TASC

Tax Injustice

Following the Tax Trail

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Acknowledgements

TASC would like to thank Christian Aid who commissioned us to produce this report, and provided us with valuable information and support. In particular, we would like to thank Sorley McCaughey and Adrian Horsman for their constructive criticism, suggestions and encouragement.

TASC would also like to acknowledge the external contributions of Dr James Stewart of Trinity College Dublin (International Financial Services Centre), Prof David Jacobson of Dublin City University (Transfer Price Fixing) and Dr Micheál Collins of the Nevin Economic Research Institute (Financial Transaction Tax). We would also like to thank Mary Farrell for her invaluable contributions and insights into the operation of the Irish taxation system.

Preface

Tax Injustice: Following the Tax Trail is an innovative and timely document that provides a robust and rational critique of tax breaks, a prime component of Ireland's taxation system. It outlines alternative taxation choices that can be made by Government to reduce inequality and increase economic efficiency. Christian Aid is to be commended highly for envisaging and commissioning this work. I believe that it can be a prime tool for lawmakers and policymakers, particularly at this time, as we carefully search for innovative ways to grow our economy in an equitable manner.

The link, however, between our domestic taxation policy choices and their impact on the Global South is less apparent for lawmakers and this is why I am particularly impressed with the vision of Christian Aid as it is manifested in this report's terms of reference. TASC's analysis of this link does not hold back any punches. The authors name boldly an inherent public policy contradiction in Ireland's taxation regime: *"despite Ireland's track record of solidarity with the Global South, the domestic system of corporate taxation is structured in a manner that supports a practice which impoverishes hundreds of millions of the world's poorest citizens by facilitating multinational firms in reducing their international tax bill."* The Irish tax regime could undermine the capacity of countries in the Global South to collect tax. Government has a responsibility, I think, to ensure that Irish aid is not undermined by tax policies.

As Ireland braces itself for our next budget this report provides lawmakers and the general public with a hugely significant analysis of taxation measures that have been missing to date. While much of current commentary notes the progressivity of our taxation system *Tax Injustice: Following the Tax Trail* challenges this un-nuanced message. If Government is committed to fairness and to a progressive approach to taxation, then our legal and policy measures should reflect the principle: 'the more you earn, the more you should pay.' As outlined in the following pages, the reader will see that there exist still a number of tax breaks or tax reliefs that reduce the tax bill of higher earners. As the authors point out these taxation measures are a form of public spending. Consequently, the public monies spent increasing the net income of higher earners necessarily reduce the amount of public monies available for public services and social welfare. Indeed tax breaks are social transfers, yet they do not carry the stigma attached to the social transfers of welfare benefits. This is another contradiction that needs to be faced by lawmakers and policymakers. The political rhetoric of 'fairness' must be grounded in ameliorating such contradictions and choosing alternative taxation measures such as those outlined in this report.

I wish to conclude by expressing my appreciation to TASC for this intellectually rigorous and accessible analysis, reflective of TASC's high standards as an independent, progressive think-tank.

Senator Katherine Zappone

Summary

CHOICES

Public policy is about choices – choices affecting individuals and communities, locally and globally.

An equitable, sufficient and sustainable taxation system is one of the hallmarks of good governance.

It is important, for both equality and economic efficiency, that a tax system is progressive: the more you earn, the more you should pay. While Ireland's basic system of taxation is progressive, that progressivity has been undermined in recent decades by an edifice of non-standard tax reliefs (also known as tax expenditures, tax subsidies, tax incentives or tax breaks).

PRIORITIES

The decision to grant a specific tax break to a particular sector of society – or, conversely, to cut spending on a service affecting a particular sector – is a political choice reflecting our social and economic priorities.

We can, for example, decide to incentivise private pension provision by providing relief on pension contributions – or we can use the money spent on such relief to help increase, and ultimately universalise, the basic State pension.

In the former instance, the beneficiaries are principally higher earners – while the latter choice would benefit everyone but especially those at the bottom of the income heap.

Those choices remain open to us even in times of economic crisis: while we have fewer resources, we remain free to allocate those resources as we see fit.

SPENDING OUR MONEY

Every time the Government grants a tax relief, it is effectively spending money – which is why tax reliefs are sometimes known as 'tax expenditures'. It is foregoing tax revenue which could otherwise be spent on public services at home or on aid abroad. It is also distorting economic activity by sucking investment into tax- incentivised sectors and away from potentially more productive sectors and activities – regardless of whether such development is of long-term benefit to the economy and society.

WHO PAYS?

As we will outline later in this report, tax breaks reduce government income and therefore, if our public finances are to remain sustainable, each tax break must be funded either by imposing a higher tax burden on the rest of society, or by reducing Government spending.

TAX AVOIDANCE

While different types of tax rates and tax reliefs are deliberately introduced by governments in an attempt to achieve a particular policy outcome, individuals and corporations may use or abuse them in a manner other than that intended in order to avoid meeting their tax liabilities. Transfer price fixing is one such mechanism, and entails fixing the price at which one part of a company transfers goods or services to another part of the company in a different jurisdiction in order to benefit from differences in the tax rates and reliefs available in different jurisdictions.

ANTI-SOCIAL BEHAVIOUR

Although often portrayed as victimless, tax avoidance is anything but. Both tax evasion and its dubious but legal counterpart, tax avoidance, are forms of anti-social behaviour by the individuals or corporations concerned. Not only do these practices reduce the tax revenues on which we all rely, whether in Ireland or in the Global South – they also lead to decisions made for tax purposes rather than for genuine economic and productive return. This, in turn, harms global growth and innovation in the long-term.

CONSEQUENCES

The consequences of a tax system built on reliefs include:

- Enhanced inequality: some tax breaks disproportionately benefit higher earners who receive relief at the higher rate and who are more likely to have the cash or borrowing capacity needed to invest in incentivised schemes.

In 2009, the ESRI calculated that the top 20 per cent of earners benefitted from 80 per cent of the money spent on pension tax reliefs.

- Reduced tax revenue: every time the government grants a tax break, it is reducing the total pot of tax revenue. The tax break therefore needs to be compensated for either by increasing tax in other areas, or by cutting government spending.

While tax breaks disproportionately benefit higher earners, low income groups are more likely to suffer from the effects of public spending cuts.

- Distortion of economic activity: investors follow the money – and tax breaks effectively funnel funds into incentivised sectors. During the 1990s, a range of property-based tax reliefs (many of which were known collectively as 'Section 23-type reliefs') sucked investment into the property sector, helping to fuel an unsustainable construction boom for which we are still paying.

Today, those counties eligible for 'Shannon Basin Relief', introduced in 1998, are home to some of the highest numbers of vacant units per households (ghost estates).

- Different tax rates and tax reliefs, cleverly combined and exploited, can enable companies to reduce their global tax bill by basing different operations in different jurisdictions to take advantage of favourable tax treatment. This can undermine the ability of countries in the Global South to collect tax, draining resources from their public services and postponing the day when they can raise sufficient revenue to reduce their reliance on aid.

When our tax arrangements facilitate multinationals in reducing their global tax bill, the price could be paid by millions of the world's poorest citizens.

SOLUTIONS

There is no one solution to the issue of tax injustice – but there are a number of measures which could render the Irish and international tax systems fairer, while reducing the scope for tax avoidance.

At a local level, TASC has long advocated *equality proofing* and *equality auditing* of all budgetary measures. This would ensure, for example, that – prior to any taxation changes being introduced – a rigorous analysis is carried out of the likely impact on overall income and wealth distribution.

In addition, all tax breaks should be subjected to a *cost-benefit analysis*, and to a so-called *'sunset clause'* ensuring that they expire after three years unless they are renewed for a further three years by the Dáil following a positive cost-benefit analysis.

At a global level, increased *transparency* in the reporting of activities of multinational companies and other entities, and the automatic *exchange of information* between tax authorities, are crucial to prevent tax tourism: companies roaming the world in an effort to reduce their global tax bill.

The introduction of a *Financial Transaction Tax* would also raise revenue while reducing the attractiveness of the kind of financial products which helped fuel the global banking and economic crises – crises which, as noted by the World Bank, have hit the world's poorest hardest (World Bank, 2009). It would also increase transparency.

WINNERS AND LOSERS

Every time we make public policy choices, there are winners and losers. So just who does taxation policy currently benefit?

In terms of many tax breaks, the big winners are those who earn enough to reap the full benefit of the relief in question. The winners are those who have sufficient funds or borrowing capacity to invest in a tax-incentivised scheme. And the winners are those individuals and companies who know how to exploit our tax rates and tax breaks – those who can pay accountants and tax advisers to save them money.

The losers are the rest of us. The losers are those who lack the income or funds to avail of tax breaks. The losers are those paying more in other taxes, such as VAT, to compensate for the revenue foregone through tax breaks. The losers are those bearing the brunt of public spending cuts imposed to pay for tax breaks: children, the elderly, the sick and the vulnerable.

The losers are those in the Global South, whose governments are losing tax revenues to the EU and North America as a result of transfer pricing and royalty payment arrangements.

Tax dodging hurts the poor everywhere.

1. Introduction

PAYING TAX IN IRELAND

The basic system of taxation in Ireland is broadly progressive; individuals with a higher annual income pay more tax. However, reliefs from basic ('benchmark') tax obligations are embedded in the Irish tax regime. These reliefs come in the form of allowances, credits and exemptions that distort the tax system and reduce the effective rate of tax paid by those individuals who benefit from them.

The OECD identifies standard tax reliefs and non-standard tax reliefs as distinct categories of tax expenditures. Standard tax expenditures are defined as *"reliefs which are unrelated to actual expenditures incurred by the taxpayer and are automatically available to all taxpayers who satisfy the eligibility rules specified in the legislation"* (OECD, 2011). In its most common form, a standard tax relief is given as a fixed amount of income on an annual basis. For example, every PAYE worker in Ireland receives €1,650 of standard tax relief in the form of the personal tax credit and a further €1,650 employee tax credit. Taken together they exempt an individual from paying income tax until their annual earnings from employment exceed €16,500. Non-standard tax credits are measures that are wholly determined by reference to an expenditure incurred. These include reliefs on contributions to approved pension schemes and tax breaks on the interest payments due on qualifying loans.

Standard tax reliefs are generally considered to be a more equitable form of tax expenditure. The cost of standard exemptions is easier to estimate, the rules of the relief are widely understood and in many cases large sections of the population are entitled to benefit from them. It is relatively simple to give an overview of the system of taxation that accounts for standard tax reliefs, and these reliefs are more properly considered part of the basic tax system.

On the other hand, though they are often a significant cost to the Exchequer, non-standard tax reliefs tend to be utilised by smaller proportions of the population. This substantially undermines the progressivity of the taxation system. Further, the cost of these types of reliefs is often difficult to calculate and the legislation governing them tends to be relatively complex. Mapping the actual effects of non-standard tax expenditures on the regular system of taxation is therefore quite difficult.

