Tax Strategy Group

Review of Tax Expenditures – Budget 2011

Introduction

1. This Paper discusses the review of tax expenditures that was announced by the Minister for Finance in his Second Stage Speech for the Finance Bill 2010. The review was to be undertaken by Ministers into the effectiveness of tax expenditures within their sectors of responsibility that were examined by the Commission on Taxation and recommended for either abolition or, in some cases, enhancement. The results of the review will feed into Budget 2011.

Definition of a tax expenditure

2. The OECD definition of a tax expenditure is: "*A transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure*".

3. In its Report, the Commission on Taxation identified those tax measures which, although they reduce the tax base, should more properly be regarded as part of the benchmark tax system; these would include personal allowances in the Income Tax system such as Personal Tax Credits, PAYE Allowance, etc. The Commission highlighted that there are valid reasons why a tax system might need to incorporate relieving measures and exemptions, for example to help it function equitably and efficiently and to interact with other systems at an international level.

4. Such measures, while they may reduce the tax base as compared with circumstances where they did not apply, may reasonably be regarded as part of the structure of the tax system or, if not inherently structural, are desirable elements that make the tax system function efficiently. The Commission considered that measures which are part of the benchmark tax system should not be considered as tax expenditures. This is the approach taken in the Review of tax expenditures for Budget 2011.

Background

5. In his Second Stage Speech for the Finance Bill 2010, the Minister for Finance announced that an assessment of the effectiveness of sectoral tax expenditures would be conducted to inform decisions about the future of such expenditure in advance of Budget 2011.

6. Specifically, the speech mentioned: *"I will ask each of my colleagues in Government to assess the effectiveness of tax expenditures within their sectors with particular reference to those that the Commission on Taxation recommended should be removed from the tax code. My Department will review the outcome of that sectoral analysis and I will report back to Cabinet by the end of June 2010. This new approach will place the onus for objectively justifying the retention of any expenditure on the sector benefiting from the relief. My Department will then be in a position to present the Cabinet with an analysis on which to make well informed decisions about the future of tax expenditures in good time for the 2011 Budget".*

Commission on Taxation Report

7. The Commission on Taxation Report (published 7th September 2009) made 111 recommendations on tax expenditures. The Report recommended that 23 expenditures should be abolished or otherwise modified; five of these were subsequently abolished (another one was modified[1]) in Finance Act 2010. The yield from this abolition amounts to €40m in a full year, the majority of which relates to service charges (€23m) from 2011 onwards.

8. The measures that were abolished were:

    - Capital Allowances for childcare facilities
    - Income Tax relief on service charges
    - Tax relief provided for long term care policies
    - BIK relief relating to the loan of certain art objects
    - Modification of residence requirements for donors of property to the State

9. The Commission estimated that the abolition of the 23 expenditures highlighted in its Report would yield approximately €235m in savings to the Exchequer in a full year.

10. A further 31 recommendations made by the Commission proposed changes to the existing tax treatment of certain schemes, while the remaining 51 recommendations proposed that there be no change in the current tax treatment of the expenditures at the time of publication.

11. For many of the expenditures recommended for change (rather than abolition) by the Commission, the Report did not provide an estimate of the cost/saving of the changes. Based on the information available, it is likely that there would be a significant Exchequer cost for some of the changes.

12. The remaining 51 recommendations propose that there be no change in the current tax treatment of the expenditures concerned at the time of the Commission's Report.

Review of expenditures by Departments

13. Ministers were asked by the Minister for Finance to review the effectiveness of tax expenditures in their sector. This included cases where the Commission recommended an enhancement of a measure. Appendix A details the measures transmitted to Ministers for review.

14. Although the request to Ministers was not proscriptive about the nature of the assessment, it was stressed that it should be conducted on an in-house basis without the use of external evaluators. It was also indicated that the assessment might take account of the benefits and costs of each tax expenditure which have occurred to date and those that can be expected to arise into the future should they be retained. Eleven suggested areas to be included in the assessment were suggested – these are detailed in Appendix B.

15. The review process involved three elements:

[1] Income Tax relief on heritage buildings and gardens was modified to exclude passive investors, owner-occupiers still receive relief.

