The Independent
Fiscal Commission NI

More fiscal devolution for Northern Ireland?

Final Report
May 2022

The Independent Fiscal Commission NI

Contents

	Page
Preface	7
Executive Summary	13
1. An introduction to fiscal devolution in Northern Ireland	
1.0 Overview	27
1.1 Key points	27
1.2 Our starting point	28
1.3 What does fiscal devolution mean?	28
1.4 Why might fiscal devolution be considered important?	29
1.5 Risk vs reward – an early example	31
1.6 The contemporary legal and lived context of Northern Ireland	32
1.7 What are the NI Executive's current fiscal powers?	38
1.8 How can the NI Executive obtain further fiscal powers?	39
1.9 Conclusions	41
2. The Northern Ireland context: economy, tax and spending	
2.0 Overview	43
2.1 Key points	43
2.2 The Northern Ireland economy	45
2.3 Key differences in the Northern Ireland economy compared to the UK	48
2.4 Public spending in Northern Ireland	54
2.5 Revenue raised in Northern Ireland	57
2.6 How does revenue raised per head in Northern Ireland compare to other regions of the UK?	61
2.7 How stable is Northern Ireland's revenue base and how correlated to the UK tax base?	62
2.8 What can be said about Northern Ireland's net fiscal position?	67
2.9 What are the sources of funding for the NI Executive?	69
2.10 How is the NI Executive budget agreed?	78
2.11 How does the NI Executive spend its resources?	79
2.12 Policy divergence in Northern Ireland ('super- and sub-parity' issues)	80
2.13 Conclusions	83
3. Wider devolution considerations: UK and Republic of Ireland	
3.0 Overview	85
3.1 Key points	85
3.2 Fiscal devolution in the UK	86
3.3 Budgetary Management Tools for fiscal powers – Scotland and Wales	93
3.4 Republic of Ireland: economy and taxation	95
3.5 Conclusions	108

4. Tax assessment: model, criteria and appraisal

4.0	Overview	111
4.1	Key points	111
4.2	What type of fiscal devolution might be appropriate?	113
4.3	What criteria could be used to assess the feasibility and desirability of fiscal devolution?	115
4.4	Summary of conclusions on suitability of taxes for devolution	117

5. How fiscal devolution might be implemented for our prioritised taxes

5.0	Overview	123
5.1	Key points	123
5.2	The scope of income tax devolution	126
5.3	Should income tax be fully devolved?	126
5.4	Should tax on savings and dividends be devolved?	128
5.5	The 'Scottish' or 'Welsh' model?	130
5.6	What proportion of revenues should be devolved?	131
5.7	What powers over rates and bands should be devolved?	134
5.8	Devolution of the apprenticeship levy	137
5.9	The model and administration of smaller taxes	138
5.10	Administrative arrangements and costs in Scotland and Wales	138
5.11	Policy flexibility and administrative innovations	140
5.12	Reaching a judgement on administrative arrangements	141
5.13	Excise taxes – duties on fuel, alcohol and tobacco products	142
5.14	Excise duties - evidence on administration and compliance costs	143
5.15	Evidence on cross-border shopping and economic distortions	146
5.16	Reaching an overall judgement on excise duties	148

6. The NI Executive fiscal framework

6.0	Overview	151
6.1	Key points	151
6.2	Elements of a fiscal framework	156
6.3	Block grant adjustments – why do we need them?	156
6.4	Principles for implementing fiscal devolution	157
6.5	How can these principles be operationalised?	160
6.6	What are the different options for indexing the block grant adjustments?	162
6.7	Examining the implications of the IPC and CM in a historical perspective	166
6.8	BGA methods that control for the different distribution of tax revenues in Northern Ireland	169
6.9	Using a different comparator	172
6.10	Population projections and implications for the choice of BGA mechanism in Northern Ireland	172
6.11	Consideration of other taxes	173
6.12	Insurance and resets	178

6.13 Budget management tools 181
6.14 Borrowing for forecast errors and reconciliations 181
6.15 Learning from the experience of Scotland and Wales 182
6.16 Borrowing for discretionary resource expenditure 184
6.17 A Northern Ireland Reserve 185
6.18 Forecasting arrangements 187
6.19 Compensatory transfers 189
6.20 Dispute resolution 192
6.21 Changing and reviewing the framework 194
6.22 New taxes 195
6.23 Wider implications of the Commission's work for devolution arrangements across the UK 197

7. Recommendations for fiscal devolution for Northern Ireland

7.0 Overview 199
7.1 Recommendation 1 – Data Reliability 199
7.2 Recommendation 2 – Corporation tax devolution 200
7.3 Recommendations 3 to 5 – Income tax devolution 200
7.4 Recommendations 6 and 7 – Apprenticeship levy devolution 202
7.5 Recommendations 8 and 9 – SDLT, APD and landfill tax devolution 203
7.6 Recommendation 10 – Devolution of excise duties 203
7.7 Recommendation 11 – Principles for implementing fiscal devolution 204
7.8 Recommendations 12 to 21 – Operationalising our principles 205
7.9 Recommendation 22 – New taxes 209
7.10 Recommendation 23 – Wider implications for devolution across the UK 209
7.11 Concluding remarks and potential timescales for fiscal devolution 210

Annex A – Glossary 213
Annex B – Tax data reliability 217
Annex C – Breakdown of Northern Ireland financial packages 237
Annex D – Policy divergence in Northern Ireland - 'super-parity' & 'sub-parity' issues 241
Annex E – Tax rates in the United Kingdom versus Republic of Ireland 249
Annex F – Appraisal of suitability of UK-based taxes for devolution in Northern Ireland 255
Annex G – Commissioners' biographies 329
Annex H – Stakeholder engagement 331

References 336

Preface

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

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

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

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

Terms of Reference

The terms of reference are to:

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

Our Approach

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

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

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

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

Terms of Reference Interpretation

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

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

[i] Social Security, in legislative terms, is a devolved competency within the control of the NI Assembly. However, the Northern Ireland Act 1998 requires the NI Executive and UK Government to consult to try to achieve "single systems of social security, child support and pensions for the United Kingdom."

Reporting

We have reported in two stages. Our interim report, published on 13 December 2021, provided the Northern Ireland context to fiscal devolution, laying out the central issues as we see them and as informed by our invaluable stakeholder engagement. We described the range of options available to Northern Ireland and the different forms which enhanced fiscal devolution could take. We gave the Commission's view on some of the fundamental factors for *successful* fiscal devolution and other factors that should be considered ahead of securing any new fiscal powers. We assessed individual taxes in the Northern Ireland context. We drew from the experience of Scotland and Wales, what has worked well, and where challenges have been encountered in those administrations, as they embarked on their own fiscal devolution journeys. We ruled out a number of taxes for further consideration and brought forward others for more in-depth analysis. The interim report was designed to publicly air and test our emerging findings.

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

Stakeholder Engagement

Over the last year, the Commission has been actively engaging with stakeholders, carrying out research and digging deeper into specific issues. We have met and/or engaged with nearly 120 individuals from over 60 organisations, spending many hours in detailed discussions. We have listened to what stakeholders have had to say. We have had honest and frank conversations about what the options are and what constraints there may be. We have had consistent requests for our report to be educational, to help inform the debate and to show a clear path forward.

Our interim report prioritised the educational and contextual request particularly, indeed it was our stakeholder requests for this focus that led our Commission to take the decision to publish in two stages. It was also this engagement which led us to test the views of stakeholders with the following questions which were included in our interim report:

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

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

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

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

We asked stakeholders to respond to these questions by 1 February 2022. We received 21 submissions from 18 individuals and organisations, ranging from members of the public to political parties, academics, businesses and representative groups to tax specialists. We have read and considered each of the responses in turn and used them to help shape our final report where appropriate. Stakeholders' feedback was also published on our website alongside the submissions we received throughout the course of our work and will be provided to the Finance Minister for consideration.

Encouragingly, feedback was overwhelmingly positive on the content of our interim report, and of the Commission's work in general. The four questions posed in the interim report were answered directly in 11 of the submissions we received. All of these respondents broadly agreed with our findings relating to Questions 1 and 2, where we raised our understanding of the importance of fiscal devolution and the Northern Ireland context. Several respondents raised the need for political and institutional resilience, as well as economic and administrative capability and capacity, to be considered when examining further fiscal devolution, reaffirming feedback from our previous stakeholder engagements.

There was also significant, though less uniform, agreement in response to Questions 3 and 4, with 9 responding positively to our assessment of the suitability and prioritisation of taxes. However, of particular note is that some respondents did disagree with our proposal that income tax be considered for devolution with two submissions suggesting that this was not appropriate. Several others, despite broadly agreeing with the suitability of taxes, urged for corporation tax to be considered further.

Timing

When considering any potential timescale for tax devolution, it must be remembered that Northern Ireland is at the beginning of a fiscal devolution journey. Scotland and Wales began theirs a number of years ago and we can look to their experience to determine how long it may take before taxes might be administered and collected locally in Northern Ireland, should it want to move in that direction.

At the outset, technical commissions were established in both Scotland and Wales, much like our own, to consider the devolution of further tax powers to the devolved administrations. These technical bodies were followed, over time, by political commissions that further examined the case for fiscal devolution and put forward recommendations that eventually were enacted in law. This legislation was followed by the establishment of dedicated tax authorities in both countries to administer and collect the devolved taxes where appropriate. The time taken between the conclusion of the technical commissions' work in Scotland and Wales, political consensus being reached and devolved taxes beginning to be administered and collected locally was significant, around six to eight years.

We might expect more expedited timescales to be possible for any devolution of taxes in Northern Ireland, given that lessons learned elsewhere can be taken into consideration. However, what is clear is that, even if fiscal devolution is to happen, the work of the Fiscal Commission NI can only be the first part of any journey.

Report Structure

As detailed previously, our final report builds upon our interim report. Chapters 1 to 3, while revised in places, remain broadly as per our interim report. Chapter 4 has been shortened, removing the individual tax appraisals and placing them in Annex F. New Chapters 5 and 6 have been added providing more in-depth analysis of those taxes we chose to short list for further consideration and the fiscal framework issues which require consideration as part of any devolution process. The final report is structured as follows:

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

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

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

- Chapter 4 outlines the Commission's view on the **options and criteria** for assessing tax devolution in Northern Ireland and presents the **Commission's shortlist of taxes considered most suitable for devolution in Northern Ireland.**

- Chapter 5 considers the potential **scope of income tax devolution, the best approach to the administration** of taxes and our further consideration of **excise duties**.

- Chapter 6 analyses options around how **block grant adjustments** might operate for any devolved taxes, the **budgetary tools** needed to operate these taxes locally and the **wider fiscal framework** issues which are necessary to support fiscal devolution.

- Chapter 7 summarises **our final recommendations and reflects on potential timelines**.

Through this final report and our surrounding work we consider that we have delivered upon our Terms of Reference as requested by the Finance Minister, Conor Murphy, MLA. It is for a new NI Executive and for the people of Northern Ireland to decide on next steps, in conjunction with the UK Government.

Paul Johnson
Chair of Fiscal Commission NI

Professor Cathy Gormley-Heenan
Commissioner

Professor Iain McLean
Commissioner

Dr Lisa Wilson
Commissioner

Further information on our work and evidence and responses submitted to the Fiscal Commission can be found at: www.FiscalCommissionNI.org

Executive Summary

The NI Executive controls most of the spending on public services that happens within Northern Ireland – almost £9 in every £10 of 'identifiable' public spending. However, other than rates on businesses and households it has no real substantive powers to vary taxes, and raises less than £1 in every £20 of Northern Ireland tax revenue. In that it contrasts to the Scottish and Welsh Governments which do have some, limited, tax powers.

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

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

Context

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

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

Earnings in Northern Ireland (median) are some 10% lower than the UK average. Combined with lower labour market participation means that tax revenues per person are 25% lower[ii]. Meanwhile, **(identifiable) public spending is about 20% higher, on a per person basis, than spending in the UK as a whole.** The result is a very large notional fiscal deficit. As we shall see, that is not in any sense an argument against some additional devolution of tax powers.

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

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

As well as spending substantially more per head, **the NI Executive has also decided to forego substantial amounts of revenue or target its resources differently than would be the case had it matched policy in other parts of the UK**. For example, the fact that water rates are not charged cost the NI Executive £345 million in 2020/21 alone, ongoing rates support to the manufacturing sector cost £59 million and mitigating welfare reforms £43 million. In total we estimate that the range of policy divergences where the NI Executive charges its citizens and businesses less or provides more cash support than in other parts of the UK (so called 'super-parity') cost around £600 to £700 million in 2020/21, or some 4% of the Northern Ireland Budget.

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

Why devolution?

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

Tax can also complement policies in other areas where responsibility is devolved. For example, the NI Executive is responsible for public health, but has no control over taxes on alcohol, tobacco or soft drinks. It is responsible for education and skills policy, but not for the apprenticeship levy.

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

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

What devolution?

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

We also do not consider pure tax assignment as a desirable way forward. That brings risks without the policy levers gained from additional powers. Tax assignment occurs when the devolved government's budget depends on the revenues raised from within its territory, but the devolved government has no ability to vary tax policy (which is set by the central government). In principle this could create the right incentives to improve economic policy so as to increase incomes and hence revenues. In practice, economic performance, and hence tax receipts, will vary for many reasons outside of the control of the devolved administration.

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

What risks and rewards might devolution bring?

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

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

Looked at in historical context the fiscal gap between Northern Ireland and the UK as a whole has been widening, by 10% (in real terms) or by £432 per head, over the last 20 years. (The fiscal gap is the difference in the size of the notional Northern Ireland deficit compared to the UK deficit). Had devolution been progressed 20 years ago, the underperformance of the Northern Ireland economy relative to that in the UK as a whole could have led to lower tax revenues for the NI Executive than it has received as part of the block grant.

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

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

Capacity to take on additional devolution

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

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

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

Secondly, the level of understanding of taxes in the Northern Ireland population. Much concern was expressed that this is currently low. Devolution is more likely to be successful if there is a good level of understanding and engagement from the populace. This will also help to reap the accountability benefits which devolution can bring. **We see our reports as playing an important role in increasing public understanding of tax in Northern Ireland** but local politicians should also consider how they can engage the public in tax debates and increase their understanding over time.

Thirdly, an important consideration is the **administrative capability and capacity of the NI Executive and the Northern Ireland Civil Service to absorb and manage additional powers**. Understandably, and by design, Northern Ireland is not currently positioned to do so – it hasn't needed to be. However, as with Scotland and Wales this capacity can be developed over time. It is not a reason in itself to not consider devolution. We do note though the report of the Northern Ireland Audit Office (NIAO) which has raised some serious concerns about leadership and delivery capacity within the Northern Ireland Civil Service.[1] The NI Executive would have to ensure that appropriate structures and people were put in place before any devolution of tax powers. We spoke to the Scottish and Welsh Governments on these issues and lessons can be learned from their experience to help chart a path through.

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

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

with our Commission as they did with similar Commissions looking at fiscal devolution for Scotland and Wales.

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

Our Recommendations - A devolution framework for Northern Ireland

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

It is our view that if Northern Ireland were to take on additional tax powers it should, like Scotland and Wales, take them on gradually so as to ensure administrative systems and the block grant adjustments essential to fiscal stability and sustainability are properly in place and functioning. So, we have prioritised a relatively small number of taxes to look at in detail. That said, in our view, **there is no reason in principle why a substantial fraction of current taxes could not be devolved over the long term**. Of course, the decision on the scale and balance of tax devolution would ultimately be a choice for politicians both local and national.

Much fuller explanations of why we arrived at the conclusions set out here and in our interim report are available in the **main body of our report and at Annex F**. Here we provide just the briefest of summaries.

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

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

We note that previous commissions for Scotland and Wales ruled out the devolution of VAT and NICs, because of EU rules in the former case and the relationship between NICs and benefit entitlements in the latter. These constraints may be less binding today and in the Northern Ireland context. Having exited the EU, we believe VAT devolution would be legally permissible. And Northern Ireland, despite broad parity with rUK, also formally operates its own benefit system, with contributory benefits also

notionally funded by a separate Northern Ireland National Insurance Fund. Nevertheless, devolving each would be more complex than devolving income tax, especially in the case of VAT. We note the simple lack of information on how revenues break down geographically has delayed assignment of VAT revenues to Scotland for over two years to date.

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

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

'Scope' of income tax powers – The Scottish Parliament and Welsh Senedd have powers over non-savings, non-dividend income only. Nevertheless, **we recommend that the taxation of savings and dividends income should be devolved to Northern Ireland.** The main impediment to devolution for Scotland and Wales previously was that financial institutions were responsible for deducting tax on interest at source. This is no longer the case. There are also administrative, efficiency and equity benefits that devolution of all elements of the income tax base could bring.

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

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

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

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

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

Corporation tax - **Devolution of corporation tax (£810m) is already legislated for in the UK Parliament, but not 'commenced'.** For a number of years there was a cross-party consensus in favour of devolution reflecting concerns about the difficulty of competing with RoI which has long had a 12.5% rate. Devolution did not actually occur. Firstly, because the NI Executive collapsed. But also the NI Executive had still to get the UK Government's agreement that its finances were 'sustainable' – a condition to commence the power. Additionally, it had not proved possible, at that point, to reach agreement with Westminster over how the block grant should be adjusted.

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

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

We consider that there is a case for lower rates of corporation tax in poorer regions of the UK in general and, given the proximity of RoI, Northern Ireland in particular.

Devolution would, though, be complex. There are technical complexities around companies dealing with more than one rate within the UK, and HMRC ensuring that the existence of different rates is not used as an opportunity for tax avoidance. There are also political complexities. The main rationale for Northern Ireland to seek devolution of corporation tax would be to give the NI Executive the opportunity to implement a significant cut in its rates. That would result in an immediate loss of tax revenue in the expectation, though not the certainty, that future economic growth would be enhanced. So, a cut would need to be accompanied by one or more of tax rises elsewhere, spending cuts, borrowing, or additional support from the UK Government. There would also need to be agreement with Westminster over whether and how the block grant should be adjusted not just in response to direct revenue losses resulting from devolving the tax but also from behavioural change: if profits move from GB to Northern Ireland the UK Government may want compensating. A significant cut in Northern Ireland corporation tax could also lead to wider tax receipt benefits for the UK

Exchequer. Even after initial agreement in principle on how these issues should be dealt with, robust processes would be needed to estimate effects, agree adjustments and arbitrate in the case of disagreement.

As a Commission, we remain of the view that there is value in the NI Executive seeking to complete the devolution of corporation tax. However, given the work already done, the scale and complexity of the issues, the need for action from the NI Executive and constructive engagement from HM Treasury, there is no value in the NI Executive simply asking for it again. **Should the NI Executive wish to pursue the devolution of corporation tax we would encourage it to demonstrate how it will maintain the sustainability of its finances following any reduction in corporation tax. We would urge the NI Executive and UK Government to work together on the pre-requisites for devolution,** which, in our view, include:

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

Excise duties **- Excise duties on petrol (£864m), alcohol (£290m) and tobacco (£484m) raise around £1.6 billion in Northern Ireland each year**. The Calman and Holtham Commissions, which examined tax devolution in Scotland and Wales respectively, ruled out consideration of their devolution. That reflected worries about the potential for cross border shopping given land borders with England. There were also administrative complexities arising from the fact that the duties are taxes on production, not on final consumption. Additionally, EU rules necessitated a single rate for each type of duty in Member States (except in a few specific instances where derogations have been granted).

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

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

In our view there could be value in the NI Executive seeking devolution of excise duties, but there are barriers to overcome first. Should the NI Executive wish to pursue devolution, we recommend

it should carry out a full study working alongside HMRC / HMT to agree on how excise duties could be administered and the costs involved. It may be prudent to await the resolution of the issues around the implementation of the NI Protocol, and a longer-term settlement for the customs and excise regime in Northern Ireland before pursuing any devolution of these duties.

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

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

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

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

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

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

Other indirect taxes - **Air passenger duty (APD) (£80m) is a good candidate for devolution and we recommend full devolution of its revenues and tax powers.** There is likely a trade-off in the consideration of APD between environmental and economic factors and these issues should be considered by the Executive.

We have also considered **betting and gaming duties (£75m), insurance premium tax (£144m), the soft drinks levy (£12m), and vehicle excise duty (VED) (£219m). Administrative costs and problems of implementation, set against relatively low revenue yield mean we don't believe the first three are priorities or strong candidates for devolution**. In the case of VED the fact that registered keepers of vehicles could be in GB as opposed to Northern Ireland, and difficulties with fleets would add to complexity and costs. **We therefore don't consider VED a priority for devolution**.

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

Tax administration for smaller taxes

We have recommended that (partially devolved) income tax (and the apprenticeship levy, given its administrative links to income tax) continue to be administered by the UK Government following any devolution – given the disproportionate complexity and administration costs of operating such a big tax locally. However, **if the devolution of SDLT, APD and landfill tax is pursued and implemented, we**

recommend that the NI Executive should establish a local revenue authority to administer these fully devolved taxes. While continued HMRC administration of these taxes might come at a somewhat lower cost, local administration would provide greater flexibility, increase accountability, and build up institutional capability and capacity.

Fiscal Frameworks

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

i. **That neither the budget of the NI Executive nor of the rest of the UK should be immediately better or worse off simply as a result of the devolution of a tax.**
ii. **That, as far as possible, following tax devolution the NI Executive should neither gain nor lose from fiscal risks or trends that can reasonably be predicted in advance, and which it has limited capacity to meaningfully influence.**
iii. **That the NI budget should capture, as far as possible, the full revenue impacts of its tax policy decisions, whether they be to raise or reduce revenue.**
iv. **That, as far as possible, the NI budget should not be exposed to the effects of tax policy changes made by the UK Government, for taxes that have been devolved to the NI Executive. And nor should rUK be exposed to the consequences from changes to devolved taxes in Northern Ireland.**
v. **That, as far as possible, the UK Government should bear the risks of revenue shocks that impact the whole of the UK equally**.

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

Block Grant Adjustments

Following devolution of a tax, a reduction to the block grant will need to be made to reflect the transfer of revenues from the UK Government to the NI Executive. In order to achieve the principles outlined above, this 'block grant adjustment' for each devolved tax should, in the first year of devolution, be set equal to Northern Ireland revenues immediately prior to devolution.

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

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

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

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

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

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

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

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

We also think that **the approach to indexing the block grant adjustments for income tax and stamp duty should take into account the fact that the Northern Ireland taxpayer base for these taxes is quite different from that in England**, with relatively fewer higher banded income taxpayers and higher

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

banded properties. This different starting point – which the NI Executive cannot directly influence – can affect subsequent revenue growth over time, a fact which the approach to indexing the block grant adjustment should take into account.

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

Fiscal Insurance

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

Forecasting arrangements

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

Budget management tools

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

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

flexibility to respond to the additional revenue risks the NI Executive's budget would face as a result of increased fiscal devolution.

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

Compensatory Transfers, Dispute Resolution and Reviews

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

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

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

New taxes

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

Wider implications of our work for devolution arrangements across the UK

Although not falling within our terms of reference, we believe that there is learning from our work which is relevant to fiscal devolution arrangements elsewhere in UK. While the asymmetric devolution

within the UK allows powers and responsibilities to be tailored to fit the individual context of each of the devolved administrations, in our view, it is appropriate that the different devolution arrangements should share common principles where possible.

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

Timescales for devolution

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

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

A full list of the Commission's recommendations can be found in Chapter 7 of this report.

Chapter 1

An introduction to fiscal devolution in Northern Ireland

1.0 Overview

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

1.1 Key points

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

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

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

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

1.1.5 There is therefore an element of both **risk and reward** with fiscal devolution. Any move to enhance fiscal devolution for Northern Ireland would be a move away from the insurance of the current system, with its reliance on the stability of block grant funding. It can, however, increase accountability and responsiveness of local policy makers, improve efficiency through

the better targeting of services to meet the specifics of local need, and allow decisions to be made locally which seek to drive necessary economic, behavioural and social changes. The Commission fully recognises, as politicians should, that gaining enhanced flexibility to realise rewards, comes with corresponding risks.

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

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

1.2 Our Starting Point

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

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

i. raise revenues to support local public services;

ii. reduce or reform taxes to increase net incomes of selected groups;

iii. improve incentives to work or invest; and/or

iv. change societal behaviours for the greater good.

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

1.3 What does 'fiscal devolution' mean?

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

1.3.2 Devolution settlements can vary with respect to the level of autonomy associated with the powers within the devolved competence. In respect of taxation, devolved powers can involve transferring varying levels of control over tax rates and/or tax bases of specific taxes levied in the devolved jurisdiction, as well as the ability to introduce new taxes and user charges for

public services. In respect of public expenditure, devolved powers can range from the devolved administration having full control over determining spending allocations, to a situation where the central government mandates the terms of the spending, and the devolved administration simply executes payment (more accurately described as "decentralisation" than "devolution" in its truest sense).

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

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

1.3.5 Fiscal devolution remains at the discretion of the UK Government. As the HM Treasury's 'Statement of Funding Policy' (2021) makes clear "Responsibility for UK fiscal policy, macroeconomic policy and funding allocation across the UK remains with HM Treasury. As a result, funding from the UK Government, as well as devolved administration self-financing, continues to be determined within this framework."[4]

1.4 Why might fiscal devolution be considered important?

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

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

Efficiency

1.4.3 Devolution can improve the efficiency of service delivery by bringing decisions closer to those who know and understand local circumstances. Taxes can also be adjusted to reflect local economic particularities. On the other hand, devolving responsibilities can result in duplication of effort between the centre and the devolved region or nation and create

distortions in the tax system which influence behaviour in unintended ways if people or firms move location or change behaviour in response to different tax rates or welfare systems.

1.4.4 Many studies of the economics of fiscal devolution have reported that increasing the fiscal responsibilities of devolved administrations has improved the economic performance for both national and sub-national economies.[5] It has been shown that most measures of fiscal decentralisation are positively correlated with the level of economic development (as measured by per capita income).[6] While it may be difficult to draw a direct link between enhanced fiscal autonomy and economic growth in all cases[7][8] and while outcomes are not automatic or guaranteed, fiscal devolution is associated with a greater focus on public investment and funding for those sectors with a role in promoting economic growth, such as education and health.[9][10][11][12][13][14]

Accountability

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

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

Local policy relevance and impact on outcomes

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

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

Resource Equalisation

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

regions may spend up to their taxable capacity; thus rich regions can spend more than poor ones, although poor regions may have more demand for services.

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

1.5 Risk vs reward – an early example

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

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

1.5.3 As well as demonstrating some of the benefits of fiscal devolution the Scottish experience also highlights some of the risks. Income tax policy changes introduced by the Scottish government in 2018/19 are estimated to have raised around £240 million in additional revenues compared to what would have been raised had UK income tax rates and bands been implemented[20]. However, the net benefit of income tax devolution to the Scottish budget in 2018/19 was only £119m. Some of the anticipated revenue impact of the policy changes was offset by relatively slower growth in the Scottish income tax base compared to the equivalent tax base in rUK. A similar story emerges in 2019/20 – the Scottish budget is only around £148m better off as a result of income tax devolution, despite tax policy changes that would in theory raise Scottish revenues by over £400m compared to what would be raise under rUK policy.

1.5.4 An example of where a devolved nation is expected to financially benefit from tax devolution, despite no domestic policy change in income tax compared to the wider UK, is in Wales. Cardiff University's Wales Governance Centre projections of the net effect of tax devolution from 2018-19 to 2024-25 suggest that Wales will be some £200m[iv] a year better off by 2024-25 than if taxes had not been devolved (this includes income tax; stamp duty land tax and landfill tax). This growth in revenues is being primarily attributed to faster growth in the Welsh devolved tax base.[21]

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

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

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

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

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

1.6 The contemporary legal and lived context of Northern Ireland

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

Legal Framework

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

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

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

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

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

Source: Cabinet Office and Northern Ireland Office - Devolution settlement: Northern Ireland. [22]

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

1.6.6 There can be a lack of clarity over excepted and reserved matters and devolved powers which can introduce complication. This lack of clarity is because of the inevitable overlapping, shared and interdependent nature of some of the powers. For example, social security does not appear on either the excepted or reserved lists, therefore social security is devolved, both officially and constitutionally. Practically however, parity with the rest of the UK had broadly always been maintained, until recently with the introduction of welfare mitigations in Northern Ireland in response to the UK's welfare reforms.[23] This can cause a tension between how these social security matters are both delivered and paid for.

Lived Experience / Stakeholder Views

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

Mutual Confidence and Meaningful Engagement

1.6.8 Firstly, from a Commission viewpoint, mutual confidence and meaningful engagement is key for the success of fiscal devolution. While much of the focus will be on the fiscal, reputational and political risks inherent for the NI Executive, it is important to recognise that devolution also creates additional risk for the UK Government. Devolving fiscal powers reduces the centre's ability to respond rapidly and act consistently across the UK, and can have reputational and political consequences where moves result in increased instability, or a marked deviation from central government policy. While commensurate with the relatively small scale of the Northern Ireland economy, fiscal risks to the UK Government remain real. It is evident that budget sustainability is a live issue in Northern Ireland given the number of additional funding packages provided to the NI Executive,[v] past requests for additional resources,[24] and previous difficulties in reaching agreement on a balanced budget.[vi] [25]

1.6.9 It is also important that the NI Executive has confidence in the commitments made by the UK Government and in the effectiveness of the structures and processes established for intergovernmental working, particularly where they relate to dispute resolution. Our Executive Summary already references the previous commitments of the UK Government (Stormont House Agreement) to consider additional fiscal devolution for Northern Ireland and the more entrenched current position. In the context of the other devolved nations, there have been strong criticisms of existing structures and processes, most recently from the Welsh Government, with representatives describing current processes as "protracted and challenging" and claiming that current mechanisms have allowed HM Treasury to repeatedly "move the goalposts",[26] resulting in what the Welsh Government sees as an inappropriate attempt to determine devolved policy.[27] It is clear that intergovernmental working to deliver successful fiscal devolution will require a level of mutual confidence and engagement between

[v] Typically these 'non-Barnett' additions to the block grant were provided to reflect political developments in Northern Ireland and are described in more detail in Sections 2.9.29 to 30 and Annex C.

[vi] As reported in the 2021 NIAO Report '*The Northern Ireland budget process*', the NI Assembly initially failed to reach agreement on a balanced budget for 2015-16, due to issues around welfare reform. After the Stormont House Agreement was signed, however, the foundations were laid for the NI Executive to reach agreement on a balanced budget.

the NI Executive and the UK Government, as well as mechanisms that are transparent and fit-for-purpose to enable the effective implementation of measures and appropriate management of risk.

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

Political and Institutional Resilience

1.6.11 An appropriate level of political and institutional resilience is fundamental to realise those benefits offered by fiscal devolution.[28] Studies show that the positive effect of fiscal devolution on economic growth is tempered where countries lack strong institutions and/or political stability.[29]

1.6.12 The system of appointing Ministers to the NI Executive (the Executive Committee of the NI Assembly) uses the D'Hondt mechanism to determine the number of ministries each party is entitled to hold.[vii] This system of appointment roughly divides ministerial portfolios among parties in proportion to their strength in the NI Assembly, thereby creating a mandatory coalition, a form of power-sharing often referred to as *consociation.*[30]

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

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

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

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

meaning that the UK Government at Westminster had to legislate for annual budgets for Northern Ireland.

1.6.16 During this period, Northern Ireland had neither functioning devolved institutions nor direct rule. This has since been referred to as a period of "indirect rule",[31] and with no sittings of the NI Assembly over that time, there was no opportunity for local politicians to debate key issues and pass key legislation on a range of important social, economic and fiscal issues which impacted on the population of Northern Ireland.

1.6.17 Most recently, the normal functioning of the NI Executive has also stalled, as a result of the DUP withdrawing the First Minister on 3 February 2022. This breakdown in devolved government did not, however, result in the suspension of the NI Assembly as on previous occasions. This was due to recent legislation at Westminster in the form of the Northern Ireland (Ministers, Elections and Petitions of Concern) Act 2022, which allows for the continuation of Executive Ministers in post for at least six months, and the continued operation of the NI Assembly to pass legislation. What was not possible was the normal operation of the Executive to take strategic cross-cutting decisions.

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

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

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

Institutional capability & capacity

1.6.21 Thirdly, an appropriate level of capacity and capability is critical to the operationalisation of fiscal devolution. The 'Capacity and Capability in the Northern Ireland Civil Service' report, undertaken by the Northern Ireland Audit Office (NIAO) in late 2020, questioned the ability of the civil service to deliver complex programmes, such as the Renewable Heat Incentive (RHI) scheme, and noted that workforce planning has been inadequate, that the recruitment approach does not result in the 'right people, in the right post, at the right time', and that there

is no record of the functional skills and experience of existing staff, among other things.[32] Against this backdrop, it is clear that the right people, in the right post, at the right time will be required to support the implementation of any new fiscal powers or responsibilities.

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

1.6.23 Through our stakeholder engagement process, we have met with both Revenue Scotland and the Welsh Revenue Authority, as well as officials from the tax departments in the Scottish and Welsh Governments. We have also analysed their structures and, whilst not directly comparable, it is evident that they are significant organisations requiring many specialist posts and individuals with specific capabilities.

1.6.24 It is clear that, similar to Scotland and Wales, any move to devolve additional fiscal responsibilities in Northern Ireland will require, by necessity, new skills and infrastructure within the public sector ranks to administer any new or devolved taxes. While recognising that capability can and will develop over time, we consider that it is important such institutions have the capability and competency from the outset to both develop and implement devolved tax policy and to administer their taxation powers efficiently and with transparency. They will need to discharge their responsibilities in protecting and utilising what is very sensitive personal and corporate information to provide an essential function of government and economy, thus maintaining credibility and the trust of local taxpayers.[33]

1.6.25 We note that the capability and capacity of local institutions established for this purpose should be commensurate with the level and extent of the powers devolved.[34] Consideration should be given to economies of scale, and the effect on administrative efficiency, when decisions are made on the extent of powers being sought.

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

1.6.27 It is reassuring that the Northern Ireland Audit Office (NIAO), in its recent submission to the Commission, noted that there has been a very positive official response to their report published in 2020 on the Capacity and Capability of the Northern Ireland Civil Service (and the associated Public Accounts Committee enquiry). The NIAO informed the Commission that they have confidence that there will be substantive and meaningful transformation in this area over the next two or three years.

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

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

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

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

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

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

Table 1.2 Tax Powers and UK Devolved Administrations

Region	Devolved Taxes	Future Considerations
Northern Ireland	• Regional Rates (set by NI Executive) and District Rates (set by local councils for local expenditure) collected by Land & Property Services on both domestic and non-domestic properties • Direct Long Haul Air Passenger Duty • Carrier Bag Levy (new tax)	• Corporation tax (commencement clause in legislation not yet triggered by HM Treasury) • Potential reconsideration post Fiscal Commission report.
Scotland	• Scottish Income Tax (partially devolved) with powers to vary rates and bands above the	• The Scottish Parliament has the power to introduce two further taxes devolved to

	Personal Allowance for non-savings and non-dividend income, which is administered by HMRC; • Scottish Land and Buildings Transaction Tax and Scottish Landfill Tax (fully devolved), which are collected by Revenue Scotland; • Control over local taxation, including Council Tax and Non-Domestic Rates, which are collected and administered by Local Authorities for local expenditure.	Scotland, which have not yet been implemented: ○ Aggregates Levy ○ Air Departure Tax (Air Passenger Duty) • The assignment of approximately half of VAT revenues raised in Scotland to the Scottish Budget has also been delayed, and now paused, given challenges in reliably estimating Scotland's share of UK VAT receipts. • A new Scottish 'Tax policy and the budget: consultation' was launched on 31 Aug 2021 seeking views on overarching approach to tax policy, as well as using devolved and local tax powers as part of the Scottish Budget 2022 to 2023. Feedback from the Consultation published in December 2021 included: a call for stability in tax rates to help with Covid-19 recovery; a progressive approach to tax; and suggestions on how tax policy could support net zero targets and climate change objectives.[35]
Wales	• Land Transaction Tax • Landfills Disposals Tax • Income tax – Partial Devolution through Welsh Rates of Income Tax • Control over local taxation, including Council Tax & Non-domestic Rates, which are collected and administered by Local Authorities for local expenditure.	• Aggregates levy (not devolved but UKG intends to do so, subject to cross border impacts being worked through in full) • 'Summary of Findings' of possible reforms to local government finance system was published in February 2021 with options including potential changes to council tax and non-domestic rates, and alternative approaches for raising local revenues such as local land value tax and local taxes based on income.[36] • Programme for Government 2021-26 committed to a consultation on legislation for a tourism levy in Wales. • Powers to introduce a Vacant Land Tax requested but not agreed.

1.8 How can the NI Executive obtain further fiscal powers?

1.8.1 The NI Executive can obtain further fiscal powers through:

i. the introduction of primary legislation at Westminster for the devolution of tax varying powers (and an NI Assembly vote to accept / use them);

ii. assessing and being satisfied (with the UK Government) that the introduction of any new taxes are substantially different to those subject to UK wide taxation; and
iii. via a request to the UK Government for a derogation of a particular tax or duty rather than seeking to have it devolved. These are explained in more detail below.

Tax Devolution

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

New Taxes

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

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

Therefore, the Act does not prevent the Assembly from imposing new taxes that do not contravene either a), b) or c) as outlined above. Item (c) is the major challenge given the broad range of activities already covered by UK-wide taxation, as clearly there needs to be an assessment of whether any proposed 'new' taxes introduced in Northern Ireland are substantially different to existing UK wide taxes before they could progress. The situation is different in Scotland and Wales where they also have the competence to introduce new taxes, however, the criteria and process for doing are more defined than in Northern Ireland. This is examined further in Section 6.22.

Tax Derogation

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

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

i. a reduction in the Aggregates levy was obtained through the Aggregate Levy Credit Scheme (ALCS) in April 2004 in order to reduce cross-border trade distortion with RoI. The ALCS ran until it was suspended on 1 December 2010 following a legal challenge by the British Aggregates Association; and
ii. an exemption from the Carbon Price Floor in April 2013 in view of the impact it would have had on Northern Ireland's electricity industry. This followed interventions by the NI

Executive and operators in the electricity market, who argued that carbon pricing 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.[37] (To note, these were policy choices with the effect of reducing tax take and/or mitigation of adverse environmental impacts.)

1.8.6 No matter which avenue is used to increase the fiscal competence of the NI Assembly or alter the fiscal environment in Northern Ireland, what is clear is that the introduction of further fiscal powers will involve a negotiation process with the UK Government which may be challenging and both time consuming and resource intensive. The likely areas of negotiation between the NI Executive and the UK Government, and the associated timescales are considered in more detail in Chapters 6 and 7.

1.9 Conclusions

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

1.9.2 Securing additional fiscal powers would provide the NI Executive with increased flexibility to achieve its policy aims. Additional fiscal powers can represent a potent policy instrument for local decision-makers in seeking to raise additional revenue, support policy priorities, incentivise economic reform and promote behavioural changes in the local population. The literature clearly demonstrates that there are potential rewards to be gained from fiscal devolution. It can increase accountability and responsiveness of local policy makers, improve efficiency through the better targeting of services to meet the specifics of local need, and allow decisions to be made locally which seek to drive necessary economic, behavioural and social changes.

1.9.3 However, moves to enhance the fiscal autonomy of Northern Ireland need to be balanced against costs and risks. There will be direct administrative costs, and there will be risks in terms of revenue stability and predictability, as well as potential risks to the UK Government if devolution creates distortions within the UK. Any move to enhance fiscal devolution for Northern Ireland would be a move away from the insurance of the current system, with its reliance on the stability of block grant funding. The counterbalance, which the Commission fully recognises, is that gaining the enhanced flexibility to realise rewards comes with corresponding risks.

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

Chapter 2

The Northern Ireland context: economy, tax and spending

2.0 Overview

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

2.1 Key points

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

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

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

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

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

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

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

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

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

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

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

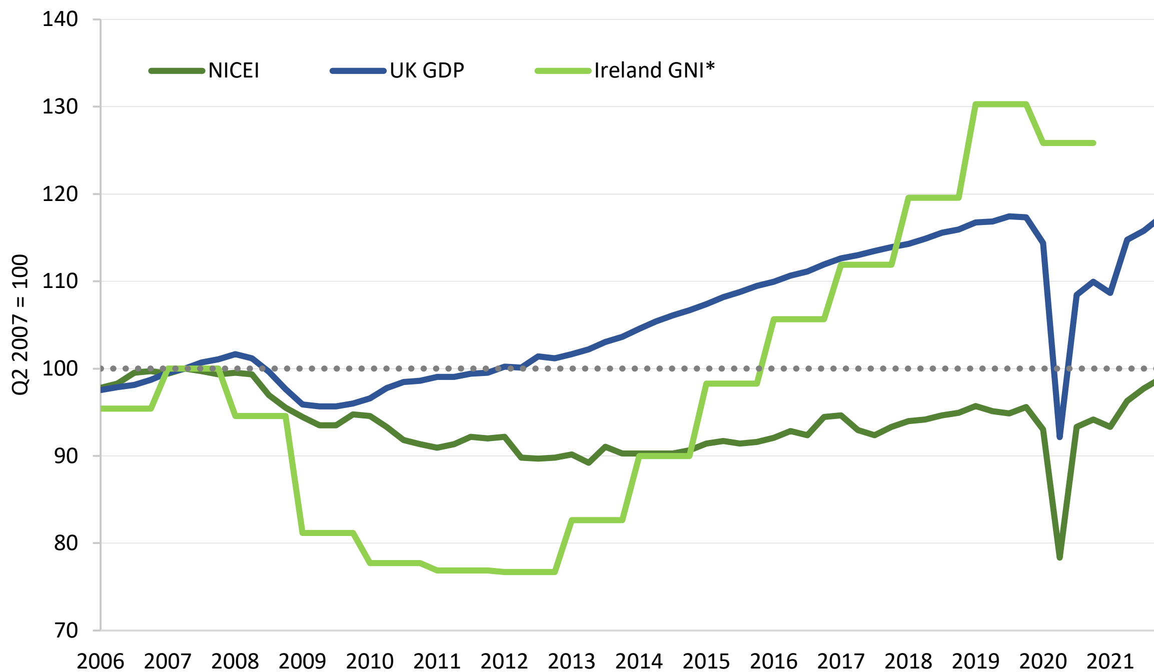
2.2 The Northern Ireland economy

2.2.1 When considering the case for fiscal devolution it is important to provide the economic and fiscal context within which further devolution might occur. Northern Ireland is recognised as having undoubted economic strengths, notably its ability to attract Foreign Direct Investment, its thriving ICT clusters, and the high attainment levels of its students, to name a few. Northern Ireland also scores highly when it comes to measures of wellbeing and quality of life compared to other parts of the UK and other OECD countries. The Ulster University Economic Policy Centre (UUEPC) Competiveness Scorecard 2020 found that people in Northern Ireland are the most satisfied with their quality of life when compared to OECD countries. The same report also found that people in Northern Ireland reported greater levels of life satisfaction, happiness and feelings of worthwhile activity relative to other UK regions.[38]

2.2.2 Despite these attributes, the Northern Ireland economy is, and has consistently been, one of the UK's weakest performing economic regions, the historical details of which have been well rehearsed in many analyses of the economy over the last 50 years.[39] [40] [41] [42] [43] GDP per capita in Northern Ireland was 21% below that of the UK as a whole in 1998 and by 2019 this figure had risen to 23%. Between 1998 and 2019 the Northern Ireland figure has varied between being 17% and 23% lower than the UK-wide value. Compared to other UK regions over the same period, Northern Ireland has typically had the third lowest figure, above Wales and the North East.

2.2.3 Chart 2.1 shows the recent underperformance of the Northern Ireland economy post the 2007 global financial crisis, as measured by the Northern Ireland Composite Economic Index[viii] (NICEI), alongside the performances of the UK and RoI economies.[ix] It highlights the dramatic fall in economic activity following the financial crisis, from which the Northern Ireland economy has still not fully recovered. Although in Q4 2021 the Northern Ireland economy reached its highest level since Q2 2008, it still remained 2.4% smaller than its pre 2008 crisis peak. While COVID-19 has had a dramatic impact on the local economy over the recent period, the Northern Ireland economy returned to pre-COVID-19 levels in Q2 2021.

Chart 2.1 NICEI, comparison with selected GDP measures Q2 2007 – Q4 2021 index (Q2 2007 = 100)



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

Note: RoI GNI annual data only available up to 2020 at date of publication.*

2.2.4 Whereas the Northern Ireland economy has struggled to regain its 'lost growth' since the financial crash, by contrast, the UK economy recovered to pre-crisis levels by Q2 2013, Scotland recovered its lost growth by Q2 2013[x] and the RoI economy recovered by 2016 (based on GNI*).[xi] Despite the very recent up-turn in economic growth, including an element of outperforming other UK regions (apart from Wales) in terms of returning to economic output

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

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

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

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

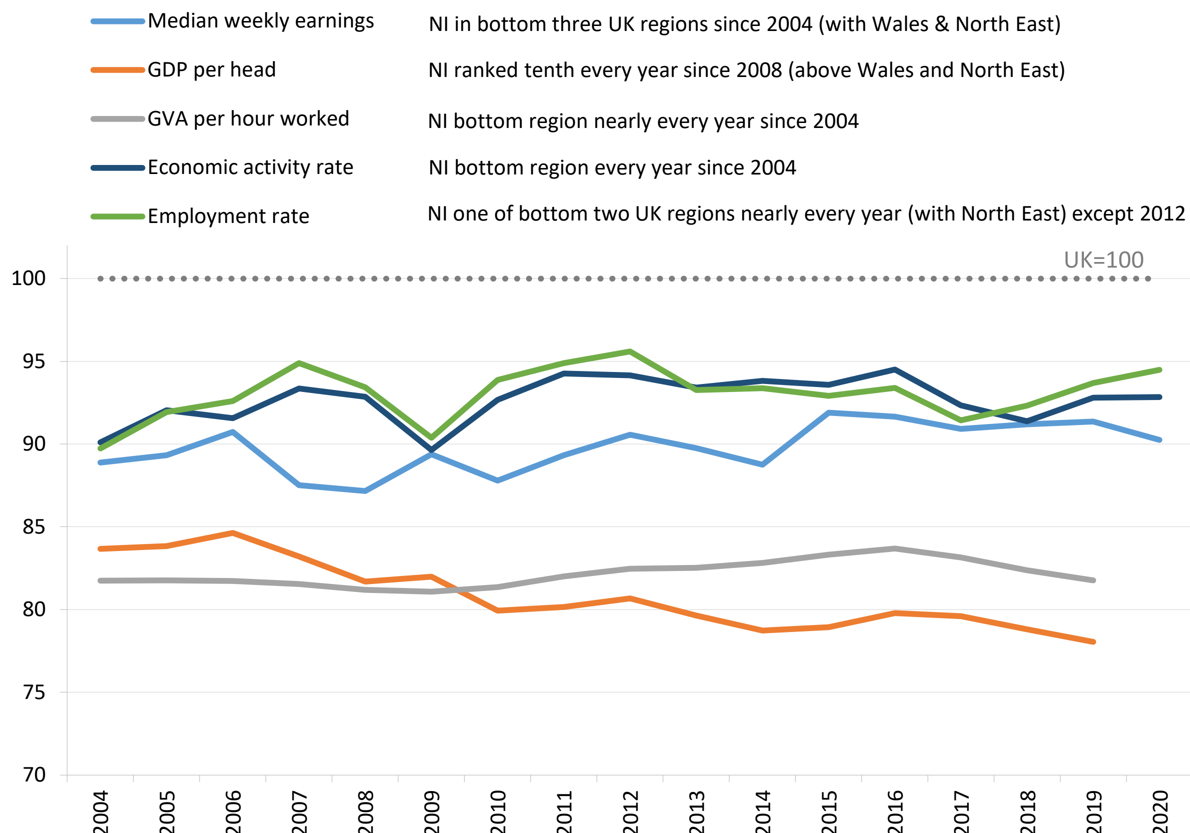
(in GVA terms) levels of Q4 2019 (i.e. pre COVID-19),[44] economic forecasters expect the economy to eventually emerge from the COVID-19 pandemic less well than the UK and RoI economies.

2.2.5 In the remainder of this section and Section 2.3, where we detail data across a number of economic metrics, we focus primarily on data from prior to COVID-19 (i.e. March 2020 and before) in order to remove potential pandemic volatility impacts. Where we use data post COVID-19 we state so clearly.

2.2.6 Chart 2.2 and Chart 2.3 below compare Northern Ireland's economic performance against the UK as a whole in a number of additional key economic metrics and provides a sense of its relative position to other UK regions. These metrics include: GDP per head, GVA per hour worked (i.e. productivity), employment rate, median earnings and the economic activity rate.

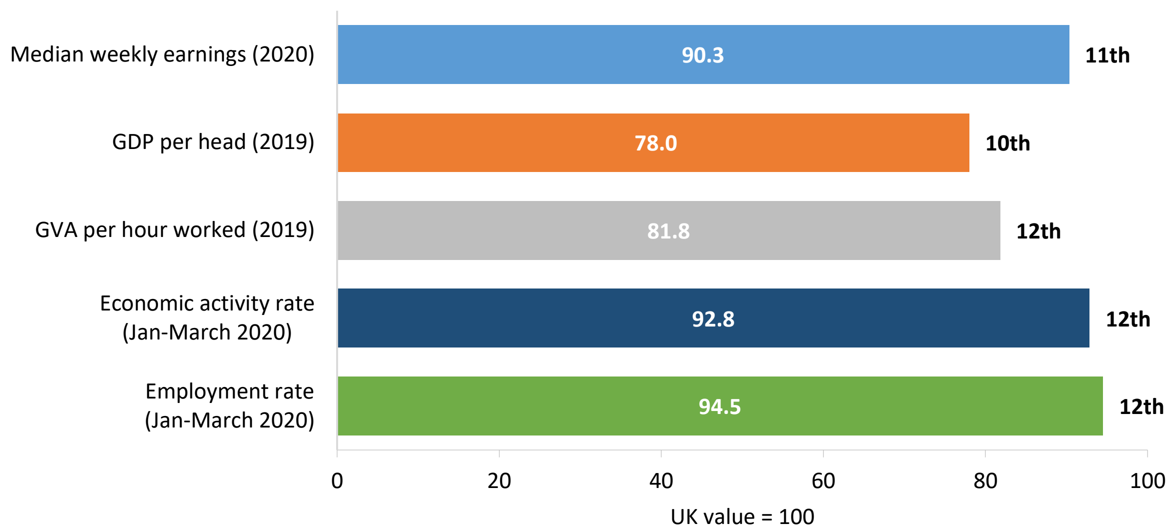
2.2.7 Compared to other UK regions, Northern Ireland has typically been in the bottom three performing UK regions across key economic metrics. Across most, Northern Ireland tends to perform at a similar level to Wales and the North East of England. As Chart 2.3 shows, Northern Ireland ranks as the bottom UK region across three metrics (employment, economic activity rate and productivity) and one of the bottom three regions in the others (median earnings and GDP per head). The UK Government has acknowledged the disparity across UK regions and in February 2022 it published its 'Levelling Up White Paper' which set out plans to improve the economic performance (as well as other measures of well-being) of underperforming UK regions and 'level up' the UK as a whole.[45]

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



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

Chart 2.3 Comparison of selected measures, Northern Ireland ranking vs UK regions (UK =100)



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

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

Lower Productivity

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

2.3.2 The UUEPC identifies that Northern Ireland's low productivity is a factor of both what it does (its sectoral structure) and how well it does it (productivity within sectors) and that productivity is the main driver of Northern Ireland's income gap with the UK, with economic inactivity being the second biggest driver.[46] Other reasons cited for poor productivity performance include: geographical peripherality; an infrastructure gap; levels of investment in research and development; and low levels of human capital as measured by educational achievement and skills.[47]

Lower Levels of Investment

2.3.3 **Lower levels of investment in R&D, technology, and its diffusion, physical infrastructure and human capital have also been identified as key to understanding Northern Ireland's underperformance.** Northern Ireland sees some of the lowest levels of investment in capital, both human and physical, relative to other UK regions.[48] Northern Ireland has long been highlighted as a region needing greater investment to help drive productivity growth, with underinvestment reflecting a long-run pattern that has harmed productivity levels.[49] [50]

Greater Economic Inactivity

2.3.4 Despite a strengthening labour market in the years directly preceding the COVID-19 pandemic Northern Ireland's labour market continues to be marked by a number of **persistent challenges including high rates of economic inactivity.** Northern Ireland has persistently had

amongst the highest rates of economic inactivity of all UK regions. In January-March 2020, pre-pandemic, 26.1% of working age adults in Northern Ireland were classified as economically inactive, compared to 20.4% across the UK as a whole.[51] The high rates of economic inactivity in Northern Ireland are driven in large part by poor long-term health or disability.[52] The greater rates of economic inactivity have been identified as the second biggest driver of Northern Ireland's income gap to the UK.[53]

Lower Wages

2.3.5 In 2020, Northern Ireland had the 2nd lowest wages of any UK region, with only the North East being lower in terms of median weekly earnings (Northern Ireland £529 vs £586 UK average) and this underperformance has consistently been the case over time.[xii] Furthermore, in 2020 at 25.3%, Northern Ireland also had the highest proportion of jobs across all regions of the UK with earnings below the real living wage, as calculated (for 2020) by the Living Wage Foundation at £9.30 per hour.[54] However, in terms of cost of living, regional consumer price levels (for 2016) found that the relative price level of Northern Ireland was the lowest of all the UK regions, with prices on average 2.3% lower than the UK.[55]

High Skills Migration

2.3.6 **Northern Ireland has historically felt the effects of a 'brain drain' to other parts of the UK**. A large share of school leavers from Northern Ireland undertake full-time tertiary education at a university elsewhere in the UK. In 2020/21, 65,545 individuals from Northern Ireland were enrolled in UK higher education institutions, the highest number for a decade, in part due to the changes in how A-level grades were awarded in 2020 following Covid-19 impacts. Some 25% or around 16,600 students from Northern Ireland left to study in GB in 2020/21,[56] this measure does not include students who leave to study outside the UK, including RoI. The data also shows that in 2019, only just over a third of graduates returned home for employment six months after their graduation. Northern Ireland also attracts limited student numbers from outside Northern Ireland for study and the retention rates for those who do attend, in terms of remaining in Northern Ireland, are low.

2.3.7 This outward mobility can, to a large degree, be explained by the Maximum Student Numbers Policy (a cap set by the Department for the Economy), which limits student recruitment in Northern Ireland, in addition to a variety of social and cultural reasons. Throughout the past decade, the cap on student numbers in Northern Ireland has remained at between 24,000 – 25,000 places per year.[57] In contrast, in England and Wales where students pay their own tuition fees, there is no such cap on student numbers (there exists an unofficial cap on Scottish student numbers at Scottish universities, given the free tuition policy in place there for Scottish students).[58] **The loss of human capital from Northern Ireland to GB by students annually - through the MASN cap - is also a 'fiscal drain'**. Northern Ireland spends considerable public resources on school-goers who go on to study and work outside of Northern Ireland. In this respect, Northern Ireland does not go on to reap the 'fiscal rewards' of these investments. Because of the loss of high skilled labour from Northern Ireland to other UK regions, and the fact that it attracts relatively few skills from elsewhere, retaining existing talent in Northern Ireland becomes even more important.[59]

[xii] Annual Survey of Hours and Earnings (ASHE) has published its provisional 2021 data, however this data has not been used given impacts of COVID-19.

Lower House Prices

2.3.8 Northern Ireland has **considerably lower house prices than the UK average.** Northern Ireland remains the cheapest UK country in which to purchase a property (North East England being the only region cheaper than Northern Ireland), with the average house price at £159,000 in December 2021. This compares to a UK average of £275,000.[60] This cost differential has consistently been the case, with the exception of the period 2005 to 2008 when house prices grew at an unsustainable level in Northern Ireland and outpaced the average growth in UK house prices. This growth was corrected following the 2007/08 financial crisis when house prices in Northern Ireland decreased sharply and by some 57% vs 19% in the UK. The Northern Ireland property market saw the largest correction of any UK region. While UK house prices recovered by August 2014, Northern Ireland's remain 30% below their peak as of December 2021. It is also worth highlighting that the housing market across the UK has been somewhat in flux throughout the course of the COVID-19 pandemic with rising prices seeing the UK average house price reach a record high in December 2021.

Smaller Private Sector

2.3.9 The **relatively large size of the public sector and small size of the private sector is a contributing factor in Northern Ireland's comparative economic underperformance**. Northern Ireland has a much higher percentage of its jobs in the public sector compared to the UK average, 25.5% vs 16.7% as of March 2020.[61] Scotland and Wales also have a higher percentage of public sector jobs than the UK average, but remain significantly below that of Northern Ireland. The relatively large size of the public sector has been suggested as a contributing factor in Northern Ireland's productivity gap by 'crowding out' private investment.[62]

Living Standards and Poverty

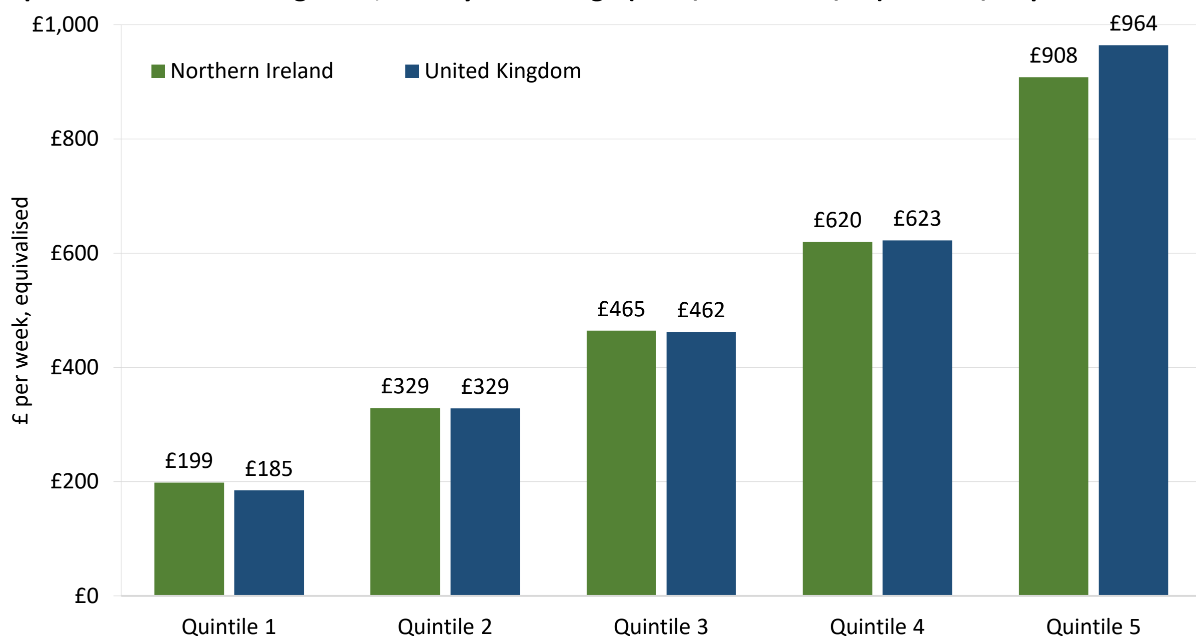
2.3.10 Average household incomes are lower in Northern Ireland than they are across the UK as a whole, however as shown in Chart 2.4, Northern Ireland performs better in terms of household income on a regional level than a number of other regions. The three-year average (2017/18 to 2019/20) median household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

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

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

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

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



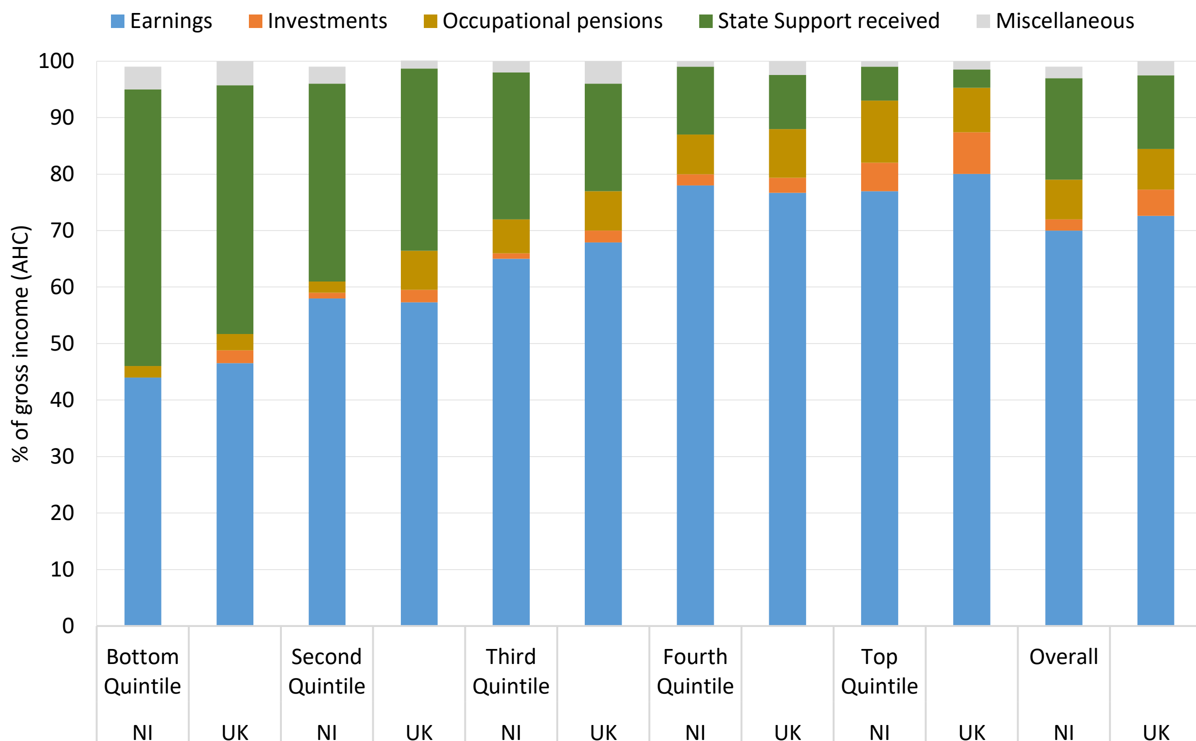
Source: Department for Communities - Households below Average Income Northern Ireland 2019/20 and Department for Work and Pensions Households below average income (HBAI) statistics 2019/20.

2.3.12 In terms of poverty, Northern Ireland has a lower percentage of people living in relative poverty before and after housing costs, than the UK. In 2019/20, 18% of individuals in the UK were considered to be in relative poverty before housing costs and 22% of individuals after housing costs.[63] This compares to 17% for Northern Ireland both before housing costs and after housing costs,[64] demonstrating that irrespective of housing costs Northern Ireland has lower poverty rates than the UK average, but that housing costs add to poverty levels at a UK level. Northern Ireland's more affordable housing costs, relative to other parts of the UK, is often cited as a key factor in its lower poverty rates.[65] It is also suggested that welfare reform mitigations have had an impact on poverty rates for those on income related benefits.[66]

Sources of Income

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

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



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

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

2.3.14 Overall income from earnings makes up 70% of income in Northern Ireland compared to 73% in the UK. It also worth noting that Northern Ireland currently has the smallest proportion of people of pension age (16.1% compared to the 17.7% UK figure). This helps point to a higher proportional share of income which comes from state support being driven by a higher proportion on welfare, not to a higher percentage of people of pension age.

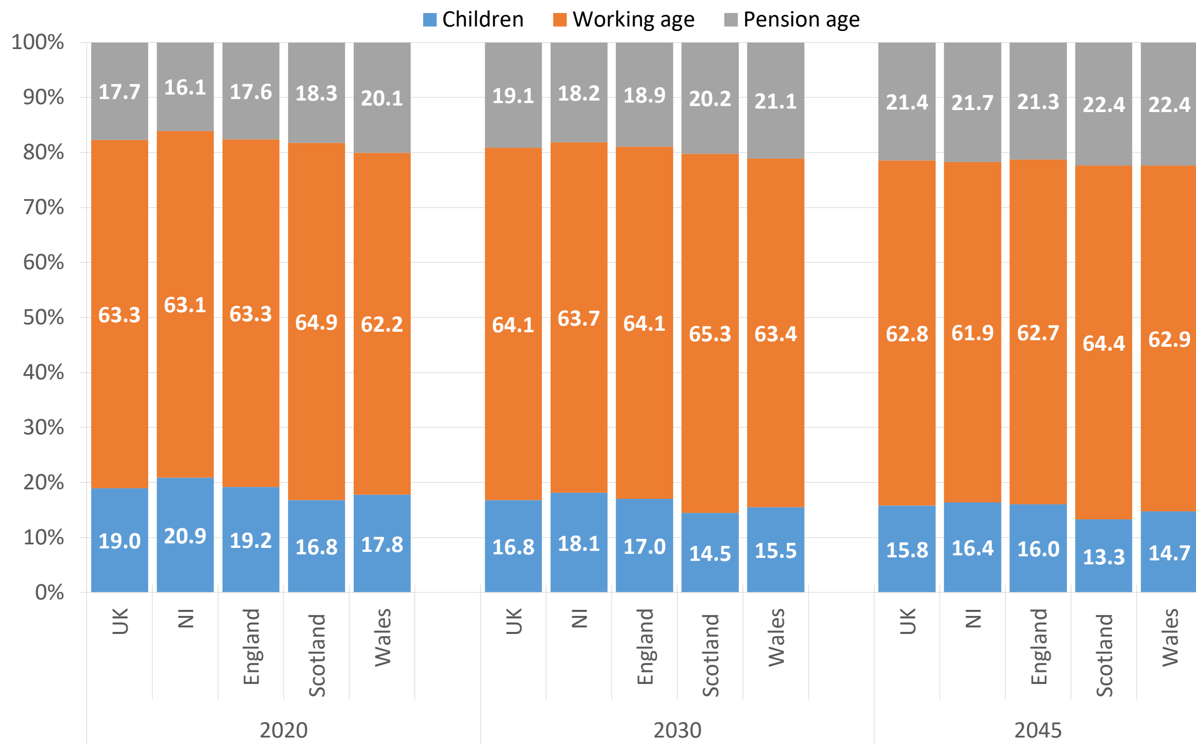
Demographic trends

2.3.15 The Northern Ireland population stood at 1,896,000 by mid-2020 or 2.83% of the UK total.[67] Since 1971, Northern Ireland has had the highest average annual population growth rate of any UK country (0.43%) with Scotland the lowest at 0.09% and the UK average at 0.37%. Over the same period Northern Ireland has had, on average, a higher birth rate than any other UK country (15.3 per 1,000 on average compared to the UK value of 12.7 per 1,000). Between 2000 and 2019, Northern Ireland's population has increased by a total of 45,000 as a result of net international immigration.[68] More recently, between 2015 and 2020, Northern Ireland's annual average population growth was 0.5%, which was below the UK average of 0.63%, but higher than Scotland (0.37%) and Wales (0.42%).

