



Northern Ireland  
Assembly

## Research and Library Service Briefing Paper

---

Paper 000/00

14 May 2010

NIAR 150-2010

**Eoin Murphy**

# A Comparison of the Varney Review and the ERGNI Report on Corporation Tax Reform

## 1 Background

This paper has been commissioned by the Committee for Enterprise, Trade and Investment in response to the debate surrounding the potential for a reduced corporation tax rate in Northern Ireland (NI). The paper will discuss the Northern Ireland Economic Reform Group's (ERGNI) paper into the reduced rate of corporation tax (CT) and the Review of Tax Policy 2007 chaired by Sir David Varney ('The Varney Review').

The paper will compare and contrast the key points from both papers, with a focus on any responses made by ERGNI to the conclusions drawn in the Varney Review.

## Key Points

The Varney Review of Tax Policy in Northern Ireland

- The review examined the case for a differential rate of corporation tax in NI and considered legal issues, implementation issues, the value for money assessment for NI and implications for the UK as a whole;

- The Review's main recommendation was that *"a clear and unambiguous case for a 12.5% rate of corporation tax cannot be made<sup>1</sup>."* It went on to state that there would be an up front cost to NI of **£300 million** a year in lost CT and it would not be recovered in a reasonable period of time;
- NI's economic growth has sped up since 1992, with the peace process acting as a primary driver. There are, however, significant structural issues that need addressed in order to ensure stable growth;
- Corporation tax has been a key part of the ROI's growth performance. However, the Varney review states that whilst: *"...the low corporation tax regime can be seen as attractive to foreign investors, as well as offering profit shifting opportunities, it cannot in itself explain Ireland's success.<sup>2</sup>";*
- It also found that: *"...there is a great deal of complexity to the relationship between tax and investment. This points immediately to the pitfalls of claiming by analogy that, as the corollary of a single policy move, the success of one economy can be repeated by another<sup>3</sup>.";*
- In conclusion regarding CT and NI, the review found that the policy would result in a net cost for the UK and NI. The policy was found to not represent good value for money when considering the up-front cost of near £300 million per year to the NI Assembly's block grant;

#### The Case for a Reduced Rate of Corporation Tax in Northern Ireland

- Released on the 10<sup>th</sup> of February 2010, with a revised edition produced on the 12<sup>th</sup> of May 2010, the ERGNI report re-examined the issue of corporation tax, responding to a number of the criticisms made against the 2006 ERINI report by the Varney Review;
- As stated within the report it builds upon an earlier study by the Tax Payers Alliance for the Conservative Way Forward, a not for profit group founded in 1991 to defend and build upon the achievements of the Conservative Party under Margaret Thatcher's leadership<sup>4</sup>;

---

<sup>1</sup> Varney, David, December 2007, *The Varney Review of Tax Policy in Northern Ireland*

<sup>2</sup> Ibid

<sup>3</sup> Ibid

<sup>4</sup> The Tax Payers Alliance paper can be found at: [http://tpa.typepad.com/home/files/cwf\\_corporation\\_tax\\_paper\\_final\\_lowres.pdf](http://tpa.typepad.com/home/files/cwf_corporation_tax_paper_final_lowres.pdf)

