Fourth Report

of the

Commission on Taxation

SPECIAL TAXATION

May 1985

DUBLIN:
PUBLISHED BY THE STATIONERY OFFICE

To be purchased through any Bookseller, or directly from the
GOVERNMENT PUBLICATIONS SALE OFFICE,
SUN ALLIANCE HOUSE, MOLESWORTH STREET, DUBLIN 2.

Pl. 2917 £5.50

THE COMMISSION ON TAXATION

Members:

Miriam Hederman O'Brien (Chairman)
Donal S. A. Carroll
Derek Chambers
James R. Gallagher
Daniel Murphy
Donal Murphy
Donal Nevin
Patrick P. O'Neill
Raymond O'Neill
W. J. Louden Ryan

Secretariat:

Donal de Buitléir	(Secretary)
Séamus P. Reic	(Assistant Secretary)
Deirdre Dowdall	(Research Officer)
Kealin Ireland	

TABLE OF CONTENTS

PART I

LOCAL TAXATION

PART II

TAXATION OF SPECIAL AREAS AND ACTIVITIES

LIST OF TABLES
(in body of report)

APPENDICES

PREFACE

1. This is our fourth report based on the results of our examination of the Irish tax system under the terms of reference given to us when we were established in March, 1980. These were

> "To enquire generally into the present system of taxation and to recommend such changes as appear desirable and practicable so as to achieve an equitable incidence of taxation, due attention being paid to the need to encourage development of the national economy and to maintain an adequate revenue yield; and to provide interim reports on such matters as the Commission considers desirable or as may be referred to it by the Minister for Finance for specific consideration".

Content of Report

2. This report gives our recommendations on the system of local taxation which should apply in Ireland, if it is considered desirable to have local government as opposed to local administration of services which are determined by central government. We also make recommendations on certain special taxes relating to the environment, mining and mineral development and the tax treatment of charities, which were not treated in our first report.

3. In preparing this report we sought specialist advice to supplement the work done by our own Secretariat. Professor Frank Convery of University College, Dublin prepared a paper on the use of taxation as an instrument of environmental protection. We are very grateful to him for his contribution to our work.

Consultations

4. We consulted with a number of individuals and organisations, both on a formal and informal basis, including the Departments of Energy, Environment, Finance and also the Department of Industry, Trade, Commerce and Tourism, the Office of the Revenue Commissioners, the Commissioners of Charitable Donations and Bequests, the Society of Chartered Surveyors in the Republic of Ireland, An Foras Forbartha, the National Board of Science and Technology, the Confederation of Irish Industry and many specialists involved in the areas which we studied.

5. We also received help from officials of the Norwegian Ministry of Finance and the Commission and Parliament of the European Community.

Secretariat

6. Fionnuala Sheehan was assigned to our Secretariat from the Department of Finance from October, 1984 to January, 1985.

Meetings of Commission

7. To date the Commission has met formally on seventy occasions over a period of seventy eight days.

Acknowledgements

8. In producing this report we have, as on previous occasions, benefitted greatly from the generous help given by individuals and organisations involved in the areas under review. Many experts, both in Ireland and elsewhere, gave freely of their time to help us clarify the issues and understand their implications.

9. The Secretariat has maintained the very high standards set in earlier reports. We are particularly conscious of the outstanding contribution of the Secretary, Donal de Buitléir, the Assistant Secretary, Séamus P. Reic and the other members during the preparation of this report.

Work in Progress

10. The Commission has now completed four reports which deal with direct taxation, incentives, indirect taxation, local taxes and the special areas covered here. The question of administration will be dealt with in another report.

Need for Reform

11. Since the publication of our first three reports, some changes have been introduced into the tax system which are not inconsistent with some of our proposals. We have, however, been unable to discern that these are part of any coherent strategy or programme for tax reform. Our previous reports show that the reforms we recommend are practicable and that they can be introduced on a phased basis. We remain of the view that such reform is both urgent and feasible and can only repeat our advice that it be carried out as soon as possible.

INTRODUCTION

1. This report deals with aspects of taxation which have not been included in our first three reports.[1] It covers taxation of special areas such as local taxation, property taxation, the environment, mining and mineral development and taxation of charities. Our recommendations are made in the context of those in our first three reports.

