest that the location of corporate activity and profits is sensitive to taxation – although tax is only one factor, and is more important for the latter than the former (for which surveys report issues like labour costs and skills, infrastructure and institutional quality are more important). For example, de Mooj and Ederveen (2008)[197] find that profit shifting is very sensitive to differences in corporation tax rates between jurisdictions, investment decisions are also sensitive but less so than profit shifting, whilst decisions over debt v. equity financing are relatively un-sensitive. Heckemeyer and Overesch (2017) similarly find that profit reporting is very sensitive to international tax rate differentials.[198]

4.8.35 Profits are therefore particularly mobile and it is unclear the extent to which the exemptions from the proposed Northern Ireland corporation tax regime would reduce this – there is no empirical evidence specifically on the proposed Northern Ireland base. However broadening the scope of devolution (e.g. to include excluded trades and activities, and granting powers over the tax base) would likely mean more scope for economic distortions and impacts on the UK Government's tax base.

4.8.36 As highlighted above, there are alternative models for corporation tax devolution in Northern Ireland. Formula apportionment (where firms reported profits are allocated geographically on the basis of the location of firms' employment, fixed capital or sales) would prevent purely paper profit-shifting, but might mean greater 'real responses' by taxpayers, likely concentrated among more footloose occupiers. The scope for 'real responses' might feasibly be lower if formula allocation is done on the basis of the location of sales, rather than on the basis of employment or fixed capital, since it is likely to be relatively more difficult for a firm to shift the location of its customers than for it to shift the location of employees and capital investment, which it can directly control.

4.8.37 Overall, the potential for distortions to the location of economic activity and tax bases (profits) as a result of sub-national variation in corporation tax is significant. It is unclear to what extent the current model would mitigate these effects. Further, even ex post, it would be difficult to estimate the extent to which any change in corporation tax revenues in Northern Ireland reflects displacement of profits and/or activity from GB, as opposed to enhanced intrinsic growth and attraction of activity from the rest of the world. This means that adjusting the NI block grant to reflect displacement from GB would always be contentious. The formula apportionment approach is worthy of consideration and is more common elsewhere in other countries, with sales-based formulas likely to minimise the scope for economic distortion.

Corporation tax summary

4.8.38 Corporation tax is a moderately-sized tax, the devolution of which would give the NI Assembly some ability to vary its budget. Its salience to debates about tax policy and economic development and the media attention this generates should also help stakeholders and the electorate hold policymakers to account for their decisions – although a (mis)perception that corporation tax is incident on companies rather than ‘real people’ may hinder this.

4.8.39 Legislation already provides for the devolution of the power to set the main rate of corporation tax in Northern Ireland, which would be applied to most profits generated in Northern Ireland. This power was called for by a cross-section of political parties and other stakeholders in Northern Ireland in order to reduce the corporation tax rate to 12.5%, the same rate which currently applies in RoI (though this is now subject to change). The powers have not been commenced though and there is a question as to whether they should be pursued.

4.8.40 The aim of corporation tax devolution and rate reduction would be to make Northern Ireland a more attractive location for companies to invest – boosting economic output, employment and wages – and locate their profits, with several studies suggesting impacts could be relatively sizeable (although subject to significant margins of uncertainty). The potential for significant benefits from a devolved and reduced corporation tax policy has been well evidenced. That said it is also clear that this evidence is somewhat dated and, inevitably, subject to uncertainty.

4.8.41 There are, however, reasons why corporation tax is a more complex candidate for devolution than many other taxes.

4.8.42 Firstly, the location of business activity and in particular where profits are reported can be highly responsive to tax rates such that differences between Northern Ireland and GB can be expected to generate economically important distortions to economic activity and/or UK government tax bases. In order to reflect these impacts, HM Treasury previously planned to adjust the NI Executive’s block grant funding not only for the revenue it would directly forgo as a result of the devolution of corporation tax, but also an estimate of the impact of the NI Executive’s corporation tax policies on revenues raised in GB. Importantly, second round effect or fiscal ‘spillovers’ where the UK Exchequer might have benefitted from increased Northern Ireland tax receipts as a result of a reduced corporation tax policy were excluded from consideration. Achieving agreement on these sorts of inevitably contested estimates would be hard. The overall impact on the NI block grant would be large.

4.8.43 Secondly, undertaking and verifying the apportionment of profits between GB and Northern Ireland would entail additional administration and compliance costs, not least in relation to the policing of anti-avoidance and transfer pricing provisions. While significant work has been undertaken for the current legislative model, this was not completed and would likely need revisiting given the passage of time.

4.8.44 Lastly, the policy context has changed. International agreement has been reached by countries for a minimum 15% effective corporation tax rate. At a UK level the government repeatedly cut its own rate over the last 14 years but now plans on significant increases in the next two years. Additionally, the RoI Government has agreed to break with its decades long policy of a 12.5% corporation tax rate and has set aside €2bn to help mitigate the effects of a changing global environment by 2025. This all points to a highly uncertain environment for a tax vulnerable to international changes and with significant changes taking place close to Northern Ireland.

Conclusion

4.8.45 **In conclusion, it is the Commission's view that there is a case for devolving corporation tax to Northern Ireland. However, it is also our view that, given the complexities, both technical and political, there is no value in the NI Executive simply asking for it again. It will need to demonstrate how it would use the powers, and how it would balance its budget. It would need to demonstrate the "sustainability" of its finances. It would need to work together with the UK Government on these issues**.

4.8.46 It is our view that there are a number of pre-requisites for successful devolution, which include:

- A clear statement of intent from the NI Executive on how devolved powers would be used;
- Agreement with HM Treasury over how the block grant would be adjusted in response to the mechanical effect of a cut in tax rate on revenue;
- A clear method for agreeing how, if at all, other effects on revenues would be taken into account, and a method for resolving disputes with HM Treasury;
- An agreement with HM Treasury over some limited additional borrowing powers to cover part of the short-term hole created by a tax cut;
- A clear commitment from the NI Executive over how it would fill the rest of the short-term hole in its revenues created by a tax cut and repay its additional borrowing.

4.8.47 As a Commission we believe that there is value in the NI Executive seeking devolution of corporation tax. Equally we see no value in them doing so unilaterally. We also recognise that our approach to corporation tax is different to our approach to other taxes and different to the approach taken in Scotland and Wales in respect of the taxes devolved there. However, corporation tax is different and the issues that need resolution are more complex. Should the NI Executive wish to pursue devolution we would urge them to develop their own plans for sustainability and we would urge HM Treasury to engage constructively on the block grant adjustment and borrowing powers.

4.8.48 **Given the work already done, the scale and complexity of the issues, the need for action from the NI Executive and constructive engagement from HM Treasury, we as a Commission will not consider corporation tax any further.**

4.9 Alcohol and tobacco duties

4.9.1 Alcohol and tobacco duties are excise taxes charged on a range of products produced in or imported in to the UK. The duties applied to beer, cider, spirits and wine are structured differently but are all based on volume and/or volume of alcohol. The duty applied to tobacco products depends on mass, except for cigarettes where it depends on the number of cigarettes and the retail price at which they are sold.

4.9.2 Taken together, alcohol duties levied on alcoholic products consumed in Northern Ireland are estimated to have raised £290 million in 2019-20, and tobacco duties £484 million, together contributing 4.9% of the total tax take in Northern Ireland.

Economic and policy context

4.9.3 The NI Assembly has responsibility for public health policy, including efforts to reduce the harms caused by smoking and excessive alcohol consumption. Tax policy is potentially one element of this, with the harms caused by smoking and drinking being one of the main economic rationales for the imposition of specific taxes on these products in the first place.

4.9.4 As it stands, the NI Assembly has the power to regulate these activities, such as via the ban on smoking in enclosed public spaces introduced in 2007. It is also able to set minimum prices, such as of the kind that exist for alcohol in Scotland (since 2018) and Wales (since 2020) and will soon exist in RoI (from 2022). However, research by the IFS has shown that such minimum prices while leading to a reduction in alcohol consumption concentrated among the heaviest drinkers, also lead to reductions in tax revenues and windfall gains to the alcohol industry (because the minimum price puts a floor on competition).[199] Combining minimum prices with reformed alcohol taxes could generate the same reduction in alcohol consumption without such large revenue losses. Devolution of tax powers could therefore facilitate a more efficient overall package of reforms. However, it is worth noting that whereas in the absence of devolution any revenue effects (negative or positive) from minimum pricing schemes are borne by the UK Government, devolution would see them borne by the NI Executive. Moreover, the NI Protocol to the EU Withdrawal Agreement requires excise policy in Northern Ireland to be in line with EU rules, potentially preventing many sensible reforms of the system.[200]

4.9.5 Alcohol and tobacco duties are required to be the same across an entire state by EU law, except in a few specific instances where derogations have been granted. However, such duties are 'devolved' and set at a state and sometimes local level in the United States,[201] and by provinces in Canada.[202]

4.9.6 Rates of alcohol and tobacco duty in RoI are currently generally higher than in the UK. For example, in the UK there is a Spirit Duty of £28.74 per litre of pure alcohol, in RoI the rate is €42.57 per litre of pure alcohol. A 2019 paper comparing alcohol taxation throughout the European Union (including the UK) found that both ROI and the UK had some of the highest alcohol duty rates with ROI typically having a slightly higher duty rate per unit of alcohol than the UK.[203] Similarly for tobacco, in 2019 the UK and ROI had the highest duties in the EU on cigarettes, with RoI slightly higher than the UK - €7.57 vs €6.57. [204] It is also worth noting that RoI's planned minimum unit price for alcohol of €1 is approximately 70% higher than the 50p currently in place in Scotland and Wales. This could have a bearing on the scale of cross-border shopping for alcoholic products and on the tax rates that the NI Assembly might want to set if alcohol duty were devolved to it.

4.9.7 As part of the Autumn Budget 2021, the UK Government announced a freezing of alcohol duty rates in the UK,[205] and published a consultation on detailed proposals for alcohol duty reform.[206] The consultation will close on 30 January 2022, with changes coming into effect in February 2023. Proposals include: simplifying the duty system, reducing the number of rates from 15 to 6 and taxing all products in proportion to their alcohol content; introducing a new small producer relief; reducing duty rates on draught beer and cider by 5%, and simplifying the way businesses register and pay for duty. In terms of tobacco duties, an increase was announced in duty rates on all tobacco products by the Tobacco Duty escalator of 2% above inflation (based on the Retail Price Index (RPI)), with the increase for hand-rolling tobacco moving to 6% above RPI inflation, and the Minimum Excise Tax increasing to 3% above RPI inflation.[207]

Legal constraints

4.9.8 We are not aware of any legal constraints to the devolution of alcohol and tobacco duties to the NI Assembly. However, as highlighted above, the NI Protocol to the EU Withdrawal Agreement requires excise policy in Northern Ireland to be in line with EU rules. It is not clear therefore, whether the reforms proposed in the UK Government's consultation on alcohol duties will be applicable in Northern Ireland as, if implemented, they would mark a departure from existing EU requirements on excise duties.

Accountability

4.9.9 Alcohol and tobacco duties are moderately-sized taxes, which in the absence of significant behavioural response, would provide the NI Assembly with some ability to vary its budget at the margin. However, as discussed further below, purchases of alcohol and tobacco are highly responsive to excise duty rates, which may limit the degree to which increases in taxes can be used to raise additional revenues.

4.9.10 Approximately 80% of adults in Northern Ireland consume alcohol, and would therefore be affected by alcohol duties to the extent that they get passed on in prices, although only 16% smoke.[208] Alcohol duty policy in particular is also covered in the media, in relation to concerns both about the impact on pubs, and the harms caused by excessive drinking.[209] This media coverage could help the electorate hold the NI Assembly to account for its tax policy.

4.9.11 Devolution could also help with public messaging in relation to the impact of smuggling excisable products, which often references the impact of lost revenues on public spending. The link to public spending in Northern Ireland would be bigger and clearer if alcohol and tobacco duty revenues were devolved, perhaps making this messaging more effective.

Administrative efficiency

4.9.12 Alcohol and tobacco duties are levied at the production and import stage rather than by retailers at the point of sale to final consumers, in order to limit the number of taxpayers (there are fewer producers and importers than retailers) and hence reduce administration and compliance costs and risks. In this context, the NI Protocol to the EU Withdrawal Agreement requires excisable goods moving from GB into Northern Ireland similarly but not identically to goods moving across an international border. This means that excise duties are formally levied on the import of excisable products into Northern Ireland from GB. However, the importing party is able to offset any excise duty already paid at the point of production in or import into GB, to both avoid double taxation and the exporting party having to claim back duties via the 'excise drawback' scheme which applies to international exports.

4.9.13 This special regime could continue to be used if excise duties were devolved to Northern Ireland, although whereas presently the offsetting of duty already paid nearly always leads to a zero liability at the point of import into Northern Ireland,[xlix] any differences in tax rates would mean either extra tax payments or refunds would need to be made. This would increase the administration and compliance costs involved, albeit to a lesser extent than if the NI Protocol regime did not already exist. These costs would be higher the greater the difference in duty structure and rules in GB and Northern Ireland. Moreover, a system would need to be put in place for reconciliation of duties on 'exports' from Northern Ireland to GB, which does not currently exist, also entailing additional costs.

4.9.14 It would be desirable to allocate revenues between the NI Assembly and UK Government as if exports were subject to zero duties and full duties payable at import stage. This would ensure that both receive duty revenues based on consumption of alcohol and tobacco products within their jurisdictions, rather than revenues based largely on what is produced in their jurisdictions.

4.9.15 It is also worth noting that if there was a desire for higher alcohol and tobacco taxation in Northern Ireland, it might theoretically be possible to devolve the ability to add on duty supplements in Northern Ireland at the point of sale. But this would bring its own administrative problems, given the diverse number of vendors and the lack of infrastructure to collect tax from those vendors currently.

Economic efficiency and risks to the UK tax base

4.9.16 As with other indirect taxes, differences in alcohol and tobacco duty rates between Northern Ireland and GB could affect the location where people purchase these products, impacting the wider UK tax base. Given the very high effective tax rates and transportability of tobacco products and, to an extent, spirits and wine, evidence suggests

[xlix] The only time when this offsetting is not exact is when excise duty policy is changed between the time of production and payment in GB and the time of import into Northern Ireland.

that moderate to large-sized proportional differences in tax rates could incentivise significant cross-border shopping and potentially organised excise fraud via undeclared cross-border movements of alcohol and tobacco for onward sale. For example, research by the IFS in the 1990s shows that the elasticity of demand for wine, for which duties in France were (and remain) substantially lower than in the UK, increased following the removal of purchase limits when the Single Market came into force in 1993, especially for residents of South East England.[210]

4.9.17 It is worth noting that the fact that Northern Ireland and GB do not share a land border such that travel by air, or for larger quantities, sea, would be required to engage in cross-border shopping would mean cross-border shopping and fraud is likely of less concern than for devolution in Scotland or particularly Wales. Evidence from Sweden, for example, suggests that a 1% reduction in prices in nearby countries (Denmark, Finland, Germany and Norway) leads to a 0.4% fall in domestic expenditure on alcohol in border areas, 0.2% at a distance of 200km from the border, and 0.1% at a distance of 400km from the border, with impacts smaller for the Danish than Finnish border given the need to pay a toll to use the Malmo-Copenhagen bridge.[211] This suggests that modest differences in tax rates would likely have only small effects on the tax base of the rest of the UK, likely driven by cross-border shopping by those travelling for other reasons, rather than specifically to take advantage of alcohol and tobacco duty differences.

Alcohol and tobacco duties summary

4.9.18 Alcohol and tobacco duties are moderately-sized taxes that have strong links to the NI Assembly's existing public health responsibilities. Devolution is legally possible, although the NI Protocol would limit the flexibility that the NI Assembly would have in determining the structure of these duties.

4.9.19 A factor militating against devolution of alcohol and tobacco duties are their structure as taxes on production or importation, rather than at point of sale. The infrastructure of the NI Protocol would help somewhat with the administration, compliance and enforcement issues that arise from this, but these could still be significant.

4.9.20 Significant differences in tax rates compared to the rest of the UK could lead to cross-border shopping by consumers, and the potential for excise fraud via onward sale. However, devolution would allow the NI Assembly to design tax policy in light of policy in RoI if it so wished, where the land border means greater propensity for cross-border shopping.

Conclusion

4.9.21 **We consider the case for devolution of alcohol and tobacco duties to Northern Ireland to be sufficiently strong to merit further consideration as part of the second phase of our work. We will carry out additional research, and identify the likely additional administration and compliance checks as far as is possible within the period before the publication of our final report.**

Analysis of UK taxes levied in Northern Ireland – Minor taxes

4.10 Vehicle excise duty

4.10.1 Vehicle excise duty (VED) is an annual tax paid by the registered keeper of private and commercial motor vehicles. For cars registered since 2017, the rate of duty in the first year it is registered is higher than in subsequent years, and depends on its carbon emissions (in subsequent years it depends on fuel source), while the rate for motorcycles depends on engine size. A higher rate is also applicable for the first five years for cars with an original list price of £40,000 or more. For cars registered between 2001 and 2017, annual duty rates depend on carbon emissions, while for cars registered before 2002 they depend on engine size.

4.10.2 VED is estimated to have raised £66 million from businesses and £153 million from households in 2019-20, for a total of £219 million (1.4% of the total tax take in Northern Ireland).

Economic and policy context

4.10.3 Climate change, environmental and transport policies are devolved matters, and devolution of VED could provide the NI Assembly with an additional policy lever that relates to these areas.

4.10.4 As the application of VED depends on the location of the 'registered keeper' of a vehicle,[l] which for most vehicles used by households is the same location as the user and owner (as they are all the same person), policy in RoI (and if VED were devolved to Northern Ireland, in GB) matters most for vehicle hire and commercial vehicles, where the locations and people/businesses that are the 'registered keeper' and user or owner are more likely to differ.

4.10.5 In this context, it is worth noting that rates in RoI are the same each year and (for vehicles registered since 2008) depend on carbon emissions, albeit using different bands than those used in the UK. Typically rates in RoI are higher for vehicles for low emissions levels. For example a petrol car first registered after 2017 with 70g emissions pays £15 in the UK for the first year and then £155 in subsequent years. In ROI, this payment would be €170 in each year. For example in ROI, cars registered before 2017 in the lowest tax band are charged €120 annually, compared to the zero rate for cars in the lowest band in the UK. Heavy goods vehicles similarly face higher rates in ROI.[212,213]

4.10.6 Equivalent taxes are devolved to sub-national governments in a range of countries in Europe including Belgium, the Netherlands and Spain, and are operated at the state and sometimes local-level in the US, and at the state- or territory-level in Australia. It has also been suggested as a tax to devolve or at least assign to the Greater London Authority.[214]

[l]The 'registered keeper' of a vehicle registered keeper has responsibility for ensuring a car is road-worthy and has a valid MOT, is insured and is the first point of contact for the police and authorities in relation to crime or motoring offences. This is often but not always the same person or business as the owner or user of a vehicle.

Legal constraints

4.10.7 We are not aware of any legal constraints to devolving VED to the NI Assembly.

Accountability

4.10.8 As a small-to-moderate sized tax, the devolution of VED would do relatively little to improve the overall financial accountability of the NI Assembly. They are, however, paid by a large share of households – approximately 83% of households in Northern Ireland have access to at least one car in 2019[215] –, and are relatively visible (as they are paid directly by households) and seem likely to be well understood in principle (despite their structure recently becoming more complex).

Administrative efficiency

4.10.9 VED is payable on an annual basis by the registered keeper of vehicle, which is often but not necessarily the same as the legal owner or user of the vehicle. This led the Holtham Commission to conclude that devolution of VED would be "administratively complex" although it is not fully clear why this would present an administrative challenge as opposed to an opportunity for economic distortions and tax avoidance. The tax is currently paid by registered keepers, for whom the Driver and Vehicle Licensing Agency (DVLA) presumably holds address details for, and these addresses could be used to assign taxing rights to Northern Ireland and GB. The DVLA could continue to be responsible for collecting taxes post-devolution in order to minimise administration costs, although it would also be possible to expand the functions of the Northern Ireland-based Driver and Vehicle Agency which is already responsible for licensing and testing vehicles and drivers.

Economic efficiency and risks to the UK tax base

4.10.10 As discussed above, the fact that the registered keeper of a car is not necessarily the same as the owner (or user) of a vehicle provides an opportunity for post-devolution tax avoidance. For example, the registered keeper of a vehicle could be changed in order to minimise tax payments if there were differences post-devolution. In the case of vehicles owned and used by private households this seems unlikely to be worthwhile unless differences in tax rates were very substantial as the registered keeper has significant responsibilities in relation to the vehicle. However, when cars are leased, the finance company that funds the agreement is often both the registered keeper and the owner, and large differences in tax might prompt a growth in leasing arrangements funded by companies in the jurisdiction with the lower taxes. Issues might also be more likely to arise for commercial and fleet vehicles, including those owned by vehicle hire firms. For example, businesses and vehicle hire firms could potentially change the address they use for vehicle licensing and taxation purposes. It may be possible to require separate registered addresses for vehicles in Northern Ireland and GB, although there may be a need for some checks to verify the normal location of vehicles, and this could affect the flexibility of businesses to move vehicles around the UK.