- The report points out that whilst NI saw consistent growth between 1998 and 2008, this was not necessarily a result of the Peace Process as was found in the Varney Review. The ERGNI report stated that all of the UK was undergoing growth during this period and that although NI did grow faster than other peripheral regions this was by only 0.7% per annum. During this same period productivity and wages in NI actually fell below the UK average<sup>5</sup>;
- Unlike Varney, the ERGNI found that the reason for the ROI's economic success lies in the low rate of CT in use since the 1950's for most manufacturing sectors, with this attracting a large inflow of investment in plant and machinery;
- The report states that post CT reduction that any costs accrued would be overtaken by benefits, as increased investment leads to a growth in employment and subsequent increases in tax revenue;
- The ERGNI report criticises the Varney Reviews estimation of static costs, stating that consideration of evidence from OECD and the ROI would change the conclusions of the Varney Review, with instead of a cumulative net loss of tax revenue in year 20 of **£2,284 million**, using the same methodology in all other respects would give a cumulative net gain of **£446 million**;
- The practice of shifting firms and profits from GB to NI as a result of a reduced CT rate could potentially result in a loss to the UK Exchequer. However, the ERGNI report states that: *"the Treasury has sufficient existing powers to control unreasonable company behaviour"*;
- The ERGNI report found that the Varney Review assumed a net Exchequer loss of £75 million due to profit shifting and did not take into account mitigation factors such as companies who stay within the UK rather than move to a foreign destination with a smaller CT rate. ERGNI did not apply this figure as part of its assessment;
- The report concludes that the estimation of the likely impact of introducing a reduced CT rate is inherently unsure, but *"the clear conclusion of this report is that a reduction in corporation tax to a level of 12.5% would bring substantial benefits to both NI and the UK."*;
- The authors also conclude that after six years of operation cumulative gains would offset cumulative losses with a substantial net gain for NI and the UK;

---

<sup>5</sup> Northern Ireland Economic Reform Group February 2010 *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*

- In terms of implementation issues and any barriers to it, both reports seem to agree that technically the CT rate could be reduced, so long as certain conditions are met;
- The greatest variation between the two pieces of research is in the monetary costs and benefits of the introduction of a reduced CT rate; and
- The differences between the two reports assessment of the monetary costs and benefits is immediately noticeable, with the ERGNI model showing significant growth in income between 2018 and 2030 (£882 million) in comparison to Varney which increases by £238 million (not including displacement and profit shifting).

## 2. Review of Tax Policy 2007 Varney

The Varney Review was commissioned following representations to the Chancellor of the Exchequer in 2006 regarding a reduction in the CT rate for NI. The Review reported on:

*“How current and future tax policy, including the tax changes announced in the Budget 2007, can support the sustainable growth of business and long term investment in Northern Ireland<sup>6</sup>.”*

The review considered a number of issues including a differential rate of CT for NI and business tax issues. In a number of areas the Varney Review responds directly to a 2006 report written by the Economic Research Institute of Northern Ireland (ERINI).

The Varney Review raised a number of concerns regarding the methodology used by the ERINI study. This focussed mainly on how the study underplayed the role of supply side factors and overestimates, relative to academic literature, the responsiveness of investment to a change in the rate of corporation tax.

The Review's main recommendation was that *“a clear and unambiguous case for a 12.5% rate of corporation tax cannot be made<sup>7</sup>.”* It went on to state that there would be an up front cost to NI of **£300 million** a year in lost CT and it would not be recovered in a reasonable period of time.

The key points from each chapter of the report will now be discussed.

### 2.1 Review of Northern Ireland's economy:

- NI's economic growth has sped up since 1992, with the peace process acting as a primary driver. There are, however, significant structural issues that need addressed in order to ensure stable growth;

<sup>6</sup> Varney, David, December 2007, *The Varney Review of Tax Policy in Northern Ireland*

<sup>7</sup> Ibid

- Major concerns included the large size of the public sector, high levels of labour force inactivity and poor basic skills in the workforce. The review highlighted this as a particular concern as NI moved away from its heavy manufacturing industries and the need to expand into high technology and high value added businesses in order to meet global opportunities and challenges;
- The review made the point that these structural and institutional weaknesses limit the growth potential of the private sector and that there is a need for a focus on them as part of a public policy debate and subsequent action; and
- As a result of this, the role of tax in contributing to sustainable growth in business is underdeveloped without efforts to address the wider supply side issues.

