The Independent
Fiscal Commission NI

UK taxes levied in Northern Ireland: An assessment for devolution

December 2021

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Introduction

As part of our Interim Report published in December 2021, we identified a set of five key criteria to inform our deliberations on the existing UK-based taxes most appropriate for devolution in Northern Ireland. Our criteria were: economic and policy context; legal constraints; accountability; administrative efficiency; and economic efficiency and risks to the UK tax base.

The Commission used this criteria to appraise the suitability of each tax, identifying those taxes prioritised for further consideration as part of the second phase of our work, and those taxes deemed not suitable for further consideration.

This report presents the Commission's full appraisal on the suitability of each tax, as published in our Interim Report, as a standalone document. The 'prioritised' taxes are considered in more depth in our final report.

Analysis of UK taxes levied in Northern Ireland: Criteria

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

1.1.1 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 considered the suitability of all existing UK taxes for devolution in Northern Ireland, against a number of specific criteria.

1.1.2 Our agreed criteria are listed in Table 1.1 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.

1.1.3 Our criteria differ only slightly from those used by the Holtham Commission in that we have merged two behavioural criteria into one, 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 2022 is, in some aspects, very different from the context for tax devolution in Wales in 2010.

Table 1.1 - 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.

1.1.4 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.

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

1.1.6 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*."

1.1.7 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

1.1.8 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.[1]

1.1.9 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.[2]

1.1.10 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.

1.1.11 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 *prioritise* 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.

Analysis of UK taxes levied in Northern Ireland Major Taxes

2.1 Income tax

2.1.1 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

2.1.2 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.

2.1.3 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).

2.1.4 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.[i] 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.

2.1.5 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[3]) without constraint. Even if income tax is deemed appropriate for devolution in Northern Ireland, questions around the scope of devolution will also need consideration.

[i] 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.

2.1.6 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 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.

2.1.7 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

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

Accountability

2.1.9 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.

2.1.10 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'.

2.1.11 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.

2.1.12 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

2.1.13 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).

2.1.14 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.

2.1.15 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.[4]

2.1.16 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.[5]

2.1.17 Income tax devolution may also impose additional costs on payroll service providers.[ii] 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

2.1.18 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.

[ii] 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.

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

2.1.20 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.

2.1.21 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.

2.1.22 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).

2.1.23 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.

2.1.24 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.

2.1.25 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.*

2.1.26 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.

2.1.27 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.

2.1.28 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

2.1.29 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.

2.1.30 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

2.1.31 **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.**

2.2 Value added tax

2.2.1 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.[iii] 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.

2.2.2 VAT is a proportional tax charged on the sales of businesses with turnovers of £85,000 a year or more.[iv] 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).

2.2.3 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.

2.2.4 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,

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

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

2.2.5 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.[6]

2.2.6 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,[v] 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%).[vi] 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

2.2.7 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 rates and rules.[vii] 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.[7]

2.2.8 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

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

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

2.2.9 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.

2.2.10 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.

2.2.11 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,[8] on pasties and other hot bakery products,[9] hot meals in cafes, pubs and restaurants,[10] and for the wider hospitality industry[11] – as well as the overall rate of VAT.[12] Such media coverage would help voters hold the NI Assembly accountable for their VAT policy decisions.

Administrative efficiency

2.2.12 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.

2.2.13 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.[viii] 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.[13]

2.2.14 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.[ix] 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.

2.2.15 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 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

2.2.16 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.[14] 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.

[viii] The 'exporter' and 'importer' could in fact be the same business if it has operations in both Northern Ireland and GB.

[ix] 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.

2.2.17 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).[15]

2.2.18 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

2.2.19 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.

2.2.20 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

2.2.21 **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.**

2.3 National Insurance contributions

2.3.1 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.

2.3.2 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.

2.3.3 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.[16] 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

2.3.4 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.[x] 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.

2.3.5 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 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.

2.3.6 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.

[x] 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.

2.3.7 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.

2.3.8 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

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

Accountability

2.3.10 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.

2.3.11 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.

2.3.12 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

2.3.13 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.

2.3.14 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.

2.3.15 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.

2.3.16 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

2.3.17 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.

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

2.3.19 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.

2.3.20 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).

2.3.21 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.

2.3.22 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.

2.3.23 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.

2.3.24 Ku et al (2020)[17], 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)[18] 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)[19] find little evidence of employment effects for a similar scheme in Finland, and Cruces et al (2010)[20] find little evidence of employment effects of regionally-varying changes in contribution rates in Argentina.

2.3.25 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

2.3.26 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.

2.3.27 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.

