Northern Ireland
Assembly

COMMITTEE FOR
FINANCE AND PERSONNEL

OFFICIAL REPORT
(Hansard)

Devolution of Corporation Tax Powers:
Departmental Briefing

5 October 2011

NORTHERN IRELAND ASSEMBLY

COMMITTEE FOR FINANCE AND PERSONNEL

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Members present for all or part of the proceedings:
Mr Conor Murphy (Chairperson)
Mr Leslie Cree
Mr Paul Girvan
Mr David Hilditch
Mr William Humphrey
Mr Ross Hussey
Mr Paul Maskey
Mr Mitchel McLaughlin
Mr Adrian McQuillan

Witnesses:

Mr Bill Pauley	)	Department of Finance and Personnel
Mr Tony Simpson	)	

The Chairperson:
Members, we will now have an update on the outcome of the consultation on the devolution of corporation tax powers. From the Department of Finance and Personnel (DFP), we have Bill Pauley, head of the strategic policy division of central finance group, and Tony Simpson, also from the strategic policy division of central finance group.

Given that discussions between the Department and the Treasury have rumbled on over the summer, the Committee is keen to get an update to see where things are. Earlier, Leslie referred to a discussion at the economic conference, and with the party conferences taking place in Britain, and some of the references made by the Secretary of State and David Cameron, you can see that there continues to be further discussion on this and it does not always bring greater clarity. The Committee is very keen to get clarity as quickly as it can. We are keen to hear whether the DFP officials can enlighten us in any fashion on those matters to allow the Committee to form its opinion and to get all the evidence that it needs to express a view on the issue.

You are both very welcome. If you could open with a statement, we will have a discussion involving Committee members.

Mr Bill Pauley (Department of Finance and Personnel):
I have a few brief opening comments. The Minister sent the Committee an update on 26 September indicating that the Government had received over 700 responses to the consultation and that they would respond in the autumn. He also said that the Treasury had asked us not to refer to the consultation outcome until it had made its formal response to it. That is something that we have respected.

The Chairperson:
The letter from the Minister, in response to our request for information, is in members' packs.

Mr Pauley:
Since the Minister's letter, the Secretary of State announced on Sunday that he has set up a ministerial working group that is designed to clarify the costs, administrative charges and legislative vehicle that would be necessary to take this forward. He also indicated in one of his interviews that he believed that the responses to the consultation were overwhelmingly in favour of the measure. He said that on BBC Radio Ulster.

The Secretary of State also wrote to the Office of the First Minister and deputy First Minister (OFMDFM) on Friday to signal that the announcement would be made on Sunday, and in that letter, he indicated that the Government remained committed to working with us over the winter on this issue and that they would work towards a final decision next year. We have no further detail on what that means.

The Minister of Finance and Personnel commented on that. He said that no decision had been taken yet, but that the Government had made it clear that we would work over the winter. He noted that, in the correspondence, the Government reaffirmed their commitment to working to rebalance the economy here. A similar commitment was made in the Chancellor's statement in relation to air passenger duty. In his press release, the Chancellor gave a strong commitment to working with us to do that.

The other comment that he made related to the fact that a number of the issues that the ministerial working group will look at are areas in which we have been asking for work to be done for some time, in order to clarify the costs, look at the administrative issues, work with the European Union and establish precisely what has to be done.

That leads me to the other aspect of the Minister's letter to the Committee. We mentioned that David Gauke had written to the Minister at the end of June about the additional costs for the branch plant estimates. Our Minister's response asked for that list of costs, so that further work could be done to examine and to quantify them. The Minister's letter indicated that we had received a reply that acknowledged that those issues would have to be taken into account, were we to proceed with this. I am happy to talk about that correspondence as well.

The Minister's letter finished by indicating that the First Minister and the deputy First Minister would write to the Government in the near future with their position on that issue. I understand that they still intend to write in the near future but that a letter outlining the Executive's position has not yet been issued to the Government.

