The Independent
Fiscal Commission NI

More fiscal devolution for Northern Ireland?

Executive Summary

May 2022

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. However, 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, published on 13 December 2021, explored the case for additional powers over taxation for Northern Ireland. In doing so it considered the economic context, current fiscal powers, the possible reasons for additional devolution, and the potential risks and rewards from such devolution. It looked at the whole array of UK taxes and reached preliminary conclusions regarding which taxes might be the best candidates for devolution in Northern Ireland and, importantly, those which are less suitable at this point in time.

In this, our final report, we build on our interim report, rather than start afresh. We provide a more in-depth analysis of those taxes we chose to shortlist for further consideration in our interim report. We look further at the case for devolving excise duties, the scope of devolution of income tax, the administration of devolved taxes, and the gritty fiscal framework issues which require consideration as part of any devolution process. All with a view to providing a framework of fiscal devolution which could be implemented in Northern Ireland if the political will exists.

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. Table 1 sets out the respective responsibilities of the UK Government and NI Executive in relation to *transferred*, *excepted* and *reserved* matters.

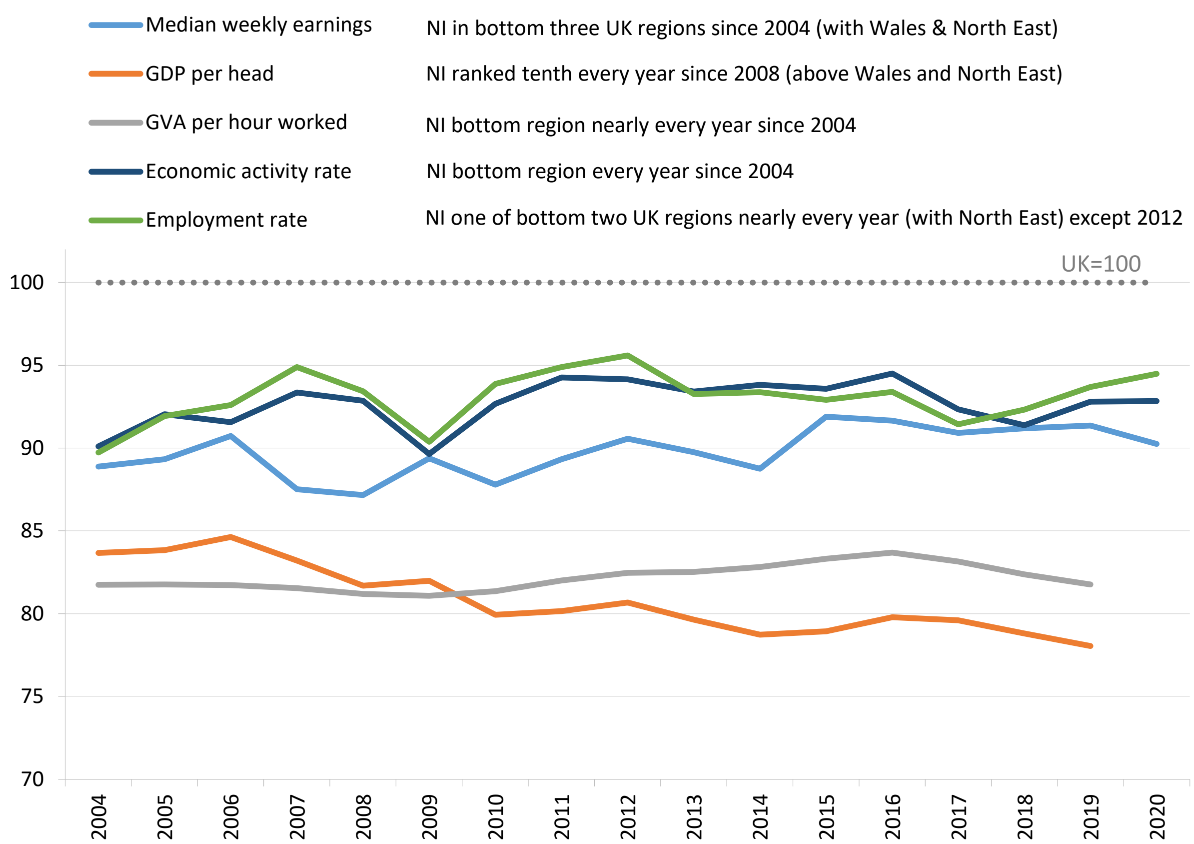
Table 1 The respective responsibilities of the UK Government and NI Executive in relation to transferred, excepted and reserved matters

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.
• 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.

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, and hence a much smaller economy overall. Chart 1 highlights Northern Ireland's economic underperformance against the UK as a whole, across a number of key economic metrics. It also provides a sense of Northern Ireland's relative position against the other 11 UK regions. This demonstrates that Northern Ireland is typically amongst the bottom performing UK regions, closely aligned to Wales and the North East of England.

Chart 1 Comparison of selected measures, NI vs UK, 2004 -2020 (UK = 100)