Though the number of non-standard tax expenditures available to individuals has fallen in recent years, significant gaps in the system remain. These include reliefs in the pension and property sectors, for instance. Such non-standard tax expenditures are explored in more detail below.

What is tax evasion?

Tax evasion is taking action to gain a tax advantage which breaks the law. Such actions include understating turnover, understating profits, over-stating expenses or failing to disclose assets.

What is tax avoidance?

As a working definition, tax avoidance could be described as utilising legislation in a manner not intended by the legislature to obtain a tax advantage, or exploiting mismatches in domestic or international law to obtain a tax advantage.

TAX BREAKS IN IRELAND

Ireland has used tax breaks extensively in pursuit of particular policy outcomes in agriculture (Stock Relief, Woodlands Relief), industry (Manufacturing Relief, R&D Credits), arts and culture (Artists' Exemption, Film Relief), social policy (Tax relief for Crèches and Nursing Homes) and tourism (Hotels and Holiday Cottages Relief).

The cost of tax breaks can be high. The question for the taxpayer is whether the direct and indirect costs of the expenditure are justified by the anticipated benefit generated by the tax break. The OECD (2007) has defined tax breaks as:

a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure

Is use of tax breaks tax avoidance?

Tax breaks (also known as tax expenditures) differ from tax avoidance schemes in that the tax legislation is used as it is intended to be used. That being said, tax is still avoided by those availing of the tax breaks.

Examples of tax breaks

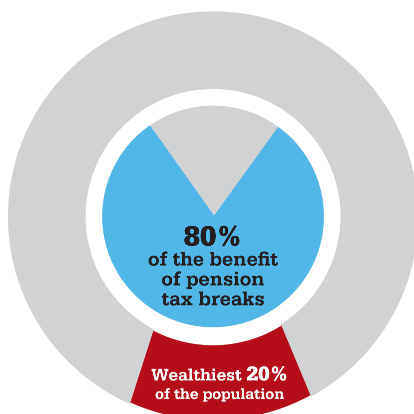
Rent-a-Room Relief, Health/Medical Expenses Relief, Film Relief, Pension Contributions relief

TAX BREAKS – WHO BENEFITS?

Tax breaks can exacerbate inequality in the long term. For example, TASC has previously noted the inequality in the tax relief on retirement savings (TASC, 2009). A 2009 ESRI analysis showed that 80 per cent of the benefit went to the highest 20 per cent of earners in Ireland. The September 2012 report on Ireland by the IMF states:

The current system subsidizes . . . beyond the incentives inherent in an EET system. These subsidies are poorly targeted, with richer taxpayers (who contribute more toward private pensions) receiving a substantial share of the subsidies. (IMF 12/264: 46)

The OECD recognises the potential problems posed by tax expenditures:



The use of tax expenditures by governments is pervasive and growing. At a time when many government budgets are threatened by population ageing and adverse cyclical developments, there is a pressing need to avoid inefficient government programmes, some of which may utilise tax expenditures. (OECD, 2010:3)

[...]

Tax expenditures ... have been a serious concern of budget and tax analysts for almost half a century. The concern is that tax expenditures may have ill effects on both budget and tax policy, and that both political and policy-making considerations may make tax expenditures easier to enact, and less likely to undergo rigorous review and repeal, than equivalent but more straightforward spending programmes.

(OECD, 2010: 14)

A 2011 report prepared by the IMF, OECD, UN and World Bank for the G-20 Development Group called *Supporting the Development of More Effective Tax Systems* identified the possible draw-backs for the Global South to using tax breaks as a means of attracting foreign investment:

Tax breaks aimed at foreign direct investment—largely to Multinational Enterprises (MNEs) domiciled in G-20 countries—are an especially significant form of tax expenditure in many developing countries, in many cases significantly undermining their tax revenue base. Developing countries sometimes believe— often correctly— that an attempt to hold the line against Multinational Enterprises negotiating for "necessary" tax breaks will simply drive the investment in question into a neighbouring country. This sort of bargaining frequently results in a "race to the bottom," in which countries in a region are made collectively worse off, to the benefit of the multinational investors. Studies also suggest that tax-driven investment does not provide a stable source of investment in the recipient country.

(IMF, OECD, UN, World Bank, 2011: 24)

TAX AVOIDANCE AND EVASION: WHAT HARM?

There is a need for a more constructive debate around appropriate and accountable taxation. Public services – like health care, education and social supports – have to be paid for. For example, society benefits when there is a solid reassurance given to everybody that we will not allow people to languish in poverty and we will not refuse essential medical treatment to those who cannot afford it. However, it costs money to provide such a 'threshold of decency', and these services must often be funded through general taxation.

When individuals avoid or 'opt out' of taxation, they undermine the funding necessary to pay for a decent level of public services. They also undermine the services (such as schooling and hospitals) that they and their families may themselves need at various points in their lives.

Tax evasion and aggressive tax avoidance constitute anti-social behaviour, and are ultimately destructive from the perspective of economic development. When economic decisions are made based on tax incentives rather than on real economic returns arising from comparative advantage, then an inefficient misallocation of resources is created. The long-term outcome is reduced economic growth and standard of living at the macroeconomic level.

The level and composition of tax revenues depends on the needs of a given society and economy, and the manner in which tax revenues are spent needs to be open, transparent and accountable. Once a society, through its democratically elected government, has decided how tax will be levied, it is the responsibility of all members of society to pay their taxes and to contribute to the public services that ultimately, directly or indirectly, benefit us all.

Tax avoidance, or tax dodging, is a problem common to many, if not most, countries. It is an issue that has provoked much international debate. A recent report by the Tax Justice Network (TJN) suggests that, through exploiting cross-border tax rules, the global super rich have hidden at least St£13 trillion in secretive jurisdictions such as the Cayman Islands. (Henry, J, 2012) They have been helped in this by specialised tax accountants, lawyers and private banks. Through these acts of tax dodging, St£13 trillion (the total of the US and Japanese GDPs put together) has been lost to the global economy and while this presents a problem to nearly all states, some countries are more vulnerable to tax avoidance and evasion than others.

The damage caused to the Global South by tax dodging can be demonstrated through some simple figures contained in the TJN report. Since the 1970s, 139 low-to-middle income countries have lost a total of $7.3 to $9.3 trillion to tax dodging by the super rich. This vast sum is more than enough to cover the debts of these countries, whose aggregate gross external debts stood at $4.08 trillion in 2010. (Henry, J, 2012) Tax dodging on this scale greatly hinders the capacity of these countries to pay these debts, and to develop their economies and pay for much needed public services.

2. 'Exchequer Give-Away'? The Economic and Social Impacts of Tax Breaks

LONG-TERM NEGATIVE EFFECTS OF TAX EXPENDITURES ON IRELAND

The negative economic effects of tax expenditure are all too familiar: from 'ghost estates' to 'zombie hotels', tax incentives caused extreme market distortion which inflated the Celtic Tiger to unsustainable levels..

The long-term inequality resulting from tax expenditures may not be as obvious. However, the scale of tax relief enjoyed by higher earners for private pensions, pension lump sums, private healthcare and similar outlays indicates that the Exchequer spends significant resources (which would pay for public services benefiting everyone) in order to provide tax breaks that disproportionately benefit higher income groups.

Tax Fact: If we reduced pension tax relief from 41% to 20%, higher earners would lose out – but we would save €470 million

TAX BREAKS AND THE SUSTAINABILITY OF PUBLIC FINANCES

Ireland's debt to GDP level is currently very high. The Irish Fiscal Advisory Council (IFAC, 2012: 6) has forecast that Ireland's debt will peak at around 119 per cent of GDP in 2013. A high debt to GDP level undermines long-run growth and employment prospects. One reason is that higher debt levels are associated with higher interest repayments on borrowings, and these repayments must eventually be funded through additional taxation and/or through lower levels of public spending. Either way, high debt levels result in lower aggregate demand, and lower output growth and employment, in the real economy over the long-term. Ireland's evolving debt dynamics are dependent both on the rate of nominal GDP growth in the coming years and on the state of the General Government Balance (GGB). The GGB for a given year is the difference between total government income and total government expenditure. The sustainability of the public finances in the long term is contingent upon successfully balancing total government revenue and total government spending over the long term. Ireland's GGB is projected to be in deficit at an unsustainable level of 8.6 per cent of GDP in 2012 and at 7.5 per cent of GDP in 2013. Ireland's total taxes (including social security contributions) were 28.2 per cent of GDP in 2010 (Eurostat, 2012: 180). The weighted EU average in the same year was over ten percentage points higher than Ireland at 38.4 per cent of GDP. Clearly, the sustainability of Ireland's current tax system must be addressed.

Tax breaks are a type of social transfer or expenditure that does not show up directly in government accounts. Each tax break represents a tax exemption, tax relief or tax reduction for a particular group of beneficiary individuals and/or firms. The exact beneficiaries of these social transfers vary from tax break to tax break. Tax breaks carry fiscal costs as they reduce the tax base and therefore undermine the public finances.

[...] tax expenditures remain a target for reforms aimed at raising revenue and enhancing the efficiency of the tax system. While personal allowances take the lowest earners out of the income tax system, the distributional nature of the other reliefs goes against progressivity as they only affect those who pay tax and benefit the highest earners the most. Fiscal consolidation should include a rationalisation and reduction of tax expenditures to restore the income tax to full functionality. Where it remains, deductibility should generally be limited to the standard rather than the marginal rate and the overall amount of relief available should be capped. (OECD, 2009: 61)

Tax breaks reduce government income. Therefore, if the sustainability of the public finances is to be maintained, each tax break must be paid for through the imposition of a higher tax burden on the rest of society. Alternatively, tax breaks can be funded by reducing public spending in areas such as education, health or pensions. Thus, each tax break represents a clear political choice with different winners and losers.

The gains for the individual or corporate beneficiaries must be weighed against the costs imposed on the rest of society in terms of higher taxes and reduced public spending. Protecting or extending tax breaks means deeper austerity in other areas than would otherwise be needed to restore Ireland's fiscal stability.

CHOICES: THE IMPACT OF THE DECLINING IRISH TAX TAKE ON SOCIETY

Every euro lost in tax revenue due to tax avoidance and tax evasion or tax breaks must be made up through other means. The Government can decide that it will replace this lost euro through increasing other taxes, such as income tax, or through cutting public expenditure. The level and quality of our public services, which benefit all of society, depend on sufficient and stable tax revenues. When public spending is cut services suffer. Those who depend more heavily on public services, for example children and older people, will feel the effects of a cut in public spending more acutely than other groups in society. However, cuts in public spending also affect society as a whole, as less money is made available for all public services and public goods such as public libraries, heritage protection etc.