2.3.16 In terms of demographic projections across the UK, between mid-2020 and mid-2045, England is projected to have the largest increase in population, at 6.7%. The projected increase over the same period for Northern Ireland is 2.3%, Wales is 4.2% and Scotland is projected to see a decrease of 1.5% over this time period.[69]

2.3.17 As shown in Chart 2.7, by 2045, Northern Ireland is projected to go from having the smallest share of people of pension age amongst UK nations (16.1% in 2020) and having a share below the UK average value (17.7%) to having a share (21.7% in 2045) much more in line with the UK average and other UK nations. Across the UK, by 2045, there are projected to be many more people at older ages. This partly reflects baby boomers being of pension age but also general increases in life expectancy. Northern Ireland currently has the highest share of children (20.9% in 2020) and this is projected to remain the case in 2045. The UK is projected to have fewer young children by 2045 but more in their mid-teens; this is expected to be influenced by fertility rates in the 2020s and 2030s being lower than those around 2010 but higher than those around 2001 when UK fertility was at a record low. These changes also mean that Northern Ireland's working age population, which as of 2020 is almost the same as the UK (63.1% vs UK value of 63.3%), is expected to decline to 61.9% by 2045. This is a slightly greater decline than the UK, which is projected to fall to 62.8% by 2045.

Chart 2.7 Changes in population makeup 2020-2045, by UK Country



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

2.3.18 The differences in demographics will be an important consideration when looking at fiscal policy for Northern Ireland. The projections that Northern Ireland's population will grow at different rates and that its working age population will experience a greater decline between 2018 and 2045 will be expected to have an impact on the Northern Ireland tax base moving forwards, and the potential tax receipts coming from labour-based taxes in particular. Higher proportions of children and those of pension age will also impact on public spending requirements and decisions.

2.4 Public spending in Northern Ireland

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

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

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

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

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

Box 2.1 Public spending terminology

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

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

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

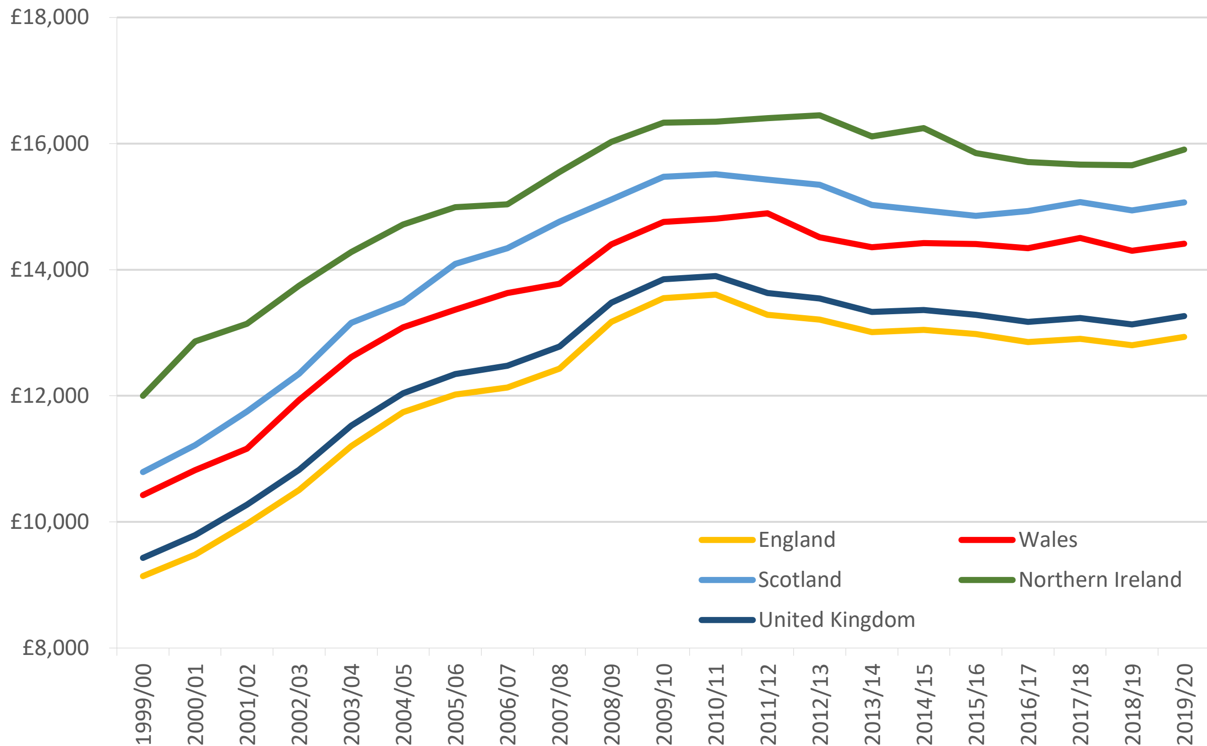
Non-identifiable expenditure refers to spending which cannot be attributed to a particular country or region and is deemed to be on behalf of the UK as a whole. Non-identifiable expenditure largely consists of defence spending and public sector debt interest payment. Northern Ireland is allocated its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

2.4.2 Translating the overall public expenditure figure of £30,118 million (Total Managed Expenditure, TME) into spending per head equates to a level of spend of £15,905 per person across Northern Ireland. This is the highest level of spend of any UK country or region and some 20% higher than the UK average of £13,263.

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

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

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



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

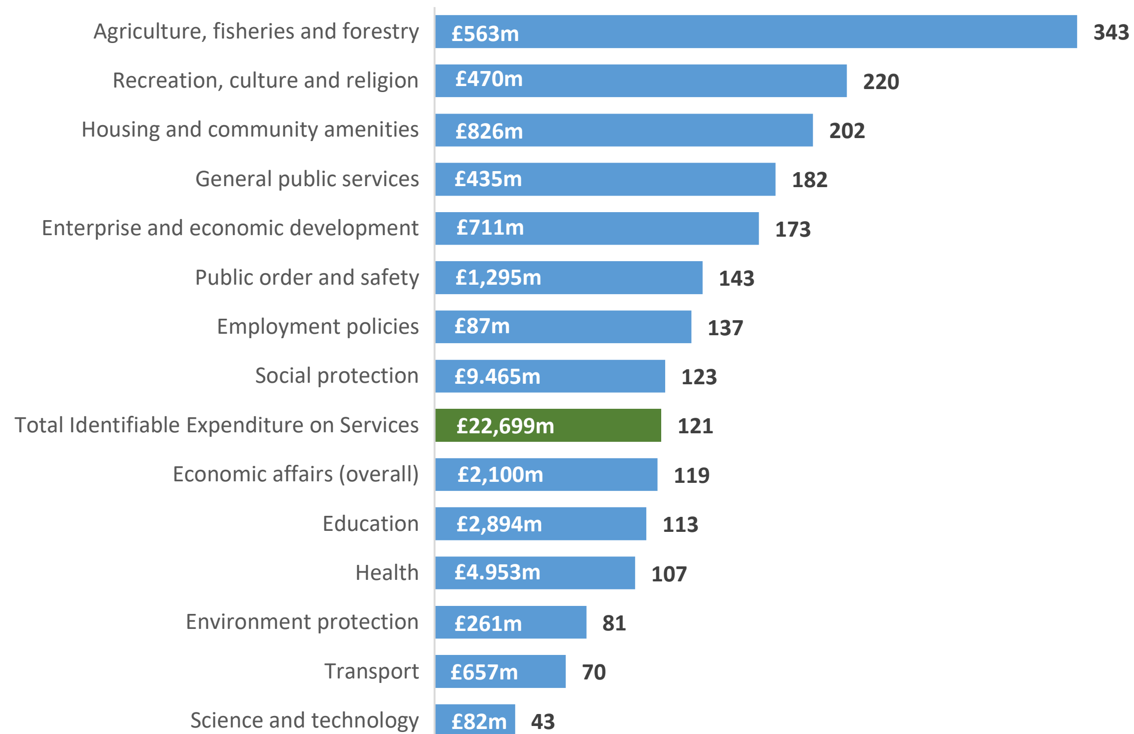
Box 2.2 'Real terms' public spending and revenue

When comparing spending and revenue over time it is important to consider the impact of inflation and therefore present figures in 'real' terms where possible. Therefore, in this chapter **when comparing public spending or revenue figures over time, the values presented are not 'nominal' figures for each year but are instead values in 2019-20 prices**. To calculate the 'real' values we have adjusted for inflation using the whole-economy ONS GDP deflator with 2019-20 values indexed to equal 100.[70]

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

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

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



Source: NISRA, HM Treasury Country and Regional Analysis 2020

Note: These expenditure areas do not necessarily correspond to Northern Ireland departmental spend.

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

2.5 Revenue raised in Northern Ireland

2.5.1 In 2019/20, £19,817 million was raised through revenues collected in Northern Ireland, either at the UK-wide level or by authorities in Northern Ireland, or by revenues attributed to Northern Ireland.[71] Of this total revenue, £15,668 million was tax revenue with the remainder made up of a combination of 'other revenue' (such as Gross Operating Surplus, interest and dividends - further detail provided below).

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

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

collected by Land and Property Services, part of the Department of Finance, raised the largest tax revenue collected by Northern Ireland authorities. Rates raised a total of £1,455 million in 2019/20 - £580 million of which was raised from domestic rates and £875 million raised from business rates.[72] This rates revenue includes both the district element, used to fund local councils, and the regional element, used to fund NI Executive's spending.[xix]

2.5.3 Table 2.2 details the specific UK-wide taxes which the Commission assesses in our report for potential devolution. In 2019/20 three 'major taxes' collected the bulk of Northern Ireland tax revenue; VAT (£3.4bn), National Insurance contributions (£3.1bn), and income tax (£3.0bn). As percentages of total tax revenue in Northern Ireland, those three taxes contributed to 61% of total receipts for Northern Ireland (22%, 19.7% and 19.2% respectively). The dominance of these three taxes is a feature shared amongst most advanced economies, albeit it is worth noting that the proportion of tax revenue raised through VAT in Northern Ireland is comparatively high, whilst the proportion raised through income tax and National Insurance contributions (social security contributions) is internationally comparatively low.[73] Table 2.2 also shows that there are considerable differences comparing the share of total revenues between Northern Ireland and the UK, particularly for VAT and income tax.

2.5.4 The next tier, of moderately sized taxes, includes fuel duties (£864m), corporation tax (£810m) and alcohol and tobacco excise duties (£774m). It is of note that, as a proportion of overall tax take, Northern Ireland generates less from corporation tax receipts and more from excise duties than the UK as a whole. The remaining taxes are relatively more minor in terms of tax revenues raised.

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

UK - wide taxes	Description	Tax take 2019/20 £million	% share of total NI tax take	UK equivalent % share of total UK tax take
Value added tax	A tax on most goods and services.	3,442	22.0%	18.1%
National Insurance contributions	A tax on income from employment, levied on employers, employees and the self-employed.	3,094	19.7%	19.6%
Income tax	A tax on most forms of income.	3,001	19.2%	26.2%
Fuel duty	Levied on manufacturers and importers of oil products.	864	5.5%	3.7%
Corporation tax	A tax on the profits of limited companies and other organisations.	810	5.2%	6.6%
VAT refunds*	VAT refunds claimed by public sector organisations.	798	5.1%	2.6%
Alcohol and tobacco excise duties	Levied on alcohol and tobacco products before release to the UK market	774	4.9%	2.9%

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

Vehicle excise duty	Payable by either the registered or actual keepers of vehicles.	219	1.4%	0.9%
Insurance premium tax	A tax on general insurance premiums, paid by companies and intermediaries	144	0.9%	0.9%
Capital gains tax	A tax on the gain or profit from selling or otherwise disposing of a possession, such as shares or property.	105	0.7%	1.3%
Stamp duties	Payable on the purchase or transfer of property or land, and on shares.	80	0.5%	2.2%
Air passenger duty	Charged on the carriage of passengers from UK airports.	80	0.5%	0.5%
Betting and gaming duties	Duty charged on net stake receipts and gross gaming yields.	75	0.5%	0.3%
Inheritance tax**	Paid on the estate of deceased persons and sometimes on trusts or gifts made by individuals during their lifetime.	43	0.3%	0.7%
Apprenticeship levy	A tax levied on employers and used for the funding of apprenticeship programmes.	60	0.4%	0.4%
Bank levy	Annual charge on certain equity and liabilities of banks, building societies, banking groups and building society groups.	36	0.2%	0.3%
Landfill tax	Charged on disposal of waste at licensed landfill sites, and paid by the site operators	24	0.2%	0.1%
Climate change levy	Chargeable on the industrial and commercial supply of taxable commodities for lighting, heating and power by business consumers.	23	0.1%	0.3%
Aggregates levy	A tax on the commercial exploitation of sand, gravel and rock.	18	0.1%	0.0%
Soft drinks industry levy	Applied to the production and importation of soft drinks containing added sugar.	12	0.1%	0.0%
Digital Services tax	A tax on the revenues of search engines, social media services and online marketplaces which derive value from UK users.	2	0.0%	0.0%
Other taxes	Includes taxes not listed above as well as taxes that are not specifically listed by ONS such as other taxes on production.	509	3.2%	3.1%
Non-Domestic and Domestic rates (or Council Tax in GB)		1,455	9.3%	9.1%
Total taxes only		**15,668**	100%	100%
Other revenue	*GOS, interest and dividends and rent and other current transfers*	*4,149*		
Total revenue		*19,817*		

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

** VAT refunds represent the refunds of VAT that some public sector bodies have paid in respect of contracted out services for non-business purposes and are therefore a revenue foregone as opposed to a revenue raised. However, they are noted here for completeness. **ONS includes inheritance tax as part of 'other taxes on capital' along with Swiss Capital Tax. As no values for Swiss Capital tax are applicable in 2019/20, the value of 'other taxes on capital' for that year is solely attributed to inheritance tax.*

Box 2.3 Gross Operating Surplus – An Explainer

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

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

According to internationally agreed statistical definitions such as the UN's System of National Accounts 2008,[74] Gross Operating Surpluses for central and local government are assumed to be the same size as capital consumption costs**, i.e. depreciation. As noted previously this is also captured on the expenditure side (Total Managed Expenditure) in the ONS statistics under accounting adjustments. Given this, there is no impact from Gross Operating Surplus on general government net fiscal balance as a result.**

Apportionment to regions

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

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

Box 2.4 Tax revenue data reliability

Taxes in the UK are not generally levied or collected at a regional level but at a national level (domestic and non-domestic rates being the significant exception for Northern Ireland**) and so it can be difficult to identify which country or region tax receipts should be allocated to.**

As a result, there is no comprehensive source of administrative figures on the actual amount of tax revenue raised in Northern Ireland. The data sources capturing the tax base in Northern Ireland are a mixture of administrative and survey data sources. These are the best available estimates of what is raised, with varying degrees of reliability. The Commission carried out an in-depth examination of the data and methods used to capture the tax base in Northern Ireland. The Commission has produced a working paper detailing this work which can be found at Annex B of this report and on the Commission's website.

The paper summarises, in the Commission's view, some of the limitations of the data captured on taxes that could potentially be devolved to Northern Ireland and highlights the specific issues across different taxes.

Tax data reliability – Recommendation 1

2.5.5 It is the Commission's view that if Northern Ireland wishes to pursue further fiscal devolution then it would be prudent to consider, at the earliest possible opportunity, what steps or actions could be taken to improve the data reliability for the taxes it wishes to pursue. This should include consideration of whether data issues are so insurmountable that they become an impediment to devolution altogether (as seen with VAT assignment in Scotland).

2.5.6 **We recommend that the NI Executive should work with ONS, HMRC and NISRA to improve data on tax receipts in Northern Ireland.**

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

2.5.8 The NI Executive should look to collect, where reasonably possible, administrative/outturn data for any tax that is to be devolved in the years prior to devolution taking place. This should help to provide more reliable estimates of the tax prior to devolution and more accurate costs post devolution.

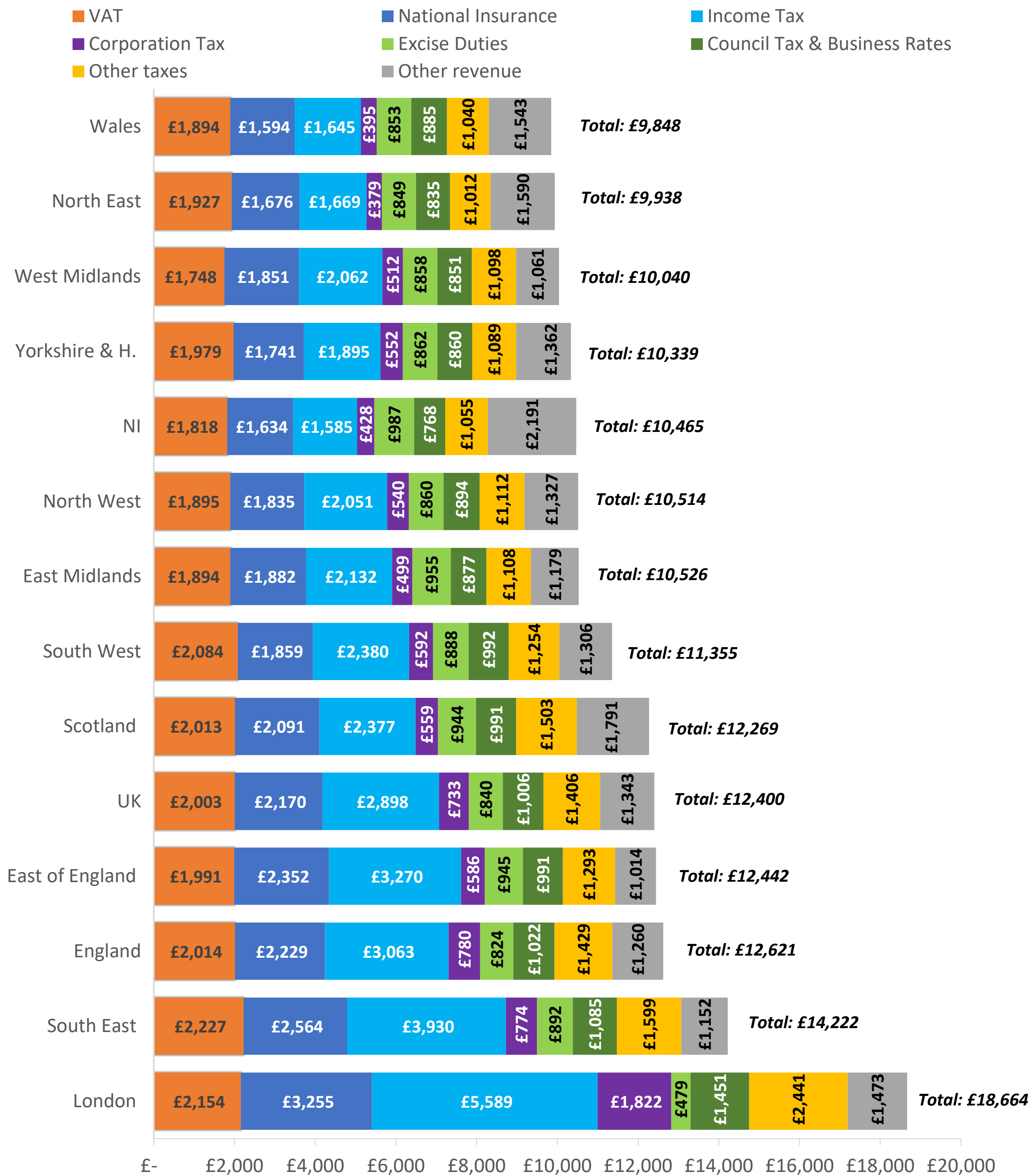
2.6 How does revenue raised per head in Northern Ireland compare to other regions of the UK?

2.6.1 Amongst UK regions, Northern Ireland is among the lowest contributors of 'total revenue' per head (as per Table 2.2, total revenue is total tax take plus 'other revenues'). Chart 2.10 highlights the figures for 2019/20 where Northern Ireland's total revenue per head was £10,465. The UK average was 18.5% higher, at £12,400 per head. However Northern Ireland is above Wales, North East, West Midlands and Yorkshire and Humber on this metric. On average since 1999/00, Northern Ireland total revenue per head has been £1,364 (14.5%) below the UK average.[75] This figure itself has been increasing in recent years, with an almost £800 increase in the difference (in nominal terms) since 2012/13, though there has been a small decline since 2018/19 (£124).

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

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

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



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

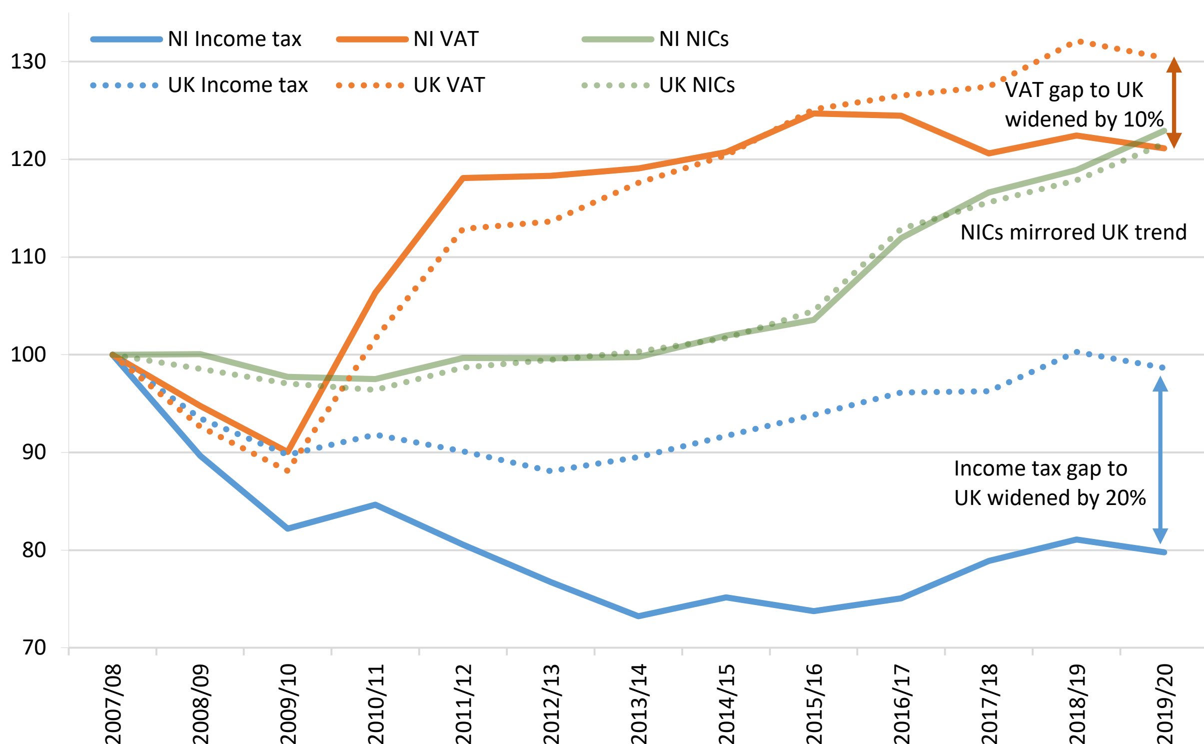
2.7 How stable is Northern Ireland's revenue base and how correlated to the UK tax base?

2.7.1 A fundamental issue when it comes to decisions around fiscal devolution relates to the size, stability and volatility of the tax base, specifically locally but also when compared to national trends. Whilst there may be a case to devolve a tax which currently raises a considerable volume of revenues, that case may well weaken or strengthen if revenues are expected to decline or increase, or be highly volatile or stable over time. These issues are explored in more

detail in Chapter 5, with regard to the subset of individual taxes we propose as being most suitable for devolution to Northern Ireland, however a useful beginning is made in this section.

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

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

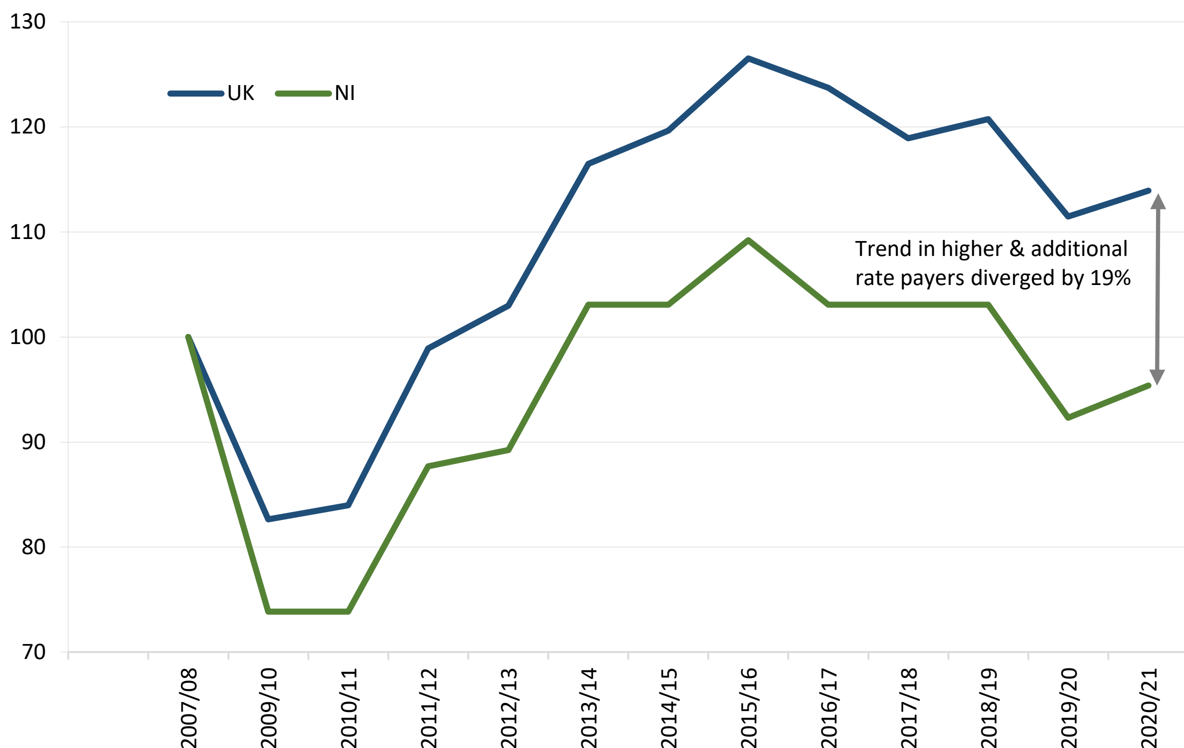


Source: ONS Country and Regional Public Sector Finances, FYE 2020: Revenue Tables.

2.7.3 Looking at the income tax base provides some insight as to why income tax receipts in Northern Ireland have experienced a poorer growth rate since 2007/08 when compared to the UK average. Firstly, regarding the number of income tax payers in Northern Ireland relative to the UK. In 2019/20, there remained circa 12,000 fewer income tax payers in Northern Ireland compared to before the 2007/08 financial crisis. This is despite the employment rate having made a full-recovery and surpassed the pre-2007/08 crisis peak by early 2016. Part of the explanation for this is the big changes to income tax policy in recent years, which has seen a large increase in the level of the Personal Allowance since 2007/08 – this has had a greater impact in Northern Ireland than the UK as a whole given the larger proportion of low income earners in Northern Ireland (see Table 2.3 below). One of the key impacts of these changes is that the number of income tax payers as a percentage of the adult population in Northern Ireland has declined from 57% in 2007/08 to 52% by 2019/20.

2.7.4 Secondly, the significantly lower proportion of total taxes deriving from the number of higher and additional rate tax payers in Northern Ireland versus the UK. Since the mid-2010s, there has been a large rise in the higher-rate threshold (which had followed a large reduction earlier in the decade). Whilst both the UK and Northern Ireland experienced a sharp decline in the number of higher and additional rate tax payers in the years subsequent to the 2007/08 financial crisis, it took Northern Ireland until 2013/14 to recover to its 2007/08 level, compared to 2011/12 for the UK as a whole. The UK has also experienced faster growth in the number of higher and additional rate taxpayers than in Northern Ireland across the period, which has resulted in an overall widening of this gap (see Chart 2.12). As of 2020/21, Northern Ireland had the lowest proportion of higher or additional rate payers of any UK region – at just 8.0%. This compares to 14.1% in England, 15.7% in Scotland and 8.2% in Wales. Table 2.3 shows the breakdown by UK region and also highlights that London and the South East have the largest shares of higher and additional rate payers of any UK region.

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



Source: HMRC income tax payers by country[76]

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

	Basic rate	Higher rate	Additional rate
London	77.2%	19.1%	3.7%
South East	81.5%	16.3%	2.2%
East of England	83.9%	14.4%	1.7%
Scotland	84.3%	15.0%	0.7%
England	85.9%	12.7%	1.4%
South West	88.1%	11.0%	0.9%
East Midlands	88.7%	10.5%	0.8%

West Midlands	88.9%	10.3%	0.8%
North West	89.3%	10.0%	0.7%
Yorkshire and the Humber	90.0%	9.3%	0.7%
North East	90.7%	8.9%	0.4%
Wales	91.8%	7.8%	0.4%
Northern Ireland	92.0%	7.5%	0.5%

Source: HMRC Number of individual income tax payers

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

2.7.5 One peculiar trend of note is the divergence between Northern Ireland and UK income tax receipts, which is not mirrored by Northern Ireland and UK National Insurance contributions receipts (see Chart 2.11). This is due to the increasingly progressive nature of income taxation compared to National Insurance, which subsequently affected the relative revenue yield from income tax, with a widening of this gap between Northern Ireland and the UK. This has not been evidenced in National Insurance contributions, given this tax's less progressive nature.

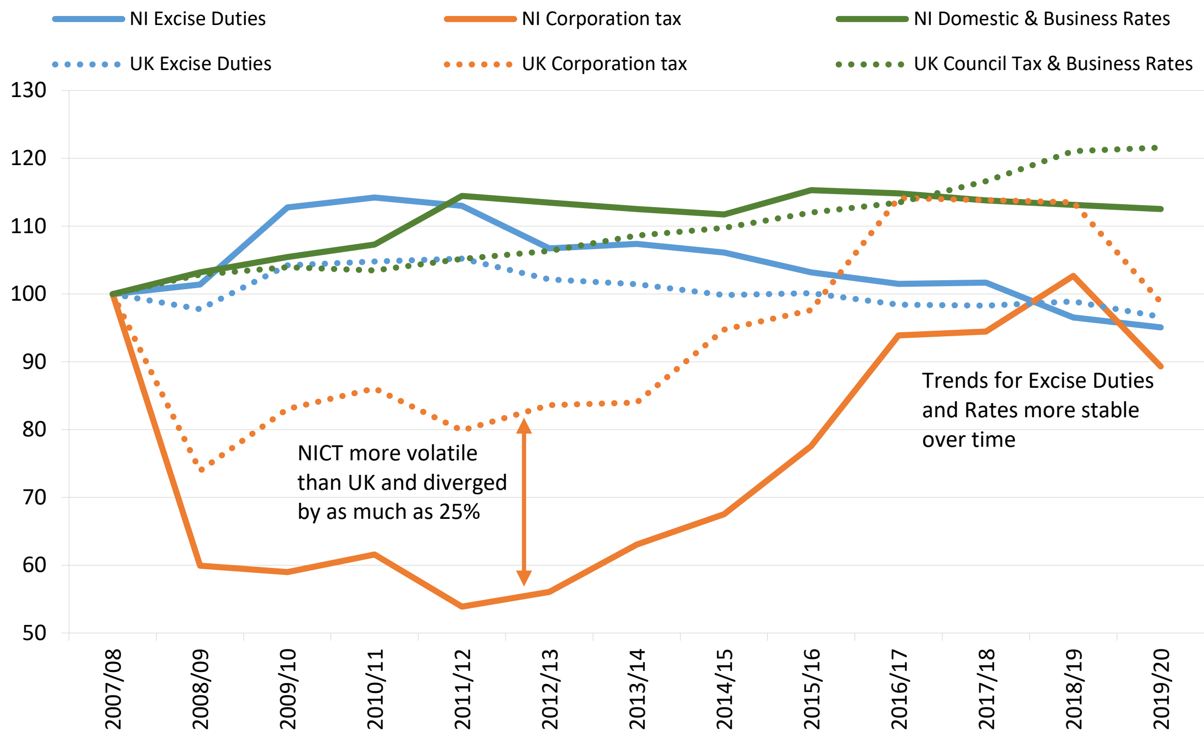
2.7.6 In terms of VAT, ONS estimates of tax receipts show that following a decline in the 2007/08 to 2009/10 period there has been significant increases in VAT receipts in both the UK and Northern Ireland (note there was a temporary VAT reduction, from 17.5% to 15% between 1 December 2008 to 31 December 2009,[77] at which point the rate reverted to 17.5% and then a further increase to a 20% rate from 4 January 2011, following the 2010 Budget). In 2019/20, 22% of total Northern Ireland tax receipts arose from VAT receipts, compared to 18.1% for the UK as a whole. However, as outlined in Box 2.4, it should also be noted that there are significant issues in relation to the reliability and precision of some tax estimates across the UK, including Northern Ireland. Estimates of VAT receipts for example (and other taxes) for the household sector apportioned regionally are derived from data from the Living Costs and Food (LCF) survey, which captures expenditure on goods and services. The current small sample size from the LCF for Northern Ireland, in addition to a number of long-standing known issues related to underreporting of expenditures presents issues in terms of the accuracy and reliability of the data collected. This means that for Northern Ireland there are significant concerns over how robust or suitable data from the LCF is as an indicator for significant tax values such as VAT and excise duties.[78]

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

2.7.8 The path of corporation tax receipts is more volatile, where Northern Ireland experienced a greater decline after the financial crisis and also took longer to recover to pre-crisis levels, only reaching 2007/08 levels (in real terms) again in 2018/19 (and then falling below again in 2019/20), compared to UK which exceeded pre crisis levels by 2016/17. It is also of note that

there is evidence that the corporation tax revenue attributable to Northern Ireland is underestimated because companies' profits are often attributed to the location of their head office. For large national corporations this is less likely to be in Northern Ireland. Therefore it may be more appropriate to allocate corporation tax based on the share of profits earned in Northern Ireland, which would see higher revenue attributed to Northern Ireland.[79]

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



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

Block grant adjustments (BGAs) – an introduction

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

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

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

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

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

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

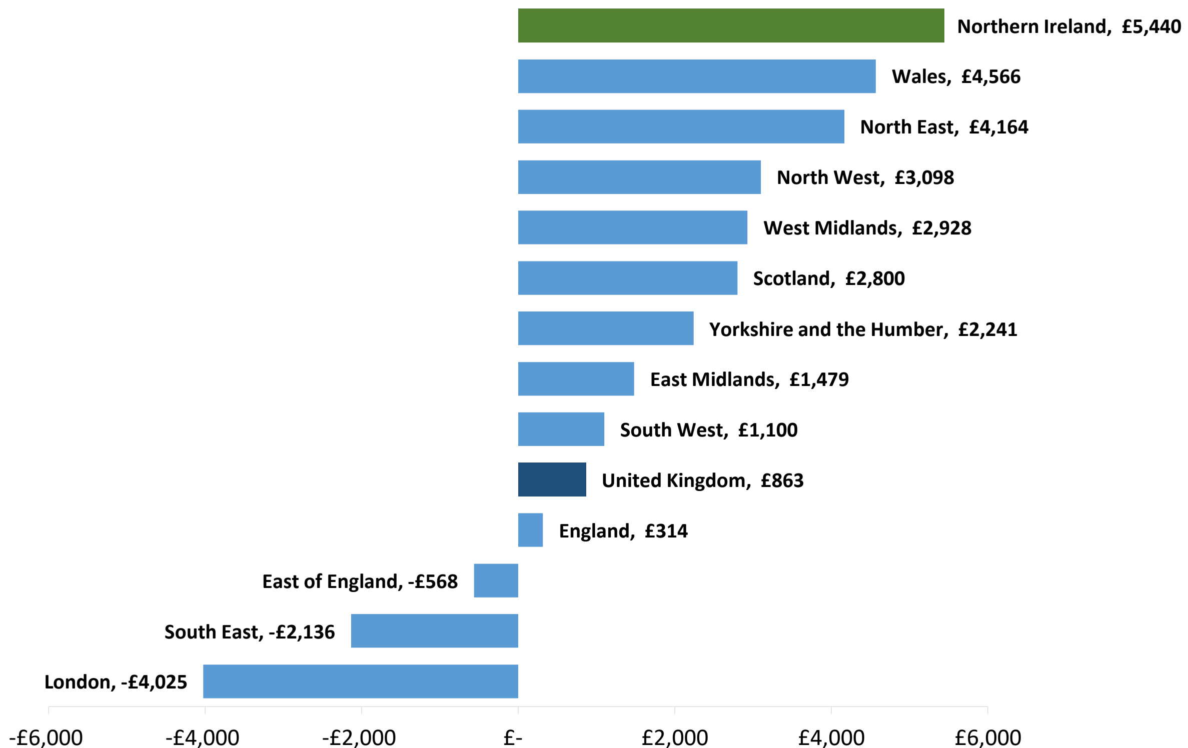
2.7.14 Block grant adjustments are therefore both technical and highly contentious issues. Options for Northern Ireland and the implications of different mechanisms for adjusting the block grant are discussed in further detail in Chapter 6.

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

2.8.1 Combining the figures for spending and revenues presented in the previous sections allows us to construct the 'fiscal balance' for Northern Ireland - in other words, what the difference is between all expenditure which is attributed to Northern Ireland (i.e. Total Managed Expenditure, TME) versus the total revenues raised or attributed to Northern Ireland (total tax take plus other revenue). TME includes, as it should, Northern Ireland's population share of 'non-identifiable' expenditure on such items as UK debt interest and overseas representation. In overall terms, Northern Ireland's net fiscal deficit for 2019/20 was £10,301 million which equates to 21% of Northern Ireland GDP[80] or 52% of Northern Ireland's overall tax take.

2.8.2 As shown in Chart 2.14, in 2019/20, Northern Ireland's net fiscal deficit per head (including public sector expenditure both identifiable and non-identifiable) was £5,440[81] which was proportionally the largest deficit of all the regions in the UK. Only three sub-regions of the UK ran a surplus, those being London, South East of England and East of England.

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

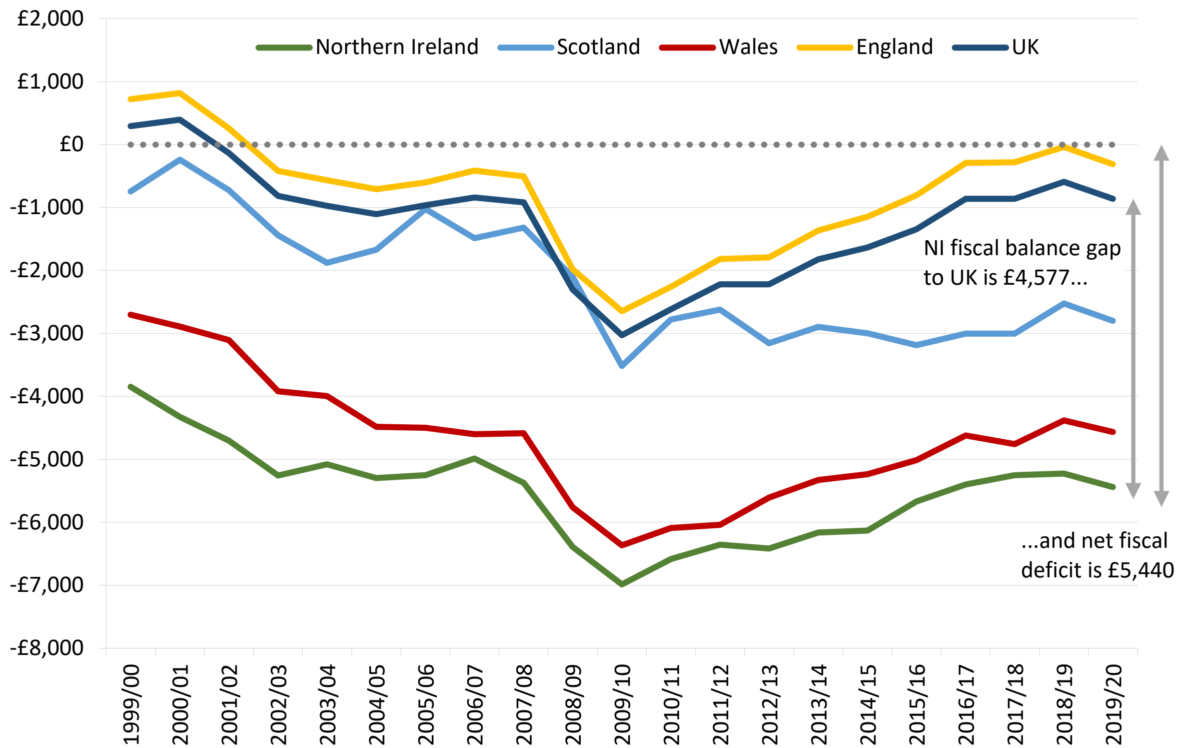


Source: ONS Country and Regional Public Sector Finances, FYE 2020.

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

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

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



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

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

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

2.9.1 While Total Managed Expenditure (TME) discussed in the previous section represents the total public spending in its very broadest sense, it is not representative of the spending that the NI Executive has 'control' over. The expenditure which the NI Executive does have control over is a subset of TME and is sometimes referred to as the NI Executive's Departmental Expenditure Limit Budget or 'DEL' Budget.

2.9.2 The funding available to the NI Executive that *is* under its control can be divided into the following main categories: the unrestricted 'block grant' from Westminster for programme spending and capital investments (otherwise referred to as 'Barnett-based grants' or DEL); Northern Ireland's own-source revenue (principally regional rates on houses and business

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

premises); and income from other fees and charges (such as annual vehicle testing fees). These primary resources are further complemented by bespoke funding or 'non-Barnett additions', for example, funding in support of political agreements made in Northern Ireland such as the 2015 Fresh Start Agreement, as well as some grants from the EU and replacement EU funding for farmers/fisheries. The NI Executive also has established borrowing facilities, through the Reinvestment and Reform Initiative (RRI).

2.9.3 Plans for the NI Executive Budget for 2022/23 and beyond have yet to be concluded, therefore we reference the most recent year here. The main sources of funding for the published 2021/22 NI Executive Budget include:

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

Each source of funding is explained in further detail below.

2.9.4 It should also be noted that the Total Budget (£16,610m) above, differs from the total departmental planned spend for Northern Ireland departments (£14,782.5m) outlined later in this chapter. This is because , in addition to the published Total Planned Spend Budget figures, departments will also receive income from EU funding and other income sources, which is then used for departmental spending that is not included within the published (Total Planned Spend) figures in the Budget.

Box 2.5 Public Spending Terminology

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

Annually Managed Expenditure (AME) - Generally, programmes are funded in AME if they are demand-led and volatile in a way that could not adequately be controlled by the devolved administrations; and/or are so large that the devolved administrations could not be expected to absorb the effects of volatility within DEL. AME therefore covers programmes such as (most) welfare payments and public service pensions. Where a devolved administration offers broadly similar terms for an AME programme, the UK Government will fund the cost of this programme. Where a devolved administration wishes to offer more generous terms for an AME programme, then the excess over that implied by adopting broadly similar terms for that programme (and therefore broadly comparable costs) must be met by the devolved administration. In these circumstances, devolved administrations will generally need to fund any costs that are above a population share of the costs of the UK Government programme.[82]

Departmental Expenditure Limit (DEL) is a spending aggregate that sets firm net expenditure limits for a multi-year period. DEL includes that expenditure which is generally within the department's control and can be managed within multi-year limits. These limits are set at an NI Executive level by UK Spending Reviews. The NI Executive Budget then sets out individual Northern Ireland departments' DEL controls which have

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

been determined through the local Budget process. DEL is split into Resource DEL (RDEL) which reflects the ongoing cost of providing services and Capital DEL (CDEL) which reflects investment in assets which will provide, or underpin, services in the longer term.[83]

The NI block grant from Westminster and applying Barnett

2.9.5 As referenced in HM Treasury's Statement of Funding Policy, the NI Executive's block grant funding is presented as the Total Departmental Expenditure Limit (DEL) within the budgeting framework. It is split between resource DEL and capital DEL.[84]

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

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

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

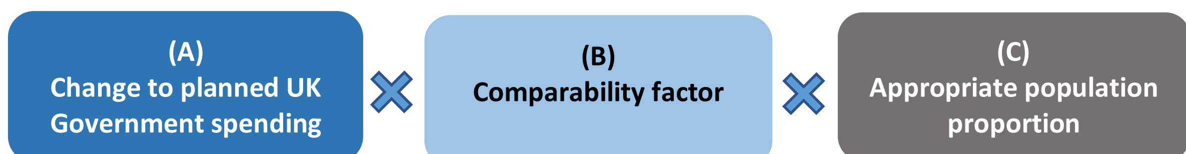
2.9.9 The Barnett formula therefore determines *changes* to each devolved administration's funding with reference to *changes* in DEL funding for UK government departments; it does not determine the *total* allocation for each devolved administration afresh each time it is applied.

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

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

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

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



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

refunded by HM Revenue and Customs. Barnett formula changes for the NI Executive are therefore abated (reduced) by 2.5%.

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

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

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

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

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

Domestic and Non-Domestic Regional Rates

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

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

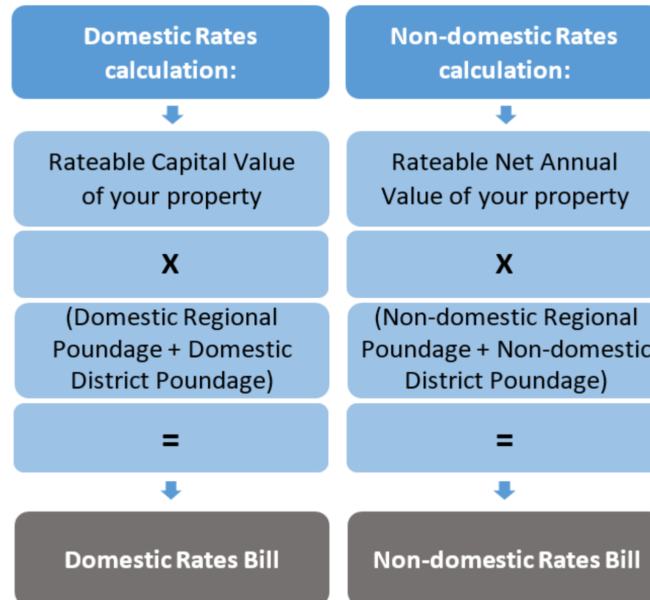
2.9.19 Two types of rates are levied in Northern Ireland – domestic rates for residential properties and non-domestic rates for business properties. There are also two elements to a rates bill – the district rate and the regional rate. The district rate serves to finance local government, i.e. local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

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

2.9.21 Domestic rates are based on the capital value of the property. The last general revaluation of domestic rates in Northern Ireland was carried out in 2007 and was based on January 2005 values. This differs from GB where valuation dates vary. In England and Scotland, Council tax is based on valuations from April 1991; and in Wales it is based on valuations from April 2003.

Non-Domestic rates are calculated on the basis of the property's rental value known as the Net Annual Value (NAV). Rates bills are calculated by taking either the rateable capital value of a property (for domestic rates) or the rateable net annual value of a property (for non-domestic) and then multiplying that value by the sum of the domestic or non-domestic district and regional rates, as appropriate. Chart 2.16 summarises this calculation.

Chart 2.16 Calculation of Northern Ireland Rates bills



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

2.9.23 For example, the capital value cap of £400,000 on domestic properties which limits the current maximum regional rate to £1,829 per property is a policy choice which limits the progressive nature of rates and reduces the total yield (note that as the £1,829 is only the regional element of the rate assessment, the total bill is capped at approx. £3,900 depending on the district Rate). The cap was introduced to create a parity with the highest council tax bands in GB.[85] In GB, each domestic property is placed in a council tax band depending on the value of the property at the relevant valuation date. Each council sets the amount of council tax that is payable for properties that fall within each band; this effectively caps council tax bills. In England, the highest band is for properties valued in 1991 at more than £320,000, Scotland more than £212,000 and Wales more than £424,000.

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

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

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

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

Note: Northern Ireland Average (mean) Rates Bill here is based on data from the Northern Ireland Capital Valuation List for domestic properties (which displays capital values as of January 2005, not current house sales) and the rates poundages published on the DoF website.[86] Council tax bills in GB are based on the value of the property at a set point in time (April 1991 for England and Scotland; April 2003 for Wales).

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

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

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

Other income

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

Non-Barnett additions[xxii]

2.9.29 The NI Executive receives various 'non-Barnett additions' to the block grant, which are typically ring-fenced for particular purposes. The NI Executive has received several such additions to reflect political developments, such as the New Decade New Approach (NDNA) agreement in 2020 (£900 million) and the Confidence and Supply Agreement between the DUP and the

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

Conservative Party in 2017 (£1bn), as well as specific funding relating to the NI Protocol, shared education/housing and security funding. In addition, like the other devolved administrations, it has also received grant funding for 'City Deals' where the NI Executive matches that funding pound for pound (£617 million).

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

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

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

Source: DoF, Public Spending Directorate

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

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

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

City Deals					£20m		**£20m**
NI Protocol						£22.5m	**£22.5m**
Total		***£40.9m***	***£44.9m***	***£462.m***	***£436.2m***	***£648.7m***	***£1.633bn***

Source: DoF, Public Spending Directorate

Grants from the EU

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

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

2.9.33 Following the introduction of the UK Internal Market Act 2020 (UKIM), additional funding from the UK Government is now also invested directly in Northern Ireland, rather than allocated through the Barnett formula and the Block Grant. The recent announcement of an allocation of £49m to Northern Ireland through the UK Government's Levelling Up Fund (which is a replacement for funding from the EU Structural Funds) is an example of this.[87]

Borrowing

2.9.34 The issue of borrowing powers is important to consider, both as a source of ongoing income and expenditure (given capital and interest repayments), but also in the context of the devolution of additional fiscal powers. If additional fiscal powers are devolved to Northern Ireland it can be expected that additional budgetary tools, including borrowing, will be required to operate these powers. This sub-section provides an outline of the borrowing powers of the NI Executive, it also provides detail of the capital borrowing powers of the Scottish and Welsh Governments, with Chapter 3 providing further detail on the additional borrowing which Scotland and Wales obtained as part of their fiscal devolution packages. Chapter 6 explores what further fiscal tools may be may be required for Northern Ireland as a result of the taxes we propose in our report.

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

2.9.36 The **Northern Ireland (Loans) Act 1975**, as amended by the Northern Ireland (Miscellaneous Provisions) Act 2006, enables the NI Executive to borrow for capital purposes up to a cumulative maximum of £3 billion. Capital borrowing facilities are available through the

Secretary of State of Northern Ireland from the National Loans Fund. Annual limits on borrowing are determined by HM Treasury.

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

2.9.38 The **Northern Ireland Act 1998** also enables NI Executive Ministers to borrow for purposes other than capital expenditure, up to a maximum of £250 million. The sole purpose of this loan facility is to give the NI Executive the ability to borrow over the short-term for cash management purposes, in circumstances where it is necessary to provide a working balance or meet an in-year excess in expenditure over income within the Northern Ireland Consolidated Fund. It cannot be used by the NI Executive to increase its budget, it is a cash borrowing power only.

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

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

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

2.9.42 In summary, the National Loans Fund is the 'mechanism' for the NI Executive to borrow capital money. It does this by using the Reinvestment and Reform Initiative (RRI) arrangements – which outline the agreement between the NI Executive and HM Treasury on the parameters around which capital borrowing can take place. The Northern Ireland Act 1998 is, in effect, an 'overdraft' or cash management facility to smooth expenditure as opposed to boost spending.

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

2.9.43 Since the introduction of the RRI borrowing facility in 2003-04, RRI Borrowing budgetary cover has been used to *cover* £3,205.2 million at the end of 2021-22. The *actual cash borrowing* from the National Loans Fund over this time period is £2,628.9 million. The RRI Principal that was repaid at the end of 2021-22 totalled £1,060 million.

2.9.44 This means that the *net borrowing position* of the NI Executive was £1,569 million by end of 2021-22. Leaving borrowing 'headroom' of £1,431 million. The value of repayments made by the NI Executive (covering principal and interest) in the latest budget year alone - 2021-22 - is £172.5 million.

2.9.45 The NI Executive's capital borrowing powers can be compared to those in Scotland and Wales. The 2012 and 2016 Scotland Acts allow the Scottish Government capital borrowing power of up to £450m per annum, with a total cap of £3 billion. This equates to £549 per capita. The Wales Acts 2014 and 2017 allow the Welsh Government capital borrowing power of up to £150m per annum, with a total cap of £1 billion. This equates to £317 per capita. As above, the NI Executive can borrow for capital purposes up to a cumulative maximum of £3 billion, equating to £1,584 per head of population in Northern Ireland. While the NI Executive has relatively more capital borrowing powers than the Scottish or Welsh Governments, this partly reflects the fact the NI Executive has many of the responsibilities of local authorities in Scotland and Wales. Chapter 3 provides further detail on the additional borrowing powers which the Scottish and Welsh Governments obtained as part of their fiscal devolution packages and which the NI Executive may require as part of any fiscal devolution process.

2.10 How is the NI Executive's budget agreed?

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

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

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

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

2.10.5 There has been much political debate surrounding the desire for the NI Executive to move to multi-year budgets, and all devolved administrations have made clear their desire for multi-year budgets to be delivered. New Decade New Approach (NDNA) also emphasised the need for a multi-year Programme for Government to be supported by a multi-year budget. The 2021

Spending Review, announced in October 2021, sets out multi-year budgets for UK government departments and the devolved administrations' block grants from 2022-23 to 2024-25.[88]This allowed the Northern Ireland Finance Minister to propose a draft multi-year Budget for 2022-23 to 2024-25, which went out for public consultation in December 2021. However, the NI Executive was not able to agree a multi-year Budget before the end of its mandate.

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

2.10.7 Following agreement of a Budget, the NI Executive has an established process for managing the in-year management of the budget. Full details of that process are published annually by the Department of Finance as In-Year Monitoring Guidelines.[89]

2.11 How does the NI Executive spend its resources?

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

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

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

Source: DoF, NI budget 2021-2022

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

2.11.3 The Total Planned Spend outlined in Table 2.7 above (£14,782.5m) does not match the NI Executive's Budget (£16,610m) as outlined earlier in this chapter (a difference of £1,827,5m). This is because in addition to the published Total Planned Spend Budget figures, departments will also receive income from EU funding and other income sources, which is used for departmental spending that is not included within the published (Total Planned Spend) figures in the Budget.

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

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

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

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

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

Department & measure	Description of Measure	Value of measure
Department for Communities		
Existing welfare mitigations	This includes payments related to certain welfare reforms including the Benefit Cap, the "Bedroom Tax" and Personal Independence Payment	£42.8m
Housing Benefit Rates	In 2013/14, the UK Government decided that Housing Benefit Rates should be moved from the AME budget to the DEL budget and applied a cut of 10%. NI Executive continues to 'compensate' for this cut each year	£12m

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

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

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

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

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

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

2.12.5 Conversely, there are also 'sub-parity' policies, where provision is less generous in Northern Ireland than in other parts of the UK, although there are relatively fewer examples of this. Two such examples are childcare support and, arguably to a lesser degree, apprenticeships. England offers 30 hours per week of free childcare to eligible working parents of three and four year olds. The same provision is not available in Northern Ireland despite costs being estimated as the second highest amongst 24 European countries reviewed in 2019.[90] The apprenticeship levy operates on a UK-wide basis; however, although Northern Ireland businesses pay the same levy, they are unable to access apprentices through government vouchers in the same way. The NI Executive does, however, receive a Barnett consequential as a result of UK government spending on apprenticeships in England.

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

2.13 Conclusions

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

2.13.2 What might give us pause, though, is the divergent *trends* between Northern Ireland and rUK. If Northern Ireland is becoming gradually poorer relative to rUK, or if relative tax revenues are falling, then devolution in and of itself could make Northern Ireland worse off over time *unless* the block grant is adjusted to account for that. Block grant adjustments are both technical and highly contentious issues which are examined in further detail in Chapter 6.

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

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

Chapter 3

Wider devolution considerations: UK and Republic of Ireland

3.0 Overview

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

3.1 Key points

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

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

3.1.3 **The RoI tax base -** The level and composition of RoI tax revenues differs significantly from those in Northern Ireland, with the amount of revenue collected on a per head basis much higher in RoI. The total amount of revenue raised in 2020 in RoI was €16,604 per head (approx. £14,760), compared to £12,400 per head in the UK and £10,465 per head in Northern Ireland. This should be understood within the context of the higher price levels and higher incomes in RoI relative to Northern Ireland and the UK. Proportionally RoI generates much more in tax revenues than the UK or Northern Ireland from taxes such as income tax, social contributions and corporation tax. RoI also has significant differences in its tax structure compared to the UK and Northern Ireland, including: a more progressive income tax structure; a (current) 12.5% corporation tax rate; a lower hospitality VAT rate; differing excise rates; and no air travel tax or aggregate levy equivalent.

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

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

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

3.2 Fiscal Devolution in the UK

3.2.1 The OECD document: *2019 Report World Observatory on Subnational Government Finance and Investment – Key Findings,* ("SNGWOFI Report")[91] draws attention to a trend for increasing decentralisation across the world over the past seventy years; one which has intensified over the last twenty years in particular.[xxv] The report also draws attention to some areas where *recentralisation* has occurred, partly attributable to political changes, but also to the fact that decentralisation, when not designed and implemented appropriately to take account of the local context, can result in unforeseen outcomes which work *against* the benefits sought.

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

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

Overview of devolved spending across UK

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

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

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

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

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

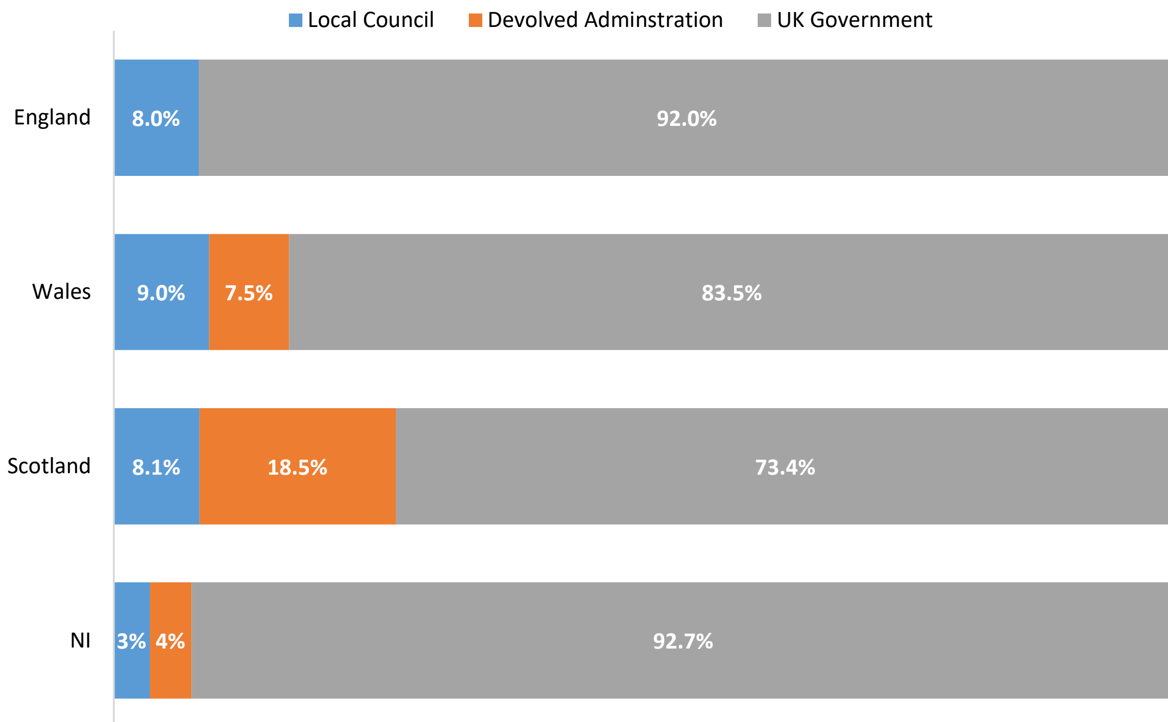
Proportion of tax revenue raised at subnational level across UK

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

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

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

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



Source: Office for National Statistics / IFG

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

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

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

Scotland

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

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

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

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

3.2.11 The ***Scotland Act 2016*** went further. It gave the Scottish Parliament the power to set the rates and thresholds of income tax on non-saving, non-dividend income, and power to introduce new rates and bands of income tax above the UK-wide Personal Allowance. The 2016 Act also included the **assignment of the first 10 percentage points of the standard rate of VAT** and the first 2.5 percentage points of the reduced rate of VAT applicable to Scotland, to the Scottish Government's budget (currently on hold), and provided for the devolution of the **aggregates levy**, which is due to be devolved in future, and devolved powers over setting **air passenger duty** (due to be replaced by air departure tax, but currently on hold).[92]

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

3.2.13 The fiscal framework commits to the use of the 'Indexed Per Capita' (IPC) method for adjusting Scotland's block grant following tax and social security devolution. Under this arrangement, if devolved tax revenues in Scotland grow at the same per capita rate as the equivalent revenues in rUK, the Scottish budget is no better or worse off than it would be without tax devolution. If devolved Scottish revenues grow relatively faster per capita than the equivalent rUK revenues – either because of tax policy changes or faster growth in the tax base in Scotland – then the Scottish budget will be better off.[93] We will discuss block grant adjustments in more detail in Chapter 6.

3.2.14 Scottish income tax policy has diverged from rUK since it was first implemented in April 2017. Scotland now has a five-band structure of income tax (as opposed to the three band UK structure). The basic rate band is split in three, to include a 19p starter rate and a 21p

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[xxviii] Subsequently, in December 2014 (and before LBTT was introduced in April 2015), the UK Government made changes to UK residential stamp duty land tax, also moving away from the 'slab structure' to one applying different rates to different bands within the total price.

intermediate rate. The higher and additional rates are each one percentage point higher in Scotland than rUK. Perhaps most significantly, the higher rate threshold is set significantly lower in Scotland (£43,662 in 2021/22) compared to rUK (£50,270). The implication is that Scottish taxpayers with incomes below the Scottish median income (£27,000) pay marginally less income tax in Scotland than they would in the rest of the UK, while those with above median incomes pay more tax than they would in the rest of the UK. The additional tax liability for a Scottish taxpayer with income of £50,000 is around £1,500 annually – equivalent to 3% of gross income.

3.2.15 As a result of these policy changes, Scottish income tax revenues were estimated in 2019/20 to be around £500m[94] (4%) higher than they would be if the rUK policy prevailed. However, the Scottish budget in 2019/20 was ultimately only around £150m better-off than it would have been without tax devolution. This is because the income tax base has grown more quickly in rUK than in Scotland. Without income tax devolution, Scotland would have received a share of this faster growth in rUK tax revenues via the Barnett Formula. But after tax devolution, growth in rUK income tax revenues are no longer pooled and shared across the UK. Thus the Scottish budget has benefited from the policy decision to vary income tax policy, but some of this revenue benefit has been offset by the fact that the Scottish budget no longer receives a share of the (relatively faster) growth in rUK revenues.

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

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

3.2.18 While the main disability and carer benefits are currently being operated in line with UK government rules, the Scottish Government is in the process of designing its own schemes to replace these, and indeed, some of the smaller UK benefits have already been replaced by new Scottish schemes e.g. *Best Start* grants replacing the UK *Sure Start* maternity grants.[95]

3.2.19 In relative terms, Scottish tax policies tend to show more generosity to taxpayers in the lower part of the distribution of the relevant tax base, and levy relatively higher tax rates on taxpayers in the upper part of the distribution of the tax base. For example, *Land and Business*

Transactions Tax levies a slightly lower tax rate on most properties in Scotland than the equivalent stamp duty land tax would imply, but a higher rate on transactions of the most expensive homes. Council tax rates are lower in Scotland than England, but Scottish homes in bands E-H pay more tax relative to those in bands A-D than is the case in England (i.e. the tax is more progressive with respect to band than in England). Business rates reliefs for low-valued properties are slightly more generous in Scotland than England (and Scotland has levied a further supplement on the highest value properties). Further, income tax, as described above, is more progressive in Scotland than in England. That said, most changes introduced by the Scottish Government do not represent a major departure from policies in place elsewhere in the UK.[96]

3.2.20 Looking forward, the issue of enhancing fiscal devolution remains live in Scotland, with the current Scottish Government having called for the devolution of National Insurance, capital gains tax and control over the savings and dividends element of income tax.[97] The current Scottish Government committed to pursuing the devolution of VAT in their 2021 manifesto,[98] following the UK's departure from the EU, and the removal of the requirement to comply with EU VAT rules.