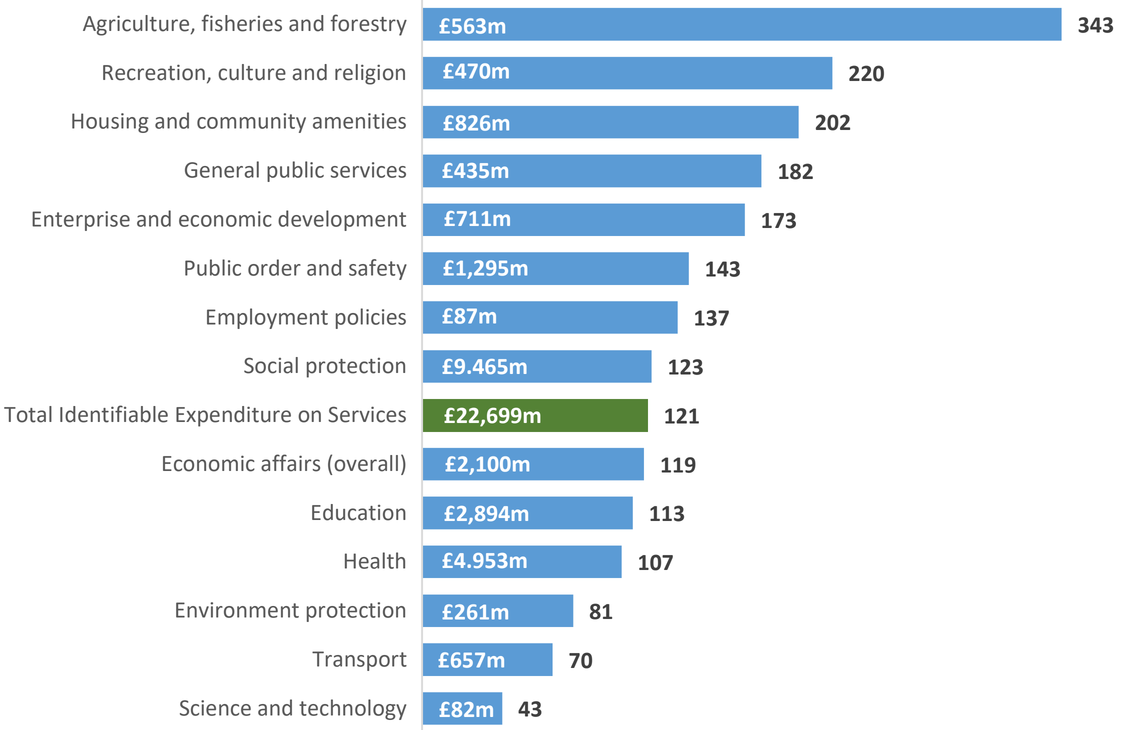


Source: Nomis, ASHE, ONS Subregional Productivity and ONS Regional GDP

Earnings in Northern Ireland (median) are some 10% lower than the UK average. Combined with lower labour market participation means that tax revenues per person are 25% lower[i]. Meanwhile, **(identifiable) public spending is about 20% higher, on a per person basis, than spending in the UK as a whole.** Chart 2 shows Northern Ireland public spending figures, focusing on 'identifiable' expenditure, and shows that the biggest spending areas for Northern Ireland include: Social Protection £9.47bn; Health £4.95bn; and Education £2.89bn. Across almost all expenditure areas Northern Ireland spends more per head than the UK average. The result is a very large notional fiscal deficit. As we shall see, that is not in any sense an argument against some additional devolution of tax powers.

[i] Tax revenues per person are based upon 'tax take' values, that is, revenue from taxes collected by HMRC and by Northern Ireland authorities and excludes 'other revenue'. 'Total revenue' includes 'other revenues' such as Gross Operating Surplus, interest and dividends, and using this metric revenues per person are 15% lower in Northern Ireland than the UK average. This is because other revenue accounts for a larger proportion of Northern Ireland revenues than UK, 23.8% versus 13.9%.

Chart 2 Northern Ireland Identifiable expenditure on services by function, £ and per head indexed, UK = 100, 2019-20



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

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. In addition, there have 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). Table 2 provides a high level summary of the resources from these funding packages and the agreed funding versus the actual funding received by the NI Executive.

Table 2 NI Executive financial packages – agreed versus actual funding profiles 2015-16 to 2024-2025

	2015-16	2016-17	2017-18	2018-19	2019- 20	2020- 21	Total to 2020-21	2021- 22	2022-23	2023-24	2024-25
Agreed	*£80m*	*£122m*	*£122m*	*£577m*	*£607m*	*£641m*	*£2.149bn*	*£254m*	*£149m*	*£104m*	*£104m*
Actual		*£40.9m*	*£44.9m*	*£462m*	*£416.2m*	*£626.2m*	*£1.591bn*				

Source: Department of Finance, Public Spending Directorate.
Note: Figures here includes funding provided as part of the Stormont House Agreement; Fresh Start Agreement; Confidence & Supply Agreement and New Decade New Approach.

As well as spending substantially more per head, **the NI Executive has also decided to forego substantial amounts of revenue or target its resources differently than would be the case 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 in 2020/21 alone, ongoing rates support to the manufacturing sector cost £59 million and mitigating welfare reforms £43 million. In total we estimate that the range of policy divergences where the NI Executive charges its citizens and businesses less or provides more cash support 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. (Table 3).

Table 3 Value of Super-parity measures, Summer 2021, £million

Measure	Value of measure
Existing welfare mitigations	£42.8m
Housing Benefit Rates	£12m
University Tuition Fees*	£14.2m to £90.5m
Industrial De-Rating**	£59m
Low Income Rate Relief**	£6.6m
Vacant property rate relief**	£35m
Freight/transport rate relief**	£2.2m
Landlords Allowance*	£13m
Prescription Charges	£20m
Domiciliary Care Charges	£17.8m to £32.5m
Concessionary Fares	£29.2m
Domestic Water Charges	£344.5m
Air Passenger Duty	£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 tuition fee funding and replacing grant funding with increased loans involves many nuances to arrive at exact estimates. The range of 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.*

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 has significant headroom for further borrowing of around £1.5 billion from this source. 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, due to the necessary repayments.

Why devolution?

Additional devolution of tax powers would, at root, be a political choice, a choice to provide the NI Executive with more power. This could increase electoral accountability, financial responsibility and policy autonomy.

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.

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 do not consider full fiscal devolution, under which Northern Ireland would be responsible for funding all of its spending from its own revenues, as a realistic option. 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 policy levers gained from additional powers. Tax assignment occurs when the devolved government's budget depends on the revenues raised from within its territory, but the devolved government has no ability to vary tax policy (which is set by the central government). 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 examine 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 revenue. Fiscal devolution could help local citizens, through their politicians, make those choices which suit them best.

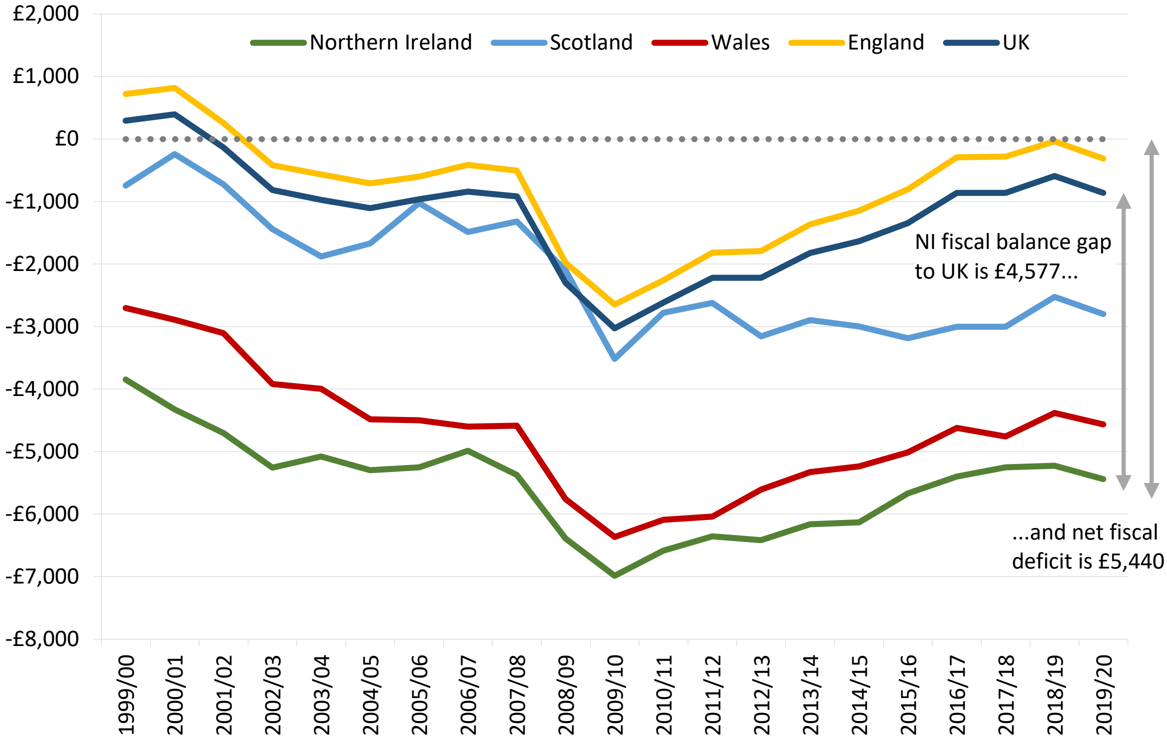
However, with additional powers and the potential for additional reward would come additional risk. If taxes are devolved to the NI Executive then the NI Executive's budget will, in part, be determined by how much revenue those taxes raise in Northern Ireland. That could well lead to a more volatile budget. It could lead to the budget rising or falling, relative to what it might have been in the absence of further devolution. If Northern Ireland tax revenues grow more slowly than expected then its budget would suffer, if they grow more quickly then it would benefit.