LOCAL TAXATION

2. The need for local taxation arises if it is decided to operate a system of local government with real discretionary powers, as distinct from a system of local administration of centrally determined and funded services. Such a decision is clearly outside our terms of reference. We confine ourselves to setting out the principles which govern a good system of local taxation in the context of a structure of local government. We apply these principles to the available options for local taxation in Ireland and make recommendations on the most practicable and desirable system in Irish conditions.

Criteria for Local Taxes

3. Local taxes should also satisfy the criteria of equity, efficiency and simplicity which we laid down in our first report. Equity must be determined, not in isolation, but in the context of the overall impact of taxation and public expenditure, both at local and national level. Three other tests must also be met:

- Firstly, the chosen base must be capable of yielding adequate revenue in each local area.
- Secondly, the possibility of genuinely independent local variation is essential.
- Thirdly, to ensure accountability, the impact of variations in the rate of local taxation should bear fully on the local electorate.

Local Property Tax

4. We have concluded that a tax on residential and other property (exclud-

[1]First Report 'Direct Taxation' July, 1982 pl 617.
Second Report 'Direct Taxation: The Role of Incentives' March, 1984 pl 1755.
Third Report 'Indirect Taxation' June, 1984 pl 2136.

ing land) is the most suitable form of local taxation. This amounts effectively to the imposition of rates on these properties. We see nothing wrong with the principle of rating, provided rates are levied on equitable valuations which are revised regularly. Such a tax is the only one which offers a real prospect of having genuinely independent variation in rates of tax in different areas without causing intolerable distortions.

5. The net effect of our proposals is that a local property tax should be introduced and that there should be no exemption thresholds for either income or capital values. A waiver scheme should operate to relieve cases of hardship and payment should be made in instalments. Our recommendations involve the abolition of the national income-related residential property tax first introduced in 1983.

6. The reintroduction of local taxation on the lines we recommend should not be used to increase the share of gross domestic product taken in taxation. To the extent that it increases the resources of local authorities, the amounts payable in grants from the central government should be reduced, thereby allowing a reduction in national taxation. It would be consistent with our earlier reports if this reduction were concentrated on personal income taxation (including pay-related social insurance contributions).

NATIONAL PROPERTY TAX

7. Should it be decided not to impose a local residential property tax, we have concluded that a national residential property tax on the lines we describe in Chapter 6 is justified. We do not favour the concurrent imposition of local and national residential property taxes for two reasons. Firstly, it is undesirable in principle for local and central government to compete for the yield from the same tax base. Secondly, it would increase unnecessarily the complexity of the system.

OTHER ISSUES

8. The tax treatment of activities and organisations of different kinds varies greatly under the existing tax system. Our general approach is that all activities should be taxed at the single rate of income tax on the definition of income in our first report, unless there are compelling reasons why this is inappropriate. We deal with those activities for which special considerations arise.

Taxation and the Environment

9. We examine the case for imposing special taxes on activities which cause environmental damage. In some areas, government intervention involves costs which make it acceptable only as a solution of last resort.

Where environmental protection is concerned, in many cases the only alternative to government intervention is to do nothing. In certain instances, the imposition of taxes is a more efficient form of intervention than setting up costly administrative machinery to oversee the implementation of regulations. In other cases, regulations may be more desirable. We conclude that special taxes on activities which cause environmental damage have a role to play in protecting the environment. Such taxes must not be looked to for substantial revenue, since their very success will reduce their yield. We explore a number of areas where environmental taxes are justified and where they can be implemented without undue administrative cost and difficulty.

Mining and Mineral Development

10. We make detailed proposals for the taxation of mining and mineral development. These proposals are based on the view that natural resources found in Ireland or on the Irish continental shelf are the property of the Irish people. While the profit potential must be high enough to encourage risk investment to discover and exploit these resources, the state is entitled to receive an economic rent from the exploitation of the resources, over and above the normal taxation of profits. This rent should be as high as possible, consistent with the need to encourage exploration for and the exploitation of the resources.

Taxation of Charities

11. The present system of charity tax exemption is obscure. The total size of the tax exemption to the charity sector is unknown. Performance cannot be measured. There is no accountability. A coherent and comprehensive public policy towards charities cannot be formulated in such circumstances.

