

Chapter 1 Department of Finance

1.1 Tax Expenditures

Introduction

Exemptions, deductions, credits, and deferrals designed to encourage certain taxpayer activities or to limit the tax burden on certain types of individuals or endeavours are known as tax expenditures — these can have a significant impact on tax revenues. When such reliefs are introduced through the annual Finance Act, a judgment is made that the overall change that will occur as a result will represent good value overall to the State for the cost of the relief viz. the tax revenue forgone. It is generally agreed that prudent financial management requires that the ongoing and ultimate actual cost and outcome for such reliefs are measured and kept under review, that the impact on taxpayer behaviour and on the overall taxbase is monitored, and appropriate action taken as necessary.

Cost Effectiveness

The Commission on Taxation¹ in 1984 acknowledged that ‘the effect on tax revenue cannot always be measured accurately, nor can the results of granting the concessions be estimated with any precision’. However the Commission also considered, while not underestimating the difficulties of doing so, that it was essential ‘that procedures be instituted to enable the government to assess the effectiveness of tax incentives on a regular basis’. My 2001 Value for Money Report on the Expenditure Review Initiative concluded that ‘operating on the principle of results-based reviews, the scope of the Expenditure Review Initiative should also be broadened to include tax expenditures such as tax reliefs and exemptions’.

In October 2002 a Department of Finance report on Tax Incentives/Expenditures² to the Tax Strategy Group listed 28 major tax incentives/expenditures estimated to cost more than €20m each per annum with an estimated total cost of €7.3bn. The report considered issues relating to tax expenditures and indicated a need to examine tax incentives/expenditures both in the terms set out by me in the Value for Money Report viz. establishing and reviewing the ongoing costs of schemes, and in terms of the introduction of new incentives/expenditures. That included the possibility of linking them to associated targets and time limits within which the provision could be examined and extended, curtailed or withdrawn as appropriate. In response, the Tax Strategy Group³ acknowledged the need for better data on tax incentives and expenditures. It agreed that there should not be an automatic roll-over of schemes reaching their end date, and that tax incentives and tax expenditure schemes should be reviewed on a case-by-case basis.

Current Deficiencies in Information Gathering

Revenue is the main source of information, statistics and data on tax incentives/expenditures as the collection of statistical information flows from the administration of the tax system. However, the extent of the data available is limited to that included on the various tax return forms and to the degree to which that data is captured on computer to facilitate extraction and analysis. The 2001 Revenue Statistical Report lists a total of 91 allowances and reliefs⁴ and indicates an estimated cost for 48 of them. A more speculative estimate is provided in a further 10 instances, and costs are not available for the remaining 33 reliefs.

¹ Commission on Taxation Second Report: Direct Taxation – The Role of Incentives, 1984.

² Department of Finance – Tax Strategy Group Papers Budget 2003 – TSG 02/28 & TSG 02/28a.

³ Department of Finance – Tax Strategy Group Papers Budget 2003 – TSG 02/27.

⁴ Statistical Report 2001 – Table IT6 – Cost of Allowances and Reliefs.

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Table 1.1 Costings of Allowances, Reliefs and Exemptions which are Particularly Tentative and Subject to a Considerable Margin of Error

Tax Relief Provision	1999-00	1998-99
	€m	€m
Employees' Contributions To Approved Superannuation Schemes	456	329
Employers' Contributions To Approved Superannuation Schemes	645	533
Exemption of Net Income of Approved Superannuation Funds (Contributions plus Investment Income less Outgoings)	1,274	967
Exemption of Irish Government Securities Where Owner Not Ordinarily Resident in Ireland	81	47
Exemption From Tax of Certain Social Welfare Payments:		
Child Benefit	127	116
Maternity Allowance	8	8
Relief under Profit Sharing Schemes	31	34
Exemption under Approved Share Option Schemes	5	20
Stock Relief	2	2
Rented Residential Accommodation	31	32