Looked at in historical context the fiscal gap between Northern Ireland and the UK as a whole has been widening, by 10% (in real terms) or by £432 per head, over the last 20 years. (The fiscal gap is the difference in the size of the notional Northern Ireland deficit compared to the UK deficit).

Chart 3 outlines the changes in the net fiscal position of each UK country over time with Northern Ireland consistently having the largest net fiscal deficit per head since 1999/2000. It also demonstrates that the gap in the fiscal balance between Northern Ireland and the UK as a whole has been widening over time to reach £4,577 per head in 2019/20. Northern Ireland's overall fiscal deficit was £5,440 per head in 2019/20.

Had devolution been progressed 20 years ago, the underperformance of the NI economy relative to that in the UK as a whole could have led to lower tax revenues for the NI Executive than it has received as part of the block grant.

Chart 3 Northern Ireland Net Fiscal balances per head, since 1999/00, £, 2019-20 prices



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

Looking to the future, **Northern Ireland's working age population is expected to decline in the years ahead**. This will impact negatively on the Northern Ireland tax base. Higher proportions of children and those of pension age, relative to the rest of the UK, will also impact on public spending requirements.

The exact way in which the block grant is adjusted in response to tax devolution, and the additional budgetary tools made available to the NI Executive to manage any new powers, will matter enormously. We discuss and make recommendations in relation to these issues below.

Capacity to take on additional devolution

In our view, there are a number of important considerations in relation to the capacity to take on devolution which should be borne in mind or acted upon by local politicians and the civil service when determining whether taxes should be devolved, and at what speed.

Firstly, **virtually everyone we spoke to 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 build capacity and improve stability. Enforced power sharing, and the need for cross party agreement, can bring significant benefits, but can also lead to greater instability or lessen the ability to gain agreement on tax policy. This could reduce the impact of devolution in terms of enhanced 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.

Secondly, 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. This will also help to reap the accountability benefits which devolution can bring. **We see our reports as playing an important role in increasing public understanding of tax in Northern Ireland** but local politicians should also consider how they can engage the public in tax debates and increase their understanding over time**.**

Thirdly, an important consideration 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. The NI Executive would have to ensure that appropriate structures and people were put in place before any devolution of tax powers. We spoke to the Scottish and Welsh Governments on these issues and lessons can be learned from their experience to help chart a path through.

Mutual confidence and sustained engagement, in particular between the UK Government and NI Executive, are also key for the success of fiscal devolution.

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 letter (September 2021) to the Northern Ireland Finance Minister the UK Chief Secretary to the Treasury 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, such as a pandemic). 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.

Our Recommendations - A devolution framework for Northern Ireland

We have looked in detail at around 20 different taxes. Starting with the biggest three: **value added tax (VAT) at £3.4bn revenues raised in Northern Ireland; 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.

Table 4 outlines the taxes we have considered along with the revenue raised by each in 2019/20 in Northern Ireland and their share of the total tax take for Northern Ireland (and in the UK).

Table 4 Tax revenues raised in Northern Ireland, 2019-20

UK - wide taxes	Tax take 2019/20 £million	% share of total NI tax take	UK equivalent % share of total UK tax take
Value added tax	3,442	22.0%	18.1%
National Insurance contributions	3,094	19.7%	19.6%
Income tax	3,001	19.2%	26.2%
Fuel duty	864	5.5%	3.7%
Corporation tax	810	5.2%	6.6%
VAT refunds*	798	5.1%	2.6%
Alcohol and tobacco excise duties	774	4.9%	2.9%
Vehicle excise duty	219	1.4%	0.9%
Insurance premium tax	144	0.9%	0.9%
Capital gains tax	105	0.7%	1.3%
Stamp duties	80	0.5%	2.2%
Air passenger duty	80	0.5%	0.5%
Betting and gaming duties	75	0.5%	0.3%
Inheritance tax**	43	0.3%	0.7%
Apprenticeship levy	60	0.4%	0.4%
Bank levy	36	0.2%	0.3%
Landfill tax	24	0.2%	0.1%
Climate change levy	23	0.1%	0.3%
Aggregates levy	18	0.1%	0.0%
Soft drinks industry levy	12	0.1%	0.0%
Digital Services tax	2	0.0%	0.0%
Other taxes	509	3.2%	3.1%
Non-Domestic and Domestic rates (or Council Tax in	1,455	9.3%	9.1%
Total taxes only	**15,668**	100%	100%
Other revenue	*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.*

It is our view that if Northern Ireland were to take on additional tax 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 a relatively small number of taxes to look at in detail. That said, in our view, **there is no reason in principle why a substantial fraction of current taxes could not be devolved over the long term**. Of course, the decision on the scale and 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 and in our interim report are available in the main body of our report and at **Annex F**. Here we provide just the briefest of summaries.

<u>*The big three*</u> - **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 will 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, especially in the case of VAT. We note the simple lack of information on how revenues break down geographically has delayed assignment of VAT revenues to Scotland for over two years to date.

Therefore, we consider that income tax is the most appropriate major tax for devolution to Northern Ireland.

<u>*'Extent' of income tax devolution*</u> - Our assessment is that ***full*** **devolution of income tax is not required to reap the main benefits of devolution**, and, in fact, could result in disproportionate complexity and unnecessary administrative costs. For this reason **we recommend that powers to determine the income tax base (e.g. the definition of what income is subject to tax, including various allowances and reliefs) remains reserved to the UK Government** (see caveat below in relation to the personal allowance), **and that HMRC retains responsibility for administering income tax in Northern Ireland.**

<u>*'Scope' of income tax powers*</u> – The Scottish Parliament and Welsh Senedd have powers over non-savings, non-dividend income only. Nevertheless, **we recommend that the taxation of savings and dividends income should be devolved to Northern Ireland.** The main impediment to devolution for Scotland and Wales previously was that financial institutions were responsible for deducting tax on

interest at source. This is no longer the case. There are also administrative, efficiency and equity benefits that devolution of all elements of the income tax base could bring.

'Model' of income tax devolution – The 'Scottish' model, where income tax revenues, rates and band-setting powers are devolved in full (but not the tax base i.e. allowances and reliefs), would maximise usability of the powers by allowing fine-tuning of the distributional effects of policy changes, but it would also entail greater risk. **If the NI Executive is keen to maximise the potential benefits of tax devolution in terms of local accountability and policy flexibility, opting for a model similar to the Scottish model would be preferable.**

If, however, the NI Executive is sufficiently concerned about the level of risk associated with the Scottish model, an alternative would be the 'Welsh' model of partial devolution. Under the Welsh model, a portion, not all, of income tax revenues are devolved and the Welsh Government has the power to vary rates, but not tax bands. This model involves less financial risk, but also less flexibility. That said, the Welsh model would still significantly increase the accountability of the NI Assembly to the electorate. There is also an option to adopt the 'Welsh' model initially and move to the 'Scottish' model in future (or some variation of the models described here), as part of an incremental approach to devolution. **In summary, there is clearly a case for the fuller, Scottish, version of devolution, but ultimately, it is the responsibility of NI's politicians to determine appropriate balance between greater financial incentives and powers, and the degree of risk involved.**

Personal allowance - **There is also a strong case for Northern Ireland to go a step further than either Scotland or Wales and seek the power to change the level of the personal allowance.** Devolving the power to set the personal allowance would not expose the NI Assembly to any significant further revenue risk, but would provide further policy flexibility, affording the NI Executive the opportunity to tailor the threshold to take account of the lower average income in Northern Ireland relative to elsewhere in the UK.

