Box C: The Department of Finance's proposals to address corporation tax risks

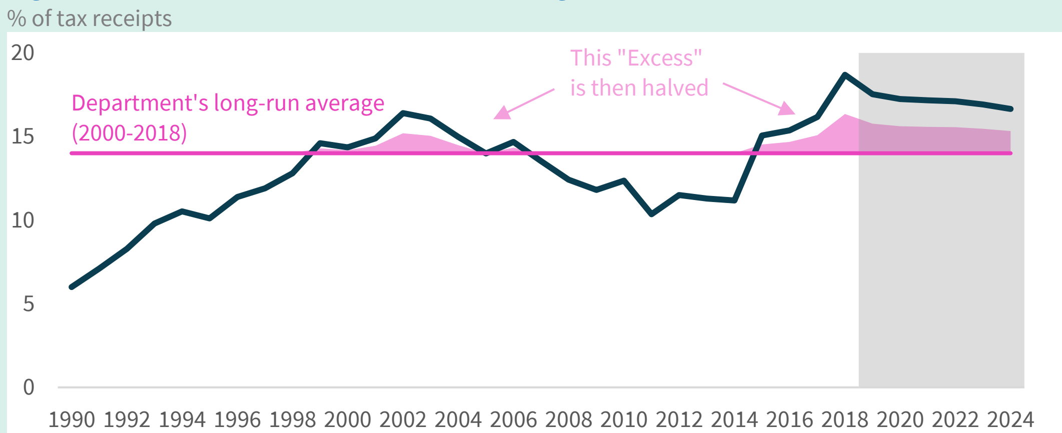
This box explores the Department of Finance's proposals to deal with vulnerabilities arising from an increased reliance on corporation tax.[22] At present, the corporation tax proposals set out by the Department are good in principle, but relatively modest in scale.

Modest proposals

The Department's proposal is to reduce the Government's exposure to reversals in potentially temporary corporation tax receipts by ring-fencing a portion of these (the example it gives is on the basis of an excess relative to the long-run average share of tax). The idea is that a portion of corporation tax would be set aside in the Rainy Day Fund so that it is not used to finance long-lasting spending increases or tax cuts.[23]

Figure C.1: The Department's proposal to ringfence excess corporation tax receipts

% of tax receipts



Source: Department of Finance; and Fiscal Council workings.
Notes: "Excess" defined as % total tax accounted for by corporation tax receipts beyond 2000–2018 average.

In principle, the Department's approach is a good one. Yet there are a few reasons why the Department of Finance proposals seem modest.

First, the proposals are based on one of the lower estimates of excess receipts that the Department of Finance calculates: the long-run average. This gives an excess of €2 billion. By contrast, its scenario where receipts return to 2014 levels suggests a €6 billion excess. This puts its proposals to ring-fence a portion of excess receipts for investment in the Rainy Day Fund at the lower end of the €2–6 billion range cited and below the €3–6 billion range assessed by the Council as potentially excess.[24, 25]

Second, the proposals are based on a 2000–2018 long-run average. Using this time period suggests that 14 per cent of total tax receipts are typically accounted for by corporation tax. More generally, relying on an average share to assess fundamental levels of corporation tax receipts is inevitably a crude and somewhat arbitrary approach. The average falls as more of the earlier observations are included and as more of the years where surges were evident are dropped. However, it could be argued that the modern corporate tax system has applied only

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[22] The Fiscal Vulnerabilities Scoping Paper (Department of Finance, 2019d) examines corporation tax overperformance and sets out policy options to help to ensure the sustainability of the public finances.

[23] The details of the proposal are set out in Table 3 of the Department of Finance (2019d) Fiscal Vulnerabilities Scoping Paper.

[24] The Department (2019, p.iv) notes that "scenario analysis based on extreme, though far from implausible, assumptions suggests that, in the absence of corrective measures, a permanent budgetary gap of the order of €2 – €6 billion could potentially open up."