The Chairperson:

Thank you for that. As I said, there was an announcement at the party conference earlier this week about the ministerial working group being set up. In many ways, I suppose, that only puts some sort of framework on a discussion that should have or, I assume, has taken place since this idea was first mooted, about what it costs and what factors would be considered. So I am not sure whether that announcement was one of any substance or simply something to announce at a party conference. However, I assume that that work is ongoing. It is referred to in the correspondence from the Minister to the Committee.

In reference to his discussions with David Gauke, the Minister asked for calculations and for further work on administration costs and the impact on other taxes to be taken into account.

Mr Pauley:
Yes.

The Chairperson:
Part of our difficulty, as a Committee, is that we are not au fait with any of the figures being kicked around in relation to that. We now have a ministerial working group being set up to look at all of that. I presume that there has been an ongoing discussion between DFP and the Treasury about what figures they are or are not taking into account. There is some challenge about that, and we are bereft of any of that information. That is a source of frustration for us. It is certainly a grey area for us. Can you elucidate on any of that?

If the next phase of this is to kick it into a joint ministerial working group, I know, from previous experience, how hard it is to get Ministers around the table in one Administration, and if you are stretching it into two, this could be kicked into a long-term discussion, with conflicting figures coming out or a lack of clarity around them. You will know from our previous discussion with NICVA (Northern Ireland Council for Voluntary Action) that that is a concern, as it is for the many other groups with an interest in this. A lack of clarity around the figures leads to an ill-informed debate.

Regardless of any other group, the Committee should have as much information as is available. There is a reference to the dispute, if you like, between DFP and the Treasury about what has been or has not been calculated. My concern as Committee Chair, which probably reflects the views of members because we have raised such questions before, is whether this kicks us into another discussion to which we are not privy. Can we have some assessment of what figures the Treasury are arguing and what figures DFP are arguing back?

Mr Pauley:
I will try to help with that. There are three parts to the Treasury's cost estimates. The first relates to what is Northern Ireland's current share of the UK's corporation tax take. The Government's consultation document estimated that to be 1·5% of the UK tax take. They estimated that percentage by taking an average of all the tax paid by companies with a BT postcode over the

past five years. Over that period, that ranged from 1·6% of the UK tax take to 1·1%, with 1·1% being the most recent year, and, in our view, the most reflective of the current state of where our economy has been post-recession and what might happen going forward.

The Chairperson:

Is that the corporation tax take only?

Mr Pauley:

Yes. We are either 1·6% of the UK receipts or 1·1%. The difference between 1·1% and 1·6% is quite significant, as each percentage point equates to approximately £40 million.

We are waiting on the figures for the next year in that series of data. We understand that those will be available around the end of October, although we have not got a firm date. They will give us an indication of whether that will be closer to 1·1% or 1·6%. For us, that is a very important aspect of those figures, and it will come in the relatively near future.

The other aspect of those costs is that, based on the estimates of growth in the UK economy by the Treasury and approved by the Office for Budget Responsibility, they are projected to the year 2015-16. Along with the Chancellor's autumn statement on 29 November, those projections will be revised. My expectation is that that will be downwards, given that the Chancellor has already made it clear that he is revising UK growth projections downwards. The estimates of future tax takes should fall within that.

It can be quite complex. Seamus said, and he is absolutely right, that the actual level of corporation tax take varies significantly year-on-year. Every year, the Treasury forecasts what it will be and it is rarely right. What companies can carry forward is very complex with regard to losses and what they can set against tax. Therefore, it is difficult to predict what the tax would be in any one year.