2.3.28 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

2.3.29 **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

3.1 Fuel duties

3.1.1 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.

3.1.2 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.

3.1.3 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

3.1.4 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.

3.1.5 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.

3.1.6 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.[21]

3.1.7 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.

3.1.8 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?

3.1.9 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.

3.1.10 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.[22][23]

3.1.11 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

3.1.12 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

3.1.13 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

3.1.14 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.

3.1.15 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.

3.1.16 But in reality, the majority of petrol, diesel and liquefied gas is imported into Northern Ireland from elsewhere in the UK.[xi] This means that to be meaningfully effective, imports of fuel into

[xi] 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.

Northern Ireland from elsewhere in UK would need to be exempted from UK fuel duty so that the Northern Ireland Duty could apply.

3.1.17 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,[xii] 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.

3.1.18 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.

3.1.19 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

3.1.20 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.

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

3.1.22 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

[xii] 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.

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.

3.1.23 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.

3.1.24 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

3.1.25 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.

3.1.26 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

3.1.27 **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.**

3.2 Corporation tax

3.2.1 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%.

3.2.2 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

3.2.3 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,[24] it now highlights NICs and VAT as its priorities for further tax devolution.[25] 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.

3.2.4 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.

3.2.5 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.[26] 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.[27] 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.

3.2.6 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.

3.2.7 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.

3.2.8 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".

3.2.9 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.[xiii]

3.2.10 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.

3.2.11 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.

3.2.12 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 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),[28] 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.

3.2.13 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>.[29]"* Therefore if a

[xiii] 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.

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.

3.2.14 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).[xiv] 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.

3.2.15 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.[30] It is also worth noting that, while we have 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.

3.2.16 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.

[xiv] 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.

3.2.17 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).[31] 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.

3.2.18 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'.[32] 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.

3.2.19 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.

3.2.20 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

3.2.21 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

3.2.22 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.

3.2.23 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.

3.2.24 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

3.2.25 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.

3.2.26 HMRC estimated the administration and compliance costs associated with the model of devolution currently legislated for in 2015.[33] 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.*

3.2.27 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.

3.2.28 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'[34] 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.

3.2.29 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.

3.2.30 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

3.2.31 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.

3.2.32 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.

3.2.33 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.

3.2.34 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)[35] 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.[36]

3.2.35 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.

3.2.36 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.

3.2.37 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

3.2.38 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.

3.2.39 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.

3.2.40 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.

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

3.2.42 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.

3.2.43 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.

3.2.44 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

3.2.45 **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**.

3.2.46 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.

3.2.47 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.

3.2.48 **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.**

3.3 Alcohol and tobacco duties

3.3.1 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.

3.3.2 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

3.3.3 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.

3.3.4 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).[37] 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.[38]

3.3.5 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,[39] and by provinces in Canada.[40]

3.3.6 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.[41] 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.[42] 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.

3.3.7 As part of the Autumn Budget 2021, the UK Government announced a freezing of alcohol duty rates in the UK,[43] and published a consultation on detailed proposals for alcohol duty reform.[44] 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.[45]

Legal constraints

3.3.8 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

3.3.9 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.

3.3.10 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.[46] 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.[47] This media coverage could help the electorate hold the NI Assembly to account for its tax policy.

3.3.11 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

3.3.12 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.

3.3.13 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,[xv] any differences in tax rates would mean either extra tax payments or refunds would need to be made. This would

[xv] 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.

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.

3.3.14 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.

3.3.15 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

3.3.16 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 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.[48]

3.3.17 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.[49] 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

3.3.18 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.

3.3.19 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.

3.3.20 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

3.3.21 **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

4.1 Vehicle excise duty

4.1.1 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.

4.1.2 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

4.1.3 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.

4.1.4 As the application of VED depends on the location of the 'registered keeper' of a vehicle,[xvi] 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.

4.1.5 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.[50,51]

4.1.6 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

[xvi] 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.

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.[52]

Legal constraints

4.1.7 We are not aware of any legal constraints to devolving VED to the NI Assembly.

Accountability

4.1.8 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[53] –, 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

4.1.9 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

4.1.10 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.

4.1.11 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.

4.1.12 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.[xvii] 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.[54] 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

4.1.13 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.

4.1.14 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

4.1.15 **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.**

4.2 Insurance premium tax

4.2.1 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

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[xvii] Zero emission electric vehicles are zero-rated for standard tax for the first and all subsequent years, meaning they are exempt from VED.

buildings, content and most vehicle insurance; and a higher 20% rate 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.