(i) if a Department disagreed with the Commission's recommendation to abolish an expenditure – it was required to provide an objective assessment of the costs and benefits associated with each tax expenditure and to make a case against abolition;

(ii) if a Department agrees with the Commission's recommendation for abolition, it was sufficient to indicate that fact without any further analysis or assessment; and

(iii) where there is a recommendation to enhance a tax expenditure, any such recommendation that is supported by a Department required identification of off-setting savings to meet the additional costs imposed by the enhancement of a tax expenditure. This identification should not preclude appropriate adjustments in the Vote provision for Departments.

16. Ministers were requested to provide the assessments to the Department of Finance by mid-June. It should be noted that only four responses were received on time with the final response received on 17th September. The material provided by Departments is currently being assessed and the results of this work will be fed into the preparatory work for Budget 2011.

Rationale for the review

17. Tax expenditures such as incentive schemes, reliefs and exemptions impose costs on the Exchequer in exactly the same way as direct programme expenditure through a Department's Voted expenditure for capital and current measures. It is, therefore, critical that these expenditures are subject to an equivalent level of scrutiny and analysis as spending proposals are covered by.

18. The purpose of the assessment of the tax expenditures is to broaden the tax base by eliminating any measures which restrict the State's ability to ensure that tax collection is optimised at a time of severe pressures on the public finances which may require increases in the tax burden across all sectors of society. From a taxation perspective, this potential policy response may involve: a mix of rate increases in existing taxation; the development of new taxes; and a reduction in reliefs/exemptions which limit the yield from existing taxation measures. It is, therefore, important that all parts of society contribute to the requirement to increase the revenue from taxation to the Exchequer. It is also critical that any tax expenditures in the system operate in an efficient and effective manner while ensuring a return to the State.

Next Steps

19. The material provided by Departments in response to the Minister for Finance's request to his Cabinet colleagues has been received. It is currently being assessed within the Department and the results of that analysis will be completed over the coming weeks so that the outcome of this work can be considered within the context of the overall tax measures to be introduced in Budget 2011.

20. From an initial, and very tentative, analysis, abolition of the measures recommended by the Commission (as detailed in Appendix A) would yield in the order of €350m; conversely, adoption of the enhancements recommended by the Commission would cost in the region of €730m.

21. The Tax Strategy Group may wish to discuss.

Appendix A

Tax expenditures recommended for abolition/enhancement by the Commission on Taxation which were reviewed by Departments

Report Reference*	Measure / Recommendation	Dept.**	Yield if Abolished (+ €m) or cost of current scheme/proposed changes (- €m)
5.20	The national training fund levy should be abolished and a different approach to funding the national training fund should be put in place.	ETI	Requires further analysis
5.25	Gains attributable to inflation should be excluded from the charge to capital gains tax.	AFF	Requires further analysis
5.26	Capital gains tax rollover relief should apply to the gains on disposal of farm land pursuant to a compulsory purchase order where the proceeds are re-invested in farm land.	AFF	Requires further analysis
5.29	Stamp duty on ATM, credit and debit cards should be phased out in the interest of promoting the move towards a cash-free society.	ETI	-€77m (cost)
5.30	The 183/280 days test for determining the tax residence of an Irish citizen should be supplemented by additional criteria, which should include a permanent home test and a test based on an individual's centre of vital interests.	ETI	Requires further analysis
5.32	The remittance basis of taxation for income tax and capital gains tax should be discontinued.	ETI	Requires further analysis **Income Tax remittance basis abolished for ordinarily resident individuals by FA10**
7.6	The 'corporation tax holiday' for new business should be extended to companies starting out in 2010 or 2011, and a similar scheme should be introduced for the non-corporate sector (see Recomm. 8.65).	ETI	Cost of Budget/FB 2010 extension to companies commencing to trade in 2010; -€6m in 2011 and -€15m in full year
7.8	Stamp duty on all share transactions should be reduced to zero.	ETI	-€156m (cost)
7.9	The tax rate on dividends received by Irish residents should be reduced to the rate applying to deposit interest. The measure should apply to ordinary shares. Safeguards should be included to ensure that the provision operates as intended.	ETI	Requires further analysis
7.10	Corporation tax payable on gains on disposal of assets used for trading purposes should be at the rate applicable to trading profits.	ETI	-€75m (cost)
7.11	All companies should be allowed to adopt a previous year option in relation to the payment of preliminary tax	ETI	Cash flow cost to the Exchequer: - €460m
8.12	Capital allowances for childcare facilities should be	FIN	**Abolished by FA10**