Table 1.2 Uncosted Allowances, Reliefs and Exemptions

Certain payments made by a person carrying on a trade or profession to an Irish university or other qualifying educational establishment
Relief for donations made to certain bodies engaged in the promotion of the arts
Exemption in respect of certain income derived from the leasing of farm land
Expenditure on certain buildings in designated inner city area
Relief for new shares purchased on issue by employees
Relief for donations made to "Cospoir" The National Sports Council
Relief for investment in research and development
Exemption in respect of stallion stud fees
Exemption of profits arising from commercially managed woodlands
Relief from averaging of farm profits
Exemption for income arising from payments in respect of personal injuries
Exemption of certain payments made by Hemophilia HIV Trust
Exemption in respect of income arising from certain patents
Exemption in respect of payments made under the Enterprise Allowance Scheme
Exemption of income from foreign trusts
Exemption of lump-sum retirement payments
Relief for allowable motor expenses
Tapering relief allowable for taxation of car benefits-in-kind
Relief for gifts to The Enterprise Trust Ltd.
Reduced tax rate of 10% for authorised unit trust schemes
Reduced tax rate of 10% for special investment schemes
Exemption of certain grants made by Údarás na Gaeltachta
Relief for donations made by companies to First Step Ltd.
Reliefs for activities related to the Customs House Docks Area and Shannon Airport Customs-Free zone
Relief for investment income reserved for policy holders in life assurance companies
Allowances for double-rent, owner-occupier and expenditure on historic buildings in Urban Renewal areas
Relief for various business-related expenses such as staff recruitment, rent, legal fees, and other general expenses
Exemption in certain circumstances on quoted bearer Eurobonds
Exemption of payments made as compensation for loss of office
Renewal scheme for traditional seaside resorts
Donations to Third Level Institutions
Exemption of scholarship income
Donations to Public Libraries

Capital Allowances

One of the main categories of tax expenditure lies in the area covered by the generic title “capital allowances”. For instance, the total amount claimed in the 1999/00 tax year (on which the 2001 Statistical Report was based) was €8,310m. Table 1.3 sets out the major elements of that figure including plant and machinery, industrial buildings and rental, and gives details of the number claiming, the average claim and the highest claim.

Table 1.3 Breakdown of 1999/00 Capital Allowance Claims

Capital Allowance Type	Average Claim	Number Claiming	Highest Claim	Total Claimed
Plant & Machinery	€210,060	35,249	€246m	€7,405m
Industrial Buildings	€77,855	3,817	€23m	€297m
Miscellaneous Reliefs	€62,402	7,676	€180m	€479m
Rental Capital Allowances	€83,436	1,546	€17m	€129m
Total				€8,310m

**The total claimed, and the estimate of cost below, do not include a significant amount in respect of 'unused capital allowances' i.e. capital allowances which are not absorbed by a company in the accounting period in which they arise, but are carried forward until sufficient profits are available for offset in future years.*

The overall estimated cost of €1,649m for capital allowance reliefs as reported in the 2001 Statistical Report⁵ was calculated by applying the relevant rates of Income Tax and Corporation Tax, as considered appropriate, to the capital allowances claimed.

Outside of the breakdown between Plant and Machinery, Industrial Buildings and Rental, no further details or costs are available for the many schemes included in the capital allowance category e.g. urban renewal, rural renewal, seaside resorts, airports, hotels, nursing homes, child care facilities, private hospitals, park and ride facilities, third level institutions. As taxpayers are not required to give details on the tax return of the particular schemes under which the capital allowances are claimed, the amount of the particular reliefs/incentives claimed cannot be extracted from the aggregated totals. A further reduction in the information required on the 2002 Corporation Tax return form will result in the loss of even the aggregate capital allowance totals for that year. 80% of the cost of capital allowances is claimed against Corporation Tax. The requirement for aggregate details was restored for 2003.

While detailed capital allowance data is effectively inaccessible when it is not entered on and coded from the tax return form to facilitate computer processing, the amounts claimed under each of the various schemes can be reviewed on a case-by-case basis from the documentation accompanying the tax return. That approach was the basis of the 2002 High Earners Report⁶ which demonstrated how the top 400 earners availed of the various property-based capital allowance incentives to minimise their effective rate of tax. In this group of earners, significant loss relief was generated through capital allowance incentives such as hotels (€12m) and multi-storey car parks (€9.7m) and other miscellaneous property based schemes (€46m). Other loss reliefs claimed included heritage homes (€4m), loan interest (€0.8m) and film relief (€0.15m).

⁵ Office of the Revenue Commissioners – Statistical Report 2001.

⁶ 2002 Revenue Commissioners Study – Effective Tax Rates for High Earning Individuals.

Audit Concerns

As I was concerned about the lack of information available on the cost to the Exchequer of many tax expenditure schemes, I asked the Accounting Officers for the Department of Finance and the Office of the Revenue Commissioners about the steps being taken to address the information deficit. I also sought the views of the Accounting Officer of the Office of the Revenue Commissioners on the level of check on the legitimacy and correctness of the reliefs claimed under the schemes, bearing in mind that a joint Revenue/Department of Finance group noted in 2002 that existing Revenue audit activity might not be adequately covering this aspect.