Wales

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

3.2.22 Under the 2017 Act, income tax was partially devolved to Wales and replaced by the *Welsh Rates of Income Tax* which apply to the non-savings and non-dividend income of Welsh taxpayers, from April 2019. The associated block grant adjustment, which accompanied devolution, is described in Section 3.2.25. In practice, the basic, higher and additional rates of income tax levied by the UK Government were reduced by 10 pence, with the Welsh rate then being added to this. In relative terms, there are fewer high-earning individuals residing in Wales, less income tax is raised per person on average, and a much smaller share of income tax is raised at the higher and additional rates. Based on the Welsh Budget as of May 2021, devolved Welsh tax revenues represented 17% of the Welsh Government's budget for 2021-22 (some £20.5bn), of which 10.2% (some £2.1bn) was attributable to Welsh income tax.[xxix] [99] To date, the Welsh Government has not used its tax-varying powers over income tax. It has always replaced the UK tax poundage vacated by the same amount, with the effect that income tax levels are the same in Wales as in England.

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

3.2.23 Recently, however, research published by the Welsh Parliament has acknowledged that, given the economic challenges faced by Wales as a result of the COVID-19 pandemic, pressure is likely to increase on the Welsh Government in future to use the tax-varying powers over income tax paid in Wales. [100] It is also acknowledged that the porosity of the Wales-England border may act as a constraint on the level of divergence that is possible between UK and Welsh income tax rates, as taxpayers could simply migrate across the border, with a corresponding impact on Welsh income tax revenues. Nearly 48% of the Welsh population live within 25 miles of the border.[101]

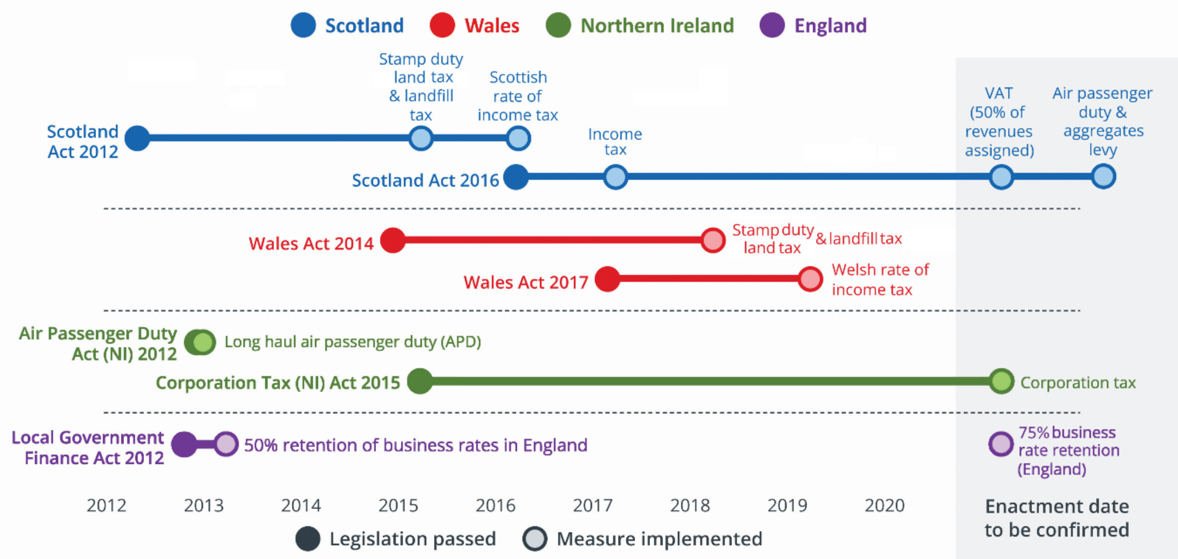
3.2.24 Under the ***Wales Act 2014***, the Welsh Government was given the power to seek competence from both Houses of the UK Parliament and the National Assembly of Wales to introduce *new taxes* in Wales. In March 2020, the Welsh Government formally requested devolution of further tax competence relating to a 'vacant land' tax and is carrying out investigations into other potential new taxes, including a disposable plastic tax and a tourism tax.[102] The formal request in March 2020 was the first time that the mechanism in the 2014 Act had been used and we understand the process has proved challenging to date, attracting criticism from the Welsh Finance Minister, and with Senedd Research, the research body of the Welsh Parliament, reporting in October 2021 that discussions with the UK Government had reached "an impasse".[103]

3.2.25 Following the fiscal framework agreed in 2016, devolved revenues from income tax became the largest source of tax revenue for the Welsh Government, followed by council tax and non-domestic rates (both local government taxes).[104] As with the position in Scotland, under the fiscal framework, the Welsh block grant is adjusted downward in line with the assessment of the revenue forgone by HM Treasury after tax devolution, meaning that differential growth in the Welsh tax base will have a significant and direct impact on the size of the Welsh budget.[105] The nature of block grant adjustment is somewhat different than in Scotland and we will discuss this in more detail in Chapter 6. Recent projections by Cardiff University's Wales Governance Centre of the net effect of tax devolution from 2018-19 to 2024-25 have estimated a positive net effect on the Welsh budget, as a result of faster growth in revenues in Wales. They predict that, inclusive of projected positive reconciliations with respect to Welsh Rates of Income Tax, the net effect of tax devolution could amount to more than £200 million by 2024-25;[106] projected gains being largely attributable to growth in the Welsh tax base.[xxx]

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

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

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



Source: Derived from Institute for Government analysis of legislation.gov.uk, the fiscal frameworks for Scotland and Wales, and the House of Commons Library briefings.

Note: Recent statements from the UK Government Communities Secretary suggest that plans for 75% business rate retention have since been shelved.[107]

3.3 Budgetary management tools for fiscal powers – Scotland and Wales

3.3.1 In Chapter 2 we outlined the 'base' borrowing powers of the three devolved administrations. In this section we highlight the additional budgetary tools which Scottish and Welsh Governments obtained alongside their recent additional fiscal powers.[108] If the NI Executive is to get additional fiscal powers, it will also likely need additional budget management tools. What these should be exactly will depend on what fiscal powers are devolved (and the outcome of any negotiations with the UK Government).

Scotland

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

3.3.3 The borrowing limit for forecast error borrowing increases to £600m per year for a period of three years when there is, or is forecast to be, a Scotland-specific economic shock.[xxxi] However, this does not alter the total annual borrowing limit, which remains £600m in such circumstances (i.e. if there is a Scotland-specific economic shock, the Scottish Government

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

could borrow £600m for forecast error; but that would leave it no capacity to borrow for cash management).

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

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

Wales

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

3.3.7 For resource borrowing, the Welsh Government **can borrow up to £200m each year for forecast errors (within an overall £500m cap)**. Furthermore the Welsh Government Fiscal Framework allows for the creation of a Wales Reserve.

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

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

Table 3.1: Budget management tools in Scotland and Wales

	Scotland	Wales
Reserve:		
annual payments in	Unlimited, subject to the aggregate cap	Unlimited, subject to the aggregate cap
aggregate limit	£700 million	£350 million
annual drawdown limit	£250 million (resource) £100 million (capital)	£125 million (resource) £50 million (capital)
Resource borrowing		
Aggregate cap:	£1.75 billion	£500 million
Resource borrowing for forecast error: annual limit	£300 million	£200 million
Resource borrowing for cash management: annual	£500 million	£500 million
Resource borrowing for economic shocks: annual limit	£600 million	n/a
Resource borrowing: total annual limit	£600 million	£500 million
Context		
Resource DEL budget 2021/22*	£36.7bn	£16.5bn
Full value of devolved revenues 2021/22	£13.8bn	£2.8bn

Source: Fiscal Commission analysis using Scottish[109] and Welsh[110] Fiscal Frameworks; Scottish Government's Medium Term Financial Strategy; OBR Welsh Taxes Forecasts March 2022; HM Treasury Block Grant Transparency: December 2021

**Resource DEL budget for Wales is after block grant adjustments. DEL budget for Scotland is before block grant adjustments*

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

3.3.11 In Chapter 6 of this report we will consider in more detail the likely requirements for budget management tools for the NI Executive in relation to the taxes that we propose as being suitable for devolution.

3.4 Republic of Ireland: economy and taxation

Introduction

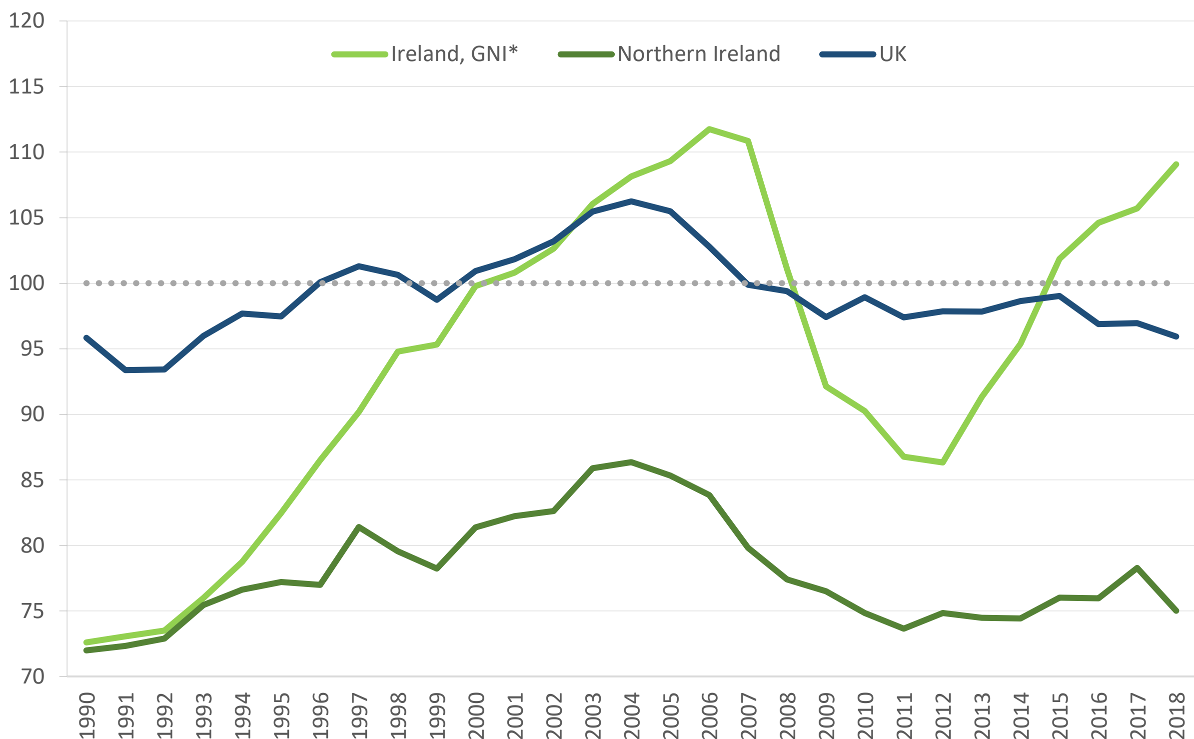
3.4.1 In the context of fiscal devolution within the UK, Northern Ireland is in a unique position. Northern Ireland shares a land border with another country and therefore tax jurisdiction, the Republic of Ireland (RoI). This sets the context for fiscal devolution in a differing light from that of Scotland and Wales. It is important to have an understanding of the economic and fiscal environment of RoI, in particular given the potential for the movement of people, consumer spending and investment across the border, when considering fiscal devolution in Northern Ireland. This section provides some insight; added detail can be found on the Commission website.[111]

Key drivers of economic growth in RoI

3.4.2 Chapter 2 showed the recent economic growth trajectory of RoI compared to the UK and Northern Ireland economies (from 2006 onwards). Looking at a longer time horizon, and

considering the growth trajectory of RoI, UK and Northern Ireland relative to the average growth levels of the EU from 1990 (as in Chart 3.4 below) it is clear to see the success of the RoI economy over the last 30 years. That is, with the notable exception of the significant impact of the financial crisis from 2007/08. The RoI economy has progressed from some 30% below the EU15 in terms of GDP/GNI*[xxxii] per head and at similar levels to Northern Ireland to an economy significantly exceeding the EU15, including the UK.

Chart 3.4 GNI/GNI* per head, adjusted for purchasing power standard (PPS)[xxxiii] , (100= EU15 average) 1990-2018



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

3.4.3 The full range of factors underlying RoI's economic success have been well rehearsed[112] [113] and include access to the EU Single Market; significant investment in education; and successful FDI attraction policies over the long-term. These successes have helped the RoI economy become one of the most globalised and successful in Europe. To better understand the drivers of growth of the RoI economy over the last 30 years Table 3.2 shows growth in GDP/GNI* and a decomposition of the growth in GDP/GNI* per capita into a series of components: productivity;

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

[xxxiii] Purchasing power standard (PPS) is the technical term used by Eurostat for the common currency in which national accounts aggregates are expressed when adjusted for price level differences using Purchasing power parities (PPPs). PPPs tell us how many currency units a given quantity of goods and services costs in different countries. Using PPs eliminates the effect of price level differences across countries created by fluctuations in currency exchange rates.

employment rate; labour market participation rate; and the working age population rate (or inverse dependency rate) across two periods, from 1990-2005 and 2005-2019.

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

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

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

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

3.4.4 A significant factor in RoI's higher growth rate than the UK or Northern Ireland over the last 30 years has been its more rapid growth in **population**. This growth in population between 1990 and 2005 owed much to a large influx of people, mainly from the Eastern European EU accession states. There was also a reversal in migration from RoI compared to previous generations, where significant numbers had previously emigrated from RoI for economic reasons.[114] The rapid growth in population has been maintained in RoI since 2005, with the population growing by 1.3% a year on average compared to 0.7% a year in Northern Ireland and the UK with this higher growth being driven by substantial immigration.[xxxv]

3.4.5 The rate of growth in **productivity** (output per person employed) in RoI in the 20 years leading up to 1990 had been higher than in the UK and much stronger than in Northern Ireland. From 1990 to 2005 performance was similar to the UK and remained significantly higher than in Northern Ireland. In the 2005-2019 period, the effects of the financial crisis significantly dented the rise in productivity, but growth in RoI remained higher than in the UK or Northern Ireland on average throughout this period with strong growth in productivity in the years post the financial crisis.[115] RoI has seen productivity growth in both absolute and relative terms, across both foreign and domestically controlled sectors and has seen its productivity gradually pull ahead of the EU15 since 2000. Even when the effect of non-resident owned firms are removed from RoI's productivity figures, the remaining domestic sector still outperforms Northern Ireland.[116]

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

Pop1564 refers to population aged 15 to 64 years

[xxxv] Note that the figures provided here will differ to figures on Northern Ireland and UK population growth in Chapter 2 as they cover different time periods. Figures are taken from ONS population projections in both examples.

3.4.6 The RoI **labour market** performed strongly between 1990 and 2005. In 1990 the **unemployment rate** in RoI was 13% and it fell rapidly in the late 1990s. By 2005 it was 4.6%. This reduction in the unemployment rate (and increase in the employment rate) was in significant part driven by individuals who were previously inactive finding work and contributing significantly to output growth in RoI - by around 0.5 percentage points a year.[117] A similar process in Northern Ireland also contributed significantly to Northern Ireland growth to 2005. For the UK, with much lower unemployment in 1990, there was a more limited increase. In the latest period since 2005, the unemployment rate rose in all three economies to a peak during the financial crisis, but had, once again, returned to high levels of employment by 2019. This meant that relative changes in the employment rate made significantly less contribution to growth in the three economies between 2005 and 2019.[118]

3.4.7 In RoI an increase in **the participation rate** between 1990 and 2005 contributed a very large 1.0 percentage point a year to growth. This exceptional contribution was largely driven by rising female labour force participation. In 1990 Irish female participation rates were very low by European standards, despite the fact that women were, on average, better educated than men. However, a combination of wider cultural changes and greatly increased labour market demand for skilled labour saw a dramatic increase in female employment as women remained in the labour market or re-entered it. For the UK, female participation rates were already high in 1990 so that there was much more limited scope for further increases in the participation rate. Therefore, for both the UK and Northern Ireland, between 1990 and 2005 the participation rate changed little and did not affect overall growth in the economy. From 2005 onwards however, there has been no growth in the RoI employment rate or labour market participation rate, in contrast to both Northern Ireland and UK experiencing small levels of growth.[119]

3.4.8 The period 1990-2005 also saw a major contribution to growth from a **falling dependency rate** in RoI resulting from a falling birth rate, growth in the population of working age, and low levels at older ages (as high numbers of those born in RoI, now in older age groups, had previously emigrated). However, more recently, since 2005, the rate of old age dependency has begun to rise. A very similar pattern is seen in the UK and Northern Ireland post-2005.[120]

3.4.9 While not referenced in Table 3.2 it is also notable that a major factor in the high rate of productivity growth, in the period from 1990-2005 was the rising **educational attainment** of the population. This played a major role in the rise in labour force participation, for example as women with tertiary level education were much more likely to be part of the labour force. The rising educational attainment also better matched the supply of labour, by level of education, to the demand for labour in the RoI economy.[121]

3.4.10 Looking beyond some of the hard economic data it is of note that, in present day terms, Northern Ireland does score more highly than RoI when it comes to many quality of life measures such as life satisfaction.[122] Additionally, in terms of household expenditure patterns, there are differences between Northern Ireland and RoI, with RoI households spending a higher share of their expenditure on healthcare, education and housing (32% versus 26% in Northern Ireland) and Northern Ireland spending proportionally more on recreation and retail.[123] This is a cautionary note that suggests that the 'lived experience' for citizens in both jurisdictions may be more similar than the hard economic data sometimes suggests.

RoI - A tale of two economies?

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

3.4.12 There is little doubt that the RoI economy has developed strongly in recent decades by attracting and retaining significant investment from MNEs.[124] A number of economic indicators highlight the differences between these two sectors of the economy, domestic and foreign owned. For example, looking at national income statistics, shows that RoI was the only EU economy to have positive GDP growth in 2020 despite the impact of COVID-19. When using GNI*, the economy decreased in size by 3.5% in 2020,[125] however this was still a much smaller decrease than experienced by many other countries (for example UK GDP fell by 9.3% in 2020).[126] These figures were driven by strong export growth (from the large foreign controlled multinational enterprises sector) whilst domestic demand slumped much like in every other EU country and the UK.

3.4.13 The difference is also evident in productivity statistics such as gross value added, labour productivity, and company productivity where the foreign controlled sector outperformed domestic sectors of the economy. Key metrics also point to a very high degree of concentration with respect to large MNEs – a small number of companies are generating high productivity growth. This is not to discount the role of the domestic economy in RoI but helps demonstrate the significance of foreign owned MNEs.[127]

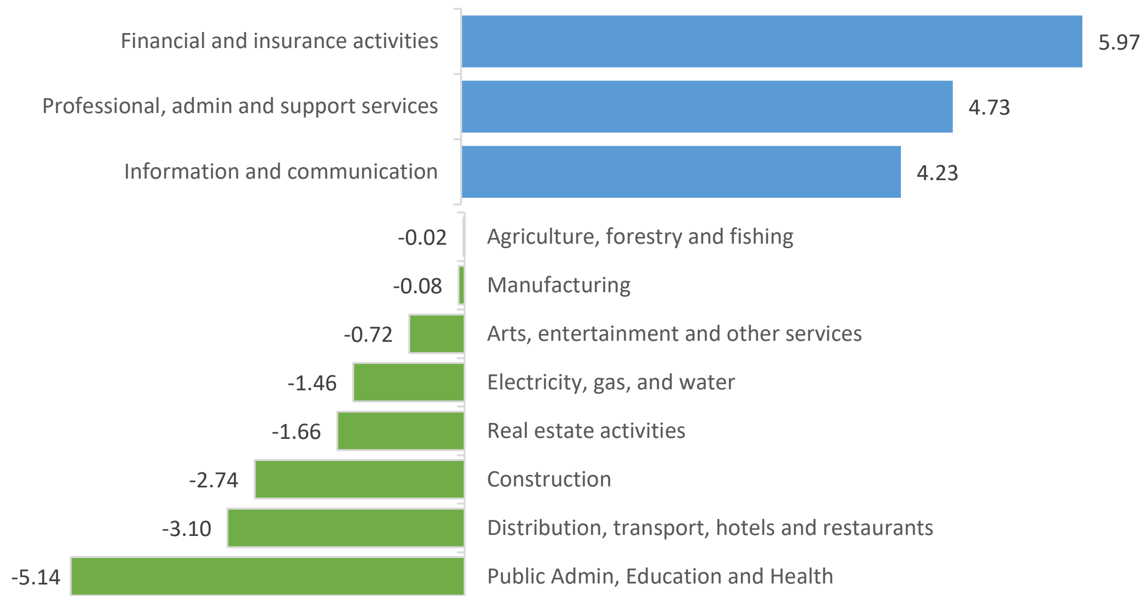
Structural differences between the RoI and Northern Ireland economies

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

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

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

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



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

*Note: *Net National Product (NNP) is used here for RoI* values as it allows analysis by industrial sector, which GNI* does not. However, NNP *excludes all depreciation. This has a particular impact on the Manufacturing sector for RoI, which has a significant depreciation value. If using other metrics that do include depreciation, then Manufacturing in RoI would account for a higher proportion relative to Northern Ireland.*

3.4.16 There is also some difference in the public sector versus private sector make-up of the two economies, with the RoI economy less reliant on the public sector than Northern Ireland. RoI employment figures for Q1 2020 also show that 21.4% of employment came from the public sector,[128] lower than Northern Ireland at 25.5% (but significantly higher than UK average of 16.7%).[xxxvii]

Government Revenue raised in RoI

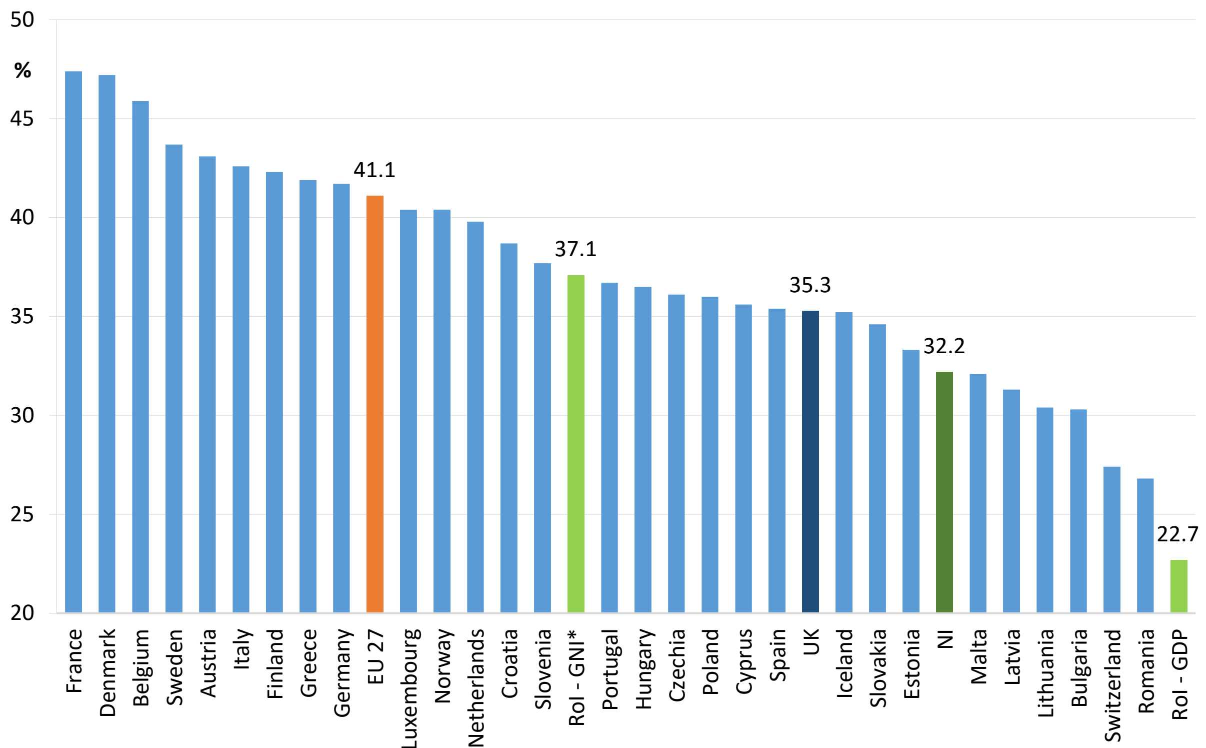
3.4.17 The total amount of government revenue raised in 2020 in RoI was €82,647 million or €16,604 (approx. £14,760) per head.[129] This compares to Northern Ireland where in 2019/20, total revenue was estimated at £19,817m or £10,465 per head or in the UK where the total revenue per head was £12,400.

3.4.18 The amount of total revenue collected on a per head basis is therefore much higher in RoI than in the UK or Northern Ireland. However, this message should be caveated given that income and price levels are also higher in RoI and looking at tax revenues in isolation does not factor this in. For example amongst EU countries, RoI is second only to Denmark in terms of comparative price levels of consumer goods and services, 36% above the EU average price level (whereas the UK was 19% above the EU average).[130]

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

3.4.19 Looking more specifically at the total tax take element of government revenue, Chart 3.6 assesses the tax take relative to the size of the economy. For RoI we use GNI* to provide a more suitable picture for comparing to other countries. GDP is used as a measure for all other countries. Looking at the most recent year for when data is available for EU countries, we see that RoI ranks in the middle of EU nations with tax take 37.1% of GNI* and above both UK and Northern Ireland (note how this position would be reversed if RoI GDP were used). It is also important to note that when including Northern Ireland within this comparison that, unlike the other countries, it is not fiscally independent and is a devolved region with many fiscal powers reserved to the UK, from where it benefits from a fiscal subvention.

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



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

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

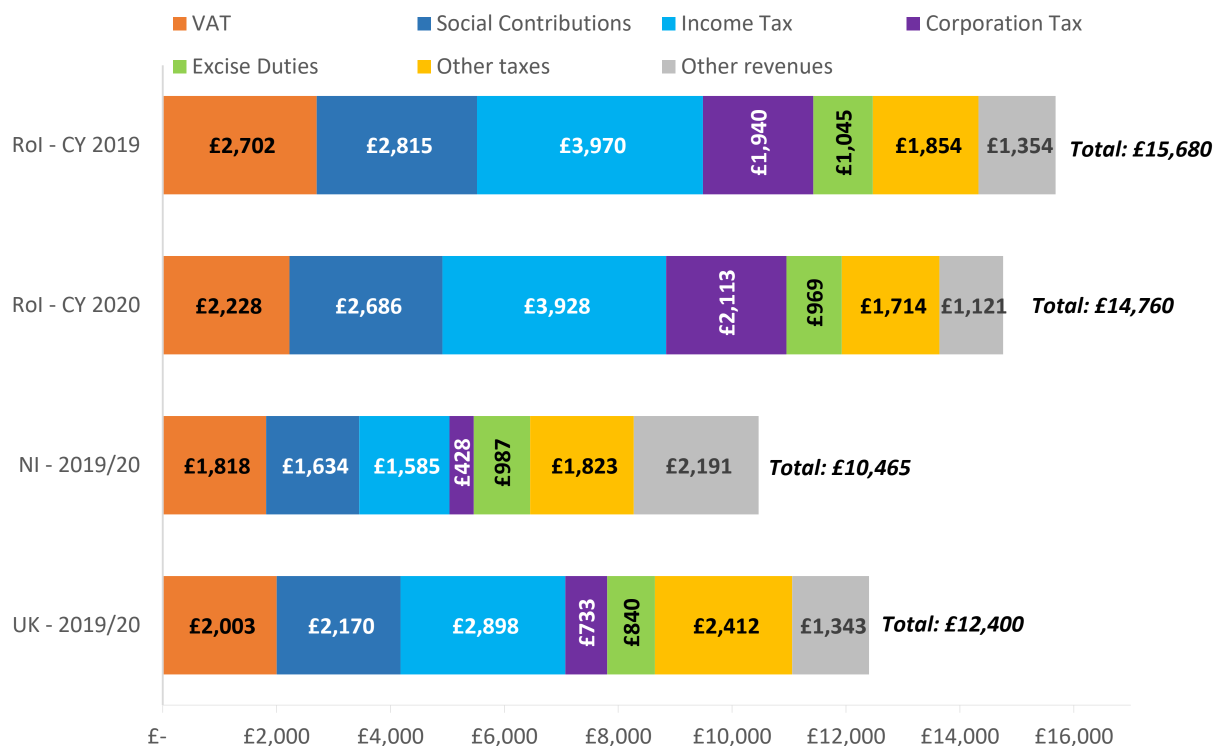
3.4.20 A further point of note, is that both the UK (as referenced previously) and RoI are heavily centralised in terms of tax revenue collection, with most other European countries being much more decentralised with significant local or regional government tax yields. However, RoI is even more centralised than the UK with only 2.2% of its taxes being collected at local level in 2019 compared to 5.4% being raised in the UK at the local level (or 11.1% when taxes collected by devolved administrations in the UK are also included, based on Fiscal Commission calculations).[131] Of course, RoI has a much smaller population and economy than that of the UK and so it might be expected that the level of decentralisation may be less as a result, for administrative efficiency purposes for example.

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

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

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

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



Source: UK and Northern Ireland data from 2019/2020 financial year - Country and Regional Public Sector Finances, FYE

2020; RoI data for 2019 and 2020 calendar years – Irish Revenue 'Revenue net receipts by tax head' and CSO Government Finance Statistics October 2021[xxxviii] Exchange rate taken from ONS: Average Sterling exchange rate: Euro.

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

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

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

Table 3.3: Comparison of UK (including Northern Ireland) and RoI tax rates (2021-22)

Taxes	UK rates*	RoI rates
Income tax	**20% basic rate** (£12,571 to £50,270) **40% higher rate** (£50,271 to £150,000) **45% additional rate** (£150,000+)[132] The standard Personal Allowance in the UK is £12,570, where tax is not paid on income below that amount.	**20% lower rate and 40% higher rate.**[133] Different bands apply for the higher tax rate dependent on marital status or number of children **RoI operates a system of tax credits** that means in effect anyone earning €17,000 or less does not pay any income tax.[134] There is an additional tax on income in RoI – the **Universal Social Charge (USC)** - From 2022 - For income of €13,001 or more: First €12,012 - 0.5%; Next €9,283 - 2%; Next €48,749 - 4.5%; remainder - 8%; Self-employed income over €100,000 – 11% [135]
National insurance contributions	**From April 2022, Employers contribution – 15.05%** on earnings above £175.01 per week. **From April 2022, Employees contribution – 13.25%** rate on earnings between £190.01 (from July 2022, £242.01) and £967 per week and 3.25% on earnings above £967 per week.[136]	Pay Related Social Insurance (PRSI) – typically **4% employee contribution.**[137] **Employers then pay 8.8%** Class A employer PRSI on weekly earnings up to €410 or pay 11.05% Class A employer PRSI on weekly earnings over €410. [138]

[xxxviii] Note that 'other taxes revenue' here includes other taxes and revenues listed in the respective ONS and CSO data that make up total revenue. For UK and Northern Ireland this includes taxes listed as part of the ONS Country and Regional Public Sector Finances Revenue Tables that are not explicitly included in the chart (e.g. business rates, council, stamp duty land taxes). It also includes values for other current receipts attributed to Northern Ireland such as: taxes on capital; gross operating surplus; interest and dividends; and rent and other current transfers. For RoI it includes other taxes such as stamp duty, local property tax, and other items of revenue attributed to general government as listed in CSO Government Finance Statistics October2021 - Table 3.

Value added tax	**Standard rate – 20%;** Reduced rate – 5%; Zero rate for certain goods, e.g. children's clothes/food[139]	From 1 January 2022- **Standard rate -23%;** Reduced rate -13.5%; Second reduced rate – 9%[140 141] The reduced rate for tourism and hospitality from 13.5% to 9% remains in place until the end of August 2022.[142]
Corporation tax	Currently **19% but will rise to 25%** by April 2023 (with an exception for smaller businesses to stay at the 19% rate)[143]	**12.5%** for trading income. 25% for non-trading or excepted trade[144] From 2023 12.5% up to €750m turnover; 15% over €750m in line with OECD tax agreement.[145]
Fuel duty	**57.95 pence** per litre for petrol/diesel with a 5p deduction for 12 months from March 23 2022 meaning rates for petrol/diesel will be **52.95 pence** per litre for 2022-23. [146]	From 13 October 2021, **63.7c per litre** of petrol and **53.5c per litre** of diesel.[147] The RoI Government announced on 9 March 2022 a temporary reduction in the excise duties charged on petrol, diesel and marked gas oil which will remain in place until the 31st of August 2022.[148] The temporary rates from 10 March 2022 will be **47.4c per litre** of petrol and **41.4c per litre** of diesel. There will then be further reductions in rates from 01 April 2022 to **46.6c per litre** of petrol and **40.5c per litre** of diesel.[149]
Alcohol and tobacco excise duties	Cigarettes - the higher of £262.90 per thousand plus 16.5% of retail price or the minimum excise tax of £347.86 per thousand.[150] Beer duty- typically 19.08 pence per litre for each % of alcohol. Spirits - £28.74 of Spirit Duty per litre of pure alcohol. [151] An overhaul of UK alcohol taxes was announced in the October budget. Changes are proposed for 2023[152]	Cigarettes - €383.42 per thousand together with an amount equal to 8.83% of the price at which the cigarettes are sold (alternatively €434.19 per thousand) Typical €22.55 per hectolitre for each % of alcohol in the beer, i.e. 22.55c per litre for each % of alcohol. €42.57 per litre of alcohol in the spirits[153]

*Note: * UK rates on Income tax do not include Scotland*

Direct taxes and the labour market

3.4.25 Taxes on income and social insurance contributions[xxxix] were estimated to have raised €37,036 million or 48.5% of total tax take and 17.8% of GNI* in RoI in 2020. This compares to similar taxes in Northern Ireland/UK (i.e. income tax and NICs), which account for 38.9% of total tax take and 12.5% of GDP in Northern Ireland and 45.8% of total tax take and 15.2% of GDP in the

[xxxix] For the UK and Northern Ireland this includes income tax and National Insurance contributions. For RoI this covers income tax, professional services withholding tax, universal social charges and PSRI.

UK[xl] in 2019/20. These taxes are therefore proportionally more valuable to RoI than the UK and Northern Ireland.

3.4.26 The RoI labour market has arguably been part of a wider British Isles labour market for an extended period. Evidence suggests that for most of the last 70 years migration between RoI and GB has been driven by differentials in the unemployment rate and differentials in the real after-tax wage rate. These studies indicate large changes in labour supply in RoI because of the potential for large labour movements to and from the GB labour market. They also suggest that there has generally been a close relationship between wage rates in RoI and the UK, albeit this relationship does not necessarily result in the same wages across the jurisdictions.[154] [155]

3.4.27 In 2019 employees' average (or mean) gross hourly earnings at £21.23 (€23.88)[156] were significantly higher in RoI than they were in Northern Ireland (£14.90) or the UK (£17.27). Median weekly earnings data for all employees in 2018 also shows that wages in RoI were significantly higher using this metric, with a value of £524 (€593), compared to £420 in Northern Ireland and £460 in the UK. Given the resultant gap with RoI earnings, it might be expected that there would also be significant flows of labour from Northern Ireland to RoI. However, there is evidence that the opposite is true, with the level of cross-border commuters in either direction lower than might be expected and a greater tendency for RoI residents to commute to Northern Ireland than vice versa.[157] [158]

3.4.28 While the wages of those employees with secondary education across the UK and RoI have remained broadly stable and in line with each other over the last 20 years those with a third level education have reversed. RoI graduates earned 80% of their potential UK wage in 2002 but twenty years later there is a RoI premium over the UK wage of some 15%.[159] This reversal may, in part, be explained by an increase in the personal tax rate of RoI employees over UK employees after 2010, with higher wages compensating for a higher tax burden.

3.4.29 As detailed previously, it is also of note that the RoI income tax system allows couples to aggregate their income, as indicated in Table 3.3 above, allowing married couples to maximise household benefits (though there is evidence that 'non-individualisation' is a barrier to second earner employment in RoI).[160] In the UK/NI couples cannot aggregate their income in the same way (although there is a Marriage Allowance which allows for a transfer of £1,260 of Personal Allowance to a husband, wife or civil partner).

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

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

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

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

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

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

Source: Fiscal Commission analysis[161]

Indirect taxes

3.4.31 The two main indirect taxes in RoI are excise taxes and VAT. Together they accounted for €17,901m or 23.4% of the total tax take in 2020 and 8.6% of GNI*. In 2019, VAT and excise taxes yielded £21,033m or 26.2% of the total tax take.

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

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

3.4.34 While evidence on the effects of differential tax rates on levels of cross border shopping is somewhat mixed, a useful example to highlight in the Northern Ireland context is evidence from the period 2013 to 2015 which examined the extent of 'fuel tourism' from Northern Ireland to RoI, driven by the higher rates of tax on motor fuels in Northern Ireland. The combined excise duty, carbon tax and VAT contribution to the RoI Exchequer associated with fuel tourism was estimated at €202 million for diesel and €28 million for petrol based on 2015 levels.[162] This also represented a loss to the UK Exchequer. Of course this situation could equally apply to the Irish Exchequer where fuel was cheaper in Northern Ireland than in RoI.

Corporation tax

3.4.35 Corporation tax was estimated to have raised €11,833m or 15.5% of total tax take and 5.7% of GNI* in RoI in 2020. This compares to 5.2% of total tax take and 1.7% of GDP in Northern Ireland and 6.6% of total tax take and 2.2% of GDP in the UK. Corporation tax is a really significant contributor to the total RoI tax take and proportionally far exceeds the total tax take from corporation tax receipts in both Northern Ireland and the UK (over 3 times more than in Northern Ireland and over twice as much in the UK as a percentage of GDP).

3.4.36 This revenue is heavily dependent on a small number of large companies. The top ten companies accounted for 40% of net corporation tax receipts in 2019.[163] And some 80% of revenues came from foreign MNEs compared to 20% from domestic companies, with around half of the foreign revenues coming from US companies.

3.4.37 Recent changes to the international tax regime have led the RoI Government to provide for a €2bn drop in corporation tax revenue by 2025 as a possible result of international reforms in the 'not-too-distant future'.[164] These reforms include the OECD (Base Erosion and Profit Shifting, 'BEPS') process; a global minimum corporate tax rate (15%); and changes to US corporate tax rates for US firm's overseas income. In October 2021, the RoI Government announced that it too will support a global deal to set a global minimum tax rate for large firms. From 2023, RoI will have a minimum rate of 15% for large companies (those over €750m in turnover).[165] The 12.5% rate is expected to continue for smaller companies. Despite the proposed changes in RoI there is still a considerable difference when compared to the UK rates (19% rising to 25% by April 2023) and by extension Northern Ireland, as detailed in Table 3.3.

3.4.38 There is strong evidence that the very low corporate tax rate in RoI has played an important part in attracting large amounts of FDI, has pushed up tax receipts and significantly contributed to the economic growth of RoI. [166] [167] [168] Research also suggests that RoI might not have experienced the same rate of growth during the 'Celtic Tiger' period (i.e. in the 1990s and early 2000s) if it had not adopted such a 'corporation-tax-driven industrialisation strategy'.[169] Research commissioned by the RoI Department of Finance suggests that the level of corporation tax rate has a significant influence on firms' FDI decisions. This research indicates that on average across the EU, corporation tax has the largest impact on the decision of where to locate FDI. It also suggests that higher RoI corporation tax rates would lead to a significant reduction in the number of new foreign firms entering RoI.[170]

3.4.39 However, it may be that the role of a low corporation tax rate has diminished more recently. While low corporate tax rates have attracted firms to set up some form of entity in RoI, over the last 20 years (and perhaps beyond) the low corporate tax rate may not have been as important as it once was in attracting firms or FDI to RoI with the resultant benefits of extensive employment. A wider range of factors may underlie RoI's recent economic success including: more appropriate fiscal and monetary policies compared to pre-1990; external global factors; English speaking graduates; a suitable regulatory regime; a degree of certainty regarding tax policy; an expansion in tertiary education; and an improvement in skills.[171] [172]

3.4.40 Whatever the views on the corporation tax policy of RoI, it is clear that when the original policy was conceived in the 1950s it was aimed at stimulating employment growth at the expense of tax revenue. Today it has, arguably, been transformed into a huge source of tax revenue which

is a very important revenue stream for the RoI Government – and one which, given the changing global environment, is at significant risk going forward.

3.5 Conclusions

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

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

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

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

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

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

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

Chapter 4

Tax assessment: model, criteria and appraisal

4.0 Overview

4.0.1 This chapter outlines the Commission's view on the possible models of fiscal devolution for Northern Ireland and the criteria that the Commission has used in assessing the suitability of individual taxes for devolution. The chapter presents the Commission's short-list of those UK-based taxes for which we assess there is a case, in principle, for devolution in Northern Ireland.

4.0.2 The full text of the Commission's appraisal of the suitability of existing UK-based taxes – which identified those taxes prioritised for further consideration, and those taxes deemed not suitable for further consideration – was published as part of the Commission's interim report (December 2021), and can be found at Annex F of this Final Report. The 'prioritised' taxes listed in this chapter are considered in more depth in Chapter 5.

4.1 Key points

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

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

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

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

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

4.1.6 We considered each of the UK-based taxes levied in Northern Ireland against our five key criteria and have prioritised a smaller list of those taxes that, in our view, represent the strongest candidates for devolution at this time. The full analysis of our tax assessment was published as part of our interim report in December 2021, and can be found at Annex F of this final report.

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

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

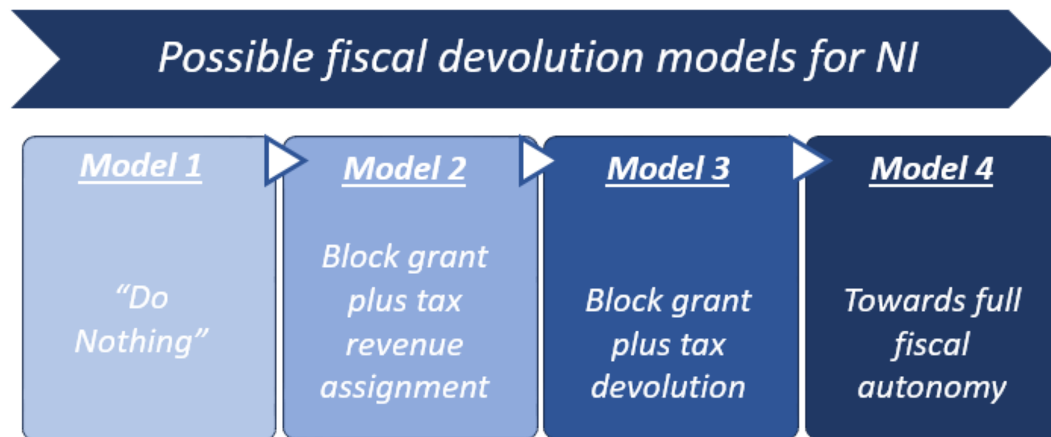
* **Income tax (and apprenticeship levy if income tax is devolved)**
* **Fuel duty**
* **Alcohol and tobacco duties**
* **Stamp duty land tax**
* **Air passenger duty**
* **Landfill tax**

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

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

4.2 What type of fiscal devolution might be appropriate?

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



Model 1 – Status quo

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

Model 2 - Block grant plus tax revenue assignment

4.2.3 A more graduated option would see the **block grant** reduced and remainder of the budget available to Northern Ireland made up of **revenue raised by certain taxes** in Northern Ireland. This option strengthens the link between revenue raised in Northern Ireland and the level of public spending, relating spend more closely to the performance of the Northern Irish economy. The revenue can be calculated in line with actual tax receipts in Northern Ireland, or an estimation of these, or alternatively by formula apportionment.[173]

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

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

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

Model 3 - Block grant plus tax devolution

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

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

4.2.9 Differing degrees of devolution are possible within this model, whereby the NI Assembly could seek the full or partial devolution of certain taxes, for example, allowing them to vary the rates (as was the case with the anticipated devolution of corporation tax 'rate-setting' powers in 2015), but with control of the tax base, i.e. the definition of what is "taxable"[174], being retained centrally by the UK Government. The ability to adopt a varied approach under this model allows a balance to be struck between securing the additional flexibility and accountability to implement local fiscal policy while balancing the administrative efficiency burden of devolving taxes in their entirety.

Model 4 – Towards full fiscal autonomy

4.2.10 This model represents the same type of fiscal powers devolved as in model 3 but where they are employed to their fullest extent, aiming to confer the strongest and most wide-ranging

powers over the local economy and, in turn, carries the highest level of risk to the stability of the funding arrangements.

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

4.2.12 It is our view that the optimal level of fiscal devolution for Northern Ireland will be that which strikes a balance between the risks and rewards offered through enhanced flexibility and autonomy. Any potential benefits resulting from enhancing devolution will vary depending on the overall degree of devolution and the circumstances around the individual tax or fiscal power, meaning that different levels of fiscal devolution may be considered more appropriate for different taxes or fiscal powers.

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

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

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

4.3.3 Our criteria differ only slightly from those used by the Holtham Commission in that we have merged two behavioural criteria into one, 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 4.1 Criteria used to assess suitability of fiscal devolution of UK taxes to Northern Ireland

Criteria		Rationale
i	Economic and policy context	any policy-relevant factors that might influence the appropriateness of a tax for devolution, including the links between the tax and existing devolved competencies, any compelling evidence as to why policy-makers might want to set tax policy differently in Northern Ireland (for example, due to policy in RoI, or the different distribution of the tax base in Northern Ireland as compared to rUK), and any relevant learning from recent Scottish and Welsh experiences.

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

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

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

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

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

Design and sequencing of devolved powers

4.3.8 To ensure the success of fiscal devolution measures, careful consideration must be given to the design and implementation of any new powers or responsibilities, with close reference to the local economic context. Studies have shown that, in addition to the *content* of policy reforms, the *speed* and *order* of such reforms have a measurable impact on the likelihood of a successful outcome following implementation.[175]

4.3.9 It is not sufficient, therefore, to consider the pros and cons of each tax or fiscal power in isolation. A consideration of the *concentration* of powers and appropriate *sequencing* of their devolution is very important. Firstly, in terms of ensuring the local administration is able to manage the new responsibilities successfully, and is given the opportunity to build capacity where necessary. Secondly, in view of the interaction of different taxes, the appropriate sequencing of reforms will ensure that fiscal powers are used to best advantage, avoiding a

situation where measures may work against each other, and instead, benefitting from the interactions between the impact of any changes, leading to beneficial outcomes for the local economy.[176]

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

4.3.11 Therefore, while there may be a case, in principle, for the devolution of a substantial number of the taxes levied in Northern Ireland, for the second phase of our work we *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.

4.4 Summary of conclusions on suitability of taxes for devolution

4.4.1 A summary of our interim conclusions on the suitability of each of the UK taxes levied in Northern Ireland is given below in Table 4.2, while the full text of the appraisals, published previously as part of our interim report, can be found at Annex F.

4.4.2 As indicated in our interim analysis, and as reflected in our conclusions below, there is a case for many of the UK-wide taxes which we considered to be devolved to Northern Ireland over the longer-term. However, recognising that it is not feasible for anywhere near all of these taxes to be devolved in the near-term, there is also a need to prioritise. In doing so, we have brought seven taxes forward for further, more detailed, consideration.

4.4.3 One of the taxes the Commission did not bring forward for additional consideration was corporation tax. The reasons for that are outlined in Table 4.2 below and in detail in Annex F. The issues around corporation tax devolution are more complex than for other taxes, both from a technical and indeed a broader political perspective. While the Commission does not consider corporation tax in more detail, we do recognise there has been significant practical progress already made in pursuit of the devolution of the tax. We also conclude that there is a case for the devolution of corporation tax and there is value in the NI Executive seeking to ‘complete’ the devolution of corporation tax. We outline the pre-requisites which we see as necessary for devolution to Northern Ireland, if the political will is there to push for it. We provide our recommendation for corporation tax devolution within Table 4.2.

Table 4.2 Summary of the Commission's interim conclusions on the suitability of each of the UK taxes levied in Northern Ireland

Taxes prioritised 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 do not 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

<table>
<tr>
<td rowspan="2">Corporation tax</td>
<td>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. We suggest a number of pre-requisites to resolve prior to completing the devolution of corporation tax to Northern Ireland.

Our approach to corporation tax is different to our approach to other taxes but the issues that need resolution are more complex. Should the NI Executive wish to pursue devolution we would urge it to develop its 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. However, we do provide the recommendation below.</td>
</tr>
<tr>
<td>Corporation Tax - Recommendation 2

We remain of the view that there is value in the NI Executive seeking to complete the devolution of corporation tax.

Should the NI Executive wish to pursue the devolution of corporation tax we would encourage it to demonstrate how it will ensure the sustainability of its finances following any reduction in corporation tax. We would urge the NI Executive and UK Government to work together on the pre-requisites for devolution. We recommend:

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

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 industry levy	The soft drinks industry 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.

Second phase of the Commission's work

4.4.4 As part of the second phase of our work, and to inform this, our final report, the Commission carried out further investigation into each of the taxes that we prioritised in Section 4.4 of this chapter. This entailed, where appropriate, a consideration of the optimum scope and mechanism of devolution (i.e. which elements of the tax base should be devolved and what degree of control over rates/bands should be devolved?) as well as considering the different administrative arrangements that could be adopted and implemented to facilitate the levying of any potential devolved taxes in Northern Ireland. The detail of this further analysis is laid out in the following chapter, Chapter 5.

Chapter 5

How fiscal devolution might be implemented for our prioritised taxes

5.0 Overview

5.0.1 This chapter sets out further analysis of those taxes prioritised by the Commission for potential devolution to Northern Ireland. It considers the optimum scope of devolution for income tax, making recommendations in relation to the income tax base and administration of the tax and what degree of control over tax rates and bands should be devolved. The chapter also provides the Commission's recommendations in respect of the model and administration of the other smaller taxes prioritised for consideration and considers further the case for the devolution of excise duties to Northern Ireland.

5.1 Key points

5.1.1 The taxes considered sufficiently strong for potential devolution in Northern Ireland and therefore prioritised for further consideration include:

*** Income tax (and the apprenticeship levy if devolution of income tax is pursued);**
*** Stamp duty land tax;**
*** Air passenger duty;**
*** Landfill tax; and**
*** Excise duties (covering fuel, alcohol and tobacco products).**

5.1.2 **Income tax - *Full devolution*** is not required to reap the main benefits of income tax devolution and (if pursued) could cause disproportionate complexity as well as a large administration and compliance burden for tax authorities and taxpayers in Northern Ireland and GB.

5.1.3 Rather, ***partial devolution***, with powers over income tax rates and (potentially) bands, but not the tax base (i.e. allowances and reliefs), would be effective in giving the NI Assembly a major new way to raise revenues, reduce taxes for its citizens or vary the progressivity of its tax system.

5.1.4 **Administration of devolved income tax** - **It is recommended that the administration of income tax remains reserved at this time**, rather than being devolved to any new Northern Ireland tax authority.

5.1.5 **Apprenticeship levy** – If powers over income tax are devolved to the NI Assembly there is a strong case for devolution of the apprenticeship levy, in parallel. Given the synergies with income tax administration, **it is recommended that, if the apprenticeship levy is devolved to Northern Ireland, it continues to be administered by HMRC.**

5.1.6 **Savings and dividends income** – prior to April 2016 UK financial institutions deducted tax on interest on savings at source, however, following the introduction of the Personal Savings Allowance[xli] it was decided that this practice should cease. This removed the main practical and administrative impediment to the devolution of tax powers over savings and dividends income (cited as the key issue against devolution by previous Commissions in Scotland and Wales). Given the removal of this impediment and the administrative, efficiency and equity benefits that devolution could bring, **we recommend that the taxation of savings and dividends income should be devolved to the NI Assembly**.

5.1.7 The strength of our recommendation would be bolstered if agreement can also be reached to devolve it to the Scottish Parliament and Welsh Senedd. If such agreement is not reached then devolution to Northern Ireland could be seen as adding some inconsistency and complexity, and hence one might want to be more tentative in taking such steps, but the case for doing so would, in our view, remain strong.

5.1.8 **Model of income tax devolution** - Scotland and Wales have adopted different devolution models for income tax. Opting for **the 'Scottish' model**, where income tax revenues, rates and band-setting powers are devolved in full (but not the tax base i.e. allowances and reliefs), would maximise the flexibility of the NI Assembly's tax varying powers by allowing fine-tuning of the distributional effects of policy changes. It would provide the NI Assembly with the tools to significantly change the structure and rates of income tax in Northern Ireland and the potential to boost the NI budget from improved local income tax revenues. All of this would significantly increase the accountability of the NI Assembly to the electorate.

5.1.9 However, the 'Scottish' model would also entail greater risk. It would introduce short-term tax revenue volatility and the potential for long-term revenue decline relative to the status quo. If the Northern Ireland tax base does not keep pace with how the block grant is adjusted (to compensate the UK Government for its loss of Northern Ireland tax revenues following devolution and which will be linked to the growth in the England income tax base) this could lead to a lower NI budget than would have been the case without devolution. It is also worth saying that this more maximal degree of devolution offers more opportunity to make policy "mistakes". The NI Executive and NI Assembly would need to be sure it had appropriate analytical capability and capacity in place, to understand the consequences of policy change, and **we would recommend that the NI Fiscal Council should have a robust role in forecasting the impacts of change**.

5.1.10 In terms of technical feasibility, it would be possible for Northern Ireland to adopt the Scottish model of income tax devolution. **Indeed, if the NI Executive is keen to maximise both the local accountability and policy flexibility benefits which are achievable from partial devolution, opting for the Scottish model would be preferable.** In addition, there is a strong case for Northern Ireland to go a step further and seek the power to change the level of the Personal Allowance. Devolving control over the threshold of the Personal Allowance would not expose the NI Assembly to any significant further revenue risk, but would provide further policy flexibility for the NI Executive, affording it the opportunity to tailor the tax to take account of the lower average income in Northern Ireland, relative to elsewhere in the UK.

[xli] which exempted the first £1,000 of basic rate taxpayers' savings income and first £500 of higher rate taxpayers' savings income from tax, see https://www.gov.uk/government/publications/personal-savings-allowance-factsheet/personal-savings-allowance

5.1.11 **Ultimately, it is the responsibility of Northern Ireland's politicians to determine the appropriate balance between greater financial incentives and powers, and the degree of risk involved.** If the NI Executive was sufficiently concerned about the level of risk associated with the Scottish model, it could opt, instead, for a form of partial devolution of income tax similar to **the 'Welsh' model**. This would represent a more limited form of devolution, where a portion, not all, of income tax revenues are devolved (currently 10 percentage points of each tax band) and the power to vary rates, but not bands. Given the more restricted extent of powers, it would provide less flexibility in how the powers could be used and less opportunity to maximise the potential benefits of devolution. However, **the Welsh model would still significantly increase the accountability of the NI Assembly to the electorate, and while it would involve similar types of financial risks to the Scottish model, the degree of risk would be much more muted, as less revenue and control is devolved.** The potential for mistakes would, though, remain live. As would the need for appropriate analytical capabilities and a role for the Fiscal Council, as per our comments on the Scottish model.

5.1.12 There is also the option to adopt the 'Welsh' model initially and move to the 'Scottish' model in future, as capacity and experience is built up as part of an incremental approach to devolution. And a hybrid approach with partial devolution of revenues (as in Wales) but full powers over rates and bands (as in Scotland) would also be possible, although more complicated to implement and explain to stakeholders and policymakers. Irrespective of the preferred model of income tax devolution, **it is the Commission's view that the NI Assembly should be obliged to vote on the agreed rates and bands (where applicable) on an annual basis, as part of the normal budgetary process, to ensure ongoing consideration and engagement on the power.**

5.1.13 **Stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax** – There is a strong case for devolution of these taxes and **we recommend that full devolution of revenues and tax powers**.

5.1.14 **Administration of SDLT, APD and landfill tax** - There is the potential for cost savings from HMRC administration but, in our view, the potential benefits of local administration in terms of greater flexibility, scope for innovation, and institutional capacity building, outweigh the likely costs. Therefore **we recommend that if the devolution of SDLT, APD and landfill tax is pursued and implemented, the NI Executive should establish a local revenue authority to administer these fully devolved taxes.**

5.1.15 **Excise duties** – **We remain of the view that there could be value in the NI Executive seeking devolution of excise duties, but over the longer term.** There are potential advantages in terms of improved accountability and additional flexibility to respond to the different issues experienced in Northern Ireland, compared to GB. However, it is clear from our investigations that complex administration and compliance issues do exist. It may be prudent to await the resolution of implementation issues around the NI Protocol, and a longer term settlement for the customs and excise regime in Northern Ireland to ensure a more stable environment, prior to the devolution of any new fiscal powers over excise duties.

5.1.16 **We recommend that, if minded to devolve excise duties in future, the NI Executive carries out a full investigatory study, working alongside HMRC / HMT, to agree on *how* such duties**

could be administered, and the costs involved, as well as engage more widely with a range of representatives from the production, retail and supply sectors, to ensure that the model of implementation would take account of the specific needs of those sectors.

5.2 The scope of income tax devolution

5.2.1 As highlighted in Chapter 4 (and the Commission's interim report), there is a sufficiently strong case for at least the partial devolution of income tax to the NI Assembly. However, there are questions about the scope and nature of income tax devolution that need to be considered. These are:

i. Should powers to determine the income tax base – that is, what income is liable to tax or not – remain reserved, as is currently the case for Scotland or Wales? Or should income tax be fully devolved, with the NI Assembly able to determine parameters such as the scope and nature of allowances, reliefs, deductions and exemptions? Additionally, should any devolved element of income tax be administered by HMRC or by a separate Northern Ireland tax authority?

ii. Under a model of partial devolution, should only non-savings non-dividends income tax revenues and tax rate-setting powers be devolved, as is currently the case for Scotland and Wales? Or have the changes to the taxation of interest and dividends income made in recent years made it more sensible to devolve revenues and rate-setting powers over income tax on all sources of income defined as taxable by UK legislation?

iii. Under a model of partial devolution, what degree of control over rates, or rates and bands, should the NI Assembly have? Would the Scottish model (devolution of all revenues and rate and band-setting powers) or Welsh model (devolution of revenues from 10 percentage points of each tax band, and rate-setting powers) or some other model be most appropriate?

5.3 Should income tax be fully devolved?

5.3.1 We begin by examining whether income tax policy and administration should be fully devolved.

5.3.2 Full devolution of policy would give the NI Assembly the most flexibility to design a system of income tax to meet its objectives. For example, changes could be made to tax relief on pension contributions and rates on pensions income, in order to increase and bring forward revenues, or to change the financial incentives people with different income levels have to contribute to a pension. Changes could be made to income tax rules governing the self-employed, such as investment allowances, or loss carry-forward provisions, to make them more or less generous. In addition, new reliefs could be introduced to support particular types of behaviour, or existing reliefs altered or abolished if it was felt they were not meeting their aims.

5.3.3 It is worth noting that full devolution of income tax in this way would be highly unusual. It does not happen within the UK. Internationally, there are examples of sub-national income tax systems where policy and/or administration is fully devolved. This includes all US states with a state income tax and the province of Quebec in Canada. The additional compliance and

administration costs associated with full devolution are therefore not insurmountable. However, it is also notable that the other provinces of Canada have opted to agree a basic common income tax base and have their income taxes administered by the federal Canada Revenue Agency. This suggests the costs are not negligible either. Indeed, estimates of the additional administration and compliance costs associated with Quebec's fully devolved and separately administered provincial income tax, on top of what it would cost if the tax was administered federally, amount to $200 million CAD or more per year, which is relatively small in the context of revenues of $33.7 billion CAD, but a sizeable cash amount nonetheless.[177] [178] It equates to $31 CAD (approx. £18) per income tax filer, or around $50 (approx. £30) per filer with a positive provincial liability.

5.3.4 Overall, it is our view that the full devolution of income tax would be a significantly bigger undertaking than partial devolution and it has never been done in the UK before. The definition of the income tax base and rules on allowances, deductions, reliefs and exemptions are complex, and the NI Assembly and NI Executive would likely have limited expertise and experience to draw upon for policymaking and scrutiny, at least initially, given their limited tax powers up until now. Differences in these complex rules between Northern Ireland and GB would also likely pose a significantly larger additional administration and compliance burden for the tax authorities and taxpayers than would differences in tax rates and/or bands. Moreover, partial devolution, with powers over tax rates and potentially bands, but not the tax base, would be effective in giving the NI Assembly a major new way to raise revenues, reduce taxes for its citizens, or vary the progressivity of its tax system (thus significantly improving the accountability of the NI Executive to its electorate). In other words, full devolution is not needed to reap the main benefits of income tax devolution.[xlii]

5.3.5 Administrative devolution would entail significant upfront and ongoing costs for both the NI Executive and taxpayers: staff would need to be hired and trained; completely new IT systems designed, set-up and maintained; and policies and guidance produced and kept updated. This would be on a much larger scale than for partial devolution. Administration by a separate Northern Ireland tax authority would mean many employers would have to remit Pay as you Earn (PAYE) income tax to, and more generally engage with, two income tax collection agencies rather than one as now - one for their Northern Ireland-resident employees, and one for their GB-resident employees. This would increase both administration and compliance costs, and would likely only make sense in a context of full income tax policy devolution.

5.3.6 Devolving administration while only partially devolving income tax could mean many taxpayers having to engage with different tax authorities for different parts of their income (e.g. their employment income and their savings income). Indeed, if administrative devolution was coupled with the "Welsh model" of only partial devolution of tax revenues and rates, *all* Northern Ireland employers and self-assessment taxpayers would likely have to engage with both the Northern Ireland tax authority and HMRC – to pay the NI Assembly and UK Government shares of their income tax liabilities, respectively. The complexity and cost this would entail would almost certainly outweigh any potential benefits – such as more stringent enforcement, and the opportunity to offer improved taxpayer services – from administrative devolution.

[xlii] Relevant to this consideration are Sections 1.6.21 - 1.6.25 on the importance of administrative capability and capacity, and Sections 4.3.8 - 4.3.11 regarding design and sequencing of new fiscal powers.

Scope and administration of devolved income tax - Recommendation 3

5.3.7 **Income tax is a strong candidate for devolution to Northern Ireland, however, we recommend that powers over the income tax base and income tax administration both remain reserved at this time.** This will help minimise the additional administration and compliance burdens generated by tax devolution, while still providing the key benefits of devolution, including a meaningful ability to vary funding levels and the progressivity of the tax system.

5.4 Should tax on savings and dividends be devolved?

5.4.1 If tax base powers remain reserved, there is still a question whether rate and band-setting powers for all of the income tax base, or just part of the tax base, should be devolved. In particular, should Northern Ireland rates (and potentially bands) apply to savings and dividends income as well as other taxable sources of income? This is an important consideration as, despite revenue from taxation of savings and dividends income representing a relatively small share of total income tax revenues, devolving part of the tax base but not others could have behavioural implications, as we discuss further below.

5.4.2 These issues were considered for Scotland by the Calman Commission in 2009. It concluded that, in principle, devolved income tax rates should apply to income from savings and dividends as well as non-savings, non-dividend (NSND) income. In practice however, the Calman Commission argued that it would not be administratively practicable to devolve tax on savings and dividend income. The main reason for this was, at the time, a significant proportion of the tax due on interest earned on savings was collected at source by banks and building societies, who deducted a 20% flat rate of tax except for those who could confirm they were non-taxpayers.

5.4.3 The Calman Commission thus argued that: '*If there were to be a different Scottish rate applied to savings, then banks and other institutions would have to identify which of their customers was liable to pay tax at the "Scottish rate" and account for it separately. This would be a disproportionate administrative burden in relation to a tax which yields only about one tenth of the total of income tax in Scotland.*' The Holtham Commission for Wales also argued that income tax on savings and dividends was 'administratively costly to devolve', and the later Smith Commission for Scotland implicitly agreed with the Calman and Holtham Commissions' assessments.

5.4.4 However, in April 2016, the Personal Savings Allowance took effect, exempting the first £1,000 of basic rate taxpayers' savings income and first £500 of higher rate taxpayers' savings income from tax. As a result, it was decided that UK financial institutions should no longer deduct tax on interest on savings at source. This means the main practical impediment to devolving income tax on savings and dividend income no longer exists.[xliii]

[xliii] It is likely that notional tax charges and tax credits associated with dividends income and chargeable insurance policy gains also entered the decision-making of previous Commissions for Scotland and Wales. E.g. until 2016 dividends were paid with

5.4.5 It is therefore important to consider how other factors affect the desirability of devolving the taxation of savings and dividends income. First, having NSND income taxed according to Northern Ireland rates and thresholds while savings and dividends income is taxed according to UK rates and thresholds would, all else being equal, complicate arrangements for both HMRC and taxpayers (who would have to understand two sets of tax parameters). Of course, all else is not equal as systems are already in place for Scotland and Wales which account for the fact that taxation of savings and dividends income is not devolved. HMRC and many national tax advice providers will be used to this approach, and having a different approach for Northern Ireland might add to complexity overall. It is therefore likely to be efficient, if possible, to ensure that the same approach is used in each of the devolved nations, whether that is to devolve, or not devolve, the taxation of savings and dividends income.

5.4.6 The second key factor is whether the devolution of taxation on savings and dividends income is likely to increase or decrease the potential economic distortions resulting from income tax devolution. On the one hand, savings and dividend income is generally more responsive to tax policy than NSND income, which could mean greater distortion to behaviour and tax bases if taxes are varied. This type of income is highly skewed, with a small number of high-income individuals contributing a large share of revenues, and therefore likely to be more geographically mobile in response to tax policy differences between different parts of the UK, than income taxpayers more generally.[179] In addition, those owning their own businesses can decide to retain income within their businesses (and potentially receive it later as capital gains, the taxation of which we are not proposing to devolve) in order to reduce their tax liabilities, making them more responsive to taxation on margins other than migration too.[180] [181]

5.4.7 On the other hand, the devolution of savings and dividends taxation could reduce distortions to behaviour and tax bases by helping close up one avenue for tax avoidance: changing the form personal income is received in. If devolved tax policy changes apply to NSND income but not savings and dividends income, a possible channel for behavioural response is for taxpayers to shift the form they take the income in (e.g. from wages to dividends) in order to minimise their tax bill. For example, suppose that the NI Assembly decided to increase the additional rate of income tax from 45% to 50%. If the tax increase did not apply to savings and dividends income, individuals would have an increased incentive to take more income in the form of dividends, including by setting themselves up as an incorporated business, if they had not already done so, in order to avoid the tax increase. This would reduce the yield to the NI Assembly from the tax increase, while boosting the revenues the UK Government receives from taxes on savings and dividends income. Conversely, a tax cut by the NI Assembly would incentivise a shift from dividends to NSND income, offsetting part of the cost of the tax cut to the NI Assembly but reducing the revenues the UK Government receives. Devolving the

notional 10% tax charge and an associated credit to offset against tax rates of 10%, 32.5% and 37.5% formally charged on the dividends income of basic, higher and additional rate taxpayers (such that the net tax due from these groups was 0%, 25% and 30.6% of the dividend payment). Further, insurance policy gains were paid with a notional tax charge and associated credit equal to the basic rate of tax (such that basic rate taxpayers were not liable to tax on these gains, and higher and additional rate taxpayers only liable to tax at a rate equal to the difference between their marginal tax rate and the basic rate). In 2016, the dividends tax credit was replaced by a special dividends tax allowance on top of the Personal Allowance. Notional charges and associated credits for insurance policy gains remain but, as no tax payments are actually deducted or calculated at source, this does not represent an important barrier to the devolution of savings and dividends income.

taxation of savings and dividends income too would allow the NI Assembly's tax changes to apply to all forms of income, thereby avoiding such distortions to behaviour and tax bases.