	discontinued		€10m
8.13	The income tax exemption for childcare service providers should be discontinued.	HC	<€1m
8.14	Exemption of employer-provided childcare from BIK	FIN	€6m
8.16	Income tax relief for rent paid for private rented accommodation should be discontinued.	EHLG	€48m
8.18	Income tax relief for service charges should be discontinued	FIN	**Abolished by FA10**
8.19	Discontinue the 'rent-a-room' relief	EHLG	€4m
8.20	The capital gains tax and stamp duty exemptions on the disposal of site to a child should be discontinued.	EHLG SP	Requires further analysis €25m
8.21	Medical insurance relief should be continued on a more limited basis.	HC	Current scheme -€321m (cost)
8.24	Range of treatments contained within the scope of the relief for health expenses should be subject to regular review	HC	
8.25	Tax relief for contributions paid to permanent health benefit schemes should continue	HC	Current scheme -€3m (cost)
8.26	Tax relief for long-term care policies should be discontinued	HC	**Abolished by FA10**
8.27	When direct expenditure support at the appropriate level is in place, the incapacitated child tax credit should be discontinued.	HC SP	€16m
8.28	The allowance for employing a carer for an incapacitated individual should continue. However, the rate of relief should be the same as that available under health expenses relief.	SP HC	Current scheme -€3m (cost)
8.29	The dependent relative tax credit should be discontinued. • The entitlement to mortgage interest relief that is derived from entitlement to the credit in relation to a principal private residence occupied by a dependent relative should continue. A person should be able to avail of first-time buyer levels of relief once in respect of himself or herself and once in respect of a dependent relative who has not claimed for himself or herself. • The separate entitlement to CGT relief on the disposal of a principal private residence occupied by a dependent relative should be discontinued.	SP HC	€1m
8.30	When direct expenditure support at the appropriate level is in place, the blind person's tax credit should be discontinued.	HC SP	€1m
8.31	The arrangements for the scheme of accelerated capital allowances for palliative care units should be modified by the introduction of a termination date for the scheme.	SP HC	Requires further analysis
8.33	The scheme for payment of tax by means of donation of heritage items should be retained but should be modified so that the tax relief is limited to 50% of the value of the item donated.	TCS	€2.5m
8.34	The scheme for payment of tax by means of donation of heritage property should be retained but should be modified so that the tax relief is limited to 50% of the value of the property donated.	TCS EHLG	€2.5m
8.35	The capital gains tax exemption on works of art loaned for public display should be retained but the exemption should only apply to the gain accruing in the period for which the work of art has been so loaned.	TCS	Requires further analysis
8.36	Income tax relief for expenditure on heritage buildings and	TCS	**Modified by FA10**