## 2.2 The role of Foreign Direct Investment in the ‘Celtic Tiger’

The Varney review discussed the impact of FDI and CT on the development of the Republic of Ireland’s (ROI) ‘Celtic Tiger’ economy. It found that the ROI focused its economic development policy in encouraging multinational corporations to locate production in the country<sup>8</sup>. This strategy has been highly successful, with FDI per manufacturing worker in 1996 2-3 times larger as such investment in the UK, France, Germany and Spain put together. In 2002, GVA per employee was five times greater in the foreign owned sector than for indigenous enterprises. As such, the ROI’s FDI strategy was highly successful.

FDI forecasts conducted in 2006 for the period up to 2010 predicted the ROI having just under €5,000 FDI inflows per head in comparison to approximately \$1,500 for the UK.

Importantly, the ROI embarked on this strategy in the 1960’s with the Industrial Development Agency (IDA) beginning a distinct strategy of attracting foreign multinationals to invest in the country.

This strategy continued into the 1980s with the ROI targeting leading multinationals such as Motorola and Intel.

Corporation tax has been a key part of the ROI’s growth performance. However, the Varney review states that whilst:

*“...the low corporation tax regime can be seen as attractive to foreign investors, as well as offering profit shifting opportunities, it cannot in itself explain Ireland’s success.”<sup>9</sup>*

Rather, Varney refers to the ROI’s development of a ‘unique selling point’ with an educated, young and English speaking population tied to a low tax environment.

The review states that NI has lessons to learn in terms of improving labour force participation, basic skills, and efficiency and organisation in the public sector and

---

<sup>8</sup> Ibid

<sup>9</sup> Ibid

encouraging greater trade with the ROI to deepen links with a potential source of and markets for goods, investments and skills.

## 2.3 Taxation

The Varney Review conducted an extensive literature review of academic papers and reports on taxation. The evidence gathered found that taxes negatively affect the location of investment. The review also highlighted limitations with academic research, surrounding areas such as analyzing capital stock and interpreting tax data.

Empirical studies differ substantially in their concepts of foreign capital data, tax rates and in their methodologies, making it difficult for policy makers to draw conclusions regarding the size of the effect of taxation on FDI.

The review concludes that tax regimes affect cross border investment behaviour and the incentives for multinational enterprises to engage in profit shifting strategies.

In addition, the literature on economic growth argues that sustained improvements in productivity and prosperity can only occur if higher investment spearheads increased technological progress.

The review also states;

*“...there is a great deal of complexity to the relationship between tax and investment. This points immediately to the pitfalls of claiming by analogy that, as the corollary of a single policy move, the success of one economy can be repeated by another<sup>10</sup>.”*

## 2.4 Tax and Northern Ireland

The review examined the case for a differential rate of corporation tax in NI and considered:

- **Legal issues:** A move to a differential corporation tax rate for NI would be possible in principle. However, the review points out that it would involve legislative changes and legal issues that would affect the design of such a scheme. Also, the fiscal consequences would have to be borne by the Northern Ireland Assembly;
- **Implementation issues:** The design of a differential corporation tax rate for NI would entail substantial new legislation to specify the scheme and to protect this rate from abuse in the form of tax motivated incorporation and artificial profit shifting. Also, it would not be possible to completely protect such a scheme from abuse. There would also be additional costs to the HMRC as a result of the need to police the regime and its border with the rest of the UK Corporation tax system.

---

<sup>10</sup> Ibid

Other costs would include businesses needing to pay for compliance and administrative burdens. The review argues that any removal of the transfer pricing SMEs exemption would potentially have to apply across the UK. There would then be an increasing burden for businesses on a UK wide basis to facilitate a reduction in tax rates purely for NI;

- **The value for money assessment for NI:** The review found that there was not a clear and ambiguous case for a preferential rate of corporation tax in NI even considering the benefits to NI; and
- **Implications for the UK as a whole:** The policy would result in an up-front cost of about £300 million per annum. Induced additional investment would be insufficient to raise revenue such that the policy would result in a net cost to the UK Exchequer of about £2.2 billion over ten years with no prospect of cost recovery over the long run. This is under an assumption of limited profit shifting within the UK.