5.4.8 A number of studies across a range of countries, including the UK, suggest that incorporation, and the form in which income is taken, is responsive to taxation.[182] [183] [184] [185] Unfortunately, recent evaluations of the changes to Scottish income tax rates in 2018-19 did not consider the impacts on incorporation or reported dividends income, otherwise this may have provided evidence on the extent to which changes in intra-UK income tax rates, in a devolved setting within the UK, had influenced the rate of incorporation or changes in dividend reporting.[186] [187]

5.4.9 The third factor is equity considerations. If taxation of savings and dividends income is not devolved, those receiving a large share of their income in these forms (e.g. owners of incorporated businesses) would be much less affected by changes in Northern Ireland tax rates than people with the same level of income who receive it in NSND form, but may be just affected by the changes in government spending. This may be seen as inequitable, particularly given that, as discussed above, savings and dividends income make up a particularly large share of incomes of those with the very highest incomes.

Devolution of tax on savings and dividends income - Recommendation 4

5.4.10 Income tax is no longer deducted at source, hence, the main practical impediment to devolution has been removed. Given the administrative, efficiency and equity benefits that devolution could bring, **we recommend that the taxation of savings and dividends income should be devolved to the NI Assembly. The strength of our recommendation would be bolstered if agreement can be reached to also devolve it to the Scottish Parliament and Welsh Senedd due to the administrative advantages inherent in operating similar systems of income tax devolution across the devolved administrations.**

5.4.11 If no agreement is reached to devolve tax on savings and dividend income to the Scottish and Welsh Governments, then devolution to Northern Ireland could be seen as adding some inconsistency and complexity, and hence one might want to be more tentative in taking such steps, but the case for doing so would, in our view, remain strong.

5.5 The 'Scottish' or 'Welsh' model?

5.5.1 While, in both cases, only powers over revenues from NSND income are devolved, the models of income tax devolution in Scotland and Wales differ. In Scotland, the UK Government no longer levies income tax on NSND income and the Scottish Parliament has the power to set both tax rates and tax bands (excluding the Personal Allowance) for this part of the income tax base, keeping all revenues raised. In contrast, in Wales, the UK Government has reduced the rate of income tax it levies on NSND income by 10 percentage points but still levies and retains the revenue from the remaining 10, 30 and 35 percentage points of the basic, higher and additional rates of tax, respectively.[xliv] The Senedd is free to set its own basic, higher and additional rates on top of the reduced UK Government tax rates (which it has currently set at

[xliv] The UK Government announced it will cut the basic rate of income tax by 1 percentage point from April 2024 as part of Spring Statement 2022.

10 percentage points),[188] and keeps the revenue from this Welsh proportion of the tax rates only.

5.5.2 There are therefore two main differences between the way income tax is devolved to Scotland and Wales. First, whereas revenues from NSND income are devolved in full to the Scottish Parliament, only a portion (currently 10 percentage points of each tax band) are devolved to the Senedd. Second, whereas the Scottish Parliament has the power to vary rates and bands of income tax (except for the Personal Allowance), the Senedd has the power to vary tax rates only.

5.5.3 Of course, Northern Ireland is not required simply to choose between these two models. A variety of alternative options are available between the Welsh and Scottish models, or even going beyond. For example, rather than devolving ten percentage points of each tax band as per the Welsh model, one option could be to devolve half of the revenues raised from each band; this would help ensure that the NI Executive's budget was more closely aligned with the revenue implications of tax rate changes to the higher and additional rates (discussed further below). It would also be possible to devolve revenues in full but not band-setting powers, or to devolve only a portion of the revenues alongside band-setting powers for the devolved element of the tax. And, going beyond the Scottish model, there may be a case for devolving powers over the Personal Allowance, as well as the tax thresholds. The advantages and disadvantages of these different models are now discussed. We focus on the distinction between the Scottish and Welsh models to keep the discussion tractable, but highlight other options where appropriate to do so.

5.6 What proportion of revenues should be devolved?

5.6.1 The proportion of income tax revenues that are devolved will affect the risk and incentives the NI Assembly faces in relation to tax revenue performance although, as discussed in Chapter 6, these risks and incentives are also affected by the block grant adjustment arrangements put in place alongside tax devolution.

5.6.2 The first column of Table 5.1 shows our estimates of the amount that would have been raised (as of 2018-19)[xlv] from Northern Ireland taxpayers under the devolution of all revenues (the "Scottish" model), the devolution of 10 percentage points of all bands (the "Welsh" model in practice) and the devolution of half of all revenues. The top part of the table shows that if NSND revenues were devolved in full, they would have amounted to an estimated £2.69 billion as of 2018/19, equivalent to 26% of the NI Executive's resource DEL in that year.[189] This means that half of revenues would have amounted to an estimated £1.35 billion (13% of resource DEL), and 10 percentage points of all bands would have amounted to an estimated £1.17 billion (11% of resource DEL). This in turn implies that, prior to any behavioural responses, a 1 percentage point change in all rates on NSND income would have yielded or cost approximately £117 million, as of 2018-19, with approximately £100 million coming from the basic rate, £14 million from the higher rate and £3 million from the additional rate. This is

[xlv] Data from 2018-19 is used in this section as this is the latest year for which published figures from the HMRC Survey of Personal Incomes, which provides granular regional data on income tax than ONS figures, are available. Revenue figures presented here will, therefore, be different to the estimates presented in Chapter 2, where ONS figures for 2019/20 are used to provide analysis across taxes.

shown in Table 5.2. This is equivalent to 1.1% of resource DEL or 15% of revenue raised from regional domestic and non-domestic rates in 2018-19.[190]

5.6.3 The bottom part of Table 5.1 provides figures for the devolution of revenues from all income sources including savings and dividends income. It shows figures of £2.89 billion if all these revenues were devolved, £1.45 billion if half were, and £1.26 billion if 10 percentage points of all bands were devolved: respectively, 28%, 14% and 12% of resource DEL. A 1 percentage point change in tax rate applied to all taxable income would have yielded or cost £126 million, equivalent to 1.2% of resource DEL or 16.1% of revenue raised from regional domestic and non-domestic rates. Of this, approximately £105 million would come from the basic rate, £17 million from the higher rate and £4 million from the additional rate, as shown in Table 5.2.

Table 5.1 Revenue yields and contributions from different income tax devolution options as of 2018/19

Devolution scope	NI Income tax revenues (£bn)	Share from taxpayers			Share from tax band		
		Basic rate (20%)	Higher Rate (40%)	Additional Rate (45%)	Basic rate (20%)	Higher Rate (40%)	Additional Rate (45%)
NSND income tax							
All	2.69	1.60 (59.5%)	0.83 (30.6%)	0.26 (9.8%)	2.02 (75.0%)	0.55 (20.6%)	0.12 (4.4%)
Half	1.35	0.80 (59.5%)	0.41 (30.6%)	0.13 (9.8%)	1.01 (75.0%)	0.28 (20.6%)	0.06 (4.4%)
10p each band	1.17	0.80 (68.3%)	0.31 (26.0%)	0.07 (5.7%)	1.01 (85.9%)	0.14 (11.8%)	0.03 (2.3%)
All income tax							
All	2.89	1.62 (56.0%)	0.90 (31.1%)	0.37 (12.9%)	2.07 (71.5%)	0.64 (22.3%)	0.18 (6.2%)
Half	1.45	0.81 (56.0%)	0.45 (31.1%)	0.19 (12.9%)	1.04 (71.5%)	0.32 (22.3%)	0.09 (6.2%)
10p each band	1.26	0.82 (65.0%)	0.34 (27.1%)	0.10 (7.9%)	1.05 (83.6%)	0.17 (13.1%)	0.04 (3.3%)

Source: Fiscal Commission calculations using Survey of Personal Incomes (2018-19) Public Use Tape. Figures here are based on Northern Ireland revenue data for 2018/19

Table 5.2 Change in revenue yields from a 1 percentage point increase on all tax bands as of 2018/19

Devolution scope	Revenue raised from 1pp raise on all bands £m	Share of revenue raised from each band		
		Basic rate (20%)	Higher Rate (40%)	Additional Rate (45%)
NSND income tax (All, half or 10pp)	117.5	100.9 (85.9%)	13.9 (11.8%)	2.7 (2.3%)
All income tax (All, half or 10pp)	125.9	105.2 (83.6%)	16.5 (13.1%)	4.2 (3.3%)

Source: Fiscal Commission calculations using Survey of Personal Incomes (2018-19) Public Use Tape. Figures here are based on Northern Ireland revenue data for 2018/19

5.6.4 These figures imply that the exposure of the NI Executive's budget to both upside and downside revenue risk (from growth in the size of the tax base, not policy changes) would be approximately 2.35 times greater if all revenues are devolved as opposed to just 10 percentage points of each band. This would provide both stronger incentives and rewards for growing the

income tax base (relative to England's) and bigger losses if the tax base shrunk (relative to England's). The devolution of 10 percentage points of each band would still provide a step change in the proportion of funding derived from devolved revenues though, with each 1% improvement in the size of tax base relative to England generating around £13 million in additional income tax revenues, as of 2018-19.

5.6.5 The second, third and fourth columns of Table 5.1 show the proportion of revenues that would come from basic, higher and additional rate taxpayers under the different devolution models, while the fifth, sixth and seventh columns show the proportion of revenues that would come from the basic, higher and additional rate tax bands (which is lower, given that taxpayers pay a significant part of their taxes at infra-marginal rates, i.e. rates that are not at the margins of the tax bands). These columns show that the share of revenue that would be derived from higher and additional rate taxpayers (and particularly the higher and additional rate tax bands) would be substantially higher if all revenues were devolved, than if revenues from 10 percentage points of each tax band were devolved. This is particularly true if taxation of savings and dividends income is devolved, given that this is concentrated at the top of the income distribution.

5.6.6 The lower reliance on higher income taxpayers and bands for revenues under the "Welsh" model of devolution means that the NI Executive's budget would both benefit less from increases in the number of and incomes of high-income residents, and be less exposed to falls and volatility in their numbers and incomes. Because Northern Ireland has relatively few high income taxpayers (as shown by Table 2.3 in Section 2.7.4), and their characteristics (and hence income trends) are likely to be different to those in England, insulation from these risks may be seen as beneficial, increasing the attractiveness of the "Welsh model" of partial revenue devolution.

5.6.7 However, it is also worth noting that the partial devolution of revenues (e.g. 10 percentage points of each band) would skew the financial incentives facing the NI Assembly. This is because, while the NI Assembly would bear the full mechanical revenue effect of changes in the tax rates it levies, it would bear the behavioural effect only for its share of the overall tax rates. For example, if it were to increase the tax rates it levied by 1 percentage point (e.g. from 10% to 11%) it would benefit from the entire additional revenue raised directly by the increased tax rate. However, if this increased tax rate caused taxpayers to earn and report less income, it would only bear the cost of the lower tax *base* for its share of the tax rates (e.g. 11%), whilst the UK Government would bear the cost of the lower tax base for the reserved tax rates (e.g. 10%, 30% and 35%). This would mean that, relative to the NI Assembly bearing the full behavioural as well as mechanical effects of its tax policies, its incentives would be skewed towards tax rises.

5.6.8 This skewing in incentives would be most significant for the higher and additional rates of tax, especially under the "Welsh" model of devolution. This is both because the NI Assembly would bear a smaller fraction of the behavioural effects (e.g. 11/41 for the higher rate, and 11/46 for the additional rate, in this example) than for the basic rate (e.g. 11/21) and because, as highlighted previously, high income taxpayers are more responsive to changes in tax rates (so the behavioural effects are more important for the amount raised from the higher and additional rate tax bands). One way to address this concern might be to devolve half of the revenues from each band, rather than just ten percentage points from each band.

5.7 What powers over rates and bands should be devolved?

5.7.1 Initial plans for income tax devolution in Scotland – as legislated for in the Scotland Act 2012 – and Wales were for the devolved legislatures to have the power to vary income tax rates on all bands of income in lockstep only. This would have allowed increases or decreases in the overall rate of income tax, but not a change to the tax rate applied to any one income tax band (e.g. the basic rate or additional rate) on its own. This was justified by the Calman Commission on the grounds that it saw the degree of redistribution undertaken by the income tax system as part of the UK's "social union". Similar distinctions between redistributive and progressive national income tax schedules and flat rate local income tax rates characterise the income tax systems in place in Denmark, Finland and Sweden.

5.7.2 Subsequently, it was decided to remove these lockstep restrictions for both Scotland and Wales. As currently enacted, legislation allows the Scottish Parliament full control of income tax rates and bands on NSND income. The Welsh Senedd has control of tax rates only, with the UK Government's (reduced) rates of tax acting as a floor to the overall rates of income tax which apply in Wales (for example if the devolved Welsh rate was set to zero then overall the basic rate would still be 10%, the higher rate 30% and the additional rate 35% as this element continues to be set by the UK Government).

5.7.3 What considerations are there in determining the most appropriate set of income tax powers for the NI Assembly? In the Northern Ireland context, the social security benefit system – which plays an even bigger role in redistribution than income tax – is already formally devolved, and while it largely mirrors the system operating in GB, the NI Assembly has chosen to make it more generous in a number of specific areas (an example of so-called 'super-parity', see Section 2.12). Moreover, even across-the-board changes in income tax rates (of the kind initially proposed by the Calman Commission) have significant redistributive effects, given the UK income tax system's high Personal Allowance. The argument that the NI Assembly should only be able to vary rates in lockstep is therefore weak.

5.7.4 Our view is that decisions on the scope of income tax powers should be made on the basis of usability and the incentives and risks inherent with different systems.

5.7.5 The power to raise or lower rates in lockstep only would mean the NI Assembly could only raise more revenue if it were willing to make all income taxpayers in Northern Ireland (including those with the lowest taxable incomes) pay more tax. Conversely, cuts would only be possible if it were willing to reduce bills for all income taxpayers, which could substantially increase their cost. This inability to target tax increases or cuts on particular groups of taxpayers would, in our view, significantly reduce the usefulness of income tax powers.

5.7.6 Granting band- as well as rate-setting powers maximises flexibility under a system of partial devolution. It allows one to increase or decrease tax payments and revenues by changing band thresholds as well as rates, and make bigger structural changes to tax thresholds through changing the number of bands. For example, the Scottish Parliament made use of these flexibilities to split the basic rate tax band into three bands: a 19% starter rate, 20% basic rate and 21% intermediate rate. It used this new structure to ensure that its tax increases only applied to approximately the top half of Scottish income taxpayers, while the bottom half enjoyed (very) small tax cuts.[191] If it had lacked powers over tax bands, the Scottish Parliament

would either have to apply its tax increases to even the lowest income basic rate taxpayers, or only higher and additional rate taxpayers – the latter raising less or requiring bigger tax increases on these bands of income.

5.7.7 On the other hand, the case of Scotland also illustrates how granting powers over bands as well as rates could lead to more complicated tax schedules. For example, the existing higher rate threshold in England, Wales and Northern Ireland is aligned with the National Insurance upper earnings limit, but the (reduced) higher rate threshold in Scotland is not, creating a band of income with a combined rate of income tax and employee National Insurance contributions (NICs) of 53% (and soon to be 54.25%).

5.7.8 In principle, one could combine powers over tax bands as well as rates as in Scotland, with partial revenue devolution as in Wales, in a hybrid approach. This would provide both the flexibility of the Scottish approach, with the lower revenue risk of the Welsh approach and could therefore be seen as attractive.

5.7.9 But this approach is likely to be more difficult to explain to policymakers and taxpayers than either the "Scottish" or "Welsh" models. This is because, for accountability purposes, people should understand the rates of tax being charged by the NI Assembly, the UK Government, and how they interact. This may be difficult when different bands apply to the devolved and reserved portions of the tax. For example, suppose that the NI Assembly wished to reduce the income level at which people pay an overall rate of income tax of 40% from £50,000 to £45,000. Under a model where 10 percentage points of each existing tax band is devolved, it could do that by introducing a new tax band between £45,000 and £50,000 with a devolved tax rate of tax of 30%, which would apply on top of the 10% reserved tax rate. But the devolved schedule of rates would then be 10%, 30%, 10%, which may be difficult to explain intuitively to taxpayers.

5.7.10 In addition, as discussed above, if revenues are only partly devolved, the financial incentives of the NI Assembly would be skewed towards tax rate increases and away from tax rate cuts. These incentives may be more easily acted upon if the NI Assembly could create new bands to apply those tax increases to small selected groups of taxpayers (e.g. those with incomes above £500,000).

5.7.11 In addition to the question of whether band setting powers should be devolved, there is also a question over whether the Personal Allowance should be devolved. The Personal Allowance is not devolved in Scotland, instead remaining reserved to the UK Government. The rationale for this is largely that devolving the Personal Allowance implies that control over the definition of the tax base has been partially devolved, and this adds further complexity to the system.

5.7.12 On the other hand, whilst we do not see a good case for devolving allowances, reliefs and deductions more broadly, there does not seem to us to be a strong in principle reason why the Personal Allowance specifically should not be devolved. Indeed, from a policy perspective the NI Assembly may see merit in setting a different Personal Allowance in Northern Ireland – since incomes are generally lower than in other parts of the UK, a relatively high Personal Allowance excludes proportionately more of the population from a system of devolved income tax. From a practical perspective, the NI Assembly may need to be constrained to set a devolved Personal Allowance no lower than the Lower Earnings Limit in National Insurance, since this is the threshold at which employers must report employee incomes to HMRC. But this constraint,

even if it needs to apply, is unlikely to be binding in a practical sense, since the Lower Earnings Limit is currently a long way below the Personal Allowance.

Devolution of powers over rates and bands of income tax - Summary

5.7.13 The decision over what proportion of income tax revenues and what powers over rates and bands to devolve, involves several trade-offs. Relative to partial devolution along "Welsh" lines, "Scottish" full devolution of revenues, rates, and bands would mean:

i. More scope for reward, and stronger financial incentives for growth, but also a higher risk of revenue volatility and decline;

ii. More of a financial incentive to engage in competitive tax rate reductions, but less of an incentive to increase tax revenues; and

iii. Greater scope for fine-tuning the distributional effects of income tax policy changes, but potentially less alignment with other UK tax thresholds (such as the NICs upper earnings limit).

Devolution of powers over rates and bands of income tax - Recommendation 5

5.7.14 **If the NI Executive is keen to maximise the flexibility of its tax varying powers and its accountability to the local electorate,** it is the Commission's view that **devolving revenues, rates and band-setting powers in full, as in Scotland, would be preferable. This would also make the most of the usability of income tax, by allowing fine-tuning of the distributional effects of policy changes. But, this 'Scottish' model would also entail greater risk of short-term revenue volatility and long-term revenue decline if the Northern Ireland tax base did not keep pace with the England tax base.** These risks could be mitigated by ensuring a robust fiscal framework, with an appropriate block grant adjustment and budget management tools, and periodic reviews of performance. (These elements are discussed further in Chapter 6)

5.7.15 It is also worth saying that this more maximal degree of devolution offers more opportunity to make policy "mistakes". The NI Executive and NI Assembly would need to be sure they had appropriate analytical capability and capacity in place, to understand the consequences of policy change, and **we would recommend that the NI Fiscal Council should have a robust role in forecasting the impacts of change.**

5.7.16 **Ultimately, however, it is the responsibility of Northern Ireland's politicians to determine the appropriate balance between greater financial incentives and powers, and the degree of risk involved.** If the NI Assembly and NI Executive are sufficiently concerned about this level of risk, **an alternative would be the Welsh model of partial devolution, which would involve less financial risk, but also provide less flexibility.** It would be possible to move from the 'Welsh' to the 'Scottish' model in future (or some variation of the models described), as part of an incremental approach to devolution. Options between these two are possible. Devolving half of revenues, rather than ten percentage points, would provide the NI Assembly with more of a stake in economic performance, but not additional policy flexibility, relative to the 'Welsh' model.

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

to tailor the threshold to take account of the lower average income in Northern Ireland, relative to elsewhere in the UK. The risk is that exercising use of this power would implicitly reduce the coherence of the tax system as a whole (following the UK Government's recent decision to realign the income tax Personal Allowance and the NICs Primary Threshold).

5.7.18 **If income tax is devolved to Northern Ireland, we recommend that the NI Assembly be required to pass a motion annually to set the Northern Ireland rates and bands (where applicable) of income tax which will apply, similar to the case in Scotland and Wales.** This obligation to vote on tax rates on an annual basis will help to promote clarity and transparency on the NI Assembly's approach to taxes, will provide opportunities for wider engagement, and will ensure that the level of tax paid by individuals and businesses is assessed on an ongoing basis with active consideration of the impact of taxation on the competitiveness of the Northern Ireland economy.

5.8 Devolution of the apprenticeship levy

5.8.1 As stated in our earlier analysis (detailed in Chapter 4 and Annex F) we consider the case for devolution of the apprenticeship levy to Northern Ireland to be sufficiently strong to merit further consideration. While the levy is a relatively small tax, and would do little to improve the financial accountability of the NI Assembly, the connection to devolved skills and apprenticeships policy is clear. Currently, however, although businesses in Northern Ireland pay the same levy, they are unable to access apprentices through government vouchers in the same way as elsewhere in the UK – instead, the NI Executive receives a Barnett consequential as a result of UK Government spending on apprenticeships in England. Therefore, unlike in England, there is no real link between the levy and funding for apprenticeships in Northern Ireland. Devolution of the levy could help make this link.

5.8.2 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.

5.8.3 As concluded previously, in terms of sequencing, the case for devolution of the apprenticeship levy would therefore be strengthened 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 presented in the previous sections, we consider that there is a strong case for devolution of the apprenticeship levy to Northern Ireland.[xlvi]

[xlvi] It should be noted that, in his March 2022 Spring Statement, the Chancellor committed to a review of the apprenticeship levy, which will be part of a new HM Treasury tax plan to be finalised in the autumn.

Devolution of the apprenticeship levy – Recommendation 6

5.8.4 **We recommend that, if powers over income tax are devolved to the NI Assembly in future, the apprenticeship levy should be devolved in parallel.**

Administration of devolved apprenticeship levy - Recommendation 7

5.8.4 **We recommend that if the apprenticeship levy is devolved to the NI Assembly, it continues to be administered by HMRC, given the synergies with income tax administration.**

5.9 The model and administration of smaller taxes

5.9.1 We have concluded that there is a sufficiently strong case for devolving stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax. Given that these are small taxes with low revenue yields, and there are benefits in restructuring them to better suit the Northern Irish context (e.g. given differences in the property market, and a border with RoI) and improve overall tax design, full devolution of revenues and tax powers is desirable.

5.9.2 However, even if full revenues and powers are devolved, there is a question for the NI Executive as to the body which should administer the tax. In particular, should HMRC be asked whether they could administer the newly devolved taxes in return for a fee? Or should either new or existing Northern Ireland-based bodies collect the taxes? Key considerations for the NI Executive issues in determining this include:

i. The relative administration and compliance costs under the different options;

ii. The extent to which HMRC administering the newly devolved tax alongside the predecessor tax would constrain the NI Assembly's tax policy decisions; and

iii. The extent to which the potential for local administration to allow changes in administrative practice (e.g. service quality, enforcement activities) and development of broader institutional capacity is valued by local policymakers.

5.9.3 The following sections draw on discussions with the Scottish and Welsh Governments and revenue authorities to tentatively address these questions.

5.10 Administrative arrangements and costs in Scotland and Wales

5.10.1 Both the Scottish and Welsh Governments have set up their own tax authorities – Revenue Scotland (RS) and the Welsh Revenue Authority (WRA) – to administer the fully devolved taxes. Table 5.3 shows both the reported administration costs and the revenues collected by the tax authorities since they were established.

Table 5.3 Reported administration costs and revenues collected, £ million

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue Scotland						
Costs	**4.7**	**4.5**	**5.5**	**6.2**	**7.1**	**6.2**
Revenue	**572.2**	**633.0**	**706.4**	**695.9**	**716.5**	**621.4**
Welsh Revenue Authority						
Costs			**8.0**		**7.4**	**6.9**
Revenue				**272.3**	**297.5**	**242.3**

Source: Various annual reports and accounts, Revenue Scotland and Welsh Revenue Authority.

5.10.2 The figures show that RS and WRA incur approximately the same annual expenditures, despite the former raising around 2.5 times more revenue than the latter. This means RS's expenditures have been equivalent to around 1% of revenues collected, compared to around 2.5% of revenues for the WRA. There are several possible reasons for this pattern, which have different implications for the costs that could be incurred from local administration in Northern Ireland.

5.10.3 First, is that there are likely to be some fixed costs involved, including governance and senior management costs, the development and maintenance of IT systems and, to some extent at least, data analysis.

5.10.4 Second, there are differences in operating models. RS outsources some of its back-office functions to the Scottish Government (such as finance and human resources) and other organisations (such as processing paper tax returns), whereas these services are undertaken in-house by the WRA. It is possible that outsourcing allows economies of scale to be reaped. This would mean comparisons between RS and WRA figures are potentially misleading about the efficiency of different operational arrangements.

5.10.5 Third, there are differences in administrative practice between RS and the WRA. If the WRA spends more on taxpayer services (including the provision of bilingual services), data analysis and refinements of its systems and processes, this would lead to relatively higher expenditure, but could have benefits in terms of taxpayer experience and revenue collections (although, as discussed below, estimating such effects is very difficult), and potentially other areas of the public sector (for example, if data can be shared more easily).

5.10.6 From the available evidence it is, therefore, difficult to break down the higher cost per unit of revenue collected incurred by the WRA relative to RS into: unavoidable fixed costs; differences in efficiency; differences in administrative practice; and potential cross-subsidisation of RS. However, it seems highly likely that fixed costs do play a role, given the range of areas to which they are likely to apply. Some of these fixed costs (such as senior management) could potentially be avoided, or at least reduced, if existing local organisations (with pre-existing senior management) were given responsibility for administering devolved taxes.

5.10.7 It is also not possible to quantitatively assess how the costs of either RS or WRA compare to what HMRC would charge to administer the devolved taxes on behalf of the Welsh and Scottish Governments (nor what HMRC would charge the NI Executive). The Welsh Government did have discussions prior to devolution about potential fees with HMRC, but, given the time that

has passed and the commercial nature of such discussions, understandably felt unable to share details with us.

5.10.8 It is worth noting that HMRC charges the Scottish and Welsh Governments the incremental cost of administering the Welsh and Scottish rates of income tax. In 2020-21, this amounted to £0.7 million for Scotland. Given revenues of approximately £12 billion, the administration costs charged amounted to approximately 0.006% of revenues. It is worth noting that total administration costs were approximately £27 million between 2012-13 and 2019-20 (of which £24.3 million related to implementation costs), equivalent to 0.06% of revenues collected during that period. For Wales, operating costs of £0.5 million were incurred in 2020-21, with total administration costs between 2017-18 and 2020-21 of £8.5 million (of which £7.7m related to implementation costs),[xlvii] equivalent to around 0.2% of revenues collected during that period.

5.10.9 It is unlikely that HMRC would be able to administer SDLT, landfill tax and APD at a cost equivalent to such a low share of the revenue collected, given how much lower revenues from these taxes are, and the fact administering fully devolved taxes may require more significant changes (and hence costs) particularly where there has been no previous work completed with respect to equivalent taxes in Scotland or Wales. Indeed, it may not be able to administer them at the same cash cost as income tax, especially if there were bigger structural differences in tax policy (e.g. changes to allowances) than exist for income tax (where differences are restricted to rates and bands only). Nevertheless, these figures suggest that – setting aside implementation costs (which could be significant, if substantial changes are required to HMRC legacy systems) – basic ongoing administration costs could potentially be several millions of pounds lower if undertaken by HMRC, rather than a separate devolved revenue authority.

5.11 Policy flexibility and administrative innovations

5.11.1 Our discussions with the Welsh and Scottish Governments, the WRA and RS suggest that local administration allowed for greater flexibility on policy. For example, the Welsh Government is currently consulting on the proposal to allow local authorities to be able to vary the rate of Land Transactions Tax (the Welsh equivalent of SDLT) on additional properties, or second homes (more narrowly defined). It is unclear whether HMRC's legacy systems would allow such geographic variation in tax rates, what the costs of a project to make such changes would be (which HMRC would recharge in the normal way) nor whether HMRC would deem it a priority to respond to such requests. In Scotland, while the primary body responsible for tax policy is the Directorate of the Exchequer, increasingly, policy development is being taken forward in collaboration with RS, with RS taking the lead in respect of some aspects, such as the approach to compliance for Scottish Landfill Tax.

5.11.2 Our discussions with the WRA and RS also suggested that local administration provided an opportunity for innovation in how taxes are administered, including through high quality support services and a more data driven approach, potentially generating additional revenues and improving taxpayer experience at the same time.

[xlvii] Implementation costs in Wales were, in part, lower in comparison to those in Scotland, as the Welsh project was able to build upon the work already completed in relation to the devolution of Scottish Income Tax.

5.11.3 While we do not know how much would have been collected if, instead, HMRC had administered the devolved taxes, it is clear that the Scottish and Welsh Governments value the opportunity provided for additional policy flexibility and the ability to administer taxes in a different manner to HMRC, in an effort to provide better services to taxpayers and more effectively manage risks to tax revenues.

5.12 Reaching a judgement on administrative arrangements

5.12.1 Based on the evidence available to us, we have been unable to quantify the likely difference in administration and compliance costs between contracting with HMRC, contracting with existing local bodies (such as the Department of Finance's Land & Property Services), or setting up a Northern Ireland Revenue Authority. However, qualitatively, it seems likely that economies of scale and the existence of existing systems mean that contracting with HMRC may entail somewhat lower costs than administering SDLT, landfill tax and APD locally. A difference of around £2 – 3 million per year (which we consider is feasible) would amount to approximately 1.1% -1.6% of revenues from these three taxes as of 2019-20, and this would come on top of savings related to up-front set-up costs for new systems, and potentially a new institution.

5.12.2 However, this does not necessarily mean that contracting with HMRC would represent the *best* value for money. Our discussions with the Welsh and Scottish Governments and revenue authorities highlighted how local administration allowed for greater flexibility, in terms of policy design and administrative practice, leading to improvements in compliance and revenue yield. As well as greater scope for flexibility and innovation, local administration would help the public understand which taxes are devolved and which are reserved, increasing the accountability of the local administration and helping to build institutional capacity, for potentially greater devolution in future.

Devolution of SDLT, APD and landfill tax - Recommendation 8

5.12.3 **We recommend full devolution of revenues and tax powers relating to stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax.**

Administrative arrangements for SDLT, APD and landfill tax - Recommendation 9

5.12.4 While continued HMRC administration of these taxes might come at somewhat lower cost, local administration would provide greater flexibility and scope for innovation.

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

5.12.6 **We recommend that if the devolution of SDLT, APD and landfill tax is pursued and implemented, the NI Executive should establish a local revenue authority to administer these fully devolved taxes.** The NI Executive should learn lessons from the devolution

journeys of Scotland and Wales, in terms of capability- and capacity-building, in line with an incremental approach to gaining responsibility for additional fiscal powers.

5.12.7 The NI Executive should also carefully consider the scope to make use of the expertise and infrastructure of existing Northern Ireland-based organisations with revenue-collection responsibilities; a new Northern Ireland Revenue Authority could, as in Scotland, outsource some functions to other bodies to maximise value for money.

5.13 Excise taxes – duties on fuel, alcohol and tobacco products

5.13.1 Our earlier analysis (Chapter 4 and Annex F) led us to conclude that the case for devolution of excise duties to Northern Ireland was sufficiently strong to merit further investigation. This investigation was to focus, in particular, on scoping out the likely additional administration and compliance effort that may be required, as well considering cross border shopping issues and economic distortions that could result from any devolution of excise duties.

5.13.2 Having some control over duties levied from excisable goods can be attractive to devolved administrations as the duties have the potential to raise significant revenue and can be used strategically to influence consumer behaviour and help deliver on local policy goals. On the other hand, having common duties can facilitate more efficient trade.

5.13.3 Duties on motor fuels/mineral oils, alcoholic drinks and tobacco products are excise taxes charged on products produced in or imported into the UK. Our earlier analysis of excise duties described them as moderately-sized and salient taxes with strong links to the NI Assembly's devolved responsibilities (environmental issues, transport, public health) meaning that any devolution of excise duties would be expected to improve the accountability of the NI Assembly to the citizens of Northern Ireland. Further, Northern Ireland's geographical location as separate from GB but sharing a land border with RoI, means that different issues are experienced with regard to trade and excise, when compared to GB, and therefore potentially making a case for additional flexibility for the local administration, to allow a more tailored approach to excise issues.[xlviii]

5.13.4 As stated in our earlier analysis, the main factor militating against devolution of excise duties is their structure as taxes on production or importation, rather than at point of sale. Most excise goods become subject to excise duties at the point of production or importation but, in respect of certain products,[xlix] the duty can be *suspended* meaning that it doesn't have to be paid until the product is released for consumption. At present, the UK system largely mirrors

[xlviii] For example, in January 2022, minimum unit pricing on alcohol came into effect in RoI affecting alcohol sold in off-licences, shops and supermarkets, sparking concerns of a potential surge in cross-border trade and potential smuggling. While the Northern Ireland Health Minister committed (in July 2020) to a public consultation on the introduction of similar arrangements for Northern Ireland, nothing has been launched to date.

[xlix] Most spirits and beer sold in Northern Ireland move between Northern Ireland and GB as "duty suspended", while all tobacco products sold in Northern Ireland travel marked "UK duty paid". Duty suspended movement of finished fuel product, such as petrol or diesel is not permitted in the UK.

that of the EU,[l] where existing rules ensure that the systems underpinning excise duties are harmonised, with general arrangements being common across EU members – these include time and nature of duties, as well as shared minimum rates[li] and common definitions and nomenclature.

5.13.5 Given Northern Ireland's unique context and the limited published evidence on devolved excise regimes elsewhere in the world, we have conducted a programme of engagement with stakeholders from the retail and production sectors, international excise tax experts and revenue authorities in Australia and Canada to learn from their experience and to test their views on what devolution of excise duties could potentially mean for Northern Ireland. The following paragraphs are informed by the evidence provided to us by those stakeholders, a list of whom can be found at Annex H.

5.14 Excise duties - evidence on administration and compliance costs

Existing arrangements

5.14.1 The vast majority of all excisable products consumed in Northern Ireland are imported from GB. Under the NI Protocol to the EU Withdrawal Agreement, excisable goods moving from GB into Northern Ireland are treated similarly, but not identically, to goods moving across an international border. This means that a new excise duty charge arises when excisable goods enter Northern Ireland from GB. This charge arises even where duty has already been paid on the goods when they were released for consumption in the UK, however, under the NI Protocol the importing party is able to offset any excise duty already paid at the point of production within, or import into, GB. This is to avoid both double taxation and the exporting party having to claim back duties via the 'excise drawback' scheme which applies to international exports.

5.14.2 Currently under these arrangements, the duty off-set mechanism means that although a charge arises as the goods enter Northern Ireland (even if the goods are not in duty suspension), in almost all cases there will be no need to pay additional duty. That said, some stakeholders have told us that the requirements represent a burden on businesses in terms of resources when moving stock from GB to Northern Ireland, and report that operating under the current system continues to be "challenging and onerous".

5.14.3 As stated in our earlier analysis of excise duties (Annex F), the current regime (under the terms of the NI Protocol) could continue to be used if excise duties were devolved in Northern Ireland, however, any change to excise duties or excise rules would mean that either extra tax payments or refunds would need to be made, increasing the administration and compliance costs involved, albeit to a lesser extent than if the NI Protocol regime did not already exist. Costs would likely be higher the greater the difference in duty structure and rules in GB and Northern Ireland. Moreover, a new system would likely need to be put in place for reconciliation of duties on 'exports' from Northern Ireland to GB, which would have associated additional costs.

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[l] As part of the Autumn Budget 2021, the UK Government published a consultation on detailed proposals for alcohol duty reform, which would mark a deviation from the existing alignment with EU system. The consultation closed on 30 January 2022, with planned changes coming into effect in February 2023.

[li] Shared minimum rates for alcohol and tobacco excise duties play an important role in reducing smuggling/evasion and in ensuring the sustainability of duties at levels which reflect the external costs of consumption of these goods.

Potential new requirements for retailers / suppliers

5.14.4 While it is difficult to draw conclusions on the precise scale of additional administration and compliance costs that will be incurred, any changes to existing arrangements for excisable products could have potentially significant implications for supplier and retailer operations. The scope of devolution, that is, the extent of devolution of duty rates, excise systems/structures, definitions, as well as the mode of implementation (e.g. location of duty points, labelling requirements) will impact on the potential cost implications.

5.14.5 Stakeholders from the supermarket sector have drawn attention to the high volume of excisable goods that are imported to Northern Ireland and the implication that this has for the administrative burden on retailers. For example, in evidence provided to the Commission, a representative from one of the top three major supermarkets operating in the UK, reported movement of upwards of 300 lorry loads containing alcohol and tobacco, from GB to Northern Ireland, per month. They anticipate that operating under an NI-specific excise system would require the gathering of duty evidence from several hundred different suppliers for an excise reclaim for each load, constituting a significant increase in administrative activity and, while it is not clear what mechanism would be employed to implement the devolved duty (i.e. whether this would resemble the existing duty off-set mechanism, or some form of duty drawback), this would have implications for the time required for HMRC to process each of the reclaims (reported as currently approximately 1 month per reclaim).

5.14.6 Further, it is likely that, as part this process, suppliers would be required to hold evidence of the original excise paid for the goods being moved to Northern Ireland, which would require tracking of the individual excisable products and thus the set-up of new systems and processes to do so. In line with HMRC guidance on implementing the terms of the NI Protocol, it appears that companies are already required to hold this evidence, to allow them to undertake duty off-set calculations. However, some of the stakeholder feedback received would cast doubt on the extent to which such arrangements and processes may be considered to be already in place and functioning sustainably.

5.14.7 Stakeholders have told us that alcohol products are not typically tracked through the supply chain at product level, and even if a retailer did track alcohol products through their own warehouses, in many instances suppliers will have paid the excise duty which would add to the complexity of product tracking and reporting. In addition, the introduction of a Northern Ireland-specific excise duty could limit direct duty-paid deliveries of Northern Ireland-produced alcohol products to internal GB customers, a process, which stakeholders have told us, is key at peak periods. In terms of tobacco products, while these are traced via the *Tobacco Track and Trace* system, the Commission has been told that there is no information held in this system regarding the excise payment; systems would therefore need to be adapted to accommodate any change.

5.14.8 Stakeholders have also drawn attention to the requirements and rules around labelling of excisable products and the fact that any devolution of excise duties will necessitate the redesign of labelling for Northern Ireland products (e.g. current alcohol packaging incorporates the existing UK duty stamp, and tobacco products have location-specific requirements for health warnings) which will likely necessitate separation of Northern-Ireland bound stock in distribution centres. In addition, changes to 'stock keeping units' may result (i.e. size and type of packaging, and market-specific promotional packs etc.) with associated implications for

manufacturing and administration costs. Stakeholders have drawn attention to the important role that market-specific labelling and packaging plays in the prevention and detection of excise fraud, a problem which poses a substantial risk in terms of public revenue, both within the UK and internationally.

5.14.9 Given the changes already made under the NI Protocol, it is not clear to what extent any new changes would result in 'prohibitive' costs or represent 'insurmountable' challenges for producers and retailers. Indeed, in the view of some stakeholders, it is likely that any new requirements will be akin to those already experienced by many companies who operate across different domestic and international markets, of varying sizes.

Potential impact on supply chain / logistics

5.14.10 Many large retailers operating in Northern Ireland operate a UK business model, which can help delivery of a wide range of products at value for the, relatively speaking, small Northern Ireland market for excisable goods. Stakeholders have told us that any changes which would act to increase the bureaucratic burden for retail companies and suppliers operating in Northern Ireland could have a direct impact on item price and the breadth of the product range considered viable for supply and sale in Northern Ireland.

5.14.11 For example, evidence from one of the two largest tobacco suppliers in the UK, JTI (Japan Tobacco International), indicates that while they hold 58% market share of the Northern Ireland tobacco market, this only represents around 3% of JTI tobacco product imported to the UK. The Commission heard evidence that an internal review of JTI product lines, responding to the additional administration requirements brought in by the terms of the NI Protocol, had resulted in 40% of products[lii] from the Northern Ireland product range being withdrawn, and thus no longer available for sale in Northern Ireland. This is particularly notable as tobacco has always been a highly controlled substance (with the destination of sale for each individual packet being determined from the outset, under the *Tobacco Track and Trace* system), and evidence from stakeholders had indicated that, *in comparison with other goods*, the NI Protocol had not increased administrative requirements for the supply and sale of tobacco products to any significant degree - yet even these (relatively) more modest changes still resulted in a notable impact on the product offer in Northern Ireland. Thus, if devolution resulted in additional, or sufficiently different, administrative requirements to those existing currently, there may be a risk of further reduction in product choice for Northern Irish consumers.

5.14.12 In terms of fuel duties, currently the majority of petrol, diesel and liquefied gas is imported into Northern Ireland from elsewhere in the UK, and travels UK duty paid, meaning that implementation of a devolved duty for fuel would be likely to result in a similar additional administrative effort involved in excise duty reclaim, as is described above for tobacco products and some types of alcohol product.

Location of the duty point

5.14.13 As described in our earlier analysis of excise duties (Annex F), alcohol and tobacco products become subject to excise duties at the point of production or importation, rather than at point

[lii] Note, not of total sales

of sale to customers. The location of the *duty point*, the point at which excise duty is payable/paid, will make a significant difference to level of infrastructure required and, by extension, the level of administrative cost for retailers and suppliers. While 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 – thus ensuring that both receive duty revenues based on consumption of products within their jurisdictions, rather than revenues based largely on what is produced in their jurisdictions – there are other logistical considerations to be taken into account.

5.14.14 With respect to alcohol duties, the vast majority of spirits and beer sold in Northern Ireland are imported from GB (some via RoI) and most move between Northern Ireland and GB as “duty suspended”, with the level of exports from Northern Ireland to GB being significantly lower.

5.14.15 With respect to tobacco duties, currently 100% of tobacco products sold in Northern Ireland are imported from GB, and all travel marked “UK duty paid” – meaning that the product is not classed as “at risk”, and thus resulting in a lower level of administration required for movement. Stakeholders have stated that moving the duty point for tobacco products to Northern Ireland would likely require significant investment in the set-up of new excise warehouses and distribution centres in Northern Ireland, with the associated resource-intensive security tracking, authorisation and financial returns processes required. In addition, as supermarkets are heavily involved in importing tobacco products into Northern Ireland, changes to the current excise arrangements could mean an impact on their established ‘Just in Time’ logistics processes.

5.14.16 Further, stakeholders have told us that while, in principle, specific duty points for goods bound for Northern Ireland could be established within existing infrastructure in GB, this would require additional investment in parallel processes and that this, as well as the requirement for duplicate excise tax returns to HMRC, could impact upon the viability of offering such products for sale in Northern Ireland.

Potential implementation issues for Northern Ireland

5.14.17 Regarding implementation issues and costs of any new excise powers for the NI Assembly, in the view of some of the expert stakeholders, while devolution powers may be used to make changes to excise rates, it would be more difficult for the NI Assembly to make significant changes to the wider excise system. This is because the current alignment of rules and processes to those of the EU customs regime supports higher efficiency in trade and movement of goods. Some stakeholders have suggested that, broadly, a replication of the existing HMRC arrangements for monitoring and compliance would be sufficient for any NI-specific excise system, and therefore devolution would not require the significant cost implied in the design of a wholly new excise system.

5.15 Evidence on cross-border shopping and economic distortions

5.15.1 As stated in our earlier analysis (Annex F), differences in alcohol and tobacco duty rates between Northern Ireland and GB could affect the location where people purchase these

products, given the very high effective tax rates and transportability of tobacco and alcohol products. However, the absence of a land border with GB means that modest differences in tax rates between Northern Ireland and GB are unlikely to result in any significant effect on the tax base of the rest of the UK, driven by cross-border shopping.

5.15.2 This is also especially true for fuel purchases, in view of the lower portability and added complications associated with transporting large quantities of fuel. Instead, the scale of cross-border shopping, and the risk of incentivising excise fraud (smuggling) between Northern Ireland and RoI are likely to be much more relevant concerns due to the high porosity of the land border. While cross-border fuel shopping would create risks for the NI Assembly (as described in Sections F1.4.22 and F1.4.23, Annex F), devolution of fuel duties would also allow the NI Assembly to design tax policy in light of policy in RoI if it so wished, to minimise economic distortions or, conversely, for tax competition reasons.

Evidence on excise fraud / smuggling

5.15.3 Cross-border smuggling is not a new problem within the Northern Ireland context, where long-standing problems have been experienced with fuel laundering and smuggling in areas along the border with RoI.[192] Tackling the issue has been made more difficult due to the involvement of organised paramilitary groups, for whom fuel fraud has been a key source of funding. The risk of incentivising fraud and smuggling is minimised by restricting access to low tax products, therefore, if minded to do so, the NI Assembly could seek devolution of excise duties with a view to aligning those with existing levels in RoI to reduce economic distortions and help address existing cross-border smuggling.

5.15.4 The Commission also heard evidence on the scale of the market for illicit tobacco products, currently a significant problem within the UK[liii] and in RoI.[liv] [193] The outcome is a high level of tax revenue forgone and stakeholders have told the Commission that they consider existing HMRC enforcement powers to be insufficiently robust to properly tackle the scale of the illicit trade in the UK. While marginal changes to tax rates may not pose a major risk for increased fraud or smuggling, over and above the existing risks, it is important to recognise the scale of the existing illegal activity in the UK, and thus the demand for illicit products, and the scale and 'preparedness' of those involved in suppling this demand, when considering making changes in Northern Ireland. This is because alterations to excise rates and rules can inadvertently create opportunities for those involved in criminal activity to exploit and create tax inefficiencies. Indeed, the risk of incentivising excise fraud and smuggling associated with the implementation of new systems for Northern Ireland, specifically under the NI Protocol, was referenced in the Annual Report & Threat Assessment 2019/20 from the Organised Crime Task Force.[194]

[liii] The high effective tax rate (~90% of the cost of a packet of cigarettes is attributable to tax) means that the market is very sensitive to smuggling, with some 25% of tobacco products consumed in the UK estimated to be illegal. This figure includes non-UK duty paid products (i.e. tobacco products from markets overseas) and also counterfeit products produced illegally in informal 'factories' within the UK.

[liv] Based on an annual survey carried out on behalf of the Revenue Commissioners and the National Tobacco Control Office of the Health Service Executive in RoI it is estimated that 15% of total cigarette consumption in Ireland in 2019 related to illegal cigarettes.

5.16 Reaching an overall judgement on excise duties

5.16.1 Following our earlier analysis of the case for devolution of excise duties to Northern Ireland (detailed in Annex F), we undertook to investigate further the likely additional administration and compliance requirements that may result, as well considering cross-border shopping issues and economic distortions that could occur. Throughout our investigations it has proved difficult to identify the likely extent of the impact on businesses in terms of actual costs, as much of the resource requirement will depend upon the scope (i.e. the extent) of devolution, the scale of any changes made to the excise regime and the chosen mode of implementation. However, what is clear is that the complexities (and thus costs) for businesses – and, by extension, the impact on the Northern Ireland market – will increase, the greater the divergence from existing arrangements.

5.16.2 Flexibility for excise policy in Northern Ireland is, in effect, limited under the current terms of the NI Protocol which tie arrangements in Northern Ireland to those of the EU. This is likely to be the case irrespective of whether excise duties are devolved in Northern Ireland or not.

5.16.3 This may mean that, even if powers over excise duties remained centralised, and remain the responsibility of the UK Government, Northern Ireland could be excluded from potentially useful reforms undertaken in GB. In this context, some stakeholders have pointed to the UK Government's proposals for alcohol duty reform, announced as part of the Autumn Budget 2021. The UK Government's proposals seek to make the tax rate per unit of alcohol as even as possible across all alcoholic drinks, and, if implemented, would mark a departure from existing EU requirements on excise duties.[195] The UK Government has stated that discussion is ongoing with the EU on the application of the proposed reforms of alcohol duty to Northern Ireland.

5.16.4 Although it is not yet clear if the proposed changes will apply in Northern Ireland, while control over excise duties remains centralised, there is a responsibility on the UK Government to consider tax policy changes on a UK-wide basis, and, therefore, where required, to engage in discussion with the EU in an attempt to extend potentially useful reforms to Northern Ireland. It is reasonable to assume that if excise duties are devolved to Northern Ireland, depending on the scope of devolution, there may be less onus on the UK Government to engage with the EU on such matters, with the responsibility being transferred to the NI Executive.

5.16.5 It is also of note that if, ultimately, it is decided that the changes to alcohol duty structures will not apply in Northern Ireland, then devolution of excise duties to the NI Assembly (at least for alcohol) may represent a potential solution to the necessarily different excise arrangements in GB and Northern Ireland. But, irrespective of whether devolution was actioned, the UK Government and suppliers may be required to put in place the necessary infrastructure to allow different arrangements to continue to operate in Northern Ireland.

5.16.6 Although our investigations reinforce our earlier conclusion that the infrastructure of the NI Protocol may help somewhat with the administration, compliance and enforcement issues that arise, the terms of the NI Protocol also effectively constrain the flexibility for policy makers in Northern Ireland in the event of devolution. While it is recognised that changes to the current terms may be negotiated and implemented, the very fact that the terms or implementation of the NI Protocol may be subject to change adds another layer of

complication making it difficult to effectively 'future-proof' any action taken, as an accurate balance of cost vs. likely outcome is more difficult while wider arrangements may be subject to change.

Devolution of excise duties - Summary

5.16.7 Devolved excise duties could improve the accountability of the NI Assembly in line with linkages to devolved policy responsibilities in public health, energy and environmental policy, and trade-offs with local issues of fuel poverty, smuggling/excise fraud, and cross border shopping. Having considered the issues presented in this section and balancing these against the potential advantages (as outlined more fully in Annex F), we, as a Commission, remain of the view that there may be value in the NI Executive seeking devolution of excise duties, albeit, over the longer term. As referred to previously, Northern Ireland's geographical location as separate from GB and sharing a land border with RoI means that different issues are experienced with regard to trade and excise, and additional flexibility for the local administration would allow a more tailored approach for the benefit of the Northern Ireland economy.

5.16.8 However, as our investigations have also shown, complex issues do exist - particularly regarding administration and compliance issues, and the corresponding impact on retailers and suppliers, as well as the scope for policy divergence that would be possible under the terms of the NI Protocol. Stakeholders have told us that any increased bureaucratic burden for retail companies and suppliers would be a key concern in view of the corresponding impact on product availability and item price.

Devolution of excise duties - Recommendation 10

5.16.9 We, as a Commission, **remain of the view that there may be value in the NI Executive seeking devolution of excise duties, albeit, over the longer term.** Our investigations have not been enough to persuade us whether the costs and complexity would be readily manageable, or not. Therefore **we recommend that, should the NI Executive wish to pursue devolution it should carry out a full study working alongside HMRC / HMT to agree on how excise duties could be administered and what the costs involved would be. It should also engage more widely with a range of representatives from the production, retail and supply sectors, to ensure that the model of implementation would take account of the specific needs of those sectors**.

5.16.10 It may also be prudent to await the resolution of the issues around the implementation of the NI Protocol, and a longer-term settlement for the customs and excise regime in Northern Ireland, to ensure the existence of a more stable environment, prior to the implementation of any new fiscal powers over excise duties.

Chapter 6

The NI Executive fiscal framework

6.0 Overview

6.0.1 This chapter considers the elements required in a new NI Executive fiscal framework to help ensure fair and effective devolution of the tax revenues and powers we propose as suitable for the Northern Ireland context. Learning lessons from Scotland and Wales, the chapter analyses how the block grant could be adjusted to reflect the transfer of devolved revenues from the UK Government to the NI Executive and the budgetary management tools required to manage those tax powers.

6.0.2 The chapter analyses several hypothetical scenarios – if the taxes we propose had been devolved previously, how might the NI Executive's budget have been impacted over time? Additionally, it considers which organisations are best placed to forecast tax revenues and their costs, how any disputes between the UK Government and NI Executive might be best resolved, as well as commenting on how potential changes to, and reviews of, the fiscal framework could be best progressed over time. The chapter concludes by considering the process for introducing new taxes in Northern Ireland, and commenting on the wider implications of the Commission's work for devolution arrangements across the UK.

6.1 Key points

6.1.1 Tax devolution will need to be accompanied by **a new fiscal framework for Northern Ireland**. The fiscal framework should set out: how the NI Executive's block grant from Westminster should be adjusted both immediately and over time, to reflect the transfer of revenues; the scope of borrowing and reserve powers to address tax forecast errors and potentially other revenue volatility; responsibilities for tax forecasting; and processes for dispute resolution.

6.1.2 We set out here our views on how such a fiscal framework should work, but recognise that fiscal frameworks are negotiated settlements and any such framework will need to be negotiated between the NI Executive and Westminster, taking account of sometimes competing priorities.

6.1.3 Currently, **the budget of the NI Executive** is largely determined by a block grant from the UK Government. If further tax devolution takes place, the Barnett-determined block grant will need to be reduced to reflect the transfer of revenues from the UK Government to the NI Executive. A block grant adjustment (BGA) is required for each tax devolved. The specific way in which the block grant is adjusted will have important implications for the nature of the budgetary risks that the budget of the NI Executive is exposed to as a result of tax devolution.

6.1.4 **In the Commission's view, a number of key principles should guide how fiscal devolution is implemented, in particular with respect to the operation of the BGAs**. Insofar as it is possible,

the aim of any BGA should be to: ensure the budget of the NI Executive is not immediately better or worse off simply as a result of the devolution of a tax; ensure that the NI Executive neither gains nor loses from fiscal risks or trends that can reasonably be predicted in advance, but which it has limited capacity to meaningfully influence; enable the NI budget to benefit from, or suffer the consequences of, the revenue impacts of its own policies; ensure that the NI budget does not benefit from increases in England spending that is funded by an increase in England tax revenues, for a tax that has been devolved to Northern Ireland; and insure the NI budget from the risk of shocks to revenues that affect Northern Ireland and the UK as a whole. Can such principles be achieved? In broad terms, yes. However, in practice, it is not possible to fully satisfy all these goals, and some trade-offs are required.

6.1.5 **BGAs generally do not, or indeed should not, offer full protection to the NI budget against the risk that the tax base (for devolved taxes) grows more slowly in Northern Ireland than it does in England**.[lv] Tax devolution implies that the NI budget will be exposed, not just to the specific effects of its tax policy decisions, but more broadly to the risk that its tax base (and hence its tax revenues) grows more slowly over time relative to the equivalent tax base in England. The flip side is that the NI budget can also benefit from faster growth in Northern Ireland's tax base (and hence its tax revenues) providing an incentive and reward for policies to encourage growth. The approach to calculating the BGAs determines which risks to the tax base the NI Executive's budget is exposed to, and which financial incentives it faces.

6.1.6 BGAs can be designed to protect against specific ways in which the growth of tax bases might diverge. For example, **the approach in Scotland protects the Scottish budget from the risk that the Scottish population grows more slowly than England's**. Population growth is clearly a key determinant of the growth of tax revenues, but the Scottish Government has argued that its ability to influence relative population growth is constrained by the nature of its devolved policy competencies.

6.1.7 **The approach in Wales, by contrast, does not fully protect against the risk of slower population growth but does protect the Welsh budget against the budgetary risks that arise as a result of its very different distribution of income taxpayers, relative to England**.

6.1.8 In terms of **a BGA for Northern Ireland we recommend that the BGA mechanisms that are adopted (for income tax and stamp duty land tax (SDLT)) control for the budgetary risks arising from Northern Ireland's different starting distribution of taxpayers** (similar to Wales). In our view, fiscal frameworks should not penalise the NI Executive for having a lower tax capacity at the point of devolution. The NI budget should not be placed at unreasonable risk in future as a result of the structure of the tax base that it inherits. **This applies to income tax and to SDLT, although not to the other taxes that we recommend as suitable for devolution** – because, unlike the other taxes we discuss, growth in income tax and SDLT revenues can be strongly influenced by the highest income earners and the highest valued properties – of which Northern Ireland has relatively few.

6.1.9 Additionally, **we recommend that the NI budget should not be exposed to the risk of differential population growth relative to England** (similar to Scotland). Relative population

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

growth is an important determinant of the relative growth in revenues, but one that the NI Executive has only partial ability to influence directly. Of course, when it comes to risk/reward trade-offs there is always a flipside. A BGA mechanism that protects the NI budget from the risk of relatively slower population growth would also mean that the NI budget would not benefit from the potentially positive revenue effects of relatively faster population growth if that outcome arose.

6.1.10 In making these recommendations, the Commission recognises that the BGAs will treat population growth differently from how the Barnett formula treats population growth when determining the underlying block grant. Whereas the BGA mechanism would insulate the NI Executive’s budget from the effects of relatively slower population growth on its tax revenues, the Barnett formula doesn't do this for the NI Executive's block grant funding - with funding per capita increasing relatively more rapidly when population growth is slower than in England, (and vice versa). If one were designing a fiscal system from scratch one would probably aim for consistency between the revenue and spending sides of the budget. However, we are not starting from scratch - the Barnett formula already exists and is the default means by which funding for the NI Executive would be determined in the absence of devolution.

6.1.11 The Commission believes that as well as ensuring that Northern Ireland does not gain or lose at the point of devolution, **appropriate BGAs should mean that Northern Ireland does not gain or lose *in expectation* in subsequent years from tax devolution**. That is, Northern Ireland should not be better or worse off going forward from tax devolution as a result of changes in those factors it has little ability to control. For example, as differences in population growth and the initial distribution of income and property values could reasonably be expected to lead to differences in revenue growth, we think the BGAs should adjust for these factors, making it less likely that Northern Ireland gains or loses from tax devolution due to factors that, to a significant extent, are outside of the NI Executive’s control.

6.1.12 We do not believe that the NI Executive’s budget should be insulated against other fiscal risks including the risk of differences in other demographic trends, for example, population age. The likely benefits are uncertain, limited, and potentially outweighed by the disadvantage of a more complex and less transparent framework. We also do not think there is a good case for calculating the BGAs by reference to one or more sub-regions of England, as opposed to England as a whole, not least because the Barnett formula allocates the NI budget a share of increases in all-England spending.

6.1.13 **We have undertaken analysis to consider the hypothetical impacts on the NI budget, using different BGAs, and assuming devolution of the relevant taxes had taken place at various points during the past 20 years**. This analysis necessarily assumes that tax devolution did not result in any policy divergence, and instead considers implications of divergence in relative growth of the devolved Northern Ireland tax base, relative to that in England. **Had devolution occurred in 2000, the budgetary impact would largely have been positive until 2008. But, if devolution had been implemented just prior to the financial crisis, the NI budget would have suffered significant losses in the subsequent decade** as the scale of the economic downturn was more severe and recovery slower in Northern Ireland than in England.

6.1.14 This reiterates the point that, **regardless of the specific BGA mechanism that is adopted, tax devolution brings with it a risk that Northern Ireland’s tax base declines significantly relative**

to England's (not as a result of tax devolution itself but given broader economic developments). This therefore raises a question over whether the fiscal framework should incorporate an element of fiscal insurance, i.e. protection against a significant and/or long-term decline in its budget as a result of weaker growth in its tax base.

6.1.15 There is a risk that introducing such insurance could undermine part of the rationale for tax devolution if it weakened the relationship between economic performance and the devolved budget. But this risk needs to be weighed carefully against the risk that devolved revenues could diverge substantially from equivalent England revenues, for reasons outside the control of Northern Ireland policy makers. Therefore, **we recommend building in an element of fiscal insurance into Northern Ireland's fiscal devolution arrangements, whilst taking care that it does not undermine the rationale for fiscal devolution.**

6.1.16 Tax devolution increases the reliance of the NI Executive on uncertain and potentially volatile tax revenues (and BGAs), therefore **additional budget management tools** will be required. These could include: the ability to borrow to cover forecast errors in tax revenues; the ability to pay into and draw down reserves; and potentially the ability to borrow for discretionary resource expenditure to respond to unforeseen events and/or poor tax revenue performance forecast in advance.

6.1.17 Tax revenue outturns can only be known with certainty sometime after the end of a financial year, however, budgets have to be set in advance. Therefore, following tax devolution, budgets will need to be made on the basis of forecasts of the revenues to be raised. These **forecasts are subject to error, and it reasonable to expect that borrowing powers will be required to meet these forecast errors.**

6.1.18 If any cap is to be placed on such borrowing, it should be set at a sufficiently high level that negative forecast errors only exceed it infrequently. In this respect, the arrangements in place in Wales for borrowing in the event of forecast errors is a better guide than those in Scotland.

6.1.19 **We recommend that the NI Executive should be able to borrow a modest amount to fund discretionary resource spending**, outside of forecast errors. This borrowing could be used to, for example, smooth an economic shock which *temporarily* depresses devolved tax revenues, even where this has been forecast in advance. A modest degree of extra budget flexibility would not pose a risk to the UK's overall public finances and it could have suitable restrictions imposed to limit any 'over-borrowing'.

6.1.20 While borrowing can be used to smooth shortfalls in tax revenues, it is also possible that revenues may be higher than expected. Therefore, **we recommend that the current Budget Exchange mechanism be replaced by a Northern Ireland Reserve** so the NI Executive has the ability to pay into and drawdown from a Reserve, like the Scottish and Welsh Governments. A Reserve would also provide additional flexibility to respond to (unexpected) shortfalls in revenue, on top of that provided by borrowing powers. If there is to be a cap on the Reserve, this should be set in line with the cap in Wales, relative to the value of devolved revenues (as Scotland's cap and annual limit are overly constrained), and if annual drawdown limits are deemed necessary, these should be set to be significantly higher than the Budget Exchange limit currently in place.

6.1.21 **In the Commission's view, it is a key condition for devolution that an independent body is responsible for forecasting Northern Ireland revenues** for any devolved taxes, to ensure credibility and transparency, and avoid the risk of forecasts being unduly optimistic. **We recommend that the NI Fiscal Council is tasked with forecasting revenues for any devolved taxes** – this would help improve local accountability, allow NI-specific factors to be taken account of, and build further institutional capacity within Northern Ireland.

6.1.22 As is the case in Scotland and Wales, **we recommend that the NI Executive fiscal framework should make provision for compensatory payments** between the UK Government and NI Executive (in either direction) when a policy implemented by one *directly* affects the revenues or spending of the other. Compensatory payments should be handled in a responsible manner, and restricting them to these 'direct' spillover effects[lvi] as far as possible would be prudent, as per Scotland and Wales.

6.1.23 Agreeing how certain types of spillover impacts are handled through the fiscal frameworks ahead of time will help pre-empt any potential disputes. Additionally, **we recommend that the NI Executive and UK Government should be required to publish their positions and underlying evidence if no agreement on compensatory payments can be reached.**

6.1.24 A well-functioning system of intergovernmental relations and processes for dispute resolution are essential if fiscal devolution is to work smoothly. Mechanisms for dispute resolution must be seen as fair to both governments if trust in the system is not to be undermined. The recent Review of Intergovernmental Relations (2022), published jointly by the UK and devolved governments, proposes a significantly revised approach to intergovernmental structures and engagement. The Commission welcomes the review, and its emphasis on mutual respect and trust. **We recommend that dispute resolution processes in any future fiscal framework for Northern Ireland should have access to and be embedded within the new Intergovernmental Relations system, supported by the Intergovernmental Relations Secretariat.**

6.1.25 **Review of the fiscal framework** – to keep the NI Executive fiscal framework effective **we recommend the periodic review of the operation of the fiscal framework.** This could be timed to take place shortly after NI Assembly elections to facilitate longer-term perspectives being taken; in which case, a period of approximately five years would seem appropriate. Additionally, **we recommend that if further tax powers and revenues are devolved** (following agreement of an initial NI Executive fiscal framework), **it would be appropriate to review the terms of the overall framework at that point**. In particular, there should be a review of any limits on borrowing and the BGA required, compared to those taxes previously devolved.

[lvi] There are three types of spillover effects: *direct*; *behavioural*; and *second-round*:
Direct effects are mechanical effects that occur as a result of policy change before any associated changes in behaviour. For example, if the UK Government changes the Personal Allowance, this would directly impact devolved Northern Ireland income tax revenues.
Behavioural effects are those which result from people changing their behaviour in response to a policy decision. For example, if the NI Assembly were to change the top rate of income tax charged in Northern Ireland, this might lead to people migrating out of the UK, affecting the UK Government's income tax revenue.
Second-round effects are wider economic impacts that may result more indirectly from policy decisions. For example, the change in income tax rates in Northern Ireland might affect wider economic activity, and hence the amount of VAT generated for the UK Government in Northern Ireland.