Figure 1 shows *some of the cuts* made to services and direct payments in Budget 2012. The cumulative effect of a small number of cuts on lower income families can be quite severe. The children's charity Barnardos has estimated that, as a result of cuts to Child Benefit, the Back to School Clothing and Footwear Allowance, the Fuel Allowance and the increased minimum contribution towards Rent Supplement, "*a lone parent with two school going children will be worse off by approximately €537 per annum; while a lone parent with three children will be worse off by €820 per annum.*"

Contrast this loss of income to lone parents with the financial gain made by wealthy individuals through the Government's decision to continue to grant tax breaks to investors in the film industry (Figure 1). Section 481 of the Taxes Consolidation Act 1997 (Section 481) was established to encourage investment in film production. The Act allows individuals to purchase up to €50,000 worth of shares in a qualifying production company and deduct the total subscribed amount from the investor's overall taxable income. For an individual with €50,000 worth of annual income liable for taxation at the higher rate—the typical class of investor in the scheme—the benefit works as outlined below. Although it encourages investment in a culturally important sector, Section 481 demonstrates how non-standard tax expenditures tend to primarily benefit affluent sections of society at a considerable cost to the Exchequer.

Figure 1: Policy and your pocket: two different experiences

Section 481 - Investment in film production

Initial Investment: €50,000
Investor's savings: €16,500
Borrowed funds: €33,500

Breakeven point on investment: €51,500
Borrowed funds: €33,500
Interest Payments: €1,500*
Savings: €16,500

Loss on investment: €16,500
Return on Investment: €35,000

Tax refund on investment: €20,500
€50,000 @ 41 per cent = €20,500

Net gain on transaction for individual: €4,000

* Assumes APR of 3.7 per cent for 390 days.

Effects on children and their families Budget 2012

- Child benefit cut for the third by €19 euro a month and fourth and subsequent child by €17 euro a month
- Back to school Clothing and Footwear Allowance cut from €200 to €150 for four to eleven year olds and €305 to €250 for twelve year olds and over
- New €25 per week cost for childcare for parents (including lone parents) on VEC or FÁS courses.
- Reduction to €40 from €76.65 and €95.75 in allowances for 16-17 year olds on Youthreach, Community Training Centres and FÁS courses
- School capitation grants (which pay for the day to day costs of running the school e.g. heating, cleaning, lighting, maintenance of school premises etc.) cut by 2 per cent

Effects on Older People Budget 2012

- Fuel allowance cut from 32 weeks to 26 weeks
- Between 555 and 898 public nursing home beds to be closed in 2012
- A reduction of 605,000 (5.5%) hours of home help in 2012

EQUALITY IMPACTS

Tax expenditures are a type of public spending that benefits particular interest groups by treating certain activities or groups in a preferential way. The main difference between tax expenditures and public spending as commonly understood is that the preferential treatment for the recipient group comes in the form of reduced taxes instead of in the form of direct subsidies or other government spending. Nevertheless the tax expenditure, or tax break, should be seen as analogous to a government spending program. In the case of pension provision for example, in 2007 *"tax reliefs – or Exchequer giveaways – amounted to nine per cent more than the cost of social insurance pensions ... and over three times the cost of means-tested pensions."* (TASC, 2010: 13) Each tax break will have its own costs and benefits and these costs and benefits will not be uniform across the population. Public spending in the form of tax expenditures tends to deliver greater benefits to higher income households. For example, reliefs that allow a tax deduction at the individual's marginal rate of income tax are more valuable to, and will disproportionately benefit, those on the highest income tax rates. The impact of these types of tax relief is to reduce the progressivity and equity of the tax system and to do so in a way that is less transparent than direct public spending. Tax expenditures may therefore undermine the principle that individuals should pay tax in proportion to their ability to pay (Combat Poverty, 2005). As James Poterba notes:

Tax expenditures are often criticised on the grounds that they are effectively camouflaged expenditure programmes, and that their true effects are not obvious. (Poterba, 2010)

In contrast, the benefits of public service provision, such as health care and education, are more evenly distributed across the population and are more transparent. Poterba continues that:

Because tax expenditures narrow the tax base, it is necessary to set average tax rates higher than they would otherwise have to be. A key challenge for economists and other policy analysts is to review tax expenditures and to ask is there a justification for these exemptions and deductions. (Poterba, 2010)

According to the Combat Poverty Agency:

[...] there is a double inequity associated with tax reliefs. On the one hand they reduce the tax base, thereby imposing higher tax burdens on average households not in a position to avail of many tax-relief schemes, and on the other hand they provide high earners with opportunities to avoid paying tax. (Combat Poverty Agency, 2005)

By and large, a government that chooses to protect or introduce tax breaks, while increasing other taxes and cutting other areas of public spending, is actively choosing to favour better off households at the expense of the rest of the population.

GROWTH AND QUALITY-OF-LIFE IMPACTS

The standard rationale given for tax expenditures is to encourage a particular economic activity. However, there is often a deadweight loss associated with tax expenditures in so far as they may subsidise economic activity that would have happened anyway in the absence of the tax break. Tax expenditures change the incentive structure for households and firms, thus influencing their behaviour. The resulting behavioural changes can have positive and negative impacts on both short-run and long-run economic growth as well as on overall societal wellbeing.

Tax breaks can negatively affect growth by distorting allocative efficiency (i.e. where money is invested), by creating inefficiencies in production and consumption, and by diverting economic activity toward rent-seeking behaviour. On the other hand, well targeted tax breaks can have positive impacts over the long term to the extent that they reduce negative externalities such as pollution, or encourage activities such as basic research that generate positive externalities.

The behavioural effects of tax expenditures can also have unintended consequences. For example, the variety of property-related tax breaks in place in Ireland during the late 1990s and 2000s incentivised speculation in property at the expense of saving or investment in productive assets.

The property-related tax breaks amplified an unsustainable boom in the construction sector and in the prices of certain assets such as housing. The outcome of the boom and subsequent bust is a prolonged balance sheet recession with high levels of unemployment, and high levels of household and corporate debt, all of which will persist for years to come.

In addition, by channelling limited investment resources towards non-productive assets, particularly housing assets, these tax breaks also diminished the productive capacity of the capital stock, thereby reducing the long-term growth potential and productive capacity of the Irish economy. This will have long-term implications for growth and employment levels in Ireland.

3. How the System Works

IRELAND – A SAFE HARBOUR?

Although Ireland's 12.5 per cent corporate tax rate is the cornerstone of our taxation regime, membership of the EU and an extensive catalogue of tax treaty agreements are two of the main reasons why Ireland is a very attractive destination for foreign investment.

Tax avoidance strategies relying solely on the use of offshore tax havens are based on a structure that is outside the global network of tax treaties. This increases a firm's risk of incurring unexpected costs due to changes in regulation: for example, jurisdictions could introduce trading-based taxes that result in a significant decrease in the company's post-tax profit.

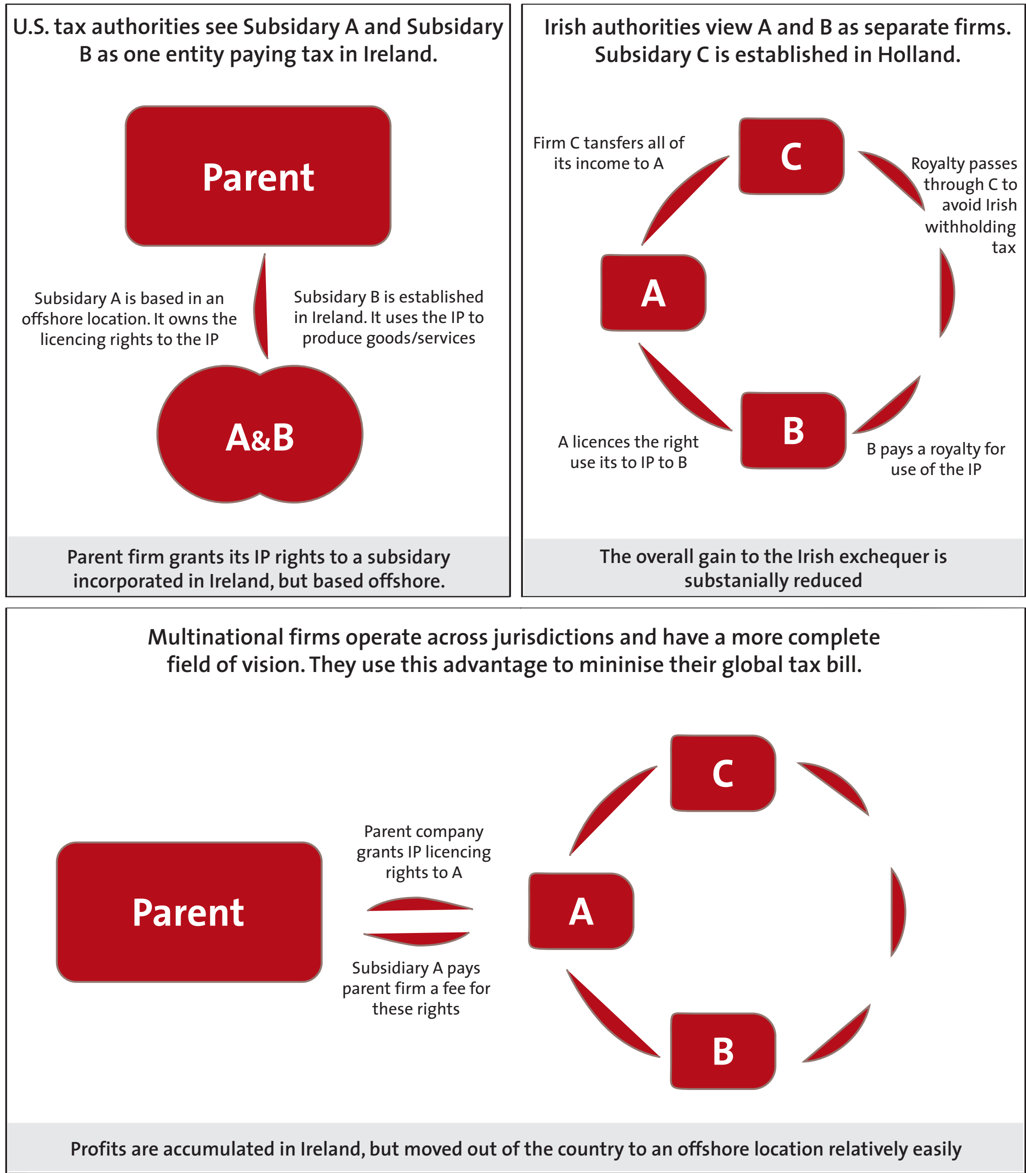
Double tax agreements are usually negotiated on a bilateral basis, and cover primary and secondary taxation rights. Establishing double tax arrangements requires officials to possess an intimate knowledge of the other jurisdiction's tax regime. The technical nature of the discussions, and the potentially large sums of money at stake, often result in protracted and complex negotiations. Jurisdictions in the Global North are more likely to have tax authorities with the experience and technical knowledge required to bring these negotiations to a successful conclusion.

From a corporation's perspective, one of the key advantages of these treaties is that they establish a regulatory framework that facilitates companies' efforts to develop a tax position that is likely to be sustained in the event of a challenge from the relevant tax authorities. In addition, tax treaties remove the risk of a government unexpectedly introducing tariffs that increases the effective corporate tax rate. In addition to providing a more stable business environment, Killian (2011) includes some examples of how these tax treaties can be used to facilitate tax-based group structures that span several countries and are intended to minimise a firm's global tax bill.