4.10.11 Post-devolution differences in tax rates could also, in principle, cause broader economic distortions. However, unless these differences were very large relative to current tax rates it seems unlikely that they would cause important distortions to economic activity across the UK (by changing businesses transport costs, for instance), given the low current rates of tax.

4.10.12 The UK Government has acknowledged the vital contribution that a transition to zero emission vehicles will have in achieving net-zero carbon emissions by 2050, and the associated fiscal implications of this transition.[li] In line with this, the UK Government has noted the requirement that revenue from motor taxes must keep pace with these changes to ensure the continuation of sustainable funding for public services and infrastructure.[216] While the extent of the effect on revenue receipts remains unclear, the transition to electric vehicles is likely to result in changes to motor tax systems which will have implications for any devolution arrangements made in respect of such taxes.

Vehicle excise duty summary

4.10.13 As a small-to-moderate sized tax, likely to diminish further as measures to promote the achievement of environmental goals are increasingly being introduced, the devolution of VED would do relatively little to improve the overall financial accountability of the NI Assembly. However, it is paid by a large fraction of households, is visible and seems likely to be well understood. Existing administration arrangements and the fact such taxes are operated sub-nationally in a number of other countries suggests it would be administratively feasible to devolve too.

4.10.14 While the risk of economic distortions, tax avoidance and negative effects on the wider UK tax base would seem to be relatively modest for vehicles owned by private households, the situation is more problematic for commercial and fleet vehicles, where the user of the vehicle is not usually the 'registered keeper'. Any changes in tax rates post devolution, would offer strong incentives to businesses and vehicle hire firms to alter the location used for vehicle licensing and taxation purposes, to take advantage of the opportunity to pay lower levels of excise duty.

Conclusion

4.10.15 **There is a case, in principle, for the devolution of vehicle excise duty to Northern Ireland. However, due to the potential for significant distortions to tax bases, under existing administrative arrangements, where the 'registered keeper' of a vehicle is liable, we do not consider the devolution of this duty to be a priority for Northern Ireland at this time, and do not intend to carry this levy forward for consideration as part of the second phase of our work.**

4.11 Insurance premium tax

4.11.1 Insurance premium tax (IPT) is a tax levied on the value of general insurance premiums paid by both consumers and businesses, excluding life, long-term and re-insurance, along with some other policy categories including commercial shipping, aircraft and some export related insurance policy categories. It is charged at two rates: a standard 12% rate covering most buildings, content and most vehicle insurance; and a higher 20% rate

[li] Zero emission electric vehicles are zero-rated for standard tax for the first and all subsequent years, meaning they are exempt from VED.

covering travel insurance and that sold alongside domestic appliances and by vehicle manufacturers or retailers. It was initially envisioned as being in lieu of VAT on insurance services (financial services are exempted from VAT), but unlike VAT neither insurers nor businesses purchasing insurance are able to claim any input cost deductions.

4.11.2 IPT is estimated to have raised £144 million from Northern Ireland-based insurance customers in 2019-20, approximately 0.9% of the total tax take in Northern Ireland.

Economic and policy context

4.11.3 The regulation of the insurance industry is a reserved matter, such that IPT has little direct relevance for devolved responsibilities. However, historically, some insurance costs have been higher in Northern Ireland than in GB. An NI Assembly Research paper[217] and Consumer Council research[218] outlined that this was particularly the case for motor insurance. Factors behind this include a younger population, a different legal system in Northern Ireland (resulting in higher insurance pay-outs typically) and a smaller number of insurers operating in Northern Ireland. If the NI Assembly were minded to offset the higher costs of insurances such as motor insurance via lower taxes (albeit at a cost), that could provide a rationale for devolution.

4.11.4 In RoI levies on insurance are typically below UK rates. Non-life insurance policies are typically subject to a 3% levy and life assurance premiums are subject to a 1% levy. The RoI Government also charges health insurers a Health Insurance levy for every member that takes out a health insurance policy. The levy forms a set amount of a person's health insurance premium. The current rates for this levy range between €157 and €449 for adults depending on the type of cover.[219]

Legal constraints

4.11.5 We are not aware of any legal constraints to the devolution of IPT to the NI Assembly.

Accountability

4.11.6 The relatively small amount of tax revenues raised by IPT means it would do relatively little to increase the financial accountability of the NI Assembly. To the extent that it is passed on in the form of higher insurance premiums, it would be paid by the large proportion of Northern Ireland residents who purchase home, vehicle, travel or other applicable general insurance policies. However, the relatively muted reaction to the big increases in IPT in recent years (with the standard rate increasing from 5% to 12% between 2011 and 2017) suggests that this tax may not be particularly salient, which could limit the ability of the electorate to hold the NI Assembly to account for tax policy.

Administrative efficiency

4.11.7 Broadly speaking there would be two ways in which IPT could be devolved. The first would be to devolve it on the basis of the location of the risk, which is in-line with international practices. This would avoid the need for insurers to use information on where the insured property or person is located when calculating the tax that is due – although as discussed below, at the cost of increasing the potential economic distortions that devolution could generate, and making devolution less of a tool to reduce the insurance premiums faced by Northern Ireland-based customers. The second approach would be for the tax to depend on the location of the person or property being insured. For many insurance contracts, there would be one relevant location (e.g. a property, the usual place a vehicle is stored, the usual place of residence) that the insurer will already be recording for their own purposes. There would be compliance and administration costs involved in reporting and monitoring this information, but these would unlikely be insurmountable. However, certain insurance contracts (such as general commercial insurance) will cover activities in both Northern Ireland and GB and apportioning the contract value between the two may not be straight-forward. The compliance and administration costs involved in making and monitoring such apportionments could be significant, although the degree of difficulty would depend on how insurers calculate premiums.

Economic efficiency and risks to the UK tax base

4.11.8 If the tax were applied on the basis of where the insured property or person is located rather than where the insurer is located, as would likely be the case, the impact of any changes in tax rates post-devolution on economic activity and tax bases in the rest of the UK would likely be limited. Differences in insurance costs for businesses could, in principle, affect the competitiveness of Northern Ireland businesses versus those in GB, although such effects would likely be negligible in practice except for those businesses where insurance costs are a very large share of their costs.

4.11.9 If the tax were applied on the basis of where the insurer is located, there could be much larger impacts on economic activity and/or the tax base of the rest of the UK, depending on how the place of establishment of the insurer was defined.

Insurance premium tax summary

4.11.10 As a relatively small and seemingly non-salient tax, the devolution of IPT would do relatively little to increase the financial accountability of the NI Assembly. It is of limited relevance to devolved responsibilities, although its devolution would provide the NI Assembly with a tool to reduce traditionally high insurance costs in Northern Ireland via lower tax rates (and hence lower revenues).

4.11.11 If devolved such that taxes were charged on the basis of ‘customer’ rather than insurer location, economic distortions would likely be relatively modest but there could be significant administration and compliance costs and challenges, not least for business insurance covering businesses that operate across Northern Ireland and GB. On the other hand, if devolved such that taxes were charged on the basis of where the insurer was based, the scope for economic and tax base distortion could be significant.

Conclusion

4.11.12 **The insurance premium tax is not a strong candidate for devolution in Northern Ireland. Therefore, we will not be carrying this tax forward for consideration as part of the second phase of our work.**

4.12 Capital gains tax

4.12.1 Capital gains tax (CGT) is a tax on the profits made when an asset is sold, or 'disposed of'. Chargeable assets include land and property (although main residences are exempt, so CGT is only chargeable on properties that are not the owner's main residence), most personal possessions worth £6,000 or more (excluding motor vehicles), shares (other than those in an ISA or similar tax exempt account), and business assets.

4.12.2 Individuals or trusts may be liable for CGT (capital gains made by businesses are taxed through corporation tax). Individuals and trusts with a liability for CGT self-report and pay any liability directly to HMRC.

4.12.3 Taxable capital gains rates depend on both the individual's income tax band and the source of the gain. Higher- and additional-rate income tax payers are subject to CGT of 28% on gains from residential property and 20% on gains from other chargeable assets. Basic-rate taxpayers are taxed at a rate of 18% for residential property and 10% for other assets so long as the sum of their taxable gains and their taxable income is below the basic income tax band.

4.12.4 Data from HMRC indicates that, for each of the four years from 2016/17 to 2019/20, there were an estimated 4,000 Northern Ireland residents who had liabilities for CGT.[220] Revenues from these taxpayers amounted to between £90 million and £120 million in those years. In 2019/20, £105 million was raised in CGT in Northern Ireland, 0.7% of the total tax take.

Economic and policy context

4.12.5 The Holtham Commission ruled out devolution of CGT on assets *other than* land and property on the grounds that it would be administratively complex and would create opportunities for avoidance. However, the Holtham Commission did believe that there was a case in principle for devolving CGT on land and property to Wales, given that many other aspects of land and property taxation are devolved already.

4.12.6 The Holtham Commission did not spell out explicitly how this 'land and property' model of CGT devolution would work. We assume that devolved rates of CGT would apply to any disposal of land and property assets in Wales, regardless of the location of the owner of those assets. The Commission's final recommendation was that 'the administrative costs of devolving capital gains tax on property and land should be explored with HMRC'. It is not clear at this point whether that recommendation was implemented, and what the conclusions were if so.

4.12.7 As well as this 'Holtham model' of CGT devolution, it is also possible to consider a broader devolution of CGT on all assets, including both physical and financial, based on the geographical location of taxpayers themselves (rather than the location of physical assets). In this report, we consider both the full devolution model, based on the location of taxpayers, and the Holtham model, based on the location of land or property disposed of.

4.12.8 The Scottish Government has recently begun to make the case for CGT devolution in Scotland. To date it has published no detailed appraisal of the case for CGT devolution, other than to note that CGT has a 'close relationship with [devolved] income tax'.

4.12.9 It also notes that 'capital gains tax is also a crucial lever in the taxation of wealth, and its design is skewed by the relatively higher values of assets in the South East of England. Devolution of this regime would allow us to tailor the policy as it applies to taxpayers in Scotland and ensure it operates as efficiently as possible'. This argument is not elucidated in any further detail by the Scottish Government. Nonetheless it implies that it is interested in a model of full CGT devolution, based on taxpayer location, rather than the Holtham model based on location of land and property assets.

Legal constraints

4.12.10 We are not aware of any legal constraints to devolving CGT to the NI Assembly.

Accountability

4.12.11 In revenue terms, CGT is not insignificant, and could be characterised as a small-to-medium tax. But the relatively small number of taxpayers means that it is a less visible and salient tax than many.

4.12.12 Unfortunately, we do not have a breakdown of Northern Ireland CGT revenues by asset type. At UK level however, financial assets accounted for 80% of gains in 2018/19, with non-financial assets accounting for 20%.[221] This may be important in the context of the merits of devolving land and property elements of CGT only. In other words, on a very rough assumption that CGT on land and property assets in Northern Ireland accounts for 20% of total CGT revenues, then the land and property element alone should very much be considered a 'small' tax, rather than a small to medium tax.

Administrative efficiency

4.12.13 We first consider the administration issues around devolving all CGT assets, and then go on to consider the 'Holtham model' of land and property assets only.

4.12.14 Individuals liable for CGT must report and pay their liability to HMRC. There are a number of ways in which this reporting can happen. Property sold on or after 6 April 2020 must be reported and paid using a 'capital gains tax on UK property account' within 30 days of sale. Other gains can be paid via self-assessment, or immediately via HMRC's 'real time' capital gains tax service. In all cases however, HMRC relies on self-reporting.

4.12.15 In principle this provides an opportunity for CGT devolution – on all assets – to happen at relatively limited administrative burden. HMRC has already identified rules to determine Scottish and Welsh taxpayers for income tax purposes. Assuming income tax is devolved to Northern Ireland, then in principle, most individuals submitting a return for CGT via self-assessment would already be identified on HMRC's systems as being a Northern Ireland taxpayer or not.

4.12.16 The costs of identifying Northern Ireland taxpayers for the purposes of CGT *only* would likely not be justified, but if we assume that income tax is devolved to Northern Ireland, there might be little additional burden involved in devolving CGT. With taxpayer status already identified, devolution would require HMRC to adapt its systems so that different rates could be applied to Northern Ireland taxpayers.

4.12.17 However, there are two additional complications to consider. One is perhaps relatively minor and concerns Northern Ireland residents who do not pay income tax. It is possible that not all those liable for CGT in Northern Ireland would be liable for income tax. Any such individual would need to self-declare their taxpayer status as Northern Ireland when making a tax return. This is unlikely to be a problematic issue from an administrative perspective, but may increase scope for avoidance.

4.12.18 A potentially bigger challenge relates to the treatment of trusts. The trustees of a trust are normally responsible for paying CGT on behalf of a trust, when assets of the trust are disposed of. But the geographical location of the trustees may be unknown. It would also be relatively easy for a trust to appoint trustees in a part of the UK offering the lowest CGT tax burden if CGT was devolved. In addition, there is a more philosophical question about whether a trust should be taxed on the basis of the geographical location of trustees, as opposed to the beneficiaries – although the latter may be either unknown at the current point in time, or spread across different parts of the UK.

4.12.19 For these reasons, one option for devolution would be to devolve CGT as it pertains to individuals, but to continue to subject trusts to UK rates of CGT, in effect removing trusts from the purview of devolved taxation. At UK level, trusts account for an average of 10% of CGT revenues between 2010/11 and 2019/20, with individuals accounting for the remaining 90%. So there is a case for saying that trusts are a relatively small part of the picture. But there is of course a risk that if CGT was devolved and a higher rate were established in Northern Ireland, then this may increase the incentives to place assets in trusts as a source of avoidance (although this risk is lessened by the fact that CGT may be liable on an individual's assets when they are placed into a trust).

4.12.20 What about the Holtham model of CGT, which would apply to any Northern Ireland-based land or property asset on disposal, regardless of the location of the individual taxpayer or trust? This model would require a change to HMRC's systems of reporting capital gains to include a more explicit identification of the location of land and property assets. Any cost here would presumably be relatively low (lower than devolving CGT on a taxpayer-residence basis). As noted previously, the Holtham Commission recommended that these administration costs be explored, but it is unclear what the conclusion (if any) of those deliberations has been.

Economic efficiency and risks to the UK tax base

4.12.21 By being based on the location of physical assets, the Holtham model of land and property CGT devolution is unlikely to create distortions or undermine the tax base of one part of the UK relative to others, even if tax rates diverge (higher rates of CGT on property in one part of the UK might overtime reduce demand for investment in those assets, but that might behavioural response might form part of the rationale for the policy – one of the reasons Holtham argued for devolution of CGT on land and property is as a tool for addressing problems associated with second homeownership in parts of Wales).

4.12.22 The broader residence-based model of CGT devolution seems very unlikely to lead to migration between UK nations to capitalise on lower CGT rates – although for very wealthy individuals disposing of a very profitable asset the incentive might exist if tax rate divergence were large.

4.12.23 The bigger risk, as discussed in the previous section, is that people might be able to use trusts to ensure they are liable for a lower CGT tax rate than prevails in their jurisdiction of normal residence. It may be worth consulting with a chartered tax professional to ascertain how significant this threat might be.

Capital gains tax summary

4.12.24 CGT is partially linked to devolved competencies in that it applies to land and property assets, but the larger share of CGT revenues derives from disposals of non-land and property assets, which have a less direct link with devolved policy competence. CGT is a small to medium sized tax which affects relatively few individuals in any given year.

4.12.25 There are two potential models for CGT devolution: devolution of CGT on disposals of land and property assets in Northern Ireland ('land and property devolution'); and devolution of CGT on disposals of all assets, based on the geographical location of the owner of the assets ('full devolution').

4.12.26 Land and property CGT devolution should be relatively easy to administer (although it would require some reform of existing HMRC systems) and create limited scope for distortions, however, this element of the tax is likely to raise relatively little revenue. Reiterating a conclusion of the Holtham Commission, it would be useful to consult with HMRC to ascertain how easy this form of devolution would be to administer.

4.12.27 'Full' CGT devolution could, in principle, be administered relatively straightforwardly if income tax were already devolved – as this would implicitly identify 'Northern Ireland' taxpayers. However, the issue of how to treat trusts may create challenges and opportunities for avoidance.

Conclusion

4.12.28 **There is a case, in principle, for the devolution of capital gains tax on disposals of land and property assets in Northern Ireland. There is much less of a case for the devolution of non-land and property assets. In view of the low revenues involved, with regard to land and property assets, we do not consider this tax to be a priority for devolution and, therefore, will not be carrying it forward for consideration as part of the second phase of our work.**

4.13 Stamp duty land tax

4.13.1 SDLT is a tax legally payable by the purchaser of land and properties and certain leases. It is currently payable on residential properties to be used as a primary residence that are purchased for over £125,000, with a marginal tax rate starting at 2% and increasing up to 12% on the portion of any transaction value above £1.5 million. There are discounts for those buying their first property and a flat 3% premium for those buying a property in addition to their primary residence (for example, to rent out or use as a holiday home), as well as a 2% premium for non-UK-residents. For commercial land and property, a 2% marginal rate applies between £150,001 and £250,000, and a 5% marginal rate applies above £250,000.

4.13.2 SDLT is a relatively small tax, raising £80 million (0.5% of the total tax take) in Northern Ireland in 2019-20, with £50 million of this coming from residential property transactions and £30 million from commercial property transactions. Its devolution would therefore not provide the NI Assembly with significant raising revenue powers, but other characteristics make it attractive for devolution.

Economic and policy context

4.13.3 Both housing policy and recurrent annual taxes on property – domestic and non-domestic rates – are already devolved to the NI Assembly. Devolution of SDLT would provide the NI Assembly with an additional policy lever to influence the housing market, and allow policy to be set to reflect the Northern Ireland policy and economic context.

4.13.4 We are not aware of any evidence of different policy preferences for SDLT in Northern Ireland. But the housing market context does differ. For example, while the same rates and bands of SDLT apply in Northern Ireland as in England, the average property price of a residential property is £153,000, over half of the average £284,000 in England.[222] As a result in 2019-20, 91% of residential property transactions were valued at less than £250,000 in Northern Ireland, compared to 56% in England; just 1% were valued at more than £500,000, compared to 11% in England. One might want to reflect such big differences in the property value distribution with a different tax rate structure.

4.13.5 Moreover, trends in house prices and transactions have notably differed between Northern Ireland and England. For example, between January 2005 and their peak in 2007, residential property prices increased by 100% in Northern Ireland compared to 21% in England, briefly making Northern Ireland the nation with the most expensive housing in the UK. Subsequently, prices fell by 57% from peak-to-trough in Northern Ireland, versus 17% in England. As of Q1 2021, average prices are still 34% below their previous peak in Northern Ireland, but 43% above it in England. To the extent that one wishes to use SDLT as a demand management tool (e.g. with holidays to boost activity and higher rates to cool the market), one may want to do this at different times and to different extents in Northern Ireland.

4.13.6 As discussed above, SDLT has already been devolved to the Scottish and Welsh parliaments,[lii] with both countries subsequently diverging from policy in England and Northern Ireland. As described in Chapter 3, it was Scotland's *Land and Buildings Transactions Tax* (LBTT) which first moved away from the 'slab' structure – where once a tax threshold was crossed, the higher tax rate applied to the entire value of the property,

[lii] It is also worth noting that SDLT has also been discussed as a tax to devolve to the Greater London Assembly, although this idea has not progressed. See London Finance Commission (2017), https://www.london.gov.uk/what-we-do/business-and-economy/promoting-london/london-finance-commission.

leading to large jumps in tax bills at threshold – that had long been used for SDLT, almost certainly helping catalyse reform in the rest of the UK. LBTT also has a different rate structure, with a higher exemption threshold but much higher rates on very high valued properties, raising approximately £50 million for the Scottish Government compared to what would be raised in Scotland if English rates applied. The *Additional Dwelling Supplement* in LBTT, at 4%, is set higher than the corresponding 3% surcharge that applies in England and NI.

4.13.7 Wales' *Land Transactions Tax* (LTT) also has a higher exemption threshold and higher rates on very high valued properties, but was designed by the Welsh Government to be broadly revenue-neutral (to assuage worries that devolution would mean higher taxation). Different decisions have also been taken on tax reliefs for first time buyers (with no specific relief available in Wales) and during the COVID-19 crisis, as well as to premiums for additional properties. Hence, where devolution has taken place, policymakers have made use of their powers and taken a range of different decisions to the UK Government.

Legal constraints

4.13.8 There are no legal constraints to devolving SDLT to the NI Assembly.

Accountability

4.13.9 The relatively small amount of tax revenues raised by SDLT means it would do relatively little to increase the financial accountability of the NI Assembly. Standard residential SDLT is also legally paid by a relatively small fraction of households in any given year due to the infrequency of property transactions.[liii] And although evidence suggests that it is existing property owners that bear most of the actual economic incidence via lower property values, this is true only on average, and the even smaller number of buyers who wish to move home more often than average bear a disproportionate burden. SDLT levied on commercial property and land and on buy-to-let and second homes are paid by even smaller fractions of Northern Ireland residents and in the former case may be particularly likely to fall on non-residents.