In another sense, that is always, at this time, an estimate in the consultation document. We would see one of the next stages of that work to be when Her Majesty's Revenue and Customs (HMRC) extracts the precise data for corporation tax payments and sets up a system to extract that, so that we know exactly what is being paid in respect of Northern Ireland for future years. The data in the consultation document comes from special exercises because our current systems do not naturally do that. If we want any future block adjustment to be made on the basis of accurate data, we believe that a system needs to be put in place to extract that. Only HMRC can do that because only HMRC has that data. Although Department of Enterprise, Trade and Investment colleagues have been leading on this, OFMDFM economists and our team have lent people to that Department to look at the top 100 companies in the Companies House data and to try to get some picture of the consistency of the level of corporation tax that has been paid over that period. Therefore, quantifying the exact level of what, precisely, is paid and extracting it will be difficult.

The second aspect of costs is those that are estimated for what the Government call behavioural effects. The first element of that is profit-shifting and what would come to Northern Ireland. That involves quite technical assumptions about how companies would behave for different sizes of reductions in the level of corporation tax. Our argument has been that we would put preventative measures in place to stop that transfer of taxes. Although I was not at the conference yesterday, I understand that people made suggestions there and in other places about possible mechanisms that could be put in place to do that. Indeed, it exists in our own tax system with regard to how companies can move tax between different international jurisdictions at present. We have told the Government that we believe that measures would be put in place to prevent that profit-shifting and, therefore, those aspects of costs that are estimated in the document are inappropriate.

The third element is the question of whether the impact on other taxes, such as national insurance or income tax, can be taken into account in this debate. The Government consultation document casts some doubt on whether that should be done. However, it indicates that it could be done. We have argued strongly that that needs to be done because it is an element of the full fiscal consequences of that measure, which is what the Azores rules require the block grant to be adjusted by. Any projections of what additional employment would be created and the impact on those other taxes would need —

The Chairperson:

Do you have any estimate of what that could be? Are you pitching a figure to the Treasury, saying that that is your estimate of the impact on other taxes in order to offset what the Treasury thinks the cost of corporation tax will be?

Mr Pauley:

The Treasury document contains an estimate of around £30 million in its last year. The key point is that that figure is based on the Treasury estimate of the benefits of this measure, which the Minister of Finance and Personnel has argued consistently would be low. The Treasury indicated that there will be an expected annual increase of approximately 6% in investment here, two thirds of which will come from foreign direct investment and one third of which will come from local companies investing more.

The Treasury will not go on to estimate the increase in employment, but the report of the Minister of Enterprise, Trade and Investment's economic advisory group contains an estimate that shows that there will be a much greater increase in employment. Therefore, the impact on other taxes from the economic advisory group's projected level of benefits from the measure would be much greater than the estimate that the Treasury has included in its consultation document for the impact on those other taxes, simply because the estimate of the economic advisory group is so much better regarding the number of jobs — I think it averages at 4,500 per annum — that would result from it.

Obviously, the amount of income tax and national insurance from 4,500 jobs is greater than the Treasury's estimation. Therefore, I do not believe that some of those issues will ever be precisely quantified or that a computer programme can extract them from the HMRC data. Some will be negotiable, and, as the Finance Minister indicated in his letter, we will face a very difficult negotiation with the Treasury on how some of those impacts need to be taken.

The Chairperson:

I will finish this point and then I will let members in. In order to negotiate with the Treasury, surely you have to have some figures to pitch against its estimate. If you are saying that the figures will never be quantified, you will have to come up with a ballpark figure, at least, to say that, in your view, this is what the other taxes will amount to.

Mr Pauley:

We have been looking at the models used by the Treasury and the economic advisory group to reach their estimates. There are different assumptions in those models about how a regional economy such as ours would behave compared to the national UK economy. We have shared those with the Treasury's technical teams, and we have been debating with them some of those features to indicate what that might be. We have also pointed out profit-shifting to the Treasury, and the types of measures that we hope will be put in place, and we discussed with them that we feel that those would need to be taken into account. I imagine that those issues will form quite a bit of the work of the ministerial working group.

Mr Girvan:
As regards the £130 million that was indicated in the document, does that equate to 1·58%?