Ireland has cultivated a broad network of tax treaties with over sixty different jurisdictions. When combined with a low corporate tax rate, this network of treaties makes Ireland a very attractive location for foreign investors, even when compared to offshore locations such as the Cayman Islands. Ireland's double tax agreement with the US is particularly important, and has encouraged numerous US firms to use Ireland as a location from which to manage their operations in Europe and the Middle East. Foreign tax risks are minimised by ensuring the hub is centrally managed and controlled from Ireland. Activities leading to an overseas tax presence are strictly limited. The 12.5 per cent tax rate can also be reduced through the use of foreign tax credits, Ireland's intellectual property regime, and research and development credits.

Membership of the EU has burnished Ireland's reputation as a legitimate, onshore location for a US company to base its international operations and engage in effective tax management. From a tax planning perspective, membership of the EU can aid a transnational company in its efforts to minimise its overall tax liability

Figure 2: The Double Irish and the Dutch Sandwich



In addition to attracting multinational investment to Ireland, the current tax regime has resulted in a large number of hedge funds being serviced in the state. According to the most recent figures, Ireland is currently home to around 40 per cent of the world's hedge fund assets (www.irishfunds.ie). The value of attracting this type of inward investment in open to question; for instance, Reinhart and Rogoff (2009) noted that the volatility of these types of funds created in financial markets often leads to banking crises.

EXPLAINING THE IFSC

The International Financial Services Centre is often described as an 'offshore financial centre': a financial centre located elsewhere other than in the established financial centres such as London and New York. The IFSC was established in 1987 in Dublin's docklands with significant tax advantages (for example a ten per cent corporate tax rate and accelerated depreciation allowances). Now, according to the IFSC website, "*More than 500 operations are approved to trade under the IFSC programme. The centre is host to half of the world's top 50 banks and to half of the top 20 insurance companies*".

Although established to attract internationally-trading financial services, many financial firms with domestic origins have a large if not exclusive location at the IFSC. These include banks such as Bank of Ireland and AIB, law firms such as Dillon Eustace and McCann Fitzgerald, and accountancy firms such as PriceWaterhouseCoopers and KPMG. The current government estimate of 33,000 employed in international financial services does not mean that IFSC has generated 33,000 jobs. Several financial or partly financial firms were already established in Ireland but subsequently relocated to the IFSC. Other long-established financial firms located outside the IFSC are now categorized as part of internationally traded financial firms. Maintaining and expanding financial services is a major plank of current Irish government policy (Department of the Taoiseach, 2011, p. 4), which aims to increase employment in the international financial services sector by 10,000 by 2016.

The annual Finance Act often amends or introduces new legislation to enhance the attractiveness of Ireland as a location for financial firms. Government strategy for the financial services sector (Department of An Taoiseach, p. 2) requires the Department of Finance and the Revenue Commission to *"fully engage and consult with the [Financial Services] industry to enhance the tax framework, including through the annual Finance Bill process"*. There are numerous examples of such 'cooperation'. The Finance Act (2012) contained 21 separate measures to support the financial services industry. It was also stated that *"none of the measures would have a significant cost element"* (Department of Finance Press Release Finance Bill, February, 2012). The Finance Act (2011) required State agencies as well as the Industrial Development Authority to support the IFSC. The Finance Act (2010) made it easier for funds to move from locations such as the Cayman Islands to Dublin (Grene, 2009).

The IFSC dominates foreign investment in the Irish economy. In 2011, IFSC investment was over 20 times that of non-IFSC foreign direct investment and over 17 times the size of GNP. In 2001, IFSC investment was about seven times direct investment and just over six times GNP.

In spite of stated high regulation standards, many of the sub-prime and other funds that collapsed in value in the recent financial crisis were listed on the Irish Stock Exchange. The collapse of these funds led in turn to large losses, especially at a number of German banks with subsidiaries at the IFSC (Sachsen Bank, WestLB, IKB and Depfa/Hypo Vereinsbank).

HOW DOES IT WORK?

In addition to subsidiaries of banks, insurance and other financial firms, the IFSC is also a significant location for sub-prime and other funds. It is thus a major centre of what has been termed the 'shadow banking' sector. These funds may be quoted in Dublin, where some administrative functions are undertaken, are often managed in London, but domiciled in a tax haven/low tax regime. As a result of the financial crisis there was an estimated outflow from hedge funds of $400 billion in 2008 (Financial Times, 21 January, 2009), and a subsequent restructuring and closure of some hedge funds. Of three funds announcing a closure on one day (March 17th) in 2009, all were managed in London, quoted in Dublin but domiciled in a tax haven (Mackintosh, 2009). One of the funds (Lansdowne Partners) had seven funds consisting of 148 sub-funds quoted in Dublin: all but one were domiciled in the Cayman Islands. A second firm (Rab Capital) had seven funds and 23 sub-funds quoted in Dublin, of which 19 were domiciled in the Cayman Islands, three in the Isle of Man and one in the British Virgin Islands. The third firm (New Star) had three main funds and eight sub-funds quoted in Dublin, and all were domiciled in Bermuda.

Hedge and other funds may operate in Ireland as a 'special purpose vehicle'. One group of special purpose vehicles (described by the ECB as Financial Vehicle Corporations) benefits from especially favourable tax treatment. The ECB currently lists 742 of these firms as located in Ireland – 26 per cent of the eurozone total.

The nominal corporate tax rate in Ireland is 12.5 per cent on trading companies, but the tax rate on passive income (such as interest received) is 25 per cent. However, there are several key tax advantages which reduce the tax rate on passive income. The 1997 Finance Act (Section 110) allowed companies meeting certain requirements to compute tax as if they were a trading company (referred to as 'section 110 companies'). This

means that all expenses, such as those involved in issuing securities, may be offset against tax. As a result of tax changes introduced in 2003, interest on debt or loan notes issued can also be deducted against tax (Ernst and Young, 2003). This has very favourable tax consequences resulting in zero corporation tax payments. These firms may have no employees or fixed assets. Local expenditure varies between one and three per cent of total expenditures and consist of audit fees, company secretarial services, tax and legal advice. Such firms are commonly described as 'brass plate' firms and are typical of firms found in a tax haven.

IS THE IFSC AND IRELAND A TAX HAVEN?

Ireland is not a tax haven as defined by some international organisations such as the OECD, but features in other definitions of a tax haven such as that produced by the Tax Justice Network. While the OECD identified 35 tax havens in 2000, Ireland was not listed among them. Tax havens were subsequently classified by the OECD into cooperative tax havens that agreed to remove harmful tax practices and uncooperative tax havens. However no tax haven is currently regarded as uncooperative. Other lists, such as that produced by Wikipedia, list states in the US such as Delaware in addition to well-known locations such as the Cayman Islands as tax havens. The problem is that many countries have some tax haven tax features, such as the Netherlands with low rates of corporate tax on holding companies, or the UK in its tax treatment of residents who are regarded as not 'domiciled' and hence exempt from tax of their foreign owned income. On this basis Ireland is not a tax haven in the classic sense, but has many of the features of the tax haven. These features are low corporation tax rates, ease of incorporation, relatively light touch regulation, and tax and other legislation that is very responsive to the needs of multinational corporations. Ireland cannot be a pure tax haven because revenue must be raised to pay for schools, hospitals, etc. This gives rise to a dual tax system: a negotiated tax environment for mostly foreign owned firms, and a strict rule based tax environment with significant penalties (which may be and are enforced) for the indigenous sector.

Because of Ireland's favourable tax regime, multinational companies have an incentive to switch profits to Ireland on intra-subsidiary trade, or via financial transactions. Even though many firms in the IFSC and elsewhere have low or zero effective tax rates, the fact that profits are high means corporate tax payments are nonetheless substantial, so that Ireland raises proportionately more from corporation tax than countries such as Germany. However, Ireland's gain is at the expense of other countries which lose tax revenue. Hence, Ireland's low corporate tax rate is often subject to criticism by other countries such as France.

Ireland has effectively developed a competitive advantage through tax and regulatory arbitrage. It is unlikely that these competitive advantages will survive moves towards greater economic and financial integration in the EU, following the 29 June 2012 agreement by the Eurozone Heads of Government and subsequent developments.

These changes are likely to involve restructuring and rebalancing (a smaller IFSC and fewer jobs for accountants and tax advisors). However, policies emphasising tax minimisation and other tax-haven-type features are unlikely to lead to economic success and extensive job creation.

HOW COMPANIES GAIN AND COUNTRIES LOSE FROM TRANSFER PRICING

Transfer pricing is simply the process of establishing the price at which one part of a company transfers goods or services to another part of the same company. What is normally known as 'Transfer Pricing' is more accurately called 'Profit Switching Transfer Pricing' (PSTP). It arises from the fact that there are differences in tax rates, in particular tax rates on corporate profits, between countries. These differences result in multinational corporations (MNCs) locating activities in jurisdictions where tax rates are low, and declaring profits in those jurisdictions. This results in profits that are actually made in one or more jurisdictions being switched to, and declared in, the jurisdiction with the lowest tax rate.

Switching of profits can be done in a number of ways. Transfer pricing is just the most obvious of these ways, and is where one subsidiary (A) of an MNC buys goods (usually inputs into its production process) from a

subsidiary (B) in another country, paying for these goods at very low prices, perhaps even below cost price. A, the buying subsidiary (located in a low tax jurisdiction), then processes the inputs and sells the output on to another subsidiary (C), or distributor, at a very high price. B and C, having to sell at low prices and buy at high prices, make no profits and therefore pay no taxes. A makes all the company's profits and declares them in the jurisdiction where it is located, where tax rates are lowest. In this way the global tax paid by the MNC is minimised, and the after-tax profits are maximised.

Examples of PSTP are difficult to document. Transactions that take place within companies, albeit different subsidiaries of those companies, can be paid for at whatever rates are decided. This is confirmed by Sikka and Wilmott (2010, p.342): *"Since costs and overhead allocation mechanisms are highly subjective corporations enjoy considerable discretion in allocating them to particular products/services and geographical jurisdictions."* Being internal to the company, it is often impossible to determine what the price of those transactions would be if they had taken place between companies in an open market. Where the goods being bought and sold by subsidiaries of an MNC are also available on open markets, a comparison can be made between the prices apparently being paid in the internal transaction with the open market price. Using this technique, and focussing on industrial production and international trade statistics for the chemical industry, Stewart (1989) produces results that are consistent with significant profit switching. He concludes that *"Ireland is important in terms of tax savings for several large US-based MNCs and as a corollary to this Ireland is also important in terms of investigations by the Internal Revenue Service of the US"* (p.40). NESC (1992) also accepts that MNCs in Ireland practice profit switching, but argues that the effect on national statistics is small.