4.13.10 The tax is visible to those who are legally required to pay it but existing property owners on whom much of the economic incidence of the tax is likely to fall may not be aware of this incidence. This is an issue whether SDLT is devolved or not, and SDLT policy is widely covered in the media, perhaps reflecting more general interest in the housing market, which would help ensure accountability.[223]

Administrative efficiency

4.13.11 The fact that the location of land and property is known and cannot be changed makes administration of and compliance with devolved property taxes relatively straight-forward. Unfortunately, estimates of the cost of collecting different taxes are not presented separately by either Revenue Scotland or the Welsh Revenue Authority.

[liii] Because SDLT is levied and reported at a property-level and a single household (e.g. one in which a large landlord lives) could be linked to multiple property transactions, we do not have precise figures for the number of households affected each year. However the fact that SDLT was levied on just 28,000 residential transactions in 2019-20, whereas there were an estimated 808,000 residential properties, would suggest at most 3.5% of households paid SDLT (if no properties transacted more than once, and no household engaged in more than one transaction).

However, the overall expenditures of Revenue Scotland and the Welsh Revenue Authority and ad-hoc figures produced by HMRC suggest that fixed costs mean that devolution entails an increase in administration costs. Revenue Scotland collected £717 million from LBTT and Landfill tax in 2019-20, and incurred costs of £7.1 million,[224] while the Welsh Revenue Authority collected £297 million from LTT and Landfill tax and incurred costs of £7.4 million,[225] with LBTT/LTT representing a large majority of the revenues and likely of administration costs too (given the volume and complexity of transactions compared to Landfill tax). By way of comparison, HMRC estimated that the financial saving from no longer having to administer SDLT in Scotland was £257,000 as of 2015-16, with equivalent funding being transferred to the Scottish Government to help pay for the cost of administering LBTT.[226] These figures suggest an increase in administration costs that is very large relative to the marginal cost of administering a UK-wide tax in Scotland, but that is small in the context of Scottish LBTT revenues (around 1%). The fact that the Welsh Revenue Authorities costs appear to be similar despite fewer taxpayers and a smaller tax base suggests that the ratio of administration costs-to-revenues could be higher for Northern Ireland, given SDLT revenues are currently around 15% of LBTT revenues in Scotland. One option that might reduce costs would be to have HMRC to continue to administer Northern Ireland's SDLT post-devolution (recall that the ongoing marginal administration costs for Scotland's different income tax rate structure are just £1-3 million), although this might mean constraints on policy (e.g. allowing different tax rates and bands, but not different reliefs).

4.13.12 Land & Property Services (LPS), is an agency of the Department of Finance with responsibility for collecting, processing and managing land and property information in Northern Ireland. LPS has developed an Integrated Mapping Application which brings together data from Ordnance Survey, Land Registry, property valuation and rate collection databases. Northern Ireland is the only part of the UK where the data from these sources has been brought together in this way. This capability, which is being developed further, could be developed and employed to support the development and administration of alternative revenue raising measures that relate to land and property, like SDLT.

4.13.13 One issue that has caused some difficulties in Wales and Scotland is that some properties straddle the border with England (the highest profile of which is the Chester City Football Stadium, 3 stands of which are in Wales, and 1 in England). The fact that Northern Ireland has no land border with any other nations of the UK means this issue should not arise in the Northern Ireland context. There may be properties straddling the Northern Ireland/RoI border requiring special treatment but this is an issue, whether SDLT is devolved or not.

Economic efficiency and risks to the UK tax base

4.13.14 SDLT is a particularly economically damaging tax, discouraging mutually beneficial transfers of property (e.g. to downsize and upsize), in turn reducing household geographical mobility (e.g. to take up employment opportunities). However, this is true irrespective of whether the tax is devolved or not (and devolution would give the NI Assembly the power to reduce or even abolish SDLT if it so wished, potentially making up the resulting loss of revenue from other taxes, such as domestic and non-domestic rates).

4.13.15 Two interrelated factors mean that devolution and subsequent differences in tax rates from those applying in England would likely have only a modest impact on efficiency or the tax base in England. First, is that land and property are immovable: if tax rates were increased or lowered, land and property could not be moved out of or into Northern Ireland in response to this. People and investment are, of course, at least somewhat mobile. However, the immovability of land and property, when combined with more general constraints on the supply of land and property mean that a large part of the economic incidence of any changes in SDLT rates would be reflected in property prices and borne by existing property owners rather than purchasers.[liv] Changes in property prices in Northern Ireland would therefore tend to reduce the extent to which differences in SDLT policy would lead to changes in flows of people or investment between Northern Ireland and England, helping minimise the impact on the UK Government's tax base.

Stamp duty land tax summary

4.13.16 As a relatively small tax paid by a small fraction of the population, the devolution of SDLT would do relatively little to increase the financial accountability of the NI Assembly. However, devolution is clearly legally and administratively feasible, and would be unlikely to cause significant economic distortion or impacts on the tax-base of the rest of the UK, given the lack of mobility of property and the fact that property prices in Northern Ireland would likely adjust following any post-devolution changes in tax policy, putting a natural break on any migration or investment responses.

4.13.17 In addition, devolution would allow SDLT policy to be set to reflect the different property market context in Northern Ireland, and allow the NI Assembly to undertake comprehensive reform of the entire property tax system (including domestic and non-domestic rates) if it so wished.

Conclusion

4.13.18 **Stamp duty land tax is a sufficiently strong candidate for devolution in Northern Ireland and we will consider it further as part of the second phase of our work. A key issue for investigation will be to consider how administration costs could be minimised.**

4.14 Air passenger duty

4.14.1 Air passenger duty (APD) is levied on passengers on flights from the UK (VAT does not apply to flights). Airlines pay APD, but typically pass the cost on to passengers as part of the ticket price.

4.14.2 The rate of APD depends on the destination of the flight and the class of travel. There are two categories of destination, band A (which basically covers all of Europe as far east as

[liv] The proportion borne by sellers as opposed to buyers is somewhat uncertain though. Analysis of the temporary SDLT holiday in the UK in the late 2000s suggests that around 40% of the benefit accured to sellers and 60% to buyers (https://www.sciencedirect.com/science/article/abs/pii/S0047272714001601). However, the incidence of a temporary cut during a time of depressed demand may differ from the effects of permanent policies at normal times. Evidence from permanent features of property transactions taxes in New Jersey and New York in the US, for instance, suggests greater incidence on sellers https://www.jstor.org/stable/24465962.

Russia west of the Urals, plus Morocco, Libya, Algeria, Tunisia), and band B (everywhere else). The 'standard rate' (which applies to business class) is £26 per flight in band A or £180 in band B, although the majority of passengers pay the reduced (economy) rate of £13 and £82 in bands A and B respectively.[227]

4.14.3 In the autumn budget 2021 the UK Government announced two changes to APD policy. First, rates on domestic flights within the UK will be cut by 50% (so the economy rate becomes £6.50 rather than £13). Second, a third tier of tax on flights over 5,500 miles will be introduced, with an economy rate of £91.[228]

4.14.4 APD raised £80 million, (0.5% of the total tax take in Northern Ireland in 2019/20 according to ONS' Country and Regional Public Sector Finances.

Economic and policy context

4.14.5 Since 2012, APD has effectively been partially devolved in Northern Ireland. Direct long haul flights departing from Northern Ireland have been zero-rated since 2013. The original rationale for this was to maintain the financial viability of direct flights from Northern Ireland to the US. The cost of the policy decision to zero-rate long haul flights from Northern Ireland, estimated at £2.3 million in 2020-21, is reimbursed by the NI Executive to HM Treasury (recent estimates suggest a lessening of this figure to c£1.2m for 2021/22 given the impact of COVID-19 on wider APD revenues and how these feeds through into the cost to the NI Executive). However it was not enough to maintain connections with the US, with United Airlines ending its service in 2017 and Norwegian pulling out in 2018.

4.14.6 More generally there have long been calls for APD more generally to be devolved and reduced in Northern Ireland, or simply abolished in the UK as a whole. The Northern Ireland Finance and Economy Ministers have both recently made statements highlighting how the unique circumstances of Northern Ireland's location means reliance on air connectivity is greater than elsewhere in the UK,[229] and claiming that the lower rates that apply in RoI (Ireland's Air Travel Tax was abolished in 2014, having been set at 10 euro for flights longer than 300km since 2009) have persistently disadvantaged Northern Ireland airports relative to those in RoI.[230] Recent calls have also been made in the context of the collapse of Flybe[231] and the impact of COVID-19.[232]

4.14.7 Indeed, for such a relatively small tax, APD generates a lot of policy debate. This reflects its perceived impact both on regional economic development (through inbound and outbound tourism, business connectivity, and consequent activity at airports), and its role as an important environmental tax. Whilst some propose abolishing the tax to promote economic activity, others have proposed reforms including higher levies on 'frequent fliers', or a shift to taxing the carbon intensity of flights more proportionately.[233]

4.14.8 The Smith Commission recommended that APD be devolved to Scotland (mirroring a recommendation that had also been made by the Calman Commission, but not implemented). Arguably, the Smith Commission's decision to recommend devolution of APD may have been heavily politically motivated; at the time, the aspiration to cut and eventually abolish APD had been a policy ambition of the SNP for some time, and had also been a key plank of its case for independence. Arguably, the economic case for devolving APD is less strong, given the risk that a devolved government could, by setting a lower rate, seek to capture activity from airports in other parts of the UK (a risk that is discussed further below) and as highlighted following the calls by the Welsh Government for APD devolution and the issues this could cause Bristol airport.[234]

4.14.9 APD is now 'ready' to be devolved to Scotland, with legislation having been drawn up at UK and Scottish levels to 'switch off' APD in Scotland and replace it with a new tax in Scotland to be known as Air Departure Tax (ADT). Revenue Scotland has also geared up to begin collecting revenues from ADT. However, the commencement of the UK legislation has been deferred whilst issues related to the Highlands and Islands Exemption are resolved. The Highlands and Islands Exemption exempted flights to the Highlands and Islands from APD. Whilst the UK was in the EU, it was possible that devolution of APD and continued operation of the Exemption, could have been challenged on State aid grounds.

4.14.10 The UK has of course now left the EU, but devolution of APD to Scotland remains paused for the time being, in part because the current Scottish Government is unclear as to what its policy aspiration is (in 2019, the Scottish Government abandoned its commitment to cut APD below UK levels, deeming this inconsistent with climate change aspirations).

Legal constraints

4.14.11 We are not aware of any legal constraints to devolving APD to the NI Assembly. The State aid issue that has stalled devolution of APD in Scotland is quite specific to the Scottish situation, relating to the exemptions for flights to the Highlands and Islands, the cost of which is borne by the UK Government. There is no direct parallel in Northern Ireland (the zero-rating of direct long-haul flights less obviously provides a major source of competitive advantage to a specific region, but more importantly the fiscal costs of that tax policy are borne by the NI Executive).

Accountability

4.14.12 In the scheme of things, APD is a relatively small tax in revenue terms. It is generally visible to those who are liable to it, given the tendency for airlines to add the tax to the ticket price explicitly. But most residents likely face limited liabilities in a typical year (a large proportion of revenues come from frequent fliers, business travellers, and those making long-haul journeys).

4.14.13 APD is therefore not an obvious candidate to devolve if the objective of devolution was purely to raise the financial accountability of the NI Assembly. However, decisions on the tax are likely to be relatively high profile, particularly in the Northern Ireland context, given the links between the tax and regional economic development, international connectivity, and the trade-offs between these objectives and climate change. These factors tilt the balance more significantly in favour of devolution.

Administrative efficiency

4.14.14 The tax is levied on airlines, who make tax returns to HMRC. If APD was devolved, HMRC could continue to collect APD on Northern Ireland's behalf, with airlines needing to distinguish in their returns the number of passengers departing Northern Ireland as opposed to GB airports. Alternatively, a devolved authority could have responsibility for collecting devolved APD revenues, with airlines making separate returns to that institution; this is the set-up envisioned for Scotland, once ADT eventually takes effect, with Revenue Scotland geared up to receive tax returns from airlines.

4.14.15 In either case, devolution implies some additional paperwork for airlines, and some additional effort in terms of tax collection. But these administrative costs are likely to be relatively small in the scheme of things.

Economic efficiency and risks to the UK tax base

4.14.16 As with other taxes, there are a number of potential responses by both passengers and airlines to changes in aviation taxes. Airlines may or may not pass on the full impacts of tax changes to passengers. If tax changes are passed on in full, these could influence passengers to substitute between air and other forms of transportation; change demand for inbound and outbound tourism; change demand for business travel. The size of responses is uncertain, although passengers' price sensitivity is likely to vary significant by passenger type (low-cost tourism v. business, short-haul v. long-haul etc).

4.14.17 However, a particular risk in the context of a devolved APD is that changes to the tax in one devolved nation could influence demand for air travel, and hence revenues, in another part of the UK. When the Scottish Government proposed to halve Air Departure Tax in Scotland relative to APD in the UK, several airports in northern England expressed concerns about the potential impacts. As detailed above this was also the case when the Welsh Government sought the power and Bristol airport raised concerns.

4.14.18 Indeed, on environmental grounds there is also a case for saying that this – and similar environmental taxes – should be levied at the highest level possible, not devolved to the lowest level. This is partly because of the risks that differences in tax policy across jurisdictions lead to behavioural responses. But is also because individual governments may not take into account the full global costs of carbon pollution.

4.14.19 The evidence as to whether aviation taxes can influence passengers' travel itinerary decisions is mixed. Some evidence for example suggests that the introduction of an aviation tax in Germany resulted in reductions in passenger numbers at German airports, and passenger gains in tax-exempt airports near the German border, consistent with the idea that passengers engage in cross-border substitution in response to aviation taxes (although a number of caveats surrounding the results are noted).[235] Similar impacts following the introduction of aviation tax in the Netherlands have also been found. Other studies however have found more limited evidence of a significant effect of aviation taxes on cross-border substitution.

4.14.20 On balance however, it seems unlikely that small differences in rates of APD in Northern Ireland would have a material impact on passenger numbers or APD revenues in GB, given the absence of a land border.

Air passenger duty summary

4.14.21 If the primary objective of tax devolution is to raise the financial accountability of the NI Assembly, APD is not immediately obviously a strong candidate for devolution, given that it raises relatively low revenues, and those revenues are raised mostly from a relatively small group of Northern Ireland residents and visitors. There is also a case for saying that environmental taxes should in general be consistent across as wide an area as is possible in order to minimise the potential for distortionary behaviours that undermine their objectives, and to ensure that tax rates are set in line with the full global social costs of air travel.

4.14.22 However, policy debate around APD is relatively high profile in Northern Ireland given the contrast with aviation tax policy in RoI, the perceived impacts on economic development and connectivity – and the balance to be struck between these issues and climate objectives. It also relates to the NI Assembly's existing responsibilities in relation to the environment, transport and economic development.

Conclusion

4.14.23 **Air passenger duty is a sufficiently strong candidate for devolution in Northern Ireland that we will consider it further as part of the second phase of our work. The Commission would stress, however, that there is likely a trade-off in the consideration of APD between environmental and economic factors, these issues should be considered ahead of pursuing this tax for devolution.**

4.15 Betting and gaming duties

4.15.1 Betting and gaming duties consist of seven separate tax regimes, which are: General Betting Duty (GBD), Pool Betting Duty (PBD), Gaming Duty, Bingo Duty, Remote Gaming Duty (RGD), Machine Games Duty (MGD), and Lottery Duty.

4.15.2 Most gambling duties are levied on gross profits' from gambling (stakes less winnings paid out, also known as Gross Gaming Yield). The exception is Lottery Duty, which is levied on the amount charged (i.e. ticket price).

4.15.3 The tax rates applied differ markedly across these taxes. For example, Gaming Duty is levied at marginal rates varying from 15% to 50% of the yield. Remote Gaming Duty is levied at a single marginal rate of 21%. General Betting Duty ranges from 3% for net receipts from financial spread bets to 15% for fixed odds bets on horse and dog racing. Lottery Duty is 12% of the ticket price.

4.15.4 Of the total cash value of betting and gaming duties at UK level, Lottery Duty accounted for 29% in 2017/18; Machine Games Duty 25%; General Betting Duty 20%; Remote Gaming Duty 16%; Gaming Duty 9%; Bingo Duty 1%; and Pool Betting Duty less than 0.5%.[236]

4.15.5 Note that On-course betting (where customers are present at the racetrack) is not liable to any of the above duties. It is covered instead by the horserace betting levy (HBL), which is charged on the gross profits of all betting on British horseracing (whether made on-course, in betting shops, or online). Receipts are collected by the horserace betting levy board (HBLB) – a UK statutory body. The levy raised £108 million in 2017-18.

4.15.6 Betting and gaming duties raised £75 million, or 0.5% of the total tax take in Northern Ireland in 2019/20, making them a relatively small tax.

Economic and policy context

4.15.7 Whilst the majority of people undertaking gambling activities are not deemed ‘problem gamblers’, gambling can cause serious health and social problems for some. 2.3% of respondents to the 2016 Northern Ireland Gambling Prevalence Survey were deemed problem gamblers, higher than the equivalent figures for Wales (1.1%), Scotland (0.7%) and England (0.5%).[237]

4.15.8 Unlike in Scotland and Wales, regulation of betting and gaming activity in Northern Ireland is a devolved competence[lv]. Northern Ireland is outside the jurisdiction of the UK Gambling Commission. Instead, activity in Northern Ireland has for many years been regulated under the Betting, Gaming, Lotteries & Amusements (NI) Order 1985, and implemented by councils.

4.15.9 Following several years of consultation, major new legislation covering regulation of betting was introduced to the NI Assembly in May 2021. This legislation includes the power to impose a statutory levy on gambling operators.[238] A levy on gambling operators would presumably be a less effective way to tax gambling activities compared to a tax on profits, if betting and gaming duties were devolved.

Legal constraints

4.15.10 We are not aware of any legal impediment to devolving betting and gaming duties to the NI Assembly.

Accountability

4.15.11 As detailed above, Betting and gaming duties raised £75 million, or 0.5% of the total tax take in Northern Ireland in 2019/20, making them a relatively small tax.

4.15.12 According to the 2016 Northern Ireland Gambling Prevalence Survey, two thirds of respondents had gambled in the last 12 months, higher than the rates in England (62.0%) and Wales (61.3%), but similar to the most recent participation rate for Scotland (67.8%).

Administrative efficiency

4.15.13 The tax is levied on betting and gaming operators who submit their tax payments to HMRC within two weeks of the relevant accounting period (which can be one month or one quarter depending on the duty).

4.15.14 Tax reforms introduced in December 2014 changed the taxation of General Betting Duty, Pool Betting Duty and Remote Gaming Duty from a ‘place of supply’ basis to a ‘place of consumption’ basis. This meant that companies providing online betting services to UK consumers became liable for tax on the profits from their UK customers. (The other duties, Gaming Duty, Bingo Duty, Machine Games Duty and Lottery Duty, are effectively

[lv] Note however that spread betting is regulated UK-wide by the Financial Conduct Authority

already based on place of consumption). In principle therefore it should be possible (but not costless) to devolve betting and gaming duties from HMRC's perspective.

4.15.15 The key issue is likely to be how easy it would be for traders to apportion their yield across different parts of the UK, potentially in order that 'NI yield' could be subject to a different tax regime from 'rUK yield'. For some activities, where consumption is at a physical location (such as Machine Games Duty and some types of General Betting), this identification is presumably theoretically possible but may nonetheless create an administrative burden for traders who operate at locations in Northern Ireland and GB in submitting separate tax returns for their Northern Ireland operations.

4.15.16 But for companies providing online betting and gaming services to customers across the UK, the identification of the geographic location of customers, and hence yields, may be more problematic. We do not know at this point how feasible this would be, and some consultation with the industry may be necessary. For example, would companies rely on customers' self-reporting their location, or could that be identified and monitored through IP addresses?

4.15.17 Additionally, given that revenues from Lottery Duty account for over one quarter of all betting and gaming duties, and important consideration is whether the national lottery can identify the proportion of its sales in Northern Ireland. We assume that it can.

Economic efficiency and risks to the UK tax base

4.15.18 Betting and gaming duties are levied on firms' yield (profit). As noted above, a key question underlying the feasibility of their devolution is the extent to which firms offering online services can geographically apportion their yield to Northern Ireland v. rUK, based on the location of their customers. Even where firms themselves are able to do this, the subsequent question that arises is, would those firms be able to avoid higher taxes in one jurisdiction by misreporting the balance of their yield between rUK and Northern Ireland? The risk here is perhaps fairly limited, but further consideration of firms' reporting requirements would be required to determine the feasibility of devolution.

4.15.19 Related to all this is the question of the extent to which firms would pass on a higher tax rate on their yields in one jurisdiction to their prices to customers in that jurisdiction. The motivation for devolution would largely be to give the NI Executive an additional lever to influence betting behaviours, but if firms did not react to a higher tax rate on their Northern Ireland yields by passing on those costs to Northern Ireland customers (for example because this was too administratively difficult for them to do), then the effectiveness of the taxes as a policy tool would be limited. Further investigation of the likely response of firms to intra-UK differences in tax rate on their yields would be required before the merits of devolution can be ascertained.