## 2.5 Conclusion

In conclusion regarding CT and NI, the review found that the policy would result in a net cost for the UK and NI. The policy was found to not represent good value for money when considering the up-front cost of near £300 million per year to the NI Assembly's block grant. The review stated:

*“these funds would be better directed towards improvements in the region's business environment.”<sup>11</sup>*

## 3. The Case for a Reduced Rate of Corporation Tax in Northern Ireland

Released on the 10<sup>th</sup> of February 2010, with a revised edition produced on the 12<sup>th</sup> May 2010, the ERGNI report “The Case for a Reduced Rate of Corporation Tax in Northern Ireland” re-examined the issue of corporation tax, responding to a number of the criticisms made against the 2006 ERINI report by the Varney Review.

As stated within the report it builds upon an earlier study by the Tax Payers Alliance for the Conservative Way Forward, a not for profit group founded in 1991 to defend and build upon the achievements of the Conservative Party under Margaret Thatcher's leadership<sup>12</sup>;

It also provided up to date information regarding the ongoing financial crisis and took into consideration concerns regarding FDI.

It must be noted that the model used by ERGNI is consistent with the Northern Ireland Simulation Model developed by Oxford Economics and funded by the Department for Enterprise, Trade and Investment, Department of Finance and Personnel, Department of Employment and Learning and the Office of the First Minister and Deputy First Minister. It

<sup>11</sup> Ibid

<sup>12</sup> The Tax Payers Alliance paper can be found at:

[http://tpa.typepad.com/home/files/cwf\\_corporation\\_tax\\_paper\\_final\\_lowres.pdf](http://tpa.typepad.com/home/files/cwf_corporation_tax_paper_final_lowres.pdf)

has been utilized by central and local government in NI in recent years for a range of research projects.

The report states that it focuses on CT for three reasons<sup>13</sup>:

- Low corporation tax has been, in the opinion of the report authors, the main driver of the Celtic Tiger Phenomenon in the ROI;
- There are few alternatives to generate a substantial acceleration of GDP growth in NI; and
- While some small EU countries have generated high productivity 'knowledge based' economies, this has taken decades to achieve and has usually relied on the powers available to an independent state but not to an individual region of a larger state.

The key points from each chapter of the report will now be discussed.

### 3.1 The Northern Ireland Economy Today

In discussing the NI economy the report points out that whilst NI saw consistent growth between 1998 and 2008, this was not necessarily a result of the Peace Process as was found in the Varney Review. The ERGNI report stated that all of the UK was undergoing growth during this period and that although NI did grow faster than other peripheral regions this was by only 0.7% per annum. During this same period productivity and wages actually fell below the UK average<sup>14</sup>.

NI's best period of growth was between 1988 and 1995, as a result of low levels of household and corporate debt driving the NI economy faster than GB's.

GDP per head has remained close to the 80% of the UK average with improving employment rates offset by declining productivity relative to GB.

Since the Good Friday Agreement, real Gross Value Added (GVA) has grown only slightly more quickly in NI than in the UK as a whole (2.54% PA as opposed to 2.48%)<sup>15</sup>.

The economy of NI is propped up by a subsidy from the rest of the UK with public expenditure in 2009/09 at £17.7 Billion compared to £11.5 billion raised in taxes (leaving a difference of £9.3 billion).

This section concludes by stating:

*"...continuing the current level of subsidy in the current way is surely not the most efficient use of taxpayers money, nor does it promise any fundamental shift in Northern Ireland's economic situation<sup>16</sup>."*

### 3.2 A Better Way – Tax and Spending Reform, Lessons from Abroad

<sup>13</sup> Northern Ireland Economic Reform Group February 2010 *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*

<sup>14</sup> Ibid

<sup>15</sup> Ibid

<sup>16</sup> Ibid



ROI's competitive CT regime played a crucial role in attracting investors and its government has made clear that this competitive advantage will be maintained.