More recent evidence of profit switching and its significance in Ireland is provided by Sikka and Wilmott (2010):

Shifting costs and revenues to Ireland is attractive because corporate profits are taxed at 12.5 per cent, nearly a third of the rate in the US, and the government offers tax incentives and exemptions to research and development companies. In just 8 months after registering its business in Ireland in 2005, SanDisk, a major US supplier of MP3 music players and memory cards, recorded a net profit of $105.96 million on revenues of $955 million. The company had no direct local staff but employed the resources of an Irish subsidiary which had an average of eight staff (Irish Times, 23 February 2007). In 2001, Microsoft established a subsidiary, Round Island One Limited, operating from the offices of a Dublin law firm. By 2004, Round Island controlled US$16 billion of Microsoft's assets and gross profits of nearly US$9 billion, approximately 22 per cent of the company's global profits (Wall Street Journal, 7 November 2005, p. A2). Much of Round Island's income came from royalties and licensing fees for copyrighted software code that originated in the US. Through another company, Flat Island Co., Round Island licenses rights to Microsoft software throughout Europe, the Middle East and Africa. Round Island has absorbed other Microsoft units, from Israel to India, moving much of their intellectual property to Ireland. As a result of the licensing and royalty arrangements, Microsoft's worldwide tax rate declined, as the company shaved at least US$500 million off its tax bill (Sunday Times, 12 February 2006). US tax authorities are said to be looking at Microsoft's transfer pricing practices. The same scrutiny is also being applied to a number of other companies, such as Dell, Pfizer, Oracle, Lucent Technologies, Apple and Hewlett-Packard, that have relocated their intellectual property to Ireland (Wall Street Journal, 7 November 2005, p. A2).
(Sikka and Wilmott, 2010: 351)

According to Sikka and Wilmott, Microsoft reregistered its Round Island One and Flat Island Company subsidiaries as companies with unlimited liability following critical press comments. As unlimited companies under Irish law, they have no obligation to publicly file their accounts (Sikka and Wilmott, 2010: fn.31).

The details provided by Sikka and Wilmott (2010), and the earlier evidence of both Stewart (1989) and NESC (1992), make it clear that there are ways other than basic transfer pricing in which profits are switched into Ireland. These relate in part to Ireland's tax and other regulations (not just its tax rates). For example, Ireland allows companies to offset R&D expenditure against taxes. What counts as R&D expenditure is nearly as subjective (to use Sikka and Wilmott's term) as the fixing of costs and overheads in transfer pricing. This facilitates two separate means of switching profits and increasing after-tax profits. First, it enables companies

to reduce taxes by declaring some of their costs as R&D. Second, it eases the process of declaring royalties in (or *"relocating intellectual property to"*) Ireland. Royalties on patents of Irish-resident companies are tax free, as long as the R&D work towards that patent can be said to have been undertaken in Ireland.

These additional ways of reducing corporate taxes in Ireland all further encourage MNCs to have a presence in Ireland. This presence does not necessarily have a real function – in terms of adding value to the product or service provided by the company – but it can still have a fiscal function, significantly reducing the payment of taxes in the company's home, and other, jurisdictions, adding to the profits declared in Ireland, and reducing the company's global, after-tax profits.

From a traditional economic perspective, PSTP is a problem because it results in economic activities being undertaken in locations for fiscal reasons rather than for reasons of comparative advantage. The comparative advantage theory basically states that in the absence of government intervention and other market imperfections, economic activities will take place where it is most efficient for them to be located. There are serious problems associated with assumptions about the absence of market imperfections but, leaving these aside, the conclusion even from within traditional economics is that PSTP causes international misallocation of resources.

From a more critical perspective, too, PSTP is unacceptable. PSTP may lead to some increase in MNC activity in low-tax jurisdictions, but it is also part of the overall 'race to the bottom', imposing pressures on more dependent economies to reduce corporate tax rates and to offer other regulatory incentives. Companies undertaking PSTP can *"report higher earnings to appease stock markets and maximize executive remuneration"* (Sikka and Wilmott, 2010: 353). This is a direct result of those companies paying less tax. But the *"loss of tax revenues curtails the ability of the state to provide public goods and alleviate poverty"* Sikka and Wilmott, 2010: 353).

QUESTIONS

In Ireland some advantage can be said to arise from PSTP, in that at least some economic activity takes place that otherwise would not. However, the calculation must be made on the basis of the sum of taxes foregone and capital and other grants provided. The question is whether a better use could have been made of this sum. Was there a better policy or policies that could have been implemented over the period since encouragement of MNCs was first introduced in 1958? To what extent have activities been located in Ireland purely as a result of Ireland's fiscal regime? Does Ireland now have a significant proportion of its economic activity arising from artificial country-specific advantages, and could alternative policies have led to a greater proportion of activities arising from natural, sustainable, country-specific advantages? Have taxes been foregone that, under different policies, could have been added to fiscal revenues? At the very least, it seems certain that, from a global perspective, PSTP results in a regressive redistribution of income and wealth from the relatively less well-off taxpayers, both in the home and the subsidiary countries, to the wealthy stock holders and high income earners of the MNCs.

PROPERTY TAX BREAKS – OUTCOMES AND COSTS

In this section we examine the consequences of some of the tax breaks usually referred to as property reliefs, in particular Section 23 Reliefs. The reason for addressing these reliefs in particular is that, while there is an obvious economic cost to the taxpayer in providing the relief, there is evidence that there has been a further 'cost' to the citizen in terms of economic, environmental and social costs.

SECTION 23-TYPE RELIEFS

This is a generic term used to describe several tax breaks, all of which were directed towards providing rented residential accommodation.

> *Tax Fact:* The cost of property-related tax breaks has declined significantly in recent years – but in 2008 they amounted to €452.6 million

The relief worked by allowing the purchaser of the property to write off the capital cost of construction against rental income from all properties. For an individual or company owning existing rental property, this was a very attractive means of avoiding tax.

Chart 1 Time frame for Section 23 reliefs.

Name of Section 23 tax break	Start date	Finish date
Customs House Dock	30th January 1991	31st Dec 1999
Temple Bar	30th January 1991	5th April 1999
Urban Renewal	1st August 1994	31st July 1997
Seaside Resorts	1st July 1995	30th June 1998
Islands	1st August 1996	31st July 1999
Upper Shannon Basin Relief	Jan 31st 1998	Dec 31st 2006

(Revenue Commissioners, 2010)

SHANNON BASIN RELIEF

This was introduced in 1998 and covered Counties Longford, Roscommon, Leitrim, Cavan and Sligo. With the exception of Sligo, they are all land-locked counties, which meant that developers in these counties could not avail of the terms of Seaside Relief.

In 1998 the Shannon Basin Relief was introduced to "*to help stimulate the development of the Upper Shannon Region*" (The Heritage Council, 2005)

The tax relief covered commercial and industrial properties as well as residential rented property, which is what we examine here. This relief allowed for a 100 per cent of the cost of construction of the residential unit as a deduction against all rental income.

This made for a very valuable relief. In effect, the taxpayer picked up the 41 per cent of the cost of constructing these premises.

It is useful to note that investors looking at Section 23 type reliefs found options closing in 1998: the Upper Shannon Basin Relief was just opening as these other options closed.

EFFECT OF RELIEF ON UPPER SHANNON BASIN AREA

This can be illustrated by statistics drawn together by the Heritage Council in 2005. (Heritage Council, 2005) Taking Counties Roscommon and Leitrim as models, the Heritage Council examined the increase in residential housing planning applications and compared it with the increase in population in a similar period. The charts below are based on this research.

CHART 2 PLANNING APPLICATIONS- 1994-2005

County	1994-1998	1999-2002	2003	2004
Leitrim	2,635	3,911	1,414	2,147
Roscommon	4,659	6,689	1,755	2,622

(Heritage Council, 2005)

CHART 3 POPULATION INCREASE

County	1996	2002	2006	2011
Leitrim	25,507	25,799	28,950	31,798
Roscommon	51,975	53,774	58,750	64,065

(Heritage Council, 2005, and CSO, 2006,2011)

The Heritage Council concluded that, while it appeared that the tax relief had worked in encouraging the development of the Upper Shannon Basin, the discrepancy between population growth and planning permissions suggested strongly that holiday homes or vacant units were a significant feature of the house building programme. It recommended that " *future programmes and tax incentive schemes are designed with the protection, preservation, enhancement and effective management of the national heritage as a 'core' principle.*(Heritage Council, 2005: 3)

HOLIDAY HOMES FOR LETTING

The temporary letting of a holiday home would be sufficient to reclassify the property from a personal asset to a rental asset, qualifying for tax relief. This tax relief was available against other rental income, as explained above. It is reasonable to conclude that the properties included a high number of holiday-type lettings. This belief is supported by the number of planning applications for multiple dwelling buildings received by both Leitrim and Roscommon County Council and referenced in the Heritage Council report (Heritage Council, 2005).

GHOST ESTATES

It is also likely that there were vacant dwellings included in the mix of properties in 2005. However, figures available for 2011 show a startling relationship between the prevalence of ghost estates and the availability of Upper Shannon Relief.

These figures were compiled by the Department of the Environment, Community and Local Government.

Their findings are that the counties having the greatest numbers of vacant units per 1,000 households are Counties Leitrim, Longford, Roscommon, Sligo and Cavan and Laois.

Chart 4 Ghost estates: number of vacant units per 1,000 households.

County	Number of vacant units	Total no. households	No. vacant units per 1,000 households
Leitrim	464	10,648	44
Longford	504	12,111	42
Cavan	757	18,655	35
Sligo	615	21,480	29
Roscommon	533	20,734	26
Laois	586	22,591	26
Westmeath	403	27,064	15
Monaghan	253	18,655	14
Meath	713	53,938	13
Mayo	441	43,431	10
Galway County	483	53,308	9
Offaly	194	23,769	8

(Table extracted from DECLG, 2011 National Housing Development Survey, Summary Report: table 2, page 5)

As can be seen from the table above, apart from Laois, the counties with the most number of vacant units per 1,000 households are those situated around the Shannon Basin. Compare neighbouring counties Galway and Roscommon or Mayo and Sligo. Roscommon has over two-and-a-half times the number of vacant units per 1,000 households as County Galway, while Sligo has just under three times the number of vacant units per 1,000 households as Mayo. The full list of counties and their rankings is available in Appendix 2.

This pattern supports the view that the existence of tax breaks on constructing residential property, encouraged development, which was unsustainable and of little benefit to the local community.

The result of this type of development suggests that there are serious social and environmental impacts arising from this overdevelopment.