Betting and gaming duties summary

4.15.20 In revenue terms, betting and gaming duties are relatively small. But from a policy perspective, the case for devolution is quite strong, in principle. Regulation of betting and gaming activities is (largely) devolved to the NI Executive, and there is some evidence that the social harm from problem gambling may be somewhat higher in Northern Ireland than other parts of the UK.

4.15.21 However, from a practical perspective, the tax is levied on the yields (profits) of traders which raises a number of practical considerations: how easily can firms (especially those providing online services) identify the geographical location of their customers and hence apportion their profits to Northern Ireland vs rUK? And would intra-UK differences in the tax rate on firms' profits be passed on to customers in the respective jurisdictions? (if not then the usefulness of the tax as a policy tool would be limited).

Conclusion

4.15.22 **There is a case, in principle, for devolution of betting and gaming duties to Northern Ireland. However, we consider that the challenges of geographic apportionment of customers and taxable yield make these duties administratively difficult and do not consider them to be a priority for devolution and, therefore, will not be carrying these duties forward for consideration as part of the second phase of our work.**

4.16 Apprenticeship levy

4.16.1 The apprenticeship levy is a tax paid by employers with annual payrolls of £3 million or more at a rate of 0.5% above that threshold. It applies to all wages of all employees, including those whose earnings are below the threshold for paying income tax or National Insurance contributions. Estimates of revenues from Northern Ireland are not published, but given £2.8 billion was collected across the UK as a whole in 2019-20, an estimate for Northern Ireland based on population share would suggest a figure of approximately £80 million, could be possible, equivalent to 0.5% of the total tax take in Northern Ireland. However, a recent response from HMRC estimated some £30 million of apprenticeship levy was attributed to businesses in Northern Ireland in 2020-21. Recognising the likely impact of the global pandemic on the 2020-21 figure, the 'real' amount is likely to be somewhere in between.

Economic and policy context

4.16.2 Education and employment policies are devolved to the NI Assembly and it may therefore seem sensible to devolve a tax that is labelled as funding a key area of policies: apprenticeships. In England, there is a direct link between the levy contributions an employer pays and the amount of government funding for apprenticeships that they can receive. However, this is not the case in Northern Ireland, where there is no fixed limit on how much funding any given employer can receive. This approach is sensible as the different nature of skills required by different employers means there is unlikely to be a simple mechanical link between the size of their payroll and their 'need' for apprenticeship funding.

4.16.3 Devolution of the levy would allow the NI Assembly to change its level and structure, to raise more or less, and/or change the distribution of payments across employers of different sizes or sectors.

Legal constraints

4.16.4 There are no legal constraints to devolving the levy to the NI Assembly.

Accountability

4.16.5 The relatively small amount of tax revenues raised by the levy means it would do relatively little to increase the financial accountability of the NI Assembly. While it is formally levied on medium and large-sized employers, economic theory and evidence suggests that a significant part of its incidence is actually likely to be borne by employees, a much larger part of the population, in the longer-term. However, this may not be widely appreciated and the levy is a relatively low-profile tax, which may limit the extent to which the electorate is able to hold the NI Assembly to account for levy policy.

Administrative efficiency

4.16.6 In order to devolve the apprenticeship levy, employers would have to separate their payroll costs into Northern Ireland and GB components. If income tax and/or NICs were devolved, this would have to be done in any case for those registered to pay income tax and/or NICs via PAYE: their tax codes could therefore be used by employers to assign their pay to Northern Ireland or GB payrolls. However, those paid below the NICs Lower Earnings Limit may not have a tax code, and allocating their payroll between Northern Ireland and GB would therefore require a separate process, which would entail some additional administration and compliance costs.

4.16.7 It is worth noting, however, that HMRC already estimates separately by employer the share of levies attributable to England using the residential address of those employees registered for PAYE. This is then used to determine how much apprenticeship funding that business can access. It would be possible to use a similar approach to identify the share of each employers' payroll that should be subject to a Northern Ireland levy, if a very slight degree of potential inaccuracy (related to employees not registered for PAYE) were deemed tolerable.

Economic efficiency and risks to the UK tax base

4.16.8 A tax on payroll could, as with NICs, affect the hiring, pay and location decisions of employers, and to the extent the levy is passed on in lower pay, the labour supply and migration decisions of employees. As discussed above, evidence on the potential scale of these effects – especially related to migration and spill-over effects between Northern Ireland and GB – is limited. However, unless the rate of apprenticeship levy were substantially increased, any spill-over effects on the economy in GB or the UK Government's tax revenues would likely be modest.

Apprenticeship levy summary

4.16.9 As a relatively small tax, devolution of the apprenticeship levy would do little to improve the financial accountability of the NI Assembly. Although skills and apprenticeships policy are devolved to Northern Ireland, unlike in England, there is no real link between the levy and funding for apprenticeships in Northern Ireland currently. Devolution could help make this link.

4.16.10 It should be administratively straightforward to devolve the levy, especially if income tax and/or NICs were devolved, which would improve the accuracy of data on earnings for those employees registered for PAYE. In this case the marginal administration and compliance costs should be low if HMRC continued to administer the Northern Ireland levy. If neither income tax nor NICs were devolved, the marginal administration and compliance costs would be higher relative to revenues from the Northern Ireland apprenticeship levy, which would make consideration for devolution more difficult.

Conclusion

4.16.11 **We consider the case for devolution of the apprenticeship levy to Northern Ireland to be sufficiently strong to merit further investigation. However, in terms of sequencing, we consider that the case for devolution would be best made following any decision to devolve income tax and/or NICs, given the likely administration costs of pursuing this tax in isolation. Given our position on income tax, we will consider the apprenticeship levy further as part of the second phase of our work.**

4.17 Inheritance tax

4.17.1 Inheritance tax (IHT) is a tax on the estate (the property, money and possessions) of someone who has died. IHT applies to the value of the estate over a minimum threshold, currently £325,000. IHT was estimated to have raised £43 million, 0.3% of the total tax take in Northern Ireland in 2019/20.[lvi]

4.17.2 Some types of assets, particularly those associated with farms and small businesses, are eligible for relief. All gifts and bequests to charities and to political parties are exempt from IHT. Most importantly, transfers of wealth between spouses and civil partners are also exempt.

4.17.3 Since 2007, the IHT threshold is increased by any unused proportion of a deceased spouse or civil partner's nil-rate band. This means that married couples and civil partners can collectively bequeath double the IHT threshold (i.e. £650,000) tax-free.

4.17.4 In 2015 a transferable main residence allowance was introduced. By 2020/2021 this was set at £175,000 and is transferable between couples. The practical implication of this is that couples can bequeath up to £1m to direct descendants tax free as long as their main residence exceeds £350,000 in value.

Economic and policy context

4.17.5 For a tax that is paid by relatively few estates (see next subsequent section for figures), IHT is a high-profile tax. It is unpopular with the public, frequently portrayed as a 'death tax' that limits the ability of parents to bequeath their 'hard-earned incomes' to their children. But the rationale for IHT is, at least in part, to enhance social mobility by

[lvi] As part of its Country Regional Public Sector Finance statistics, ONS includes Inheritance tax as part of 'other taxes on capital' along with Swiss Capital Tax. As no values for Swiss Capital tax are applicable in 2019/20, the value of 'other taxes on capital' for that year is solely attributed to Inheritance tax.

mitigating the extent to which financial advantage is transferred from one generation to the next. It therefore has a role in 'levelling the playing field' although it is unlikely to be the most effective way of doing this in reality.

4.17.6 The extent to which IHT is linked to devolved competencies is open to some debate. Intergenerational inequality and social mobility are issues which any devolved administration will perceive as important, but arguably these are concerns that are shared by both levels of government, rather than clearly being in the domain of one over another.

Legal constraints

4.17.7 We are not aware of any legal constraints to devolving IHT to the NI Assembly.

Accountability

4.17.8 One argument against devolution of IHT is that it applies to relatively few individuals in any given year. This is largely of course because only a minority of the population die in any given year. But only a minority of estates now incur liability for IHT, given how high the tax threshold has become. HMRC data indicates that in 2018/19 (the latest year for which such statistics are available), only 252 estates in Northern Ireland were liable for IHT.

Administrative efficiency

4.17.9 The individual making the IHT payment to HMRC (the Executor/Administrator of the estate, or an agent of), must apply to HMRC for a reference number. The deceased's name, date-of-birth and National Insurance number are required pieces of information in order to receive a reference number and pay the tax on behalf of the deceased's estate.

4.17.10 In principle then, if National Insurance numbers were linked to taxpayers' geographical status, relatively little administrative change would be required to implement a devolved IHT. As was the case with CGT however, there are complications.

4.17.11 First is the point that, even if income tax were devolved and HMRC had categorised all income taxpayers as being Northern Ireland taxpayers or taxpayers in some other part of the UK, it is quite possible that some individuals liable for IHT would not have been liable for income tax in the years leading up to their death, and thus may not have been formally categorised as a Northern Ireland taxpayer. In these cases it would be left to the Executor to declare the geographical taxpayer status of the deceased, and this may create some opportunities for avoidance if the IHT rate differed across the UK. However, given that relatively few individuals are liable for the tax, and on the basis of the information provided to HMRC on the tax return, it may not be too difficult to monitor and ensure compliance, though the efficiency of this is questionable.

4.17.12 Second, IHT can be due on certain types of trust. For example, assets transferred out of a trust can be liable for IHT. Identifying the geographic location of a trust is likely to be problematic – the location of the trustees is irrelevant and can easily be changed; the location of the settlor or the beneficiaries may be difficult to ascertain. IHT on trusts may therefore need to be excluded from the purview of devolved IHT, but consideration should be given as to whether this could create further opportunities for avoidance.

Economic efficiency and risks to the UK tax base

4.17.13 For those liable to IHT, the average tax bill is relatively high (£158,000 in Northern Ireland in 2018/19). In principle therefore one might anticipate that taxpayers might be quite sensitive to differences in the tax rate in different parts of the UK. In other words, tax rate differences might induce people to relocate to capitalise on lower tax rates in particular parts of the UK.

4.17.14 However, evidence from Switzerland (where inheritance taxes are devolved to Cantons), suggests that the tax base is not very sensitive to differences in inheritance tax rates across cantons, or changes in tax rates over time.[239] In many ways, this conclusion is intuitive. The relevant tax base – high income retirees – tend to have strong social and economic ties to their place of residence, and may be reluctant to move in response to differences in IHT rates.

Inheritance tax summary

4.17.15 On one hand, the lower levels of wealth in Northern Ireland provides a policy justification for devolution – there may be a good case for setting lower thresholds for the tax in Northern Ireland, especially if a future NI Executive has different views on inequality and social mobility to the UK Government.

4.17.16 However, the relatively small scale of the tax, the fact that it applies to few estates in any year, and the absence of a very explicit link to devolved policy competencies, militate against concluding that IHT is a strong contender for devolution. In addition, there is potential for additional compliance and administration costs. The added complication of determining the geographic location of trusts, and the implication this may have for creating opportunities for tax avoidance may create problems.

Conclusion

4.17.17 **There is a case, in principle, for devolution of inheritance tax, given Northern Ireland's different wealth distribution. However, we consider the potential issues around avoidance and the relative size of the cost to administer the tax compared to its yield, impact on the feasibility of devolution. Therefore, we do not consider this tax to be a priority for devolution and will not be carrying it forward for consideration as part of the second phase of our work.**

4.18 Landfill tax

4.18.1 Landfill tax is a tax on waste disposed by way of landfill. Two rates are levied: a standard rate of £96.70 per tonne, and a 'lower rate' of £3.10 per tonne. The lower rate in general applies to various low polluting, non-hazardous wastes with potential for greenhouse gas emissions.[240]

4.18.2 The tax is levied on landfill operators, who pass costs on to businesses disposing of waste by landfill.

4.18.3 It is estimated that landfill tax raised £24 million in 2019-20 in Northern Ireland, 0.2% of the total take.[241]

Economic and policy context

4.18.4 Landfill tax has been devolved to both Scotland and Wales, having been recommended for devolution by the Calman and Holtham Commissions respectively. In Scotland, UK landfill tax was replaced in 2015 by a new 'Scottish Landfill Tax'. In essence this works identically to landfill tax in England and Northern Ireland, with the tax administered by Revenue Scotland. In Wales, landfill tax was replaced by the Land Disposals Tax in 2018. The tax is administered by the Welsh Revenue Authority.

4.18.5 In both Scotland and Wales, tax rates on the devolved equivalents of landfill tax have been set at the same rates as rUK since devolution occurred. In other words, in all UK nations the standard rate is £96.70 per tonne and the lower rate is £3.10 per tonne, despite three completely different taxes operating. Both the Scottish and Welsh Governments have chosen to maintain parity with prevailing UK government tax policy, in order to minimise the risk of 'waste tourism', i.e. the potential for waste to be transported across UK nations to reduce tax liability.

4.18.6 The case put forward for devolution of landfill tax by the Holtham Commission was that it is a tax on an 'immobile' base, and that whilst the tax will do little to raise financial accountability of devolved Ministers, it does have links to devolved areas of policy responsibility. In hindsight, the characterisation of landfill tax as being one with an immobile base seems misguided, as the reality is that landfill material itself is mobile across borders.

4.18.7 The risks that landfill material might be transported between Northern Ireland and rUK in response to differences in landfill tax policy is clearly much lower in the Northern Ireland context than for Scotland and Wales given the absence of land border with rUK. Policy makers in Northern Ireland would presumably feel much less constrained by rUK policy in setting a devolved policy for the tax, than their counterparts in Scotland and Wales.

4.18.8 Indeed, the policy in RoI is likely to be much more directly relevant for policy makers in Northern Ireland. Devolution of landfill tax to Northern Ireland would enable the NI Executive to set policy taking into account both their own environmental policy objectives, and the risks that policy divergence with RoI could result in behavioural responses that could potentially mitigate the impact of tax policy changes. Currently, standard rates of landfill tax are somewhat lower in RoI (€75 per tonne) than in the UK (£94 per tonne).

Legal constraints

4.18.9 We are not aware of any legal constraints to devolving landfill tax to the NI Assembly.

Accountability

4.18.10 Landfill tax seems unlikely to score highly on measures of accountability. It is levied on landfill operators who pass the costs on to businesses disposing of waste to landfill. As highlighted above, revenues are relatively low.

Administrative efficiency

4.18.11 The tax is levied on landfill operators based on the geographical location of the site. It is therefore relatively easy to operate at a devolved level, although operators with multiple sites across the UK may find devolution somewhat burdensome, particularly if tax policy did differ across UK nations.

Economic efficiency and risks to the UK tax base

4.18.12 Although landfill sites are physically immoveable, the tax base – landfill material – is highly mobile. Devolution does therefore create risks. A devolved government wanting to discourage landfilling and encourage recycling through an increase to landfill tax rates may find that a part of the impact of the policy is to divert landfill to other parts of the UK. As a result, the devolved government faces lower revenues but without having instigated material levels of behavioural change.

4.18.13 These risks have crystallised in the Scottish and Welsh cases, with both governments so far committing to maintain policy parity with the UK Government. However, because tax policy has remained unchanged across the UK, we have no evidence as to how responsive landfill material might be to within-UK differences in landfill tax rates.

4.18.14 It seems reasonable to assume that these risks are lower for Northern Ireland than for Scotland and Wales given the costs associated with transporting landfill materials across the Irish Sea.

Landfill tax summary

4.18.15 In hindsight, the decision to devolve landfill tax to Scotland and Wales is not as clear-cut as it was sometimes framed at the time. Landfill tax was recommended for devolution because of the links to other areas of devolved policy competence, including land-use and the environment. However the tax base, landfill material, is highly mobile (at least on the same land mass), and this limits the scope for the Scottish and Welsh governments to use the tax as a policy tool. These concerns are likely to be less pressing in the Northern Ireland context given the absence of a land border with GB.

4.18.16 In addition, it is closely linked to the existing environmental and land-use responsibilities of the NI Assembly. From an administrative perspective, devolution should be relatively straightforward (it was in Scotland and Wales), reflecting the small number of taxpayers (landfill operators).

Conclusion

4.18.17 **Landfill tax is a sufficiently strong candidate for devolution in Northern Ireland and we will consider it further as part of the second phase of our work.**

4.19 Climate change levy

4.19.1 The UK Government charges a range of environmental levies including the climate change levy and the carbon price floor. These aim to reduce carbon emissions through reductions in energy use and/or changes in the energy mix. The first operates broadly on a UK-wide basis, although certain aspects of administration in Northern Ireland are the responsibility of the Northern Ireland Authority for Utility Regulation (NIAUR). It is charged on 'taxable commodities' supplied for lighting, heating and power purposes to business customers in the industrial, commercial, agricultural and public service sectors. Businesses that pay the standard rate of VAT (20%) are also charged the climate change levy, although there are exceptions. Businesses that meet the minimal use requirements and are charged the reduced rate of VAT (5%) don't pay the climate change levy. Northern Ireland is exempt from the carbon price floor following interventions by the NI Executive and operators in the electricity market, who argued that it would distort the all-island market, creating a competitive disadvantage for market participants in Northern Ireland making it difficult to compete within the Single Electricity Market.[242]

4.19.2 This means that it is only the climate change levy which is not already devolved and needs consideration. It is estimated that climate change levy revenues attributable to Northern Ireland were £23 million (0.1% of the total tax take) in 2019-20.

Economic and policy context

4.19.3 With the exception of nuclear, energy policy is devolved to the NI Assembly. Northern Ireland operates a separate electricity market from GB – the Single Electricity Market which is shared with RoI – and makes its own decisions around incentives and regulated costs that are passed onto energy consumers' bills. As the climate change levy is a tax on the emissions associated with energy use by businesses, it is not part of devolved energy policy and is set by the UK Government. Collection is managed by HMRC, although the NIAUR is responsible for issuing exemption certificates.

4.19.4 Northern Ireland does not have its own climate change law, unlike all other parts of the UK. Northern Ireland is currently tackling climate change through a UK-wide Climate Change law, called the 'UK Climate Change Act 2008'. In 2019, the UK Climate Change Act 2008 was updated by the UK Government, to include the requirement that emissions of Greenhouse Gases must be reduced enough to achieve 'UK Net Zero', by the year 2050. Scotland and Wales have created local laws, to support them in achieving their requirements under the UK Climate Change Act 2008. [243]

4.19.5 RoI also operates a carbon tax, introduced in 2010, which applies to kerosene, marked gas oil, liquid petroleum gas, fuel oil, natural gas and solid fuels. It is currently set at €33.50 per tonne.

Legal constraints

4.19.6 We are not aware of any legal constraints to devolving the climate change levy to the NI Assembly.

Accountability

4.19.7 The relatively small amount of tax revenues raised the climate change levy means that its full devolution would do relatively little to increase the financial accountability of the NI Assembly. In addition, it is directly paid by only a small subset of the population, is relatively complex and is not very visible.

Administrative efficiency

4.19.8 It seems unlikely that administration issues would preclude the full devolution of the climate change levy.

4.19.9 The levy is charged on the supply of electricity, natural gas, liquefied petroleum gas, and coal and similar products to industrial, commercial, agricultural or public sector users. The first two are by far the most important, and the use of property-specific meters in calculating utility bills means that suppliers should be able to relatively easily separate Northern Ireland and GB-based supplies and charge taxes appropriately. HMRC could continue to administer payments as currently to avoid the additional administration and compliance costs that would likely be incurred if the NIAUR's role was expanded beyond the issuing of exemptions.

Economic efficiency and risks to the UK tax base

4.19.10 If large differences in climate change levy rates arose post-devolution, the resulting differences in businesses' energy input costs could distort the location of energy-intensive businesses, with knock on effects for the wider UK tax base, however, evidence on the potential scale of these effects is lacking. Moving environmental charges and taxes too far out of line with GB charges and taxes could also see leakage of emissions in either direction.

4.19.11 It is also important to note that climate change is a global externality – it is the volume of carbon that is emitted into the atmosphere not its location that matters for its impact on the climate. For global externalities, it is generally better for tax and market-based mechanisms (such as permit trading schemes) to cover as wide a geographic area as possible. Doing so 'internalises' more of the externality in the jurisdiction setting policy, reducing the risk of downwards pressure on tax rates (or upwards pressures on the number of permits issued) in order to influence the location of economic activity. Devolution goes against this principle. It is only if there was to be a severe mismatch with EU taxation of a similar kind (in RoI) that the issue of treating Northern Ireland differently would perhaps apply, for example, if there was a wide divergence between UK and EU Emission Trading Scheme (ETS) prices. However, even then, it is highly questionable whether it would be wise to have divergence in Northern Ireland.

Climate change levy summary

4.19.12 There are substantial differences in energy policies, markets and regulations between GB and Northern Ireland which could potentially provide a rationale for devolving the climate change levy as well. However, ultimately, climate change is a global issue typically best tackled by policies that operate over larger rather than smaller geographic areas.

4.19.13 Moreover, as a small tax, the devolution of the climate change levy would do little to increase the financial accountability of the NI Assembly.