Department of Finance Response

The Accounting Officer of the Department of Finance informed me that the Department recognised the need for close monitoring of tax expenditures and that the Minister and the Department were committed to keeping such schemes and provisions under review. For that reason, the Department had been working with Revenue for some time on ways to improve the availability of costing information to assist in such reviews. Any developments in that area must also take into account a number of other public policy objectives such as facilitating tax compliance and minimising regulatory burdens. He indicated that a number of developments were under consideration including amending the tax return system to capture data on capital allowances. It was envisaged that a working group of Finance and Revenue officials at senior level would be established to examine further the issues involved and to monitor progress.

The Accounting Officer stated that tax expenditures and reliefs were being kept under review. The Tax Strategy Group paper had indicated that with better data it should be possible to monitor, evaluate and review existing tax reliefs in a more systematic manner. It had also indicated that it would be necessary to look critically at existing reliefs. Following the Tax Strategy Group discussion, submissions were made to the Minister assessing a range of reliefs. Following consideration of the issues arising, the Minister had announced in Budget 2003 the termination of nine tax incentive schemes at the end of 2004 and the immediate termination of two schemes. In addition, in the context of the Finance Act 2003, the Minister provided for inclusion in the tax return of certain exempt income.

The Accounting Officer pointed out that assessments of certain reliefs on a more extensive basis had also been conducted through the engagement of consultants. Examples included a review of the Urban Renewal Scheme in 1996⁷ and a review of the Film Relief Scheme in 1999⁸. He also noted that the Seed Capital Scheme and the Business Expansion Scheme had been reviewed on a number of occasions, most recently in 2001, by the Department of Finance in conjunction with the Revenue Commissioners and the Department of Enterprise, Trade and Employment. Both schemes were currently under review prior to their expiry on 31 December 2003.

Revenue Response

The Accounting Officer of the Office of the Revenue Commissioners stated that he was in strong agreement as to the need to be able to accurately cost tax incentives and reliefs and to track the effect of budget changes, and that had already been signalled to the Department of Finance. However, a cornerstone of Revenue's strategy to maximise tax compliance was to keep compliance costs for taxpayers as low as possible through ongoing simplification of forms, procedures and regulations.

Revenue considered, therefore, that the challenge it was faced with was that of being able to gather the costing data required without creating a more complex tax compliance environment for the vast bulk of taxpayers who did not avail of the incentives or reliefs. However, recent technology developments in Revenue, particularly electronic filing through the Revenue On-line Service, were enabling the

⁷ Review of the Urban Renewal Scheme conducted by KMPG on behalf of the Department of the Environment and Local Government (1996).

⁸ Review of the Film Relief Scheme by Indecon on behalf of the Department of Arts, Culture, Gaeltacht and the Islands (1999)

development of firm proposals to do that in a manner that would source the information needed (and in a timely manner) while keeping the extra compliance burden for taxpayers to a minimum. While Revenue fully accepted the need to have accurate and timely data for the purposes of effective policy formulation, the Accounting Officer also pointed out that there would be substantial costs involved in making the necessary changes to Revenue computer systems and that looking for such extra information from taxpayers would undoubtedly lead to expressions of concern amongst tax practitioners.

As regards the validation of reliefs claimed, the Accounting Officer confirmed that, by and large, the verification of taxpayer specific claims to reliefs was subsumed into the ordinary audit process. Over the years particular verification exercises would have been carried out in individual audit districts in regard to some of the reliefs e.g. film relief, etc. For the future, there was no doubt that Revenue, in obtaining data on claims for such reliefs in a more structured manner (to comply with Department of Finance requirement for detailed costing data), would also be gaining a valuable input to its new Risk Analysis system. That would allow for more targeted monitoring of taxpayers availing of the various reliefs and incentives than was the case at present. He also stated that the establishment of a High Wealth Individuals Unit in the new Revenue Large Cases Division would ensure a much closer focus on the tax affairs of the top 200 - 250 wealthy individuals including the monitoring of incentives claimed by such individuals. Revenue was confident that such a more risk-focused approach to taxpayers generally (including the checking of tax reliefs where risk analysis deemed it necessary) would provide adequate assurance regarding the legitimacy of such claims.