SOCIAL AND ENVIRONMENTAL CONSEQUENCES

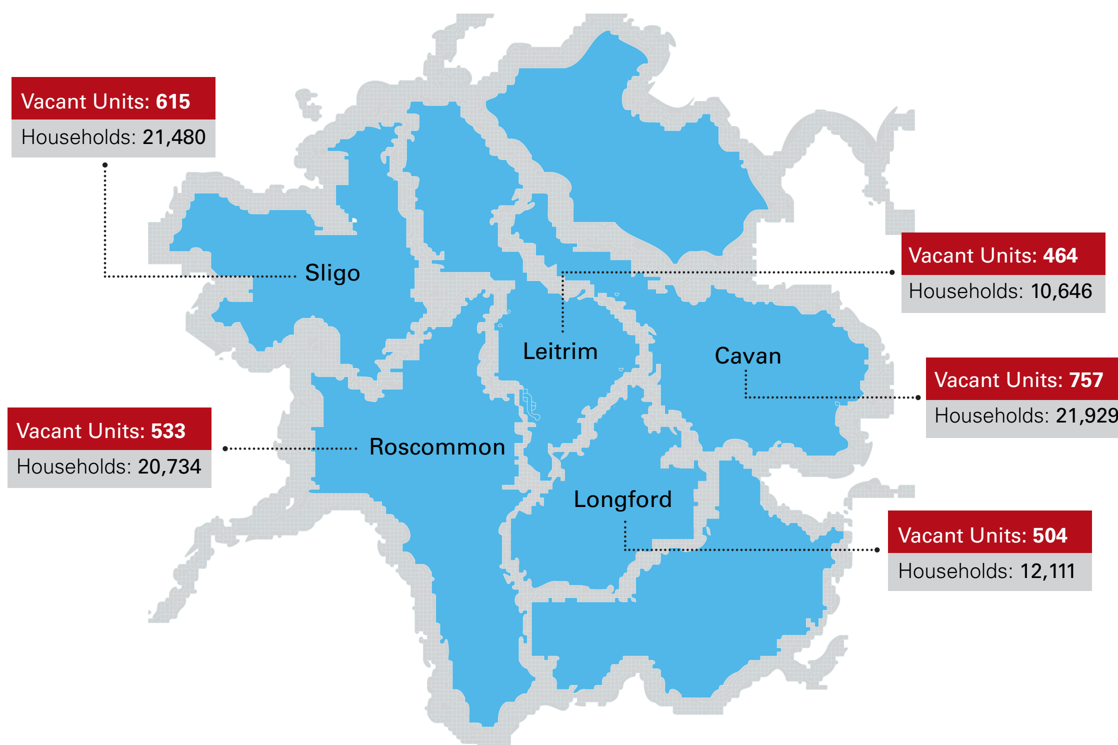
Unfinished housing estates and unoccupied apartment blocks have started to pose a health and safety risk. This was well illustrated by a report carried by RTE on 25th June2012 indicating that the National Asset Management Agency had decided to demolish an unsafe apartment block in Longford.

A NAMA spokesperson said that

Where it is uneconomic to finish an estate or a part of an estate or if the local authority deems it to be structurally unsafe we will invest our resources in demolishing the relevant structure and ensure that it is made safe for other residents. This will benefit residents of those estates and make the estate safe from a Health and Safety perspective. (RTE 2012).

Map 1 shows the number of vacant units per 1,000 households in counties Leitrim, Longford, Roscommon, Sligo and Cavan. As can be seen from the map, these counties have a higher level of vacant units per households than surrounding counties. Over development in this region was detrimental to the needs of the local population and out of line with population projections.

Map 1: Vacant housing units in the Shannon Basin Relief counties 2011



(DECLG, 2011 National Housing Development Survey, Summary Report: 5)

COST OF UPPER SHANNON AREA RELIEF

The published reports of the Revenue Commissioners for the period do not identify this relief separately, so costing is not possible. However, similar Section 23 relief for investment in holiday cottages was promoted on-line, quantifying the tax saving (tax cost) as follows.

The 48 luxury turn-key holiday houses at Waterford Castle Lodges, The Island, Waterford, all qualify for capital allowances in respect of qualifying expenditure provided certain conditions are met. This can mean that up to €703,000 of taxable rental income (Irish) can be sheltered, resulting in a tax saving of up to €326,895 to the purchaser...... The Castle Gardens holiday home development will be fully completed by October 2007 and the holiday homes will be registered with Bord Fáilte for letting to holiday makers http://www.waterfordcastle.com/holidayhomes/property-sales.asp)

This of course represents a tax cost to the Irish taxpayer of €326,895 per lodge, or a total cost of €15.7 million for the entire development. If this is extrapolated to the investment/rental properties in the Upper Shannon Basin area, it represents a huge transfer of public money to private landlords.

BENEFIT TO TAXPAYER OF RELIEF

It is difficult to see any benefit coming to the taxpayer from these reliefs in general. A benefit accrues to the landowner who sells the sites, to the developer who builds the residential unit and to the landlord who benefits from a transfer of public money to the private sector.

A case could be made for the early breaks in terms of rejuvenating derelict city centres and attempting to bring a resident population back into large cities and towns.

However, it is impossible to see this benefit translating to rural Leitrim or Roscommon. Instead, the citizens of those counties were left with an environmental hazard which will cost more public money to remedy.

RELIEF FOR INVESTMENT IN HOTELS OR HOLIDAY COTTAGES

Section 409 B of the Taxes Consolidation Act applies to hotels. The relief is not dissimilar to Section 23 relief already discussed. There is a slight variation in that, in most cases, excess Capital Allowances (the relief) can be set off against other non-rental income to a maximum of €31,750 per annum.

However, this restriction does not apply to certain hotels in Counties Donegal, Leitrim, Mayo, Monaghan, Roscommon or Sligo.

How the hotel relief works

The relief is similar to Section 23 in that it allows capital expenditure to be written off against rental income and in some cases against total income. There is a restriction on the amount to be written off against total income in most cases, but not where the hotels were developed in the counties identified above, during a specific period.

The relief is used over seven years. It is not available upfront as in the Upper Shannon Basin Relief. At the end of the seven year period, the investor had the option of selling the asset back. This would have assumed an increase in the capital value. The relief was widely availed of by high net worth individuals.

Cost of relief

There is no separate costing available in the Reports of the Revenue Commissioners. Relying on published information on one hotel, The Ritz Carlton Powerscourt Hotel, reports advise that the 148 individual Suites in the hotel were sold to investors at a cost of between €600,000 and €2 million.

Taking a modest average price of €1milion per suite and using the rate of 41 per cent higher tax rate, this would indicate a cost per suite to the Irish taxpayer of €410,000. This is one suite in one hotel in an industry with an oversupply of 15,000 rooms. (Sunday Independent, 2010).

Economic consequences

The availability of the Tax Break for investment was attractive and widely taken up. The effect was an increase in hotel rooms between 1998 and 2008. This was estimated by Peter Bacon as an oversupply of rooms to the amount of 15,000. This oversupply was depressing prices to an extent that the industry was in fact insolvent (Bacon, 2009).

Bacon argues that market economics would normally force closures, which would deal with over supply. However, in this case the closures are not happening. He identifies two reasons for this pattern:

Currently there are powerful reasons such as the interests of investors wishing to avail of tax allowances and the interests of banks, for insolvent hotels to remain open and it cannot be guaranteed that these will not persist. (Bacon, 2009)

If investors sell or the hotel closes before the seven year period expires, the investors' tax relief is clawed back. This was a specific anti avoidance provision to ensure that investors did not set up short term 'shell' hotels to avail of the relief. However, it is now operating to maintain over supply in the industry, with potentially serious problems for employment in that sector.

IS THERE A BENEFIT TO THE TAXPAYER?

The original intention may have been to promote tourism by creating a sufficient supply of good quality accommodation. Had that worked, there might have been some small justification for the transfer of huge amounts of public money to the private sector. Instead, the relief has actually operated to damage the industry and will continue to represent a drain on the taxpayer.

TAX BREAKS SUMMARY

While tax breaks can serve a purpose in stimulating economic sectors, the Irish experience indicates that they can have unexpected negative consequences for communities and industries, with significant transfers of public money to the private sector and no real public benefit.

IRELAND AND THE GLOBAL SOUTH

Ireland has to a large extent built its economic strategy on taxation policy, and specifically on offering a low rate of taxation for foreign companies locating here, coupled with a wide range of tax treaties that facilitate the movement of capital through the jurisdiction. Multinational firms may be tempted to manage their internal pricing in a manner that shifts large amounts of income from their operations in other regions to Ireland, thereby reducing their overall international tax liability.

One way in which Ireland lures multinationals at the expense of other countries is through the patent royalty tax expenditure—an exemption which remains in force despite a recommendation by the 2009 Commission on Taxation that it be discontinued. For example, if a multinational hosted in the Global South were to establish a Research & Development base in Ireland, it could avail of transfer pricing and royalty payment arrangements to reduce its overall tax liability.

> ***Tax Fact:*** In 2009 – the latest year for which we have figures – we spent €216.1 million on R&D credits alone.

This could undermine the ability of countries in the Global South to collect tax, draining resources for their public services and postponing the day when they can raise sufficient revenue from local economic activity to reduce their reliance on aid. The ability to raise revenue from the economic activity taking place within their respective jurisdictions is of particular significance for developing countries, as it represents a more sustainable solution to poverty than international aid.

It is important that taxes are designed not only with domestic policy objectives in mind, but also with a view to their consequences internationally. Ireland has been an active participant in many international bodies dealing with tax and development. As well as being involved in EU and OECD initiatives, Irish Aid participates in the African Tax Administration Forum, while country-to-country initiatives include the Revenue Commissioners' cooperation with the Rwanda Revenue Authority. There is also a growing trend towards exchanging information with other tax authorities. This work enhances the internal capacity of countries in the Global South to collect tax, and goes some way toward making the international tax environment more conducive to developing economies being able to tax transnational corporations in an effective manner.

There is thus an inherent public policy contradiction: despite Ireland's track record of solidarity with the Global South, the domestic system of corporate taxation is structured in a manner that supports a practice which impoverishes hundreds of millions of the world's poorest citizens by facilitating multinational firms in reducing their international tax bill.

Tax Fact: Between 2005 and 2007, six Irish Aid programme countries lost nearly €82 million in tax revenue to EU or US – almost 17 per cent of total Irish Aid budget for the countries concerned*.

* Figures courtesy of Christian Aid

To date, the Irish Government's attempts to combat transfer pricing abuse have been solely focussed on preserving the domestic corporate tax base. The Finance Act 2010, for instance, grants the Irish Revenue powers to retrospectively impose a tax liability on a corporation when it deems that a firm has abused the system of internal transfers in order to reduce its tax liability. However, this measure only allows for the adjustment to be made in the event that a firm either overstated expenses or understated trading receipts within the Irish entity. This policy is purely self-centred and unlikely to be effective at combating transfer pricing abuse, as companies are likely to maximise their stated income in Ireland in order to avail of its low corporate rate.

Introducing measures aimed at closing the loopholes that may encourage multinational firms to use Ireland as the hub of a corporate structure that facilitates aggressive tax avoidance, often at the cost of developing countries, would be a vital step towards establishing a coherent development policy that recognises Ireland's moral obligation to the Global South.