Irrespective of the preferred model of income tax devolution, it is the Commission's view that **the NI Assembly should be obliged to vote on the agreed rates and bands (where applicable) on an annual basis as part of the normal budgetary process, to ensure ongoing consideration and engagement on the power.**

Apprenticeship levy - **There is a very strong case for devolving the apprenticeship levy (£60m)**, not least because it complements the NI Executive's responsibility for economic growth and skills. It should only be devolved *if* powers over income tax are also devolved. The cost of doing so in isolation is likely to be excessive. As with income tax, we recommend it should continue to be administered by the UK Government, through HMRC.

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. A lower corporation tax rate in Northern Ireland could be economically beneficial. It could impact foreign direct investment (FDI) decisions. The case for devolution may have been strengthened by the UK Government's Spring Budget 2021 announcement that the UK corporation tax rate will rise to 25% from 1 April 2023. Even in the face of an increase in the RoI rate to 15%, for larger firms, 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.

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 that the existence of different rates is not used as an opportunity for tax avoidance. There are also political complexities. The main rationale 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 UK 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 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.

As a Commission, we remain of the view that there is value in the NI Executive seeking to complete the devolution of corporation tax. However, 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, there is no value in the NI Executive simply asking for it again. **Should the NI Executive wish to pursue the devolution of corporation tax we would encourage it to demonstrate how it will maintain the sustainability of its finances following any reduction in corporation tax. We would urge the NI Executive and UK Government to work together on the pre-requisites for devolution,** which, in our view, 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.

Excise duties **- Excise duties on petrol (£864m), alcohol (£290m) and tobacco (£484m) 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 given land borders with England. There were also administrative complexities arising from the fact that the duties are taxes on production, not on final consumption. Additionally, EU rules necessitated a single rate for each type of duty in Member States (except in a few specific instances where derogations have been granted).

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 the UK as a whole so as to be able to account for policy in RoI. In addition, taxation of alcohol and tobacco could support the NI Executive's wider public health agenda. For administrative reasons the existence of the NI Protocol could also make devolution easier, than had it not existed. That said, the NI Protocol could also limit the policy flexibility in Northern Ireland, by tying arrangements to those of the EU.

Overall our investigations have identified that complex administration and compliance issues do exist, and more work is required to determine whether the added complexity and costs would be readily manageable for retailers and suppliers operating in Northern Ireland.

In our view there could be value in the NI Executive seeking devolution of excise duties, but there are barriers to overcome first. Should the NI Executive wish to pursue devolution, we recommend it should carry out a full study working alongside HMRC / HMT to agree on how excise duties could be administered and the costs involved. It may be prudent to await the resolution of the issues around the implementation of the NI Protocol, and a longer-term settlement for the customs and excise regime in Northern Ireland before pursuing any devolution of these duties.

Stamp duty land tax (SDLT) - While it only raises £80 million per annum, given the lower values of properties in Northern Ireland, relative to rUK, there is a case for having different rates of SDLT in Northern Ireland. As a tax on property, SDLT is well suited to devolution and has been successfully devolved to Scotland and Wales, and significantly reformed by the Scottish Government. **We recommend full devolution of revenues and tax powers relating to SDLT.**

Other taxes on capital – **There is a case for devolving inheritance tax (£43m), not least because of the very different levels of wealth in Northern Ireland, but a combination of administrative complexity and the small amounts of money involved means we do not prioritise it for devolution.**

We see little case for prioritising capital gains tax (£105m).

Stamp duty on shares would be complex to devolve and achieve little.

Environmental levies - **Landfill tax (£24m) is a good candidate for devolution, despite raising little in revenue terms, and we recommend full devolution of its revenues and tax powers**.

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 and we recommend full devolution of its revenues and tax powers.** There is likely a trade-off in the consideration of APD between environmental and economic factors and these issues should be considered by the Executive.

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 our full report and at Annex F.

Tax administration for smaller taxes

We have recommended that (partially devolved) income tax (and the apprenticeship levy, given its administrative links to income tax) continue to be administered by the UK Government following any devolution – given the disproportionate complexity and administration costs of operating such a big tax locally. However, **if the devolution of SDLT, APD and landfill tax is pursued and implemented, we recommend that the NI Executive should establish a local revenue authority to administer these fully devolved taxes.** While continued HMRC administration of these taxes might come at a somewhat lower cost, local administration would provide greater flexibility, increase accountability, and build up institutional capability and capacity.

Fiscal Frameworks

Increased tax devolution will need to be accompanied by a new fiscal framework for Northern Ireland. The fiscal framework will set out rules and processes necessary to operationalise tax devolution, including how the NI Executive's block grant will be adjusted to reflect tax devolution, rules around borrowing and the use of reserves to address tax forecast errors, and rules to manage the interaction between devolved and reserved tax policy and its effects. The fiscal framework will need to be negotiated between the NI Executive and UK Government. As well as determining the operation of any devolved tax powers, this framework will also determine the nature and extent of fiscal risks that the NI Executive is exposed to. **We propose five key principles which should guide how fiscal devolution is implemented, particularly with regard to block grant adjustments:**

- **i. That neither the budget of the NI Executive nor of the rest of the UK should be immediately better or worse off simply as a result of the devolution of a tax.**
- **ii. That, as far as possible, following tax devolution the NI Executive should neither gain nor lose from fiscal risks or trends that can reasonably be predicted in advance, and which it has limited capacity to meaningfully influence.**

iii. **That the NI budget should capture, as far as possible, the full revenue impacts of its tax policy decisions, whether they be to raise or reduce revenue.**

iv. **That, as far as possible, the NI budget should not be exposed to the effects of tax policy changes made by the UK Government, for taxes that have been devolved to the NI Executive. And nor should rUK be exposed to the consequences from changes to devolved taxes in Northern Ireland.**

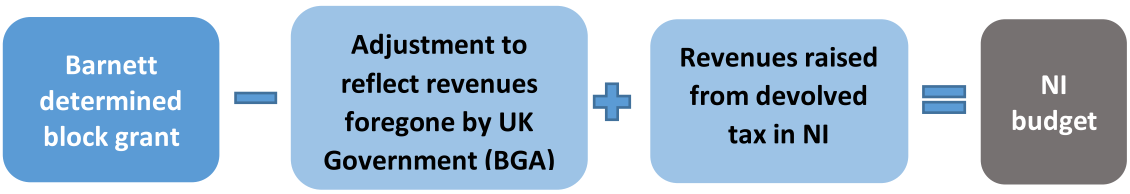
v. **That, as far as possible, the UK Government should bear the risks of revenue shocks that impact the whole of the UK equally**.