[25] The Council's range of estimates are set out in Box B of the *June 2019 Fiscal Assessment Report*.

since about 1998 at the earliest (when Ireland's 12.5 per cent corporation tax for trading income was introduced, though this was not fully commenced until 2003 and the 10 per cent rate for financial services (IFSC) companies expired only in 2005).

Third, the Department's proposals halve the excess but do not provide a justification for this.

Fourth, the proposals consider only the period 2018–2024. And there are no plans to build savings to account for excess corporation tax receipts received prior to now. Of course, it may be difficult to adjust the public finances for these past excess returns. But it is important to note that a further excess of €2¼ billion would have been evident for 2015–2017 (comparing shares of corporation tax receipts against the 14 per cent level). The Department forecasts that the share of total receipts accounted for by corporation tax will fall back towards the long-run average of 14 per cent in coming years. The planned allocations are therefore lower than they might otherwise be should higher-than-expected receipts persist.

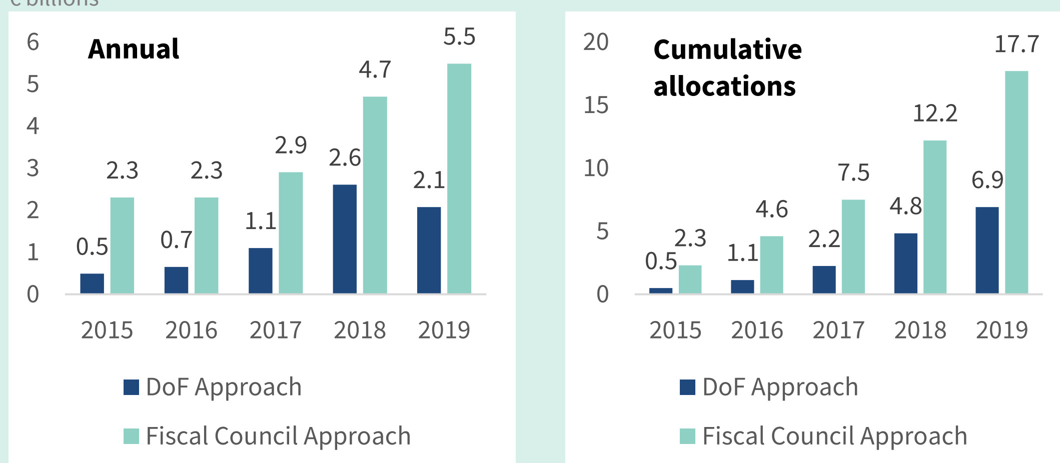
Comparison with the Council's proposals

The Council set out an approach for a "Prudence Account" in its last report (Box B, Fiscal Council, 2019). The Prudence Account was a mechanism to commit the Government to saving unexpected—and potentially temporary—tax receipts such as those from corporation tax as they arise. This approach would overcome the time inconsistency problems that can arise.[26] Allocations would be based on the excess between actual and forecast corporation tax receipts (i.e., using the Exchequer profiles set out for corporation tax receipts after the previous year's budget and adjusting the base).

Comparing the Department's proposals for ringfencing excess corporation tax receipts with the Prudence Account approach that the Council set out, we can see that the amounts involved are drastically different. The Council's proposals would have entailed annual allocations close to €5 billion in 2018 and 2019—more than double the Department's. In terms of cumulative amounts ringfenced, the Council's proposal would have amounted to €17.7 billion by end-2019—more than €10 billion more than the Department's proposals had they applied from 2015 onwards.

Figure C.2: The Department's proposed corporation tax savings are relatively modest

€ billions



Source: Department of Finance; and Fiscal Council workings.
Notes: The "excess" is defined as the share of total tax accounted for by corporation tax receipts in excess of the 2000–2018 average.

[26] Kydland and Prescott's (1977) time-inconsistency problem shows that policymakers with complete discretion at every point in time might not use resources available to them in the best way possible. In other words, good policy commitments made at an earlier stage might not be followed through on at a later stage. A key conclusion is that one can improve long-run outcomes by limiting future discretion so as to preserve earlier commitments.