Response from
The Institute of Chartered Accountants of Scotland to
HM Treasury

Rebalancing the Northern Ireland Economy

21 June 2011
The Institute of Chartered Accountants of Scotland welcomes the opportunity to comment on the issues around devolving corporation tax to Northern Ireland, given the consequences to corporation tax law as it will affect the rest of the UK and the parallel debate over devolving corporation tax powers to the Scottish Parliament. The views expressed below represent those of members of the Institute consulted in recent years over Scottish tax devolution issues, updated by those from several tax committees comprised of members with considerable experience on corporate and cross border business tax issues.

The concerns we have in respect of devolving corporate tax powers to Northern Ireland are the same as those for Scotland, which were included in the final report from the Calman Commission published on 15 June 2009 as “Serving Scotland Better: Scotland and the United Kingdom in the 21st century (Final Report)”. Specifically, the evidence provided in that report and which remain as current concerns may be summarised as:

1) The potential for divergent rates of corporation tax across the UK to create economic inefficiencies as firms react to considerations other than commercial factors, and indeed harmful rather than efficient tax competition.

2) Evidence that a cut in Scottish corporation tax would attract more profit shifting behaviours than create real economic activity. This is an increasing issue in the electronic age and with video conferencing. The application of anti-avoidance provisions relating to profit shifting would have to be widened to deal with this, adding unwelcome administrative complexity for all UK businesses, not just those in the specific devolved jurisdiction.

3) The potentially significant additional administrative burden and tax compliance costs for companies throughout the UK and HMRC from changes necessary to monitor profit-shifting through, for example, transfer pricing legislation. In particular the exemption currently enjoyed by many small and medium sized enterprises would need to be reconsidered if devolved corporation tax powers are to be effective in achieving their aims, given the predominate business profiles in each jurisdiction, even if the devolved corporation tax rates do not vary significantly from the main UK rate. Determining tax residence of companies, branches and permanent establishments would also create additional burdens.

4) The case for substantive reduction in the possible rate of corporation tax for Scotland was considered to be limited in the short term if the level of public services were to be maintained, at least until or unless Scottish Parliament revenues could be raised from other sources. However, the risk if more than one jurisdiction within the UK has corporation tax varying powers, of a “race to the bottom” is likely to be counter-productive.

5) A key driver to devolution of tax powers was the accountability of the Scottish Parliament; this was thought to be better achieved through devolving powers on taxes other than corporation tax, particularly those with a closer connection to the electorate.

6) The volatility of corporation tax receipts on a localised basis rather than from the UK economy as a whole was a concern, given that European Union state aid rules do not permit any shortfall to be subsidised by the UK government in such circumstances.
We see no case for considering the Northern Ireland tax issues as sufficiently distinct from those of Scotland to reach a different conclusion, particularly around tax competition and complexity.

There are other key aspects of tax policy making in the UK which are relevant considerations.

1) Firstly, the principle of aiming for stability and certainty in tax matters at a UK level has been greatly welcomed as a means of making the UK as a whole more competitive on the international stage. Any devolution of corporation tax powers to different parts of the UK would reduce stability and certainty, so could reduce the attractiveness of the UK as a whole as well as the particular jurisdiction. This could make any changes counterproductive.

2) Simplification of the tax legislation and the practical operation of the UK’s self-assessment regime have been called for consistently and we support the Government doing more in this area. Devolving corporation tax powers will require additional efforts from businesses and their advisers working across the UK achieves less, rather than more, simplification.

3) In considering the potential for a reduced corporation tax rate of 12.5% for Northern Ireland (or any rate materially lower than an income tax rate) the behavioural consequence of unincorporated businesses seeking to incorporate to take advantage of this rate needs to be considered, along with any evidence that it would stimulate economic activity on a standalone basis. The UK experience of the years 2000 to 2005 with a 10% and then 0% corporation tax rate gave a marked demonstration of this and resulted in an overall reduction in tax payable on those earnings; we have not seen any evidence that additional economic activity resulted from that approach, hence the lower rates were abolished in 2006.

Finally, evidence from members raises serious concerns as to the impact on HMRC resources, and whether HMRC would be able to cope with either the changes required or implementation of such devolved powers at any stage in the current spending round. We have expressed in the past concerns over delays and service levels at HMRC, which were also addressed by House of Commons Committee earlier this year. Any additional resources required will have to be costed fully, should any devolved power be required to meet such costs. There may be both fixed costs, which will be presumably incurred up front, when the expected revenue generation will be undetermined, and variable costs of operating increased legislative burdens in, as suggested above, areas such as transfer pricing.

We look forward to the outcome of the consultation process.
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