	gardens to be abolished		€4.5m
8.38	The CAT exemption of heritage property and heritage property of companies should be retained.	TCS EHLG	Current scheme -€1m (cost)
8.39	The threshold on the eligibility of individual donations to charities and approved bodies to attract tax relief should be reduced from €250 to €100.	TCS	-€40m (cost)
8.40	The relief for individuals under Recommendation 8.39 should be at the standard rate in all cases.	CEGA TCS	€25m
8.41	An upper limit of €500,000 per person on the annual value of donations which may attract tax relief is recommended. This limit should be enforced using the principles of self-assessment and audit.	CEGA TCS	Requires further analysis
8.42	The self-employed should be treated in the same way as PAYE earners under the scheme with the tax relief being paid to the charity or approved body	TCS	- €10m (cost)
8.43	In relation to donations from companies, the amount that would attract tax relief should be the same as for individuals, i.e. a maximum of €500,000 per annum. The rate of tax relief on corporate donations should be the corporate tax rate and, as with donations from individuals, the tax relief should be paid to the charity or approved body.	TCS	- €5m (cost)
8.44	The tax relief scheme available on donations to sports bodies should be modified. The tax relief regime that is recommended in respect of donations to charities and other approved bodies should also apply in relation to relief for donations to sports bodies and aggregate limits should apply to both reliefs.	TCS	<€1m
8.46	The tax-exempt status of philanthropic and sports bodies should continue. However, the capital gains tax exemption should be discontinued where development land is disposed of.	TCS	Requires further analysis
8.47	The restriction of balancing charges on a building to the relevant holding period for that building should be discontinued for future acquisitions.	ETI AFF	Requires further analysis
8.48**	Grants to meet revenue expenditure should be taken into account in calculating taxable trading income and capital allowances should be available on expenditure net of capital grants. However, in the case of employment related grants, there may be a case for postponing the approach we suggest until more favourable labour market conditions apply.	ETI AFF	Requires further analysis
8.50	Tax exemption for patent royalties should be discontinued.	ETI	€50m
8.54	Stock relief for farming businesses should be discontinued.	AFF	€2m
8.56	The accelerated allowance for capital expenditure on farm buildings for pollution control should not be continued when it expires in 2010. For subsequent years, normal capital allowances should apply.	AFF	€1m
8.57	The tax relief for the purchase of milk quota should be discontinued.	AFF	Requires further analysis
8.59	The tax exemption for payments to National Co-operative Farm Relief Services Ltd. and payments made to its members should be discontinued.	AFF	<€1m
8.62	The Mid-Shannon corridor scheme should not be continued beyond its current expiry date.	TCS	Requires further analysis
8.63	The investment allowance for machinery and plant and for exploration expenditure should be discontinued.	CENR	<€1m
8.65	The relief from tax for start-up companies should be continued. However, the scheme should be modified so that companies who begin trading in 2010 or 2011 would benefit	ETI	- €10m Cost of Budget/FB

	from the exemption for two-years or one-year, respectively, within the existing three-year timeframe for the relief. In addition, the exclusion which applies to service companies should be removed. • A new scheme for unincorporated businesses should be established which would have its own three-year time cycle in line with the approach we recommend for the existing scheme. • Both the existing scheme and the proposed new one for unincorporated business should be subject to review in accordance with our general principles as set out in Section 5 of this Part after a reasonable period of time.		2010 extension to companies commencing to trade in 2010; -€6m in 2011 and -€15m in full year
8.66	The tax treatment of venture fund managers should be modified such that in the case of an individual who is a venture capital fund manager: • Where the investment return on a carried interest represents income, it should be taxed at the appropriate marginal rate, and • Where the investment return on a carried interest is a capital gain, it should be subject to capital gains tax at the normal rate (25%).	ETI	Requires further analysis
8.68**	The capital gains tax relief for family transfers should be continued but limited so that it applies to asset values up to €3 million. Where the value of the asset transferred exceeds €3 million, only the part of the gain that is attributable to the excess over €3 million should be charged to tax.	ETI AFF	Requires further analysis
8.70	For business relief for CAT, a reduction of no more than 75% of the value of the business should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million.	ETI	€11m
8.71	For agricultural relief for CAT, a reduction of no more than 75% of the value of the property should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million. A condition of the relief should be that a farm asset is owned and operated as a farm for a period of six years after the transfer.	AFF	€36m
8.72	Business relief and agricultural relief should be amalgamated into a single relief.	AFF ETI	Requires further analysis
8.76	Income tax relief for trade union subscriptions should be discontinued	FIN	€22m
8.84	Income tax relief for *ex-gratia* termination payments should continue but the quantum of the exempt payment should be limited to €200,000 and the reliefs for Standard Capital Superannuation Benefit and top-slicing relief should be simplified.	ETI	€1m
8.85	*Ex-gratia* termination payments related to death or disability should be subject to a limit in relation to the tax-free amount permissible	ETI	Requires further analysis
8.86	Income tax relief for termination payments where an employment involves foreign service should continue. However, it should be subject to an overall monetary cap of €200,000 in line with our recommendation for termination payments in excess of the statutory redundancy amount.	ETI	Requires further analysis
8.88	There are grounds for discontinuing the systematic short-time relief for equity reasons. However, discontinuation should not be implemented until more favourable labour market conditions apply.	ETI SP	Current scheme - €2m (cost)
8.91	The PRSI exemption for employee (unapproved) share		€15m