4. What should be done?

A FINANCIAL TRANSACTIONS TAX

Over the last four decades, since its initial suggestion in 1972 by Nobel Prize winning economist James Tobin, various names have been given to the proposition of implementing a very small tax on global capital flows. The Tobin tax, a Financial Transactions Tax (FTT), a Currency Transaction Tax (CTT) and the Robin Hood tax are among the names for the proposal. In the context of the recent international financial crisis, one principally derived from the reckless speculative behaviour of numerous banking and financial corporations, the long-standing hesitancy regarding this tax has begun to thaw with politicians, governments and international agencies joining the previous coalitions of many researchers, economists, NGOs and development charities in calling for the introduction of an FTT.

At a European level, the European Commission produced a proposal for a Council Directive in September 2011 suggesting that such a tax be levied on financial transactions in Europe. The Commission proposed a tax of 0.1 per cent (one-tenth of one per cent) on the trading of bonds and shares and 0.01 per cent (one-hundredth of one per cent) on derivative products (EU, 2011). The proposal was focused on open market activities and movements (i.e. trading) and excluded inter-bank transfers and trades which might occur in the normal course for business. The FTT was discussed at the 2011 G-20 but while the final communiqué referred to *"the initiatives in some of our countries to tax the financial sector for various purposes, including a financial transaction tax, inter alia to support development,"* its supporters failed to get agreement on the issue. (G-20, 2011)

There are three reasons why the idea of an FTT is worthwhile, and has gained added support in recent years.

The implementation of such a tax would necessitate Central Banks and governments to establish real-time monitoring mechanisms for the various flows of financial transactions happening each and every day. It was apparent as the 2008 financial crisis unfolded that governments and their agencies had limited insight into the nature and scale of financial transactions; something which impeded a response to the crisis. Despite this, as the crisis proved, it is governments and societies who have to step-in and pick up the pieces when things go wrong – a fact demonstrated across the world via multiple financial sector collapses over recent decades. From a societal perspective, it would be worth implementing an FTT that provided, as a bi-product, immediate information on financial movements and liabilities, even if the tax raised no money over and above that required to establish and run such a system. However, given the scale of financial transactions a significant amount of revenue will be raised.

An FTT would provide governments with a large sum of additional tax revenue. Despite the small tax rates proposed the volume of international financial transactions is such that a small percentage of a big sum adds up to a large amount of tax revenue. Depending on the tax rate chosen, and the definition of the tax base (what is taxed and what is not), estimates of annual revenue from the tax vary from €50bn-€200bn within the EU. The EU Commission's baseline estimate for the EU is €59bn per annum and for Ireland is between €490-730m per annum. (EU, 2011)

The presence of an FTT would dampen the attractiveness of short-term speculative financial transactions – the original focus of Tobin's proposition four decades ago. Often such transactions are targeted at vulnerable countries (such as Greece and Spain in recent times) and their speculative nature suggests that they are driven by profiteering and are far removed from any real (and useful) economic activity.

There are also some impediments to achieving these outcomes. Initially, these exist at a technical level with the challenge of establishing sufficient and comprehensive mechanisms for monitoring and collecting the tax as well as ensuring that there are few, if any, ways of circumventing it. However, while these would take time to establish, and resources to maintain, such technical impediments are surmountable and the co-operation of financial institutions with the tax is feasible given the post-crisis regulatory frameworks currently being developed by Central Banks and governments across the world.

A more serious challenge is the likelihood that certain regions and countries are unlikely to want to implement an FTT and will use this as a competitive advantage against those regions where such a tax is in force. Given that universalism is unlikely, there will be a need for large regions like Europe and the US (and ideally both) to adopt this measure irrespective of these objections. In effect, this will force financial institutions within regions with an FTT to absorb the tax into their profit margins, rather than charge higher rates for services that those competing institutions in non FTT regions. As such, financial institutions are likely to campaign hard to protect their profits and block the implementation of the tax. Clearly, some displacement and reductions in activity will occur because of the tax, in particular speculative transactions should decrease, but the economic activity and employment costs of such moves in countries/regions with an FTT needs to be traded off against the appropriateness of those activities in the first place and the significant additional tax revenue and its usefulness.

Over time there have been various areas cited as the best place to use the additional resources an FTT would generate. These include providing exchequer revenue for general use, providing funds for the budgets of international agencies such as the European Commission and funding enhanced budgets to finance overseas aid and development. For much of the last two decades, it is the latter area that has been most prominent with arguments centring on enhancing funding to allow countries reach the UN Overseas Development Assistance (ODA) target of 0.7 per cent of GDP, provide sufficient resources to fund HIV/AIDS programmes, address environmental degradation and meet the Millennium Development Goals – estimated by the World Bank to require an additional US$40bn (€32bn) per annum. However, judging by the most recent FTT proposals issued by the EU and US authorities, the impact of the recent crisis on the balance sheets of governments across the developed world has focused attention on using the FTT revenues for internal exchequer funding and budgets rather than financing development. In all likelihood, the scale of the revenue raised by an FTT will be sufficient to provide funds for domestic, international and development needs. However, it would seem timely that the development community re-asserted the case for funding development from an FTT.

In Ireland the European proposals for an FTT have been met with interest but hesitancy. Government has indicated that it finds the concept appealing; something which is unsurprising given the central role financial institutions played in Ireland's economic crash. However, the Government is unwilling to support the proposal unless the UK also adopts it; a position driven by fears of competitive disadvantages between Dublin's IFSC and the City of London's financial centre. A preliminary evaluation by the Central Bank and the ESRI (2012) found that an FTT would generate a net increase in Irish tax revenues of between €300m-600m when account is taken of the likely simultaneous elimination of stamp duty on financial transactions. Evidence is limited to suggest that many, if any, financial institutions would relocate or restructure if an FTT existed in Ireland but not the UK. However, it would be preferable for the FTT to be introduced across all EU countries simultaneously. As such Ireland needs to play a more enhanced role in supporting the moves at a European level and convincing other governments, such as that in the UK, to support an FTT.

For four decades the idea of imposing a small tax on global capital flows has appeared and re-appeared without being successfully implemented. The inherent relationship between the recent severe world financial crash and the behaviour of the financial sector clearly highlights that the uncontrolled and unmonitored speculative ways of the past cannot be allowed to return. An FTT offers a way of raising additional tax revenue, dampening needless speculative activities and monitoring the activities of the financial sector. After four decades, its time has surely come.

Budget measures

EQUALITY PROOFING AND EQUALITY AUDITING

Equality proofing and auditing refers to a robust evidence-based process of minimising inequity and ensuring the progressivity of the overall tax system, in order to increase income and wealth equality in society. Progressivity – where those on higher incomes pay proportionately more than those on lower incomes – occurs in the income tax system but, from an equality perspective, this principle should extend to the tax system as a whole.

In studies on taxation there is more often a concern with 'equity' rather than equality:

Tax expenditures can result in individuals with similar incomes and expenses paying different amounts of tax, depending on whether they engage in tax-subsidised activities. Different tax liabilities for individuals in similar circumstances run counter to horizontal equity. Tax expenditures also violate vertical equity if the cost of government is unfairly distributed among income classes.

(Cavalcanti and Swift, 2004: 206)

An equality audit of tax expenditure would involve the requirement that every budget includes estimates of the likely effects of each proposed change to tax law on the overall distribution of income and wealth. In addition, tax expenditure that benefits narrow populations of taxpayers would have to generate sufficient social benefit for such tax expenditure to pass an equality audit.

The Department of Finance should be obliged to produce a full briefing document annually, explaining the economic rationale for all existing tax expenditures and for all tax expenditures being proposed; including how much it is expected to cost the Exchequer; which households and firms are expected to benefit, and how it is expected to work. Even where there is a clear public policy case for supporting a particular group or activity through the use of tax expenditures there still needs to be a rigorous social cost benefit analysis of the overall effect of the proposed tax expenditure. The results of this social cost benefit exercise should be transparent with the winners and losers clearly identified months in advance of the proposed tax break becoming law. The social cost benefit ratio for the tax break should also be measured against the cost benefit ratio for direct public subsidy of the group or activity. In addition, all tax breaks should have a built-in sunset clause of no longer than three years which automatically triggers unless the tax break is renewed by the Dáil. An updated and transparent cost benefit analysis exercise should be undertaken in advance of the tax break's expiration with continuation of the measure made contingent upon the results of the cost benefit analysis.

TRANSPARENCY AND AUTOMATIC EXCHANGE OF INFORMATION BETWEEN TAX AUTHORITIES

The lack of transparency in international financial transactions exacerbates the already difficult challenge involved in ensuring that the level of income subject to tax in a particular jurisdiction is congruent with the level of value-adding activity that actually occurs within that jurisdiction. The secrecy surrounding these transactions facilitates tax avoidance strategies by making it harder for national tax authorities to identify where the genuine wealth creating activity is occurring and prevent profits being accumulated in low tax jurisdictions. Lack of data and information is a problem faced by all states, though tax authorities in the Global South countries are considerably less likely to possess the institutional capacity to identify and track financial transactions involving multinational firms operating in their jurisdiction.

The problems created by a lack of information on cross-border financial transactions are widely recognised, as is the need to enhance international cooperation in this area. In 2010, the European Commission noted *"freely moving capital, together with the existence of non-cooperative jurisdictions that shroud financial activities in secrecy, in a context of insufficient international tax cooperation, make it difficult for tax authorities to assess tax liabilities"* (Killian, 2011: 15). Ireland plays an active role on a number of supranational bodies addressing this issue— the OECD Committee on Fiscal Affairs, for instance— and has supported greater tax cooperation by accepting the EU negotiating position within the UN Financing for Development conference in Doha. In addition, when negotiating double tax treaties the state insists on an exchange of information clause being included in the agreement. (Killian, 2011)

Ensuring greater transparency requires an enhanced level of cooperation that includes an *automatic* exchange of information between tax jurisdictions and an international accounting standard on country-by-country reporting. The OECD Agreement on Exchange of Information in Tax Matters governs much of the cooperation between states in this area. This standard stops short of requiring countries to automatically share information with other participants; the tax authority seeking information must make a formal request to the state they wish to obtain data from. However, many authorities in Southern countries are unaware of the kinds of records that are available, and so may not request the information that would help identify illegal transactions that are eroding their tax base. A multilateral agreement to automatically share information on financial transactions would help overcome this deficit in institutional capability and would equip states with the information they need to target companies abusing the transfer pricing system. Similarly, requiring multinational corporations to record the level of trade that occurs between subsidiaries operating in different tax jurisdictions would help all states monitor tax payments made by transnational firms and encourage firms to abide by good corporate governance practices.

5. Conclusion

"Democracies rely on a spirit of trust and co-operation in paying taxes. If every individual devoted as much energy and resources as the rich do to avoiding their fair share of taxes, the tax system either would collapse, or would have to be replaced by a far more intrusive and coercive scheme. Both alternatives are unacceptable."

(Joseph Stiglitz, 2012)

Tax avoidance and tax evasion are anti-social acts which strike at a state's ability to collect and allocate resources to meet the needs of its people. When individuals or companies avoid or evade paying their fair share of tax, they undermine the state's capacity to provide for schools, roads, hospitals and other public services. They also place an extra burden on those citizens and companies who do pay their fair share of tax.