The ROI's economic position was extremely difficult in the 1980's with stagnate growth, high unemployment and spiralling deficits. In 1987, the government began a major economic reform, including spending and tax cuts. This led to:

- Between 1987 to 2003 the main standard CT was cut from 50% to 12.5%. The CT rate for exporters had been set at 10% in 1957 and had played a long term role in building up a large foreign owned manufacturing sector;
- Personal tax rates were reduced from 35, 48 and 58 % in 1987 to 20 and 42% by 2001;
- Capital gains tax was also reduced from 40 to 20%;
- Between 1987 and 2003 overall tax receipts increased four fold, while CT receipts increased 16 fold;
- Unemployment also fell, from 16.2 per cent to 6.4 per cent in 2008; and
- Finally, and importantly, overall flows of FDI into ROI increased from an annual average of approximately \$140 million in the 1980s to \$2,700 million a year in the latter half of the 1990s.

Unlike Varney, the ERGNI found that the reason for the ROI's economic success lies in the low rate of CT for most manufacturing sectors since the late 1950s, with this attracting a large inflow of investment in plant and machinery. The advantages of low tax were supported by the normal factors in a western European economy, including a well educated workforce and first world infrastructure.

### 3.3 Reduced Corporation Tax for Northern Ireland

The report states that over time any costs accrued would be overtaken by benefits, as increased investment leads to a growth in employment and subsequent increases in tax revenue.

The report cites four estimates in this area<sup>17</sup>:

1. The Varney Review estimated that a 12.5% CT would result in a cost of £300 million in the first year, with a cumulative cost of £2.2 billion by year 10;
2. An ERINI report in 2006 estimated the first year cost of a reduction in the UK's main rate of CT and small companies rate to be £310 million<sup>18</sup>. The report went on to state that increases in other taxes and reductions in benefit expenditure would mean that

---

<sup>17</sup> Ibid

<sup>18</sup> ERINI 2006 *Assessing the Case for a Differential Rate of Corporation Tax in Northern Ireland*

the cumulative affect on public finances would become positive after seven years. The ERINI report assumed that no profit shifting would occur, based on evidence from the Institute of Chartered Accountants in Ireland that the practice could be effectively policed;

3. The Taxpayers Alliance commissioned the Centre for Economics and Business Research to model the effect of a phased reduction in the UK's rates of corporation tax to 12.5 per cent. The simulations found that the effect would be positive after eight years; and
4. The Varney Report cited an analysis based on OECD tax revenue statistics for 2005. This showed that OECD countries with low rates of corporation tax tended to have high levels of corporate taxable income as a percentage of GDP. On average a reduction in CT from 33% to 12% was associated with a doubling in corporate taxable income. This implies that a reduction in the CT rate from 33% to 12% would lead to a one third reduction in CT revenue rather than the two thirds implied by the change in rates. According to the ERGNI report, the Varney Review did not appear to take this into account in its assessment of the static cost of the cut CT rates in NI. The ERGNI report suggests that this is a significant omission which results in an exaggerated estimate to the cost of a reduction in CT rates.

The Varney Review estimated that CT revenue in NI was in the range of 1-1.5% of UK CT revenues. This would provide NI with between £340 – 520 million for this year. In the Varney Review, it was assumed that a reduction in CT from 30% would halve the revenue derived. At current prices this would provide between £170 – 260 million with a central estimate of £215 million.

Following consideration of the CT tax base for NI, Varney estimated that a 50% loss in this revenue (as a result of CT being reduced to 12.5%) would result in a CT rate of £278 million per annum. The ERGNI report points out that in making the calculations for this figure Varney ignored OECD and ROI evidence that reductions in CT rates do not lead to pro rata reductions in CT revenues or, indeed, any reduction at all<sup>19</sup>.

The ERGNI report takes this into consideration and applies an initial loss in revenue of between 26-30% of the tax base resulting in a reduction of £130 million, around half of the original Varney estimate.