It would be wrong to suggest that all these criteria can be met in full, and we note that there are particular limits to the application of principles (iii) and (iv) given that changes in tax policy can result in behavioural effects on other tax bases, the impact of which on revenues can be hard to estimate. Furthermore, there will be trade-offs between them. Nevertheless, we believe it is possible to implement devolution in a way which is consistent with these principles, in broad terms.

Block Grant Adjustments

Following devolution of a tax, a reduction to the block grant will need to be made to reflect the transfer of revenues from the UK Government to the NI Executive. See Figure 1 below.

Figure 1 Example of NI Budget and Block Grant Adjustment calculations

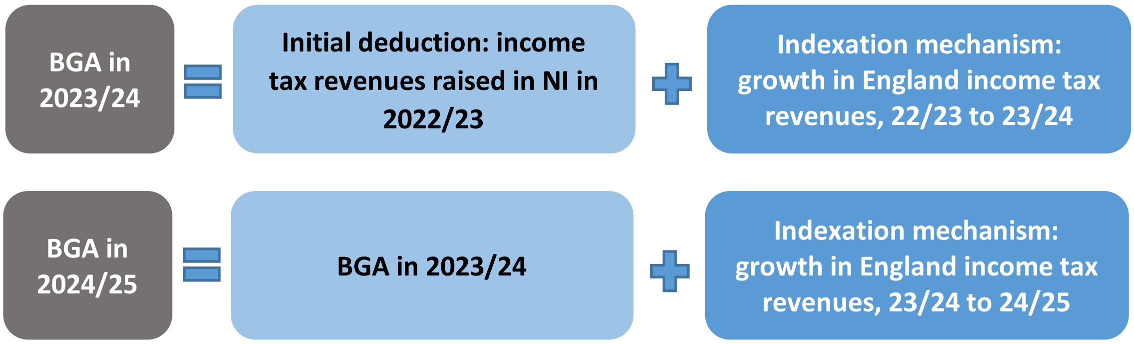


In order to achieve the principles outlined above, this 'block grant adjustment' for each devolved tax should, in the first year of devolution, be set equal to Northern Ireland revenues immediately prior to devolution.

In subsequent years, the block grant adjustment should be increased in line with some measure of growth in equivalent revenues in England[ii]. See Figure 2 for an illustration, with regards to income tax. This approach helps ensure that the budget of the NI Executive is protected from factors which affect revenues UK-wide, such as a recessionary shock, but enable it to benefit from policy decisions by the NI Executive that cause revenues to grow relatively more or less quickly than equivalent revenues in England.

[ii] The comparator may differ, depending on the tax in question. For income tax and SDLT, the comparator will be comparable tax revenues in England, since they are already devolved in Scotland and Wales. Whereas for corporation tax, for example, the comparator would be the tax base in rUK.

Figure 2 Example of Block Grant Adjustment calculations for Income Tax



However, the precise way in which the block grant adjustment is indexed to equivalent England revenues determines which specific budgetary risks the NI budget bears and could lead to differing budgetary outcomes. For example, the precise way in which the block grant adjustment is indexed determines the extent to which the NI budget bears the fiscal risks of having faster or slower population growth than England, or whether it is insulated from these risks.

Regardless of the specific BGA mechanism that is adopted, tax devolution would of course bring budgetary risks. Most significantly, this includes the risk that the NI budget ends up smaller following tax devolution than it would have been without tax devolution – even in the absence of any divergences in tax policy – as a result of its tax base growing at a slower rate than the equivalent England tax base.

By way of a hypothetical example, if income tax had been devolved in 2000/01 the impact on the NI Executive's budget, compared to a scenario where tax devolution had not occurred, would largely have been positive until 2008. But, following the financial crisis, the NI budget would have suffered significant losses in the subsequent decade. Over the whole period, the NI Executive's budget would have been cumulatively worse off by over £2bn.

This outcome is partly the result of the Northern Ireland economy, and hence the income tax base, being more significantly negatively affected by the financial crisis and its aftermath than was the case in England.

However, the outcome is also in part a result of tax policy changes introduced at UK level, and the more significant impact those changes had on reducing revenues in Northern Ireland relative to England, given the different structure of the Northern Ireland tax base. These included changes to raise the personal allowance and increases to tax rates for higher earners, which impacted to narrow or shrink the tax base in Northern Ireland relative to England.

Of course, the past is not necessarily a good guide to the future, and looking ahead, Northern Ireland could gain rather than lose from risks related to policy change, population growth and wider economic growth: tax devolution would bring both upside and downside revenue risks.

However, having considered these issues, and in the context of our principles above, we think that **the approach to indexing the block grant adjustment, for any tax devolved, should protect the NI budget from the risk of differential population growth relative to England**. This is not a risk that the NI Executive has significant ability to control, and so its budget should not be exposed to this risk.

We also think that **the approach to indexing the block grant adjustments for income tax and stamp duty should take into account the fact that the NI taxpayer base for these taxes is quite different from that in England**, with relatively fewer higher banded income taxpayers and higher banded properties. This different starting point – which the NI Executive cannot directly influence – can affect subsequent revenue growth over time, a fact which the approach to indexing the block grant adjustment should take into account.

It can be expected that the NI budgetary losses, with respect to income tax detailed above, would have been significantly ameliorated if this 'by band' approach had been used as it would have accounted for the fact that Northern Ireland relies more heavily on basic rate taxpayers for revenues than England and less so on higher and additional rate earners. However, it also helps to illustrate some of the risk with fiscal devolution. There is no guarantee that the NI budget will be better off as a result of tax devolution.

Fiscal Insurance

Regardless of the adjustment mechanism chosen, risks to the NI budget will remain. Principally, the risk that the NI tax base does not keep pace with that in England. For this reason, **it is important that some element of, limited, insurance should go alongside tax devolution**. This would mean that the NI budget would bear some of the costs, or benefits, from tax revenues diverging from UK revenues after devolution, but with the downside limited. The UK Government might also insist on a ceiling, limiting any upside benefits – though given the small fiscal scale in the UK context it would not be unreasonable for this to be asymmetrically generous. Carefully designed, fiscal insurance need not undermine the rationale for devolution, and is consistent with the notion of fiscal union.

Forecasting arrangements

Tax devolution will bring with it tax revenue forecasts for the NI budget and a decision is required as to which organisation will have responsibility for forecasting Northern Ireland revenues for any taxes that are devolved. **We recommend, indeed would insist upon it as a condition for devolution, that forecasts are made by an independent body, to ensure the credibility and transparency of the forecasting process. We further recommend that the NI Fiscal Council take on this role for Northern Ireland.**

Budget management tools

More fiscal devolution will increase the reliance of the NI Executive on uncertain and potentially volatile tax revenues for its funding. To avoid having to make immediate cuts or increases to spending in response to discrepancies between forecasts and actual tax revenue outturns (i.e. forecast errors), the NI Executive will require additional budget management tools. **We recommend that the NI Executive should be afforded borrowing powers to cover negative forecast errors in full** (more than is available to Scotland and Wales currently), **and powers to borrow a modest amount to cover discretionary resource spending** in order to offset temporary falls in revenues that are forecast in advance.

