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cc Mr Gibson
Mr Gamble
Mr MacCann
File

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To: Robin Shaw
Central Management and Communications

From: Robert Clulow
Economics Branch

EVOLUTION OF GOVERNMENT POLICY

I attach comments on the tax policy areas specifically referred to by the Minister (lower Corporation tax for Northern Ireland exporters, employment subsidies and the VAT threshold). In addition, as Mr Gibson has suggested, I have attached a list of other possible ideas for consideration by the Minister.

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IDEAS ON TAXES - LOWER CORPORATION TAX RATE FOR COMPANIES LOCATED IN NORTHERN IRELAND WHICH EXPORT

Possible Advantages

- Encouragement of export led growth; particularly amongst Northern Ireland owned companies.
- Increase in the attractiveness of Northern Ireland to inward investors; especially those seeking a base in SEM.
- Increased economic activity would raise local Northern Ireland incomes leading to increased consumer expenditure in Northern Ireland on goods and services and consequently increased output in Northern Ireland firms supplying local consumer market.

Possible Disadvantages

- Such a tax measure is likely to be regarded by the European Union as a state aid and it would require clearance from Brussels (even if accepted, the EU would probably allow this measure to run for a limited period only say to 2010 in line with the 10% Corporation Tax rate in the Republic). It would run counter to the aim of harmonising tax and monetary regimes within the EU.
- Scotland, Wales and the English regions would push for a similar tax measure to be introduced in their territories.
- It would be strongly resisted by HM Treasury as a breach of the integrity of the UK tax system. In compensation for such a measure, HM Treasury would seek a reduction in Northern Ireland grants to industry.

- This measure would be hard to police as Inland Revenue would have to distinguish between exporters and non-exporters. It is also open to abuse. Manufacturing companies from GB and elsewhere would establish the minimum facility necessary to qualify for the lower rate. Other companies would nominally export a small percentage of their output in order to obtain the benefit of the lower tax rate (alternatively profits would have to be allocated between export and non-export activities).

Overall Assessment

This appears an unpromising tax option for Northern Ireland. It is most likely to be strongly resisted by HM Treasury and viewed by the EU as a State Aid. Northern Ireland exporters may prefer attractive guaranteed insurance against non payment for their output exported as opposed to a tax measure.

IDEAS ON TAXES - AN EMPLOYMENT SUBSIDY FOR NORTHERN IRELAND

Possible Advantages

- In the short term, this would lead to additional employment in Northern Ireland industry. Northern Ireland firms would be encouraged to hire more labour than they would otherwise have done.

Possible Disadvantages

- An employment subsidy conflicts with UK (and DED) strategy of encouraging competitiveness. With such a subsidy Northern Ireland firms would most likely seek to maximise employment (and hence the subsidy) leading to "overmanning" and inefficiency. In this situation, Northern Ireland company profits would be raised artificially, blunting market signals and leading to inefficiency. An employment subsidy conflicts with the national policy of deregulation and non-intervention in the labour market where market forces are allowed to operate fully.
- This measure is open to abuse. Northern Ireland firms could take a subsidy for jobs which they would have created in any case (deadweight).
- An employment subsidy by lowering labour costs, sends out the wrong signals to firms encouraging them to stay in labour intensive sectors (and compete with the Developing Nations) when, in the longer term, survival is most likely to lie in becoming leaner and fitter.

Overall Assessment

- An employment subsidy, per se, has short term attractions. However, it conflicts with DED strategy and current national policy towards competitiveness and the labour market.
- An employment subsidy aimed at persuading employers to recruit employees from the long-term unemployment register (ie to recruit people who have been unemployed for more than one year) rather than those who have been unemployed for only a short term may have social advantages.
- Such an employment subsidy properly targeted upon the long-term unemployed and of limited duration say for a year or two years, may also have "supply" - side economic benefits, bringing these people back into the labour market and enabling them to effectively compete for existing job vacancies.

IDEAS ON TAXES: RAISING THE VAT THRESHOLD FOR NORTHERN IRELAND SMALL FIRMS

Advantages

- This measure removes small firms (below the turnover threshold) from the VAT net and in doing so encourages start-ups and the initial growth of small firms by removing a tax on their output.
- Encourages activity in the small firm sector by removing the administrative costs associated with filling in VAT returns.

Overall Assessment

The VAT threshold is the subject of National Tax Policy and a matter for HM Treasury. It is dealt with in the Budget and in November 1994 was raised from £45,000 to £46,000. A further raising in the threshold would assist entrepreneurial small firms whether in Northern Ireland or the rest of the UK.

POSSIBLE OTHER IDEAS IN THE TAX/SUBSIDY AREA

- ACCELERATED CAPITAL ALLOWANCES: The rate which Northern Ireland companies are allowed to offset the value of capital expenditure against Corporation tax could be raised.
- AN EMPLOYMENT SUBSIDY FOR THE LONG TERM UNEMPLOYED: An employment subsidy properly targeted upon the long-term unemployed and of limited duration, say for a year or two years, may also have "supply" - side economic benefits, bringing these people back into the labour market and enabling them to effectively compete for existing job vacancies (with the short-term unemployed).
- A MORE ATTRACTIVE CORPORATION TAX RELIEF GRANT.
- EXEMPT REVENUE GRANTS FROM CORPORATION TAX.