Mr Pauley:
No. That has been added. As I indicated, the Treasury consultation document estimated those receipts from companies with a BT postcode that pay tax. That is an additional estimate based on companies from the rest of the UK that submit tax returns but have a branch plant or operation in Northern Ireland. The Treasury then looked at those companies and offset that amount. Based on the proportionate allocation on issues such as levels of sales or levels of employment, it has reached an estimate of how much the Northern Ireland operation of those companies contributes overall. Therefore, it has increased the estimate accordingly.

We have a number of queries about that. The Treasury has only done it for one year, rather than the average of five years that we discussed earlier for the full bid. We believe that it has taken the top of the economic cycle in 2006-07, after which we all suffered and things went down. There are also features in which some of the branches that pay taxes here, such as retail and banking businesses, which you discussed with Seamus McAleavey, can include some sectors that pay a substantial proportion of the total cake of corporation tax.

Mr Girvan:
I understand where you are coming from, but our difficulty is that we are very much reliant on the figures that are being provided to us by the Treasury and HMRC; we have very little local data from which to extrapolate information. The Treasury will be holding all the aces when it comes to the negotiations, and we are going to have difficulty with our arguments.

What body of work can we undertake? We know the indigenous companies in Northern Ireland, and we have a fair idea of the returns that they are publishing. Can we do a sort of tabletop exercise, pick a number of key industries, target them and come up with our own figures? Ultimately, we will be given one chance at this. If we do not come out as winners, we could end up losing a sizeable sum of money from our block grant and not recoup it through corporation tax gains, simply because we negotiated a bad deal at this point, when we do not have all the facts. Unless all the figures are on the table, we are going to be playing against a rigged deck.

Mr Pauley:

It is a fact that tax-receipt data belongs to HMRC. It has the data and the systems. I referred to the exercise that we are doing, in which people are going through records in Companies House to look at a considerable number of the companies that we have. However, that will not provide a precise figure for any one year. It will be a benchmark; a reality check. It will give us an understanding of the level involved and will be something that we can use to compare to the information provided by the Treasury. We are doing that work as we speak. It is quite detailed work and involves going through every record. The three Departments most involved have lent people to the task.

Mr Girvan:

Perhaps it is early in the day to ask this question, but do the figures correlate with what you have received from Whitehall?

Mr Pauley:

The very first indications show that the corporation tax payments of some of our larger companies have been relatively stable. Beyond that, we have no further findings. We are talking about all the estimates. Before we sign an agreement to adjust the block grant by a particular amount, we want HMRC to undertake an exercise to put a new system in place to extract our data. That will require investment by HMRC, but if corporation tax is to be devolved, it needs to be done. Obviously, it can link to the administration costs. However, we cannot move forward until we have the exact figure for what has been paid in the past few years to help us to adjust the block grant and to make the projections required for a spending review period. That is the Treasury's methodology: it has a projection of the tax receipts for the spending review period.

Mr Cree:

You have touched on two of my questions, but maybe not enough. I know that you were not at the conference, Bill, but I think that Tony was there, so you will have heard some of this. As regards the amount of corporation tax paid, all companies have to file accounts somewhere. Are you looking only at Companies House in Belfast, or will you be able to look at some of the other parts of the UK in which accounts might be found?

Mr Pauley:

So far, we have gone only to Belfast to get a feel for the Treasury's estimated figure of 1·5% of the UK's tax take. Strictly speaking, we can go to Companies House anywhere. We can ask for a file and be given it.

Extracting the branch plant estimate is a huge piece of work, which is why the Treasury has done it only for one year so far. We want the Treasury to have a system that will pick up that information automatically. It will need to do so when power is devolved. The Treasury said that it had done it for one year only because it was a huge piece of work, and I acknowledge that, but if we go forward with the measure, we need to know, and the UK's tax system needs to know, what has been attributed to Northern Ireland from branch plants and companies located here.

Mr Cree:

It is important to know whether the year was last year, 2007 or some other year.