Further, **we recommend that the existing Budget Exchange mechanism** – which allows the NI Executive to transfer financial underspends in one year to the following year's budget (subject to strict limits) – **should be replaced by a Northern Ireland Reserve.** A Northern Ireland Reserve will allow the NI Executive to pay into and draw down from reserves it has previously built up when revenues are higher than expected. This is similar to what is in place for Scotland and Wales **and would provide flexibility to respond to the additional revenue risks the NI Executive's budget would face as a result of increased fiscal devolution.**

We also recommend that, *if* there is to be a 'cap' or limit on the amount that the NI Executive can save in the Reserve, it should be set to be at least in line with the cap in Wales (which is £350m or 12.3% of devolved revenues in 2021/22), relative to the value of revenues devolved. Further, in our view, there is a good case for saying that, if there is a cap on the overall value of the Reserve, annual drawdown limits should not apply, and instead be a matter of discretion for the NI Executive.

Compensatory Transfers, Dispute Resolution and Reviews

Fiscal devolution will bring with it the potential for policies implemented by the NI Executive, or by the UK Government, to cause financial impacts on the other. There will therefore need to be a mechanism which can be deployed to ensure compensation is paid – when policies introduced in one jurisdiction have cost implications in the other – to account for these impacts. There will also be the potential for disagreements between the NI Executive and UK Government in relation to compensatory impacts and other fiscal devolution issues. A robust dispute resolution process will help incentivise the effective implementation of the fiscal framework. Furthermore, there can be no guarantees that the fiscal devolution environment will not continue to evolve or that unforeseen events will require the amendment of any agreed fiscal framework. It will therefore be important that the fiscal framework can adapt over time.

With the above issues in mind **we recommend that a fiscal framework should make provision for compensatory payments to be made in both directions between the NI Executive and UK Government –** and, **where disagreement exists in relation to such payments, each party should be required to publish their position, with evidence, to facilitate independent scrutiny and incentivise early agreement.**

We recommend that dispute resolution processes built into the NI Executive fiscal framework should have access to, and be embedded within, the new Intergovernmental Relations system between the UK Government and devolved administrations, which sets out new principles and infrastructure arrangements to support the resolution of intergovernmental disputes. **We recommend that the fiscal framework should be reviewed on a periodic basis, and on every occasion when additional fiscal powers are devolved.**

New taxes

Northern Ireland already has the legislative competency to introduce new taxes, as set out in the Northern Ireland Act 1998. However, the extent of these powers, and the process which they could be implemented, lacks clarity. **We recommend that the NI Executive works with the UK Government to agree a transparent process for the introduction of new taxes in Northern Ireland.**

Wider implications of our work for devolution arrangements across the UK

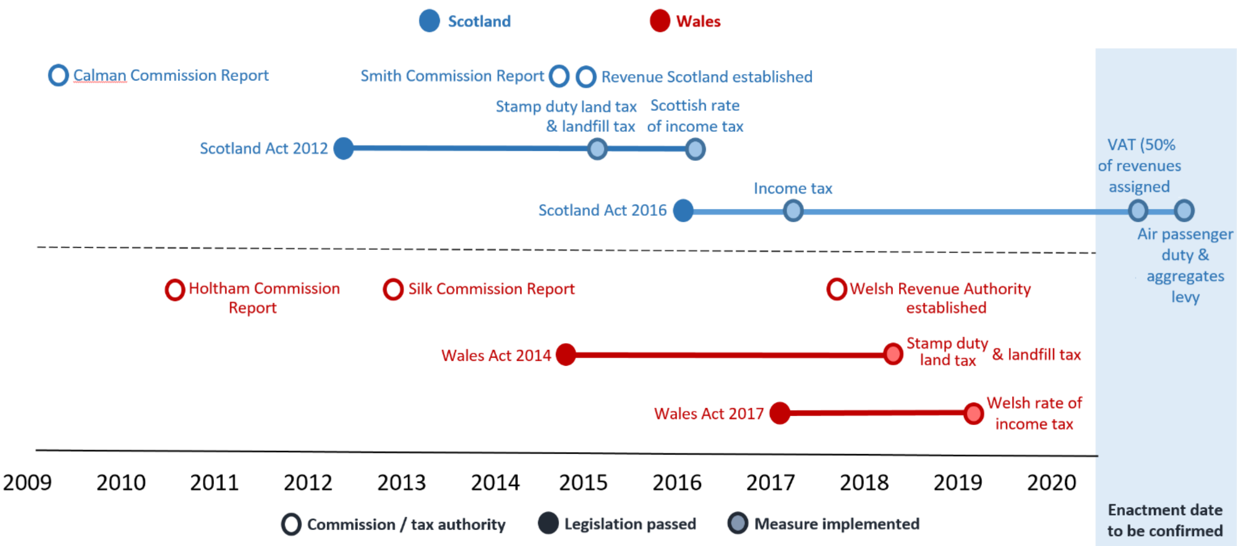
Although not falling within our terms of reference, we believe that there is learning from our work which is relevant to fiscal devolution arrangements elsewhere in UK. While the asymmetric devolution within the UK allows powers and responsibilities to be tailored to fit the individual context of each of the devolved administrations, in our view, it is appropriate that the different devolution arrangements should share common principles where possible.

Therefore, we recommend that the UK Government instigates a review to consider developing and implementing a shared institutional framework for fiscal devolution across the UK. Such a review could usefully consider the drawing up of shared principles and the establishment of shared processes/infrastructure particularly in the area of dispute resolution and the use of independent analysis. We believe this would help inform the wider public and improve the accountability that tax devolution brings it, both for devolved administrations and the UK Government.

Timescales for devolution

Northern Ireland is at the beginning of a potential fiscal devolution journey. Political considerations will ultimately decide whether any fiscal devolution occurs, as well as its scale and pace. We note that there was a gap of six to eight years in Scotland and Wales between the publication of technical commissions' recommendations, political consensus being reached, and the implementation of devolved taxes. Chart 5 provides an outline for this timeline of tax devolution in Scotland and Wales.

Chart 5 Timeline of tax devolution in Scotland and Wales



That is not say change couldn't be quicker, but any change will depend on political will in both Northern Ireland and Westminster. The NI Assembly elected in 2022 and any ensuing coalition discussions provide an opportunity to generate local political consensus on fiscal devolution by an incoming NI Executive. Should that be achieved, and subject to the consent of the Westminster government, we believe the constituent parts can be in place to realise significant increased fiscal devolution to Northern Ireland, as per the framework outlined in our final report, by 2027/28.

A complete list of the Commission's final recommendations is included below:

<table>
<tr><td rowspan="2">Tax revenue data reliability</td><td>Recommendation 1</td></tr>
<tr><td>We recommend that the NI Executive should work with ONS, HMRC and NISRA to improve data on tax receipts in Northern Ireland.

This should include consideration of increasing sample sizes as well as examining what other improvements could be made in order to boost response rates and solve methodology issues (e.g. underreporting issues).

The NI Executive should look to collect, where reasonably possible, administrative/outturn data for any tax that is to be devolved in the years prior to devolution taking place. This should help to provide more reliable estimates of the tax prior to devolution and more accurate costs post devolution.</td></tr>
<tr><td rowspan="2">Devolution of corporation tax powers</td><td>Recommendation 2</td></tr>
<tr><td>We remain of the view that there is value in the NI Executive seeking to complete the devolution of corporation tax.