**In the ERGNI report it is highlighted that this single difference in estimating static costs would change the conclusions of the Varney Review. Instead of a cumulative net loss of tax revenue in year 20 of £2,284 million, it would give a cumulative net gain of £446 million (this is assuming the same methodology is used).**

### 3.4 Costs and Benefits to NI and UK:

- One main benefit would be via the private sector, with new jobs created. This would help balance the public and private sectors within the region, reducing dependence on tax transfers from GB;
- There would be higher levels of income taxes, National Insurance, VAT, etc and through lower social security costs; and

<sup>19</sup> Ibid

- A potential cost is the reduction in CT revenues for the NI executive (although the ERGNI report points out that there was no reduction in revenue when the ROI reduced its rates eight years ago). A reduction in revenues could reduce spending on public services by up to 2%, although the reports authors stated that these reductions could be absorbed by improving planning of annual under spending.

### 3.5 Implementation Issues

The ERGNI report suggests that the simplest way of introducing a CT reduction is to devolve CT revenues to NI in return for a one off reduction of the same amount in the baseline for the NI executives Departmental Expenditure Limit. This will result initially in no change to tax revenues until the Executive begins to lower the CT rate, when it will have to absorb the loss by adjusting its expenditure.

In order to implement an alteration in CT certain criteria must be met in order for it to be legal under EU law. In the Azores Judgment, three conditions were laid down that must be met in order to introduce a reduced corporation tax rate within a region<sup>20</sup>:

- the region must have political and administrative authority to introduce its own tax regime;
- the national government must have no authority to influence such a decisions; and
- the region must bear the full fiscal consequences of introducing its own tax regime and in particular must not be compensated by the national authorities for a loss of tax revenue.

### 3.6 Profit Shifting:

The practice of shifting firms and profits from GB to NI as a result of a reduced CT rate could potentially result in a loss to the UK Exchequer.

However, the ERGNI report states that:

*“the Treasury has sufficient existing powers to control unreasonable company behaviour.”*

It goes on to say, however, that the movement of genuine firms and branches is more difficult to control and cites evidence that such behaviour would be limited as few firms moved to ROI to take advantage of its CT rate, suggesting this is not a significant issue.

Arguing against Varney’s stance that profit sharing could be a significant problem, the ERGNI report states that such movement may also benefit the UK economy, with firms moving from the congested South East of England which has existing levels of high

---

<sup>20</sup> ERINI Hewitt, Victor 2007 *Differential Corporation Tax in Northern Ireland: Analysis and Policy*

employment and subsequently scarce sources of labour and premises to NI, spreading economic benefits and freeing up resources for other firms expansion and development. Problems would be more likely to occur if firms shifted from areas of high unemployment to NI.

The ERGNI report found that the Varney Review assumed a net Exchequer loss of £75 million due to profit shifting and did not take into account the mitigation factors identified by ERGNI. ERGNI did not apply this figure as part of its assessment.

### **3.7 Impact of Reduced Corporation Tax on the NI Economy**

The ERGNI report identified the following main impacts on the NI economy from a reduced CT rate:

- CT revenues will be initially reduced but will start to increase as new investment takes place. Importantly, it would take over 20 years for CT levels to return to their current level;
- Tax revenues accruing to the NI Executive remain £100-250 million per annum lower than at the original CT level (ERGNI points out at this stage that in ROI no reduction occurred but the authors took a pessimistic approach);
- Total tax revenues build up much more rapidly, with a break even point after seven years. The majority of this revenue would accrue directly to the HM Treasury. At this point, the Treasury subvention to NI would begin to reduce; and
- The calculations presented DO NOT include consideration of profit shifting but states that the Varney estimate would only delay the break even point by a year.