6.2 Elements of a fiscal framework

6.2.1 The NI Executive (and UK Government) would require a new fiscal framework if tax devolution were to occur. A fiscal framework would need to be negotiated and would likely need to set out the principles, processes, and rules for:

i. Adjusting the block grant funding the NI Executive receives from the UK Government to reflect the transfer of devolved tax revenues to the NI Executive;
ii. Budget management tools, such as borrowing and reserves, to enable the NI Executive to manage the increased volatility in its funding that tax devolution would entail;
iii. Which organisation should have responsibility for forecasting newly devolved tax revenues;
iv. Any compensatory payments to be made between the UK Government and NI Executive if tax or spending decisions by one have implications for the tax revenues or spending levels of the other;
v. Dispute resolution, if either the UK Government or the NI Executive has concerns about the implementation of the framework, and;
vi. Changes to the fiscal framework, including periodic reviews of its operation.

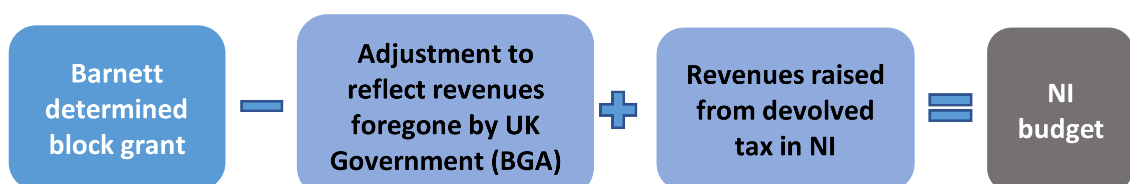
6.2.2 Such a framework would need to be agreed between the NI Executive and UK Government. In this chapter we set out our view on what an appropriate fiscal framework would cover. In doing so, we draw on experience from Scotland and Wales, and consider the implications of the particular economic and institutional characteristics of Northern Ireland. We do so, on the basis of the taxes we have proposed as suitable candidates for devolution to Northern Ireland.

6.3 Block grant adjustments – why do we need them?

6.3.1 We first introduced block grant adjustments (BGAs) at a high level in Chapter 2. In this and subsequent sections we go into much more detail in terms of their importance, how they work and potential options.

6.3.2 Currently, the budget of the NI Executive is largely determined by a block grant from the UK Government. If further tax devolution takes place, the NI Executive's block grant will continue to be determined by the Barnett formula. However, the Barnett-determined block grant will need to be reduced to reflect the transfer of revenues from the UK Government to the NI Executive. Without any such offsetting reduction to the block grant, the budget of the NI Executive would benefit from a windfall funding increase, whilst the UK Government would see a fall in its revenues without any offsetting reduction in expenditure.

6.3.3 The basic idea is that if the revenues raised in Northern Ireland from income tax exceed the BGA for income tax, for example, the NI budget will be better off than it would without income tax devolution (and vice versa).



6.3.4 The question is, how should these block grant adjustments be calculated? The challenge is to adjust the NI block grant in such a way that the budget of the NI Executive is not immediately better or worse off, simply as a result of the transfer of revenues to Northern Ireland, but at the same time to enable the future budgets of the NI Executive to capture the revenue impacts of tax policy choices made by the NI Executive, and of faster or slower growth in the underlying tax base.

6.3.5 BGAs will be required not just in the first year that revenues are devolved, but in all subsequent years, to reflect the transfer of revenues from the UK Government to the NI Executive. Separate BGAs will be needed for each tax that is devolved.

6.3.6 The way in which the block grant is adjusted will have important implications for the nature of the budgetary risks that the budget of the NI Executive is exposed to, as a result of tax devolution. For example, if revenues for a tax that is devolved to Northern Ireland decline, how much of that decline in revenues should the NI budget bear, and to what extent does the answer to this question depend on the reasons for the decline in revenues? The way in which the block grant is adjusted for tax devolution will determine the answer to this sort of question.

6.3.7 We first discuss the principles underpinning the concept and design of the BGAs. We then discuss the concept and operation of the BGA in relation to income tax in more detail, before going on to consider whether the issues are fundamentally any different for other taxes proposed for devolution.

6.4 Principles for implementing fiscal devolution

6.4.1 In the Commission's view there are a number of principles that should guide how fiscal devolution is implemented, in particular with respect to the operation of the BGAs. These are:

Principles for implementing fiscal devolution – Recommendation 11

i. That **neither the budget of the NI Executive nor of the rest of the UK should be immediately better or worse off simply as a result of the devolution of a tax**. Over the course of time, it should of course be possible for the NI budget to be better or worse off financially than it would have been without tax devolution, depending on the tax policy choices taken in Northern Ireland, and the performance of the Northern Ireland economy. But the NI budget should not be immediately advantaged or disadvantaged on day 1 of tax devolution.

ii. **That, as far as possible, following tax devolution the NI Executive should neither gain nor lose from fiscal risks or trends that can reasonably be predicted in advance, and which it has limited capacity to meaningfully influence.**

iii. **That the NI budget should capture, as far as possible, the full revenue impacts of its tax policy decisions, whether they be to raise or reduce revenue.** If income tax is devolved and the NI Executive increases income tax rates, the NI Executive's budget should benefit from any resultant increase in revenues. Likewise, if tax rates are reduced for a tax that has been devolved, the budget of the NI Executive should be exposed to any resultant fall in revenues.

iv. **That, as far as possible, the NI budget should not be exposed to the effects of tax policy changes made by the UK Government, for taxes that have been devolved to the NI Executive.**

And nor should rUK be exposed to the consequences from changes to devolved taxes in Northern Ireland. (We note that there are particular limits to the application of this principle given that tax changes can result in behavioural effects, the impact of which on tax revenues can be hard to estimate) For example, if income tax has been devolved, then if the UK Government reduces income tax and spending in GB, then this should not have a negative impact on the NI Executive's budget, since the tax cut would not apply in Northern Ireland.

v. **That, as far as possible, the UK Government should bear the risks of tax revenue shocks that impact the whole of the UK.** If a shock (such as the Covid-19 pandemic) hits the UK as a whole, then the UK Government should manage the tax revenue impacts of this, even in relation to taxes that are devolved in Northern Ireland. The NI Executive does not have the fiscal, borrowing or public policy competencies or capacity to absorb such shocks.

6.4.2 Can such principles be achieved? In broad terms, yes. As we describe in more detail below, if the BGA, for a tax being devolved, is initially set equal to the revenues raised in Northern Ireland immediately prior to devolution, and in subsequent years is increased in line with some measure of the growth in the equivalent revenues in England,[lvii] then the principles outlined above can broadly be achieved. However, in practice, it is not possible to fully satisfy all these goals, and some trade-offs are required. We note that there are particular limits to the application of principles (iii) and (iv) given that changes in tax policy can result in behavioural effects on other tax bases, the impact of which on revenues can be hard to estimate. As we will see, there are a number of important caveats and exceptions to any BGA method.

6.4.3 Related to this, two other important issues or questions must be addressed, implicitly or explicitly, when determining how the BGAs are calculated. These two questions are:

i. Which risks to the devolved tax base should the NI Executive's budget be exposed to, and which should it be insulated from?

ii. To what extent should pooling and sharing of revenues across the UK take place, once a tax is devolved?

6.4.4 Considering the first issue, risks to the tax base, we noted above the principle that the NI budget should capture, in full, the revenue impacts of its tax policy decisions. But it is inevitable that tax devolution implies that the NI budget will be exposed not just to the specific effects of its tax policy decisions, but more broadly to the risk that its tax base (and hence its tax revenues) grow more slowly over time relative to the equivalent tax base in England (The flipside of this is that the NI Executive's budget will benefit from relatively faster growth in its tax base, relative to the equivalent tax base in England).

6.4.5 This has logic both in terms of practicalities and principle. In principle some of the changes in the tax base will reflect policy choices by NI Assembly and NI Executive that affect performance of the Northern Ireland economy and it should be exposed to these to provide financial incentive for good policy. In practice it will rarely be possible to distinguish between changes in the tax base that are related to Northern Ireland policy and those that are outside of the NI Assembly and NI Executive's control. The question then is whether one wants to insulate the

[lvii] As noted previously, the comparator may differ, depending on the tax in question. For income tax and SDLT, the comparator will be the tax base in England, since already devolved in Scotland and Wales. Whereas for corporation tax, for example, the comparator would be the tax base in rUK.

NI Executive's budget from changes in the tax base that are more likely to be outside of their control.

6.4.6 For example, an important determinant of income tax revenues is the size of population. A faster growing population is likely to mean faster growing revenues. BGAs can either be calculated in a way that exposes the NI budget to the risk of relatively faster or slower growth in its population relative to England, or in a way that does not.

6.4.7 Which is the right approach? In truth, it is difficult to argue one way or the other on the basis of principles (and there is certainly nothing in the UK's wider constitution or Northern Ireland's existing funding settlement that provides a definitive answer). On the one hand, it could be argued that Northern Ireland should not be exposed to the risk of a relatively slower population growth, not least because it has no powers over migration policy. On the other hand, it could be argued that, over the medium to longer term, population growth is determined by the attractiveness of a location to live and do business – factors over which the NI Executive does have significant ability to influence.

6.4.8 So, in designing the BGAs, one has to consider which budgetary risks it is reasonable to expect the NI budget to bear. In this chapter, we discuss in particular the extent to which the NI budget should be exposed to population risks, demographic risks, and risks arising from a different starting distribution of taxpayers.

6.4.9 In considering the second issue, the choice of BGA mechanism also has implications for the degree of revenue pooling and sharing post devolution of a tax. One might argue that, once a tax has been devolved, then there should be no pooling and sharing of subsequent revenue growth of revenues from that tax across the UK. But as we discuss below, the practical implication of implementing this argument is that revenues in Northern Ireland would need to grow relatively much more quickly than the equivalent revenues in England, if the NI budget was not to be worse off in subsequent years as a result of devolution. Such an outcome would appear to us to be against the spirt of devolution. Hence, we do not think that a principle of devolution should be that pooling and sharing of revenues across the UK should cease entirely after devolution, even for taxes that have been devolved.

6.4.10 But how much pooling and sharing of revenues is appropriate and reasonable? And linked to this, should a future fiscal framework for Northern Ireland incorporate elements of fiscal insurance, to insure the NI budget against the risk of fiscal shocks that impact the Northern Ireland economy but not the GB economy?

6.4.11 It is difficult, if not impossible, to come to a view on these issues based on purely objective criteria. There is inevitably a degree of subjectivity in weighing up the risks and coming to a view about how those risks should be shared within the context of a fiscal union with tax devolution. But the choices could have significant impacts on the size of the NI Executive's budget post-devolution of tax.

6.4.12 Our objective in this chapter is to set out the choices, risks and trade-offs involved in deciding on a particular BGA mechanism. We draw on this analysis to make recommendations for the calculation of the BGAs.

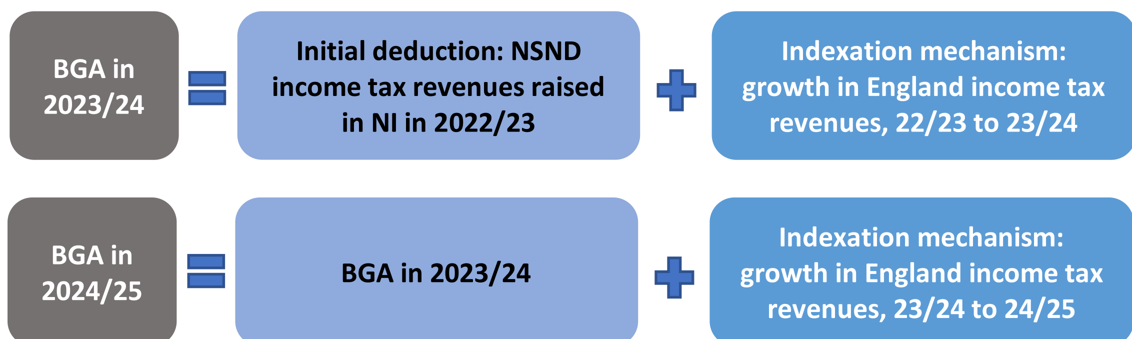
6.5 How can these principles be operationalised?

6.5.1 We can draw on the experience in Scotland and Wales when considering how BGAs might work in practice.

6.5.2 The calculation of the block grant adjustments for Northern Ireland will likely be based on two elements: *an initial deduction* and an *indexation mechanism*.

i. The *initial deduction* is simply the revenues raised from the tax by the UK Government in Northern Ireland in the year before devolution becomes operational.[lviii] So, if income tax is devolved to Northern Ireland in 2023/24, the initial deduction is simply the revenues from income tax raised by the UK Government in Northern Ireland in 2022/23 (it is also likely important that the year chosen as the basis for the calculation is considered representative of 'normal' times, i.e. not one significantly affected by a health pandemic, or the economic rebound following such an event).

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



6.5.3 One way of seeing the block grant adjustment is as an estimate of the revenues that the UK Government is likely to have forgone as a result of transferring a tax stream to Northern Ireland. In effect, an assumption is made that, in the absence of devolution, the UK Government's revenues from the tax in Northern Ireland would have grown at the same rate as in England after devolution occurred.

6.5.4 In our example above, the block grant adjustment is calculated as £3.15bn. This figure would be deducted from the NI Executive's block grant in 2023/24. If the actual revenues from income tax in Northern Ireland were higher than £3.15bn, then the NI Executive's budget

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[lviii] Note that the arrangement for calculating the initial deduction for the income tax BGA in Wales is slightly different – the initial deduction is based on Welsh revenues in the first year of devolution, rather than the year before devolution.

[lix] Since income tax is partially devolved in Scotland and Wales, the BGA for income tax in Northern Ireland will be indexed according to the growth in England income tax.

would be better off compared to the position without income tax devolution by the value of the difference. However, if actual revenues were less than the block grant adjustment, then the NI Executive's budget would be worse off.

6.5.5 Assuming that the block grant adjustments are calculated as described above – with an initial deduction that is indexed to some measure of the growth in equivalent revenues in England – then the block grant adjustments broadly meet the principles identified above:

i. First, they enable the NI budget to benefit from the revenue impacts of its own policies. If the NI Executive increased tax rates relative to those prevailing in England, revenues in Northern Ireland would grow relative to the BGA.

ii. Second, they can help ensure that the NI budget does not benefit from increases in England spending that is funded by an increase in England tax revenues for a tax that has been devolved to Northern Ireland. If the UK Government increases tax rates for a tax that has been devolved to Northern Ireland, then that tax increase would not apply in Northern Ireland. The UK BGA would increase, reflecting the increase in England revenues. At first glance, this might not appear reasonable insofar as the treatment of the NI budget goes. However, it must be remembered that the UK Government's additional revenues would be spent by the UK Government. If they were spent on 'comparable' public services in England, this would generate a consequential increase in the NI Executive's block grant, via the Barnett formula. The higher BGA would at least partly offset this increase; without this, the NI Executive would see an increase in its block grant funded by a tax increase in England that didn't apply in Northern Ireland. If the UK Government spend the additional revenues on 'reserved' matters (like defence, welfare or debt interest), the BGA ensures that taxpayers in Northern Ireland make a broadly similar contribution to that expenditure as taxpayers in England, despite the tax increase not applying directly in Northern Ireland.[lx]

iii. Third, they protect the NI budget from UK-wide shocks to revenues. When there is a major shock such as a pandemic, revenues from a devolved tax in Northern Ireland are likely to fall. But if revenues from the equivalent tax in England fall in a similar proportion, then the block grant adjustment will also fall. The fall in revenues in Northern Ireland is matched by a fall in the BGA (which is deducted from the block grant), insulating the NI budget from the fall in its devolved revenues.

iv. Fourth, it is possible to insulate the NI budget from certain risks or expected trends, such as differential population growth, by choosing an appropriate measure of growth in equivalent revenues in England.

6.5.6 It is important to reiterate that the BGAs offer no protection to the NI budget against the risk that the tax base – for a tax that has been devolved – grows more slowly in Northern Ireland than it does in the UK after it has been devolved, for reasons unconnected to the policy decisions of the NI Executive.

[lx] There is a complicating factor worth mentioning here. Depending on the precise mechanism used for calculating the BGA, it is likely that some proportion of the increased income tax revenues raised by the UK Government in this case will transfer to the NI budget. This is because the Barnett formula provides the NI budget with a population share of the England spending increase. But the BGA, if it is based on the percentage growth in England revenues, is likely to increase by relatively less in cash terms. This is because Northern Ireland raises relative less revenue per capita from income tax. This issue is explained in more detail in Box 6.1.

6.5.7 However, there are ways in which some of these risks could be mitigated through the specific design of the indexation mechanism. These are discussed later in Sections 6.8 - 6.10.

6.6 What are the different options for indexing the block grant adjustments?

6.6.1 The key issue to consider in relation to the BGAs is the *indexation mechanism* – the precise way in which the BGA is related to England revenues. There are a number of different ways that the indexation mechanism could be calculated. Different methods have different implications for the risks that the devolved budget is exposed to.

6.6.2 The example above assumed that the indexation mechanism was simply based on the percentage growth in total England revenues. If England revenues grow 5%, the BGA grows 5% too. A potential limitation with this approach occurs if the population growth rate is expected to be different in Northern Ireland relative to England. If the population growth rate in Northern Ireland was expected to be slower than that in England, then indexing the BGA to the growth in total England revenues might set Northern Ireland an unreasonably high bar to meet – it implicitly would be creating a baseline that required Northern Ireland revenues per capita to grow more quickly than England revenues per capita, simply for the NI budget to stand still.

6.6.3 The approach to calculating the indexation mechanism in Scotland is actually based on the percentage growth in England revenues *per capita*. This approach insulates the Scottish budget from the risk that its population might grow more slowly over time than the England population. A second approach to calculating the indexation mechanism is also identified in the Scottish Government's fiscal framework; this method offers less protection to the risk of differential population growth. It is calculated in parallel with the 'per capita' approach, but it is the 'per capita' approach which determines the Scottish budget.

6.6.4 The approach to calculating the indexation mechanism in Wales is slightly different. It provides a more partial protection of the Welsh budget to the risks of differential population growth, but also protection against the effects of the different distribution of taxpayers in Wales. We now discuss the Scottish model, the alternative model referenced in the Scottish Government's fiscal framework, and subsequently the Welsh model (see Section 6.8).

Option 1: Indexed per capita – the Scottish model

6.6.5 Under the Indexed Per Capita (IPC) model, the block grant adjustment increases in line with the growth in revenues per capita in England, adjusted for population growth in the devolved nation. An illustrative example is shown in Table 6.1. Imagine that in one year the initial deduction (or the BGA) for income tax in Northern Ireland is £3bn and that, with a population of 1.9 million, this is equivalent to revenues per capita of £1,579. The question that then arises is: what should the BGA be the subsequent year? In this hypothetical example, revenues in England grow by 5% between year 1 and year 2; with population growth of 3%, this is equivalent to a growth in per capita revenues of 2%.

6.6.6 The IPC methodology applies this 2% per capita growth rate to Northern Ireland's revenues per capita in year 1. It then applies this uprated revenues per capita figure to Northern

Ireland's population in year 2. We assume in this case that Northern Ireland's population has grown 1% between the two years; in year 2, therefore, the BGA for income tax is £3.089bn.

Table 6.1 Hypothetical BGA calculation, IPC methodology

	Year 1	Year 2	Growth rate
Initial deduction (NI revenues in base year)	**£3,000m**		
Northern Ireland population	1.9m	1.919m	1.01
Northern Ireland revenues per capita	£1,579		
England income tax revenues	£170,000m	£178,500m	1.05
England population	56m	57.68m	1.03
England revenues per capita	£3,036	£3,095	1.02
BGA in year 2		**£3,089m**	

Source: Fiscal Commission calculations

6.6.7 Implicitly therefore, the IPC methodology assumes that if income tax had not been devolved, tax revenues in Northern Ireland would have grown at the same per capita rate as tax revenues in England. It might seem reasonable to calculate the BGAs based on the growth in revenues per capita, rather than the growth in total England revenues. After all, the devolved governments have limited ability to control population growth in their territories relative to population growth in England.

6.6.8 This was the argument that the Scottish Government made when it negotiated the use of the IPC method in 2016.

6.6.9 However, it is also the case that the Barnett Formula only partially takes into account relative population change on the spending side. This means that, under the Barnett Formula, the devolved governments can actually benefit from having relatively slower growth than England.[lxi] This is indeed why HM Treasury argued that it would be inappropriate to protect the Scottish budget from the risk of relatively slower population growth in Scotland on the tax side (via IPC) given that the Scottish budget can benefit from slower population growth through Barnett.

Option 2: Comparable Method – the alternative model in the Scottish Government's fiscal framework

6.6.10 The Comparable Model (CM) increases the BGA in line with a tax-capacity adjusted population share of the change in England revenues. Its practical effect is to increase the BGA in line with

[lxi] To see why this is the case, consider a simple hypothetical example. Imagine that there is population growth in England, but that population is unchanged in the devolved nations. Imagine further that the UK Government increases total spending on 'comparable' functions in England in order to maintain spending per person in England in constant terms. The Barnett Formula provides the devolved nations with a 'population share' of changes in total England spending. So in this example, the devolved nations would see their total budgets rise, and since their populations are unchanged, spending per person would increase in the devolved nations. But in England, spending per person remains unchanged. This example illustrates how, over time, the devolved governments can, and have, benefited from relatively slower population growth as a result of the Barnett formula, and hence why HM Treasury argues that their budgets should not be protected through relatively slower population growth on the tax side.

the increase in England tax revenues, without taking into account whether or not Northern Ireland's population has grown more or less quickly than England's in the period.

6.6.11 The practical effect can be shown using a numerical example, shown in Table 6.2, using the same base numbers as in the example above. The cash value of the change in total England revenues between year 1 and year 2 is £8.5bn. This cash change in England revenues is multiplied by 3.3%, which represents Northern Ireland's population relative to England's. It is then multiplied by 52% which is the 'comparability factor' – a measure of revenues per capita in Northern Ireland relative to revenues per capita in England. The resulting figure of £147m is added to Northern Ireland's baseline revenues/BGA of £3bn, to arrive at a figure for the BGA in year 2 of £3.147bn.

Table 6.2 Hypothetical BGA calculation, CM methodology

	Year 1	Year 2	Growth rate
Initial deduction (NI revenues in base year)	**£3,000m**		
Northern Ireland population	1.9m	1.919m	1.01
Northern Ireland revenues per capita	£1,579		
England income tax revenues	£170,000m	£178,500m	1.05
England population	56m	57.68m	1.03
England revenues per capita	£3,036	£3,095	1.02
Northern Ireland's population share	3.4%	3.3%	
Northern Ireland's 'comparability factor'	52%		
BGA in year 2		**£3,147m**	

Source: Fiscal Commission calculations

6.6.12 Despite using the same 'base' numbers, the BGA is slightly higher (£3.147bn) under the CM method than it is under the IPC method above. This reflects the fact that Northern Ireland's population has, in this example, grown more slowly than England's. IPC fully accounts for differential population growth between Northern Ireland and England, whereas the CM only accounts for differential population growth in respect of the marginal change in England revenues.

6.6.13 One question that might be posed here is why the UK Government proposed the 'Comparable Method' rather than a potentially simpler method that simply increased the BGA in line with the percentage growth in total England revenues (rather than revenues per capita). The answer to this is that the Comparable Method – which is based on cash changes in England revenues – was seen to be more in line with the Barnett Formula, which allocates the devolved governments a population share of cash changes in England spending. This issue is discussed in more detail in Box 6.1.

Box 6.1 Levels deduction and pooling and sharing

In fiscal framework negotiations with the Scottish Government, the UK Government argued that, once a tax has been devolved to Scotland, subsequent revenue growth from that tax in rUK should not feed through to the Scottish budget.[lxii] A BGA mechanism based on the IPC approach is unlikely to achieve this principle in full. This is because of the interaction with the Barnett formula, and the fact that Scotland – like Northern Ireland – raises relatively less per capita from income tax than rUK.

The point can be illustrated with an example. Imagine the UK Government increases income tax rates in England in such a way as to raise £10bn for spending on social care in England. Via the Barnett Formula, the devolved governments would each receive a population share of this increased funding, despite the fact that the tax rise would not automatically apply in those territories. As a result, taxpayers in the devolved territories would benefit from higher spending, despite not having contributed via higher taxation.

In principle, the BGA mechanism deals with this issue. As a result of the increase in England tax revenues, the BGA will increase too. This will offset at least some of the increase in the block grant.
But the increase in the BGA is likely to be less in cash terms than the increase in the block grant. This is because of the different ways that the increases to the block grant and the BGAs are calculated:

- **The Barnett consequential allocates the devolved budget *a per capita share of the England spending increase*.**
- **However, to calculate the BGA, the *percentage increase* in England revenues is applied to devolved revenues per capita.**

Since the devolved governments raise less in income tax per capita than England, the rise in the BGA is likely to be less in cash terms than the rise in the NI Executive's consequential.

In the above example, a rise in England tax revenues and spending of £10bn would generate a consequential for Northern Ireland of around £340m, but potentially a rise in Northern Ireland's BGA of closer to £200m. In this case the NI budget would benefit from a tax increase in England, despite the tax rise not applying in Northern Ireland.

The implication of this outcome is that the NI budget has benefited from an increase in England tax rates that does not apply in Northern Ireland – the rise in the Barnett consequential is not fully offset by the rise in the BGA. (Of course a tax cut could have the opposite effect – the budget of the NI Executive might fall more than the fall in tax liabilities paid by Northern Ireland taxpayers).

An alternative BGA mechanism, called 'Levels Deduction', could ensure no leakage of revenues from England to Northern Ireland. Under Levels Deduction, the BGA increases in line with a population share of the increase in England tax revenues. In the example above, Northern Ireland would receive a population share of the increase in England spending, but its BGA would increase by a population share of the England tax increase – and since these two things are the same in cash terms, taxpayer fairness is achieved.

However, this approach would require revenues per capita in Northern Ireland to have to grow relatively much more quickly in percentage terms than in England simply for Northern Ireland's budget not to be any worse off as a result of income tax devolution. The Comparable Method acknowledges this, and includes the comparability factor to address lower tax capacity in the devolved nations.

In summary, the UK Government proposed using the Comparable Method, rather than a method based on the percentage change in total revenues because, by being based on levels changes, rather than percentage changes, it at least looks closer in spirit to the spending (Barnett formula) side of the equation.

[lxii] This reflected the UK Government's decision to prioritise one of the principles of the Smith Commission, the so-called *taxpayer fairness principle*, over the so-called *no detriment principle*; the two principles are inconsistent with one another.

6.7 Examining the implications of the IPC and CM in a historical perspective

6.7.1 **How would the budget of Northern Ireland have fared if income tax had been devolved in 2000 and the block grant been adjusted by either the IPC or CM approaches?** We can answer this question by using data on estimated income tax revenues in Northern Ireland and England. Note, therefore, that this is a hypothetical exercise – it implicitly assumes that income tax devolution to Northern Ireland would not have resulted in any tax policy divergence between Northern Ireland and England. It also assumes that the estimates of 'actual' income tax revenues in Northern Ireland since 2000 are an appropriate measure of the revenues that would have been raised in Northern Ireland, had tax devolution happened.

6.7.2 Nonetheless, this experiment is useful in indicating some of the risks of tax devolution, and how those risks vary, depending on the BGA mechanism adopted. Chart 6.1 shows the results of this scenario analysis. The BGAs are calculated by using income tax revenues in Northern Ireland in 1999/00 as the basis of the 'initial deduction', and indexing this initial deduction according to the two methods described above.

6.7.3 The first thing to note is that the BGA is fairly similar whether it is calculated using the IPC or CM methods. This reflects the fact that population growth rates have not been very dissimilar in Northern Ireland and England over this period, and so, whether the BGA is indexed according to the growth in total revenues or revenues per capita, amounts to broadly the same outcome. However, there has been slightly slower population growth in Northern Ireland in the most recent years so that, by the end of the period, the BGA calculated according to the Comparable Method is around £50m higher than the BGA calculated according to the IPC method.

6.7.4 We can also look forward and ask how much difference the IPC method might make relative to CM in future. Taking existing ONS population projections as given, and assuming that income tax was devolved to Northern Ireland in 2025, then by 2030 the BGA according to the CM approach would be around £40m higher than the BGA according to the IPC approach. By 2035, the CM BGA would be around £90m higher than the IPC BGA.[lxiii]

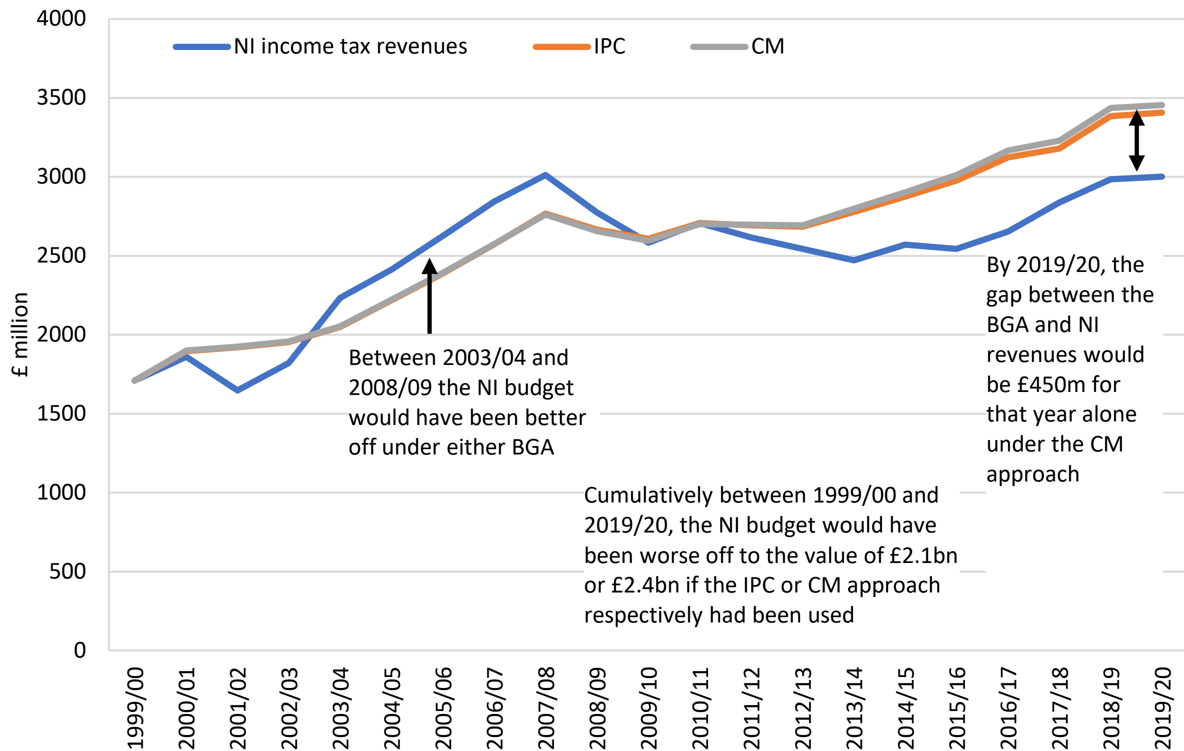
6.7.5 Turning back to the historical analysis, the analysis reveals that, under both methods, the NI budget would have been better off as a result of income tax devolution between 2002/3 and 2008/9, to the tune of around £200m per year. But after 2008/9, tax revenues per capita in Northern Ireland declined in cash terms for several years, whilst remaining broadly constant in England. As a result, the BGA would have exceeded revenues by 2011/12.

6.7.6 There was further divergence in the growth of income tax revenues in subsequent years. By 2015/16 a substantial gap between the BGA and revenues would have opened up, with the BGA exceeding revenues by around £400m in some years. Table 6.3 shows the results of the same scenario analysis on an annual and aggregate basis by both IPC and CM BGAs, helping to demonstrate more clearly the years where the NI budget would be better off and where it

[lxiii] This analysis is based on assumed growth in nominal England revenues of 5% per annum, which is slightly lower that the OBR's forecasts for annual revenue growth between 2023/24 and 2025/26. A slower rate of nominal tax revenue growth does reduce the size of the estimated gap between the two BGA methods, but only slightly. For example, if England tax revenue growth averages 3% rather than 5% per annum, the gap between the two methods in 2035 is £80m – compared to £90m if average annual growth is 5%.

would be worse off. Over this long-term trend the NI budget is estimated to have been between £2.1bn and £2.4bn worse off using the IPC and CM BGAs respectively.

Chart 6.1 Income tax revenues & BGAs in Northern Ireland under two methods for estimating BGAs



Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

Table 6.3 Income tax – IPC and CM methods- 1999/00 to 2019/20, £ million

	NI IT revenues	IPC	IPC impact	Total IPC impact	CM	CM impact	Total CM impact
1999/00	1,710	1,710	-	-	1,710	-	-
2000/01	1,861	1,896	- 35	- 35	1,899	- 38	- 38
2001/02	1,648	1,921	- 273	- 308	1,925	- 277	- 316
2002/03	1,822	1,953	- 131	- 439	1,957	- 135	- 451
2003/04	2,234	2,049	185	- 254	2,054	180	- 270
2004/05	2,413	2,218	195	- 60	2,223	190	- 81
2005/06	2,626	2,387	239	179	2,393	233	152
2006/07	2,844	2,574	270	449	2,575	269	422
2007/08	3,011	2,767	244	693	2,762	249	671
2008/09	2,773	2,666	107	801	2,656	117	788
2009/10	2,583	2,607	- 24	777	2,596	- 13	774
2010/11	2,708	2,707	1	777	2,702	6	780
2011/12	2,617	2,692	- 75	702	2,696	- 79	701
2012/13	2,543	2,684	- 141	561	2,694	- 151	550
2013/14	2,471	2,778	- 307	254	2,798	- 327	223

2014/15	2,571	2,875	- 304	- 51	2,902	- 331	- 108
2015/16	2,543	2,977	- 434	- 485	3,011	- 468	- 576
2016/17	2,653	3,124	- 471	- 956	3,167	- 514	- 1,089
2017/18	2,837	3,180	- 343	- 1,298	3,228	- 391	- 1,481
2018/19	2,984	3,385	- 401	- 1,699	3,435	- 451	- 1,932
2019/20	3,001	3,407	- 406	- 2,105	3,454	- 453	- 2,385

Source: Fiscal Commission calculations

Note: Numbers in this table highlighted red indicate a negative impact on the NI budget and numbers highlighted green indicate a positive impact on the NI budget.

6.7.7 **What has caused Northern Ireland's income tax revenues to grow so much more slowly than England's between 2008/09 and 2015/16?** One might presume that the explanation relates to divergence in one or more of the economic determinants of income tax revenues, such as earnings growth or employment. However, analysis of the underlying data suggests that this is not the explanation. The employment rate and average earnings in Northern Ireland have tended to close the gap (i.e. grow more quickly) than those in England during the period since 1999. There is certainly no evidence that employment or earnings in Northern Ireland grew sufficiently more slowly relative to England to explain the divergence in Chart 6.1.

6.7.8 A more likely explanation relates to various tax policy changes at UK level. These are likely to have affected revenues in Northern Ireland relatively more than revenues in England, given differences in the distribution of taxpayers by income in the two countries. These changes include:

- the substantial real terms increase in the income tax Personal Allowance. Expressed in 2021/22 prices, the Personal Allowance increased from just over £7,000 in 2007/8 to just over £12,000 in 2015/16. Since Northern Ireland has relatively more low earners, this change will have narrowed the tax base by more in Northern Ireland than in England. Furthermore, since the Personal Allowance does not apply to the highest earners, the rise in the Personal Allowance will constitute a tax cut to a relatively higher proportion of Northern Ireland's income taxpayers.
- The introduction of the additional rate of income tax in 2010 will have raised revenues per capita by relatively more in England than in Northern Ireland. This reflects the fact that England has proportionately more of these taxpayers than Northern Ireland.
- The substantial reduction in the higher rate threshold between 2009/10 and 2013/14 may have raised revenues per capita in England relatively more rapidly than those in Northern Ireland given that this change constitutes a tax increase for higher income taxpayers – of whom there are proportionately more in England.

6.7.9 Partly as a result of these tax changes, the top 1% of income taxpayers (of whom there are proportionately far more in England than in Northern Ireland) paid 21% of income tax revenues in 1999/00 but 29% of income tax revenues in 2019/20.

6.7.10 The outcome described above – where the NI Executive is 'worse off' following tax devolution than it would otherwise have been because of the way that tax policy changes by the UK Government interact with Northern Ireland's very different distribution of income taxpayers –

rather than inferior economic performance – could be perceived as being unreasonable, or at least against the spirit of devolution.

6.7.11 The Commission's view is that, in the same way that it is reasonable to protect the NI budget against its lower tax capacity at the point of devolution, it is also reasonable to protect the NI budget against budgetary risks arising from its differing initial distribution of income taxpayers.

6.7.12 The challenge, therefore, is to seek to identify a BGA mechanism that does not expose the NI Executive's budget to the significant risks arising from its very different distribution of income taxpayers – and which could lead to an outcome that appears, at face value, to be against the spirit of devolution.

6.8 BGA methods that control for the different distribution of tax revenues in Northern Ireland

6.8.1 The BGA model used in Wales adjusts for Wales' very different distribution of income taxpayers by tax band relative to those in England. In essence, the Comparable Method is used. However, rather than indexing the BGA to changes in total revenues, the Welsh model calculates *a BGA for each band of income tax separately*.

6.8.2 This approach means that if income tax revenue in England from the Additional Rate band grows more quickly than income tax revenue from the basic rate band, the Welsh budget is not disadvantaged simply by the fact that it has proportionately fewer Additional Rate taxpayers. This sort of adjustment is likely to be particularly important in the context of the sorts of tax policy changes described above – including the above real terms increase in the Personal Allowance, combined with freezing of the Additional Rate threshold.

6.8.3 The 'by band' method is therefore important in protecting the devolved budget from the effects of a different starting distribution of taxpayer income. The devolved budget is protected from the risks of proportionately faster growth from the additional or higher rates in England than from the basic rate – whether that comes about through faster growth in taxpayer incomes in the upper part of the distribution, or tax policy changes that increase the share of tax revenues raised from the higher and additional bands.[lxiv] Of course, there is a flipside to the risks here. There may in future be periods where revenue growth from basic rate taxpayers is relatively faster than revenue growth from additional rate taxpayers. Under such a circumstance, the adoption of a by band approach to the BGA might actually limit the extent of the potential financial gain of the NI Executive, relative to a situation where the 'by band' approach did not apply.

[lxiv] Analysis by the Scottish Government shows that, as long as income growth is even across the taxpayer distribution, then the devolved budgets are not disadvantaged by the fact that they have proportionately fewer higher and additional rate taxpayers than England, even if there is no 'by band' adjustment. However, if income growth is faster for taxpayers in the upper part of the distribution, then even if taxpayer income growth in the devolved nations matches that in England, the devolved budgets can be disadvantaged by a BGA mechanism that does not take the different starting distribution of taxpayers into account.

6.8.4 Chart 6.2 shows what the outcome for Northern Ireland's income tax BGAs would have been had income tax been devolved in 2011/12 (or in 2017/18), according to different BGA mechanisms.[lxv] The BGA mechanisms include the 'by band' model based on both the Comparable Method and the IPC. Controlling for the distribution of tax revenues by band makes a significant difference to the estimated BGA. The two 'by band' BGA mechanisms are both noticeably lower than the CM or IPC methods introduced previously.

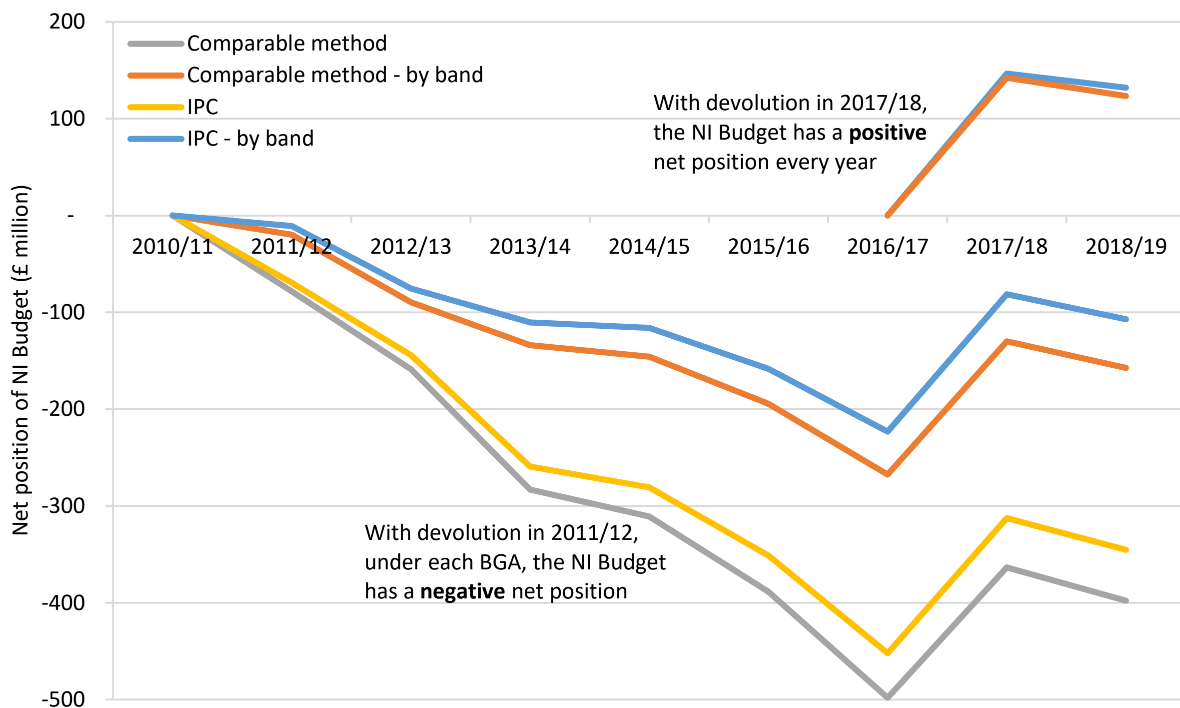
6.8.5 Whether the NI budget is 'better' or 'worse' off as a result of income tax devolution depends on the starting point. Had income tax devolution occurred in 2011/12 (with the initial deduction in 2010/11), the NI budget would be worse off in 2018/19 by between £100m, under the IPC by band approach, and £400m under the Comparable Method (with no adjustment for the distribution of tax). Note therefore that, whilst the 'by band' mechanisms provide a better outcome for the NI budget than the IPC or CM mechanism, the NI budget would still have been worse off as a result of tax devolution in this period, even with the by band mechanism in place. This implies that Northern Ireland's slower growth in revenues per capita was not necessarily purely a result of the distributional issue. This reiterates the point that no BGA mechanism can, or indeed should, protect the NI budget in full from the risk that its tax base grows more slowly over time than the equivalent England tax base.

6.8.6 If income tax had been devolved to Northern Ireland in 2017/18 (with the initial deduction in 2016/17), then by 2018/19 the NI budget would be between £120m to £130m better off as a result of income tax devolution. This reflects generally faster growth in the tax base in Northern Ireland between 2016/17 and 2018/19 than in England, and is similar across all methods described here (though only CM and IPC are detailed in Chart 6.2 for ease).

6.8.7 This helps to demonstrate that the timing of devolution is also important. Chart 6.2 shows that the relative poor growth in Northern Ireland's income tax revenues compared to England's from 2010/11 to 2015/16 has an impact on BGA calculations thereafter, even when Northern Ireland's performance relative to England's improves. Whereas devolution in 2017/18 would harness the improved Northern Ireland performance over subsequent years, (without building in the declining performance in the years prior) resulting in a positive NI budget position for each year between 2017/18 and 2018/19.

[lxv] We shorten the period of analysis to the period since 2010/11 to abstract from structural changes to the income tax schedule prior to this. These include the abolition of the starter rate in 2007/08 and the introduction of the additional rate in 2010/11. These changes would require some form of reset of the BGA, the solution to which would obfuscate from the issue that we are trying to explore – and which are further complicated by the absence of published SPI data 2008/09.

Chart 6.2 Income tax revenues and BGAs in Northern Ireland under four scenarios for estimating the BGAs and two timeframes



Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

Note: Income tax data prior to 2010 is not available on 'by band' basis, given the structural changes to income tax prior to that point, therefore this chart focuses on data from 2010/11 onwards only.

BGA indexation mechanism – Recommendation 12 (part A)

6.8.8 **We recommend that, following tax devolution to Northern Ireland, the BGA mechanisms that are adopted control for the budgetary risks arising from Northern Ireland's different starting distribution of taxpayers. This will insure the NI Executive's budget against the fiscal risks that arise from it having a different distribution of taxpayers by tax band at the point of devolution.**

6.8.9 This applies to income tax and to stamp duty land tax (SDLT), although not the other taxes that we recommend as suitable for devolution. Unlike the other taxes we discuss, growth in income tax and SDLT revenues can be strongly influenced by the highest income earners and the highest valued properties – of which Northern Ireland has relatively few. In our view, fiscal frameworks should not penalise the NI Executive from it having lower tax capacity at the point of devolution. The NI budget should not significantly gain or lose as a result of devolution simply because of the tax base that it inherits.

Recommendation 12 continued below

6.9 Using a different comparator

6.9.1 The discussion so far has assumed that Northern Ireland's tax BGAs would be calculated by reference to revenue trends in England. This reflects arrangements in Wales and Scotland. It could be argued that using England as a benchmark on which to calculate a counterfactual estimate of Northern Ireland's revenues is unrealistic. One reason for this is the observation that London and the South East, in particular, differ substantially from Northern Ireland in respect of their industrial, occupational and earnings structures. Tax base trends in London may not represent a particularly reasonable way to estimate what Northern Ireland's tax base trends 'would have been' had a tax not been devolved.

6.9.2 A case could, therefore, be made for calculating Northern Ireland's tax BGAs based on trends in English regions *excluding* London and the South East of England. Indeed, this might be a more effective, and simpler, way of insulating the NI budget from the effects of its different tax base distribution discussed above.

6.9.3 There is a counter-argument however. The devolved governments receive, via Barnett, a share of increases in *total* England spending. As a result, it is right and proper than the BGA is indexed to changes in total England revenues.

6.9.4 From this perspective, the fact that London and the South East may not be a good benchmark for tax trends in Northern Ireland is less relevant. Instead, the point is that once a tax is devolved, relatively faster growth in revenues from that tax in England should not be shared with the devolved governments. If the BGA was indexed to tax revenues in England, excluding London and the South East, it would imply that if revenues in London grew relatively more quickly than in Northern Ireland, the NI Executive would receive a share of the faster growth in London's revenues, in addition to receiving all of the growth in its own, devolved revenues.

6.9.5 In previous negotiations the UK Government has resisted calls to index BGAs on England excluding London and the South East.

BGA indexation mechanism – Recommendation 12 (part B)

6.9.6 **Northern Ireland's BGAs should be indexed to tax growth in England as a whole, not, for example, England excluding London and the South East.** Many of the concerns that arise in indexing the BGAs to all England can be addressed using a 'by band' approach, and we believe this would be a more appropriate approach.

6.10 Population projections and implications for the choice of BGA mechanism in Northern Ireland

6.10.1 We have discussed the choice to be made about whether the BGA mechanisms should protect the NI budget against the risk of slower population growth in Northern Ireland and insulate it from a different starting distribution of taxpayers. There may potentially be other budgetary risks that we might want to consider whether or not the NI Executive's budget should be exposed to. One of these is the risk of differences in other demographic factors, for example, population age.

6.10.2 There is a clear relationship between age and average annual income tax liability. On average, tax liabilities are an increasing function of age throughout most of our working lives, but from the age of late 50s onwards, tax liabilities tend to fall with increasing age. It is possible that if, following tax devolution, Northern Ireland's share of younger or older individuals grew more quickly than England's, this could pose further risks to the NI Executive's budget even if differential growth in total population was already controlled for.

6.10.3 A preliminary look at the data does not suggest the risk of demographic change poses a substantial risk for the NI budget in the context of income tax devolution.[lxvi] The case for adopting BGAs that account for demographic change is perhaps outweighed by the costs of added complexity and reduced transparency, but further consideration of this issue should not be ruled out.

Population projections and implications for choice of BGA mechanism – Recommendation 13

6.10.4 **We recommend that the BGA mechanism takes account of relative population growth. In our view, the NI budget should not, as a result of tax devolution, be exposed to the risk of differential population growth relative to England.** Relative population growth is an important determinant of the relative growth in revenues, but not one that the NI Executive has significant ability to influence, except perhaps over a very long term. The latest population projections indicate that Northern Ireland's population will grow more slowly than England's, and it is difficult to argue that the devolution of tax powers will in itself be sufficient for the NI Executive to reverse this projection.

6.10.5 We are not persuaded by arguments that the NI Executive's budget should be insulated against other fiscal risks, including the risk of differences in other demographic trends, for example, population age. The likely benefits are uncertain, limited, and potentially outweighed by the disadvantage of a more complex and less transparent framework.

6.11 Consideration of other taxes

6.11.1 We have so far discussed the BGAs using income tax as an example, but BGAs will also be required for any other taxes that are devolved. The issues to consider are not fundamentally any different when thinking about BGAs for these other taxes. The questions are about which fiscal risks the NI budget should bear, and which it should be insured against. There is clearly a case for consistency of BGA method across different taxes unless there are strong reasons to depart from the main method for a particular tax.

6.11.2 Charts 6.3 to 6.7 and Table 6.4 show how the budget of the NI Executive would have fared had various taxes[lxvii] been devolved in 2000/01, and had either the IPC or CM methods for

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[lxvi] Northern Ireland's dependency ratio (the proportion of the population aged under 16 and above 65 relative to those of working age) is projected to grow more quickly than that in England over the next ten years. However, the share of the population aged under 16 (individuals who pay no income tax) is projected to fall more quickly in Northern Ireland than in England, whilst the share of population aged 50-65 is projected to decline slightly less quickly in Northern Ireland than in England.

[lxvii] The charts included here examine the various other taxes that the Commission is considering as outlined in Chapter 4. However, due to the lack of historical data being available, no analysis on apprenticeship levy is presented.

calculating the BGAs been used.[lxviii] It is important to note that the 'by band' approach, as recommended at Recommendation 12, is *not* included in this analysis for income tax and SDLT given the changing structure of these taxes over the period. Therefore, the effect of Northern Ireland having a different distribution of tax payers is not accounted for in this analysis, as we suggest it should at Recommendation 12.

6.11.3 A general observation is that there is never significant difference between the IPC and CM calculated BGAs. This reflects the fact that population growth has been only marginally slower in Northern Ireland over the time period in question.

6.11.4 The extent to which the NI budget would have been better or worse off as a result of tax devolution, had it happened in the past, would depend on when devolution occurred. In general, if tax devolution had occurred in 2000, the NI budget would have been slightly better off as a result throughout the 2000s. However, if tax devolution had occurred just prior to, or around the time of, the financial crisis, the NI Executive's budget could have been significantly worse off by the mid-2010s and still suffering from the legacy effects today.

6.11.5 This would have been driven by significantly slower growth in stamp duty revenues in Northern Ireland compared to England since the financial crisis, driving a large wedge between Northern Ireland's revenues and the BGA. A similar, but less substantial story, is observed for APD and fuel duty. The story for alcohol and tobacco duties is somewhat more positive from a Northern Ireland perspective, as revenues from these duties in Northern Ireland grew more quickly than those in England.

6.11.6 The reasons for the weaker growth of several taxes in Northern Ireland relative to England since 2008 is multi-faceted. In general, the financial crisis had a particularly marked impact on the Northern Ireland economy, in part given spillovers from the severe economic downturn in RoI.

6.11.7 These general effects were arguably accentuated by some tax policy changes and other specific effects. The continuing expansion of Dublin airport and the abolition of Air Travel Tax in RoI in 2014 may help explain weaker revenue growth of APD revenues in Northern Ireland, than England, since. Northern Ireland's housing market has closer links to the fortunes of the housing market in the rest of the island of Ireland than elsewhere in the UK, and in particular the house price boom and bust cycle observed before and after the financial crisis. Changes to the structure of SDLT will also have contributed to much weaker revenue growth in Northern Ireland than in England, given substantial differences in the distribution of the tax base in Northern Ireland compared to England (similar to the income tax issue described above).

6.11.8 Revenues in Northern Ireland can also be significantly affected by exchange rate fluctuations and the impact of this on cross-border shopping. Indeed, the relatively rapid growth in revenues from tobacco and alcohol duties in Northern Ireland, relative to England, since 2008 may reflect changes in the sterling-euro exchange rate.

6.11.9 These results demonstrate the risks of tax devolution. Had a basket of taxes, including income tax and SDLT, been devolved just prior to the financial crisis, the NI Executive's budget could

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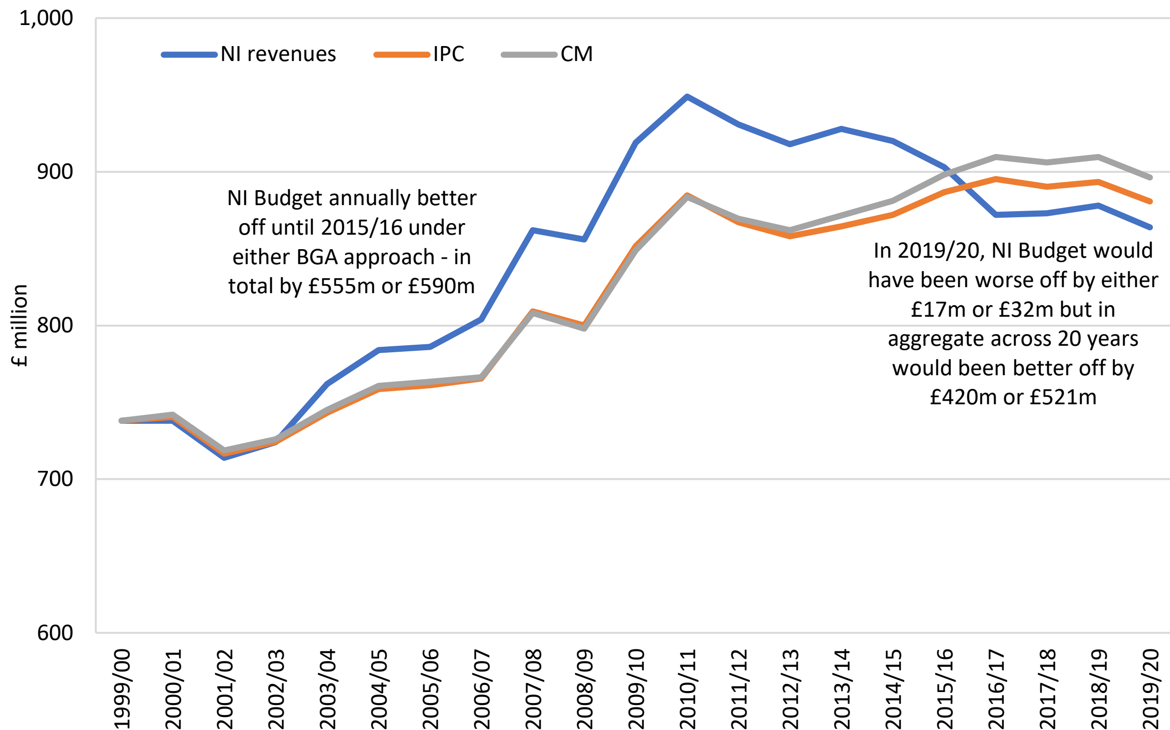
[lxviii] In order to calculate the 'by band' BGA methodologies for SDLT, two sources of data are required. First, GB revenues 'by band' and second, Northern Ireland revenues by band, at least for the 'initial deduction' year, i.e. the year before devolution. HMRC does publish revenue by band for UK as a whole. However, revenues by band are only available at sub-UK level between 2015/16 (the year when the current structure of SDLT was introduced) and 2017/18. Therefore, although we note that a by-band approach is applicable for SDLT, the historical data is not available.

have ended up being substantially worse off as a result – compared to its budget had tax devolution not occurred; and despite a more positive picture in recent years, the gap between Northern Ireland's revenues and the BGAs would not yet have been recouped. This emphasises the potential importance of building in some element of fiscal insurance to Northern Ireland's fiscal framework following tax devolution.

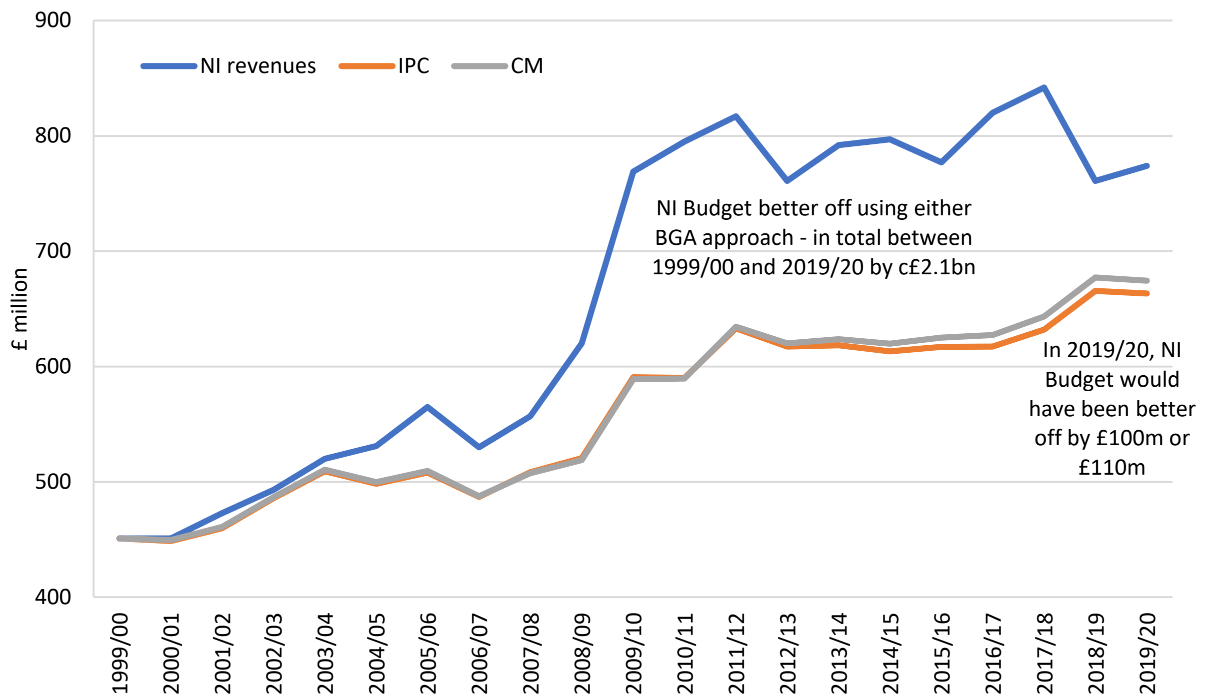
Chart 6.3 Fuel duty revenues & BGAs in Northern Ireland under two methods for estimating BGAs



Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

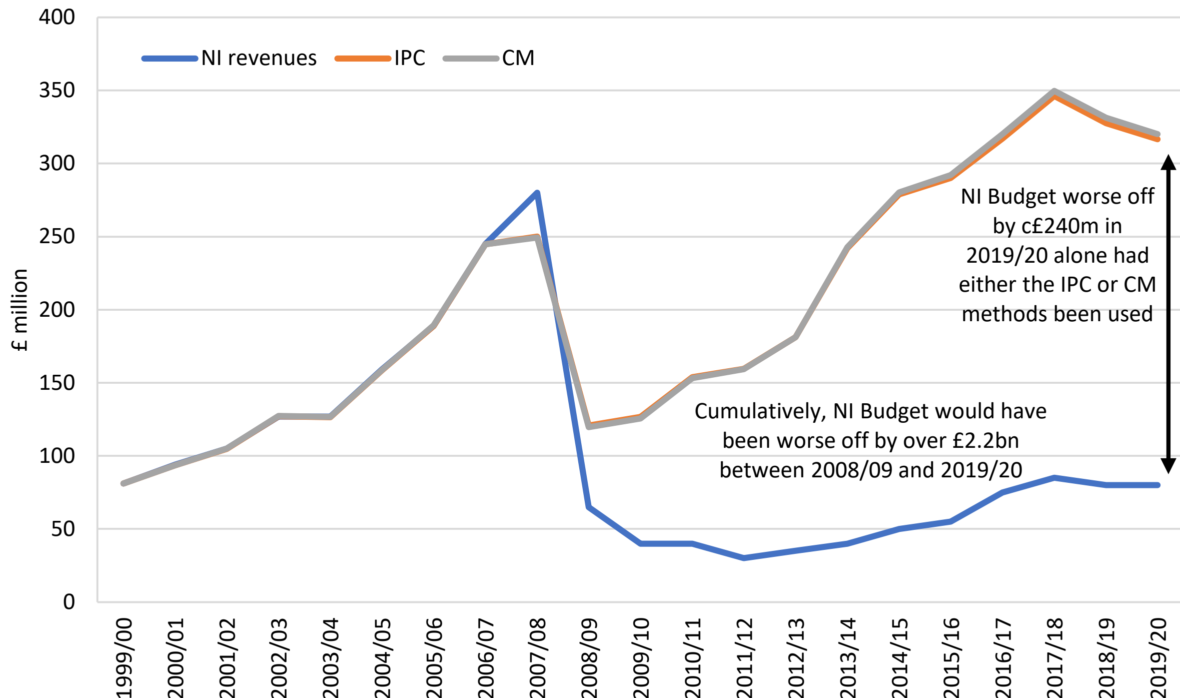
Note: Fuel duty estimates for 2005 and after use data from the Department for Business, Energy and Industrial Strategy (BEIS) statistics on Road transport energy consumption at regional and local authority level. Data before 2005 uses only experimental statistics and BEIS advise that any historical comparisons use 2005 as the baseline year. This means figures presented here for the years prior to 2005 should be treated with caution.

Chart 6.4 Alcohol and tobacco duties in Northern Ireland under two methods for estimating BGAs



Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

Chart 6.5 SDLT tax revenues and BGAs in Northern Ireland under two methods for estimating BGAs

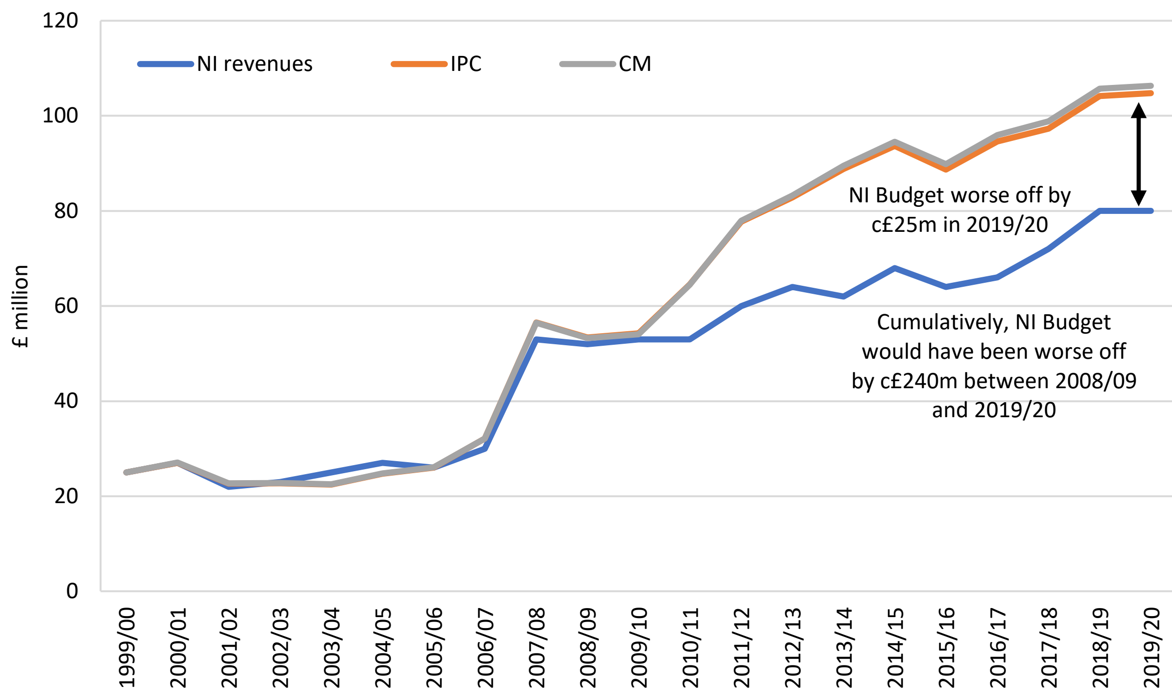


Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

Note: Data on SDLT revenues from in Northern Ireland is not available prior to 2006. The ONS publication assumes that, in years prior to 2006, Northern Ireland's share of UK SDLT was the same as the average observed between 2006 and 2008. Implicitly, this means that the data shows Northern Ireland's revenues growing at exactly the same rates as the equivalent revenues in GB, hence the perfect congruence between revenues and BGA.