Conclusion

4.19.14 **There is arguably a case, in principle, for devolution of the climate change levy to Northern Ireland, given the local policy context. However, given climate change is a**

global issue typically best tackled by policies that operate over larger rather smaller geographical areas, we do not consider this tax to be a priority for devolution and will not be carrying it forward for consideration as part of the second phase of our work.

4.20 Aggregates levy

4.20.1 This is a tax on sand, gravel and rock that has either been dug from the ground, dredged from the sea in UK waters, or imported. It is an environmental tax designed to discourage the extraction of virgin aggregate and encourage the reuse and recycling of construction and demolition waste (the levy does not apply to secondary or recycled aggregate). The tax is currently £2 per tonne (frozen since 2009), and is levied on producers (e.g. those who quarry or import aggregates, the levy becomes due when it is commercially exploited in the UK and UK waters).[244] Some minerals are not subject to the levy, and use of aggregates in certain agricultural products is exempt.

4.20.2 The UK Government cites increased use of secondary and recycled aggregate in the UK as a success of the levy,[245] although it is likely that regulation and increases in landfill taxes have also contributed to this trend.

4.20.3 Estimated aggregates levy revenue for Northern Ireland in 2019-20 were £18 million, 0.1% of the total tax take.

Economic and policy context

4.20.4 There are two elements of policy context that are relevant to discuss here. First are the issues that arose in Northern Ireland when the UK aggregates levy was introduced in 2002 around the impact of the levy on Northern Ireland's aggregate production given that no levy applied in RoI. Second are the issues in relation to State aid, which contributed to legal disputes, in recent years which have delayed the devolution of aggregates levy to Scotland and Wales.[lvii] [246]

4.20.5 Prior to and following the introduction of the UK aggregates levy in April 2002, concerns were repeatedly raised that the levy would have a number of undesirable consequences in Northern Ireland.[247] Primarily, these included the risk that the levy would result in an increase in illicit imports of aggregate from RoI. Although the levy in principle applied to imports from RoI, there were concerns that resources for monitoring and enforcement were limited and would cause competitiveness issues in Northern Ireland. Additionally, it did not apply to processed aggregates i.e. that is aggregates which had been taken from industrial or engineering waste, then treated to form construction aggregates for high quality concrete.

4.20.6 Concerns were raised that the levy (at £1.60 per tonne when introduced) represented a tax rate of 60% in Northern Ireland, compared to 23% in GB, where the price of aggregates is higher. This rate was easily sufficient to make transportation of aggregates across the

[lvii] Devolution to Wales is being kept under review with the intention to devolve, subject to the agreement of both governments and cross-border impacts being worked through in full.

land border cost effective (with 75% of Northern Ireland's territory within 25 miles of the border with RoI). These concerns were compounded by the, at the time, weak value of the Euro, and the fact that Northern Ireland accounts for 12% of UK aggregate production (and therefore may be proportionately more significantly impacted by the levy). Furthermore, there was a perception that Northern Ireland had a more limited opportunity to 'benefit' from the levy, in the sense that it had more limited opportunities to recycle and reuse aggregate. The UK Treasury in 2003 concluded that: "the specific circumstances in Northern Ireland mean that we are unlikely to meet the environmental aims of the levy—to increase the use of recycled or alternative materials to primary aggregates and also to reduce the environmental impact of quarrying".[248]

4.20.7 In response to these concerns, the UK Government introduced the Aggregates Levy Credit Scheme (ALCS) in Northern Ireland in April 2004, which enabled companies in Northern Ireland to claim an 80% relief on the levy, providing they met specified environmental conditions (The environmental conditions were a necessary part of the ALCS, as they were used to demonstrate to the European Commission that Northern Ireland's aggregates producers were not benefitting from preferential treatment). However, the ALCS was suspended in December 2010 due to repeated court challenges led by the British Aggregates Association (BAA).

4.20.8 Since 2010, Northern Ireland operators have paid the full rate of £2 per tonne. According to industry body QPANI (Quarry Products Association Northern Ireland) in 2015, this represent nearly 40% of the selling price for stone in Northern Ireland. QPANI claims the levy "has and continues to cause significant loss of business to imports from RoI and to the growing black market across Northern Ireland."[249]

4.20.9 Mining and quarrying industries in Northern Ireland are estimated to employ around 2,300 people, with a combined turnover of £390 million (2016 data).

4.20.10 In terms of lessons from Scotland, the Scotland Act 2016 included new legislative powers for devolution of the aggregates levy to Scotland, following the recommendations of the Smith Commission. The Commission did not explicitly outline the rationale for devolution of aggregates levy, although one might presume that the fact that the tax is related to land use was a material factor. However, devolution of aggregates levy to Scotland has been delayed by legal issues relating to State aid.[lviii] The long-standing litigation was concluded in February 2019.

4.20.11 In July 2020, the UK Government concluded a review considering potential reforms to the levy, taking account of its objectives and impact, the effectiveness of the current design and the environmental and business context for aggregate construction and supply. Subsequent to this, the Scottish Government has investigated options for a Scottish-specific aggregates levy, although a timeline for devolution of the levy has not yet been agreed. The UK levy continues to apply in Scotland until the Scottish Government has worked through policy options, and introduced legislation to the Scottish Parliament. We understand that this legislation is now being prepared, and will be introduced at some point during the 2021 – 2026 parliament.

[lviii] In a nutshell, the British Aggregates Association complained that exemption of 'secondary aggregates' from the levy was a form of State aid that is not permissible under EU rules. BAA withdrew its litigation against the UK Government and EU Commission in 2019, after a four-year litigation process.

4.20.12 The policy options considered in the Scottish Government's report included setting a higher or lower rate of aggregates levy in Scotland than in rUK, or keeping the levy the same as in rUK while creating additional band of landfill tax for aggregates which is higher than the rate for landfilling inert materials. The options analysis concluded that setting a higher levy, or creating an additional band of landfill tax for primary aggregates, would both increase the amount of aggregates recycling. However, these policy options would also require 'additional monitoring and enforcement, which will increase the implementation costs' of the measures.

4.20.13 HM Treasury reports that industry stakeholders tend to express concerns about the prospect of differential levies on aggregates in different parts of the UK, citing concerns around enforcement and competition.[250]

Legal constraints

4.20.14 We are not aware of any legal constraints to devolving aggregates levy to the NI Assembly.

Accountability

4.20.15 As a tax raising low amounts of revenue, aggregates levy is unlikely to do much to raise the financial accountability of the NI Assembly. Furthermore, the tax is levied on a small number of producers rather than the electorate directly.

Administrative efficiency

4.20.16 Levying a tax on aggregates *produced within* Northern Ireland would be relatively straightforward – a relatively small number of companies would be involved, with liability simply dependent on quarrying location.

4.20.17 However, the limitation of such an approach is that aggregate produced in GB and imported into Northern Ireland would be liable for GB rates (and similarly, aggregate produced in Northern Ireland but being exported for use into GB being liable for Northern Ireland rates). This could be potentially be a route for avoidance and economic distortion if rates varied between Northern Ireland and GB.

4.20.18 In principle the solution to this issue would be for aggregate extracted in Northern Ireland and 'exported' to GB to be exempt from the Northern Ireland levy but liable for the UK levy, effectively treating transfers between Northern Ireland and GB (and vice versa) in the same manner as international exports. Conversely, aggregate extracted in England but 'imported' to Northern Ireland should be exempt from the UK levy and liable for the Northern Ireland levy. In this sense, a devolved levy would therefore entail additional paperwork for businesses and checks to limit avoidance (although perhaps little additional work relative to what is already required as part of the EU Withdrawal Agreement).

4.20.19 We understand that it is this latter approach – with the devolved tax applying to the commercial exploitation of aggregate, rather than the location of extraction – that will be implemented in Scotland. It will be instructive to keep a watching brief on the implementation of a devolved aggregates levy in Scotland, to understand the practical lessons that emerge.

4.20.20 Understanding more about the pattern of imports and exports of aggregates between Northern Ireland and GB would also help inform these issues.

Economic efficiency and risks to the UK tax base

4.20.21 If a devolved aggregates levy applied to imports from GB and was exempted on exports from Northern Ireland, the risks are likely minimal. If aggregates levy is devolved, and a lower rate is adopted in Northern Ireland, producers of aggregate based in England or Wales would have no incentive to seek to extract aggregate in Northern Ireland and import it to England or Wales, because the aggregate would continue to be liable for GB rates when imported from Northern Ireland.

4.20.22 If rules on imports/exports within the UK did not apply (so that the levy was applied where material was extracted, regardless of the location of consumption), it is perhaps unlikely that devolution would pose risks given the costs of transporting aggregate between Northern Ireland and the UK mainland. However, as noted above, the levy is relatively high in the context of aggregate produced in Northern Ireland, so a levy that differed significantly across the UK may induce some cross-border transportation of material.

Aggregates levy summary

4.20.23 Aggregates levy is a land-based tax with links to the NI Assembly's existing responsibilities related to the environment and land-use, and historically, the different context in Northern Ireland was reflected in a special regime.

4.20.24 While it is recognised that transportation costs between Northern Ireland and GB would act as a limiting factor (unless rates are varied significantly), concerns remain regarding the potential for introducing market distortions and incentivising tax avoidance resulting from any variation in levies that are applied within the UK.

Conclusion

4.20.25 **There is a case, in principle, for devolution of the aggregates levy to Northern Ireland. However, it remains unclear to what extent the administrative costs associated with a devolved levy would justify the potential benefits. We recommend that the NI Executive follows the progress being made in the implementation of a devolved aggregates levy in Scotland and makes a decision on whether to pursue the tax further at that point. At this stage, therefore, we will not be carrying this levy forward for consideration as part of the second phase of our work.**

4.21 Stamp Duty on shares

4.21.1 Stamp duty on shares consists of two (technically separate) taxes. When shares are bought and sold electronically, Stamp Duty Reserve Tax (SDRT) applies. Under SDRT, purchases of shares in a UK company or a foreign company with a UK share register are liable to a tax rate of 0.5%. Purchases of paper shares are liable for stamp duty if the transaction is over £1,000.

4.21.2 Stamp tax on shares raises around £3.6bn at UK level. The ONS' Country and Regional public finance statistics implies Stamp Duty on Shares raised nothing in Northern Ireland. We believe that this is because of the methodology used for apportionment, which effectively allocates shares of the UK revenue to nations and regions based on the geographical location of incorporation.

4.21.3 A more appropriate apportionment methodology would be to allocate shares of the revenue based on Northern Ireland residents' share of UK share ownership, or to proxy share ownership via financial wealth.

Economic and policy context

4.21.4 Stamp Duty on Shares has no obvious link to existing devolved competencies of the NI Assembly. We are not aware of calls having been made to devolve this tax to Northern Ireland or either Scotland or Wales.

Legal constraints

4.21.5 We are not aware of any legal constraints to devolving Stamp Duty on Shares to the NI Assembly.

Accountability

4.21.6 For those who are liable for Stamp Duty on Shares the tax is reasonably visible, usually quoted directly on transactions, but it seems likely that relatively few individuals would face a liability in a given year. Investments in ISAs and Investment Funds are not liable to Stamp Duty on Shares, so only individuals purchasing shares with such vehicles would face a liability.

Administrative efficiency

4.21.7 If devolution of stamp duty on shares were to work effectively, robust mechanisms would need to be in place to identify the geographical location of the purchaser of shares.

4.21.8 Currently, electronic share transactions are mostly carried out through the CREST system (a computerised register of shares and shareowners). CREST, administered on HMRC's behalf by Euroclear, automatically collects the SDRT liable on a transaction and sends it to HMRC. 'Off-market' transactions, where shares and transferred outside of CREST, must be notified to HMRC via a written notice, and the stamp duty paid separately.

4.21.9 Whichever channel through which SDRT is paid, some seller details are required for the transaction, but there is no requirement to provide to HMRC a National Insurance Number or a taxpayer reference number that would enable HMRC to link a particular share transaction with a taxpayers 'formal' geographic status. Therefore, even if income tax were devolved to Northern Ireland, so that in principle UK income taxpayers were identified as being 'Scottish', 'Welsh', 'Northern Irish' or rUK by default, the existing systems for administering SDRT do not allow for any linkage between a purchaser of shares and the purchasers geographical status. Further, many share transactions are made by businesses and investment trusts, rather than individuals, for which there is no existing process for determining geographic status within the UK.

4.21.10 There is no obvious way to resolve these administrative challenges. Requiring individuals (via their brokers) to provide a National Insurance Number with their transactions, and linking these to geographic taxpayer status, would require a significant revamp of existing administrative arrangements. There may also be concerns that it would disincentivise share transactions more generally and, of course, it does nothing to resolve the issue of how to identify the geographic location of companies which make share transactions.

Economic efficiency and risks to the UK tax base

4.21.11 The question of efficiency is inextricably linked to the administration question. If it is not possible to robustly identify the geographic status of a share purchaser, then the scope for tax avoidance is very large indeed. A higher rate of SDRT in one part of the UK could relatively easily be avoided by claiming residence of the low-tax jurisdiction.

4.21.12 Some such claims may be fraudulent, but compliance may be resource intensive, requiring a follow up of claims on a case-by-case basis.

Stamp Duty on Shares summary

4.21.13 Stamp duty on shares (SDRT) is paid by a relatively small proportion of the population, and there is no obvious link between the tax and the devolved competencies of the NI Assembly.

4.21.14 If the tax were to be devolved so that different rates of tax were potentially chargeable to residents of Northern Ireland relative to rUK, robust systems would need to be in place to identify the geographical taxpayer status of any individual purchasing shares.

4.21.15 Even if a definition of a Northern Ireland taxpayer exists for income tax purposes, identifying the geographic status of share purchasers is likely to be problematic for several reasons. In the case of individuals, existing share transactions administration would need to be revamped to require detailed information on National Insurance Number and this information would need to be linked to the income tax database. This in itself may lead to an overall fall in share transactions and would leave unaddressed the question of how to treat share transactions made by organisations.

Conclusion

4.21.16 **Stamp duty on shares is not a strong candidate for devolution in Northern Ireland. Therefore, we will not be carrying this duty forward for consideration as part of the second phase of our work.**

4.22 Soft drinks industry levy

4.22.1 The soft drinks industry level is a tax levied on sugary soft drinks produced in or imported into the UK for domestic consumption. It covers those drinks to which sugar has been added, and containing at least 5 grams of sugar per 100 millilitres (once diluted), with a higher rate applying to those containing at least 8 grams of sugar per 100 millilitres. It was introduced in 2018 with the aim of both encouraging the reformulation of products by manufacturers to reduce sugar content, and to encourage consumers to consume fewer sugary drinks as a result of higher prices.

4.22.2 It is estimated that £12 million of levy was charged on soft drinks consumed in Northern Ireland in 2019-20, equivalent to less than 0.1% of the total tax take in Northern Ireland.

Economic and policy context

4.22.3 The NI Assembly has responsibility for public health policy, including efforts to reduce the harms caused by excessive sugar consumption, such as diabetes and obesity. Tax policy is potentially one element of this, by incentivising manufacturers to reformulate their products in order to avoid the tax and consumers to reduce their consumption as a result of higher prices. Research suggests that both factors help explain a decline in the amount of sugar and calories consumed in the form of soft drinks in the UK following the introduction of the levy.[251] It is unclear whether manufacturers would reformulate products if a relatively small part of the UK such as Northern Ireland (which represents approximately 3% of the soft drinks market) adopted a different tax regime which could reduce the impact of increases in a devolved levy on sugar consumption – evidence on this issue is limited. Internationally, and especially in the US, there are examples of soft drink taxes that are operated at a sub-national level.[252]

4.22.4 It is worth noting that RoI has a tax on soft drinks with the same structure to, albeit slightly lower rates than, the soft drinks industry levy. The striking similarity in design and rates may reflect the fact that many products have traditionally been supplied across the UK and RoI, and concern about the scope for cross-border shopping between RoI and Northern Ireland if rates differed significantly.

Legal constraints

4.22.5 We are not aware of any legal constraints to the devolution of the soft drinks industry levy to the NI Assembly.

Accountability

4.22.6 The very small amount of tax revenues raised by the levy means it would do little to increase the financial accountability of the NI Assembly. While it is formally levied on producers and importers, as discussed above, there is evidence that part of its incidence is actually on consumers, a much larger share of the population as a whole, in the form of higher prices.[lix] Despite being a relatively small tax, its introduction was relatively high-

[lix] Estimates of the extent to which taxes on soft drinks are passed through in prices vary considerably. Reviewing 27

profile, given debate around the appropriate role of government intervention in product markets and consumption choice.[253] Such media coverage may help the electorate hold the NI Assembly to account for its levy policies.

Administrative efficiency

4.22.7 The levy is payable at the production and import stage rather than by retailers at the point of sale to final consumers, in order to limit the number the number of taxpayers (there are fewer producers and importers than retailers) and hence reduce administration and compliance costs and risks. Unlike for exciseable products (like alcohol and tobacco) movements of soft drinks between GB and Northern Ireland are not treated as imports or exports for the purpose of the soft drinks industry levy.[lx] New processes would therefore be needed to set up to track the movement of soft drinks and apply taxes appropriately. This could be done via an offset scheme as is currently the case for excisable products like alcohol and tobacco, where the importing party pays or receives an amount equal to the net levy liability, accounting for the levy already paid in the exporting country. Alternatively it could be done via a 'drawback' scheme whereby the exporting party reclaims the levy paid and the importer pays the full levy due in the importing country. It is not possible to estimate the scale of the compliance and administration costs that operating and enforcing either approach would involve, but they may represent a relatively large share of tax revenues given the very low yield of this tax (£12 million).

Economic efficiency and risks to the UK tax base

4.22.8 As with other indirect taxes, differences in levy rates between Northern Ireland and GB could, in principle, affect the location where people purchase soft drinks. Norway's former sugar tax, which was relatively high and applied to a much wider range of goods (including confectionary), led to the opening of large confectionary retailers in border areas of Sweden.[254] Indeed, concerns about the impact of cross-border shopping as a result of Norway's high taxes prompted the Norwegian government to abolish its existing taxes on soft drinks and confectionary in 2021 and replace them with a lower general sugar tax.[255] However, at current duty rates of the soft drink industry levy (a maximum of 24p per litre), and given that Northern Ireland and GB do not share a land border, it seems unlikely that cross-border shopping by consumers would be a major concern even if the NI Assembly were to abolish or double the tax. Large changes relative to existing levy rates would likely be needed for organised fraud involving unregistered cross-border movements of larger volumes of soft drinks for onward sale to be of concern.

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studies across 11 jurisdictions, https://ifs.org.uk/publications/14382 find that in all cases prices increased, with pass-through being close to 100% when the taxes applied to larger areas, reducing the scope for 'cross-border' shopping. The only study of the UK soft drink levy, available at: (https://journals.plos.org/plosmedicine/article?id=10.1371/journal.pmed.1003025) finds a much lower rate of pass-through (30%), although the application of the policy across the entire UK means the methodology used in this study has some drawbacks relative to those used internationally.

[lx] It is worth noting that the NI Protocol to the EU Withdrawal Agreement requires businesses moving goods, including soft drinks from one GB to NI to register the transaction. However, such rules do not apply when goods are moved from Northern Ireland to GB.

Soft Drinks levy summary

4.22.9 The soft drinks industry levy is relevant for devolved public health responsibilities, and unless its level was drastically altered post-devolution it would be unlikely to have significant impacts on the UK Government's tax base.

4.22.10 However, the levy raises very little revenue and therefore, increases in administration and compliance costs could be large relative to revenue yield, and devolution would do little to improve the financial accountability of the NI Assembly. Changes in product formulation – one of the main responses to the UK's levy – may also be less likely for a Northern Ireland-only tax.

Conclusion

4.22.11 **The soft drinks levy is not a strong candidate for devolution in Northern Ireland. Therefore, we will not be carrying this levy forward for consideration as part of the second phase of our work.**

4.23 Taxes on specific business activities

4.23.1 The UK Government has introduced a number of taxes on specific business activities:

- The diverted profits tax, currently set at 25% (but due to rise to 31% from April 2023), which HMRC applies to profits it deems large business groups have tried to divert from the UK either by (a) engaging in practices solely to avoid the creation of a UK permanent establishment that would generate tax liabilities, or (b) engaging in transactions solely for the purpose of reducing UK tax liabilities. This aims to discourage such activities.
- The banking levy, a tax on banks' UK-based equities and liabilities (with some exceptions) if they exceed £20 billion, currently levied at 0.05% for equity and long-term liabilities and 0.1% for short-term liabilities. The aim is that by paying such a tax, banks will take account of the risk associated with their balance sheets, both reducing the risk and contributing to the cost of potential bail outs by the government.
- The digital services tax, a 2% tax on revenue of search engines, social media services and online marketplaces (and associated advertising revenues), applied on UK-derived revenues above £25 million on businesses with global revenues of more than £500 million.

4.23.2 There is no estimate of the amount raised from the diverted profits tax in Northern Ireland. The banking levy is estimated to have raised £36 million from Northern Ireland in 2019–20 on the basis of the share of banks and building societies' fees, commissions and intermediary services income that is attribute to Northern Ireland, equivalent to 0.2% of the total tax take in Northern Ireland. The digital services tax is estimated to have raised £2 million in Northern Ireland 2019–20, and although this is likely to have increased to around £16 million in the current financial year, that is still less than 0.1% of the total tax take in Northern Ireland.