### **3.8 Implementation Issues**

The ERGNI report identified a number of issues regarding implementation:

- Ensuring that new and additional tax legislation is compliant with EU legislation;
- Ensuring that any new or additional legislation interacts appropriately with existing UK tax legislation;
- That the scope of the NI CT rate is appropriately targeted to encourage the growth of genuine economic trading activity in NI;
- That the legislation aims to prevent artificial profit shifting within the UK;
- That businesses are not incentivised to incorporate solely as a result of the NI CT rate; and
- Additional burdens to companies as a result of the introduction of a NI CT rate are kept to a minimum.

### 3.9 Conclusions to the ERGNI report

The report concludes that the estimation of the likely impact of introducing a reduced CT rate is inherently unsure, *“the clear conclusion of this report is that a reduction in corporation tax to a level of 12.5% would bring substantial benefits to both NI and the UK.”*

The authors also conclude that after about seven years of operation cumulative gains would offset cumulative losses with a substantial net gain for NI and the UK.

## 4. Comparison of the Reports

Both reports differ significantly in their overall findings, with the Varney review categorically stating that a clear case for a CT reduction could not be made. The ERGNI report takes an opposite approach and recommends Corporation Tax essentially as an experiment for the regional areas of the UK, with a potential roll out across England, Wales and Scotland if it proves successful in NI.

In terms of implementation issues and any barriers to it, both reports seem to agree that technically the CT rate could be reduced, so long as certain conditions are met.

Issues such as profit sharing and brass plating are mentioned and whilst the degree of impetus placed on these issues varies within the pieces of research, they both agree that with changes to legislation and increased enforcement and vigilance in the area via the HRMC, most difficulties should be avoided.

It must be noted however that the Varney review does point out the potential increased administrative costs and burdens placed upon existing firms in NI as a result of the taxation system. However this point was criticised in Oral Evidence provided by the Institute of Chartered Accountants in Ireland who said:

*“The critique of transfer pricing rules is perhaps unfair. It attempts to justify an underlying assumption that low tax rates encourage profit shifting...it would be naïve to suggest that low tax rates do not encourage profit shifting but equally it is naïve to suggest that existing mechanisms in place under international agreements are burdensome or ineffective<sup>21</sup>.”*

The greatest variation between the two pieces of research is in the monetary costs and benefits of the introduction of a reduced CT rate.

The table below, developed by ERGNI, provides a comparison of the Varney estimates and the ERGNI report<sup>22</sup>. Please note, the ERGNI model assumes the introduction of the reduced rate in corporation tax in 2010.

<sup>21</sup> House of Commons, Northern Ireland Affairs Committee Oral Evidence Institute of Chartered Accountants in Ireland *The Varney Review of Tax Policy in Northern Ireland* 27<sup>th</sup> February 2008

<sup>22</sup> Northern Ireland Economic Reform Group February 2010 *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*

**Table 1:** Comparison of Varney and ERGNI report findings

<b>Varney</b>	<b>2010</b>	<b>2013</b>	<b>2018</b>	<b>2030</b>
Additional tax from new FDI	4	18	49	100
CT from domestic investment	1	6	15	30
Reduced tax from existing firms	-278	-279	-279	-279
Other taxes	14	62	162	334
<b>TOTAL</b>	<b>-259</b>	<b>-193</b>	<b>-53</b>	<b>185</b>
Displacement and profit Shifting	-16	-78	-84	-94
<b>TOTAL incl Displacement and profit Shifting</b>	<b>-275</b>	<b>-271</b>	<b>-137</b>	<b>91</b>
<b>Oxford Economics Tax Model</b>	<b>2010</b>	<b>2013</b>	<b>2018</b>	<b>2030</b>
Additional tax from new FDI	1	16	58	229
CT from domestic investment	0	3	14	59
Reduced tax from existing firms	-136	-240	-324	-433
Other taxes and benefit reductions	-35	49	285	1069
<b>TOTAL</b>	<b>-170</b>	<b>-171</b>	<b>32</b>	<b>924</b>
Displacement and profit Shifting	0	0	0	0
<b>TOTAL incl Displacement and profit Shifting</b>	<b>-170</b>	<b>-171</b>	<b>32</b>	<b>924</b>
<b>Difference OE less Varney</b>	<b>2010</b>	<b>2013</b>	<b>2018</b>	<b>2030</b>
Additional tax from new FDI	-3	-2	9	129
CT from domestic investment	-1	-3	-1	29
Reduced tax from existing firms	142	39	-45	-154
Other taxes	-49	-13	123	735
<b>TOTAL</b>	<b>89</b>	<b>22</b>	<b>85</b>	<b>739</b>
Displacement and profit Shifting	16	78	84	94
<b>TOTAL incl Displacement and profit Shifting</b>	<b>105</b>	<b>100</b>	<b>169</b>	<b>833</b>