4.2.2 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

4.2.3 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[55] and Consumer Council research[56] 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.

4.2.4 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.[57]

Legal constraints

4.2.5 We are not aware of any legal constraints to the devolution of IPT to the NI Assembly.

Accountability

4.2.6 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

4.2.7 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

4.2.8 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.

4.2.9 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

4.2.10 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).

4.2.11 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

4.2.12 **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.**

4.3 Capital gains tax

4.3.1 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.

4.3.2 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.

4.3.3 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.

4.3.4 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.[58] 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

4.3.5 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.

4.3.6 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.

4.3.7 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.

4.3.8 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'.

4.3.9 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

4.3.10 We are not aware of any legal constraints to devolving CGT to the NI Assembly.

Accountability

4.3.11 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.

4.3.12 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%.[59] 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

4.3.13 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.

4.3.14 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.

4.3.15 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.

4.3.16 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.

4.3.17 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.

4.3.18 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.

4.3.19 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).

4.3.20 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

4.3.21 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).

4.3.22 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.

4.3.23 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

4.3.24 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.

4.3.25 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').

4.3.26 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.

4.3.27 '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

4.3.28 **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.**

4.4 Stamp duty land tax

4.4.1 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.

4.4.2 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

4.4.3 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.

4.4.4 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.[60] 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.

4.4.5 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.

4.4.6 As discussed above, SDLT has already been devolved to the Scottish and Welsh parliaments,[xviii] 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, 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.

4.4.7 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

[xviii] 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.

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

4.4.8 There are no legal constraints to devolving SDLT to the NI Assembly.

Accountability

4.4.9 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.[xix] 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.

4.4.10 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.[61]

Administrative efficiency

4.4.11 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. 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,[62] while the Welsh Revenue Authority collected £297 million from LTT and Landfill tax and incurred costs of £7.4 million,[63] 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.[64] These figures suggest an increase in administration costs that is very large relative to the marginal cost of

[xix] 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).

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).

4.4.12 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.

4.4.13 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

4.4.14 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).

4.4.15 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.[xx] 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

4.4.16 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.

4.4.17 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

4.4.18 **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.**

4.5 Air passenger duty

4.5.1 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.

4.5.2 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 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.[65]

4.5.3 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

[xx] 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.

£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.[66]

4.5.4 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

4.5.5 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£1.2 million 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.

4.5.6 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,[67] 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.[68] Recent calls have also been made in the context of the collapse of Flybe[69] and the impact of COVID-19.[70]

4.5.7 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.[71]

4.5.8 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.[72]

4.5.9 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.

4.5.10 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

4.5.11 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

4.5.12 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).

4.5.13 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

4.5.14 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.

4.5.15 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

4.5.16 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).

4.5.17 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.

4.5.18 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.

4.5.19 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).[73] 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.

4.5.20 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

4.5.21 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.

4.5.22 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

4.5.23 **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.**

4.6 Betting and gaming duties

4.6.1 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.

4.6.2 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).

4.6.3 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.

4.6.4 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%.[74]

4.6.5 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.

4.6.6 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

4.6.7 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%).[75]

4.6.8 Unlike in Scotland and Wales, regulation of betting and gaming activity in Northern Ireland is a devolved competence[xxi]. 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.

4.6.9 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.[76] 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

4.6.10 We are not aware of any legal impediment to devolving betting and gaming duties to the NI Assembly.

Accountability

4.6.11 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.

4.6.12 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

4.6.13 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).

4.6.14 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 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.

4.6.15 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.

[xxi] Note however that spread betting is regulated UK-wide by the Financial Conduct Authority

4.6.16 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?

4.6.17 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

4.6.18 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.

4.6.19 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

4.6.20 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.

4.6.21 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

4.6.22	**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.**

4.7 Apprenticeship levy

4.7.1 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. The apprenticeship levy was estimated by ONS to have raised £60m, or 0.4% in 2019/20 in Northern Ireland following an information request by the Commission.[77]

Economic and policy context

4.7.2 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.

4.7.3 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

4.7.4 There are no legal constraints to devolving the levy to the NI Assembly.

Accountability

4.7.5 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

4.7.6 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.

4.7.7 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

4.7.8 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

4.7.9 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.

4.7.10 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

4.7.11 **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.**

4.8 Inheritance tax

4.8.1 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.[xxii]

4.8.2 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.

4.8.3 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.

4.8.4 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

4.8.5 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 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.

4.8.6 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

4.8.7 We are not aware of any legal constraints to devolving IHT to the NI Assembly.

Accountability

4.8.8 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.

[xxii] 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.