Taxes on specific business activities conclusion

4.23.3 **As these are small and highly complex taxes that relate to HMRC's efforts to tackle international tax avoidance (the diverted profits tax and digital services tax) or a non-devolved responsibility (financial services regulation and insurance), we do not consider them strong candidates for devolution. Therefore, we will not be carrying these taxes forward for consideration as part of the second phase of our work.**

4.24 Summary of tax assessment conclusions

4.24.1 A summary of our conclusions on the suitability of each of the UK taxes levied in Northern Ireland is given below in Table 4.2.

Table 4.2 – Summary of the Commission's conclusions on the suitability of each of the UK taxes levied in Northern Ireland

Taxes that will advance for further consideration	
Income tax	Income tax is a sufficiently strong candidate for devolution in Northern Ireland and we will consider it further as part of the second phase of our work. A key issue for consideration will be the scope of devolution, that is, if devolution was agreed which elements of the tax base should be devolved and what degree of control over rates and bands should be devolved.
Fuel duty	We consider the case for devolution of fuel duty to Northern Ireland is sufficiently strong to merit further investigation as part of the second phase of our work. We will carry out additional research, and take forward analysis of the likely additional administration and compliance issues as far as is possible within the period before the publication of our final report.
Alcohol and tobacco duties	We consider the case for devolution of alcohol and tobacco duties to Northern Ireland to be sufficiently strong to merit further consideration as part of the second phase of our work. We will carry out additional research, and take forward analysis of the likely additional administration and compliance issues as far as is possible within the period before the publication of our final report.
Stamp duty land tax	Stamp duty land tax is a sufficiently strong candidate for devolution in Northern Ireland and we will consider it further as part of the second phase of our work. A key issue for investigation will be to consider how administration costs could be minimised.
Air passenger duty	Air passenger duty is a sufficiently strong candidate for devolution in Northern Ireland and we will consider it further as part of the second phase of our work. The Commission would stress, however, that there is likely a trade-off in the consideration of APD between environmental and economic factors, these issues should be considered ahead of pursuing this tax for devolution.
Apprenticeship levy	We consider the case for devolution of the apprenticeship levy to Northern Ireland to be sufficiently strong to merit further investigation. However, in terms of sequencing, we consider that the case for devolution would be best made following any decision to devolve income tax and/or NICs, given the likely administration costs of pursuing this tax in isolation. Given our position on income tax, we will consider the apprenticeship levy further as part of the second phase of our work.
Landfill tax	Landfill tax is a sufficiently strong candidate for devolution in Northern Ireland and we will consider it further as part of the second phase of our work.

Taxes that <u>will not</u> advance for further consideration	
VAT	There is a case, in principle, for devolution of VAT to Northern Ireland. However, the uncertainty regarding the significant additional compliance and administration burdens relative to income tax are sufficient that, in our view, further work at this stage should prioritise consideration of options for devolving income tax, rather than VAT. At this stage, therefore, we will not be carrying this tax forward for consideration as part of the second phase of our work.
NICs	There is arguably a slightly stronger case for devolving NICs to Northern Ireland than for Scotland or Wales. However, there remain additional complications relative to income tax, sufficient that, in our view, further work at this stage should prioritise consideration of options for devolving income tax, rather than NICs. If the NI Assembly wished to prioritise NICs over income tax or subsequent to any decisions to successfully devolve some or all income tax revenues to Northern Ireland, there may be a case to reconsider the devolution of NICs. At this stage, however, we will not be carrying this tax forward for consideration as part of the second phase of our work
Corporation tax	It is the Commission's view there is a case for devolving corporation tax to Northern Ireland. However, it is also our view that, given the complexities, both technical and political, there is no value in the NI Executive simply asking for it again. It will need to demonstrate how it would use the powers, and how it would balance its budget. It would need to demonstrate the "sustainability" of its finances. It would need to work together with the UK Government on these issues. It is our view that there are a number of pre-requisites for successful devolution, which include: • A clear statement of intent from the NI Executive on how devolved powers would be used; • Agreement with HM Treasury over how the block grant would be adjusted in response to the mechanical effect of a cut in tax rate on revenue; • A clear method for agreeing how, if at all, other effects on revenues would be taken into account, and a method for resolving disputes with HM Treasury; • An agreement with HM Treasury over some limited additional borrowing powers to cover part of the short-term hole created by a tax cut; • A clear commitment from the NI Executive over how it would fill the rest of the short-term hole in its revenues created by a tax cut and repay its additional borrowing. As a Commission we believe that there is value in the NI Executive seeking devolution of corporation tax. Equally we see no value in them doing so unilaterally. We also recognise that our approach to corporation tax is different to our approach to other taxes and different to the approach taken in Scotland and Wales in respect of the taxes devolved there. However, corporation tax is different and the issues that need resolution are more complex. Should the NI Executive wish to pursue devolution we would urge them to develop their own plans for sustainability and we would urge HM Treasury to engage constructively on the block grant adjustment and borrowing powers. Given the work already done, the scale and complexity of the issues, the need for action from the NI Executive and constructive engagement from HM Treasury, we as a Commission will not consider corporation tax any further.
Vehicle excise duty	There is a case, in principle, for the devolution of vehicle excise duty to Northern Ireland. However, due to the potential for significant distortions to tax bases, under existing administrative arrangements, where the 'registered keeper' of a vehicle is liable, we do not consider the devolution of this duty to be a priority for Northern Ireland at this time, and do not intend to carry this levy forward for consideration as part of the second phase of our work.

Insurance premium tax	The insurance premium tax is not a strong candidate for devolution in Northern Ireland. Therefore, we will not be carrying this tax forward for consideration as part of the second phase of our work.
Capital gains tax	There is a case, in principle, for the devolution of capital gains tax on disposals of land and property assets in Northern Ireland. There is much less of a case for the devolution of non-land and property assets. In view of the low revenues involved, with regard to land and property assets, we do not consider this tax to be a priority for devolution and, therefore, will not be carrying it forward for consideration as part of the second phase of our work.
Betting and gaming duties	There is a case, in principle, for devolution of betting and gaming duties to Northern Ireland. However, we consider that the challenges of geographic apportionment of customers and taxable yield make these duties administratively difficult and do not consider them to be a priority for devolution and, therefore, will not be carrying these duties forward for consideration as part of the second phase of our work.
Inheritance tax	There is a case, in principle, for devolution of inheritance tax to Northern Ireland, given Northern Ireland constitutes a part of the UK with different wealth distribution. However, we consider the potential issues around avoidance and the relative size of the cost to administer the tax compared to its size, impact on the feasibility of devolution. Therefore, we do not consider this tax to be a priority for devolution and will not be carrying it forward for consideration as part of the second phase of our work.
Climate change levy	There is arguably a case, in principle, for devolution of the climate change levy to Northern Ireland, given the local policy context. However, given climate change is a global issue, typically best tackled by policies that operate over larger rather smaller geographical areas, we do not consider this tax to be a priority for devolution and will not be carrying it forward for consideration as part of the second phase of our work.
Aggregates levy	There is a case, in principle, for devolution of the aggregates levy to Northern Ireland. However, it remains unclear to what extent the administrative costs associated with a devolved levy would justify the potential benefits. We recommend that the NI Executive follows the progress being made in the implementation of a devolved aggregates levy in Scotland and makes a decision on whether to pursue the tax further at that point. At this stage, therefore, we will not be carrying this levy forward for consideration as part of the second phase of our work.
Stamp duty on shares	Stamp duty on shares is not a strong candidate for devolution in Northern Ireland. It is paid only by a relatively small proportion of the population, and there is no obvious link between the tax and the devolved competencies of the NI Assembly. Identifying the geographic status of share purchasers is also likely to be problematic. Therefore, we will not be carrying this duty forward for consideration as part of the second phase of our work.
Soft drinks levy	The soft drinks levy is not a strong candidate for devolution in Northern Ireland. The levy raises very little revenue and therefore increases in administration and compliance costs could be large relative to revenue yield and devolution would do little to improve the financial accountability of the NI Assembly. Therefore, we will not be carrying this levy forward for consideration as part of the second phase of our work.
Taxes on specific business activities (*Diverted profits, Banking levy, Digital services*)	As these are small and highly complex taxes that relate to HMRC's efforts to tackle international tax avoidance (the diverted profits tax and digital services tax) or a non-devolved responsibility (financial services regulation and insurance), we do not consider them strong candidates for devolution. Therefore, we will not be carrying these taxes forward for consideration as part of the second phase of our work.

Chapter 5

What happens next?

5.0.1 As indicated in the Preface to this report, we are reporting in two stages. This *Interim Report* provides information on the Northern Ireland context and describes the key issues as we see them, and as informed by the views of stakeholders. We have presented our view on the range of options available to Northern Ireland in terms of enhanced fiscal devolution, and what we see as some of the fundamental factors necessary for *successful* fiscal devolution, based on experiences from elsewhere.

5.0.2 Importantly, this Interim Report provides our analysis of individual taxes levied in Northern Ireland and sets out which of those taxes we consider to be the most appropriate candidates for devolution at this time. In our final report we will revise and add to our interim report, rather than start afresh. We will be considering these 'prioritised' taxes further, aiming to reach firmer conclusions on which taxes we believe are most suitable for devolution in Northern Ireland, and in what form.

5.0.3 Ultimately, our *Final Report,* to be published for the beginning of the next political mandate, will put forward options that are, in our view, realistically implementable for Northern Ireland. We will present our analysis of the operational aspects of implementation of any new powers proposed, the impact on the NI block grant, any additional budgetary management tools required and, where appropriate, a consideration of the optimum scope/mechanism of devolution (i.e. which elements of the tax base should be devolved and what degree of control over rates/bands should be devolved).

5.0.4 Decisions over fiscal devolution in Northern Ireland need to balance the risks and rewards. They also need to take account of its unique context, and its political and institutional capacity and resilience. These potential costs, benefits and risks will vary according to the specific characteristics of the individual taxes under consideration. We will also consider whether, and to what extent, the spending power of the NI block grant could be insulated from volatilities in tax revenues if more fiscal powers were devolved.

5.0.5 As we work towards the completion of our Final Report, we are keen to garner views and responses from as wide a range of people as possible. Only through this engagement will a meaningful report with meaningful conclusions be completed, that will be of benefit to Northern Ireland. We hope we can count on your contribution and would ask that stakeholders consider and respond to the Commission by 1 February 2022.

You may find following questions useful in structuring your submission to us.

QUESTION 1 – Do you agree with our understanding and representation of why fiscal devolution might be considered important and the contemporary context of Northern Ireland, as described in Chapter 1?

If you disagree, can you explain where your analysis differs? Are there additional factors that we should also consider?

QUESTION 2 - Do you agree with our understanding and our representation of the current Northern Ireland context?
If you disagree, can you explain in relation to which aspects?

QUESTION 3 - Do you agree with our analysis of the suitability or otherwise for devolution of the individual taxes listed in Chapter 4?
If you disagree, can you explain where you own analysis may differ and how?

QUESTION 4 - Do you agree with our conclusions regarding the prioritisation of specific taxes to be carried forward for further consideration in the second phase of our work?
If you disagree, can you explain which taxes you believe should be treated differently and why?
Can you provide information which would support or detract from the potential devolution of Excise Duties to Northern Ireland?

We will take all of your responses into consideration for the second stage of our work. Once this second stage has concluded, we will provide the Northern Ireland Finance Minister with a detailed final report, including our conclusions. It will then be for a new NI Executive and for the people of Northern Ireland to decide on next steps.

Further information on our work to date can be found at: www.FiscalCommissionNI.org and evidence and responses to the Fiscal Commission's Interim Report can be submitted to the Fiscal Commission via: Info@FiscalCommissionNI.org

We look forward to hearing from you

P. Johnson

Paul Johnson
Chair of Fiscal Commission NI

Cathy Gormley Heenan

Professor Cathy Gormley-Heenan
Commissioner

Iain S McLean

Professor Iain McLean
Commissioner

Lisa Wilson

Dr Lisa Wilson
Commissioner

Annex A

Glossary

AME	Annually Managed Expenditure: the budgets of UK Government Departments and devolved administrations to finance demand-led expenditure (for example, social security payments)
BGA	Block Grant Adjustment reflects how the funding to a devolved government is adjusted to account for the loss of revenue to the UK Treasury from the devolution of fiscal powers to the respective devolved Parliament or Assembly
British-Irish Council	A body established under the Belfast Agreement of 1998 which aims to "promote the harmonious and mutually beneficial development of the totality of relationships among the peoples of these islands". It's members include representatives of the UK and Irish Governments, of the devolved Scottish, Welsh and Northern Irish executives and of the administrations of Jersey, Guernsey and the Isle of Man
Carbon Price Floor	UK Government policy implemented to support the EU Emissions Trading System. It was introduced to underpin the price of carbon at a level that drives low carbon investment, which the EU ETS has not achieved
City Deals	Bespoke packages of funding and decision-making powers negotiated between central government and local authorities
CSO	Central Statistics Office: the statistical agency responsible for the gathering of information relating to economic, social and general activities and conditions in the Republic of Ireland (RoI)
DEL	Departmental Expenditure Limit: the allocated budgets of UK Government Departments and devolved administrations to fund public expenditure
ERINI	Economic Research Institute of Northern Ireland
EU	European Union: a political and economic union of 27 member states that are located primarily in Europe
EU State aid	State aid in the European Union is the name given to a subsidy or any other aid provided by a government that distorts competitions. Under European Union competition law, if it distorts competition or the free market, it is classed by the European Union as being illegal State aid
FDI	Foreign Direct Investment: investment in the form of a controlling ownership in a business in one country by an entity based in another country
G7	Group of Seven: a forum of countries representing around half of global economic output that meet regularly to discuss key issues related to global economic stability. It consists of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States of America
GB	Great Britain: geographically the islands comprising England, Scotland and Wales; politically used to denote the UK except for Northern Ireland
GDP	Gross Domestic Product: measures the total value of all of the goods made, and services provided, during a specific period of time

GERS	Government Expenditure and Revenue in Scotland: a Scottish Government publication estimating Scotland's fiscal balance
GNI	Gross National Income: defined as gross domestic product, plus net receipts from abroad of compensation of employees, property income and net taxes less subsidies on production
GVA	Gross Value Added: the amount of goods and services that have been produced in a country, minus the cost of all inputs and raw materials that are directly attributable to that production
HMT	Her Majesty's Treasury: the government's economic and finance ministry, maintaining control over public spending, setting the direction of the UK's economic policy and working to achieve strong and sustainable economic growth
HMRC	Her Majesty's Revenue and Customs: a non-ministerial department of the UK Government responsible for the collection of taxes, the payment of some forms of state support, the administration of other regulatory regimes including the national minimum wage and the issuance of national insurance numbers
IFG	Institute for Government: United Kingdom independent think tank which aims to improve government effectiveness through research and analysis
IFS	Institute for Fiscal Studies: an independent UK research institute specialising in UK taxation and public policy, with the principal aim of better informing public debate on economics in order to promote the development of effective fiscal policy
IMF	International Monetary Fund: an international financial institution consisting of 190 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world
MNE	Multinational Enterprise: An enterprise producing goods or delivering services in more than one country
NDR	Non-Domestic Rates
NI Protocol	Agreement between the EU and UK to account for customs tariffs, customs declarations and customs controls in trade between Northern Ireland and the European Union, in particular the Republic of Ireland
NICs	National Insurance contributions: a UK Government-levied tax on employers and employees hypothecated to fund social security payments and the National Health Service
NISRA	Northern Ireland Statistics and Research Agency: the principal source of official statistics and social research on Northern Ireland
NNP	Net National Product: the total value of goods produced and services provided in a country during one year, after depreciation of capital goods has been allowed for
Northern Ireland Consolidated Fund	The sum of money provided annually by the UK Parliament to establish a budget for the NI Assembly. The Northern Ireland Consolidated Fund has existed since 1921. All central government income and expenditure (with respect to NI) flows through the Northern Ireland Consolidated Fund

OECD	Organisation for Economic Co-operation and Development: an intergovernmental economic organisation with 38 member countries, founded in 1961 to stimulate economic progress and world trade
ONS	Office for National Statistics: UK's largest independent producer of official statistics and the recognised national statistical institute of the UK
rUK	Rest of the United Kingdom comprising England, Scotland and Wales
RHI	Renewable Heat Incentive scheme: a 20-year incentive to encourage the move from fossil fuels such as oil and gas, to a renewable source of heat. It was managed by the Department of Enterprise, Trade and Investment (DETI), the forerunner of the Department for the Economy
RRI	Reinvestment and Reform Initiative: a borrowing facility that was set up in 2002 to support the Northern Ireland Executive's infrastructure investment programme
SNP	Scottish National Party
Spending Review	Governmental process carried out by HM Treasury to set firm expenditure limits and, through public service agreements, define the improvements that the public can expect from these resources
Sub-national Government	Term used in academic literature to describe the tier of government between national and local or municipal
TES	Total Expenditure on Services: actual spending undertaken by the public sector within a region and is used by HM Treasury as the basis for the reporting of functional, economic category and territorial spending across the Devolved Administrations
TME	Total Managed Expenditure: all expenditure by the entire public sector - namely, the UK Government, NI Executive, local authorities and public corporations
UK	The United Kingdom of Great Britain and Northern Ireland
VAT	Value Added Tax: tax on goods and services levied in the UK by HMRC

Annex B

Overview of block grant adjustment

B1.1 Overview

Currently, the budget of the NI Executive is largely determined by a block grant from the UK Government. Changes in this block grant from one year to the next are determined by the Barnett Formula.

If UK Government revenues are devolved to Northern Ireland, the NI block grant will need to be reduced – in all future years – to reflect the transfer of revenues. Without any such offsetting reduction to the NI block grant, the budget of the NI Executive would benefit from a windfall funding increase, whilst the UK Government would see a fall in its revenues without any offsetting reduction in expenditure.

B1.2 Block grant adjustment in Scotland and Wales

But how should these block grant adjustments be made? In the Scottish and Welsh cases, the block grants have been adjusted to ensure two key outcomes. First, so that the devolved budget is not immediately better off or worse off simply as a result of the initial transfer of revenues. Second, that the future budgets of the devolved government capture the revenue impacts of their devolved tax policy choices, and of faster or slower growth in the underlying tax base

We know a lot about how these block grant adjustments are likely to be calculated based on the arrangements in Scotland and Wales following recent rounds of tax devolution there. But the arrangements do differ slightly in Scotland and Wales, with the two approaches having different implications for the types of budgetary risk borne by the devolved governments.

B1.3 Calculating the block grant adjustment in Northern Ireland

What we do know, based on the Scottish and Welsh experiences is that the calculation of the block grant adjustments for Northern Ireland will consist of two elements: *an initial deduction* and an *indexation mechanism*.

- The *initial deduction* is simply the revenues raised from the tax by the UK Government in NI in the year before devolution becomes operational. So if income tax, for example, is devolved to Northern Ireland in 2023/24, the initial deduction is simply the revenues raised by the UK Government from income tax in NI in 2022/23.
- The *indexation mechanism* is a measure of the subsequent growth rate of revenues in rUK from the tax that has been devolved to Northern Ireland. So for example, imagine that income tax is devolved to Northern Ireland in 2023/24 and the initial deduction (the amount raised in Northern Ireland in 2022/23 by the UK Government) is £3bn. If income tax revenues in rUK subsequently grow by 5%, then *one way* to calculate the block grant adjustment would be to apply this 5% growth rate to the initial deduction, to give a figure for the block grant adjustment in 2023/24 of £3.15bn. This figure would be deducted from the Executive’s block grant.

Viewed this way, the block grant adjustment is effectively an estimate of the revenues that the UK Government is likely to have foregone as a result of transferring a tax stream to Northern Ireland. To make this calculation, an assumption is made that, in the absence of devolution, the UK Government's revenues from the tax in Northern Ireland would have grown at the same rate as in rUK after devolution occurred.

In our example above, the block grant adjustment is calculated as £3.15bn. This figure would be deducted from the NI Executive's block grant in 2023/24. If the actual revenues from income tax in Northern Ireland were higher than £3.15bn, then the Executive's budget would be better off compared to the position without income tax devolution by the value of the difference. But if actual revenues were less than the block grant adjustment, the NI Executive's budget would be worse off.

B1.4 Purpose of the block grant adjustment

The block grant adjustments serve a number of purposes.