12. Private donations to charities are a matter for the individual concerned. It could be argued that the public has a right to some form of supervision over those seeking funds for charitable purposes. However, that is outside our brief. Where tax relief of any form is given, the public is entitled to require that the state provide it in a manner which is fair and efficient. We recommend that bodies in receipt of charitable exemption should be required to satisfy the Revenue Commissioners at regular intervals that their funds are being applied for charitable purposes.

13. Leaving aside questions of regulation, we consider that the present tax treatment of charities is generally satisfactory. Under our proposals, gifts to charities above a specified limit would be treated in the same way as savings for expenditure tax purposes.

Implementation

14. We have not made specific phasing proposals for the recommendations in the report. We see no reason why our proposals on local taxation cannot be implemented at an early date if the political decision to operate local government is taken. The provisions relating to mining and mineral development depend on events outside the tax system. The recommendations on environmental control and charities can be introduced at any time.

LIST OF RECOMMENDATIONS

Chapter 1: General Principles

1. Central government grants to local authorities should be consolidated into a single local taxation support grant which would be distributed to local authorities on a basis which takes account of differences in their needs and resources.

2. Charges for services should be introduced only where

(i) the charge is related to the services received, and

(ii) the costs of collection are economically viable.

Chapter 5: Local Property Taxes

3. Should it be decided that a system of local taxation is desirable, a local property tax should be introduced on all residential, industrial and commercial property (excluding land).

4. Local property tax should be allowed as a credit against income tax liability where the property is used to generate income charged to national income tax.

5. Companies which retain their rights to incentive reliefs under the old system should continue to have rates, or any form of property tax which may be introduced to replace rates, allowed only as a deduction in computing profits for tax purposes.

6. Valuations for purposes of local property tax should be self-assessed. The values should be classified into broad bands and should remain valid for a period of five years. Administration and audit of valuations should be the responsibility of local authorities.

7. Valuations for residential property should be open market capital values on a fee simple basis. Other property should be charged on annual rental values. A formula should be used to relate the two sets of values.

8. If a local residential property tax is introduced on the lines we propose, there should be unrestricted allowance of real interest on mortgage debt for income tax purposes.

9. Real property other than residential, commercial and industrial property should be excluded from the scope of the tax.

10. Local property tax should be levied on the occupier of the property. Tax on empty properties should be charged on the owner.

11. Payment of property tax should be in a minimum of four instalments.

12. A waiver scheme for persons on low incomes should be operated through the social welfare system.

13. The introduction of a local property tax should not be used to increase the share of gross domestic product taken in taxation.

Chapter 7: Taxation and the Environment

14. The principle of imposing special taxes on activities which cause environmental damage should be accepted and applied in appropriate instances.

Chapter 8: Mining and Mineral Development

15. The tax and royalty structure for all on-shore and off-shore mineral development in Ireland should have the following elements:

(i) a ring fence should be imposed around individual developments for the purposes of royalties,

(ii) a ring fence for all on-shore and off-shore mining and mineral developments should apply for corporation tax purposes and should embrace on-shore distribution of oil and gas,

(iii) exploration expenditure should be allowed on an indexed basis,

(iv) development expenditure should be allowed on an indexed basis over the useful life of the asset or on a unit of production basis if the taxpayer so opts,

(v) royalties should be progressive and based on profits in excess of a threshold rate of return,

(vi) income tax at the single rate should be levied on profits after deduction of royalties, and

(vii) discretionary powers should exist to reduce the tax and royalties payable on marginal mines or fields to the level necessary to ensure that the resources in them are exploited.

Chapter 9: Charities

16. Charitable exemption should be allowed only where the Revenue Commissioners are satisfied that the accounts of the charity show that the exempt income is being applied for charitable purposes. Charities which fail to supply accounts should have their relief withdrawn.

17. The tax relief for gifts towards education in the arts should be withdrawn. The responsibility for aiding such education should fall directly on the Exchequer rather than being met through tax expenditures.

18. Gifts to charities, other than small gifts, should be treated as savings for purposes of expenditure tax. Gifts to charities, which are within the definition of small gifts set out in paragraph 9.29, should be included in the taxable expenditure of the donor for purposes of expenditure tax.

19. Receipts of charitable donations (including inheritances) should not be charged to tax in the hands of the charity provided the Revenue Commissioners are satisfied that they are applied for charitable purposes.

20. Except where the conditions in paragraph 9.31 are met, profits from a trade, including farming, carried on by charities should be charged to tax in the normal way.