	options should be discontinued.	ETI	
8.92	Remove exemption from PRSI, etc. from Approved Profit Sharing Schemes	ETI	€35m
8.94	• The income tax exemption for approved share option schemes (APSOs) should be discontinued. • The taxable value of option gains should also be liable to both employer and employee PRSI and to the health contribution levy and the income levy.	ETI	€3m
8.95	Continue the income tax exemption for the save as you earn (SAYE) schemes and remove the PRSI, health contribution levy and income levy exemptions.	ETI	€2m
8.96	Extend the SAYE rules to permit a broader range of employee stock purchase plans (offered to all employees on similar terms and subject to an overall share purchase limit) to be eligible for income tax relief.	ETI	- €6m (cost)
8.97	The income tax exemption for new shares purchased on issue by employees should be discontinued.	ETI	€0.2m
8.98	The artist's exemption should be discontinued; consideration should be given to introducing income averaging in the taxation of income from creative work	TCS	€25m
8.99	The sportsperson's relief should continue. • The total repayment of tax for any 10-year period should be capped at €350,000 as adjusted for inflation. • The sportsperson can only select a block of 10 consecutive years for which to claim the relief as opposed to the best 10 non-continuous years. The relief should be subject to review after five years of operation under these new arrangements.	TCS	€2m
8.100	The seafarer's allowance should be discontinued.	AFF	€0.4m
8.102	The income tax exemption for payments under Scéim na bhFoghlaimeoirí Gaeilge should be discontinued.	CEGA	<€1m
8.108	Relief from income tax in respect of payments related to service during War of Independence to continue	Def	Requires further analysis
8.109	The relief from income tax of military and other pensions, gratuities and allowances should continue. In future, the tax treatment of military service gratuities should be consistent with the tax treatment of lump sum payments in other public service employments.	Def	Current scheme - €2m (cost)
10.8	• As the annual earnings limit does not apply to employer contributions, there is a need to retain the standard fund threshold. • There should be a correlation between the annual earnings limit and the standard fund threshold, and the reduction in the annual earnings limit suggests that there should be a corresponding reduction in the standard fund threshold.	SP	Requires further analysis
10.9	A lump sum taken on retirement should be liable to tax as follows: An amount of up to €200,000 should be tax free. The balance of the lump sum should be subject to tax at the standard rate of income tax.	SP	Requires further analysis
9.5	Continue the Accelerated Capital Allowance for energy-efficient equipment scheme for its current term; evaluate the potential for expanding the scheme to incentivise innovation (based, for example, on the Dutch model).	CENR	Requires further analysis

* Tax expenditure shared with another Department

** Departments are as follows:

AFF – Dept. of Agriculture, Food & Fisheries
CEGA – Dept. of Community, Equality and Gaeltacht Affairs
Def – Dept. of Defence

ETI – Dept. of Enterprise, Trade & Employment
EHLG – Dept. of Environment, Heritage & Local Government
FIN – Dept. of Finance
HC – Dept. of Health & Children
SP – Dept. of Social Protection
TCS – Dept. of Tourism, Culture & Sport

Appendix B

Factors which may be taken into account by Departments when assessing the effectiveness of tax expenditures

- Description of the measure and policy rationale, including the sector benefiting from the expenditure.
- Economic and employment impact, including any benefits in relation to increased foreign direct investment and indigenous business investment, where relevant.
- Cultural, heritage and educational impacts.
- Environmental impact.
- Impact on innovation.
- International aspects to the measure, including any North/South involvement.
- Costs arising from the measure, including deadweight (the extent to which the intended outcomes targeted by the tax expenditure would have occurred anyway in the absence of the tax expenditure), displacement (the degree to which outputs resulting from the tax expenditure are created at the expense of output elsewhere in the economy) and any externalities (a side effect to an economic action that affects a third party such as pollution and other similar intangible factors).
- Any potential adverse impacts which may arise from the abolition of the tax expenditure.
- The costs to the Department of replacing the tax expenditure with direct Exchequer funding to meet the same policy objectives.
- Requirement for transitional arrangements if the expenditure is to be abolished in line with the Commission on Taxation Report.
- If the tax expenditure is not abolished in Budget 2011, is there a later potential abolition date.