*Note: Analysis of income tax and SDLT using the 'by-band' approaches, as referenced and recommended in Recommendation 12, are **not** included in this analysis given the changing structure of these taxes over the period. As a result it is only possible to use the IPC and CM methods.*

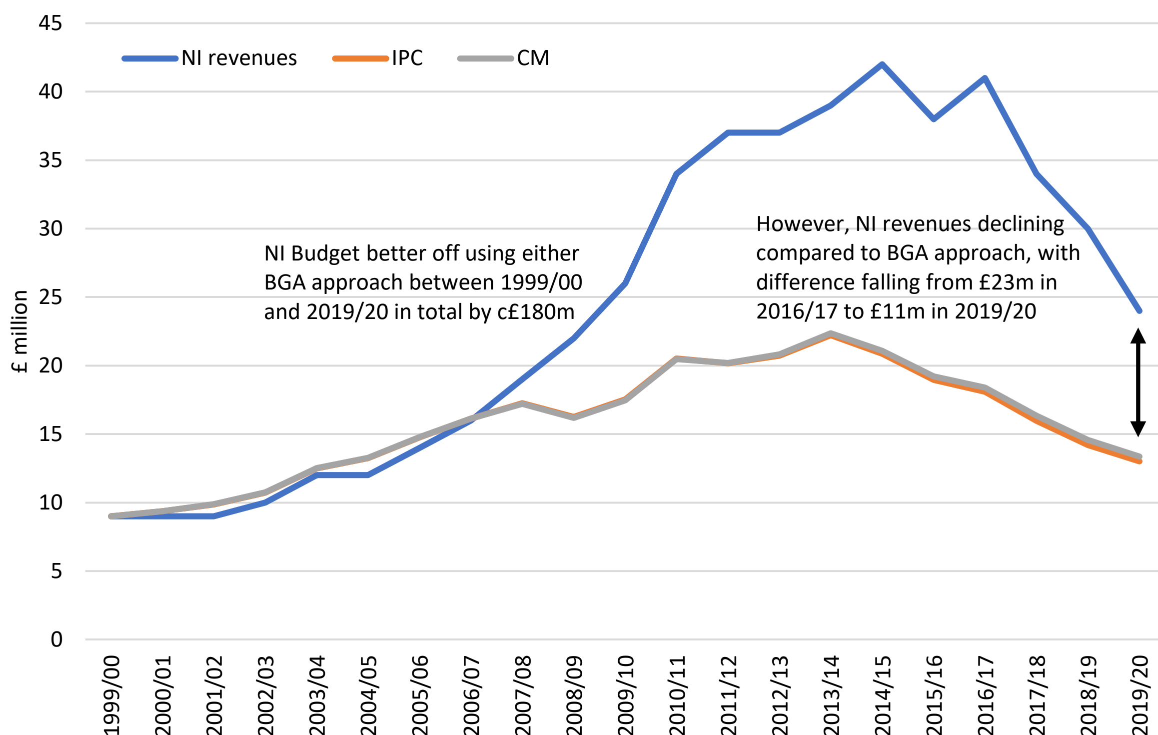
Chart 6.6 APD tax revenues and BGAs in Northern Ireland under two methods for estimating BGAs



Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

Note: The available ONS data does not provide a breakdown of short haul and long haul APD estimates for UK regions, including England (which are subsequently used to calculate IPC and CM values). Values apportioned to UK regions are based upon Civil Aviation Authority (CAA) passenger data rather than administrative revenue data. Therefore the values for England and Northern Ireland include both long and short haul and do not account for the fact that direct long haul flights have been devolved to the NI Executive and zero rated since 2013.

Chart 6.7: Landfill tax revenues & BGAs in Northern Ireland under two methods for estimating BGAs



Source: Fiscal Commission analysis, ONS Country and Regional public sector finances

Table 6.4 Summary of all taxes cumulative difference to NI budget – IPC and CM methods- 1999/00 to 2019/20, £ million

	Cumulative IPC difference since 1999/00 £million	Annual average IPC difference since 1999/00 £million	Cumulative CM difference since 1999/00 £million	Annual average CM difference since 1999/00 £million
Income tax*	- 2,105	- 105	- 2,385	- 119
SDLT*	- 2,154	- 108	- 2,169	- 108
APD	- 232	- 12	- 241	- 12
Fuel duty	521	26	420	21
Alcohol & tobacco duties	2,161	108	2,090	105
Landfill tax	183	9	181	9
All taxes	- 1,627	- 81	- 2,105	- 105

Source: Fiscal Commission calculations

Note: Numbers in this table highlighted red indicate a negative impact on the NI budget and numbers highlighted green indicate a positive impact on the NI budget.
** Analysis of income tax and SDLT using the 'by-band' approaches, as referenced and recommended in Recommendation 12, are **not** included in this table of analysis given the changing structure of these taxes over the period. As a result it is only possible to use the IPC and CM methods.*

6.12 Insurance and resets

6.12.1 Regardless of the specific BGA mechanism that is chosen, there will always remain risks to the NI Executive's budget following tax devolution. Principally, this includes the risk that Northern Ireland's tax base declines significantly relative to rUK's – either as the result of a short-term shock that affects Northern Ireland's economy, or more gradual divergence in the performance of the tax base over a longer time period. In either case, this divergence might not be attributable in any direct way to the policy decisions of the NI Executive.

6.12.2 Such divergence could have significant effects on the NI Executive's budget, by causing a large gap between Northern Ireland's devolved revenues on the one hand, and the BGA on the other. There is therefore an argument for building in some element of fiscal insurance into the fiscal framework to protect the NI budget from the risks of significant budgetary losses following tax devolution, as a result of relative economic changes that are beyond the influence of the NI Executive.

6.12.3 On the other hand, incorporating insurance into the fiscal framework could somewhat undermine the objective of tax devolution to enhance the financial accountability of devolved politicians. In addition, insurance could imply a degree of symmetry in response to fiscal risk. In other words, if the NI budget is protected against the risk that it does particularly badly, symmetry might mean that, if it does particularly *well* relative to England, some of those revenues should be redistributed to parts of the UK that are 'lagging'. Furthermore, there is a practical challenge of implementing a fiscal insurance mechanism. That is distinguishing between the revenue effects arising as a result of tax policy divergence between Northern Ireland and England, and those arising as a result of wider economic changes (see Section 6.12.9 below).

6.12.4 There are broadly two approaches available for incorporating insurance into the fiscal framework. First, there could be predetermined limits (a 'floor') on the gap between revenues and the corresponding BGA that are allowed to appear before the UK Government commits to protect the NI Executive's budget from any further divergence. For example, there might

be prior agreement that the BGA for income tax should not exceed the corresponding revenues by a certain predetermined amount (expressed in cash terms or as a percentage of revenues). If the calculated gap between the BGA and revenues did exceed this amount, the UK Government would commit to limiting the difference to the predetermined amount. Effectively the UK Government (and UK taxpayers) would be committing to protect the NI budget from any further divergence in Northern Ireland's relative tax performance (hence the likely requirement for symmetry, noted above). A more nuanced version of this arrangement would be possible, whereby, below a pre-determined threshold, the NI budget was only exposed to half (or some other share) of the divergence between devolved tax revenues and the corresponding BGA.

6.12.5 Second is the option for periodic 'resets' of the BGA. For example, after a predetermined period of, say five years, the governments could agree to reset the BGA equal to actual tax revenues. This arrangement would expose the NI Executive's budget in full to any revenue divergence within the five year period, but by resetting the clock after every five years, protect it from the risks of permanently slower growth in its tax base.

6.12.6 Such an abrupt reset every five years may feel unreasonable – why should the NI Executive's budget be protected against tax base divergence relatively more in some years than in others? It may also create perverse incentives for devolved politicians to reduce revenues in years when a reset was taking place. A variation on this hard reset would be to reset the BGA on a rolling five year basis. For example, in the sixth year of devolution the BGA could be calculated using tax revenues in the first year of devolution as the 'initial deduction'; in the seventh year of tax devolution, the BGA would be calculated using tax revenues in the second year of devolution as the 'initial deduction'. This arrangement exposes the NI Executive's budget to divergence in tax base growth relative to England, but only for the past five years, rather than indefinitely.

6.12.7 Of course, the two broad methods discussed above, resets and limits, could be combined if desired – so that the NI Executive's budget is exposed to differential growth during a specific time period, with limits on the extent of divergence that the budget is exposed to during this time period.

6.12.8 One potential disadvantage of resets, from the NI Executive's point of view, is that if the devolved tax base in Northern Ireland consistently grows more strongly than the BGA, a reset of the BGA would disadvantage the NI Executive's budget relative to a situation where the reset did not apply. A floor, in itself, would not have this effect. This is why it seems likely that the quid quo pro of having a predetermined floor to protect the NI budget is that there is also a ceiling, and that if Northern Ireland's revenues exceeded the BGA by a certain amount, some of Northern Ireland's excess revenue may be redistributed to the UK Government. This may not be the case, however. Indeed, in some other countries, such as Germany and Austria, floors provide regional governments (Länder) with fiscal insurance if their revenues fall below certain thresholds, but do not equalise perfectly symmetrically in the other direction.

6.12.9 As noted previously, there is a significant practical challenge in implementing a fiscal insurance mechanism – whether a floor or reset. That is the challenge that arises when tax policy diverges between Northern Ireland and England. Imagine, for example, that after devolution the NI Executive lowers income tax rates relative to those that prevail in England. That policy decision will lower Northern Ireland's revenues. It would clearly not be appropriate for the NI Executive to be insulated from the revenue effects of this decision. This implies that the effects of policy divergence on revenues will need to be discounted when either 'resetting' the BGA or determining whether a revenue 'floor' has been breached.

6.12.10 In other words, if the BGA is being reset, this needs to be done on the basis of what the BGA would be if the same tax policy applied in England as applies in Northern Ireland. Similarly, in determining whether the gap between revenues and the BGA exceeds a particular threshold, this would need to be estimated on an assumption of equivalent tax policies in the two territories. These estimates would not necessarily be straightforward, and may be subject to significant uncertainty and dispute. As a result, the estimates would need to be undertaken by an independent institution. In any case, we would have to expect long lags between a tax year ending and the subsequent estimates being made, and there would remain scope for intergovernmental disputes over the results. These complexities may weaken the case for incorporating insurance into the fiscal framework. They certainly emphasise the importance of good faith between the governments, and the need for adequate provisions for intergovernmental communication and dispute resolution.

6.12.11 One implication of fiscal insurance – whether via a floor or a periodic reset – is that it implies there remains an element of risk pooling and sharing across the UK, even for revenues that are devolved. Some may argue that this runs counter to the purpose of tax devolution, since it implies that some proportion of tax revenues from English taxpayers flow to Northern Ireland, even where a tax is devolved to Northern Ireland. However, a degree of revenue risk pooling and sharing is not unusual internationally, even in relatively fiscally competitive federations (such as Canada). In the UK, the Welsh Government's 'funding floor' is a clear example of the use of a fiscal insurance mechanism, designed to insure the Welsh budget against the risk that its funding declines below a pre-determined floor.[lxix]

6.12.12 An important risk with fiscal insurance relates to accountability and incentives. Policy decisions can make a significant difference to economic performance, but make a sustainable difference only over relatively long time horizons. If Northern Ireland were to be insulated from the long term negative effects of poor policy, or not gain from the effects of good policy, a significant part of the reason behind devolution would be lost.

Fiscal insurance – Recommendation 14

6.12.13 **In summary, we recommend building in some, limited, element of fiscal insurance into tax devolution arrangements.** We do not have a strong view on what form this should take, i.e. whether a floor, a ceiling or a periodic reset, but it is clear that at least one of these will be necessary. The risk of fiscal insurance, or 'equalisation', is that it could undermine part of the rationale for tax devolution if it weakens the relationship between economic performance and the devolved budget. But this risk needs to be weighed carefully against the risk that devolved tax revenues could diverge substantially from the equivalent England revenues for reasons outside the control of devolved policy-makers.

6.12.14 We believe the NI budget should bear some of the costs, or benefits, from tax revenues diverging from UK revenues after devolution, but with the downside limited. Carefully designed, fiscal insurance need not undermine the rationale for devolution, and is consistent with the notion of fiscal union.

[lxix] Under the funding floor mechanism, all changes in the Welsh Government's block grant determined by the Barnett Formula are multiplied by a needs-based factor, seeking to ensure that Wales' funding won't fall below a relative needs-based floor. This is applied before the impact of tax devolution.

6.13 Budget management tools

6.13.1 Tax devolution would increase the reliance of the NI Executive on uncertain and potentially volatile tax revenues and associated block grant adjustments for its funding. To avoid discrepancies between forecasts and outturns leading to the NI Executive having to make immediate cuts or increases to its spending if revenues are lower or higher than budgeted for, it will need to be provided with additional budget management tools. This includes the ability to borrow to cover revenue shortfalls or negative reconciliation payments, as well as the ability to pay into and draw down reserves. In addition, we believe that there is a case for the NI Executive to have the ability to borrow a modest amount for discretionary resource expenditure to better respond to both unforeseen events and poor tax revenue performance that is forecast in advance.

6.14 Borrowing for forecast errors and reconciliations

6.14.1 Tax revenue outturns can only be known with certainty at the end of a financial year – and often with a significant lag after the end of the year. Budgets obviously have to be set in advance of the financial year. Following tax devolution, budgets will need to be made on the basis of forecasts of the revenues to be raised.

6.14.2 Tax revenue forecasts even just a few months before the start of a financial year can be subject to margins of error due to uncertainty about how the drivers of the tax base (such as employment and incomes in the case of income tax, or property prices and transactions in the case of SDLT) will evolve over time. For some taxes with relatively stable and predictable tax bases, like the domestic and non-domestic rates already devolved to Northern Ireland, these margins of error are relatively small. But for the taxes that we propose to devolve, and particularly income tax due to its size, these margins of error, or 'forecast errors', are more significant. For example, a 3% error on the forecast for income tax – which is not unusual – would equate to around £90m in cash terms.

6.14.3 In Northern Ireland's case, however – as is the case with tax devolution in Scotland and Wales – the NI Executive's budget will not be exposed to the absolute difference between revenue forecasts and revenue outturn. The BGAs will also be based on forecasts of tax revenues in England when a budget is set, and will themselves also be subject to error. Thus the NI Executive's budget will be exposed to differences between the forecast 'net tax' position and the outturn 'net tax' position. The 'net tax' position is the difference between revenues and the BGA.

6.14.4 This distinction is important. Assuming there is at least some positive correlation between forecast errors for Northern Ireland's taxes, and forecast errors for the BGAs, then the NI Executive's budget should get some protection from the risk of forecast errors. For example, imagine income tax revenues are forecast at £3bn, and the BGA for income tax is also forecast at £3bn. Outturn data might then reveal that tax revenues in Northern Ireland were only £2.7bn. But if tax revenues forecast for England had also been overestimated, the BGA would also end up lower than forecast. If the forecast errors made for Northern Ireland's revenues were identical to the forecast errors made for England's revenues, then the outturn BGA might be £2.7bn. In this case, the NI Executive's budget would face no reconciliation.

6.14.5 In determining an appropriate level of forecast error borrowing for the NI Executive, the question, therefore, is not just what scale of forecast error are we likely to see for Northern

Ireland's revenues. One also needs to consider how strongly correlated the forecast errors for Northern Ireland's revenues are likely to be with forecast errors on the equivalent England revenues, and hence the BGAs.

6.14.6 Anticipating how strongly correlated Northern Ireland revenue forecasts will be with England revenue forecasts is challenging. We would expect there to be some positive correlation over the medium term, particularly where revenues are driven by UK-wide issues that are unforeseen for both Northern Ireland and England forecasts (e.g. the emergence of something like the COVID-19 pandemic, or weaker than expected wage growth). However, we should also expect forecast errors to be weakly correlated in some years, and occasionally we will see forecast errors that are negatively correlated (e.g. where outturn revenues in Northern Ireland are lower than forecast, but the BGA is higher than forecast).

6.14.7 It is inevitable therefore that the NI Executive will require access to some forecast error borrowing powers following tax devolution. But what would be an appropriate scale of forecast error borrowing be? It is instructive to consider the Scottish and Welsh experiences.

6.15 Learning from the experience of Scotland and Wales

6.15.1 The Scottish Government is able to borrow up to £300 million per year to address forecast errors in normal times. This limit is increased to £600 million per year for a period of three years if a so-called 'Scotland-specific economic shock' is forecast or takes place. This is defined as a period of any length during which, on a rolling four-quarters basis, growth in Scottish GDP is (or is forecast to be) less than 1% and is at least 1 percentage point lower than in the UK as a whole. In either case, the total stock of debt that can be incurred at any given point is capped at £1.75 billion. Each of these limits is fixed in cash-terms.

6.15.2 £300 million was equivalent to 2.6% of revenues from Scotland's newly devolved tax powers in 2017-18, the first year of their operation. Based on forecasts, it is expected to be equivalent to 2.2% of revenues in the financial year, 2021-22, and 1.7% of revenues in 2026-27.[196] Note that the Scottish Government's forecast error borrowing limit was also intended to cover forecast errors associated with devolution of social security payments worth around £3.5bn in 2020-21.

6.15.3 The Scottish Government has already faced a negative forecast reconciliation for income tax that exceeds the usual £300 million limit: £309 million in 2018-19. A number of studies have attempted to estimate how often the forecast errors on Scottish income tax will exceed the £300m limit in future. In reality however, the results of these scenarios are driven by these studies' specific assumptions about the likely size and correlation of forecast errors, and different assumptions lead to wide ranges of estimates.[lxx] [197] [198] [199] In practice it remains too early to say with any certainty how frequently the £300m limit will be exceeded, but it could be fairly frequently (up to four times per decade).

6.15.4 The Welsh Government is able to borrow up to £200 million per year for forecast errors, up to a total debt cap of £500 million, and with repayment of borrowing required within a maximum of 4 years. As in Scotland, these limits are fixed in cash terms. Unlike in Scotland, no provision is made for higher borrowing in the case of a Wales-specific economic shock.

[lxx] The Scottish Government estimates that the £300 million limit could be exceeded in between 8% and 24% of years, while the Scottish Fiscal Commission, estimates between 10% and 40%. Taking account of both income tax and the largest devolved social security benefit (DLA/PIP), Bell. et al estimate that that the £300 million borrowing limit could be exceeded in between 8% and 26% of years (see referenced endnotes).

6.15.5 This limit, while lower in cash-terms than in Scotland is substantially higher as a share of devolved tax revenues in Wales. In 2019-20, it amounted to 8.6% of newly devolved revenues. Forecasts imply that it will be equivalent to 7.0% of these revenues this year, 2021-22, and 5.2% in 2026-27.[200]

6.15.6 We might expect forecast errors to be smaller in the case of Wales than Scotland. First, Wales' 10 percentage points of each band of income tax should be less volatile and easier to forecast than Scotland's revenues, given the reduced exposure to trends in the very highest incomes. Second, Wales' economy is more closely tied to England's, on which the BGAs are based, meaning forecast errors for revenues and the BGAs are likely to be more strongly positively correlated. However, as with Scotland, the cash-terms freeze in the borrowing limits is set to significantly erode their value relative to the 'cash at risk'.

6.15.7 The Welsh Government's borrowing limits therefore are likely to be insufficient in far fewer years than the Scottish Government's. However, as in Scotland's case, the adequacy of the Welsh forecast error borrowing powers will only become fully clear once they have been operational for a reasonable period.

Summary

6.15.8 Despite the uncertainties, our view is that the scale of any forecast error borrowing limit (measured relative to the amount of revenues devolved) should be set much closer to the Welsh than the Scottish limits. Indeed, the fact that one might expect the forecast errors for revenues and the BGAs to be less positively correlated for Northern Ireland than Wales (for example, due to the Northern Ireland economy's closer links with the RoI economy), is grounds for limits to be set higher than in Wales.

6.15.9 However, given that the scale of forecast errors is, with appropriate independent forecasting arrangements in place, outwith the control of the NI Executive, and that borrowing for forecast errors is naturally restricted in scope and scale (by the size of forecast errors), there is a case for saying that a fixed annual cash borrowing limit is not actually necessary. In the absence of caps on annual borrowing, caps could still be placed on the total stock of debt, and short repayment periods mandated (such as in Wales).

Borrowing for forecast errors and reconciliations – Recommendation 15

6.15.10 **We recommend that the NI Executive should be able to borrow to cover negative forecast errors in full.** Any cap placed on such borrowing, perhaps to encourage the NI Executive to hold and make use of reserves as well, should be set at a sufficiently high level that negative forecast errors only exceed it infrequently. This means that the relative size of Wales' forecast error borrowing limit (£200m or 7.0% of devolved revenues in 2021/22) represents a better guide than the relative size of Scotland's limit (£300m or 2.2% of devolved revenues in 2021/22).

6.15.11 Any limit should also be indexed over time, for example, based on changes in the level of revenues devolved to the NI Executive. Periodic reviews of the fiscal framework should also consider whether the limits are appropriate or should be revised.

6.16 Borrowing for discretionary resource expenditure

6.16.1 It is also worth asking whether the NI Executive should have access to resource borrowing powers for additional reasons other than addressing forecast errors. One obvious example is where a shock that *temporarily* depresses devolved revenues relative to the BGAs is forecast in advance. For example, forecasts might indicate that income tax revenues in Northern Ireland might be relatively weak in one year, perhaps because of an economic development in RoI that Northern Ireland is more exposed to than GB, before recovering again in subsequent years. Neither the Scottish nor Welsh governments are able to borrow to offset these forecast funding shortfalls. Instead, they must draw down any reserves they hold (subject to annual drawdown limits), reduce spending or increase tax rates so that they can continue to balance their budgets.

6.16.2 Such forecast shortfalls in revenue are different from forecast errors that become apparent after the start of a year: they are known before budgets and tax rates are set, and hence, any changes to spending or tax rates can be planned in advance. They should therefore be easier to address than the in-year changes to spending or taxes that would be needed if the devolved governments could not borrow to address forecast errors.

6.16.3 However, an inability to borrow to address temporary falls in revenue that are forecast in advance could engender a degree of pro-cyclicality to fiscal policy. In particular, when relatively slow economic growth is forecast, to reduce tax revenues relative to the rest of the UK for a temporary period the NI Executive would have to cut spending or increase taxes (unless sufficient reserves are available and can be drawn down), potentially exacerbating the economic slowdown.

6.16.4 There is therefore a case to allow for the NI Executive to borrow to address temporary shortfalls in revenue that are forecast, as well as those that arise unexpectedly after forecasts are made (and lead to forecast errors). However, borrowing would not be an appropriate response to a longer term, more permanent slowdown in Northern Ireland revenues relative to the BGA. Herein lies a significant practical difficulty – it is likely to be challenging to define what counts as a forecast of a temporary shortfall in revenue from the forecast of a more permanent shortfall. Furthermore, changes in revenues relative to the rest of the UK can reflect both differences in underlying factors (such as economic performance) and differences in policies.

6.16.5 This suggests that rather than provide powers specifically to address forecast revenue shortfalls, it may be more practical to provide some degree of general discretionary resource borrowing powers to the NI Executive.

6.16.6 The UK Government has traditionally been reluctant to countenance discretionary resource borrowing by the devolved governments on two grounds: first, risks to the UK 'fiscal aggregates'; and second, on equity grounds.

- The *fiscal aggregate* point is that devolved government borrowing implies some loss of control of overall fiscal policy as borrowing by devolved governments counts towards UK government borrowing and UK government fiscal targets.
- The *equity* point is that since the UK Government implicitly already borrows on behalf of the devolved governments, it would be both unnecessary and unfair to enable the devolved governments to borrow 'on top of' that underlying UK government borrowing. The argument about unfairness is that it would be unfair for taxpayers in one part of the UK to be able to benefit from borrowing and additional resource spending, when those in

other parts of the UK do not have that option. In particular, the current operation of the Barnett formula means that there is no England-only borrowing: any UK government borrowing is either for UK wide spending, or generates funding via the Barnett formula for the devolved governments too.

6.16.7 However, as discussed in a recent study analysing the devolved governments' fiscal frameworks within the context of the COVID-19 pandemic, if discretionary resource borrowing is restricted to a modest level (both on an annual basis and in total), it would not pose any risk to the UK's overall public finances given how small devolved government borrowing would be in the context of a £1 trillion UK-wide budget.[201] Nor would it create substantial equity concerns: while the ability to borrow is valuable, that value is modest if the level of borrowing is modest, especially given the devolved governments would have to repay their borrowing themselves. Resource borrowing powers would, however, provide the NI Executive with a useful additional tool to address forecast revenue under-performance (as well as forecast errors) and extra flexibility to respond to unexpected events. Moreover, while no England-only borrowing is possible, neither is there an England-only budget, and the UK Government has unfettered ability to respond to revenue shortfalls or unexpected events in England (or the devolved nations) by borrowing.

Borrowing for discretionary resource expenditure – Recommendation 16

6.16.8 **We recommend that the NI Executive should be able to borrow a modest amount to fund discretionary resource spending.** This would allow it to borrow to offset temporary falls in revenues even if these were forecast in advance, and more generally, respond to unforeseen events affecting its budget.

6.16.9 We suggest that an annual borrowing limit of 1% of its current resource DEL (approximately £138 million[lxxi]) might be a useful starting point, providing a modest degree of extra budget flexibility, and posing no risk to the UK's overall public finances. To avoid the risk of 'over-borrowing', a limit on the total stock of debt that could be incurred could be imposed, and rules put in place requiring borrowing to be paid back over a relatively short period.

6.16.10 We recognise that granting substantially larger resource borrowing powers would represent a bigger change to the UK's fiscal architecture.

6.17 A Northern Ireland Reserve

6.17.1 While borrowing powers can be used to address (unexpected) shortfalls in revenues relative to forecast, revenues could also be temporarily higher than expected in any given year. Following tax devolution, the NI Executive will need access to a Reserve into which it can pay the proceeds of revenues when these come in higher than forecast. Such a Reserve can in turn be used to provide an additional source of flexibility, in addition to borrowing, at times when revenues come in below forecast. A Reserve would also provide additional flexibility to respond to (unexpected) shortfalls in revenue, on top of that provided by borrowing powers.

6.17.2 The Scottish and Welsh Governments have the ability to pay into and draw down from a Reserve, this additional capability came with increased fiscal devolution. These Reserves

[lxxi] £138 million figure calculated using the Northern Ireland Resource DEL figures for 2021/22 from HM Treasury Public Expenditure Statistical Analyses 2021 (PESA).

enable the Scottish and Welsh Governments to address both revenue volatility, and smooth spending between and within years. The total amount that can be held in reserve is capped, and the amount that can be drawdown in any single year is subject to limits (see Table 6.5).

Table 6.5 Reserve limits in Wales and Scotland

	Scotland	Wales
Reserve:		
Aggregate limit	£700 million	£350 million
Annual payments in	Unlimited, subject to the aggregate cap	Unlimited, subject to the aggregate cap
Annual drawdown limit	£250 million (resource) £100 million (capital)	£125 million (resource) £50 million (capital)
Context		
Resource DEL budget 2021/22*	£36.7bn	£16.5bn
Full value of devolved revenues 2021/22	£13.8bn	£2.8bn

Source: Fiscal Commission analysis using Scottish[202] and Welsh[203] Fiscal Frameworks; Scottish Government's Medium Term Financial Strategy; OBR Welsh Taxes Forecasts March 2022; HM Treasury Block Grant Transparency: December 2021
**Resource DEL budget for Wales is after block grant adjustments. DEL budget for Scotland is before block grant adjustments*

Note: Scotland's drawdowns limits are waived in the case of a Scotland-specific economic shock

6.17.3 The NI Executive does not currently have a Reserve. Instead, it can make use of the Budget Exchange mechanism, similar to that available to Whitehall departments, to transfer underspends in one year to the following year's budget, (subject to limits of 0.75% of resource DEL and 1.75% of capital DEL).

6.17.4 The Budget Exchange is only suitable for the transfer of underspends from one year to the next. It does not provide sufficient flexibility to address revenue volatility associated with tax devolution, where payments in and withdrawals from the Reserve might need to take place during the year.

Northern Ireland Reserve – Recommendation 17

6.17.5 **We recommend that, following devolution of tax responsibilities to Northern Ireland, the Budget Exchange mechanism should be replaced by a Northern Ireland Reserve, to provide flexibility to respond to the additional revenue risks the NI Executive's budget would face. If there is to be a cap on the Reserve, it should be set to be at least in line with the cap in Wales (which is £350m or 12.3% of devolved revenues in 2021/22), relative to the value of revenues devolved.**

6.17.6 There is a good case for saying that, if there is a cap on the overall value of the Reserve, annual drawdown limits should not apply, and instead be a matter of discretion for the NI Executive. At the very least, drawdown limits should be set to be significantly higher than the Budget Exchange limit currently in place, since the Reserve will be used to address forecast error risk in addition to existing underspend requirements. Any caps or limits should be indexed over time, rather than being fixed in cash terms.

6.18 Forecasting arrangements

6.18.1 Forecasts will be needed for any taxes devolved to Northern Ireland, and the associated BGAs. The NI Executive will require these in order to set and manage its budget, and cost tax policy measures. In addition, the Office for Budget Responsibility (OBR), the independent UK economic and fiscal forecasting body, will also require its own forecasts of the revenues and spending to allow it to construct its forecasts for the UK's overall public finances as part of its Economic and Fiscal Outlook (EFO) forecasts.

6.18.2 A decision will need to be taken as to which organisation has responsibility for forecasting Northern Ireland revenues for the NI Executive, for any taxes that are devolved. This could be specified in the fiscal framework agreement negotiated between the NI Executive and the UK Government (as is the case with the Scottish Government fiscal framework agreement, which specifies the Scottish Fiscal Commission). Alternatively, the fiscal framework agreement could set out the principles for forecasting, such as them being independently produced, but leave the choice of organisation to the NI Executive (as is the case with the Welsh Government fiscal framework agreement).

6.18.3 Bearing this in mind, there are three main organisations to choose from:

i. The NI Executive, itself, which is currently responsible for forecasting revenues from domestic and non-domestic rates;

ii. The new NI Fiscal Council, which has recently been set up to “prepare an annual assessment of the Executive’s revenue streams and spending proposals and how these allow the Executive to balance their budget” and “prepare a further annual report on the sustainability of the Executive’s public finances”; and

iii. The OBR which would also have responsibility for forecasting equivalent revenues in England/GB and hence the block grant adjustments that would sit alongside tax devolution.

6.18.4 The choice of whether the NI Fiscal Council or the OBR should be responsible for the forecasts required by the NI Executive involves a number of trade-offs:

- If the forecasts were made by the NI Fiscal Council, they could potentially take account of additional local factors or make use of different methods than the OBR. For example, the Scottish Fiscal Commission uses a more ‘bottom-up’ approach to forecasting than the OBR does, and takes account of Scotland-specific factors and data. The OBR’s approach to forecasting in Wales, at least so far, has not tried to take account of how differences in the structure of the Welsh economy or tax bases could affect future changes in the tax bases (except to the extent that policy changes will have different impacts). However, it is currently examining the possibility of undertaking more bespoke forecasts for Wales, and could potentially do so for Northern Ireland too;
- On the other hand, the OBR may have access to a bigger pool of expertise than is available in Northern Ireland, and there may be economies of scale with respect to forecasting revenues for Northern Ireland, Wales and the UK as a whole. However, as with the administration of the taxes we propose are fully devolved to the NI Assembly, local forecasting by the NI Fiscal Council could help build up the forecasting skills and the capacity of the Council. This could be an important benefit were further fiscal devolution to take place in future, as the ability to take account of more NI-specific

factors would be of increasing importance, the more that the NI Executive's budget depends on devolved tax revenues.

6.18.5 One issue that has arisen in Scotland and Wales, is a difficulty in understanding differences in trends between tax revenues and the associated BGAs. In Scotland this reflects the fact that, while the Scottish Fiscal Commission is responsible for forecasting Scottish revenues, the BGAs are based on OBR forecasts which are then calculated by the UK and Scottish Governments. Differences in modelling approaches, data used and judgements applied, can all contribute to differences between the forecasts, as well as the fact that the forecasts are produced at different times, and are therefore based on different versions of the datasets. In Wales, the OBR is responsible for *both* the Welsh revenue forecasts and the forecasts underlying the BGAs, again the UK and Welsh Governments are responsible for actually calculating the latter. In both Scotland and Wales, therefore, the independent forecaster has been reticent to analyse and explain differences between revenue forecasts and BGA forecasts, seeing their remit as being to forecast taxes for which they are mandated to, but not to explain reasons for differences with another organisation's equivalent forecasts. Having said this, the Scottish Fiscal Commission has made positive steps in this direction in response to recommendations from the Scottish Parliament.

6.18.6 In our view, an ongoing lack of sufficient comparison between the drivers of devolved revenues and the equivalent BGAs is an important shortcoming in arrangements in Wales and Scotland. Understanding why revenues are growing faster or slower than the BGAs is important because it is the difference between revenues and the BGA that would matter for the NI Executive's funding. It is also key to the increased financial accountability that tax devolution is intended to bring. To what extent do differences between revenues and the BGAs reflect policy, versus a range of underlying economic factors? If different forecasters have responsibility for the revenue and BGA forecasts, to what extent may differences reflect different forecast judgements about the outlook for the UK as a whole, as opposed to any NI-specific factors?

6.18.7 If a single forecaster is responsible for forecasting both Northern Ireland revenues and the UK revenue forecasts that underlie the calculation of the BGAs, it would likely be somewhat easier to undertake such comparative analysis. However, either through information-sharing or a joint analysis, it should be possible for such analysis to be undertaken if the NI Fiscal Council is responsible for forecasting Northern Ireland revenues.

Forecasting arrangements – Recommendation 18

6.18.8 **We recommend, as a key condition for devolution, that forecasts are made by an independent body and not by the NI Executive.** This is vital to ensure the credibility and transparency of the forecasting process, and to avoid the risk of forecasts being unduly optimistic (in order to generate more revenue in the short-term).

6.18.9 **We recommend that the NI Fiscal Council is tasked with forecasting revenues for any devolved taxes.** This would help increase local accountability, allow NI-specific factors to be most fully taken account of, and would help build further institutional capacity within Northern Ireland. These forecasts would be in addition to any forecasts that the OBR would produce as part of its Economic and Fiscal Outlook (EFO) forecasts.

6.18.10 Irrespective of which organisation forecasts Northern Ireland revenues, that body should also be responsible for publishing an analysis and explanation of why trends and forecasts for Northern Ireland revenues and the BGAs differ.

6.19 Compensatory transfers

6.19.1 Tax and spending decisions by one government can have implications for the revenue or spending of other governments, either positive or negative. For example, if the UK Government were to substantially increase the income tax Personal Allowance, this could have a disproportionately negative impact on income tax revenues in Northern Ireland, given the lower average incomes of income taxpayers – although, as discussed in Section 6.8, the use of separate BGAs for each income tax band can address most of this issue. Conversely, if the NI Executive was to increase the rate of income tax charged on low and middle-earners, this would increase UK government expenditure on Universal Credit, as entitlement to this benefit depends on post-tax income.

6.19.2 Both the Scottish and Welsh Government fiscal frameworks make provisions for compensatory payments to be made for such policy 'spillover' effects for the newly devolved tax (and in Scotland's case, social security) powers. In doing so, they distinguish between three types of effects:

- *Direct effects*, which are the mechanical effects that occur as a result of policy change, before any associated changes in behaviour. For example, if the UK Government changes the Personal Allowance, this would directly reduce Northern Ireland income tax revenues;
- *Behavioural effects*, which result from people changing their behaviour in response to a policy decision. For example, if the NI Assembly were to change the top rate of income tax charged in Northern Ireland, this might lead to people migrating, affecting the UK Government's income tax revenue; and
- *Second-round effects*, which are the wider economic impacts that may result more indirectly from policy decisions. For example, the change in income tax rates in Northern Ireland might affect wider economic activity, and hence the amount of VAT generated for the UK Government in Northern Ireland.

6.19.3 The frameworks state that all direct effects will be compensated for, either automatically via the block grant adjustments, or through specific compensatory payments. In Scotland, in the case of welfare spending, compensation for behavioural effects is expected to be paid only in 'exceptional circumstances' when effects are 'material' and 'demonstrable', while in the case of tax revenues, agreement of both governments that it is appropriate to do so is also required. In Wales, compensation for all behavioural effects is expected to be paid only in 'exceptional circumstances' when effects are 'material' and 'demonstrable' and where both governments agree it is appropriate to do so. Finally, in both Scotland and Wales, compensation for second-round effects is not expected to be paid.

6.19.4 Notwithstanding these specific rules, the frameworks also state any specific compensatory payment must be jointly agreed by both the devolved administration and the UK Government, based on a "shared understanding of the evidence". Discussions on spillovers and compensatory payments are first to take place at the official level, and then by Ministers at the Joint Exchequer Committee,[lxxii] in both cases potentially informed by the views of independent bodies. If agreement cannot be reached, a dispute can be raised through dispute

[lxxii] The Joint Exchequer Committees for Scotland (established 2011) and for Wales (established 2014) are the intergovernmental ministerial forums established to oversee the transfer of additional fiscal and welfare powers to the devolved administrations. The Committees allow the UK and devolved Governments to work closely to review the implementation of the devolved taxes and borrowing powers and operation of the fiscal frameworks.

resolution mechanisms set out in the fiscal framework agreements (see the Section 6.20). Alternatively, if no agreement is reached, no compensation payments are made.

6.19.5 The principle of compensation for policy spillovers is a good one; governments should, as far as possible, bear the full revenue or spending effects of their decisions, so that they take them into account in their decision-making. However, in practice, agreeing the amount of compensation due in different circumstances is likely to be both technically and politically difficult. This means that priority should be placed on ensuring the automatic elements of the fiscal framework, such as the BGAs, are appropriately designed, limiting the perceived need for discretionary payments. It also means that limiting compensatory payments to those cases which are clearest and most significant, is sensible.

6.19.6 The political difficulty arises from the fact that, financially at least, negotiation over compensatory payments is a zero-sum game: if one government receives (more) compensation, the other pays (more). Any compensation payments will be much bigger in the context of the NI Executive's budget than the UK Government's budget which means it likely has a stronger political incentive to 'fight' for an advantageous decision. But, the dispute resolution process that currently exists for Scotland and Wales (see Section 6.20), also gives the party opposing a compensatory transfer (or arguing for a smaller transfer) significant power - if agreement cannot be reached, the default is no transfer.

6.19.7 The technical difficulty relates to the potential for disagreement over relevant policy baselines and counterfactuals. Even for the mechanical effects that both the Scottish and Welsh Government fiscal frameworks say should be accounted for, there may be disagreement over the most appropriate baseline to calculate the scale of the spillover effect against. For example, the Scottish Government and the UK Government have so far been unable to agree the scale of transfers required to compensate the Scottish Government for the disproportionate effect of increases in the income tax Personal Allowance on its revenues (which will not be fully offset by the indexation of the income tax BGA). It is our understanding that the Scottish Government has argued for compensation for any increase in the Personal Allowance, whereas the UK Government has argued that, at most, compensation should be for above-inflation indexation (meaning that when the Personal Allowance is frozen, as planned between April 2021 and April 2026, a transfer from the Scottish Government to the UK Government could be due, as a result of the disproportionate revenue increases this would generate). In the Welsh Government fiscal framework, the Welsh and UK Governments agreed that the impact of changes in the Personal Allowance on Welsh income tax revenues would be deemed to have been addressed via the BGAs, ruling out separate specific compensatory payments.

6.19.8 Behavioural effects would likely be even harder to agree on. Even after a policy is implemented, one can never know how much it affected behaviour and, in turn, revenues or spending, because one can never observe the counterfactual world in which the policy was not implemented. Instead, one can only estimate the behavioural effect based on assumptions and approaches designed to estimate that counterfactual. Such assumptions are, to at least some extent, subjective (different people can draw different conclusions from reviewing the same evidence), and such estimates are subject to often wide margins of error and methodological critique. There is, therefore, scope for legitimate differences in opinion about the scale of behavioural responses between the two governments, potentially amounting to many millions of pounds per year.

6.19.9 As a concrete example, suppose that the NI Executive were to increase the additional rate of income tax to 50%, and that only income tax on NSND was devolved. This could lead to several different behavioural effects, both reducing and increasing the UK Government's revenues:

- There may be a reduction in the incomes of Northern Ireland additional rate taxpayers as they work less. This would result in a reduction in National Insurance contributions made by these taxpayers to the UK Government.
- Some additional rate taxpayers in Northern Ireland may be able to re-classify some of their income from earned income (on which the Northern Ireland rates would be due) to dividend income (on which UK rates would be payable), thus increasing UK Government tax revenues.
- Some additional rate taxpayers may relocate from Northern Ireland to England (or Scotland and Wales), increasing UK Government (or Scottish and Welsh Government) income tax revenues.

6.19.10 Which, if any, of these effects should be accounted for? What scale of compensatory payments would be appropriate if different assumptions or methods lead to different figures? Given these issues it is sensible to restrict the circumstances in which behavioural effects are compensated for to 'exceptional' circumstances, where effects are both 'material' and 'demonstrable'. Of course, each of these terms is subjective, and 'material' effects are precisely those where the amount of money at stake is largest, and hence the scope for political rancour likely greatest.

6.19.11 One possible way to reduce the risk of impasses being reached would be to require the NI Executive and the UK Government to publish their positions and the evidence underlying their positions, if agreement cannot be reached on a particular issue. They could then be subject to external and independent critique. As we discuss in the next section on dispute resolution more generally, there could be a role for independent mediation or potentially even arbitration, earlier in the process than currently set out in the Scottish and Welsh Government fiscal frameworks. There may also be benefits from setting out more clearly which types of mechanical and behavioural effects are expressly excluded from eligibility for specific compensatory payments, as the Welsh Government fiscal framework does for changes in the income tax Personal Allowance.

6.19.12 While behavioural effects are difficult to assess, the case arguably becomes even more difficult when considering second-round effects. The Commission agrees that, where possible, second-round effects should be excluded from compensatory transfers, as in Scotland and Wales, to avoid difficult and subjective disputes. However, we also recognise the potential for second round cost impacts to arise. For example, when considering the NI Executive's previous policy of a significantly reduced corporation tax rate in Northern Ireland (12.5%) compared to the wider UK (currently 19%, with plans to rise to 25% in 2023) it is not difficult to imagine that this policy could lead to an improved economic landscape in Northern Ireland. Improved levels of economic activity could have led to significant revenue impacts for the UK Exchequer through increases in VAT, NICs and income tax. Why should the NI Executive not receive the full benefits of its policy decisions (which would also help to limit its policy costs, given the block grant adjustment)? As we note in our conclusions in Table 4.2 and our wider tax appraisals Annex F, corporation tax is, arguably, different to other taxes in this regard and, as we do not consider corporation tax further for devolution, it does not feed into our current conclusions on compensatory transfers. If corporation tax is pursued further this is a consideration which should be reflected upon, recognising that the measure of second-round effects will be difficult and contentious for corporation tax, as for other taxes.

Compensatory transfers – Recommendation 19

6.19.13 **We recommend that the NI Executive fiscal framework should make provision for compensatory payments to be made in both directions between the UK Government and NI Executive, when policies related to the taxes we propose are devolved, have spillover effects.**[lxxiii] However, both governments should invoke these provisions in a responsible manner, and similarly restricting payments to 'direct' spillover effects as in Scotland and Wales would be sensible.

6.19.14 It may also be possible for the fiscal framework agreement to set out in advance how certain types of spillover effects would be treated – such as the way in which the Welsh Government's fiscal framework agreement does for changes in the income tax Personal Allowance – in order to pre-empt potential disputes.

6.19.15 **We recommend that the NI Executive and the UK Government should be required to publish their positions and the evidence underlying them, if no agreement on compensatory payments can be reached; the external and independent scrutiny this would allow could encourage a more responsible approach and incentivise agreement earlier in the process.**

6.20 Dispute resolution

6.20.1 A new NI Executive fiscal framework will require a process by which disputes between the NI Executive and the UK Government on the operation of the framework can be considered, and hopefully resolved. However, the primary objective should be to avoid disputes arising in the first place through well-designed and clearly defined rules (such as for the calculation of BGAs, borrowing or reserves limits, and, as far as possible, the calculation of spillover effects), underpinned by a set of principles (such as those detailed at section 6.4). The two governments should also strive to avoid approaching the operation of the framework as a zero-sum game; if it operates smoothly, facilitating the enhanced financial accountability of the NI Executive and NI Assembly, it will be, in our view, to the benefit of both Northern Ireland and the UK as a whole.

6.20.2 Intergovernmental relations (IGR) have not been without their difficulties within the UK's system of devolution. Mechanisms for intergovernmental relations have tended to neglect questions of how policy interdependency can be managed, and they have provided little scope for the devolved governments to influence the decisions of the UK Government.[204]

6.20.3 This has been the case particularly when it comes to dispute resolution. Most intergovernmental disputes have involved funding. Formal processes do exist for 'dispute resolution' – both generally through the Joint Ministerial Committee (JMC), and more specifically through the Scottish and Welsh Government fiscal frameworks. However, these processes are undermined, in the eyes of the devolved governments, by the hierarchical nature of the decision-making structures, and the fact that the UK Government tends to act as judge and jury in any dispute.

[lxxiii] Spillover effects can be: *direct* (mechanical effects occurring as a result of policy change before any associated changes in behaviour); *behavioural* (resulting from behaviour change in response to a policy decision); or *second-round* (wider economic impacts resulting more indirectly from policy decisions).

6.20.4 Nevertheless, disputes will potentially arise. The Scottish and Welsh fiscal framework agreements set out dispute resolution mechanisms, with disagreements escalated upwards from operational, to senior, to Ministerial level, and ultimately to the level of the Prime Minister and First Minister.

6.20.5 Whilst intergovernmental relations and dispute resolution have traditionally been a weak link, recent developments may put intergovernmental relations on a more sustainable footing. In January 2022, the UK and devolved Governments jointly published a review of intergovernmental relations.[205] This establishes a new three-tier system of intergovernmental forums (replacing the existing JMC structures):

i. Portfolio agreement at official and ministerial level;
ii. Engagement on cross-cutting issues, including interministerial standing committees;
iii. Prime Minister and Heads of Devolved Governments Council

6.20.6 At the heart of the three tier system will be two key forums: an Interministerial standing committee (IMSC) and a Finance: Interministerial Standing Committee (F:ISC). Financial matters, including disputes, will be dealt with by the F:ISC.

6.20.7 The Review outlines a new set of principles underlining mutual respect for the separate and shared roles and responsibilities of each government. It also establishes a standing secretariat, operating 'outside' of any one government (despite being hosted in the Cabinet Office). The secretariat will oversee a new dispute resolution procedure. Whereas, previously, the UK Government could deny the existence of a dispute, now any administration can escalate a disagreement to a formal dispute. The secretariat can seek third-party advice or mediation, and the process must be chaired by a body not party to the dispute.

6.20.8 On paper at least, the reforms promise a quite significant overhaul of the machinery of intergovernmental relations, and the promise of a more reasonable process of dispute resolution. However, the proof will be in the practice. This is the case particularly in relation to financial disputes (determined via F:ISC), where the agreement appears to retain HM Treasury's role as ultimate arbiter in funding disputes.

Dispute Resolution – Recommendation 20

6.20.9 A well-functioning system of intergovernmental relations and processes for dispute resolution are essential if fiscal devolution is to work smoothly. Intergovernmental communication on tax policy changes is essential, particularly where taxes are shared between the UK and Northern Ireland Governments. Mechanisms for dispute resolution must be seen as fair to both governments if trust in the system is not to be undermined.

6.20.10 The recent review of intergovernmental relations establishes a significantly revised approach to intergovernmental relations. The Commission welcomes the review, and its emphasis on mutual respect and trust.

6.20.11 **We recommend that dispute resolution processes in any future fiscal framework for Northern Ireland should have access to and be embedded within the new Intergovernmental Relations system between the UK Government and devolved administrations, which sets out new principles and infrastructure arrangements to support the resolution of intergovernmental disputes.**

6.20.12 However, the effectiveness of the revised machinery, particularly when it comes to the resolution of financial disputes, will be in the practice. Ultimately, the culture and conduct of governments will be key. **If tax devolution to Northern Ireland is to happen, then it is vital that both governments work constructively and positively together in its implementation.**

6.21 Changing and reviewing the framework

6.21.1 The NI Executive and the UK Government should seek to agree a fiscal framework that is suitable for the tax and other fiscal powers devolved to it. A framework that would be likely to need frequent re-negotiation would not serve the interests of either side, given the uncertainty created, and the time and effort such re-negotiations would take.

6.21.2 However, it would also be inappropriate to view the framework agreement as perpetual. It may turn out that the rules and processes initially agreed are not actually fit for purpose. For example, if forecast errors turn out to be significantly larger than expected, even relatively generous borrowing limits may need to be revised up. As discussed in Section 4.3 of this report, tax devolution may be a process rather than a one-off event, and the devolution of additional taxes, with different characteristics, may require different approaches and rules.

6.21.3 The Scottish Government's fiscal framework agreement has provisions for a review of the fiscal framework after five years. The commencement of these reviews was delayed given different interpretations of the agreement and preferences for the scale of the review, with the Scottish Government favouring a wide-ranging review (including whether new tax powers should be devolved) and the UK Government favouring a narrower review (focusing just on elements of the fiscal framework). Agreement was reached last Autumn for an independent report focusing on the block grant adjustment, and an intergovernmental review covering a broader set of issues (although just how broad is not yet clear), with the report commencing earlier this year.

6.21.4 The Welsh Government's fiscal framework also has provision for a review, albeit on different terms. Although the agreement is expected to operate without regular re-negotiation, the Welsh and UK Governments have agreed that it should be subject to periodic review. The first review will be triggered before the end of the block grant funding transitional period, that is, when the Welsh Government's relative funding falls below the pre-determined "floor" (of 115% of equivalent English funding per head). This review may include input from independent bodies. Additionally, either government can request a review but it is not intended that the arrangements will be reviewed more than once during an Assembly or Parliamentary term.[206]

Changing and reviewing the framework – Recommendation 21

6.21.5 **We recommend that if further tax powers and revenues were devolved following the agreement of an NI Executive fiscal framework, it would be appropriate to review the terms of the overall framework at that point.** In particular, any limits on borrowing for the purpose of addressing forecast errors would likely need to be revised, and a different approach to block grant adjustment may be warranted, compared to those taxes previously devolved.

6.21.6 **We recommend reviewing the framework on a periodic basis, even if no further tax powers were devolved.** This review should be timed to take place shortly after, rather than shortly

before, the expected date of elections to facilitate longer-term perspectives being taken. Bearing this in mind, a period of approximately five years would seem appropriate.

6.22 New Taxes

6.22.1 Another area of potential consideration as part of a new NI Executive fiscal framework is the introduction of new taxes. Although it should be noted that neither the Scottish nor Welsh Government fiscal frameworks set out a process for managing the devolution of new taxes (it has been developed through related processes) as we will see below. Similar to UK-wide taxes that the NI Executive may wish to devolve, the NI Executive may wish to introduce a new tax to: raise revenues to support local public services; change societal behaviours for the greater good; and/or increase flexibility to incentivise and implement local policy goals.

Current legislation

6.22.2 As detailed in Chapter 1 (Section 1.8.3), Section 63 of the Northern Ireland Act 1998, '*Financial acts of the Assembly'* already provides for a tax to be imposed or increased in Northern Ireland, thereby allowing the NI Executive to introduce new taxes. However, Schedule 2 constrains this significantly by indicating that the following matters are 'Excepted':

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

6.22.3 Therefore, the Act does not prevent the NI Assembly from imposing new taxes that do not contravene either a), b) or c). Item (c) is the major challenge, as clearly there needs to be an assessment of whether any proposed 'new' taxes introduced here are substantially different before they could progress. To date, the power to introduce a new tax has only been explicitly utilised on one occasion, the Carrier Bag Act (NI) 2014. This act was an extension of the Climate Act 2008 and made additional provision in relation to charging for carrier bags in Northern Ireland.

6.22.4 The situation is different in Scotland and Wales. Originally, the Scotland Act 1998 did not explicitly give the powers to create new taxes, with taxes being entirely reserved apart from one exception for local authority taxes (for example, council tax and non-domestic rates). The Wales Act 2006 provided similar measures in Wales. However, more latterly the Scotland Act 2012 and the Wales Act 2014 did provide the power for the Scottish and Welsh Parliaments to introduce new taxes, in agreement with the UK Parliament and subject to certain restrictions. As a result, Scotland and Wales now have the ability to introduce new taxes into their devolution settlements.

Criteria for creating new taxes

6.22.5 Prior to the legislation being introduced for Scotland and Wales, the UK Government detailed a set of pre-determined criteria to manage the introduction of new taxes through the Scotland Bill 2010 Command Paper, Strengthening Scotland's Future[207] and the Wales Bill 2014 Command Paper, Financial Empowerment and Accountability.[208] These papers set out that, when assessing a new tax, the UK Government will consider the impact against the pre-determined criteria, foremost of which is the need to ensure that the proposed tax would not

impose a disproportionate negative impact on UK macroeconomic policy or impede, to any degree, the UK single market.

Process for devolving a new tax

6.22.6 In line with the criteria set out in the 2010 and 2014 Command Papers and following on from the legislation, the respective governments, in agreement with the UK Government, established a formal nine-stage process for managing the devolution of new taxes,[209] although there are slight differences between the two.

6.22.7 In 2018 the Welsh Government announced plans for the introduction of a Vacant Land Tax (VLT) and sought to follow the nine-stage process. Despite the process having been agreed by both governments, Welsh Government officials have indicated to the Commission that this has been a challenging and protracted process with significant barriers to progress. One of the main barriers was the level of information deemed necessary by the Welsh and UK Governments respectively, to support the proposal so that public consultation and legislation could take place. Some four years have gone by and the creation of VLT has yet to take place. The Scottish Government has not yet sought to make use of their nine-stage process.

New taxes summary

6.22.8 Legislatively, Northern Ireland has scope to introduce new taxes. However, the process for doing so is less defined and could be less restrictive than those agreed by Scotland and Wales. It could be argued that given the existing legislative framework for Northern Ireland, most of the assessment criteria set out in the Scottish and Welsh Command Papers is not relevant, as any proposed 'new' taxes introduced in Northern Ireland must only prove to be substantially different in nature to existing UK wide taxes. Therefore, arguably, the test for a new devolved tax in Northern Ireland should focus on the nature of the tax, as set out in the legislation, and not on whether it satisfies similar criteria to those used in Scotland and Wales.

6.22.9 Ultimately, however, the NI Executive would need to work with the UK Government on the introduction of any new measures and the UK Government could seek to take action through the UK Parliament to change the fiscal competence of the NI Assembly, if it were not content with any proposed action of the NI Assembly. While the direct lessons that can be learned from Scotland and Wales may be limited, given the differences to Northern Ireland legislation, the experience of VLT in Wales shows the importance of clarity and suggests that there is benefit in seeking to agree an approach with the UK Government as part of a wider fiscal framework for Northern Ireland.

New Taxes – Recommendation 22

6.22.10 Northern Ireland currently has the legislative powers to introduce new taxes, as set out in the Northern Ireland Act 1998. However, the NI Assembly has made very limited use of these powers to date and it does not have predetermined criteria or a formal process with the UK Government on how new taxes would be implemented, as in Scotland and Wales.

6.22.11 **We recommend that the NI Executive and the UK Government agree a transparent process for the introduction of any new taxes in Northern Ireland.**

6.23 Wider implications of the Commission's work for devolution arrangements across the UK

6.23.1 As we reflect on our work over the last year, it is the Commission's strong view that there is learning from our work relevant to fiscal devolution elsewhere in UK. This encompasses not only our appraisal and conclusions on the over 20 UK-wide taxes which we consider for devolution to Northern Ireland, but also the mechanics of how those powers are operationalised. While we recognise this consideration is not within our terms of reference we feel it is worthy of comment nonetheless and we observe that introducing new devolved tax powers for Northern Ireland would provide an opportunity to take stock of the fiscal devolution arrangements that have unfolded across the UK. The timing of the review of fiscal framework arrangements in Scotland may also add weight to this.

6.23.2 As described previously in our report, devolution within the UK is asymmetric with the three devolved nations having different levels of legislative, administrative and budgetary autonomy. While this allows powers and responsibilities to be tailored to fit the individual context of each of the devolved administrations, in our view, it is appropriate that the different devolution arrangements should also aim to share common principles where able. Having completed this work for Northern Ireland, and after similar processes in Scotland and Wales, we believe there is an opportunity to optimise current devolution arrangements by developing a more consistent, 'standardised' approach across the UK, based upon evidence of best practice and experience to date. This could imply some shared institutional framework. This is likely to be particularly useful in a number of areas including intergovernmental dispute resolution, fiscal insurance and a potential role for external independent analysis when views differ between governments. This would also help inform the views of the wider public and improve the sought after accountability that tax devolution brings with it, both for devolved administrations and the UK Government.

Wider implications of the Commission's work for devolution arrangements across the UK – Recommendation 23

6.23.3 **We recommend that the UK Government instigates a review to consider developing and implementing a shared institutional framework for fiscal devolution across the UK.** This could usefully consider the drawing up of shared principles and the establishment of shared processes/infrastructure particularly in the area of dispute resolution and the use of independent analysis.

Chapter 7

Recommendations for fiscal devolution in Northern Ireland

7.0 Overview

7.0.1 This chapter sets out the Commission's final recommendations. Recommendations are made on the following areas: data reliability; the devolution of ***income tax***, the ***apprenticeship levy***, ***stamp duty land tax***, ***air passenger duty***, ***landfill tax*** and ***excise duties***; block grant adjustments; budgetary management tools; and wider fiscal framework issues. Recommendations are in the order in which they appear in the report. The chapter closes with concluding remarks on the context for increased fiscal devolution in Northern Ireland and on the potential timescales for the implementation of any new powers.

7.0.2 Our initial conclusions, with respect to the suitability of each of the UK-wide taxes the Commission considered for devolution in Northern Ireland and the individual appraisals of each of these taxes, can be found in Chapter 4 and Annex F respectively.

7.1 Recommendation – Data reliability

<table>
<tr><th colspan="2">Data reliability</th></tr>
<tr><td colspan="2">Any move towards further devolution of fiscal powers to Northern Ireland requires careful consideration of the tax data that is available and its suitability in terms of providing reliable estimates of the tax base in Northern Ireland. These estimates are a key element of the evidence base that will inform the decision-making process regarding devolution and the policies which might be deployed following devolution.</td></tr>
<tr><td rowspan="2">Tax revenue data reliability</td><td>Recommendation 1</td></tr>
<tr><td>We recommend that the NI Executive should work with ONS, HMRC and NISRA to improve data on tax receipts in Northern Ireland.

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

The NI Executive should look to collect, where reasonably possible, administrative/outturn data for any tax that is to be devolved in the years prior to devolution taking place. This should help to provide more reliable estimates of the tax prior to devolution and more accurate costs post devolution.</td></tr>
</table>

7.2 Recommendation - Corporation tax devolution

<table>
<tr><th colspan="2">Corporation tax devolution</th></tr>
<tr><td colspan="2">The issues around corporation tax devolution are more complex than for other taxes, both from a technical and a broader political perspective. There has been significant practical progress made in the pursuit of devolution, however, a number of key pre-requisites, which we see as necessary for devolution to Northern Ireland, remain outstanding.</td></tr>
<tr><td rowspan="2">Devolution of corporation tax powers</td><td>Recommendation 2</td></tr>
<tr><td>We remain of the view that there is value in the NI Executive seeking to complete the devolution of corporation tax.

Should the NI Executive wish to pursue the devolution of corporation tax we would encourage it to demonstrate how it will ensure the sustainability of its finances following any reduction in corporation tax. We would urge the NI Executive and UK Government to work together on the pre-requisites for devolution. We recommend:

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

7.3 Recommendations – Income tax devolution

<table>
<tr><th>Income tax devolution</th></tr>
<tr><td>It is the Commission’s view that to have the capacity to raise serious amounts of revenue, or effect significant redistribution through the tax system, the NI Executive is likely to need powers over one ‘major tax’ (i.e. VAT, National Insurance contributions or income tax). We consider that, of the major taxes, income tax is most appropriate for devolution, at this time.</td></tr>
</table>

Scope and administration of devolved income tax	***Recommendation 3***
	Income tax is a strong candidate for devolution to Northern Ireland, however, we recommend that powers over the income tax base and income tax administration both remain reserved at this time (see caveat on Personal Allowance below at Recommendation 5). This will help minimise the additional administration and compliance burdens generated by tax devolution, while still providing the key benefits of devolution, including a meaningful ability to vary funding levels and the progressivity of the tax system.
Devolution of tax on savings and dividends income	***Recommendation 4***
	Income tax is no longer deducted at source, hence the main practical impediment to devolution has been removed. Given the administrative, efficiency and equity benefits that devolution could bring, **we recommend that the taxation of savings and dividends income should be devolved to the NI Assembly. The strength of our recommendation would be bolstered if agreement can be reached to also devolve it to the Scottish Parliament and Welsh Senedd due to the administrative advantages inherent in operating similar systems of income tax devolution across the devolved administrations.** If no agreement is reached to devolve tax on savings and dividend income to the Scottish and Welsh Governments, then devolution to Northern Ireland could be seen as adding some inconsistency and complexity, and hence one might want to be more tentative in taking such steps, but the case for doing so would, in our view, remain strong.
Devolution of powers over rates and bands of income tax	***Recommendation 5***
	If the NI Executive is keen to maximise the flexibility of its tax varying powers and its accountability to the local electorate, it is the Commission's view that **devolving revenues, rates and band-setting powers in full, as in Scotland, would be preferable. This would also make the most of the usability of income tax, by allowing fine-tuning of the distributional effects of policy changes. But, this 'Scottish' model would also entail greater risk of short-term revenue volatility and long-term revenue decline if the Northern Ireland tax base did not keep pace with the English tax base.** These risks could be mitigated by ensuring a robust fiscal framework, with an appropriate block grant adjustment and budget management tools, and periodic reviews of performance. (These elements are discussed further in Chapter 6.) It is also worth saying that this more maximal degree of devolution offers more opportunity to make policy "mistakes". The NI Executive and NI Assembly would need to be sure they had appropriate analytical capability and capacity in place, to understand the consequences of policy change, and

	we would recommend that the NI Fiscal Council should have a robust role in forecasting the impacts of change. **Ultimately, however, it is the responsibility of Northern Ireland's politicians to determine the appropriate balance between greater financial incentives and powers, and the degree of risk involved.** If the NI Assembly and NI Executive is sufficiently concerned about this level of risk, **an alternative would be the Welsh model of partial devolution, which would involve less financial risk, but also provide less flexibility.** It would be possible to move from the 'Welsh' to the 'Scottish' model in future (or some variation of the models described), as part of an incremental approach to devolution. There is a strong case for devolving the power to set the Personal Allowance, which would not expose the NI Assembly to any further revenue risk, but would provide further policy flexibility, going beyond the current 'Scottish' model. **If income tax is devolved to Northern Ireland, we recommend that the NI Assembly be required to pass a motion annually to set the Northern Ireland rates and bands (where applicable) of income tax which will apply, similar to the case in Scotland and Wales.**

7.4 Recommendations – Apprenticeship levy devolution

Devolution of the apprenticeship levy	
We consider that there is a strong case for the devolution of the apprenticeship levy, but that it should only be devolved in conjunction with income tax, given the likely administration costs of pursuing devolution of this tax in isolation.	
Devolution of the apprenticeship levy	***Recommendation 6*** **We recommend that, if powers over income tax are devolved to the NI Assembly in future, the apprenticeship levy should be devolved in parallel.**
Administration of devolved apprenticeship levy	***Recommendation 7*** **We recommend that if the apprenticeship levy is devolved to the NI Assembly, it continues to be administered by HMRC, given the synergies with income tax administration.**

7.5 Recommendations – SDLT, APD and landfill tax devolution

SDLT, APD and landfill tax	
In our view stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax are strong candidates for devolution in Northern Ireland.	
Devolution of SDLT, APD and landfill tax	***Recommendation 8*** **We recommend full devolution of revenues and tax powers relating to stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax.**
Administrative arrangements for SDLT, APD and landfill tax	***Recommendation 9*** While continued HMRC administration of these taxes might come at somewhat lower cost, local administration would provide greater flexibility and scope for innovation. We believe the potential benefits of local administration outweigh the likely costs. As well as offering greater scope for flexibility and innovation, local administration would improve public understanding of taxes, increase accountability of the local administration and build up institutional capability and capacity for potential enhanced devolution in future. **We recommend that if the devolution of SDLT, APD and landfill tax is pursued and implemented, the NI Executive should establish a local revenue authority to administer these fully devolved taxes.**

7.6 Recommendation – Devolution of excise duties

Excise duties	
Our interim analysis of excise duties led us to conclude that the case for devolution to Northern Ireland was sufficiently strong to merit further investigation. This investigation was to focus on the likely additional administration and compliance requirements, and cross-border shopping issues and economic distortions that could occur following any devolution. We conducted a programme of engagement with stakeholders from the retail and production sectors, international excise tax experts and revenue authorities in other jurisdictions to learn from their experience and to test their views on what devolution of excise duties could potentially mean for Northern Ireland; our findings have informed the recommendation below.	
Devolution of excise duties	***Recommendation 10*** We, as a Commission, **remain of the view that there would be value in the NI Executive seeking devolution of excise duties, albeit, over the longer term.**

	Our investigations have not been enough to persuade us whether the costs and complexity would be readily manageable, or not. Therefore **we recommend that, should the NI Executive wish to pursue devolution it carry out a full study working alongside HMRC / HMT to agree on *how* excise duties could be administered and what the costs involved would be. It should also engage more widely with a range of representatives from the production, retail and supply sectors, to ensure that the model of implementation would take account of the specific needs of those sectors.** It may also be prudent to await the resolution of the issues around the implementation of the NI Protocol, and a longer-term settlement for the customs and excise regime in Northern Ireland, to ensure the existence of a more stable environment, prior to the implementation of any new fiscal powers over excise duties.

7.7 Recommendation – Principles for implementing fiscal devolution

Principles to guide implementation of fiscal devolution	
In the Commission's view a number of key principles should guide how any fiscal devolution is implemented, in particular, with respect to the operation of the Block Grant Adjustments (BGAs). We believe it is possible to implement devolution in a way which is consistent with these principles, in broad terms, but recognise that, in practice, it is not possible to fully satisfy all these goals, and some trade-offs will be required. In particular, we note that there are limits to the application of principles (iii) and (iv) given that changes in tax policy can result in behavioural effects on other tax bases, the impact of which on revenues can be hard to estimate.	
	Recommendation 11
Principles for implementing fiscal devolution	i. **That neither the budget of the NI Executive nor of the rest of the UK should be immediately better or worse off simply as a result of the devolution of a tax.** ii. **That, as far as possible, following tax devolution the NI Executive should neither gain nor lose from fiscal risks or trends that can reasonably be predicted in advance, and which it has limited capacity to meaningfully influence.** iii. **That the NI budget should capture, as far as possible, the full revenue impacts of its tax policy decisions, whether they be to raise or reduce revenue.** iv. **That, as far as possible, the NI budget should not be exposed to the effects of tax policy changes made by the UK Government, for taxes that have been devolved to the NI Executive. And nor should rUK be exposed to the consequences from changes to devolved taxes in Northern Ireland**. v. **That, as far as possible, the UK Government should bear the risks of revenue shocks that impact the whole of the UK equally**.