Administrative efficiency

4.8.9 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.

4.8.10 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.

4.8.11 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.

4.8.12 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

4.8.13 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.

4.8.14 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.[78] 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

4.8.15 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.

4.8.16 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

4.8.17 **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.**

4.9 Landfill tax

4.9.1 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.[79]

4.9.2 The tax is levied on landfill operators, who pass costs on to businesses disposing of waste by landfill.

4.9.3 It is estimated that landfill tax raised £24 million in 2019-20 in Northern Ireland, 0.2% of the total take.[80]

Economic and policy context

4.9.4 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.

4.9.5 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.

4.9.6 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.

4.9.7 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.

4.9.8 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

4.9.9 We are not aware of any legal constraints to devolving landfill tax to the NI Assembly.

Accountability

4.9.10 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

4.9.11 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

4.9.12 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.

4.9.13 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.

4.9.14 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

4.9.15 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.

4.9.16 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

4.9.17 **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.**

4.10 Climate change levy

4.10.1 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.[81]

4.10.2 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

4.10.3 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.

4.10.4 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. [82]

4.10.5 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

4.10.6 We are not aware of any legal constraints to devolving the climate change levy to the NI Assembly.

Accountability

4.10.7 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

4.10.8 It seems unlikely that administration issues would preclude the full devolution of the climate change levy.

4.10.9 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

4.10.10 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.

4.10.11 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

4.10.12 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.

4.10.13 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

4.10.14 **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.**

4.11 Aggregates levy

4.11.1 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).[83] Some minerals are not subject to the levy, and use of aggregates in certain agricultural products is exempt.

4.11.2 The UK Government cites increased use of secondary and recycled aggregate in the UK as a success of the levy,[84] although it is likely that regulation and increases in landfill taxes have also contributed to this trend.

4.11.3 Estimated aggregates levy revenue for Northern Ireland in 2019-20 were £18 million, 0.1% of the total tax take.

Economic and policy context

4.11.4 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.[xxiii] [85]

4.11.5 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.[86] 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.

4.11.6 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 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".[87]

4.11.7 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).

4.11.8 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."[88]

[xxiii] 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.

4.11.9 Mining and quarrying industries in Northern Ireland are estimated to employ around 2,300 people, with a combined turnover of £390 million (2016 data).

4.11.10 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.[xxiv] The long-standing litigation was concluded in February 2019.

4.11.11 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.

4.11.12 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.

4.11.13 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.[89]

Legal constraints

4.11.14 We are not aware of any legal constraints to devolving aggregates levy to the NI Assembly.

Accountability

4.11.15 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

[xxiv] 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.

4.11.16 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.

4.11.17 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.

4.11.18 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).

4.11.19 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.

4.11.20 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

4.11.21 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.

4.11.22 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

4.11.23 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.

4.11.24 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

4.11.25 **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.**

4.12 Stamp Duty on shares

4.12.1 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.

4.12.2 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.

4.12.3 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

4.12.4 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

4.12.5 We are not aware of any legal constraints to devolving Stamp Duty on Shares to the NI Assembly.

Accountability

4.12.6 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

4.12.7 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.

4.12.8 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.

4.12.9 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.

4.12.10 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

4.12.11 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.

4.12.12 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

4.12.13 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.

4.12.14 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.

4.12.15 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

4.12.16 **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.**

4.13 Soft drinks industry levy

4.13.1 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.

4.13.2 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

4.13.3 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.[90] 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.[91]

4.13.4 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

4.13.5 We are not aware of any legal constraints to the devolution of the soft drinks industry levy to the NI Assembly.

Accountability

4.13.6 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.[xxv] Despite being a relatively small tax, its introduction was relatively high-profile, given debate around the appropriate role of government intervention in product markets and consumption choice.[92] Such media coverage may help the electorate hold the NI Assembly to account for its levy policies.

Administrative efficiency

4.13.7 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.[xxvi] 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

4.13.8 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.[93] Indeed, concerns about the impact of cross-border shopping as a result of

[xxv] Estimates of the extent to which taxes on soft drinks are passed through in prices vary considerably. Reviewing 27 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.

[xxvi] 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.

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.[94] 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.

Soft Drinks levy summary

4.13.9 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.

4.13.10 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

4.13.11 **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.**

4.14 Taxes on specific business activities

4.14.1 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.

4.14.2 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

4.14.3 **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.**

Summary of tax assessment conclusions

5.1 Summary of tax assessment conclusions

5.1.1 A summary of our conclusions on the suitability of each of the UK taxes levied in Northern Ireland is given below in Table F1.

Table F1 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.

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