The differences between the two reports is immediately noticeable, with the ERGNI model showing significant growth in income between 2018 and 2030 (£892 million) in comparison to Varney which increases by £238 million (not including displacement and profit shifting).

The biggest area of growth for ERGNI and Varney is in 'Other taxes' although the difference between the two sets of figures is quite high. Varney suggests a growth of £172 million, whilst ERGNI's report found that this area of income would grow by £784 million in the 12 year period between 2018 and 2030.

The differences between the two totals suggests that the methodologies employed by the reports are varied, despite the ERGNI making several changes to the original ERINI model to reflect criticisms made by the Varney Review. These differences have resulted in the large variation in income/costs of the introduction of a 12.5% CT rate and would suggest that academic review is needed to assess the viability of the two methodologies.

Also, it is important to note that the ERGNI report covers a 20 year period from the introduction of a reduced corporation tax with the results discussed in these terms. However, only the first eight years of data are provided in the report and its appendix.

Future, more in-depth assessments of both reports would benefit from access to this data.

Please note, in a recent debate on Corporation Tax, Minister for Finance and Personnel, Sammy Wilson MP, MLA made a number of pertinent comments regarding the implementation of a reduced CT rate. The main points the Minister made are<sup>23</sup>:

- The Minister criticised the assumptions made by the ERGNI report based on data from 2002 – 2009 on which the model is based, as during this period the world economy was relatively stable;
- *“Projecting from the past and assuming that job creation will be the same in the 2002 – 09 period gives an unrealistic assumption of the job potential that will result from a reduction in Corporation Tax.”*
- DFP wrote to ERGNI with a number of questions regarding the model’s assumptions;
- CT earned in Northern Ireland currently stands between £340 to £520 million. The report authors assumed (although based on a similar method to that of the Varney Review) that it would be £200 million –please note the figure quoted by the Minister is cited within the ERGNI report with the methodology for its calculation explained:  
  
*“The Varney Review estimated that CT revenue in NI was in the range 1-1.5% of UK CT revenues. Since the HMRC estimates that UK CT revenues will be £34 billion in 2009/2010, this would give NI revenues in the range £340 – 520 millions for this year. Varney assumed that a reduction in CT rates from 30% for large firms (and 19% for small firms) would halve the revenues.”<sup>24</sup>*
- Implementation of the CT rate will be difficult for a number of reasons including identifying what organisations it will be applicable to, increased costs in administration and examination of tax, and political and legal barriers such as the need to have legislation passed through Parliament, support from HM Treasury for the measure, and the need to get European Union and European Court of Justice approval;
- There would be an immediate cost to the public purse but it would take longer for any increase in employment to occur; and
- It will take eleven years for the proposal to pay for itself.

---

<sup>23</sup> Hansard Official Report Tuesday 11<sup>th</sup> May 2010 Volume 51, No 5  
<http://www.niassembly.gov.uk/record/reports2009/100511.pdf>

<sup>24</sup> Northern Ireland Economic Reform Group February 2010 *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*

The Minister concluded his comments by saying:

*“We have a balanced economic strategy at present. We have to build up the infrastructure to ensure that we have the right people skills in Northern Ireland. That is the policy we ought to stick with.”*