7.8 Recommendations – Operationalising our principles

<table>
<tr><th colspan="2">Block grant adjustments (BGAs)</th></tr>
<tr><td colspan="2">We believe our principles, as outlined above, can broadly be achieved if the BGA for a devolved tax is initially set equal to Northern Ireland revenues immediately prior to devolution, and in subsequent years increased in line with some measure of growth in equivalent revenues in England. However, this is subject to a number of important trade-offs with respect to how budgetary risks are allocated and in particular those which we consider the NI budget should reasonably bear. See below.</td></tr>
<tr><td rowspan="2">BGA indexation mechanism</td><td>Recommendation 12 (parts A and B)</td></tr>
<tr><td>We recommend that, following tax devolution to Northern Ireland, the BGA mechanisms that are adopted control for the budgetary risks arising from Northern Ireland's different starting distribution of taxpayers. This will insure the NI Executive's budget against the fiscal risks that arise from it having a different distribution of taxpayers by tax band at the point of devolution.

This applies to income tax and to stamp duty land tax (SDLT), although not the other taxes that we recommend as suitable for devolution. Unlike the other taxes we discuss, growth in income tax and SDLT revenues can be strongly influenced by the highest income earners and the highest valued properties – of which Northern Ireland has relatively few. In our view, fiscal frameworks should not penalise the NI Executive from it having lower tax capacity at the point of devolution. The NI budget should not significantly gain or lose as a result of devolution simply because of the tax base that it inherits.

Northern Ireland's BGAs should be indexed to tax growth in England as a whole, not, for example, England excluding London and the South East. Many of the concerns that arise in indexing the BGAs to all England can be addressed using a 'by band' approach, and we believe this would be a more appropriate approach.</td></tr>
<tr><td rowspan="2">Population projections and implications for choice of BGA mechanism</td><td>Recommendation 13</td></tr>
<tr><td>We recommend that the BGA mechanism takes account of relative population growth. In our view, the NI budget should not, as a result of tax devolution, be exposed to the risk of differential population growth relative to England. Relative population growth is an important determinant of the relative growth in revenues, but not one that the NI Executive has significant ability to influence, except perhaps over a very long term.

We are not persuaded by arguments that the NI Executive's budget should be insulated against other fiscal risks, including the risk of differences in other demographic trends, for example, population age. The likely benefits are uncertain, limited, and potentially outweighed by the disadvantage of a more complex and less transparent framework.</td></tr>
</table>

Fiscal insurance	***Recommendation 14*** **We recommend building in some, limited, element of fiscal insurance into tax devolution arrangements.** We do not have a strong view on what form this should take, i.e. whether a floor, a ceiling or a periodic reset, but it is clear that at least one of these will be necessary. The risk of fiscal insurance, or 'equalisation', is that it could undermine part of the rationale for tax devolution if it weakens the relationship between economic performance and the devolved budget. But this risk needs to be weighed carefully against the risk that devolved tax revenues could diverge substantially from the equivalent English revenues for reasons outside the control of devolved policy-makers. We believe the NI budget should bear some of the costs, or benefits, from tax revenues diverging from UK revenues after devolution, but with the downside limited. Carefully designed, fiscal insurance need not undermine the rationale for devolution, and is consistent with the notion of fiscal union.
Budgetary management tools	
Tax devolution would increase the reliance of the NI Executive on uncertain and potentially volatile tax revenues and associated BGAs for its funding. To avoid discrepancies between forecasts and outturns leading to the NI Executive having to make immediate cuts or increases to its spending, if revenues are lower or higher than budgeted for, it will need to be provided with additional budget management tools.	
Borrowing for forecast errors and reconciliations	***Recommendation 15*** **We recommend that the NI Executive should be able to borrow to cover negative forecast errors in full.** Any cap placed on such borrowing, perhaps to encourage the NI Executive to hold and make use of reserves as well, should be set at a sufficiently high level that negative forecast errors only exceed it infrequently. This means that the relative size of Wales' forecast error borrowing limit (£200m or 7.0% of devolved revenues in 2021/22) represents a better guide than the relative size of Scotland's limit (£300m or 2.2% of devolved revenues in 2021/22). Any limit should also be indexed over time, for example, based on changes in the level of revenues devolved to the NI Executive. Periodic reviews of the fiscal framework should also consider whether the limits are appropriate or should be revised.
Borrowing for discretionary resource expenditure	***Recommendation 16*** **We recommend that the NI Executive should be able to borrow a modest amount to fund discretionary resource spending.** This would allow it to borrow to offset temporary falls in revenues even if these were forecast in advance, and more generally, respond to unforeseen events affecting its budget.

	We suggest that an annual borrowing limit of 1% of its current resource DEL (approximately £138 million) might be a useful starting point, providing a modest degree of extra budget flexibility, and posing no risk to the UK's overall public finances. To avoid the risk of 'over-borrowing', a limit on the total stock of debt that could be incurred could be imposed, and rules put in place requiring borrowing to be paid back over a relatively short period. We recognise that granting substantially larger resource borrowing powers would represent a bigger change to the UK's fiscal architecture.
A Northern Ireland Reserve	***Recommendation 17***
	We recommend that, following devolution of tax responsibilities to Northern Ireland, the Budget Exchange mechanism should be replaced by a Northern Ireland Reserve, to provide flexibility to respond to the additional revenue risks the NI Executive's budget would face. If there is to be a cap on the Reserve, it should be set to be at least in line with the cap in Wales (which is £350m or 12.3% of devolved revenues in 2021/22), relative to the value of revenues devolved. There is a good case for saying that, if there is a cap on the overall value of the Reserve, annual drawdown limits should not apply, and instead be a matter of discretion for the NI Executive. At the very least, drawdown limits should be set to be significantly higher than the Budget Exchange limit currently in place, since the Reserve will be used to address forecast error risk in addition to existing underspend requirements. Any caps or limits should be indexed over time, rather than being fixed in cash terms.
Forecasting arrangements	***Recommendation 18***
	We recommend, as a key condition for devolution, that forecasts are made by an independent body and not by the NI Executive. This is vital to ensure the credibility and transparency of the forecasting process, and to avoid the risk of forecasts being unduly optimistic (in order to generate more revenue in the short-term). **We recommend that the NI Fiscal Council is tasked with forecasting revenues for any devolved taxes.** This would help increase local accountability, allow NI-specific factors to be most fully taken account of, and would help build further institutional capacity within Northern Ireland. Irrespective of which organisation forecasts Northern Ireland revenues, that body should also be responsible for publishing an analysis and explanation of why trends and forecasts for Northern Ireland revenues and the BGAs differ.
Compensatory transfers	***Recommendation 19***
	We recommend that the NI Executive fiscal framework should make provision for compensatory payments to be made in both directions

	between the UK Government and NI Executive, when policies related to the taxes we propose are devolved, have spillover effects.[lxxiv] However, both governments should invoke these provisions in a responsible manner, and similarly restricting payments to 'direct' spillover effects as in Scotland and Wales would be sensible. **We recommend that the NI Executive and the UK Government should be required to publish their positions and the evidence underlying them if no agreement on compensatory payments can be reached; the external and independent scrutiny this would allow could encourage a more responsible approach and incentivise agreement earlier in the process.**
Dispute resolution	***Recommendation 20***
	A well-functioning system of intergovernmental relations and processes for dispute resolution are essential if fiscal devolution is to work smoothly. **We recommend that dispute resolution processes in any future fiscal framework for Northern Ireland should have access to and be embedded within the new Intergovernmental Relations system between the UK Government and devolved administrations, which sets out new principles and infrastructure arrangements to support the resolution of intergovernmental disputes.** **If tax devolution to Northern Ireland is to happen, then it is vital that both governments work constructively and positively together in its implementation.**
Changing and reviewing the framework	***Recommendation 21***
	We recommend that if further tax powers and revenues were devolved, following the agreement of an NI Executive fiscal framework, it would be appropriate to review the terms of the overall framework at that point. In particular, any limits on borrowing for the purpose of addressing forecast errors would likely need to be revised, and a different approach to block grant adjustment may be warranted, compared to those taxes previously devolved. **We recommend reviewing the framework on a periodic basis, even if no further tax powers were devolved.** This review should be timed to take place shortly after, rather than shortly before, the expected date of elections to facilitate longer-term perspectives being taken. Bearing this in mind, a period of approximately five years would seem appropriate.

[lxxiv] Spillover effects can be: *direct* (mechanical effects occurring as a result of policy change before any associated changes in behaviour); *behavioural* (resulting from behaviour change in response to a policy decision); or *second-round* (wider economic impacts resulting more indirectly from policy decisions).

7.9 Recommendation – New taxes

New taxes	
Northern Ireland currently has the legislative powers to introduce new taxes, as set out in the Northern Ireland Act 1998. However, there are neither clear predetermined criteria as to the extent of these powers, nor a formal process with the UK Government on how they could be implemented.	
New taxes for Northern Ireland	***Recommendation 22***
	We recommend that the NI Executive and the UK Government agree a transparent process for the introduction of any new taxes in Northern Ireland.

7.10 Recommendation – Wider implications for devolution across the UK

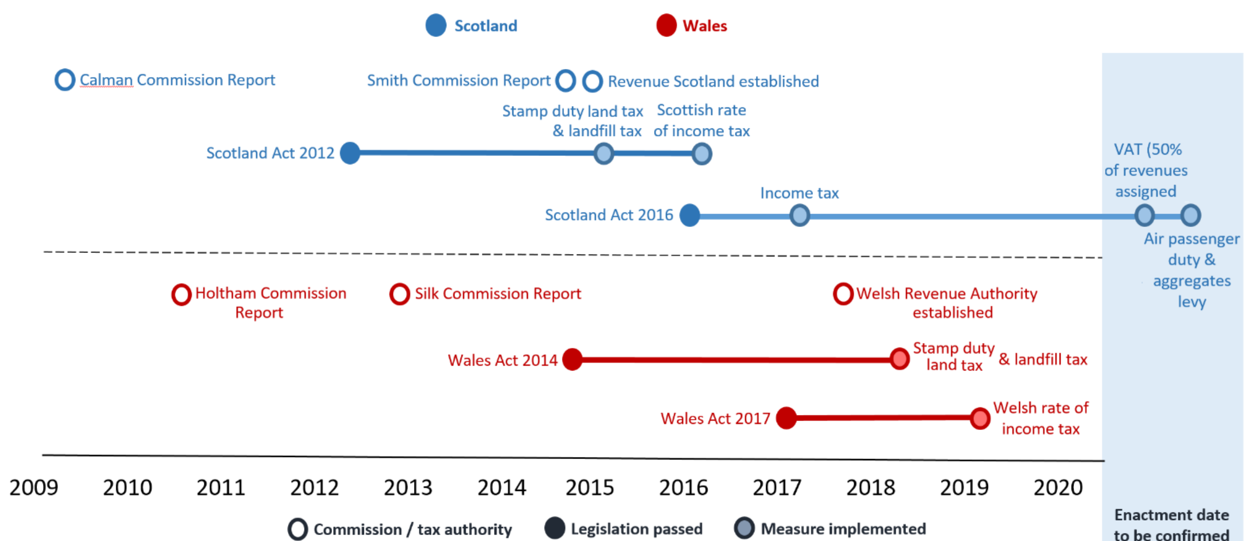
Wider implications	
We believe there is learning from our work which is relevant to fiscal devolution arrangements elsewhere in UK. While the asymmetric devolution within the UK allows powers and responsibilities to be tailored to fit the individual context of each of the devolved administrations, in our view, it is appropriate that the different devolution arrangements should also aim to share common principles, where able. Having completed this work for Northern Ireland, and after similar processes in Scotland and Wales, we believe there is an opportunity to optimise current devolution arrangements by developing a more consistent, 'standardised' approach across the UK, based upon evidence of best practice and experience to date. This would also help inform the views of the wider public and improve the sought after accountability that tax devolution brings with it, both for devolved administrations and the UK Government.	
Wider implications for devolution across the UK	***Recommendation 23***
	We recommend that the UK Government instigates a review to consider developing and implementing a shared institutional framework for fiscal devolution across the UK. This could usefully consider the drawing up of shared principles and the establishment of shared processes/infrastructure particularly in the area of dispute resolution and the use of independent analysis.

7.11 Concluding remarks and potential timescales for fiscal devolution

7.11.1 It must be remembered that Northern Ireland is at the beginning of a *potential* fiscal devolution journey. Despite the detail and conclusions of our final report there are, inevitably, political considerations which will ultimately decide whether any fiscal devolution occurs, as well as its scale and pace. There are no set timeframes when considering timescales for tax devolution.

7.11.2 As we have discussed in detail, Scotland and Wales began their devolution journeys a number of years ago. We can look to their experience as a broad indication of what might be possible in relation to how long before taxes could be devolved, administered, and collected locally in Northern Ireland. Chart 7.1 shows the timeline of tax devolution in Scotland and Wales. The time taken between the conclusion of the technical commissions' work in Scotland and Wales, political consensus being reached and devolved taxes beginning to be administered and collected locally was significant, at around six to eight years.

Chart 7.1 Timeline of tax devolution in Scotland and Wales



7.11.3 While more expedited timescales may be possible for Northern Ireland, given lessons learned elsewhere, what is clear is that the work of the independent Fiscal Commission NI can only be the first part of that journey.

7.11.4 As a Commission, we have aimed to provide thorough, evidence-based analysis and commentary on the potential for fiscal devolution for Northern Ireland. We have sought to reflect the views and, where relevant, the concerns from all sides in relation to increased devolution. We have said what we feel it is technically feasible and why. We have outlined the risks. We have established that there is a good case for devolving certain fiscal powers to Northern Ireland from an economic and policy perspective and we have prioritised those taxes we assess as best placed to do so. We have concluded with a series of recommendations that provides a comprehensive framework for implementing fiscal devolution. Perhaps most importantly, we have recognised the potential of fiscal devolution to raise the accountability of the NI Assembly to its electorate.

7.11.5 What might happen next? Northern Ireland would need to ask for increased fiscal powers and the UK Government would need to be agreeable to the request. The NI Assembly elected in

2022 and any ensuing coalition discussions provide an opportunity to generate local political consensus on fiscal devolution by an incoming NI Executive. We believe the constituent parts can be in place to realise significant increased fiscal devolution to Northern Ireland, as per the framework outlined in our final report, by 2027/28. The choice as to whether that happens or not remains one for politicians both in Northern Ireland and the UK, and the people they represent.

Paul Johnson
Chair of Fiscal Commission NI

Professor Cathy Gormley-Heenan
Commissioner

Professor Iain McLean
Commissioner

Dr Lisa Wilson
Commissioner

Further information on our work and evidence and responses submitted to the Fiscal Commission can be found at: www.FiscalCommissionNI.org

Annex A

Glossary

AME	Annually Managed Expenditure: the budgets of UK Government Departments and devolved administrations to finance demand-led expenditure (for example, social security payments)
BGA	Block Grant Adjustment reflects how the funding to a devolved government is adjusted to account for the loss of revenue to the UK Treasury from the devolution of fiscal powers to the respective devolved Parliament or Assembly
British-Irish Council	A body established under the Belfast Agreement of 1998 which aims to "promote the harmonious and mutually beneficial development of the totality of relationships among the peoples of these islands". It's members include representatives of the UK and Irish Governments, of the devolved Scottish, Welsh and Northern Irish executives and of the administrations of Jersey, Guernsey and the Isle of Man
Carbon Price Floor	UK Government policy implemented to support the EU Emissions Trading System. It was introduced to underpin the price of carbon at a level that drives low carbon investment, which the EU ETS has not achieved
City Deals	Bespoke packages of funding and decision-making powers negotiated between central government and local authorities
CSO	Central Statistics Office: the statistical agency responsible for the gathering of information relating to economic, social and general activities and conditions in the Republic of Ireland (RoI)
DEL	Departmental Expenditure Limit: the allocated budgets of UK Government Departments and devolved administrations to fund public expenditure
ERINI	Economic Research Institute of Northern Ireland
EU	European Union: a political and economic union of 27 member states that are located primarily in Europe
EU State aid	State aid in the European Union is the name given to a subsidy or any other aid provided by a government that distorts competitions. Under European Union competition law, if it distorts competition or the free market, it is classed by the European Union as being illegal State aid
FDI	Foreign Direct Investment: investment in the form of a controlling ownership in a business in one country by an entity based in another country
G7	Group of Seven: a forum of countries representing around half of global economic output that meet regularly to discuss key issues related to global economic stability. It consists of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States of America
GB	Great Britain: geographically the islands comprising England, Scotland and Wales; politically used to denote the UK except for Northern Ireland
GDP	Gross Domestic Product: measures the total value of all of the goods made, and services provided, during a specific period of time

GERS	Government Expenditure and Revenue in Scotland: a Scottish Government publication estimating Scotland's fiscal balance
GNI	Gross National Income: defined as gross domestic product, plus net receipts from abroad of compensation of employees, property income and net taxes less subsidies on production
GVA	Gross Value Added: the amount of goods and services that have been produced in a country, minus the cost of all inputs and raw materials that are directly attributable to that production
HMT	Her Majesty's Treasury: the government's economic and finance ministry, maintaining control over public spending, setting the direction of the UK's economic policy and working to achieve strong and sustainable economic growth
HMRC	Her Majesty's Revenue and Customs: a non-ministerial department of the UK Government responsible for the collection of taxes, the payment of some forms of state support, the administration of other regulatory regimes including the national minimum wage and the issuance of national insurance numbers
IFG	Institute for Government: United Kingdom independent think tank which aims to improve government effectiveness through research and analysis
IFS	Institute for Fiscal Studies: an independent UK research institute specialising in UK taxation and public policy, with the principal aim of better informing public debate on economics in order to promote the development of effective fiscal policy
IMF	International Monetary Fund: an international financial institution consisting of 190 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world
MNE	Multinational Enterprise: An enterprise producing goods or delivering services in more than one country
NDR	Non-Domestic Rates
NI Protocol	Agreement between the EU and UK to account for customs tariffs, customs declarations and customs controls in trade between Northern Ireland and the European Union, in particular the Republic of Ireland
NICs	National Insurance contributions: a UK Government-levied tax on employers and employees hypothecated to fund social security payments and the National Health Service
NISRA	Northern Ireland Statistics and Research Agency: the principal source of official statistics and social research on Northern Ireland
NNP	Net National Product: the total value of goods produced and services provided in a country during one year, after depreciation of capital goods has been allowed for
Northern Ireland Consolidated Fund	The sum of money provided annually by the UK Parliament to establish a budget for the NI Assembly. The Northern Ireland Consolidated Fund has existed since 1921. All central government income and expenditure (with respect to NI) flows through the Northern Ireland Consolidated Fund
OBR	The Office for Budget Responsibility was established in 2010 to provide independent and authoritative analysis of the UK's public finances. Alongside the UK Government's Budgets and other fiscal statements, they produce forecasts for the economy and the public finances

OECD	Organisation for Economic Co-operation and Development: an intergovernmental economic organisation with 38 member countries, founded in 1961 to stimulate economic progress and world trade
ONS	Office for National Statistics: UK's largest independent producer of official statistics and the recognised national statistical institute of the UK
rUK	Rest of the United Kingdom comprising England, Scotland and Wales
RHI	Renewable Heat Incentive scheme: a 20-year incentive to encourage the move from fossil fuels such as oil and gas, to a renewable source of heat. It was managed by the Department of Enterprise, Trade and Investment (DETI), the forerunner of the Department for the Economy
RRI	Reinvestment and Reform Initiative: a borrowing facility that was set up in 2002 to support the Northern Ireland Executive's infrastructure investment programme
SNP	Scottish National Party
Spending Review	Governmental process carried out by HM Treasury to set firm expenditure limits and, through public service agreements, define the improvements that the public can expect from these resources
Sub-national Government	Term used in academic literature to describe the tier of government between national and local or municipal
TES	Total Expenditure on Services: actual spending undertaken by the public sector within a region and is used by HM Treasury as the basis for the reporting of functional, economic category and territorial spending across the Devolved Administrations
TME	Total Managed Expenditure: all expenditure by the entire public sector - namely, the UK Government, NI Executive, local authorities and public corporations
UK	The United Kingdom of Great Britain and Northern Ireland
VAT	Value Added Tax: tax on goods and services levied in the UK by HMRC

Annex B

Tax Data Reliability - An in-depth look at the data and methods used to capture the Northern Ireland tax base

B1.0 Overview

Any move towards further devolution of fiscal powers to Northern Ireland requires careful consideration to be given to the data which is available and its suitability in terms of providing us with accurate figures on the tax base. It is important to understand the accuracy and reliability of the tax estimates for Northern Ireland, as these estimates are a key element of the evidence base that will inform any decision-making process regarding devolution. These estimates could also impact upon the initial block grant adjustments used in the event of devolution (prior to any outturn data becoming available). This means that it is important that estimates of the Northern Ireland tax base are as robust and accurate as possible.

This paper provides a detailed investigation of the data and methodology for capturing revenue raised in Northern Ireland. In doing so it provides insight into any issues in terms of limitations, gaps or concerns about reliability and validity of these data. It also outlines how Scotland and Wales have considered issues of concern around tax data and any steps that they have taken to try to resolve availability or quality issues. Lastly, we consider the potential solutions that could be taken in order to improve the quality of estimates capturing the tax revenue raised in Northern Ireland.

B1.1 Where does the data capturing the Northern Ireland tax base come from?

There is no Department within the Northern Ireland Executive which is directly responsible for accounting for the amount of taxation revenue raised within Northern Ireland, and ascertaining exactly the level of revenue generated in Northern Ireland is not a straightforward exercise. Furthermore, because taxes are not generally levied or collected on a regional basis (domestic and non-domestic rates being the exception for Northern Ireland) it can be difficult to identify to which country or region tax receipts should be allocated. This is particularly so with indirect and business taxes, which are paid to Government by corporations.

In recent years, regional statistics on public finances, such as public sector revenue and statistics on Northern Ireland's tax base have been provided through two sources:

i. Office for National Statistics (ONS) Country and regional public sector finance (CRPSF) statistics – produced since 2017 and classified as experimental statistics.
ii. HMRC Disaggregated Tax receipts between England, Scotland, Wales and Northern Ireland - produced between 2013 and 2020.

Since 2020, HMRC's Disaggregated Tax receipts publication has been discontinued. Therefore, while HMRC currently retain responsibility for producing certain regional tax receipts breakdowns, ONS

Experimental Country and regional public sector finance (CRPSF) statistics remains the published source for capturing regional public finance data across all of the UK.

On an annual basis, the Scottish Government publish 'Government Expenditure and Revenue Scotland', otherwise known as 'GERS'. GERS, unlike the experimental ONS CRPSF publications, is a National Statistics publication which is assessed by the independent UK Statistics Authority to ensure that it meets the standards set out in the Code of Practice for Statistics. GERS is an annual estimate of the Scottish fiscal position. It provides a summary of how much revenue is raised in Scotland, how much the country pays for the public services consumed, and to what extent the revenues raised cover the costs of these public services. GERS uses the UK Public Sector Finances statistics as its underlying data source and the methodologies used are broadly consistent with those utilised in the ONS CRPSF statistics publication and, on the expenditure side, with HMT's annual 'Public Expenditure: Statistical Analyses' (PESA)

The data sources for the ONS publication vary depending on the tax, but in general estimates are based on revenue data from the UK-wide Public Sector Finances statistics. A "top-down" approach is then used to calculate country and regional figures from the UK-level data. The allocation of revenue to regions is based on a variety of methods, consistent with the "who pays" concept, i.e. identifying the location where the revenue is raised. ONS use an "indicator" dataset (which varies across the taxes) to apportion total revenue from UK public finance statistics to countries and regions. We discuss in further detail some of the "indicator" datasets and apportionment methods used by ONS for specific taxes in more detail later in this paper.

In broad terms however, much of the data used for CRPSF estimates comes from administrative sources, i.e. actual tax outturn data or other administrative data used as a proxy (e.g. passenger numbers in the case of APD), and is therefore not subject to sampling error (though there may still be underlying errors or issues with the data). However, a non-trivial amount of apportionment data does come from sample surveys. As far as possible, the data is comparable across countries and regions, but certain items necessarily have different data sources for country-level data and English regional data. Table 1 below outlines the data sources used for apportioning taxes to Northern Ireland in the CRPSF.

Table B1 List of data sources used for apportioning taxes to Northern Ireland in CRPSF

Tax	Data source
Income tax	Survey of Personal Incomes (SPI) and modelled using Income Tax liabilities statistics (ITLS) methodology
Value added tax	Living Costs and Food Survey data, published by ONS; and Regional gross value added (GVA) statistics from ONS's regional accounts
National Insurance contributions	HMRC's 1% Pay As You Earn (PAYE) sample
Fuel duties	Department for Business, Energy and Industrial Strategy (BEIS) statistics on Road transport energy consumption at regional and local authority level
Corporation tax (excl. North Sea)	Percentage shares for the ITL1 regions based on HMRC administrative data on Corporation Tax; and data from ONS Inter-Departmental Business Register (IDBR)
Tobacco duties	Living Costs and Food Survey data, published by ONS
Alcohol duties	Family Food report published by the Department for Environment, Food and Rural Affairs (DEFRA) which analyses data from the Living Costs and Food Survey data, published by ONS

VAT refunds	Public Expenditure Statistical Analyses published by HM Treasury, which contains information on government expenditure.
Vehicle excise duties	Department for Transport's Vehicle licensing statistics; Public Sector Finances statistics
Insurance premium tax	Living Costs and Food Survey data, published by ONS
Capital gains tax	Capital Gains Tax administrative data provided by HMRC, covering both individuals and Trusts
Stamp duty land tax	Stamp Duty Land Tax bulletin, published by HMRC
Air passenger duty	Civil Aviation Authority (CAA) data on total terminal passengers travelling from UK airports; and CAA Departing Passenger Survey
Betting and gaming duty	Living Costs and Food Survey data, published by ONS
Inheritance tax	ITL1 Inheritance Tax statistics published by HMRC
Landfill tax	Northern Ireland local authority collected municipal waste management statistics published by the Department of Agriculture, Environment and Rural Affairs (DAERA)
Aggregates levy	UK Minerals Yearbook (UKMY), published by the British Geological Survey
Climate change levy	Electricity consumption statistics for Northern Ireland were obtained from BEIS Sub-national non-domestic electricity consumption statistics in Northern Ireland publication. Gas consumption statistics for Northern Ireland were obtained from Utility Regulator's annual Transparency Reports. Coal consumption statistics for all ITL1 regions were obtained from the BEIS Sub-national residual fuel consumption publication.
Stamp tax on shares	Postcodes for firm-region identification originate from Companies House. Firm name and turnover information originate from the London Stock Exchange monthly Company Trading Summary
Soft Drinks Industry Levy	Family Food report published by the Department for Environment, Food and Rural Affairs (DEFRA) which analyses data from the Living Costs and Food Survey data, published by ONS

Specifically for NI, the values for domestic rates and non-domestic rates, VAT refunds and vehicle excise duties are available directly from Public Sector Finance statistics (and no further apportionment method is required.)

In summary, the ONS Country and regional public sector finance statistics (CRPSF) publication is the central source for capturing regional public finance data across all of the UK.

B1.2 What are the issues relating to the data and methodology utilised to estimate the Northern Ireland tax base?

ONS CRPSF statistics provide a picture of public sector revenue and expenditure for all countries and regions of the UK. These are currently the only statistics produced within the Government Statistical Service that provide this information for the whole of the UK. ONS caution however, that they may not be an accurate representation of public finances should fiscal powers be fully devolved among UK countries and regions.

The complex process by which the CRPSF estimates are produced means that it is not currently possible to define the precision of the estimates in terms of detailed statistical properties - for example, in the case of estimates from survey data through their standard errors. Therefore, the overall reliability of the estimates is measured by the extent of revisions. Further to this however, the ONS caution that there are other aspects of accuracy which revisions analysis cannot attempt to measure. A value can be reliable (as in, not revised) without being accurate if the underlying methodology or quality of data collected is not of sufficient quality. Thus, the ONS recommend that users of public finance statistics refer to the specific methodological information to judge the accuracy of specific data or whether their particular use of the statistics is appropriate. In this respect, revisions will not pick errors or issues arising from inaccuracies in the underlying methodology itself.

Experimental statistics classification

The ONS CRSPF are classified as experimental statistics. ONS state that these are statistics that are within their development phase and are published to involve potential users at an early stage in building a high-quality set of statistics that meet user needs. It should be emphasised that an Experimental Statistics label does not mean that the statistics are of low quality, it only signifies that the statistics are novel and the methodologies used in producing them are still being developed.

Data sources – survey data or administrative data

Typically the preference would be for administrative data (and more specifically outturn tax data) to be used if available, however for many taxes the use of survey data is necessary given a lack of administrative data. The Living Costs and Food Survey (LCF) is one of the main sources of survey data used in the CRPSF and the Commission's investigations have found a number of issues surrounding the use of the LCF data.

Issues with data from the Living Costs and Food Survey

The Living Costs and Food Survey (LCF) produces certified National Statistics for the UK as a whole, in terms of average weekly expenditure on a range of items per household and numbers of households by country and region. ONS has responsibility for the design, methodology and content of the LCF, whilst the Northern Ireland Statistics and Research Agency (NISRA) works with ONS in the collection of LCF data in Northern Ireland.

The data from the LCF is used in the apportionment of tax values across regions for a number of taxes, including VAT and Excise duties. However, the ONS CRSPF methodology papers recognise that the use of this LCF data in this way is a problem. ONS note that while the LCF is a large, nationally representative survey, when broken down into regions, small cell sizes mean that the there is uncertainty in the estimates.

The NI sampling frame for the LCF has changed on multiple occasions. It was cut from circa 1,200 households to 300 households in April 2009. This was primarily due to funding constraints and this sample size of 300 households was considered proportionate to the NI population relative to the UK rather than the boosted sample size[210]. From April 2016, a sample boost on the NI LCF was put in place, this time to an overall sample of 1,000 households (slightly less than that prior to 2010). This sample boost was designed to increase the robustness of the NI LCF dataset in order to produce the NI equivalent of the specified expenditure estimates that are delivered to ONS National Accounts on a quarterly basis. This sample boost has remained in place since the 2016/17 LCF.

The NI sample, since the 2016/17 boost commenced, has tended to have a response rate of approximately 45%, equating to approximately 380 participating households annually[211]. A three-year rolling average is used to improve the accuracy of estimates, therefore since 2016/17, this rolling average has been based on a sample of approximately 1,150 households providing a response. This increase in sample size since 2016 has had a modest but positive impact on the precision of LCF estimates according to NISRA. These responses are being used to inform estimates of VAT revenue in NI to the value of £3.4bn in 2019/20 and excise duties worth almost £800m in 2019/20.

The achieved number of completed responses on the LCF across the UK annually (circa 5,000 cases) is considered a limitation for any sub-regional analysis. A recently published assessment of the Living Costs and Foods survey from the Office for Statistics Regulations (OSR) has concluded that the LCF data processing system as a whole (i.e. not just for NI) is not fit for purpose[212]. They state that the system is unstable, and as a result often produces inconsistent results between processing runs of data. As a result of the recommendations made in the OSR report the LCF processing system is currently being rewritten to improve efficiency and reduce the risk of future processing errors.

A previous National Statistics Quality Review carried out in 2016 also noted that respondents intentionally do not report certain expenditure items such as alcohol or tobacco, leading to these items being potentially underreported in LCF results.[213]It also recommended carrying out a follow-up survey of households included in the LCF sample, of both responding and non-responding households, to provide further information on non-response bias in the LCF.

As part of its bid for investment under ONS's spending review in 2019, the LCF statistics team highlighted the inefficiency of the data processing systems as a limitation to the development of the quality and accuracy of LCF. Additional funding was eventually secured during 2021/22 to improve the stability of the LCF processing system. This followed unsuccessful bids for additional funding in previous years to develop a new expenditure survey and to deliver a short-term boost to the LCF.

Therefore, a key issue with the LCF relates to its underperformance in terms of small sample size in regions, including in NI, and its response rate in recent years. Furthermore, long-standing known issues related to underreporting of expenditure on certain items, including alcohol and tobacco, presents issues in terms of the accuracy and reliability of the data collected. Consideration should be given to making improvements to the LCF in order to ensure the robustness of estimates, prior to any devolution taking place (of those taxes assessed via LCF). These methodological improvements would be for ONS to consider implementing.

ONS investigation into Living Costs and Food Survey data for Northern Ireland

At the request of the Commission, the LCF team within ONS carried out an internal investigation in late 2021 as to how the small sample size impacts on the volatility in the NI estimates, as well as considering the impact a higher sample size would potentially have on reducing volatility.

In this investigation, ONS looked at the data quality of the Northern Ireland estimates of Total expenditure and a smaller grouping of expenditure on Tobacco, Alcohol and Narcotics. They also did this for the other country and regions within the UK. As regional estimates of the LCF are typically done

on a three-year basis, so ONS looked at three three-year samples (2006/07 to 2008/10, 2013/14 to 2015/16, and 2017/18 to 2019/20)[lxxv].

ONS found that in comparing Northern Ireland to other countries and regions, it was not noticeable that Northern Ireland was subject to more variability when looking into the quality of the data across these three samples. NI's confidence intervals and coefficient of variation are typically smaller than for the average region. This does not change when looking at either Total Expenditure or the only Tobacco, Alcohol and Narcotics expenditure.

The ONS investigation also reiterated that the precision of the estimates from the LCF is linked to the sample size, with a larger sample size increasing the precision of the estimates. This can be seen when comparing the three three-year samples to each other. Those with higher sample sizes have smaller confidence intervals and are more precise. Therefore, in years where there is a lower sample size, there will likely be less precision in estimates.

Overall, the ONS view is that the Northern Ireland data from the LCF is of sufficient quality *for current purposes*. The precision of the estimates for NI are not noticeably different compared to other countries or regions.

That said, ONS are also of the view that a higher sample size would increase the quality of estimates. It is the Commission's view that the issues noted in this paper regarding small sample sizes and accuracy of expenditure data collected, and the subsequent impact on the precision of estimates, mean that there are reservations over how robust or suitable data from the LCF is as an indicator for significant tax values at the regional level, such as VAT and excise duties.

Gross Operating Surplus

The Commission's Interim Report highlighted the issue of Gross Operating Surplus (which makes up 23.8% of total revenues for Northern Ireland in 2019/20) as a revenue item in the ONS CRSPF[lxxvi]. It also noted that consumption of fixed capital, which is equal to Gross Operating Surplus for government bodies due to the 'sum of costs' method of estimating government output, is captured on the expenditure side of the ONS statistics. This means that there is no impact from Gross Operating Surplus on the overall net fiscal balance.

The Gross Operating Surplus values for Northern Ireland are considerably higher than for other UK regions. This is due to the existing ONS methodology where the Gross Operating Surpluses for central and local government, estimated as being equal to consumption of fixed capital as described above, are for the most part apportioned according to civil service headcount. Therefore, regions with a higher per-capita proportion of civil servants – as is the case in Northern Ireland – will end up with a higher value compared to the proportionate share of services the population of that region might be consuming.

[lxxv] It should be noted that both the 2006/07 to 2008/10 and the 2017/18 to 2019/20 periods in this analysis would have been based on a boosted NI sample. The 2013/14 to 2015/16 period was during the time when the NI sample boost had been discontinued. It should also be noted that response rates to the LCF (across the whole of the UK) have been falling steadily in the last decade.

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

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

ONS views on tax revenue estimates for Northern Ireland

The Commission has engaged with ONS to understand their views on the current robustness of estimates for Northern Ireland**. ONS have indicated that in their view, the estimates are the best available using current data sources and methodologies**. ONS have further stated that given the experimental nature of these statistics, they are committed to working with stakeholders to improve the quality and usability of estimates with a view towards them gaining accreditation as official statistics.

ONS have also noted to the Commission that as with all statistics, any assessment of the robustness and accuracy will depend on the potential uses. For example, data subject to modelling might be very reliable at showing trends over time, but might be considered less reliable at showing precise values. In the specific case of the ONS Public Sector Finances estimates that we use for Northern Ireland, this is particularly the case in the most recent year, 2019/20, which is subject to an element of 'nowcasting' using the previous year's proportions.

ONS have also cautioned that the CRPSF estimates may not be an accurate representation of public finances should fiscal powers be fully devolved among UK countries and regions. However, the Commission does note that the Scottish GERS publication, which achieves national statistics standards, utilises in many cases the same data and methods as the CRPSF, although outturn tax data is utilised in the Scottish case for taxes which are devolved.

B1.3 Revisions to tax receipts data

The ONS methodology states that the overall reliability of the estimates can be understood by the extent of revisions to tax receipts statistics. Table 2 below therefore presents data which captures the scale of revisions made across the various taxes in monetary terms and as a percentage of the tax receipts as originally published (pre-revisions) for the year 2018/19. It does this for both Northern Ireland and the UK as a whole.

Total public sector current receipts for 2018/19 for Northern Ireland were subject to considerable revisions. Specifically, total tax receipts were revised as being £746 million higher than they were originally calculated, which equates to around 4% of total tax receipts as originally published. Whilst revisions occur right across the tax base, the scale of revisions are much greater for some taxes than they are for others. Furthermore, the scale of revisions is much greater in Northern Ireland than it is for the UK as a whole. This can partly be explained by the greater volatility in the Northern Ireland data arising from issues related to timeliness and survey sample sizes. However, the size of Northern Ireland in proportion to the UK can also lead to exaggerated revisions for some data items. The ONS Public Sector Finances data is typically produced to the nearest £m, which in percentage terms can show an apparently significant revision for smaller lines in the context of Northern Ireland tax receipts.

Therefore, **revisions to estimates highlight the higher volatility in estimates for Northern Ireland compared to the UK as a whole. This reinforces the benefit of having regional outturn data available where possible and robust alternatives where not.**

Table B2 Revisions to 2018/19 Total Public Sector Current Receipts excl. PS Banks for UK and NI as published in 2019/20 publication

	UK		Northern Ireland	
	£ m	%	£ m	%
Income tax*	0	0.00	100	3.47
Capital gains tax	0	0.00	19	21.59
Miscellaneous taxes on income and wealth	0	0.00	0	0.00
Corporation tax (excl. North Sea)	-548	-0.99	56	6.55
Taxes on income and wealth paid by PCs	35	29.66	1	33.33
Taxes on income and wealth	-513	-0.20	176	4.58
Value added tax, of which:	-30	-0.02	-129	-2.98
VAT net of refunds	-22	-0.02	-132	-3.73
VAT refunds	-8	-0.04	3	0.38
Fuel duties*	0	0.00	4	0.46
Business rates paid by market sector bodies	712	2.54	0	
Taxes on land and buildings transactions, of which:	0	0.00	0	0.00
Stamp duty land tax*	3	0.03	0	0.00
Land transaction tax	3	1.33	0	0.00
Land and buildings transaction tax	-6	-1.07	0	0.00
Annual Tax on Enveloped Dwellings	0	0.00	0	0.00
Stamp tax on shares	0	0.00	0	0.00
Tobacco duties*	0	0.00	-78	-14.58
Alcohol duties*	0	0.00	-43	-12.39
Vehicle excise duties paid by businesses	-386	-16.14	-12	-15.58
Other taxes on production, of which:	9	0.03	-22	-1.87
Air passenger duty*	0	0.00	1	1.27
Insurance premium tax	0	0.00	-9	-6.00
Climate change levy	0	0.00	11	100.00
Environmental levies	-7	-0.09	4	2.99
EU ETS auction receipts	-54	-16.46	-2	-22.22
Betting and gaming duty	0	0.00	-5	-6.25
Taxes on landfill, of which:	-20	-2.39	-9	-23.08
Landfill tax*	-20	-3.06	-9	-23.08
Landfill disposals tax	0	0.00	0	
Scottish landfill tax	0	0.00	0	
Aggregates levy	0	0.00	-8	-29.63
Northern Ireland regional non-domestic rates	0	0.00	0	0.00
Immigration Skills Charge	0	0.00	0	0.00
Soft Drinks Industry Levy	0	0.00	-1	-8.33
Digital Services Tax	0		0	
Other	90	1.01	-4	-2.01
Northern Ireland district non-domestic rates	0	0.00	0	0.00
Taxes on production	305	0.11	-280	-3.58
Bank Levy	0	0.00	0	0.00
Business rates paid by private sector non-profit institutions	16	3.43	0	
Northern Ireland regional domestic rates	0	0.00	0	0.00
Northern Ireland district domestic rates	0	0.00	0	0.00
Other, of which:	1,579	19.39	46	18.47

Vehicle excise duties paid by households	286	6.56	10	7.58
TV Licence fees	0	0.00	0	0.00
Visa Fees	1,249		36	
Miscellaneous other current taxes	44	7.90	0	0.00
Council tax	417	1.21	0	
Other current taxes	2,012	4.37	46	5.22
Taxes on capital	0	0.00	0	0.00
National Insurance Contributions	219	0.16	15	0.51
Gross operating surplus	1,708	3.23	778	33.28
Interest and dividends	838	3.48	16	3.38
Rent and other current transfers	-9	-0.17	-5	-3.09
Other current receipts	2,756	1.22	804	13.55
Total current receipts (excl. North Sea Oil & Gas revenues)	4,560	0.56	746	4.04
Total current receipts (incl. North Sea Oil & Gas revenues by population share)	**4,544**	**0.56**	**746**	**4.03**

Note: Comparison of public sector current tax receipts statistics data for 2018/19 as published in 2020 as compared to revised data published in 2021.

**Taxes being considered further by the Commission in its Final Report.*

B1.4 Key issues with data and methodology for those taxes being considered further in the Commission's final report

Income tax

Regional apportionment of personal income tax receipts and the income tax base, produced as part of ONS country and regional public finance data, comes from the Survey of Personal Incomes (SPI), which is modelled using Income Tax liabilities statistics (ITLS) methodology. HMRC have indicated that they do not hold administrative data at the required level to apportion income tax between countries and regions on a tax receipts basis and as such, estimates for countries and regions are arrived at using the SPI.

The SPI is based on information held by HMRC on individuals who could be liable for UK Income Tax. Samples of individuals' taxable incomes are drawn from HMRC's Pay as you earn (PAYE) self-assessment and claims administrative systems. Income tax liability statistics are based on a micro-simulation model of the UK income tax system taking account of the main features, including rates, thresholds, allowances and the major tax reliefs and tax credits.

Income tax revenues are apportioned from ITLS based on the total estimated income tax liabilities of residents in each region. The split for England, Scotland, Wales and Northern Ireland is obtained on the basis of the residential postcode of individuals within the SPI rather than where the income is generated (workplace basis). In addition to this, ITLS provides estimates for the current tax year of individual income taxpayer numbers broken down by country/region and by marginal rate of tax (e.g. basic rate taxpayers).

It is important however to draw attention to the fact that there are reasons as to why income tax liabilities statistics might not be appropriate in the estimating of income tax receipts for Northern Ireland, and why in the event of a decision to devolve such fiscal powers, careful consideration would need to be given to getting precise estimates of income tax receipts and the income tax payer base[214]. Most importantly, ITLS statistics are not gathered for the purpose of estimating income tax collected

within particular areas. ITLS are focused on income tax liabilities, which are amounts of tax due in respect of individuals' incomes arising in a particular tax year, and reflecting the structure and parameters (e.g. rates, allowances and thresholds) of the UK income tax system in force for each tax year. Thus, ITLS statistics for a particular tax year may differ appreciably from income tax receipts, which are amounts of tax paid and collected in the same year. These differences occur for a variety of reasons including timing, where there are lags in the payment and collection of tax, particularly for self-assessment, or when over or underpayments of tax occur which are repaid or recovered in later years. Perhaps most importantly, while the data is representative of the UK population as a whole, the sample is not stratified by sub-national area and so HMRC[215] caution that these may be less robust at that level. For example, when actual income tax outturns data for 2016-17 was available from Scotland it was somewhere between £500m and £700m lower than what GERs data had estimated[216].

It is worth pointing out that HMRC publish tax receipts data separately to tax liabilities data. Data used in the Income Tax receipts tables comes from HMRC departmental administrative sources. PAYE receipts come from the BROCS system (Business Review of the Collection Service) for all years up to and including 2012/2013. From 2013/2014 PAYE receipts come from a different PAYE accounting system (the Enterprise Tax Management Platform, or ETMP), linked to the Real Time Information (RTI) programme. Self-Assessment receipts come from the HMRC system SAMAS (Self-assessment Management Accounting System). Other components come from the HMRC system SAFE (Strategic Accounting Framework Environment).

Table 2 shows that there were some revisions to income tax estimates in 2018/19, though one of the smaller revisions in percentage in terms at 3.47% of the total value of income tax revenues for that year.

Apprenticeship levy

The Commission recommended that the case for devolution of the apprenticeship levy to Northern Ireland was sufficiently strong to merit further investigation, albeit that, due to the size of the tax, any moves to devolve the apprenticeship levy would be best made following any decision to devolve income tax and/or NICs.

In terms of the data capturing revenue raised from the apprenticeship levy, ONS have provided the Commission with values for apprenticeship levy revenue in Northern Ireland for 2017-18 to 2019-20, with a value of £60m estimated for 2019-20. However, these figures were not published in the previous ONS CRPSF publications (hence apprenticeship levy values are not included in Table 2 above). In previous publications, data on the apprenticeship levy has been captured within the 'Other taxes on production' estimates and a more granular breakdown was not available. This also meant that limited information was provided by ONS on the methodology behind the estimates. The available information does indicate that revenue data for the apprenticeship levy comes from Public Sector Finances statistics and is then apportioned to regions using data on workforce jobs and gross weekly earnings.

If the apprenticeship levy was to be devolved, then as the Commission's Interim Report suggests, it should be devolved alongside either income tax or NICs, which would improve the accuracy of data on earnings for those employees registered for PAYE and in turn provide a specific Northern Ireland source for Apprenticeship levy data. ONS have also indicated to the Commission that they plan to include estimates for Apprenticeship Levy revenues for all countries and regions of the UK in the CRPSF publication going forward.

Alcohol and tobacco excise duties

Data for tax receipts for tobacco products comes from the LCF survey data which include average weekly expenditure on tobacco products per household and numbers of households by country and region. Average weekly household expenditures on tobacco products were multiplied by the average weighted number of households in each ITL1 region to obtain total weekly expenditure per region. UK Tobacco Duty revenues for public sector finances statistics were apportioned to regions using total weekly expenditure per region.

As discussed earlier in this paper, there are concerns about the statistical robustness and reliability of estimates arising from the small sample size for the LCF Survey in Northern Ireland and in turn estimates of alcohol and tobacco revenue for Northern Ireland arising from such data. This is further highlighted by the significant revisions to the estimates for excise duties in Northern Ireland for 2018/19 as shown in Table 2 (14.5% of the total value for tobacco duties and 12.5% of the total value for alcohol duties). Significant revisions were also registered in prior years.

That being said, investigation by ONS into the data quality of the estimates of total expenditure and a smaller grouping of expenditure on Tobacco, Alcohol and Narcotics arising from the LCF in Northern Ireland and other regions of the UK found that in comparing Northern Ireland to other countries and regions it was not noticeable that Northern Ireland is subject to more variability when looking into the quality of the data. This may be due to the extent of underreporting issues being similar in Northern Ireland to other regions and does not override the fact that there are concerns over reliability, only that they are of as much concern for Northern Ireland estimates as for estimates in other countries or regions.

Fuel duties

UK revenues from ONS public sector finances statistics are split between petrol, diesel and other fuels based on proportions calculated from HMRC's historic receipts. HM Revenue and Customs' (HMRC's) Hydrocarbon Oils Duties bulletin[217] is the data source for historic receipts for petrol, diesel and other fuels.

Revenues are then apportioned to regions based on consumption. Department for Business, Energy and Industrial Strategy (BEIS) statistics on Road transport energy consumption at regional and local authority level[218] are used to capture consumption, and have been since 2005. The methodology for calculating fuel consumption combines traffic activity data with fleet composition data. With fuel consumption/emission factors also developed from two mapping datasets. For Northern Ireland a dataset of roads comes from Ordnance Survey of Northern Ireland, part of Land & Property Services Northern Ireland.

No significant data or methodology issues are identified as affecting estimated fuel duties for Northern Ireland. Table 2 shows that revisions for 2018/19 were small at under 0.5% of the total value. However, the issue of fuel tourism related to fuel consumption by Northern Ireland residents in the Republic of Ireland (and at times vice versa) is a separate issue that Northern Ireland faces in terms of its impact on fuel duty revenues that does not exist elsewhere in the UK. This issue will require additional analysis.

Stamp Duty Land Tax

The ONS CRPSF uses outturn data on Stamp Duty Land Tax from the HMRC published Stamp Duty Land Tax bulletin, which includes actual country and regional breakdown of receipts. It provides a split of revenue and transactions between UK regions (at ITL1 level) based on the location of the property being transacted.

Following the typical ONS apportionment approach, these statistics are used to calculate proportions, which are then applied to Public Sector Finances UK total values for Stamp Duty Land Tax receipts to calculate the country and regional values for CRPSF statistics.

It should be noted that the HMRC Stamp Duty Land Tax bulletin only provides data for England and NI and following devolution of Stamp Duty powers, both Scotland and Wales have their own data sources for Scottish Land and Buildings Transaction Tax and Land Transaction Tax respectively. From the FYE 2016 onwards, data for the Scottish Land and Buildings Transaction Tax has been obtained from Revenue Scotland, and from the FYE 2019 onwards, data for the Land Transaction Tax in Wales has been obtained from the Welsh Revenue Authority.

The fact that administrative data for Stamp Duty Land Tax revenues in Northern Ireland are already collected as part of the HMRC Stamp Duty Land Tax bulletin, means that there are no significant data or methodology issues with estimates of Stamp Duty Land Tax for Northern Ireland. No revisions were made to 2018/19 data. This means that should Northern Ireland wish to devolve this tax, a reliable estimate of revenues would be available in advance of any devolution.

Air passenger duty

Revenue data for air passenger duty comes from Public Sector Finances statistics. The ONS CRPSF statistics then use the published Civil Aviation Authority (CAA) data on total terminal passengers travelling from UK airports and the CAA's Departing Passenger Survey (which provides more granular data that indicates the number of passengers flying in each of the destination bands and classes of travel, as well as the number of exempt passengers) as the data sources for apportioning revenue data across countries and regions.

Data from these two sources is combined to provide estimates of the number of passengers across countries and regions by each destination band (based on their final destination) and ticket class. Estimated total passenger numbers by destination band and ticket class based on the data are then multiplied by the current air passenger duty rates to produce APD revenue estimates. These estimates are scaled to the UK total air passenger duty revenue estimate from the Public Sector Finances statistics.

The CAA Departing Passenger Survey only surveys a limited number of airports every year> Whilst both Belfast City and Belfast international Airports were included in the sample for the 2019 survey, prior to that they had not been included in a sample since 2006. Scottish airports are also typically only sampled every 5 years. For all countries and regions, data is interpolated by ONS to provide estimates for years that have not been sampled. This does raise some potential concerns as to the quality of the data for regions. However, the fact that this data is combined with CAA data on total terminal passengers, which does collect data from over 60 UK airports on a monthly basis, including both Belfast airports and City of Derry airport, means that the quality of data can be seen as fairly robust.

No significant data or methodology issues are identified as affecting estimates for air passenger duty in Northern Ireland. Table 2 shows that revisions for 2018/19 were small at under 1.3% of the total value. If Northern Ireland wished to devolve this tax then a recommendation would be that, prior to any devolution taking place, Northern Ireland airports are included on a more regular basis (ideally annually) in the CAA Departing Passenger Survey to reduce the need for interpolation of data.

Landfill tax

Data on the tonnages of waste landfilled in Northern Ireland is obtained from the Department of Agriculture, Environment and Rural Affairs (DAERA), which produces municipal waste management statistics, including data on landfill tonnage. Data used in this report is collected using 'WasteDataFlow', which is a web-based system for local authority collected municipal waste reporting. It is used by all UK local authorities.

Landfill tax revenue is then apportioned to English regions and Northern Ireland based on the estimated tax liability for each region. The liabilities for each region are derived by assigning each region's tonnages of waste to standard and reduced rates depending on its European Waste Catalogue (EWC) waste category and then aggregating waste tonnages by region to get total tonnage figures. These total tonnage figures are then multiplied by the tax rate per tonne to deduce total tax liabilities by region.

The method for apportioning revenue to Scotland and Wales is different given that they have both devolved powers over landfill tax. From the FYE 2016 onwards, outturn data for Scottish Landfill Tax, as collected by Revenue Scotland, is used for Scotland, and for the FYE 2019 onwards, outturn data for Landfill Disposals Tax, as collected by the Welsh Revenue Authority, is used for Wales.

No significant data or methodology issues are identified as affecting estimates for landfill tax in Northern Ireland. However, Table 2 does highlight significant revisions to the estimates for landfill tax in Northern Ireland, at 23% of total value, for 2018/19, though revisions were minimal in previous years. Therefore, should Northern Ireland wish to devolve this tax, a reliable estimate of revenues would be available in advance of any devolution.

B1.5 Key issues with other major taxes

National insurance contributions

The ONS CRPSF data source for national insurance contributions (NICs) comes from a regional (i.e. International Territorial Level (ITL) 1 regions) breakdown of Class 1 NICs from HM Revenue and Customs' (HMRC's) 1% sample of Pay As You Earn (PAYE) from the National Insurance Recording System (NIRS2), where data is available on a residential basis. However, some unknown and non-UK addresses are also pro-rated to ITL1 regions. Percentage breakdowns for each ITL1 region are calculated from the Class 1 NICs data and applied to the UK total of all NICs revenue.

The HMRC disaggregated tax receipts estimates sources NICs data for 2018-19 from HMRC's Real Time Information for Pay As You Earn (PAYE RTI) system. Tax years from 2014-15 to 2017-18 were revised in the latest publication to also use data sourced from RTI but for earlier years data from a 1% sample of Pay-As-You-Earn (PAYE) is still used. The RTI administrative system covers all employed individuals paid under PAYE rather than a sample.

As outlined in the Commission's Interim Report, 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. In order to apportion NICs values to NI, the postcode of each employee or self-employed individual is extracted from the PAYE RTI system to estimate the share of individuals who have paid NICs that reside in Great Britain and Northern Ireland. These shares are then rounded to the nearest percentage point and applied to UK wide NICs revenues to apportion them between the Great Britain and Northern Ireland National Insurance Funds. Thus, the apportionments are based on rough estimates of the NICs from Great Britain and Northern Ireland, rather than a precise calculation using the actual NICs paid on the earnings of specific employed and self-employed individuals. Table 2 further shows that revisions for 2018/19 were small at only 0.5% of the total value.

Value added tax

The ONS public sector finances VAT receipts estimates are based on a number of data sources. The most important source is the ONS expenditure analysis of the 'Living Costs and Food' (LCF) survey, which measures average weekly family spend on a range of items for England, Scotland, Northern Ireland and Wales. Also used is the 'Public Expenditure Statistical Analysis' (PESA), which covers the majority of government expenditure activity: ONS data on Gross Value Added (GVA); and population estimates from ONS, National Records Office for Scotland and Northern Ireland Statistics & Research Agency. Table 2 shows that revisions for 2018/19 were relatively small at 3.3% of the total value.

As discussed earlier in this paper, there are concerns about the statistical robustness and reliability of estimates, arising from the small sample size and low response rate for the LCF Survey in Northern Ireland as well as methodological issues which could then in turn impact on estimates of VAT receipts arising from such data.

Corporation Tax

The UK figure for total corporation tax is taken from the Public Finances Databank published by HM Treasury. North Sea corporation tax payments are deducted using data from HMRC published tables on corporation tax. The estimate of NI corporation tax excludes North Sea corporation tax. NI's share of UK corporation tax (excluding North Sea revenues) is taken to be its share of profits (less holding gains) of all public and private corporations in the UK. Information on profits (less holding gains) is directly supplied by ONS and comes from HMRC administrative data on corporation tax and data from the ONS Inter-Departmental Business Register (IDBR). A three-year average of 2016-17, 2017-18 and 2018-19 is used to estimate 2019-20 proportions for each region.

In efforts to ensure that regional shares of corporation tax are allocated correctly to the region, taxable profits are split into two categories, which are aligned with the different category income streams for corporation tax.

Category (i) includes overseas income, interest income, income from land and property, chargeable gains and gains on intangible assets. Category (ii) principally contains trading profit which makes up the vast majority of taxable profits.

All category (i) profits are allocated to the location of the registered office. Category (ii) profits are allocated to countries according to the sub-national split of enterprises' employment totals; however, if no information is available from the IDBR on the location of a company's employment, then the profits are allocated to the registered office location. Where employment data is available at the group level but not the enterprise level, then companies' category (ii) profits are allocated between the sub-

national areas in line with the rest of the group. Some research does suggest that this approach could underestimate the tax related to profits actually earned by branches of firms in Northern Ireland who have their head offices elsewhere in the UK.[219]

Data from the IDBR on local employment for enterprises is extracted and aggregated for each IDBR 'enterprise'. The proportion of each enterprise's employment that is in each of the four countries is calculated. This enterprise-level data is then joined to the company-level data from HMRC's corporation tax administrative system (COTAX) using the company registration number. Each IDBR enterprise may match to one or more companies, while each company matches to only one enterprise. The corporation tax data is taken from data on corporation tax assessments, returns and designatory data from COTAX, the commercial accounts database Financial Analysis Made Easy ('FAME') and postcode geographies. If all employment is based in a single sub-national area, then all category (ii) profits are allocated to the location of the registered office.

Country of Ownership split by Northern Ireland and Great Britain has been available since 2013. In 2020, close to 800 enterprises operating in Northern Ireland, or around 1% of the total, had a Great Britain ownership. These enterprises accounted for circa 10% of total employment in Northern Ireland.

Table 2 shows that revisions for 2018/19 were greater at 6.5% of the total value than for other substantial taxes such as income tax, NICS, VAT or fuel duties.

B1.6 What were the views of the previous Commissions in Scotland and Wales on the availability and robustness of data capturing the tax base?

It is important to highlight that the sources of UK country and regional tax data that we have discussed here were not available at the time that the Calman, Holtham or Silk Commissions, established in Scotland and Wales to examine the case for fiscal devolution, were undertaking their work. The HMRC Disaggregated Tax receipts between England, Scotland, Wales and Northern Ireland publication was first published in 2013. It was not then until 2017 that the ONS CRPSF statistics were first published. In this context, it is perhaps unsurprising that the previous Commissions did not consider the reliability of tax data in any great detail. Nevertheless, it is notable that despite not having the extensivity of data which are currently available, the comparative Commissions in Scotland and Wales worked on the assumption that data issues were surmountable and so did not conclude that data issues were such that they would render fiscal devolution infeasible.

It is nevertheless worth pointing out that despite not devoting detailed attention to these issues, the Calman, Holtham and Silk Commissions did raise concern over the availability of tax data at a regional level. Calman (2008) noted that that most Scottish tax receipts were not separately identified with some taxes such as Corporation Tax being especially difficult to define. It noted *"Major challenges of estimation are involved, and the breakdown of tax revenues in GERS shows the difficulties involved."*

Holtham (2010) included a recommendation concerning improved statistics, though this was more focused on expenditure rather than revenue[lxxvii] and recommended that UK national accounts should include a 'provincial' tier of government spending.

Silk (2012) similarly recommended that the ONS UK accounts should include a 'sub-national' tier of government spending. It also expanded further to recommend "*that figures on the amount of tax collected in Wales should be produced. Such figures should also include estimates of the Welsh fiscal balance. This country and regional analysis should be done on a consistent basis across the United Kingdom.*"

More recently, under the Scotland Act 2016, the UK Government agreed to assign the first 10p of the standard rate of VAT (20%) and the first 2.5p of the reduced rate of VAT (5%) raised in Scotland to the Scottish Government. However this assignment of Scottish VAT revenues to the Scottish budget has been delayed. This delay has been due to challenges around reliably estimating Scotland's share of VAT estimates based on the data currently available (e.g. from the LCF). A Scottish VAT assignment model has been jointly developed by HM Revenue and Customs, the Scottish Government and HM Treasury, however this model has not yet been finalised or fully agreed. In October 2020 the UK and Scottish Government agreed that a new implementation date will be established as part of the review of the Scottish Government's Fiscal Framework.[220]

The development by ONS of the CRSPF statistics and its publication from 2017 onwards has addressed in part the recommendations made by the Holtham and Silk Commissions in terms of additional tax revenue and public spending data being available at country and regional level within the UK. However, as detailed in this paper, there still remains potential to further improve the suitability of the ONS statistics being used to estimate the fiscal base at a regional level, given the limitations of the data available and the methods of apportionment currently in place.

B1.7 What are the possible solutions to improving the reliability of tax estimates for Northern Ireland?

When considering what possible solutions could be put in place to improve the reliability of tax estimates for Northern Ireland, it is important to understand the difference between:

i) What is possible to achieve prior to any decision regarding devolution of further fiscal powers, i.e. ensuring the most robust data and thus estimates of revenue are available, which would then help inform any decisions regarding any devolution;

ii) What can be done once a decision to devolve a tax has been made, but before devolution has happened, to ensure there are no major surprises or issues post devolution; and

iii) What would be possible (or even a requirement) after devolution has taken place, this could include how any outturn data is published.

In general, one of the most effective changes that would improve the reliability of estimates would be to make more use of administrative data, where possible.

[lxxvii] The recommendation was that "the Assembly Government should seek modification of the UK's national accounts to include a "provincial" tier of government spending. This reform would ensure that official statistics reflect the reality of devolved government and would help clarify the distinction between expenditure by UK Government departments and by the devolved administrations."

However, this would not be easy to achieve for a number of taxes and could also require an additional burden to be placed on business. For example, it would require VAT returns or Company Tax Returns (used to calculate Corporation Tax) that are provided to HMRC to include regional breakdowns. Therefore, the feasibility of doing this remains questionable and may not be feasible until after devolution takes place, given the additional costs and additional burden it would place on business. ONS are currently looking to improve their collaboration with HMRC in regards to developing secure methods for sharing and using existing administrative data.

Making more use of administrative data may be more feasible for Income Tax – Scottish income tax estimates are now based on administrative outturn data from HMRC's Scottish Income Tax Outturn Statistics and this is an approach that could be replicated in Northern Ireland if Income Tax was to be considered suitable for devolution. However, it should be noted that there are still issues with the data for Scottish Income Tax. There is a long lag to the data and HMRC’s Pay as You Earn (PAYE) Real Time Information (RTI) does not provide good predictions for the Scottish Income Tax Outturn Statistics for reasons that are still unclear. This means that there are challenges in developing an up to date estimate for Scottish income tax prior to the official Outturn Statistics being published. These same issues would also be applicable in the case of income tax being devolved in any form to Northern Ireland. There would also be significant costs in collecting administrative data, so this would likely only be feasible to do after a firm decision has been made to devolve.

Furthermore, embedding administrative data into the production of regional statistics would likely take some time, and to some extent would probably still need to be augmented with specific survey information. Therefore, when administrative data is not readily available, action needs to be taken to ensure a high level of accuracy and reliability of survey data. This would require efforts to improve both data processing and the size of the sample in any existing surveys currently used, in order to ensure larger sample sizes at smaller geographical levels, for example UK ITL1 regions. As highlighted previously, much of the data used for CRPSF estimates does come from administrative sources - either being based on samples of administrative data (e.g. Income tax, national insurance contributions), using existing outturn data from another source (e.g. Stamp duty land tax and data from the Stamp duty land tax bulletin) or directly using outturn data from ONS Public sector finance statistics without the need for any apportionment method (i.e. domestic & non-domestic rates; vehicle excise duties; and VAT refunds).

Given the potential issues with obtaining further administrative data, an alternative is to look at how improvements could be made to the survey data that is currently used, either prior to the decision on devolution being made or at least prior to the devolution actually occurring. New and/or existing surveys should be designed to take account of the need for more robust regional statistics.

However, given the potentially high costs involved in sampling at a regional level, exactly how this should be done would depend on a relative assessment of the costs and whether a boosted sample would fully resolve the issues. For example, in the case of LCF survey and issues with it in terms of underreporting of expenditures, further resources would be required to improve data accuracy and ensure that data captured is of sufficiently high quality. Therefore, improving the quality of survey data is something that could be carried out prior to any decisions regarding further devolution, if it could be demonstrated that the additional costs would bring about enough of a benefit in the estimates to make incurring them worthwhile.

ONS have noted to the Commission that they are already considering some potential improvements to help the reliability of data. Some ideas are at an early stage of development, for example, using more timely administrative data for VAT or Corporation Tax and exploring the use of HMRC administrative PAYE data for Income Tax. Other ideas might be more readily achievable, for example, ONS are currently investigating the suitability of using population estimates based on the Labour Force Survey (LFS) for the number of households, rather than relying on the outputs of the LCF survey.

An example of attempts to improve survey data can be found in the ongoing work being carried out by the UK and Scottish governments to better estimate VAT revenues for Scotland, following the agreement to assign approximately half of VAT revenue raised in Scotland to the Scottish budget. The Scottish and UK governments and HMRC have together developed a VAT assignment model for Scotland and the LCF survey remains a primary data source. However, this has proved to be a difficult exercise and no methodology has been agreed upon after several years of work. Even the boosting of survey sample sizes has not been a sufficient solution. A particular issue here is that assigning VAT revenue to Scotland rather than actually devolving VAT powers in some form means that placing the additional burden of extra paperwork or administration onto business is not cost-effective. These same issues would also be applicable for Northern Ireland if VAT was to be potentially devolved in any form, meaning the lack of a reliable VAT estimate could be seen as a similarly major obstacle for assigning VAT revenues to Northern Ireland.

ONS have indicated that if more NI-specific source data were to be made available, such as outturn tax receipts in NI, then this would be welcomed by them. ONS would then be able to include any such NI-specific source data in the regional breakdown of Public Sector Finances (PSF). A precedent already exists in this manner, whereby various tax receipts, i.e. of taxes devolved to Scotland, are published by the Scottish Government and are then used as source data within both GERS and the ONS Country & Regional PSF publication. ONS are of the view that GERS as a national statistic is an authoritative and referenceable source of regional data.

This then raises the question as to whether developing something similar to GERS for Northern Ireland would be of value. In fact, between 2006-07 and 2013-14, the Department of Finance produced a publication, the Northern Ireland Net Fiscal Balance Report, which largely mirrored GERS and CRPSF. However, the Northern Ireland Net Fiscal Balance Report was discontinued on the basis that when the CRPSF began publication there was no added value from replicating its work.