- First, they protect the NI budget from UK-wide shocks to revenues. When there is a major shock such as a pandemic, revenues from a devolved tax in Northern Ireland are likely to fall. But if revenues from the equivalent tax in rUK fall in a similar proportion, then the block grant adjustment will also fall. The fall in revenues in Northern Ireland is matched by a fall in the t amount deducted from the block grant, insulating the NI budget from the fall in its devolved revenues.
- Second, they enable the NI budget to benefit from the revenue impacts of its own policies. If the NI Executive increased tax rates relative to those prevailing in rUK, revenues in Northern Ireland (all other things being equal) would grow relative to the block grant adjustment.
- Third, they ensure that the NI budget does not benefit from increases in rUK spending that is funded by an increase in rUK tax revenues for a tax that has been devolved to Northern Ireland. If the UK Government increases tax rates for a tax that has been devolved to Northern Ireland, then that tax increase would not apply in Northern Ireland. The UK block grant adjustment would increase, reflecting the increase in rUK revenues. At first glance, this might not appear 'fair' to the NI budget. However, it must be remembered that the UK Government's additional revenues would be spent by the UK Government. If they were spent on 'comparable' public services in England, this would generate a consequential increase in the Executive's block grant. The higher block grant adjustment would offset this increase, and without this, the NI Executive would see an increase in its block grant funded by a tax increase in rUK that didn't apply in Northern Ireland. And if the UK Government spends the additional revenues on 'reserved' matters, the block grant adjustment ensures that taxpayers in Northern Ireland make a broadly similar contribution to that expenditure as taxpayers in rUK, despite the tax increase not applying directly.

B1.5 Issues with the block grant adjustment

So what are the issues? First, there are a number of different ways that the indexation mechanism could be calculated. The example above assumed that the indexation mechanism was simply based on the percentage growth in total rUK revenues. The approach to calculating the indexation mechanism in Scotland is actually based on the percentage growth in rUK revenues per capita. This approach insulates the Scottish budget from the risk that its population might grow more slowly over time than the rUK population.

The approach to calculating the indexation mechanism in Wales is slightly different. It provides a more partial protection of the Welsh budget to the risks of differential population growth, but is arguably somewhat fairer to rUK taxpayers in respect of increases in rUK revenues over time.[lxi]

Second, although the block grant adjustments protect the NI budget from the risk of UK-wide economic shocks, they provide no protection to the NI budget from shocks that are specific to the NI economy. There is a reasonable question to ask as to whether this makes sense, or whether tax devolution in Northern Ireland should incorporate some sort of insurance mechanism against the risk of either a Northern Ireland-specific economic shock, or a weaker performance of the economy, and hence tax revenues, in the long run.

B1.6 Summary

In summary, the approach to calculating the block grant adjustments, whilst somewhat dry and technical, makes a significant difference to the balance of budgetary risks and rewards that tax devolution implies. First, the BGA mechanisms determine the fiscal risks the NI Executive faces over the long run – for example, is it exposed to the fiscal risks of demographic change, or insulated from them. Second, the approach to calculating the block grant adjustment will also influence the degree of expose of the NI budget to forecast error risks, and hence to the degree of borrowing and other cash management tools required alongside tax devolution.

Our subsequent phase of work will consider the options and implications of different mechanisms for adjusting the block grant in further detail.

[lxi] The reason for this relates to the fact that the Barnett Formula allocates to devolved governments a population share of changes in English spending, but the changes to block grant adjustments are based on percentage changes in rUK revenues. And because the devolved nations raise less tax revenue per person than England, the devolved governments tend to benefit from increases in rUK revenues that are used to fund increases in English spending. This is because the increase in Barnett consequential tends to be higher in cash terms than the corresponding increase, in cash terms, of the BGA, given that the increase in the BGA is a percentage increase applied to a lower base. For a practical example, see: https://fraserofallander.org/funding-a-rise-in-social-care-spending-england-implications-for-the-scottish-budget/

Annex C

Breakdown of Northern Ireland financial packages

C1.1 Overview

The Commission has commissioned DoF to provide further details of the funding levels that the Executive expected to receive via various financial packages in recent years and how much was actually drawn down in the Executive's Budget.

The links and tables below were provided by DoF Public Spending Directorate (PSD) in response to the Commission's request.

C1.2 Links to details of financial packages

Stormont House Agreement

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/390673/Stormont_House_Agreement_Financial_Annex.pdf

Fresh Start Agreement

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/479116/A_Fresh_Start_-_The_Stormont_Agreement_and_Implementation_Plan_-_Final_Version_20_Nov_2015_for_PDF.pdf

Confidence and Supply Agreement

https://www.gov.uk/government/publications/conservative-and-dup-agreement-and-uk-government-financial-support-for-northern-ireland/uk-government-financial-support-for-northern-ireland

New Decade New Approach

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/856998/2020-01-08_a_new_decade__a_new_approach.pdf

DoF briefing note at the time

https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/Briefing%20note%20-%20financial%20package%20LATEST.pdf

Parliament publication

https://publications.parliament.uk/pa/cm5801/cmselect/cmniaf/160/16006.htm

C1.3 Financial Packages – Additional funding initial profiles

Table C1 Stormont House Agreement

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	2021 22	2022 23	2023 24	2024 25
Dealing with the Past	30.0	30.0	30.0	30.0	30.0					
Shared Education	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Total Additional Funding	**80.0**	**80.0**	**80.0**	**80.0**	**80.0**	**50.0**	**50.0**	**50.0**	**50.0**	**50.0**

Table C2 Fresh Start

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	2021 22	2022 23	2023 24	2024 25
Welfare Reform - Fraud and Error		25.0	25.0	25.0	25.0	25.0				
Tackling Paramilitary Activity		5.0	5.0	5.0	5.0	5.0				
Shared Future		12.0	12.0	12.0	12.0	12.0				
Total		**42.0**	**42.0**	**42.0**	**42.0**	**42.0**				

Table C3 Confidence and Supply

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	2021 22	2022 23	2023 24	2024 25
Health and Education				50.0	50.0					
Health Transformation				100.0	100.0					
Mental Health				10.0	10.0	10.0	10.0	10.0		
Infrastructure				200.0	200.0					
Broadband				75.0	75.0					
Severe Deprivation				20.0	20.0	20.0	20.0	20.0		
Total				**455.0**	**455.0**	**30.0**	**30.0**	**30.0**		

Table C4 New Decade New Approach

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	2021 22	2022 23	2023 24	2024 25
Immediate Budget Pressures						350.0				
Delivering pay parity for nurses					30.0	85.0	85.0			
Transformation Funding						44.0	49.0	49.0	49.0	49.0
Graduate medical school in Derry/Londonderry*						15.0	15.0	20.0	5.0	5.0
Ultra-low emission transport						25.0	25.0			
Total					**30.0**	**519.0**	**174.0**	**69.0**	**54.0**	**54.0**

**Includes £45m of Capital for IFF*

Table C5 City Deals

£m	Total
Belfast Regional City Deal	350.0
Derry and Strabane*	105.0
Mid and South West Growth	126.0
Causeway Coast and Glens	36.0
Total	**617.0**

**Includes £55m IFF*

Table C6 Northern Ireland Protocol Funding

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21	2021 22	2022 23	2023 24	2024 25
NI Protocol Implementation						30.3	35.6			
Total						**30.3**	**35.6**			

C1.4 Financial Packages – Actual drawdown figures

Table C7 Stormont House Agreement

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21
Dealing with the Past						
Shared Education		2.6	6.1	10.9	13.4	26.5
Total Additional Funding		**2.6**	**6.1**	**10.9**	**13.4**	**26.5**

Table C8 Fresh Start

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21
Welfare Reform - Fraud and Error		25.0	25.0	25.0	25.0	25.0
Tackling Paramilitary Activity		1.9	3.2	4.7	5.8	8.7
Shared Future		11.4	10.6	12.0	12.0	11.4
Total		**38.3**	**38.8**	**41.7**	**42.8**	**45.1**

Table C9 Confidence and Supply

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21
Health and Education			20.0	80.0		
Health Transformation				100.0	100.0	
Mental Health				10.0	10.0	10.0
Infrastructure				200.0	200.0	
Broadband						21.1
Severe Deprivation				20.0	20.0	19.5
Total			**20.0**	**410.0**	**330.0**	**50.6**

Table C10 New Decade New Approach

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21
Immediate Budget Pressures						350.0
Delivering pay parity for nurses					30.0	85.0
Transformation Funding						44.0
Graduate medical school in Derry/Londonderry*						
Ultra-low emission transport						25.0
Total					**30.0**	**504.0**

Table C11 City Deals

£m	Total
Belfast Regional City Deal	20.0
Derry and Strabane*	
Mid and South West Growth	
Causeway Coast and Glens	
Total	**20.0**

*Includes £55m IFF

Table C12 Northern Ireland Protocol Funding

£m	2015 16	2016 17	2017 18	2018 19	2019 20	2020 21
NI Protocol Implementation						22.5
Total						**22.5**

Source: DoF PSD

Annex D

Policy divergence in Northern Ireland -'super-parity' and 'sub-parity' issues

D1.1 Overview

The imprecise term **'super parity'** is often used in Northern Ireland's policy circles to describe policy divergence in respect of policies which confer an element of benefit or differentiation with the wider UK population (most often England). This differentiation generally comes from reduced costs and charges for local citizens and businesses, which have a resultant public expenditure impact.[lxii] In other words, there are a number of specific examples of policy divergence where Northern Ireland could raise additional revenue or reduce expenditure if policies matched other parts of the UK. It is not for the Fiscal Commission to judge on the merits or otherwise of these policy choices. That is a political decision.

This annex highlights a number of the 'super-parity' and 'sub-parity' measures (those instances where provision is greater in other locations of the UK than Northern Ireland). These measures have already been identified in Section 2.12 of our report, this annex provides a more detailed overview of each example of policy divergence, as understood by the Commission.

D1.2 Overview of 'super-parity' measures

In order to understand the extent of the various exemptions and mitigations in place relating to existing policies; the Commission requested, through the Department of Finance, that all Northern Ireland Executive departments provide an overview of areas of policy divergence ('super-parity') and their associated costs within their departmental remit. The information that follows in this annex is based on the information returns provided by each department.

Table D1 provides an overview of the responses received by each department. It shows that the total estimated cost of policy divergence, and all various relief and exemption measures provided is estimated to be between **£600m to £700m** or approximately 3.8-4.2% of the total annual DEL budget available to the NI Executive. Measures provided by Departments which implied a cost of less than £1m have not been included.

Table D1: Super-parity measures identified by NI Executive departments, Summer 2021, £million

Department & measure	Description of Measure	Value of measure
Department for Communities		
Existing welfare mitigations	This includes payments related to certain welfare reforms including the Benefit Cap, the "Bedroom Tax" and Personal Independence Payment	£42.8m

[lxii] The HM Treasury statement of funding policy document states "devolved administrations will generally need to fund any costs that are above a population share of the costs of a UK government programme".

Housing Benefit Rates	In 2013/14 the UK Government decided that Housing Benefit Rates should be moved from the AME budget to the DEL budget and applied a cut of 10%. Executive continues to 'compensate' for this cut each year	£12m
Department for Economy		
University Tuition Fees*	Northern Ireland has not introduced higher tuition fees for students as seen in England. Currently DfE provides funding directly to Northern Ireland universities from the block grant to help subsidise part of the cost.	£14.2m to £90.5m
Department of Finance		
Industrial De-Rating**	Properties which are occupied and used for manufacturing purposes receive 70% reduction in their rates bill.	£59m
Low Income Rate Relief**	A supplement to Housing Benefit to help with rates charges	£6.6m
Vacant land rate relief**	In general, once a non-domestic property becomes vacant, it will receive 100% exemption for the first three months, after that it will then only have to pay 50% of the occupied rates liability.	£35m
Freight/transport rate relief**	Properties occupied for the purpose of freight transport receive 75% rates relief.	£2.2m
Landlords Allowance**	10% allowance for landlords who make lump sum payments for several properties at the same time.	£13m
Department of Health		
Prescription Charges	The NI Executive abolished all prescription charges in Northern Ireland in April 2010.	£20m
Domiciliary Care Charges	Domiciliary care is provided free of charge in Northern Ireland.	£17.8m to £32.5m
Department for Infrastructure		
Concessionary Fares	The Northern Ireland Concessionary Fares Scheme (NICFS) offers free bus and rail travel for Northern Ireland residents aged between 60 and 64.	£29.2m
Domestic Water Charges	The Executive has extended the power for DfI to pay a subsidy to NI Water in lieu of domestic water charging since 2007. Water charges are currently in place elsewhere in the UK where it is either added to a property's Council tax bill or charged on a usage basis.	£344.5m
Non Departmental measures		
Air Passenger Duty	Long-haul Air Passenger Duty has been devolved since January 2013 and since then there has been a zero-rate policy in place for long-haul flights from Northern Ireland.	£2.3m
Total Super Parity measures		**£599m to £690m**

Source: Commission calculations from Northern Ireland Departmental returns via Department of Finance, Summer 2021

Note: Minor measures under the value of £1m are not included in table above. Figures provided in Summer 2021 but do not necessarily correspond to figures for that year but the latest available.

** The issue of fee funding and replacing grant funding with increased loans involves many nuances and DfE have indicated to the Commission that significant analysis would be required to arrive at exact estimates. The estimates presented here reflect whether or not the additional costs associated with the write offs of loans would be met by the UK Treasury or would be met by the NI Executive from its own DEL Budget.*

*** For a number of rating reliefs, revenue foregone is split between the NI Executive and the district councils, therefore not all additional revenue raised by removing these reliefs would go to the NI Executive.*

D1.3 Breakdown of 'super parity' measures by Department

In addition to the high level summary provided in Table D1 above, a more detailed outline of each super-parity measure as identified by each NI Executive department is provided below.

Department for Communities (DfC)

Existing welfare mitigations - As part of the 2015 Stormont Fresh Start Agreement and its Implementation Plan, the NI Executive agreed to put in place schemes to mitigate against some of the impacts of welfare reforms (including Universal Credit, the benefit cap and the 'bedroom tax') introduced elsewhere in the UK. The welfare mitigation schemes came to a statutory end on 31 March 2020 in accordance with the relevant legislation. But under the New Decade New Approach agreement the mitigation schemes were extended, and payments are now being made under the sole authority of the relevant Budget Act, pending the approval of new legislation by the NI Assembly. The schemes introduced 'top-up' the UK welfare arrangements in Northern Ireland. *The cost of this measure is estimated by DfC at £42.8m per annum.*

Housing benefit rates - In 2013/14 the UK Government decided that Housing Benefit Rates should be moved from the Annually Managed Expenditure budget to the Departmental Expenditure Limited budget and applied a cut of 10%. The Executive has continued to 'compensate' for this cut each year with DfC allocated a ring-fenced budget based on forecast spend each year. *The cost of this measure is estimated by DfC at £12m per annum.*

Department for the Economy (DfE)

Increased University Tuition Fees – As in some other devolved administrations, Northern Ireland has not introduced higher tuition fees for students undertaking full time undergraduate programmes as seen in England where students are charged up to £9,250 per annum. Instead, Northern Ireland students are charged £4,530 per annum.

Currently DfE provides funding directly to Northern Ireland universities from the NI block grant to help subsidise part of the cost gap, with the universities making up the remaining shortfall. If tuition fees were increased to a level similar to England, then additional funding *could* be made available directly to the universities (from students) and the amount paid to universities from the NI block grant *could* be reduced. DfE indicates, however, that simply increasing tuition fees will not necessarily directly lead to increased revenues for the NI Executive. The issue of fee funding and replacing grant funding with increased loans involves many nuances and DfE have indicated that significant analysis would be required to arrive at exact estimates. There are particular aspects that need to be considered, including: the cost of issuing loans; the cost associated with the future write offs of loans; and, from a budgetary perspective, the fact that the cost associated with the write off of loans may be charged to the NI Executive's Resource DEL if it exceeded the ring-fenced DEL Budget. In other words, the range estimated here reflects whether this would be met by the UK Treasury or require the Executive to meet this from its own DEL Budget.

Therefore DfE estimates on potential revenue raising amounts are presented as a minimum and maximum range depending if full additional write offs are met. *Increasing tuition fees to a level* *similar to England has the potential to raise revenue of between £14.2m to £90.5m per annum, based DfE estimated figures provided in October 2021.*

Department of Finance (DoF)

Rates are the main revenue raising power available to the NI Executive. Rates are collected by the DoF Land & Property Services on behalf of the Executive and the 11 Councils. The revenue raised is then allocated between Councils and the Executive, with approx. 55% going to the Executive, and 45% going to the Councils.

Given that a number of domestic and non-domestic reliefs and exemptions are in place within the rating system, the removal of these would raise additional revenue. However, revenue forgone as a result of reliefs/exemptions is not split evenly between the Executive and the 11 Councils. Some are paid for exclusively by the Executive with Councils also paying for some of the rate support provided to ratepayers, which acts a loss to their tax-base.

Additionally, the Executive (via DfC) compensates District Councils for loss to their taxbase incurred from central government policies associated with, for example, Industrial Derating, Sport and Recreation relief, and Freight Transport Relief i.e. the Derating Grant, (DoF estimate is £31m). Some 'poorer' Councils also receive an additional Rate Support Grant from DfC (estimated at £22.3m. There is also a Transfer of Function Grant, which is worth £5.8m.

An overview of each of the rate reliefs, either non-domestic or domestic as identified by DoF as super parity measures is provided below[lxiii].

Industrial Derating - Businesses are taxed on non-domestic rates in Northern Ireland, however a significant rate support scheme is 'Industrial Derating' which is only available in Northern Ireland. It was introduced in 1929 for properties which are occupied and used for manufacturing purposes. The policy was retained in its current form for so long as it was treated as a pre-accession aid under the EU State aid framework. This meant that the Executive could retain the policy in its fixed form, but could not provide the support in a re-targeted fashion (i.e. to incentivise Research and Development work). Phasing out Industrial Derating completely by 2011 was considered, but following a further review of rating policy it was instead decided to cap liability at the current level of 30%. *The cost of this super-parity measure is estimated by DoF at £59 million per annum (after the cost of the DfC derating grant is factored in).*

Vacant rate relief - In general, once a non-domestic property becomes vacant, it will receive 100% exemption for the first three months of that vacant period. After this period has elapsed, the property owner will only have to pay 50% of the occupied rates liability. This compares to a situation in GB where the owners of a vacant property incur the full 100% liability (90% in Scotland). Vacant property rating relief represents a loss to both district and regional rate revenue raised. This relief was significantly impacted by the pandemic. *The potential revenue that could be raised by removing this relief is estimated by DoF at £35m per annum using 2020/21 figures.* The 2020/21 figure was slightly lower than usual due to the pandemic (associated with lockdowns and low level of property 'occupancy churn'). For comparison, the cost in 2019/20 was £38 million. This revenue foregone is split as a loss to the taxbase between the Executive and Councils.

Freight transport rate relief - properties occupied for the purpose of freight transport receive 75% relief from rates. Its aim is to encourage lower freight charges and is intended to benefit exporting firms as Northern Ireland is on the periphery of Europe, which it is argued, results in

[lxiii] It should also be noted that the removal of any of these reliefs/exemptions will result in an element of non-payment, with debt and additional collection and recovery costs incurred, and therefore they slightly overstate the actual revenue loss.

higher transport costs when trying to access the main European markets. *The potential revenue that could be raised by removing this relief is limited, with the cost estimated by DoF at £2.2m per annum.* There is no loss to the Councils in relation to this measure (as the loss, to Councils is subsided through the DfC derating grant).
Low-income rate relief (***LIRR)*** – DoF have also noted that Low Income Rate Relief as a supplement to Housing Benefit is a form of domestic relief available in Northern Ireland that is not available in England. This is separate from the DfC scheme. *The total cost this relief is estimated by DoF at £6.6m per annum using 2020/21 figures.*

Landlord allowance - this 10% allowance is awarded to landlords who make lump sum payments for several properties at once, reducing administration costs in LPS. *This allowance is estimated by DoF to cost £13m per annum.* This cost is split between the Executive and Councils.

Department of Health

Prescription charges are an example where charges previously existed however, in this case, the Executive abolished all prescription charges in Northern Ireland in April 2010. Prescription charges have also been abolished in Scotland (since 2011) and Wales (since 2007) whilst charges are in place in England. *DoH estimate that reintroducing this measure could help generate up to £20m per annum.*

The exact value of any revenue raised would however depend on the final charging model arrived at, the amount charged per prescription and the number of people exempted from charges (as is the case in England or similar to medical charges in RoI). Before they were dropped in Northern Ireland, prescription charges generated around £13m (in 2007)[lxiv]. Furthermore, DoH have also indicated that robust modelling is required to fully develop and assess options for charging to estimate the respective levels of income. Administrative charges, for the preferred model would also have to be offset against any income generated. Taking account of the preferred model and new IT systems development for the administration and implementation could take up to 12-18 months following any decision (by Minister with Executive agreement) to re-introduce prescription charges. Savings would not likely to start to be realised until at least 2023-24. It should be noted that the potential for fraud and the cost of counter-fraud arrangements could also outweigh or reduce the financial benefits.