Mr Pauley:

It was 2006-07, which was quite close to the top of our cycle.

Mr Cree:

The figure for 2011 would be quite different.

Mr Pauley:

We have seen the way that the economic indicators have gone since then.

Mr Cree:

The administration cost could be crucial. It is important that, in getting the best deal, the Treasury does not use smoke and mirrors and as many clawback mechanisms as possible. One of those might be the cost of administration. Have you any idea of how significant that might be? What are your views on the possibility of borrowing to allow for the devolution of corporation tax? We do not have the power to cater for peaks and troughs. You referred to air passenger duty (APD). Is there any danger of a clawback in that area? If the power to set APD were devolved to

Northern Ireland, would we end up paying part of the amount that is to be reduced on 1 November?

Mr Pauley:

We do not know the administration costs, because we do not have an exact estimate. The Treasury included a number in an early draft of the consultation document, which we disputed and which, eventually, was removed because it was not appropriate. The document, when published, stated that we would deal only with the additional net costs.

The first estimate of what it would cost to run our system was on a gross cost basis. We have established the principle that the administration cost will be only the difference between what it costs the Treasury now and what it might cost it in the future. All the companies that pay corporation tax here already need HMRC officials to check their returns and to do what HMRC does with corporation tax returns. We do not want to have to pay for all of what is happening now in some of those elements.

The issue is about what exactly what will be devolved. We had a bit of a discussion with Seamus about whether only the rate will be devolved or whether responsibility for the rate and the base will be devolved. We discussed whether we wanted to allow different levels of allowances here; for example, on capital investment. We discussed whether, rather than having HMRC collect the tax on a contract-type basis, we might establish our own tax collection agency. As far as I am aware, the Executive have never taken a decision on that, but our preference is not to replicate the work of HMRC. It would be hugely complex, and we have no expertise in the Northern Ireland Civil Service at this point to begin to do that. However, we have never ruled it out, because it might be necessary in order to meet the Azores requirement that we are fully responsible. We did not rule out taking on all those powers, because we want the measure, and if we have to take on everything to get the measure, we would look at doing so on that basis.

Administration costs will grow exponentially, depending on the different types of arrangements that we have here. Some people have commented that as many as two thirds of the people in the big accountancy houses in Northern Ireland and the UK generally are involved in tax. So, the administration costs for looking at what companies put in would be huge. That being said, given the relative size of HMRC, the figure could be lower than £25 million, but that is speculative.

The Treasury published estimated administration costs for a measure being taken forward for the UK as a whole, whereby controlled foreign companies located in the UK would pay a 10% corporation tax rate on profits earned from patents. If you read the document, you can see that making such corporation tax changes is a very complex procedure and is quite similar, in some of its features, to what would have to be done for each individual company's return to us. The Treasury estimates that it would cost between £2 million and £5 million. In debate with Treasury officials, we have asked them why our figure would be higher than or different from that one. The answer, I suppose, is that there was once a figure of £25 million, but we disputed that, and it was removed. There is another scenario in which the cost could be between £2 million and £5 million, but that is far from accepted.

On the issue of borrowing, the Executive are able to borrow up to £200 million per annum under the reinvestment and reform initiative. That amount was increased by £175 million for this financial year to deal with the issue of the Presbyterian Mutual Society. So, it is possible to negotiate with the Treasury when certain circumstances make it more appropriate to have a higher level of borrowing in any one year.

We have discussed with the Treasury the fact that corporation tax receipts are known to be extremely volatile. As I understand it, a company has to file its tax return by 31 October of the following year to which the tax relates. So, we will not know what the receipts are for last year until October next year. To manage budgets in line with public expenditure requirements, such as not busting Votes, and the rules of control, there needs to be a mechanism to deal with the uncertainty over the level of receipts. In order to meet the Azores ruling, the measure would also need to ensure that if we fell short in one year, we could make that up in some way over future years. Although there is no agreed arrangement with the Treasury, I believe that we could put a measure in place to do that. I imagine that it would be related to borrowing, given that our current borrowing is under the reinvestment and reform initiative, with some adaptation. So, nothing is in place, but there is no impediment to putting something in place. I believe that there is a requirement for something along those lines in order for it to operate.