At this stage, the Commission's view is that nothing has changed in this regard and there is no justification for restarting such a publication. However, should further fiscal devolution take place and new outturn data become available then perhaps there may be a case. An alternative would be to work with ONS to make sure that any new outturn data for Northern Ireland becomes fully incorporated into the CRPSF methodology to increase reliability and robustness of Northern Ireland estimates for any devolved tax.

The UK Government's February 2022 White paper "Levelling up the United Kingdom"[221] considers the importance of having robust regional or subnational data throughout the UK, including on public sector finances. The Government Statistical Service's (GSS) Subnational Data Strategy was published in December 2021 with similar ambitions. It remains to be seen if these strategies will lead to improvements in regional data over time.

In short, it is important to be aware that any assessment of NI tax estimates made before any further devolution of powers will perhaps inevitably involve some form of modelling or estimation. Using Scotland as an example, further devolution of tax powers may itself help to address the availability of useful source data at the NI level, but also has its own issues, such as data lags.

A further avenue to explore would be for representatives from relevant NI Executive departments to consider gaining membership to the ONS Country and Regional Public Sector Finance peer review group or the Sub-UK Public Sector Finances Working Group. Participation in these groups would provide an opportunity to be involved in the quality assurance of outputs prior to publication. It could also provide an avenue to raise concerns and potentially widen the collective understanding of the available data on tax estimates. ONS are also currently developing a new Statistical Business Register and it may be useful for NI representatives to engage with ONS to understand if it could play a role in collecting additional tax data from businesses.

B1.8 What are the key takeaways in the context of the Commission's work?

The ONS CRPSF statistics publication is now the central source for capturing regional tax receipt data across all of the UK. This has addressed, at least in part, the recommendations made by the Holtham and Silk Commissions in terms of additional data being available at country and regional level within the UK. However, there remains the potential to improve the suitability of the ONS statistics being used to estimate the fiscal base at a regional level, given the limitations of the data available and the methods of apportionment currently in place.

This paper helps to demonstrate some of the limitations of the data captured on taxes that could potentially be devolved to Northern Ireland and highlights the specific issues across different taxes.

Tax data reliability – Recommendation 1

It is the Commission's view that if Northern Ireland wishes to pursue further fiscal devolution then it would be prudent to consider, at the earliest possible opportunity, what steps or actions could be taken to improve the data reliability for the taxes it wishes to pursue. This should include consideration of whether data issues are so insurmountable that they become an impediment to devolution altogether (as seen with VAT assignment in Scotland).

We recommend that the NI Executive should work with ONS, HMRC and NISRA to improve data on tax receipts in Northern Ireland.

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

The NI Executive should look to collect, where reasonably possible, administrative/outturn data for any tax that is to be devolved in the years prior to devolution taking place. This should help to provide more reliable estimates of the tax prior to devolution and more accurate costs post devolution.

Annex C

Breakdown of Northern Ireland financial packages

C1.0 Overview

The Commission has commissioned DoF to provide further details of the funding levels that the Executive expected to receive via various financial packages in recent years and how much was actually drawn down in the Executive's Budget.

The links and tables below were provided by DoF Public Spending Directorate (PSD) in response to the Commission's request.

C1.1 Links to details of financial packages

Stormont House Agreement

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/390673/Stormont_House_Agreement_Financial_Annex.pdf

Fresh Start Agreement

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/479116/A_Fresh_Start_-_The_Stormont_Agreement_and_Implementation_Plan_-_Final_Version_20_Nov_2015_for_PDF.pdf

Confidence and Supply Agreement

https://www.gov.uk/government/publications/conservative-and-dup-agreement-and-uk-government-financial-support-for-northern-ireland/uk-government-financial-support-for-northern-ireland

New Decade New Approach

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/856998/2020-01-08_a_new_decade__a_new_approach.pdf

DoF briefing note at the time

https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/Briefing%20note%20-%20financial%20package%20LATEST.pdf

Parliament publication

https://publications.parliament.uk/pa/cm5801/cmselect/cmniaf/160/16006.htm

C1.2 Financial Packages – Additional funding initial profiles

Table C1 Stormont House Agreement

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Dealing with the Past	30.0	30.0	30.0	30.0	30.0					
Shared Education	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Total Additional Funding	**80.0**	**80.0**	**80.0**	**80.0**	**80.0**	**50.0**	**50.0**	**50.0**	**50.0**	**50.0**

Table C2 Fresh Start

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Welfare Reform - Fraud and Error		25.0	25.0	25.0	25.0	25.0				
Tackling Paramilitary Activity		5.0	5.0	5.0	5.0	5.0				
Shared Future		12.0	12.0	12.0	12.0	12.0				
Total		**42.0**	**42.0**	**42.0**	**42.0**	**42.0**				

Table C3 Confidence and Supply

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Health and Education				50.0	50.0					
Health Transformation				100.0	100.0					
Mental Health				10.0	10.0	10.0	10.0	10.0		
Infrastructure				200.0	200.0					
Broadband				75.0	75.0					
Severe Deprivation				20.0	20.0	20.0	20.0	20.0		
Total				**455.0**	**455.0**	**30.0**	**30.0**	**30.0**		

Table C4 New Decade New Approach

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Immediate Budget Pressures						350.0				
Delivering pay parity for nurses					30.0	85.0	85.0			
Transformation Funding						44.0	49.0	49.0	49.0	49.0
Graduate medical school in Derry/Londonderry*						15.0	15.0	20.0	5.0	5.0
Ultra-low emission transport						25.0	25.0			
Total					**30.0**	**519.0**	**174.0**	**69.0**	**54.0**	**54.0**

**Includes £45m of Capital for IFF*

Table C5 City Deals

£m	Total
Belfast Regional City Deal	350.0
Derry and Strabane*	105.0
Mid and South West Growth	126.0
Causeway Coast and Glens	36.0
Total	**617.0**

**Includes £55m IFF*

Table C6 Northern Ireland Protocol Funding

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
NI Protocol Implementation						30.3	35.6			
Total						**30.3**	**35.6**			

C1.3 Financial Packages – Actual drawdown figures

Table C7 Stormont House Agreement

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Dealing with the Past						
Shared Education		2.6	6.1	10.9	13.4	26.5
Total Additional Funding		**2.6**	**6.1**	**10.9**	**13.4**	**26.5**

Table C8 Fresh Start

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare Reform - Fraud and Error		25.0	25.0	25.0	25.0	25.0
Tackling Paramilitary Activity		1.9	3.2	4.7	5.8	8.7
Shared Future		11.4	10.6	12.0	12.0	11.4
Total		**38.3**	**38.8**	**41.7**	**42.8**	**45.1**

Table C9 Confidence and Supply

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Health and Education			20.0	80.0		
Health Transformation				100.0	100.0	
Mental Health				10.0	10.0	10.0
Infrastructure				200.0	200.0	
Broadband						21.1
Severe Deprivation				20.0	20.0	19.5
Total			**20.0**	**410.0**	**330.0**	**50.6**

Table C10 New Decade New Approach

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Immediate Budget Pressures						350.0
Delivering pay parity for nurses					30.0	85.0
Transformation Funding						44.0
Graduate medical school in Derry/Londonderry*						
Ultra-low emission transport						25.0
Total					**30.0**	**504.0**

Table C11 City Deals

£m	Total
Belfast Regional City Deal	20.0
Derry and Strabane*	
Mid and South West Growth	
Causeway Coast and Glens	
Total	**20.0**

*Includes £55m IFF

Table C12 Northern Ireland Protocol Funding

£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
NI Protocol Implementation						22.5
Total						**22.5**

Source: DoF PSD

Annex D

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

D1.0 Overview

The imprecise term **'super parity'** is often used in Northern Ireland's policy circles to describe policy divergence in respect of policies which confer an element of benefit or differentiation with the wider UK population (most often England). This differentiation generally comes from reduced costs and charges for local citizens and businesses, which have a resultant public expenditure impact.[lxxviii] In other words, there are a number of specific examples of policy divergence where Northern Ireland could raise additional revenue or reduce expenditure if policies matched other parts of the UK. It is not for the Fiscal Commission to judge on the merits or otherwise of these policy choices. That is a political decision.

This annex highlights a number of the 'super-parity' and 'sub-parity' measures (those instances where provision is greater in other locations of the UK than Northern Ireland). These measures have already been identified in Section 2.12 of our report, this annex provides a more detailed overview of each example of policy divergence, as understood by the Commission.

D1.1 Overview of 'super-parity' measures

In order to understand the extent of the various exemptions and mitigations in place relating to existing policies; the Commission requested, through the Department of Finance, that all Northern Ireland Executive departments provide an overview of areas of policy divergence ('super-parity') and their associated costs within their departmental remit. The information that follows in this annex is based on the information returns provided by each department.

Table D1 provides an overview of the responses received by each department. It shows that the total estimated cost of policy divergence, and all various relief and exemption measures provided is estimated to be between **£600m to £700m** or approximately 3.8-4.2% of the total annual DEL budget available to the NI Executive. Measures provided by Departments which implied a cost of less than £1m have not been included.

Table D1 Super-parity measures identified by NI Executive departments, Summer 2021, £million

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

[lxxviii] The HM Treasury statement of funding policy document states "devolved administrations will generally need to fund any costs that are above a population share of the costs of a UK government programme".

Housing Benefit Rates	In 2013/14 the UK Government decided that Housing Benefit Rates should be moved from the AME budget to the DEL budget and applied a cut of 10%. Executive continues to 'compensate' for this cut each year	£12m
Department for Economy		
University Tuition Fees*	Northern Ireland has not introduced higher tuition fees for students as seen in England. Currently DfE provides funding directly to Northern Ireland universities from the block grant to help subsidise part of the cost.	£14.2m to £90.5m
Department of Finance		
Industrial De-Rating**	Properties which are occupied and used for manufacturing purposes receive 70% reduction in their rates bill.	£59m
Low Income Rate Relief**	A supplement to Housing Benefit to help with rates charges	£6.6m
Vacant land rate relief**	In general, once a non-domestic property becomes vacant, it will receive 100% exemption for the first three months, after that it will then only have to pay 50% of the occupied rates liability.	£35m
Freight/transport rate relief**	Properties occupied for the purpose of freight transport receive 75% rates relief.	£2.2m
Landlords Allowance**	10% allowance for landlords who make lump sum payments for several properties at the same time.	£13m
Department of Health		
Prescription Charges	The NI Executive abolished all prescription charges in Northern Ireland in April 2010.	£20m
Domiciliary Care Charges	Domiciliary care is provided free of charge in Northern Ireland.	£17.8m to £32.5m
Department for Infrastructure		
Concessionary Fares	The Northern Ireland Concessionary Fares Scheme (NICFS) offers free bus and rail travel for Northern Ireland residents aged between 60 and 64.	£29.2m
Domestic Water Charges	The Executive has extended the power for DfI to pay a subsidy to NI Water in lieu of domestic water charging since 2007. Water charges are currently in place elsewhere in the UK where it is either added to a property's Council tax bill or charged on a usage basis.	£344.5m
Non Departmental measures		
Air Passenger Duty	Long-haul Air Passenger Duty has been devolved since January 2013 and since then there has been a zero-rate policy in place for long-haul flights from Northern Ireland.	£2.3m
Total Super Parity measures		**£599m to £690m**

Source: Commission calculations from Northern Ireland Departmental returns via Department of Finance, Summer 2021
Note: Minor measures under the value of £1m are not included in table above. Figures provided in Summer 2021 but do not necessarily correspond to figures for that year but the latest available.

** The issue of fee funding and replacing grant funding with increased loans involves many nuances and DfE have indicated to the Commission that significant analysis would be required to arrive at exact estimates. The estimates presented here reflect whether or not the additional costs associated with the write offs of loans would be met by the UK Treasury or would be met by the NI Executive from its own DEL Budget.*
*** For a number of rating reliefs, revenue foregone is split between the NI Executive and the district councils, therefore not all additional revenue raised by removing these reliefs would go to the NI Executive.*

D1.2 Breakdown of 'super parity' measures by Department

In addition to the high level summary provided in Table D1 above, a more detailed outline of each super-parity measure as identified by each NI Executive department is provided below.

Department for Communities (DfC)

Existing welfare mitigations - As part of the 2015 Stormont Fresh Start Agreement and its Implementation Plan, the NI Executive agreed to put in place schemes to mitigate against some of the impacts of welfare reforms (including Universal Credit, the benefit cap and the 'bedroom tax') introduced elsewhere in the UK. The welfare mitigation schemes came to a statutory end on 31 March 2020 in accordance with the relevant legislation. But under the New Decade New Approach agreement the mitigation schemes were extended, and payments are now being made under the sole authority of the relevant Budget Act, pending the approval of new legislation by the NI Assembly. The schemes introduced 'top-up' the UK welfare arrangements in Northern Ireland. *The cost of this measure is estimated by DfC at £42.8m per annum.*

Housing benefit rates - In 2013/14 the UK Government decided that Housing Benefit Rates should be moved from the Annually Managed Expenditure budget to the Departmental Expenditure Limited budget and applied a cut of 10%. The Executive has continued to 'compensate' for this cut each year with DfC allocated a ring-fenced budget based on forecast spend each year. *The cost of this measure is estimated by DfC at £12m per annum.*

Department for the Economy (DfE)

Increased University Tuition Fees – As in some other devolved administrations, Northern Ireland has not introduced higher tuition fees for students undertaking full time undergraduate programmes as seen in England where students are charged up to £9,250 per annum. Instead, Northern Ireland students are charged £4,530 per annum.

Currently DfE provides funding directly to Northern Ireland universities from the NI block grant to help subsidise part of the cost gap, with the universities making up the remaining shortfall. If tuition fees were increased to a level similar to England, then additional funding *could* be made available directly to the universities (from students) and the amount paid to universities from the NI block grant *could* be reduced. DfE indicates, however, that simply increasing tuition fees will not necessarily directly lead to increased revenues for the NI Executive. The issue of fee funding and replacing grant funding with increased loans involves many nuances and DfE have indicated that significant analysis would be required to arrive at exact estimates. There are particular aspects that need to be considered, including: the cost of issuing loans; the cost associated with the future write offs of loans; and, from a budgetary perspective, the fact that the cost associated with the write off of loans may be charged to the NI Executive's Resource DEL if it exceeded the ring-fenced DEL Budget. In other words, the range estimated here reflects whether this would be met by the UK Treasury or require the Executive to meet this from its own DEL Budget.

Therefore DfE estimates on potential revenue raising amounts are presented as a minimum and maximum range depending if full additional write offs are met. *Increasing tuition fees to a level similar*

to England has the potential to raise revenue of between £14.2m to £90.5m per annum, based DfE estimated figures provided in October 2021. DfE also presented an example of further analysis to the Economy Committee in January 2022 where it highlighted that raising tuition fees by 59% to about £7,200 a year (rather than raising to the full £9,250) - could raise revenue of £63m.[222]

Department of Finance (DoF)

Rates are the main revenue raising power available to the NI Executive. Rates are collected by the DoF Land & Property Services on behalf of the Executive and the 11 Councils. The revenue raised is then allocated between Councils and the Executive, with approx. 55% going to the Executive, and 45% going to the Councils.

Given that a number of domestic and non-domestic reliefs and exemptions are in place within the rating system, the removal of these would raise additional revenue. However, revenue forgone as a result of reliefs/exemptions is not split evenly between the Executive and the 11 Councils. Some are paid for exclusively by the Executive with Councils also paying for some of the rate support provided to ratepayers, which acts a loss to their tax-base.

Additionally, the Executive (via DfC) compensates District Councils for loss to their tax base incurred from central government policies associated with, for example, Industrial Derating, Sport and Recreation relief, and Freight Transport Relief i.e. the Derating Grant, (DoF estimate is £31m). Some 'poorer' Councils also receive an additional Rate Support Grant from DfC (estimated at £22.3m. There is also a Transfer of Function Grant, which is worth £5.8m.

An overview of each of the rate reliefs, either non-domestic or domestic as identified by DoF as super parity measures is provided below.[lxxix]

Industrial Derating - Businesses are taxed on non-domestic rates in Northern Ireland, however a significant rate support scheme is 'Industrial Derating' which is only available in Northern Ireland. It was introduced in 1929 for properties which are occupied and used for manufacturing purposes. The policy was retained in its current form for so long as it was treated as a pre-accession aid under the EU State aid framework. This meant that the Executive could retain the policy in its fixed form, but could not provide the support in a re-targeted fashion (i.e. to incentivise Research and Development work). Phasing out Industrial Derating completely by 2011 was considered, but following a further review of rating policy it was instead decided to cap liability at the current level of 30%. *The cost of this super-parity measure is estimated by DoF at £59 million per annum (after the cost of the DfC derating grant is factored in).*

Vacant rate relief - In general, once a non-domestic property becomes vacant, it will receive 100% exemption for the first three months of that vacant period. After this period has elapsed, the property owner will only have to pay 50% of the occupied rates liability. This compares to a situation in GB where the owners of a vacant property incur the full 100% liability (90% in Scotland). Vacant property rating relief represents a loss to both district and regional rate revenue raised. This relief was significantly impacted by the pandemic. *The potential revenue that could be raised by removing this relief is estimated by DoF at £35m per annum using 2020/21 figures.* The 2020/21 figure was slightly lower than usual due to the pandemic (associated with lockdowns and low level of property 'occupancy churn'). For comparison, the cost in 2019/20 was £38 million. This revenue foregone is split as a loss to the tax base between the Executive and Councils.

Freight transport rate relief - properties occupied for the purpose of freight transport receive 75% relief from rates. Its aim is to encourage lower freight charges and is intended to benefit exporting

[lxxix] It should also be noted that the removal of any of these reliefs/exemptions will result in an element of non-payment, with debt and additional collection and recovery costs incurred, and therefore they slightly overstate the actual revenue loss.

firms as Northern Ireland is on the periphery of Europe, which it is argued, results in higher transport costs when trying to access the main European markets. *The potential revenue that could be raised by removing this relief is limited, with the cost estimated by DoF at £2.2m per annum.* There is no loss to the Councils in relation to this measure (as the loss, to Councils is subsided through the DfC derating grant).

Low-income rate relief (***LIRR)*** – DoF have also noted that Low Income Rate Relief as a supplement to Housing Benefit is a form of domestic relief available in Northern Ireland that is not available in England. This is separate from the DfC scheme. *The total cost this relief is estimated by DoF at £6.6m per annum using 2020/21 figures.*

Landlord allowance - this 10% allowance is awarded to landlords who make lump sum payments for several properties at once, reducing administration costs in LPS. *This allowance is estimated by DoF to cost £13m per annum.* This cost is split between the Executive and Councils.

Department of Health

Prescription charges are an example where charges previously existed however, in this case, the Executive abolished all prescription charges in Northern Ireland in April 2010. Prescription charges have also been abolished in Scotland (since 2011) and Wales (since 2007) whilst charges are in place in England. *DoH estimate that reintroducing this measure could help generate up to £20m per annum.*

The exact value of any revenue raised would however depend on the final charging model arrived at, the amount charged per prescription and the number of people exempted from charges (as is the case in England or similar to medical charges in RoI). Before they were dropped in Northern Ireland, prescription charges generated around £13m (in 2007)[223]. Furthermore, DoH have also indicated that robust modelling is required to fully develop and assess options for charging to estimate the respective levels of income. Administrative charges, for the preferred model would also have to be offset against any income generated. Taking account of the preferred model and new IT systems development for the administration and implementation could take up to 12-18 months following any decision (by Minister with Executive agreement) to re-introduce prescription charges. Savings would not likely to start to be realised until at least 2023-24. It should be noted that the potential for fraud and the cost of counter-fraud arrangements could also outweigh or reduce the financial benefits.

Domiciliary care is provided free of charge in Northern Ireland and the total cost is around £299 million per year. Charging for services is an accepted part of community care provision in England and Wales including for domiciliary Care. However, there is significant variability in the charging regimes for domiciliary care. People in Scotland aged over 65 can receive free personal care if they have been assessed by their local authority as needing it. The Scottish Government is also currently looking into the removal of charging for non-residential social care support. Charging for a proportion of the costs of domiciliary care and day care (and the associated transport costs) could be introduced in Northern Ireland, as could an increase in the charge levied by Trusts for community meals, as both are currently heavily subsidised. *The potential revenue that could be raised by introducing a charge for domiciliary care on a means tested basis is estimated by DoH to be between £17.8m and £32.5m annually depending on the amount charged.*

Department for Infrastructure (DfI)

Concessionary fares – Since 2008 the Northern Ireland Concessionary Fares Scheme (NICFS) has offered free bus and rail travel to all Northern Ireland residents aged 60 and above. In England, by contrast, the English National Concessionary Travel Scheme (ENCTS) offers free bus travel only to those who have attained the State Pension age (currently 66), although some English local authorities (notably London and Liverpool) have set a qualifying age of 60. In Scotland and Wales, the qualification age for concessionary travel is also 60 years old (It should be noted that Northern Ireland only gives a half fare concession to people with a disability rather than full fare as is the case elsewhere). *The cost of this measure is estimated by DfI at £29.2m per annum.* This includes free transport on buses to those aged 60 to 67 (worth £13.2m per annum) and given that under the Northern Ireland Scheme a concessionary fare can also be obtained on trains, which equates to approximately £16m per annum unlike in GB.

Domestic water charges - Water supply and sewerage is in the public sector in Northern Ireland, delivered through the public corporation NI Water. The company does not charge domestic customers for its services, unlike the private sector water suppliers in England, the not-for-profit supplier in Wales and the publicly-owned supplier in Scotland. The issue of introducing ***water charges*** in Northern Ireland has been debated heavily since the restoration of devolution in 2007.

The NI Executive has extended the power for DfI to provide a budget to NI Water since 2007. Water charges are currently in place elsewhere in the UK where it is either added to a property's Council tax bill or charged on a usage basis. *The current cost to the Executive of not charging is estimated by DfI to be c£215m capital DEL and c£129.5m resource DEL based on 2021-22 allocations.* Any designs as to how much a change in policy on water charges would affect the Executive's finances is uncertain and would need further examination, e.g. regarding level of charges and potential exemptions from charges.

Non-Departmental Measures

Another measure in Northern Ireland, and one that is not department-specific concerns ***Long-Haul Air Passenger Duty*** which has been devolved since January 2013 and since then there has been a zero-rate policy in place. This policy has resulted in an adjustment to the block grant to compensate the UK Government for tax receipts forgone as a result of devolution. *The cost of this measure is estimated by DoF at £2.3m per annum (though this cost is now expected to reduce due to the impact of COVID-19 on long-haul flights).*

Sub-parity measures

There are also **'sub-parity'** policies, where provision is less generous in Northern Ireland than in other parts of the UK, although there are relatively fewer examples of this. Two such examples are ***childcare support*** and, arguably to a lesser degree, ***apprenticeships***.

In terms of childcare support England offers 30 hours per week of free childcare to eligible working parents of three and four year olds. The same provision is not available in Northern Ireland despite costs being estimated as the second highest amongst 24 European countries reviewed in 2019[224]. Instead in Northern Ireland, rather than subsidised childcare, parents of three- and four-year-olds in Northern Ireland can apply for 12½ hours per week of free preschool education. This is only available over 2½ hours per day, 5 days a week, during term time.

The UK-wide apprenticeship levy was announced by the UK Government in summer 2015. It operates on a UK-wide basis and applies to all employers in Northern Ireland as it does across the UK. Those

with a pay bill of over £3 million (including government departments), contribute to the levy. However, although Northern Ireland businesses pay the same levy, they are unable to access apprentices through government vouchers in the same way. The NI Executive does, however, receive a Barnett consequential as a result of UK government spending on apprenticeships in England. Businesses in Northern Ireland that pay the levy, as well as business representative organisations, have described this lack of provision as inhibiting growth plans and diminishing productivity levels.[225]

Annex E

Tax rates in the United Kingdom versus Republic of Ireland

Table E1: Tax Rates UK (including Northern Ireland) v RoI (2021-22)

Taxes	UK rates	RoI rates
Income tax	**20% basic rate** (£12,571 to £50,270) **40% higher rate** (£50,271 to £150,000) **45% additional rate** (£150,000+)[226] The standard Personal Allowance in the UK is £12,570, where tax is not paid on income below that amount.	**20% lower rate and 40% higher rate.**[227] Single and widowed person: no dependent children- up to €36,800@20%, balance @ 40% Single and widowed person, qualifying for single person child carer credit : up to €40,800 @20%, balance @ 40% Married couple: one income - up to €45,800 @20%, balance @ 40% - under joint assessment married couples are chargeable to tax on their combined total income[228]. Married couple: two incomes - up to €45,800 with an increase of €27,800 max[lxxx], @20%, balance @ 40% **RoI operates a system of tax credits** that are used to reduce the amount of tax owed. In effect this system means that means that anyone earning €17,000 or less does not pay any income tax because the tax credits will be more than or equal to the amount of tax due.[229]

[lxxx] For 2022 the standard (20%) rate band for couples in a marriage or civil partnership is €45,800. If both people are working it is increased by the lower amount of either: €27,800 or the income of the lower earner. This means that the maximum standard rate band a couple can have is €73,600 (€45,800 + €27,800). It is not possible for one person to use the full amount of €73,600.

		There is an additional tax on income in ROI –the **Universal Social Charge (USC)** - From 2022 - For income of €13,001 or more: First €12,012 - 0.5%; Next €9,283 - 2%; Next €48,749 - 4.5%; remainder - 8%; Self-employed income over €100,000 – 11% [230]
National Insurance contributions	**From April 2022, Employers contribution – 15.05%** on earnings above £175.01 per week. **From April 2022, Employees contribution – 13.25%** rate on earnings between £190.01 (from July 2022, £242.01) and £967 per week and 3.25% on earnings above £967 per week.[231] 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 if profits are £6,515 or more a year [232]. The Health and Social Care Levy Bill will provide for a temporary 1.25 percentage point increase to both the main and additional rates of employer Class 1, employee Class 1, Class 1A, Class 1B and Class 4 National Insurance contributions for the 2022 to 2023 tax year (i.e. to the rates outlined above). From 6th April 2023 onwards, the National Insurance contributions rates will decrease back to 2021 to 2022 tax year levels and will be replaced by a new 1.25% Health and Social Care Levy.[233]	Pay Related Social Insurance (PRSI) – typically **4% employee contribution.**[234] **Employers then pay 8.8%** Class A employer PRSI on weekly earnings up to €410 or pay 11.05% Class A employer PRSI on weekly earnings over €410. [235]
Value added tax	**Standard rate – 20%;** Reduced rate – 5%; Zero rate for certain goods, e.g. children's clothes/food[236]	From 1 January 2022- **Standard rate - 23%;** Reduced rate -13.5%; Second reduced rate – 9%[237] [238] The reduced rate for tourism and hospitality from 13.5% to 9% remains in place until the end of August 2022.[239]
Corporation tax	Currently **19% but will rise to 25%** by April 2023 (with an exception for smaller businesses to stay at the 19% rate)[240]	**12.5%** for trading income. 25% for non-trading or excepted trade[241] From 2023 12.5% up to €750m turnover; 15% over €750m in line with OECD tax agreement.[242]
Fuel duty	**57.95 pence** per litre for petrol/diesel with a 5p deduction for 12 months from 23 March 2022 meaning rates for	From 13 October 2021, **63.7c per litre** of petrol and **53.5c per litre** of diesel.[244]

	petrol/diesel will be **52.95 pence** per litre for 2022-23. [243]	The RoI Government announced on 9 March 2022 a temporary reduction in the excise duties charged on petrol, diesel and marked gas oil which will remain in place until the 31st of August 2022.[245] The temporary rates from 10 March 2022 will be **47.4c per litre** of petrol and **41.4c per litre** of diesel. There will then be further reductions in rates from 01 April 2022 to **46.6c per litre** of petrol and **40.5c per litre** of diesel.[246]
Alcohol and tobacco excise duties	Cigarettes - the higher of £262.90 per thousand plus 16.5% of retail price or the minimum excise tax of £347.86 per thousand.[247] Beer duty- typically 19.08 pence per litre for each % of alcohol. Spirits - £28.74 of Spirit Duty per litre of pure alcohol. [248] An overhaul of UK alcohol taxes was announced in the October budget. Changes are proposed for 2023[249]	Cigarettes - €383.42 per thousand together with an amount equal to 8.83% of the price at which the cigarettes are sold (alternatively €434.19 per thousand) Typical €22.55 per hectolitre per cent of alcohol in the beer, i.e. 22.55c per litre for each % of alcohol. €42.57 per litre of alcohol in the spirits[250]
Vehicle excise duty	Various based on emissions/fuel type[251]	Various based on emissions/fuel type[252]
Stamp duty land tax / stamp duty	From October 2021 for residential properties: £125,001 to £250,000 - 2% £250,001 to £925,000 - 5% £925,001 to £1.5 million - 10% above £1.5 million - 12%[253] There are discounts for those buying their first property and a flat 3% premium for those buying a property in addition to their primary residence (for example, to rent out or use as a holiday home), as well as a 2% premium for non-UK-residents. For commercial land and property, a 2% marginal rate applies between £150,001 and £250,000, and a 5% marginal rate applies above £250,000.	1% on the first €1 million 2% on excess over €1 million. Transfer of non-residential property (other than policies of insurance) is 7.5%.[254]
Capital gains tax	Typically 28% on residential property and 20% on other assets if you pay the higher rate of income tax.	33% for most gains[257] Entrepreneur Relief - those that qualify pay tax at 10% on gains from the disposal of qualifying business assets

	For basic rate payers, it depends on the value of the gain, if it is within the basic income tax band the rate is 10% on the gain (or 18% on residential property) [255] Those that qualify for Business Asset Disposal Relief pay tax at 10% on all gains on qualifying assets when they sell (or 'dispose of') all or part of their business.[256]	(20% for disposals from 1 January to 31 December 2016) [258] Retirement Relief – full relief for disposals of any part of a business or farming assets made up to 31 December 2013 if you are 55 or older – for disposals made from 1 January 2014, full relief if you are between 55 and 65, restricted to €3 million for 66 or older[259]
Betting and gaming duties	The tax rates vary. For example, Gaming Duty is levied at marginal rates varying from 15% to 50% of the yield. Remote Gaming Duty is levied at a single marginal rate of 21%. General Betting Duty ranges from 3% for net receipts from financial spread bets to 15%. Lottery Duty is 12% of the ticket price. [260]	2% (nil for On-course or tote bets) or 25% for Betting Intermediary Duty[261]
Inheritance tax	40% above £325,000 threshold[262]	Standard Capital Acquisitions Tax (CAT) Rate is 33%. [263] Gifts and Inheritances taken by a Spouse or Civil Partner are exempt. Other thresholds apply.[264] The 7 year rule that applies in the UK (a gift made more than 7 years prior to the date of death is not liable for inheritance tax) does not apply in ROI.
Insurance premium tax	Standard rate is 12%, higher rate of 20%[265]	Typical 3% levy on Non-Life Insurance. [266]
Landfill tax	£96.70/tonne standard rate or lower rate of £3.10/tonne[267] From Apr 2022 £98.60/tonne standard rate or lower rate of £3.15/tonne[268] From Apr 2023 £102.10/tonne standard rate or lower rate of £3.25/tonne	€75 per tonne[269]
Climate change levy	Various rates for climate change levy depending on fuel source. [270] Other environmental taxes in the UK also in place, e.g. plastic bag levies.	Various environmental taxes, e.g. carbon tax as part of fuel/vehicle taxes/ or plastic bag levy (22c per bag).[271] The PSO (Public Service Obligation) levy charged to all electricity customers in Ireland and supports the generation of electricity from sustainable, renewable and indigenous sources. Current PSO levy as of October 2021 is €58.57 per year inclusive of VAT for domestic users. For business it is €13.63 per

		month (Excl. VAT) or €1.63 per kVA per month (Excl. VAT) if MIC => 30kVA.[272]
Aggregates levy	Typically £2 per tonne[273]	n/a –no similar levy
Air passenger duty	From April 2022[274] Short haul rates: Reduced – £13; Standard – £26; Higher - £78 Long haul rates: Reduced – £84; Standard – £185; Higher - £554 Direct long-haul rates in Northern Ireland are zero. Changes from April 2023[275] Domestic (Flights within UK): Reduced – £6.50; Standard – £13; Higher - £78 Short-haul rates: Reduced – £13; Standard – £26; Higher - £78 Long-Haul Rate: Reduced – £87; Standard – £191; Higher - £574 Ultra-long-haul rates: Reduced – £91; Standard – £200; Higher - £601	Air Travel tax abolished in 2014
Soft Drinks Industry Levy	Standard Rate: 18p per litre Higher Rate: 24p per litre[276]	Standard Rate: €16.26 per hectolitre Higher Rate: €24.39 per hectolitre[277]
Bank Levy	Levy on banks' UK-based equities and liabilities (with some exceptions) if they exceed £20 billion: Chargeable equity and long-term liabilities - 0.05% short-term chargeable liabilities - 0.1% [278]	The levy is designed to produce a fixed annual yield of €150m. It is based on the amount of deposit interest retention tax (DIRT) paid by a financial institution in a specified rolling base year. Rate of charge for 2022 (% of DIRT paid) of 308% on 2019 base year[279]
Stamp Duty on Shares	Typically 0.5%[280]	Typically 1%[281]

Annex F

Appraisal of suitability of UK-based taxes for devolution in Northern Ireland

F1.0 Overview

F1.0.1 This Annex details the full text of the Commission's interim appraisals of the suitability of each of the UK taxes levied in Northern Ireland, published previously as part of our Interim Report. The taxes are considered in the following order:

Analysis of UK taxes levied in Northern Ireland – Major taxes

F1.1 Income tax
F1.2 Value added tax
F1.3 National Insurance contributions

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

F1.4 Fuel duties
F1.5 Corporation tax
F1.6 Alcohol and tobacco duties

Analysis of UK taxes levied in Northern Ireland - Minor taxes

F1.7 Vehicle excise duty
F1.8 Insurance premium tax
F1.9 Capital gains tax
F1.10 Stamp duty land tax
F1.11 Air passenger duty
F1.12 Betting and gaming duties
F1.13 Apprenticeship levy
F1.14 Inheritance tax
F1.15 Landfill tax
F1.16 Climate change levy
F1.17 Aggregates levy
F1.18 Stamp duty on shares
F1.19 Soft drinks industry levy
F1.20 Taxes on specific business activities

F1.21 Summary of tax assessment conclusions

Analysis of UK taxes levied in Northern Ireland – Major taxes

F1.1 Income tax

F1.1.1 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

F1.1.2 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.

F1.1.3 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).

F1.1.4 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.[lxxxi] 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.

F1.1.5 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[282]) without constraint. Even if income tax is deemed appropriate for devolution in Northern Ireland, questions around the scope of devolution will also need consideration.

F1.1.6 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

[lxxxi] 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.

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.

F1.1.7 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

F1.1.8 We are not aware of any legal constraints to the devolution of income tax.

Accountability

F1.1.9 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.

F1.1.10 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'.

F1.1.11 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.

F1.1.12 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

F1.1.13 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).

F1.1.14 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.

F1.1.15 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.[283]

F1.1.16 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.[284]

F1.1.17 Income tax devolution may also impose additional costs on payroll service providers.[lxxxii] 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

F1.1.18 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.

F1.1.19 All of these potential responses would apply to Northern Ireland taxpayers if income tax was devolved and rates in Northern Ireland were varied.

[lxxxii] 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.

F1.1.20 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.

F1.1.21 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.

F1.1.22 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).

F1.1.23 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.

F1.1.24 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.

F1.1.25 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.*

F1.1.26 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.

F1.1.27 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.

F1.1.28 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

F1.1.29 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.

F1.1.30 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

F1.1.31 **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.

F1.2 Value added tax

F1.2.1 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.[lxxxiii] 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.

F1.2.2 VAT is a proportional tax charged on the sales of businesses with turnovers of £85,000 a year or more.[lxxxiv] 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).

F1.2.3 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.

F1.2.4 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, 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.

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

Economic and policy context

F1.2.5 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.[285]

F1.2.6 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,[lxxxv] 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%).[lxxxvi] 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

F1.2.7 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.[lxxxvii] 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.[286]

F1.2.8 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 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

[lxxxv] 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.

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

[lxxxvii] 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).

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

F1.2.9 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.

F1.2.10 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.

F1.2.11 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,[287] on pasties and other hot bakery products,[288] hot meals in cafes, pubs and restaurants,[289] and for the wider hospitality industry[290] – as well as the overall rate of VAT.[291] Such media coverage would help voters hold the NI Assembly accountable for their VAT policy decisions.

Administrative efficiency

F1.2.12 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.

F1.2.13 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.[lxxxviii] From a fiscal perspective, this would mean that full taxing rights would lie with the importing jurisdiction. Because of this, the NI

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

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.[292]

F1.2.14 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.[lxxxix] 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.

F1.2.15 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

F1.2.16 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.[293] 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.

F1.2.17 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

[lxxxix] 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.

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).[294]

F1.2.18 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

F1.2.19 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.

F1.2.20 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

F1.2.21 **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.**

F1.3 National Insurance contributions

F1.3.1 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.

F1.3.2 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.

F1.3.3 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.[295] 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

F1.3.4 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.[xc] 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.

F1.3.5 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.

F1.3.6 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.

F1.3.7 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

[xc] 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.

a single National Insurance Fund with England and a formally integrated contributory benefits system.

F1.3.8 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

F1.3.9 There are no legal constraints to devolving NICs to the NI Assembly.

Accountability

F1.3.10 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.

F1.3.11 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.

F1.3.12 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

F1.3.13 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.

F1.3.14 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.

F1.3.15 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.

F1.3.16 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

F1.3.17 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.

F1.3.18 All of these potential responses would apply to Northern Ireland taxpayers if NICs were devolved and rates in Northern Ireland were varied.

F1.3.19 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.

F1.3.20 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).

F1.3.21 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.

F1.3.22 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.

F1.3.23 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.

F1.3.24 Ku et al (2020)[296], 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)[297] 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)[298] find little evidence of employment effects for a similar scheme in Finland, and Cruces et al (2010)[299] find little evidence of employment effects of regionally-varying changes in contribution rates in Argentina.

F1.3.25 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

F1.3.26 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.

F1.3.27 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.

F1.3.28 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

F1.3.29 **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

F1.4 Fuel duties

F1.4.1 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.

F1.4.2 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.

F1.4.3 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

F1.4.4 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.

F1.4.5 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.

F1.4.6 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.[300]

F1.4.7 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.

F1.4.8 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?

F1.4.9 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.

F1.4.10 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.[301302]

F1.4.11 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

F1.4.12 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

F1.4.13 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

F1.4.14 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.

F1.4.15 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.

F1.4.16 But in reality, the majority of petrol, diesel and liquefied gas is imported into Northern Ireland from elsewhere in the UK.[xci] This means that to be meaningfully effective, imports of fuel into Northern Ireland from elsewhere in UK would need to be exempted from UK fuel duty so that the Northern Ireland Duty could apply.

[xci] 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.

F1.4.17 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,[xcii] 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.

F1.4.18 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.

F1.4.19 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

F1.4.20 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.

F1.4.21 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.

F1.4.22 It is worth noting that the issue of cross-border shopping in RoI could create real risks for the NI Assembly. If the UK Government decided to increase fuel duty rates across the UK, then under current arrangements those increases would apply in Northern Ireland, leading to an increase in the proportion of fuel purchases made by Northern Ireland consumers in RoI. The UK Government would bear the risks of resulting revenue losses from Northern Ireland.

[xcii] 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.

F1.4.23 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.

F1.4.24 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

F1.4.25 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.

F1.4.26 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

F1.4.27 **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.**

F1.5 Corporation tax

F1.5.1 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%.

F1.5.2 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

F1.5.3 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,[303] it now highlights NICs and VAT as its priorities for further tax devolution.[304] 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.

F1.5.4 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.

F1.5.5 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.[305] 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.[306] 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.

F1.5.6 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.

F1.5.7 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.

F1.5.8 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".

F1.5.9 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.[xciii]

F1.5.10 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.

F1.5.11 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.

F1.5.12 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),[307] 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.

F1.5.13 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 but it will not take into account second round effects on other taxes.[308]"* Therefore if a reduced corporation tax rate Northern Ireland led to improved employment and wage levels in Northern Ireland, which in turn led to improved tax generation for the UK Exchequer from taxes such as income tax, National Insurance contributions and VAT, these improved tax

[xciii] 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.

revenues – or fiscal '*spillovers*' – from Northern Ireland would not be considered in helping reduce the costs of corporation tax devolution to the NI Executive.

F1.5.14 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).[xciv] 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.

F1.5.15 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.[309] 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.

F1.5.16 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.

F1.5.17 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).[310] Under the deal the long-standing 12.5% rate that has been a cornerstone of RoI's industrial policy will no

[xciv] 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.

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.

F1.5.18 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'.[311] 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.

F1.5.19 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.

F1.5.20 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

F1.5.21 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

F1.5.22 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.

F1.5.23 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.

F1.5.24 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

F1.5.25 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.

F1.5.26 HMRC estimated the administration and compliance costs associated with the model of devolution currently legislated for in 2015.[312] 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.*

F1.5.27 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.

F1.5.28 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'[313] 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.

F1.5.29 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.

F1.5.30 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

F1.5.31 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.

F1.5.32 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.

F1.5.33 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.

F1.5.34 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)[314] 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.[315]

F1.5.35 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.

F1.5.36 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.

F1.5.37 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

F1.5.38 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.

F1.5.39 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.

F1.5.40 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.

F1.5.41 There are, however, reasons why corporation tax is a more complex candidate for devolution than many other taxes.

F1.5.42 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.

F1.5.43 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.

F1.5.44 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

F1.5.45 **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**.

F1.5.46 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.

F1.5.47 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.

F1.5.48 **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.**

F1.6 Alcohol and tobacco duties

F1.6.1 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.

F1.6.2 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

F1.6.3 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.

F1.6.4 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).[316] 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.[317]

F1.6.5 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,[318] and by provinces in Canada.[319]

F1.6.6 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.[320] 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. [321] 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.

F1.6.7 As part of the Autumn Budget 2021, the UK Government announced a freezing of alcohol duty rates in the UK,[322] and published a consultation on detailed proposals for alcohol duty reform.[323] 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.[324]

Legal constraints

F1.6.8 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

F1.6.9 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.

F1.6.10 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.[325] 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.[326] This media coverage could help the electorate hold the NI Assembly to account for its tax policy.

F1.6.11 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

F1.6.12 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.

F1.6.13 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,[xcv] any differences in tax rates would mean either extra tax payments or refunds would need to be made. This would

[xcv] 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.

F1.6.14 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.

F1.6.15 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

F1.6.16 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.[327]

F1.6.17 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.[328] 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

F1.6.18 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.

F1.6.19 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.

F1.6.20 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

F1.6.21 **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

F1.7 Vehicle excise duty

F1.7.1 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.

F1.7.2 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

F1.7.3 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.

F1.7.4 As the application of VED depends on the location of the 'registered keeper' of a vehicle,[xcvi] 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.

F1.7.5 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.[329,330]

F1.7.6 Equivalent taxes are devolved to sub-national governments in a range of countries in Europe including Belgium, the Netherlands and Spain, and are operated at the state and sometimes local-level in the US, and at the state- or territory-level in Australia. It has also been suggested as a tax to devolve or at least assign to the Greater London Authority.[331]

[xcvi] The 'registered keeper' of a vehicle registered keeper has responsibility for ensuring a car is road-worthy and has a valid MOT, is insured and is the first point of contact for the police and authorities in relation to crime or motoring offences. This is often but not always the same person or business as the owner or user of a vehicle.

Legal constraints

F1.7.7 We are not aware of any legal constraints to devolving VED to the NI Assembly.

Accountability

F1.7.8 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[332] –, 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

F1.7.9 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

F1.7.10 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.

F1.7.11 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.

F1.7.12 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.[xcvii] 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.[333] 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

F1.7.13 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.

F1.7.14 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

F1.7.15 **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.**

F1.8 Insurance premium tax

F1.8.1 Insurance premium tax (IPT) is a tax levied on the value of general insurance premiums paid by both consumers and businesses, excluding life, long-term and re-insurance, along with some other policy categories including commercial shipping, aircraft and some export related insurance policy categories. It is charged at two rates: a standard 12% rate covering most buildings, content and most vehicle insurance; and a higher 20% rate 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

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

services are exempted from VAT), but unlike VAT neither insurers nor businesses purchasing insurance are able to claim any input cost deductions.

F1.8.2 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

F1.8.3 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[334] and Consumer Council research[335] 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.

F1.8.4 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.[336]

Legal constraints

F1.8.5 We are not aware of any legal constraints to the devolution of IPT to the NI Assembly.

Accountability

F1.8.6 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

F1.8.7 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

F1.8.8 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.

F1.8.9 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

F1.8.10 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).

F1.8.11 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

F1.8.12 **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.**

F1.9 Capital gains tax

F1.9.1 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.

F1.9.2 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.

F1.9.3 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.

F1.9.4 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.[337] 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

F1.9.5 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.

F1.9.6 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.

F1.9.7 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.

F1.9.8 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'.

F1.9.9 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

F1.9.10 We are not aware of any legal constraints to devolving CGT to the NI Assembly.

Accountability

F1.9.11 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.

F1.9.12 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%.[338] 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

F1.9.13 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.

F1.9.14 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.

F1.9.15 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.

F1.9.16 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.

F1.9.17 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.

F1.9.18 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.

F1.9.19 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).

F1.9.20 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

F1.9.21 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).

F1.9.22 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.

F1.9.23 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

F1.9.24 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.

F1.9.25 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').

F1.9.26 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.

F1.9.27 '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

F1.9.28 **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.**

F1.10 Stamp duty land tax

F1.10.1 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.

F1.10.2 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

F1.10.3 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.

F1.10.4 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.[339] 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.

F1.10.5 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.

F1.10.6 As discussed above, SDLT has already been devolved to the Scottish and Welsh parliaments,[xcviii] 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.

F1.10.7 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

[xcviii] 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

F1.10.8 There are no legal constraints to devolving SDLT to the NI Assembly.

Accountability

F1.10.9 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.[xcix] 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.

F1.10.10 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.[340]

Administrative efficiency

F1.10.11 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,[341] while the Welsh Revenue Authority collected £297 million from LTT and Landfill tax and incurred costs of £7.4 million,[342] 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.[343] These figures suggest an increase in administration costs that is very large relative to the marginal cost of

[xcix] 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).

F1.10.12 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.

F1.10.13 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

F1.10.14 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).

F1.10.15 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.[c] 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

F1.10.16 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.

F1.10.17 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

F1.10.18 **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.**

F1.11 Air passenger duty

F1.11.1 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.

F1.11.2 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.[344]

F1.11.3 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

[c] 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.[345]

F1.11.4 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

F1.11.5 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.

F1.11.6 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,[346] 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.[347] Recent calls have also been made in the context of the collapse of Flybe[348] and the impact of COVID-19.[349]

F1.11.7 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.[350]

F1.11.8 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.[351]

F1.11.9 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.

F1.11.10 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

F1.11.11 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

F1.11.12 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).

F1.11.13 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

F1.11.14 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.

F1.11.15 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

F1.11.16 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).

F1.11.17 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.

F1.11.18 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.

F1.11.19 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).[352] 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.

F1.11.20 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

F1.11.21 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.

F1.11.22 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

F1.11.23 **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.**

F1.12 Betting and gaming duties

F1.12.1 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.

F1.12.2 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).

F1.12.3 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.

F1.12.4 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%.[353]

F1.12.5 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.

F1.12.6 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

F1.12.7 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%).[354]

F1.12.8 Unlike in Scotland and Wales, regulation of betting and gaming activity in Northern Ireland is a devolved competence[ci]. 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.

F1.12.9 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.[355] 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

F1.12.10 We are not aware of any legal impediment to devolving betting and gaming duties to the NI Assembly.

Accountability

F1.12.11 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.

F1.12.12 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

F1.12.13 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).

F1.12.14 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.

F1.12.15 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.

F1.12.16 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

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

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?

F1.12.17 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

F1.12.18 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.

F1.12.19 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

F1.12.20 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.

F1.12.21 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

F1.12.22 **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.

F1.13 Apprenticeship levy

F1.13.1 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.[356]

Economic and policy context

F1.13.2 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.

F1.13.3 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

F1.13.4 There are no legal constraints to devolving the levy to the NI Assembly.

Accountability

F1.13.5 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

F1.13.6 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.

F1.13.7 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

F1.13.8 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

F1.13.9 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.

F1.13.10 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

F1.13.11 **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.**

F1.14 Inheritance tax

F1.14.1 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.[cii]

F1.14.2 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.

F1.14.3 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.

F1.14.4 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

F1.14.5 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.

F1.14.6 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

F1.14.7 We are not aware of any legal constraints to devolving IHT to the NI Assembly.

Accountability

F1.14.8 One argument against devolution of IHT is that it applies to relatively few individuals in any given year. This is largely of course because only a minority of the population die in any given year. But only a minority of estates now incur liability for IHT, given how high the tax threshold has become. HMRC data indicates that in 2018/19 (the latest year for which such statistics are available), only 252 estates in Northern Ireland were liable for IHT.

Administrative efficiency

F1.14.9 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-

[cii] 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.

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.

F1.14.10 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.

F1.14.11 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.

F1.14.12 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

F1.14.13 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.

F1.14.14 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.[357] 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

F1.14.15 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.

F1.14.16 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

F1.14.17 **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.**

F1.15 Landfill tax

F1.15.1 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.[358]

F1.15.2 The tax is levied on landfill operators, who pass costs on to businesses disposing of waste by landfill.

F1.15.3 It is estimated that landfill tax raised £24 million in 2019-20 in Northern Ireland, 0.2% of the total take.[359]

Economic and policy context

F1.15.4 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.

F1.15.5 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.

F1.15.6 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.

F1.15.7 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.

F1.15.8 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

F1.15.9 We are not aware of any legal constraints to devolving landfill tax to the NI Assembly.

Accountability

F1.15.10 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

F1.15.11 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

F1.15.12 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.

F1.15.13 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.

F1.15.14 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

F1.15.15 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.

F1.15.16 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

F1.15.17 **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.**

F1.16 Climate change levy

F1.16.1 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.[360]

F1.16.2 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

F1.16.3 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.

F1.16.4 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. [361]

F1.16.5 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

F1.16.6 We are not aware of any legal constraints to devolving the climate change levy to the NI Assembly.

Accountability

F1.16.7 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

F1.16.8 It seems unlikely that administration issues would preclude the full devolution of the climate change levy.

F1.16.9 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

F1.16.10 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.

F1.16.11 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

F1.16.12 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.

F1.16.13 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

F1.16.14 **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.**

F1.17 Aggregates levy

F1.17.1 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).[362] Some minerals are not subject to the levy, and use of aggregates in certain agricultural products is exempt.

F1.17.2 The UK Government cites increased use of secondary and recycled aggregate in the UK as a success of the levy,[363] although it is likely that regulation and increases in landfill taxes have also contributed to this trend.

F1.17.3 Estimated aggregates levy revenue for Northern Ireland in 2019-20 were £18 million, 0.1% of the total tax take.

Economic and policy context

F1.17.4 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.[ciii] [364]

F1.17.5 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.[365] 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.

F1.17.6 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".[366]

F1.17.7 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).

F1.17.8 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."[367]

F1.17.9 Mining and quarrying industries in Northern Ireland are estimated to employ around 2,300 people, with a combined turnover of £390 million (2016 data).

F1.17.10 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

[ciii] 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.

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

F1.17.11 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.

F1.17.12 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.

F1.17.13 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.[368]

Legal constraints

F1.17.14 We are not aware of any legal constraints to devolving aggregates levy to the NI Assembly.

Accountability

F1.17.15 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

F1.17.16 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.

F1.17.17 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).

[civ] 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.

This could be potentially be a route for avoidance and economic distortion if rates varied between Northern Ireland and GB.

F1.17.18 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).

F1.17.19 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.

F1.17.20 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

F1.17.21 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.

F1.17.22 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

F1.17.23 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.

F1.17.24 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

F1.17.25 **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.**

F1.18 Stamp Duty on shares

F1.18.1 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.

F1.18.2 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.

F1.18.3 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

F1.18.4 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

F1.18.5 We are not aware of any legal constraints to devolving Stamp Duty on Shares to the NI Assembly.

Accountability

F1.18.6 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

F1.18.7 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.

F1.18.8 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.

F1.18.9 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.

F1.18.10 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

F1.18.11 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.

F1.18.12 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

F1.18.13 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.

F1.18.14 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.

F1.18.15 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

F1.18.16 **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.**

F1.19 Soft drinks industry levy

F1.19.1 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.

F1.19.2 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

F1.19.3 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.[369] 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.[370]

F1.19.4 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

F1.19.5 We are not aware of any legal constraints to the devolution of the soft drinks industry levy to the NI Assembly.

Accountability

F1.19.6 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.[cv] 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.[371] Such media coverage may help the electorate hold the NI Assembly to account for its levy policies.

Administrative efficiency

F1.19.7 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.[cvi] 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

F1.19.8 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.[372] Indeed, concerns about the impact of cross-border shopping as a result of Norway's high taxes prompted the Norwegian government to abolish its existing taxes on soft drinks and confectionary in 2021 and replace them with a lower general sugar tax.[373] 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.

[cv] 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.

[cvi] It is worth noting that the NI Protocol to the EU Withdrawal Agreement requires businesses moving goods, including soft drinks from one GB to NI to register the transaction. However, such rules do not apply when goods are moved from Northern Ireland to GB.

Soft Drinks levy summary

F1.19.9 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.

F1.19.10 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

F1.19.11 **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.**

F1.20 Taxes on specific business activities

F1.20.1 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.

F1.20.2 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

F1.20.3 **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.

F1.21 Summary of tax assessment conclusions

F1.21.1 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.

<table>
<tr><th colspan="2">Taxes that <u>will not</u> advance for further consideration</th></tr>
<tr><td>VAT</td><td>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.</td></tr>
<tr><td>NICs</td><td>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</td></tr>
<tr><td>Corporation tax</td><td>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.</td></tr>
<tr><td>Vehicle excise duty</td><td>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.</td></tr>
</table>

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.

Annex G

Commissioners' biographies

Mr Paul Johnson (Chairman)

Director of the Institute for Fiscal Studies (IFS). Paul has been Director of the IFS since January 2011. He is also currently visiting professor in the Department of Economics at University College London and is a member of the Climate Change Committee. Paul has worked and published extensively on the economics of public policy, particularly on the areas of income distribution, public finances and tax. He has previously worked in Treasury as Director of Public Services and between 2004 and 2007 he was the Deputy Head of the Government Economic Service.

Prof Cathy Gormley-Heenan (Commissioner)

Former Deputy Vice-Chancellor at Ulster University and Professor of Politics with research interests and publications that include both UK and devolved public policy and multi-level governance. Currently serves as a board member on UKRI's Research England and on the UK Government's advisory body on EU Exit, Universities, Research and Innovation among other things.

Prof Iain McLean (Commissioner)

Emeritus Professor of Politics at Oxford University and a Senior Research Fellow of Nuffield College. His research interests include UK public policy; devolution, including related issues in taxation and public expenditure such as the Barnett Formula; electoral systems and constitutional reform.

Dr Lisa Wilson (Commissioner)

Senior Economist at the Nevin Economic Research Institute (NERI) and is based in the Belfast office. Her main research interests lie in the areas of labour markets, income distribution, poverty, public expenditure, living standards and well-being. PhD from Queen's University, Belfast which focused on income inequality and well-being.

Annex H

Stakeholder engagement

H1.0 Fiscal Commission website

The website of the Fiscal Commission NI is hosted at: www.fiscalcommissionni.org

On the website, we have published:

- The Terms of Reference for the work of the Commission;
- Call for Evidence;
- News updates on progress;
- Brief reports on key Fiscal Commission meetings;
- Evidence submitted by stakeholders;
- Presentations delivered at Fiscal Commission meetings.

The Commission also uses its official twitter account @fiscal_ni to provide news updates and publicise Commission events and engagements.

H1.1 Calls for evidence

The Commission hosted an open call for evidence on our website at the outset of our work programme, and a specific request for feedback on the content of our Interim Report following its publication. We received 29 responses from 21 individuals and organisations:

Call for Evidence

Alliance Party
Dr Esmond Birnie, Senior Economist Ulster University Business School
Derek Birrell, Professor of Social Policy, Ulster University
Chartered Accountants Ireland
The Green Party
Victor Hewitt
Sinn Fein
Ulster University Economic Policy Centre

Response to Interim Report

Alliance Party
Joint submission from Professor Joan Ballantine, Professor Ann Marie Gray and Dr Michelle Rouse, Ulster University, Schools of Accounting, Finance & Economics, Social Policy, Applied Social and Policy Sciences
Chartered Accountants Ireland
Dr Edward Cooke X 4

Democratic Unionist Party
Professor Deirdre Heenan, Ulster University School of Applied Social and Policy Sciences
Victor Hewitt
Invest Northern Ireland
Irish Congress of Trade Unions
Northern Ireland Audit Office
Northern Ireland Chamber of Commerce and Industry
Northern Ireland Council for Voluntary Action
Northern Ireland Women's Budget Group
Pivotal
Sinn Fein
Strategic Investment Board
Traditional Unionist Voice
Ulster University Economic Policy Centre

All submissions received, where the author gave permission, were published on the Commission's website. We wish to thank all those who provided evidence and supported the work of the Commission in this way.

H1.2 Feedback on Interim Report

Four questions were posed in the Interim Report to test the views of our stakeholders and help structure their submissions. Eleven respondents directly addressed the four questions, the results of which are summarised below.

QUESTION 1 – Do you agree with our understanding and representation of why fiscal devolution might be considered important and the contemporary context of Northern Ireland, as described in Chapter 1?

All of the submission were in broad agreement with the Commission's understanding of why fiscal devolution might be considered important and the contemporary context of Northern Ireland. Several respondents raised the need for political and institutional resilience, as well as economic and administrative capability and capacity, to be considered when examining further fiscal devolution, reaffirming feedback from our previous stakeholder engagements.

QUESTION 2 - Do you agree with our understanding and our representation of the current Northern Ireland context?

All of the submission were in broad agreement with the Commission's understanding of the current Northern Ireland context.

QUESTION 3 - Do you agree with our analysis of the suitability or otherwise for devolution of the individual taxes listed in Chapter 4?

The majority of submissions (9 out of 11) were in broad agreement with the Commission's analysis of the suitability or otherwise for devolution of the individual taxes listed in Chapter 4. Some respondents disagreed with our proposal that income tax be considered for devolution with two respondents suggesting that this was not appropriate. Several others, despite broadly agreeing with the suitability of taxes, urged that devolution of corporation tax be considered further.

QUESTION 4 - Do you agree with our conclusions regarding the prioritisation of specific taxes to be carried forward for further consideration in the second phase of our work?

The majority of submissions (9 out of 11) were in broad agreement with the Commission's conclusions regarding the prioritisation of specific taxes to be carried forward for further consideration. Despite broad agreement on this question, two respondents disagreed with the Commission's prioritisation, citing income tax and excise duties as not suitable for devolution due to a perceived lack of administrative capacity here. There were also further calls for the Commission to reconsider corporation tax as a priority and requests for further evidence on excise, SDLT and landfill taxes.

Those submissions that did not directly address the four questions above covered a range of topics and opinions, from the call for further taxes to be considered, including National Insurance and VAT, to the need for equality considerations to be taken into account when assessing tax devolution.

H1.3 Contributors to Fiscal Commission plenary meetings

The following subject matter experts were invited to present at Fiscal Commission meetings:

David Eiser, Senior Knowledge Exchange Fellow, Fraser of Allander Institute
Professor John Fitzgerald, Adjunct Professor, Department of Economics, Trinity College Dublin
Neil Gibson, Chief Economist, EY
Professor Gerald Holtham, Hodge Professor of Regional Economy at Cardiff Metropolitan University
Officials from Department of Finance – Bill Pauley, Tony Simpson, Wendy Lecky, Joanne McBurney and Jeff McGuinness
Officials from Land and Property Services, Department of Finance - Ian Snowden, Chief Executive and Alan Bronte, Director of Rating Policy
David Phillips, Associate Director, Institute for Fiscal Studies
Mairi Spowage, Interim Director & Principal Knowledge Exchange Fellow at Fraser of Allander Institute

We offer our sincere thanks to all those who gave of their time and expertise to support the work of the Commission.

H1.4 Wider stakeholder meetings and engagement

The following stakeholders met and/or engaged with the Fiscal Commission members to contribute their views on the key priorities for our work and discuss their perspective on increasing fiscal devolution for Northern Ireland, some also provided comment on early drafts of our reports:

Madeleine Alessandri, Permanent Secretary, Northern Ireland Office / SOS
Rodney Allen, Chief Operating Officer, Northern Ireland Audit Office
Australian Tax Office officials
Professor Alan Barrett, CEO Economic and Social Research Institute (ESRI) and member of the Northern Ireland Fiscal Council
Dr Esmond Bernie, Senior Economist, Economic Policy Centre, University of Ulster and member of the Northern Ireland Fiscal Council

Dr Jayne Brady MBE, Belfast City Council
Alan Bridle, Head of Economics & Market Analysis, Bank of Ireland
Dr Graham Brownlow, Senior Lecturer, Queen's Management School, Queens University Belfast
Christine Burns, Audit Manager, Northern Ireland Audit Office
Canadian Revenue Agency officials
Nicola Carruthers, Northern Ireland Drinks Industry Group
Lynn Carvill, Convenor of the Northern Ireland Women’s Budget Group and Chief Executive at WOMEN'STEC
Isabelle Chatry, Organisation for Economic Co-operation and Development (OECD)
Sir Robert Chote, Chair of the Northern Ireland Fiscal Council
Crona Clohisey, Public Policy Lead, Chartered Accountants Ireland
Norah Collender, Professional Tax Leader, Chartered Accountants Ireland
Aodhan Connolly, Northern Ireland Retail Consortium
Kieran Donnelly, Comptroller and Auditor General, Northern Ireland Audit Office
Anita Farmer, AF Consultancy Ireland Ltd
Neil Gibson, Chief Economist, EY
Paul Goldrick Kelly, Economist, Nevin Economic Research Institute
Alan Gourley, Tax Committee Chair, Chartered Accountants Ireland
HM Revenue & Customs officials
HM Treasury officials
Simon Hamilton, CEO, Belfast Chamber of Trade & Commerce
John Healy, Vice President & Managing Director, Allstate Northern Ireland
Paul Henry, Institute President, Chartered Accountants Ireland
Gareth Hetherington, Associate Director, Economic Policy Centre, University of Ulster
Dr Victor Hewitt
Kevin Holland, CEO, Invest Northern Ireland
Iain Joannides, Invest Northern Ireland
Irish Government, Department of Finance officials
Richard Johnston, Ulster University Economic Policy Centre
Kevin Kingston, CEO Danske Bank UK
Charlotte Lafitte, Organisation for Economic Co-operation and Development (OECD)
Conor Lambe, Chief Economist & Strategy Lead, Danske Bank
Sharon Magee, Director of Rating Policy, Land and Property Services, Department of Finance
Jonathan McAdams, Chief of Staff, Northern Ireland Fiscal Council
Seamus McAleavey, CEO, Northern Ireland Council for Voluntary Action (NICVA)
Philip McDonagh OBE, Chair of the Northern Ireland Statistics Advisory Committee
Joe McDonald, Asda
Dr Tom McDonnell, Co-director, Nevin Economic Research Institute
Conor McGeown, Audit Manager, Northern Ireland Audit Office
Gerry McGinn, Chairman of Strategic Investment Board (SIB)
Angela McGowan, Director, Confederation of British Industry (CBI)
Ann McGregor MBE, CEO, Northern Ireland Chamber of Commerce and Industry
Kirsty McManus, National Director, Institute of Directors (IoD)
Conor Murphy, Finance Minister, Northern Ireland Executive
Maureen O’Reilly, Independent Economist and Member of the Northern Ireland Fiscal Council
Office for National Statistics officials

Le Phung, Asda
Roger Pollen, Head of External Affairs, Federation of Small Businesses Northern Ireland
Richard Ramsey, Chief Economist, Ulster Bank
Owen Reidy, Assistant General Secretary, Northern Ireland Committee of Irish Congress of Trade Unions
Revenue Scotland officials
Stephen Rusk, Deputy Director of Economy Group, Northern Ireland Office
Jamie Sanders, Japan Tobacco International UK
Scottish Exchequer officials
Nicky Small, Japan Tobacco International UK
Martin Spollen, Chief Investment Officer & Head of Data Science, Strategic Investment Board (SIB)
Sir David Sterling, ex-Head of the Northern Ireland Civil Service
Welsh Revenue Authority officials
Welsh Treasury officials
Jeremy White QC, Pump Court Tax Chambers

Political Representatives

Alliance Party - Stephen Farry MP, Andrew Muir, MLA, Stewart Dickson, MLA, Kellie Armstrong, MLA
Democratic Unionist Party - Sir Jeffrey Donaldson MP
Green Party - Clare Bailey MLA and Ernest Purvis
People Before Profit - Gerry Carroll MLA
Sinn Fein – Dr Caoimhe Archibald MLA, John Finucane MP
Social Democratic and Labour Party Matthew O'Toole MLA, Mark Durkan, Claire McGregor
Traditional Unionist Voice Party - Jim Allister MLA
Ulster Unionist Party - Doug Beattie MLA, Steve Aiken MLA

We record our thanks to all stakeholders who attended meetings with Fiscal Commissioners for their enthusiastic engagement and valuable contributions to our considerations. We also offer sincere thanks to those stakeholders who provided incredibly valuable comment on drafts of our reports.

H1.5 Representation at other Events

The Chair of the Commission accepted invitations to present at a number of events, including:

- The 2021 British-Irish Association conference, held on 3rd-5th September 2021 at Pembroke College, Oxford
- The 9th Annual NERI Dónal Nevin lecture, held on 29th September 2021 at Queens University Belfast.
- Oral evidence on the Interim Report of the Fiscal Commission for Northern Ireland at the Northern Ireland Assembly Committee for Finance meeting, held on 19th January 2022.

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