Should the NI Executive wish to pursue the devolution of corporation tax we would encourage it to demonstrate how it will ensure the sustainability of its finances following any reduction in corporation tax. We would urge the NI Executive and UK Government to work together on the pre-requisites for devolution. We recommend:
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; and
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.</td></tr>
<tr><td rowspan="2">Scope and administration of devolved income tax</td><td>Recommendation 3</td></tr>
<tr><td>Income tax is a strong candidate for devolution to Northern Ireland, however, we recommend that powers over the income tax base and income tax administration both remain reserved at this time (see caveat on Personal Allowance below at Recommendation 5).</td></tr>
</table>

	This will help minimise the additional administration and compliance burdens generated by tax devolution, while still providing the key benefits of devolution, including a meaningful ability to vary funding levels and the progressivity of the tax system.
Devolution of tax on savings and dividends income	***Recommendation 4***
	Income tax is no longer deducted at source, hence the main practical impediment to devolution has been removed. Given the administrative, efficiency and equity benefits that devolution could bring, **we recommend that the taxation of savings and dividends income should be devolved to the NI Assembly. The strength of our recommendation would be bolstered if agreement can be reached to also devolve it to the Scottish Parliament and Welsh Senedd due to the administrative advantages inherent in operating similar systems of income tax devolution across the devolved administrations.** If no agreement is reached to devolve tax on savings and dividend income to the Scottish and Welsh Governments, then devolution to Northern Ireland could be seen as adding some inconsistency and complexity, and hence one might want to be more tentative in taking such steps, but the case for doing so would, in our view, remain strong.
Devolution of powers over rates and bands of income tax	***Recommendation 5***
	If the NI Executive is keen to maximise the flexibility of its tax varying powers and its accountability to the local electorate, it is the Commission's view that **devolving revenues, rates and band-setting powers in full, as in Scotland, would be preferable. This would also make the most of the usability of income tax, by allowing fine-tuning of the distributional effects of policy changes. But, this 'Scottish' model would also entail greater risk of short-term revenue volatility and long-term revenue decline if the Northern Ireland tax base did not keep pace with the English tax base.** These risks could be mitigated by ensuring a robust fiscal framework, with an appropriate block grant adjustment and budget management tools, and periodic reviews of performance. (These elements are discussed further in Chapter 6.) It is also worth saying that this more maximal degree of devolution offers more opportunity to make policy "mistakes". The NI Executive and NI Assembly would need to be sure they had appropriate analytical capability and capacity in place, to understand the consequences of policy change, and **we would recommend that the NI Fiscal Council should have a robust role in forecasting the impacts of change.** **Ultimately, however, it is the responsibility of Northern Ireland's politicians to determine the appropriate balance between greater financial incentives and powers, and the degree of risk involved.** If the NI Assembly and NI Executive is sufficiently concerned about this level of risk, **an alternative would be the Welsh model of partial devolution, which would involve less financial risk, but also provide less flexibility.** It would

<table>
<tr><td></td><td>be possible to move from the 'Welsh' to the 'Scottish' model in future (or some variation of the models described), as part of an incremental approach to devolution.

There is a strong case for devolving the power to set the Personal Allowance, which would not expose the NI Assembly to any further revenue risk, but would provide further policy flexibility, going beyond the current 'Scottish' model.

If income tax is devolved to Northern Ireland, we recommend that the NI Assembly be required to pass a motion annually to set the Northern Ireland rates and bands (where applicable) of income tax which will apply, similar to the case in Scotland and Wales.</td></tr>
<tr><td rowspan="2">Devolution of the apprenticeship levy</td><td>Recommendation 6</td></tr>
<tr><td>We recommend that, if powers over income tax are devolved to the NI Assembly in future, the apprenticeship levy should be devolved in parallel.</td></tr>
<tr><td rowspan="2">Administration of devolved apprenticeship levy</td><td>Recommendation 7</td></tr>
<tr><td>We recommend that if the apprenticeship levy is devolved to the NI Assembly, it continues to be administered by HMRC, given the synergies with income tax administration.</td></tr>
<tr><td rowspan="2">Devolution of SDLT, APD and landfill tax</td><td>Recommendation 8</td></tr>
<tr><td>We recommend full devolution of revenues and tax powers relating to stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax.</td></tr>
<tr><td rowspan="2">Administrative arrangements for SDLT, APD and landfill tax</td><td>Recommendation 9</td></tr>
<tr><td>While continued HMRC administration of these taxes might come at somewhat lower cost, local administration would provide greater flexibility and scope for innovation.

We believe the potential benefits of local administration outweigh the likely costs. As well as offering greater scope for flexibility and innovation, local administration would improve public understanding of taxes, increase accountability of the local administration and build up institutional capability and capacity for potential enhanced devolution in future.

We recommend that if the devolution of SDLT, APD and landfill tax is pursued and implemented, the NI Executive should establish a local revenue authority to administer these fully devolved taxes.</td></tr>
<tr><td rowspan="2">Devolution of excise duties</td><td>Recommendation 10</td></tr>
<tr><td>We, as a Commission, remain of the view that there would be value in the NI Executive seeking devolution of excise duties, albeit, over the longer term.</td></tr>
</table>

	Our investigations have not been enough to persuade us whether the costs and complexity would be readily manageable, or not. Therefore **we recommend that, should the NI Executive wish to pursue devolution it carry out a full study working alongside HMRC / HMT to agree on *how* excise duties could be administered and what the costs involved would be. It should also engage more widely with a range of representatives from the production, retail and supply sectors, to ensure that the model of implementation would take account of the specific needs of those sectors.** It may also be prudent to await the resolution of the issues around the implementation of the NI Protocol, and a longer-term settlement for the customs and excise regime in Northern Ireland, to ensure the existence of a more stable environment, prior to the implementation of any new fiscal powers over excise duties.
Principles for implementing fiscal devolution	***Recommendation 11*** i. **That neither the budget of the NI Executive nor of the rest of the UK should be immediately better or worse off simply as a result of the devolution of a tax.** ii. **That, as far as possible, following tax devolution the NI Executive should neither gain nor lose from fiscal risks or trends that can reasonably be predicted in advance, and which it has limited capacity to meaningfully influence.** iii. **That the NI budget should capture, as far as possible, the full revenue impacts of its tax policy decisions, whether they be to raise or reduce revenue.** iv. **That, as far as possible, the NI budget should not be exposed to the effects of tax policy changes made by the UK Government, for taxes that have been devolved to the NI Executive. And nor should rUK be exposed to the consequences from changes to devolved taxes in Northern Ireland**. v. **That, as far as possible, the UK Government should bear the risks of revenue shocks that impact the whole of the UK equally**.
BGA indexation mechanism	***Recommendation 12 (parts A and B)*** **We recommend that, following tax devolution to Northern Ireland, the BGA mechanisms that are adopted control for the budgetary risks arising from Northern Ireland's different starting distribution of taxpayers. This will insure the NI Executive's budget against the fiscal risks that arise from it having a different distribution of taxpayers by tax band at the point of devolution.** This applies to income tax and to stamp duty land tax (SDLT), although not the other taxes that we recommend as suitable for devolution. Unlike the other taxes we discuss, growth in income tax and SDLT revenues can be strongly influenced by the highest income earners and the highest valued properties – of which Northern Ireland has relatively few. In our view, fiscal