Domiciliary care is provided free of charge in Northern Ireland and the total cost is around £299 million per year. Charging for services is an accepted part of community care provision in England and Wales including for domiciliary Care. However, there is significant variability in the charging regimes for domiciliary care. People in Scotland aged over 65 can receive free personal care if they have been assessed by their local authority as needing it. The Scottish Government is also currently looking into the removal of charging for non-residential social care support. Charging for a proportion of the costs of domiciliary care and day care (and the associated transport costs) could be introduced in Northern Ireland, as could an increase in the charge levied by Trusts for community meals, as both are currently heavily subsidised. *The potential revenue that could be raised by introducing a charge for domiciliary care on a means tested basis is estimated by DoH to be between £17.8m and £32.5m annually depending on the amount charged.*

[lxiv] http://www.niassembly.gov.uk/globalassets/documents/raise/publications/2014/general/6114.pdf

Department for Infrastructure (DfI)

Concessionary fares – Since 2008 the Northern Ireland Concessionary Fares Scheme (NICFS) has offered free bus and rail travel to all Northern Ireland residents aged 60 and above. In England, by contrast, the English National Concessionary Travel Scheme (ENCTS) offers free bus travel only to those who have attained the State Pension age (currently 66), although some English local authorities (notably London and Liverpool) have set a qualifying age of 60. In Scotland and Wales, the qualification age for concessionary travel is also 60 years old (It should be noted that Northern Ireland only gives a half fare concession to people with a disability rather than full fare as is the case elsewhere). *The cost of this measure is estimated by DfI at £29.2m per annum.* This includes free transport on buses to those aged 60 to 67 (worth £13.2m per annum) and given that under the Northern Ireland Scheme a concessionary fare can also be obtained on trains, which equates to approximately £16m per annum unlike in GB.

Domestic water charges - Water supply and sewerage is in the public sector in Northern Ireland, delivered through the public corporation NI Water. The company does not charge domestic customers for its services, unlike the private sector water suppliers in England, the not-for-profit supplier in Wales and the publicly-owned supplier in Scotland. The issue of introducing ***water charges*** in Northern Ireland has been debated heavily since the restoration of devolution in 2007.

The NI Executive has extended the power for DfI to provide a budget to NI Water since 2007. Water charges are currently in place elsewhere in the UK where it is either added to a property's Council tax bill or charged on a usage basis. *The current cost to the Executive of not charging is estimated by DfI to be c£215m capital DEL and c£129.5m resource DEL based on 2021-22 allocations.* Any designs as to how much a change in policy on water charges would affect the Executive's finances is uncertain and would need further examination, e.g. regarding level of charges and potential exemptions from charges.

Non-Departmental Measures

Another measure in Northern Ireland, and one that is not department-specific concerns ***Long-Haul Air Passenger Duty*** which has been devolved since January 2013 and since then there has been a zero-rate policy in place. This policy has resulted in an adjustment to the block grant to compensate the UK Government for tax receipts forgone as a result of devolution. *The cost of this measure is estimated by DoF at £2.3m per annum (though this cost is now expected to reduce due to the impact of COVID-19 on long-haul flights).*

Sub-parity measures

There are also **'sub-parity'** policies, where provision is less generous in Northern Ireland than in other parts of the UK, although there are relatively fewer examples of this. Two such examples are ***childcare support*** and, arguably to a lesser degree, ***apprenticeships***.

In terms of childcare support England offers 30 hours per week of free childcare to eligible working parents of three and four year olds. The same provision is not available in Northern Ireland despite costs being estimated as the second highest amongst 24 European countries reviewed in 2019[256]. Instead in Northern Ireland, rather than subsidised childcare, parents of three- and four-year-olds in Northern Ireland can apply for 12½ hours per week of free preschool education. This is only available over 2½ hours per day, 5 days a week, during term time.

The UK-wide apprenticeship levy was announced by the UK Government in summer 2015. It operates on a UK-wide basis and applies to all employers in Northern Ireland as it does across the

UK. Those with a pay bill of over £3 million (including government departments), contribute to the levy. However, although Northern Ireland businesses pay the same levy, they are unable to access apprentices through government vouchers in the same way. The NI Executive does, however, receive a Barnett consequential as a result of UK government spending on apprenticeships in England. Businesses in Northern Ireland that pay the levy, as well as business representative organisations, have described this lack of provision as inhibiting growth plans and diminishing productivity levels.[257]

Annex E

Tax rates in the United Kingdom versus Republic of Ireland

Table E1: Tax Rates UK v RoI

Taxes	UK rates	RoI rates
Income tax	**20% basic rate** (£12,571 to £50,270) **40% higher rate** (£50,271 to £150,000) **45% additional rate** (£150,000+)[258] The standard Personal Allowance in the UK is £12,570, where tax is not paid on income below that amount.	**20% lower rate and 40% higher rate.**[259] The following tax bands will apply from 1 January 2022. Single and widowed person: no dependent children- up to €36,800@20%, balance @ 40% Single and widowed person, qualifying for single person child carer credit : up to €40,800 @20%, balance @ 40% Married couple: one income - up to €45,800 @20%, balance @ 40% - under joint assessment married couples are chargeable to tax on their combined total income[260]. Married couple: two incomes - up to €45,800 with an increase of €27,800 max[lxv], @20%, balance @ 40% **RoI operates a system of tax credits** that are used to reduce the amount of tax owed. In effect this system means that means that anyone earning €16,500 or less does not pay any income tax because the tax credits will be more than or equal to the amount of tax due.[261]

[lxv] For 2022 the standard (20%) rate band for couples in a marriage or civil partnership is €45,800. If both people are working it is increased by the lower amount of either: €27,800 or the income of the lower earner. This means that the maximum standard rate band a couple can have is €73,600 (€45,800 + €27,800). It is not possible for one person to use the full amount of €73,600.

		There is an additional tax on income in ROI –the **Universal Social Charge (USC)** - From 2022 - First €12,012 - 0.5%; Next €9,283 - 2%; Next €48,749 - 4.5%; remainder - 8%; Self-employed income over €100,000 – 11% [262]
National Insurance contributions	**Employers contribution – 13.8%** on earnings above £170.01 per week. **Employees contribution – 12%** rate on earnings between £184.01 and £967 per week and 2% on earnings above £967 per week. [263] The **self-employed** pay a rate of 9% on profits between £9,569 and £50,270 per year, and 2% on profits above £50,270, as well as a flat £3.05 a week. The Health and Social Care Levy Bill will provide for a temporary 1.25 percentage point increase to both the main and additional rates of Class 1, Class 1A, Class 1B and Class 4 National Insurance contributions for the 2022 to 2023 tax year. From April 2023 onwards, the National Insurance contributions rates will decrease back to 2021 to 2022 tax year levels and will be replaced by a new 1.25% Health and Social Care Levy.[264]	Pay Related Social Insurance (PRSI) – typically **4% employee contribution**.[265] **Employers then pay 8.8%** Class A employer PRSI on weekly earnings up to €398.or pay 11.05% Class A employer PRSI on weekly earnings over €398. From 1 January 2022 higher rate of employer's PRSI will increase from €398 to €410 [266]
Value added tax	**Standard rate – 20%;** Reduced rate – 5%; Zero rate for certain goods, e.g. children's clothes/food[267] Temporary reduced rate of VAT of 5% for hospitality until 30 September 2021, then 12.5% until 31 March 2022.[268]	From 1 March 2021- **Standard rate -23%;** Reduced rate -13.5%; Second reduced rate – 9%[269] [270] The reduced rate for tourism and hospitality from 13.5% to 9% remains in place until the end of August 2022.[271]
Corporation tax	Currently **19% but will rise to 25%** by April 2023 (with an exception for smaller businesses to stay at the 19% rate)[272]	**12.5%** for trading income. 25% for non-trading or excepted trade[273] From 2023 12.5% up to €750m turnover; 15% over €750m in line with OECD tax agreement.[274]
Fuel duty	**57.95 pence** per litre for petrol/diesel[275]	From 1 May 2021, **63.7c per litre** of petrol and **53.5c per litre** of diesel.[276]
Alcohol and tobacco excise duties	Cigarettes - 16.5% of the retail price plus £5.26 on a packet of 20	Cigarettes - €383.42 per thousand together with an amount equal to 8.83% of the price at which the

	Beer duty- typically 19.08 pence per litre for each % of alcohol. Spirits - £28.74 of Spirit Duty per litre of pure alcohol. [277] An overhaul of UK alcohol taxes was announced in the October budget. Changes are proposed for 2023[278]	cigarettes are sold (alternatively €434.19 per thousand) Typical €22.55 per hectolitre per cent of alcohol in the beer. €42.57 per litre of alcohol in the spirits[279]
Vehicle excise duty	Various based on emissions/fuel type[280]	Various based on emissions/fuel type[281]
Stamp duty	From October 2021 for residential properties: £125,001 to £250,000 - 2% £250,001 to £925,000 - 5% £925,001 to £1.5 million - 10% above £1.5 million - 12%[282] There are discounts for those buying their first property and a flat 3% premium for those buying a property in addition to their primary residence (for example, to rent out or use as a holiday home), as well as a 2% premium for non-UK-residents. For commercial land and property, a 2% marginal rate applies between £150,001 and £250,000, and a 5% marginal rate applies above £250,000.	1% on the first €1 million 2% on excess over €1 million. Transfer of non-residential property (other than policies of insurance) is 7.5%.[283]
Capital gains tax	Typically 28% on residential property and 20% on other assets if you pay the higher rate of income tax. For basic rate payers, it depends on the value of the gain, if it is within the basic income tax band the rate is 10% on the gain (or 18% on residential property) [284] Those that qualify for Business Asset Disposal Relief pay tax at 10% on all gains on qualifying assets when they sell (or 'dispose of') all or part of their business.[285]	33% for most gains[286] Entrepreneur Relief - those that qualify pay tax at 10% on gains from the disposal of qualifying business assets (20% for disposals from 1 January to 31 December 2016) [287] Retirement Relief – full relief for disposals of any part of a business or farming assets made up to 31 December 2013 if you are 55 or older – for disposals made from 1 January 2014, full relief if you are between 55 and 65, restricted to €3 million for 66 or older[288]
Betting and gaming duties	The tax rates vary. For example, Gaming Duty is levied at marginal rates varying from 15% to 50% of the yield. Remote Gaming Duty is levied at a single marginal rate of 21%.	2% (nil for On-course or tote bets) or 25% for Betting Intermediary Duty[290]

	General Betting Duty ranges from 3% for net receipts from financial spread bets to 15%. Lottery Duty is 12% of the ticket price. [289]	
Inheritance tax	40% above £325,000 threshold[291]	Standard Capital Acquisitions Tax (CAT) Rate is 33%. [292] Gifts and Inheritances taken by a Spouse or Civil Partner are exempt. Other thresholds apply.[293] The 7 year rule that applies in the UK (a gift made more than 7 years prior to the date of death is not liable for inheritance tax) does not apply in ROI.
Insurance premium tax	Standard rate is 12%, higher rate of 20%[294]	Typical 3% levy on Non-Life Insurance. [295]
Landfill tax	£96.70/tonne standard rate or lower rate of £3.10/tonne[296] From Apr 2022 £98.60/tonne standard rate or lower rate of £3.15/tonne[297] From Apr 2023 £102.10/tonne standard rate or lower rate of £3.25/tonne	€75 per tonne[298]
Climate change levy	Various rates for climate change levy depending on fuel source. [299] Other environmental taxes in the UK also in place, e.g. plastic bag levies.	Various environmental taxes, e.g. carbon tax as part of fuel/vehicle taxes/ or plastic bag levy (22c per bag).[300] The PSO (Public Service Obligation) levy charged to all electricity customers in Ireland and supports the generation of electricity from sustainable, renewable and indigenous sources. Current PSO levy as of October 2021 is €58.57 per year inclusive of VAT for domestic users. For business it is €13.63 per month (Excl. VAT) or €1.63 per kVA per month (Excl. VAT) if MIC => 30kVA.[301]
Aggregates levy	Typically £2 per tonne[302]	n/a –no similar levy

Air passenger duty	As of April 2021[303] Short haul rates: Reduced – £13; Standard – £26; Higher - £78 Long haul rates: Reduced – £82; Standard – £180; Higher - £541 Flights from Scottish Highlands and Islands are exempt. From April 2022 Short haul rates: Reduced – £13; Standard – £26; Higher - £78 Long haul rates: Reduced – £84; Standard – £185; Higher - £554 Long haul rates in Northern Ireland are zero. Changes from April 2023[304] Domestic (Flights within UK): Reduced – £6.50; Standard – £13; Higher - £78 Short haul rates: Reduced – £13; Standard – £26; Higher - £78 Long Haul Rate: Reduced – £87; Standard – £191; Higher - £574 Ultra-long haul rates: Reduced – £91; Standard – £200; Higher - £601	Air Travel tax abolished in 2014
Soft Drinks Industry Levy	Standard Rate: 18p per litre Higher Rate: 24p per litre[305]	Standard Rate: €16.26 per hectolitre Higher Rate: €24.39 per hectolitre[306]
Bank Levy	Levy on banks' UK-based equities and liabilities (with some exceptions) if they exceed £20 billion: Chargeable equity and long-term liabilities -0.05% short-term chargeable liabilities - 0.1% [307]	The levy is designed to produce a fixed annual yield of €150m. It is based on the amount of deposit interest retention tax (DIRT) paid by a financial institution in a specified rolling base year. Rate of charge for 2021 (% of DIRT paid) of 308% on 2019 base year[308]
Stamp Duty on Shares	Typically 0.5%[309]	Typically 1%[310]

Annex F

Commissioners' biographies

Mr Paul Johnson (Chairman)

Director of the Institute for Fiscal Studies (IFS). Paul has been Director of the IFS since January 2011. He is also currently visiting professor in the Department of Economics at University College London and is a member of the Climate Change Committee. Paul has worked and published extensively on the economics of public policy, particularly on the areas of income distribution, public finances and tax. He has previously worked in Treasury as Director of Public Services and between 2004 and 2007 he was the Deputy Head of the Government Economic Service.

Prof Cathy Gormley-Heenan (Commissioner)

Former Deputy Vice-Chancellor at Ulster University and Professor of Politics with research interests and publications that include both UK and devolved public policy and multi-level governance. Currently serves as a board member on UKRI's Research England and on the UK Government's advisory body on EU Exit, Universities, Research and Innovation among other things.

Prof Iain McLean (Commissioner)

Emeritus Professor of Politics at Oxford University and a Senior Research Fellow of Nuffield College. His research interests include UK public policy; devolution, including related issues in taxation and public expenditure such as the Barnett Formula; electoral systems and constitutional reform.

Dr Lisa Wilson (Commissioner)

Senior Economist at the Nevin Economic Research Institute (NERI) and is based in the Belfast office. Her main research interests lie in the areas of labour markets, income distribution, poverty, public expenditure, living standards and well-being. PhD from Queen's University, Belfast which focused on income inequality and well-being.

Annex G

Stakeholder engagement

G1.1 Fiscal Commission website

The website of the Fiscal Commission NI is hosted at: www.fiscalcommissionni.org

On the website, we have published:

- The Terms of Reference for the work of the Commission;
- Call for Evidence;
- News updates on progress;
- Brief reports on key Fiscal Commission meetings;
- Evidence submitted by Stakeholders;
- Presentations delivered at Fiscal Commission meetings.

The Commission also uses its official twitter account @fiscal_ni (@fiscal_ni) to provide news updates and publicise Commission events and engagements.

G1.2 Call for evidence

The Commission has hosted an open call for evidence on the website throughout the duration our work programme, and we have received responses from 8 individuals and organisations:

Alliance Party
Dr Esmond Birnie, Senior Economist Ulster University Business School
Derek Birrell, Professor of Social Policy, Ulster University
Chartered Accountants Ireland
The Green Party
Victor Hewitt
Sinn Fein
Ulster University Economic Policy Centre

All submissions received were published on the Commission's website, with the authors' permission. We wish to thank all those who provided evidence and supported the work of the Commission in this way.

G1.3 Contributors to Fiscal Commission plenary meetings

The following experts were invited to present at Fiscal Commission meetings:

David Eiser, Senior Knowledge Exchange Fellow, Fraser of Allander Institute
Professor John Fitzgerald, Adjunct Professor, Department of Economics, Trinity College Dublin
Neil Gibson, Chief Economist, EY
Professor Gerald Holtham, Hodge Professor of Regional Economy at Cardiff Metropolitan University
Officials from Department of Finance – Bill Pauley, Tony Simpson, Wendy Lecky, Joanne McBurney and Jeff McGuinness
Officials from Land and Property Services, Department of Finance - Ian Snowden, Chief Executive and Alan Bronte, Director of Rating Policy
David Phillips, Associate Director, Institute for Fiscal Studies
Mairi Spowage, Interim Director & Principal Knowledge Exchange Fellow at Fraser of Allander Institute

We offer our sincere thanks to all those who gave of their time and expertise to support the work of the Commission.

G1.4 Wider stakeholder meetings and engagement

The following stakeholders met and/or engaged with the Fiscal Commission members to contribute their views on the key priorities for our work and discuss their perspective on increasing fiscal devolution for Northern Ireland, or to provide comment on early drafts of this report:

Madeleine Alessandri, Permanent Secretary, Northern Ireland Office / SOS
Rodney Allen, Chief Operating Officer, Northern Ireland Audit Office
Professor Alan Barrett, CEO Economic and Social Research Institute (ESRI) and member of the NI Fiscal Council
Dr Esmond Bernie, Senior Economist, Economic Policy Centre, University of Ulster and member of the NI Fiscal Council
Dr Jayne Brady MBE, Belfast City Council
Alan Bridle, Head of Economics & Market Analysis, Bank of Ireland
Dr Graham Brownlow, Senior Lecturer, Queen's Management School, Queens University Belfast
Christine Burns, Audit Manager, Northern Ireland Audit Office
Lynn Carvill, Convenor of the Northern Ireland Women’s Budget Group and Chief Executive at WOMEN'STEC
Isabelle Chatry, Organisation for Economic Co-operation and Development (OECD)
Sir Robert Chote, Chair of the Northern Ireland Fiscal Council
Crona Clohisey, Public Policy Lead, Chartered Accountants Ireland
Norah Collender, Professional Tax Leader, Chartered Accountants Ireland
Aodhan Connolly, Northern Ireland Retail Consortium

Kieran Donnelly, Comptroller and Auditor General, Northern Ireland Audit Office
Neil Gibson, Chief Economist, EY
Paul Goldrick Kelly, Economist, Nevin Economic Research Institute
Alan Gourley, Tax Committee Chair, Chartered Accountants Ireland
HM Treasury officials
Simon Hamilton, CEO, Belfast Chamber of Trade & Commerce
Paul Henry, Institute President, Chartered Accountants Ireland
Gareth Hetherington, Associate Director, Economic Policy Centre, University of Ulster
Dr Victor Hewitt
Kevin Holland, CEO, Invest Northern Ireland
Richard Johnston, Ulster University Economic Policy Centre
Kevin Kingston, CEO Danske Bank UK
Charlotte Lafitte, Organisation for Economic Co-operation and Development (OECD)
Conor Lambe, Chief Economist & Strategy Lead, Danske Bank
Sharon Magee, Director of Rating Policy, Land and Property Services, Department of Finance
Jonathan McAdams, Chief of Staff, Northern Ireland Fiscal Council
Seamus McAleavey, CEO, Northern Ireland Council for Voluntary Action (NIVCA)
Philip McDonagh OBE, Chair of the NI Statistics Advisory Committee
Dr Tom McDonnell, Co-director, Nevin Economic Research Institute
Conor McGeown, Audit Manager, Northern Ireland Audit Office
Gerry McGinn, Chairman of Strategic Investment Board (SIB)
Kirsty McManus, National Director, Institute of Directors (IoD)
Angela McGowan, Director, Confederation of British Industry (CBI)
Ann McGregor MBE, CEO, Northern Ireland Chamber of Commerce and Industry
Conor Murphy, Finance Minister, NI Executive
Maureen O'Reilly, Independent Economist and Member of the NI Fiscal Council
Roger Pollen, Head of External Affairs, Federation of Small Businesses Northern Ireland
Richard Ramsey, Chief Economist, Ulster Bank
Owen Reidy, Assistant General Secretary, Northern Ireland Committee of Irish Congress of Trade Unions
Stephen Rusk, Deputy Director of Economy Group, Northern Ireland Office
Sir David Sterling, ex-Head of the Northern Ireland Civil Service
Martin Spollen, Chief Investment Officer & Head of Data Science, Strategic Investment Board (SIB)

Political Representatives

Alliance Party - Stephen Farry MP, Andrew Muir, MLA, Stewart Dickson, MLA, Kellie Armstrong, MLA
Democratic Unionist Party - Sir Jeffrey Donaldson MP
Green Party - Clare Bailey MLA and Ernest Purvis
People Before Profit - Gerry Carroll MLA
Sinn Fein – Dr Caoimhe Archibald MLA, John Finucane MP
Social Democratic and Labour Party Matthew O'Toole MLA, Mark Durkan, Claire McGregor
Traditional Unionist Voice Party - Jim Allister MLA
Ulster Unionist Party - Doug Beattie MLA

We record our thanks to all stakeholders who attended meetings with Fiscal Commissioners for their enthusiastic engagement and valuable contributions to our considerations. We also offer sincere thanks to those stakeholders who provided incredibly valuable comment on drafts of our report.

G1.5 Representation at other Events

The Chair of the Commission accepted invitations to present at a number of events, including:

- The 2021 British-Irish Association conference, held on 3rd-5th September at Pembroke College, Oxford
- The 9th Annual NERI Dónal Nevin lecture, held on 29th September at Queens University Belfast.

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