In the Treasury press release, note three in the notes to editors indicates that APD will be paid for — I forget the precise wording — in line with the Azores requirements. It means that for the devolution of this power, the European requirement will be that the full fiscal consequences will fall to Northern Ireland. We will discuss that with the Treasury. The Minister announced in his press release, on the day that the air passenger duty announcement was made, that we would discuss the details of the devolution of air passenger duty with the Treasury as soon as practicably possible.

The Chairperson:

As regards having a ministerial working group to take these items forward, there is still a lot of work to be done to get answers to some questions, including those on administration costs. What is your time frame for the working group? Have firm arrangements been put in place for it? Will it take over the discussions that you and the Minister of Finance and Personnel have been having with the Treasury? Will it be a formal vehicle for having those discussions, or will engagement between you and the Treasury continue?

Mr Pauley:

It will be a formal vehicle for taking forward what we have been doing.

As I intimated, many of the things that the Government have indicated that the working group will deal with are included in the correspondence that our Minister has been having with the Treasury asking that this additional work be done. We phrased it in such a way that we wanted to move the work to the next stage, which is to quantify precisely what are only estimates in the consultation document and to look at exact mechanisms as to how that would be done. The working group will do that.

The Government have not said that they have moved the work to the next stage. They have said that it is still in the balance, and have used language such as that. However, this is work that needs to be done before we can know the exact cost and how the block grant should be adjusted. The legislation would be put in place to achieve that. The only timing given by the Government is that this will happen over the winter, for a decision next year.

The Chairperson:

Is there any sense in DFP that there is continuing uncertainty and dispute over the figures, continuing reference to the decision being in the balance, and now the setting up of a working group, which seems to be stretching out engagement even longer? Companies that are going to invest here on the back of a potential reduction in the rate of corporation tax will be making their investment plans now. This seems to be a back-pedalling exercise; whether that is the case or not, that is the perception people have from the Secretary of State and the Prime Minister. Is there any sense, in discussions, that although an effort is being made to get the detail correct, it is also having an impact on confidence in business and investment?

Mr Pauley:

We have not spoken to the Treasury about that, nor have our Ministers, to the best of my knowledge. I know that our Minister has not spoken to his Treasury colleagues to get ministerial views or to find out whether there is anything behind the way that they made their announcement or whether there is any back-pedalling.

In the statement made by the Minister of Finance and Personnel, we pointed to the fact that we have had some reasonable commitments from the Government recently to working with us to rebalance our economy. The air passenger duty issue shows that the Government are prepared to announce that they will devolve fiscal powers to us in relation to that tax. I think that that shows that greater fiscal powers for our Administration have not been ruled out. We will move this forward in a way that stresses the possibilities that it offers for our economy, and work through the detail of the cost that comes with it.

The Chairperson:

Was the idea of a joint ministerial working group always on the cards or did that announcement come out of the blue?

Mr Pauley:

We heard of this joint ministerial working group by way of an announcement. The Exchequer Secretary sent a letter to the First Minister and deputy First Minister late on Friday evening. However, the Government members proposed for the working group are exactly those Ministers who met on at least three occasions during agreement on the consultation document and the discussions that took place during the consultation period with the Exchequer Secretary and the Secretary of State. Obviously, the Government announcement does not identify the Ministers involved for the Executive; the Executive will decide that. The letter was copied to the Minister of Enterprise, Trade and Investment and to the Minister of Finance and Personnel who have been involved in this work up until now.

The Chairperson:

If you were cynical, you could suggest that it is something to fill up a conference space. Thank you for the briefing. That concludes our session on corporation tax.