	frameworks should not penalise the NI Executive from it having lower tax capacity at the point of devolution. The NI budget should not significantly gain or lose as a result of devolution simply because of the tax base that it inherits. **Northern Ireland's BGAs should be indexed to tax growth in England as a whole, not, for example, England excluding London and the South East.** Many of the concerns that arise in indexing the BGAs to all England can be addressed using a 'by band' approach, and we believe this would be a more appropriate approach.
Population projections and implications for choice of BGA mechanism	***Recommendation 13***
	We recommend that the BGA mechanism takes account of relative population growth. In our view, the NI budget should not, as a result of tax devolution, be exposed to the risk of differential population growth relative to England. Relative population growth is an important determinant of the relative growth in revenues, but not one that the NI Executive has significant ability to influence, except perhaps over a very long term. We are not persuaded by arguments that the NI Executive's budget should be insulated against other fiscal risks, including the risk of differences in other demographic trends, for example, population age. The likely benefits are uncertain, limited, and potentially outweighed by the disadvantage of a more complex and less transparent framework.
Fiscal insurance	***Recommendation 14***
	We recommend building in some, limited, element of fiscal insurance into tax devolution arrangements. We do not have a strong view on what form this should take, i.e. whether a floor, a ceiling or a periodic reset, but it is clear that at least one of these will be necessary. The risk of fiscal insurance, or 'equalisation', is that it could undermine part of the rationale for tax devolution if it weakens the relationship between economic performance and the devolved budget. But this risk needs to be weighed carefully against the risk that devolved tax revenues could diverge substantially from the equivalent English revenues for reasons outside the control of devolved policy-makers. We believe the NI budget should bear some of the costs, or benefits, from tax revenues diverging from UK revenues after devolution, but with the downside limited. Carefully designed, fiscal insurance need not undermine the rationale for devolution, and is consistent with the notion of fiscal union.
Borrowing for forecast errors and reconciliations	***Recommendation 15***
	We recommend that the NI Executive should be able to borrow to cover negative forecast errors in full. Any cap placed on such borrowing, perhaps to encourage the NI Executive to hold and make use of reserves as well, should be set at a sufficiently high level that negative forecast errors only

	exceed it infrequently. This means that the relative size of Wales' forecast error borrowing limit (£200m or 7.0% of devolved revenues in 2021/22) represents a better guide than the relative size of Scotland's limit (£300m or 2.2% of devolved revenues in 2021/22). Any limit should also be indexed over time, for example, based on changes in the level of revenues devolved to the NI Executive. Periodic reviews of the fiscal framework should also consider whether the limits are appropriate or should be revised.
Borrowing for discretionary resource expenditure	***Recommendation 16***
	We recommend that the NI Executive should be able to borrow a modest amount to fund discretionary resource spending. This would allow it to borrow to offset temporary falls in revenues even if these were forecast in advance, and more generally, respond to unforeseen events affecting its budget. We suggest that an annual borrowing limit of 1% of its current resource DEL (approximately £138 million) might be a useful starting point, providing a modest degree of extra budget flexibility, and posing no risk to the UK's overall public finances. To avoid the risk of 'over-borrowing', a limit on the total stock of debt that could be incurred could be imposed, and rules put in place requiring borrowing to be paid back over a relatively short period. We recognise that granting substantially larger resource borrowing powers would represent a bigger change to the UK's fiscal architecture.
A Northern Ireland Reserve	***Recommendation 17***
	We recommend that, following devolution of tax responsibilities to Northern Ireland, the Budget Exchange mechanism should be replaced by a Northern Ireland Reserve, to provide flexibility to respond to the additional revenue risks the NI Executive's budget would face. If there is to be a cap on the Reserve, it should be set to be at least in line with the cap in Wales (which is £350m or 12.3% of devolved revenues in 2021/22), relative to the value of revenues devolved. There is a good case for saying that, if there is a cap on the overall value of the Reserve, annual drawdown limits should not apply, and instead be a matter of discretion for the NI Executive. At the very least, drawdown limits should be set to be significantly higher than the Budget Exchange limit currently in place, since the Reserve will be used to address forecast error risk in addition to existing underspend requirements. Any caps or limits should be indexed over time, rather than being fixed in cash terms.
Forecasting arrangements	***Recommendation 18***
	We recommend, as a key condition for devolution, that forecasts are made by an independent body and not by the NI Executive. This is vital to ensure the credibility and transparency of the forecasting process, and to avoid the

	risk of forecasts being unduly optimistic (in order to generate more revenue in the short-term). **We recommend that the NI Fiscal Council is tasked with forecasting revenues for any devolved taxes.** This would help increase local accountability, allow NI-specific factors to be most fully taken account of, and would help build further institutional capacity within Northern Ireland. Irrespective of which organisation forecasts Northern Ireland revenues, that body should also be responsible for publishing an analysis and explanation of why trends and forecasts for Northern Ireland revenues and the BGAs differ.
Compensatory transfers	***Recommendation 19***
	We recommend that the NI Executive fiscal framework should make provision for compensatory payments to be made in both directions between the UK Government and NI Executive, when policies related to the taxes we propose are devolved, have spillover effects.[iii] However, both governments should invoke these provisions in a responsible manner, and similarly restricting payments to 'direct' spillover effects as in Scotland and Wales would be sensible. **We recommend that the NI Executive and the UK Government should be required to publish their positions and the evidence underlying them if no agreement on compensatory payments can be reached; the external and independent scrutiny this would allow could encourage a more responsible approach and incentivise agreement earlier in the process.**
Dispute resolution	***Recommendation 20***
	A well-functioning system of intergovernmental relations and processes for dispute resolution are essential if fiscal devolution is to work smoothly. **We recommend that dispute resolution processes in any future fiscal framework for Northern Ireland should have access to and be embedded within the new Intergovernmental Relations system between the UK Government and devolved administrations, which sets out new principles and infrastructure arrangements to support the resolution of intergovernmental disputes.** **If tax devolution to Northern Ireland is to happen, then it is vital that both governments work constructively and positively together in its implementation.**

[iii] Spillover effects can be: _direct_ (mechanical effects occurring as a result of policy change before any associated changes in behaviour); _behavioural_ (resulting from behaviour change in response to a policy decision); or _second-round_ (wider economic impacts resulting more indirectly from policy decisions).

Changing and reviewing the framework	***Recommendation 21***
	We recommend that if further tax powers and revenues were devolved, following the agreement of an NI Executive fiscal framework, it would be appropriate to review the terms of the overall framework at that point. In particular, any limits on borrowing for the purpose of addressing forecast errors would likely need to be revised, and a different approach to block grant adjustment may be warranted, compared to those taxes previously devolved. **We recommend reviewing the framework on a periodic basis, even if no further tax powers were devolved.** This review should be timed to take place shortly after, rather than shortly before, the expected date of elections to facilitate longer-term perspectives being taken. Bearing this in mind, a period of approximately five years would seem appropriate.
New taxes for Northern Ireland	***Recommendation 22***
	We recommend that the NI Executive and the UK Government agree an implementation process for the introduction of any new taxes in Northern Ireland.
Wider implications for devolution in rUK	***Recommendation 23***
	We recommend that the UK Government instigates a review to consider developing and implementing a shared institutional framework for fiscal devolution across the UK. This could usefully consider the drawing up of shared principles and the establishment of shared processes/infrastructure particularly in the area of dispute resolution and the use of independent analysis.

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