Tax competition, through the construction of complex tax rules and tax breaks which allow companies and wealthy individuals to decrease their tax bills, can also hinder the state's capacity to develop its economy and pay for much needed public services. While many of these rules and tax breaks were introduced by Governments to achieve a particular policy outcome, that does not mean that they are always used in the manner in which they were intended: instead, they are sometimes used merely to avoid tax liabilities. The use of transfer price fixing, for example (as explained in Section 3), allows a company to benefit from the tax rates and reliefs available in different jurisdictions by transferring goods and services between different subsidiaries of the company. Countries in the Global South are particularly vulnerable to loss of revenue from this type of mechanism.

The IMF, World Bank, UN and OECD have all highlighted the risk to countries in the Global South posed by the use of tax breaks to encourage multinational enterprises (MNEs) from the Global North to invest in the tax incentivised country rather than other countries. They argue that in negotiating with MNEs and agreeing tax breaks, Governments are facilitating a "race to the bottom" which does not benefit the region, but the multinational investors.

When a Government creates a tax break, it is effectively spending money. That means that the lost revenue must be made up either through increasing other taxes or through cuts in spending. Cuts in public spending mean that there is less money to spend on public services. Those who depend most on public services, children and older people for example, will feel the effects of those cuts more acutely than other groups in society.

From an equality perspective, it is also important to note that not all citizens can avail of tax breaks and/or get the same level of return from them. For example, this report highlights the fact that pension tax relief, which is given at the standard and marginal rates, benefits higher earners more than lower earners. Not only are low-income groups unable to avail of reliefs at the higher rate of tax – they generally lack the funds to invest in many incentivised schemes in the first place. They are also unlikely to have access to the kind of specialist (and expensive) tax advice which enable some citizens and companies to reduce their tax liability.

As well as often militating against equality, tax breaks are an inefficient policy tool that can distort economic activity and can have unintended consequences. The use of property tax breaks in Ireland over the past decade, for example, has contributed to environmentally and socially damaging development, and an over-supply of housing units and hotel rooms.

Whenever a government introduces a new relief or extends an existing one, it is making a political choice – the choice to prioritise one section of society or one economic sector over others. Such choices always result in winners and losers and, as this report indicates, the losers are often those with few or no resources – in Ireland and in the Global South.

Appendix 1

HISTORY OF TAX AVOIDANCE AND EVASION IN IRELAND

AVOIDANCE: COUNTER ACTION - IRISH EXPERIENCE

As tax avoidance exploits weaknesses in the legislation, the counter action has to be legislative. In the past Ireland dealt with identified tax avoidance schemes by closing specific loopholes. This meant that revenue authorities were always one step behind those planning avoidance schemes.

ANTI-AVOIDANCE LEGISLATION

In more recent times the focus has shifted to enacting specific anti-avoidance legislation.

There are a number of these provisions but the main one is Section 811 of the Taxes Consolidation Act 1997, which was updated in 2006.

The legislation attempts to deal with the substance of the transaction as distinct from the form of the transaction. A number of cases have gone through the Courts under the terms of this provision, most notably The Revenue Commissioners –v- O Flynn Construction Ltd, where Revenue's position was upheld. (MacMahon, 2011)

Similar anti-avoidance legislation exists in the UK where a number of cases have been taken.

DISCLOSURE OF TAX AVOIDANCE SCHEMES (DOTAS)

While Section 811 has been shown to be effective, the difficulty with it is that the authorities have to identify the existence of an avoidance scheme before the terms of the legislation can be invoked.

Regulations requiring the reporting of tax avoidance schemes, by their promoters, were passed into Irish legislation in January 2011.

The motivation for the legislation was set out by the then Finance Minister, Brian Lenihan. The following extract from his speech, cited by Matthews, Ormbsy and Prentice, explains the rationale.

It is important to emphasise again that it is not the intention of the disclosure rules to stop tax advisers advising clients in the normal way on their tax affairs and on the use of the various legitimate tax incentives that are provided for in the tax code. That is entirely acceptable tax planning and will remain so. The vast majority of tax advisers giving routine day-to-day tax advice to clients have nothing to be concerned about and won't be affected by the disclosure rules. It is the small minority of advisers with the propensity to devise and market aggressive avoidance schemes that are in the frame and will be affected.

(Matthews Ormbsy & Prentice, 2011)

Similar legislation exists in the UK, US and Canada. Revenue sources advise that certain schemes have been disclosed as a result of this legislation.

COUNTERING TAX AVOIDANCE

It is reasonable to say that no method has been found fireproof. Robust legislation dealing with "form over substance" type activity can be effective, but costly.

A technically skilled audit presence, capable of detecting avoidance, is needed regardless of the type of legislation in force.

To be effective, anti-avoidance requires carefully drafted legislation which will stand up to legal challenge.

TAX EVASION - THE IRISH EXPERIENCE

Of the many identified difficulties which Ireland faces in dealing with the economic crisis, institutionalised tax evasion has not been suggested as something to be addressed. This represents considerable progress over a twenty-four year period.

INTRODUCTION OF SELF-ASSESSMENT FOR SELF-EMPLOYED AND COMPANIES

In 1988 Ireland moved from a system of administrative assessment of taxes on the self-employed and companies to a system of self assessment of taxes due. This system was widely welcomed by the representative bodies of the self-employed, who saw it as a release from "assumed" taxation and its replacement by a more predictable system.

AUDIT, INTEREST, PENALTIES AND PUBLICATION

The system introduced included a number of checks and balances.

These incorporated an audit system, including the charging of interest and penalties in the event of default being identified. Where tax, interest and penalties exceeded IR£10,000, the name, address and occupation of the defaulter were published, together with the amount paid.

EFFECTIVENESS OF SYSTEM

From the outset the system was effective to the extent that a public campaign was mounted to have Revenue Audits curtailed. That campaign was partly successful, in that it culminated in the "Tax Amnesty" legislation of 1993, "Waiver of Certain Tax Interest and Penalties Act of 1993"

This allowed tax defaulters to pay an amount of 15 per cent on undisclosed profits to cover all taxes, interest and penalties.

BOGUS NON RESIDENT ACCOUNT INVESTIGATION

This commenced in 2002. It related to accounts held in Irish banks by Irish residents using a bogus foreign address. This allowed the person to escape Deposit Interest Retention Tax (DIRT).

FLIGHT OF CAPITAL CONCERNS

Fear of capital flight is a common concern, particularly for countries in the Global South. In Ireland, this fear has impacted on taxation legislation.

The problem had been identified by the Department of Finance but action was not taken. The following extract from a report on the website of the Irish Comptroller and Auditor General explains the rationale for this inactivity:

Both organisations were convinced that any moves in that direction would have led to a flight of capital from the country with all the attendant consequences for the economy particularly when it was vulnerable in the 1980s and in the first half of the 1990s. In that context, bogus non-resident accounts were seen as the lesser of two evils and for that reason any action taken could only be at the margins.

(Comptroller and Auditor General)

COUNTERING TAX EVASION - TOWARDS TAX COMPLIANCE

The existence of these accounts were finally disclosed when the political will was present to provide the necessary legislation to examine the banks:

Even before the introduction of DIRT in 1986 there was an acceptance that there was a significant problem with bogus non-resident accounts and this led to intermittent efforts to address the problem. These and later efforts had only very limited effect because they all fell short of implementing a regime of full disclosure to Revenue of interest payments by financial institutions and also because they did not provide for Revenue access to bank accounts except in very restrictive circumstances. Either or both of these measures would almost certainly have had a major impact on the incidence of bogus non-resident accounts. (Comptroller and Auditor General)

UNTAXED UNDERLYING FUNDS

Public outrage at the extent of tax evasion uncovered by the Public Accounts Committee hearings on Bogus Non Resident Accounts helped generate the political will to introduce legislation requiring the banks to provide information on depositors to Revenue.

The DIRT evasion was established to be the minor part of the tax evasion. Subsequent investigation of these accounts by Revenue Auditors showed that the amounts held on deposit, in many cases, came from money which was untaxed. An examination of the Revenue Commissioners' archive of published lists of tax defaulters show a series of publications, from 2004 onwards, of tax defaulters identified through the access to information in the banks (Revenue Commissioners).

The extent of the lists indicates that, during the 1980s and early 1990s, Ireland was far from tax compliant. Indeed, a comparison with present day Greece is not unfair.

The publication of defaulters' names, including the amounts evaded, shifted public opinion towards a lower tolerance of tax evasion.

RESULTS OF LEGACY INVESTIGATIONS

The results of this investigation and other legacy-type investigations yielded tax of €2.6 billion at 31/12/2010 (Revenue Commissioners, 2011).

The Irish experience suggests that a culture of tax compliance can be engendered by a political will to tackle tax evasion. The political will is needed to provide the appropriate legislation. The legislation must contain real deterrents, which makes evasion a high-risk strategy.

Revenue auditors must have the technical skills to detect and deal with evasion to ensure that the deterrent is real. They must be deployed in sufficient numbers and with sufficient visibility to convince tax evaders that there is a real prospect of detection.

Appendix 2

NUMBER OF VACANT UNITS PER 1,000 HOUSEHOLDS – FULL TABLE

Local Authority	No. vacant units derived from survey	Total no. households	No. vacant units per 1,000 households
Leitrim	464	10,648	44
Longford	504	12,111	42
Cavan	757	18,655	35
Sligo	615	21,480	29
Roscommon	533	20,734	26
Laois	586	22,591	26
Cork County	2363	123,295	19
Dun Laoghaire Rathdown	1080	68,412	16
Westmeath	403	27,064	15
Carlow	257	17,195	15
Monaghan	253	18,655	14
Kilkenny	425	29,651	14
Meath	713	53,938	13
Fingal	1051	80,402	13
Clare	490	38,210	13
North Tipperary	296	22,992	13
Kerry	615	48,110	13
Donegal	600	50,415	12
Louth	457	38,703	12
South Dublin	995	80,631	12
Wexford	539	45,566	12
Mayo	441	43,431	10
Cork City	429	43,939	10
Galway County	483	53,308	9
Dublin City Council	1553	190,984	8
Offaly	194	23,769	8

Local Authority	No. vacant units derived from survey	Total no. households	No. vacant units per 1,000 households
Kildare	424	60,957	7
Limerick	322	44,675	7
South Tipperary	216	29,375	7
Galway City	117	25,353	5
Wicklow	214	42,870	5
Waterford County	100	21,511	5
Waterford City	90	17,069	5
Limerick City	59	19,550	3

(DECLG, 2011 National Housing Development Survey, Summary Report: table 2, page 5)

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TASC is an independent think-tank dedicated to promoting equality, democracy and sustainability in Ireland through evidence-based policy recommendations.

Tax Injustice: Following the Tax Trail was commissioned by Christian Aid and examines the equality and economic impacts of different tax policy measures such as tax breaks.

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