21. There should be no change in the treatment of investment income of charities.

22. There should be no change in the existing arrangements for dealing with indirect taxes paid by charities.

GLOSSARY

Covenant:	Contractual agreement to donate part of one's income to an individual or group.
Equity, Tax:	Standards of fairness. The tax payable should accord with ability to pay.
Externality:	The effect of the activities of producers or consumers on third parties.
Farm-out:	A term used in the mining industry when the holder of a licence to explore surrenders part of his licence interest in exchange for financial assistance but retains some interest in the licence.
Local Taxation:	Tax which is set by local authorities and used to finance local services.
Rates:	A tax on real property raised by local authorities at so much per pound of the assessed value of buildings and land.
Ring Fence:	A designated area for an activity isolated for tax purposes from other activities.
Royalty:	A payment to the owner of a good or resource which is related to its use.
Tax Base:	The object to which the tax rate is to be applied, for example, income, consumption, property.
Trust:	Instrument through which money or property is entrusted to an individual or group of individuals to administer in the interests of others.

Part I

Local Taxation

CHAPTER 1

GENERAL PRINCIPLES

Introduction

1.1 In this chapter we are concerned with the financing of the expenditure of elected local authorities. In present Irish circumstances these are county councils, county borough corporations, borough corporations, urban district councils and town commissioners. We examine the case for local taxation and the criteria which local taxes should satisfy. We also give our views on the principles which should govern the system of central government grants to local authorities and the imposition of charges for services.

Why Local Government?

1.2 Whether or not there is a system of local government, with real discretion as to what services are provided and to what extent, must be decided by the Oireachtas. That issue is outside our terms of reference.

Case for Local Taxation

1.3 In a submission to the Minister for the Environment, a copy of which we received, the General Council of County Councils stated that

> "There can be little doubt that a crucial and necessary condition of some measure of freedom from central control is a flexible and autonomous source of local finance. In practical terms, independent sources of local finances are the *sine qua non* of true local discretion."[1]

1.4 Since any system of local taxation involves variations in the rate of tax levied in different local authority areas, it follows that such a system is inevitably more complicated than a uniform national tax levied on the same base. Why then should we incur the additional costs associated with a system of local taxation?

---

[1]Submission to the Minister for the Environment on Local Government Reform. August, 1984.

1.5 We believe it is useful to classify the services provided by local authorities as either local or national. National services are those undertaken by local authorities on behalf of the state. Uniform guidelines for their provision are laid down by central government. The case for devolving administration of these services to local authorities is based on considerations of efficiency and of giving people greater access to services, thus allowing easier contact with local representatives and officials. National services should be financed wholly from national taxation.

1.6 Local services are optional insofar as the locality has wide discretion over what is done and the manner in which it is done. This offers scope for local initiative and variety and decisions are left to the representatives of the local community. Such local services should be financed mainly, though not exclusively, from the area. National subvention of these services would be related to differences in local resources.

1.7 The additional costs arising from a system of local taxation are justified only if it is considered desirable to give local authorities real discretion to provide or not to provide services. If they were given the power to provide services but had no responsibility to raise the money to finance them, they would be under no pressure to weigh the costs and benefits of the services concerned. The price for allowing local authorities discretion in providing services is to supply them with an adequate tax base capable of financing the exercise of this discretion. Ideally, the local tax base provided should bear only on the electorate in a given local authority area.

1.8 There is no need to provide local authorities with an independent source of local revenue if they are charged only with the local administration of services, the level and nature of which are decided by central government.

Amount of Local Taxation

1.9 We raised with the Department of the Environment the issue of the amount of local taxation needed to ensure the satisfactory operation of local government in Ireland. They replied that

> "it is difficult to say what the appropriate level of funding from local resources should be: it has gone from about 60 per cent in 1976 to about 35 per cent as regards current account expenditure and this is regarded as too great a swing".[2]

[2]Agreed note of meeting of 11 June, 1984.

Criteria for Local Taxes

1.10 In designing a tax system, it is important that the sum of the individual parts forms a coherent whole. Once the total system has been devised, parts of it can then be allocated to different levels of government. In deciding which elements of the total tax system be given to local authorities, the main considerations are

(i) what is the required yield from local taxation, and

(ii) what taxes are the most suitable in this context.

1.11 Local taxes should satisfy the criteria of equity, efficiency and simplicity which we laid down in our other reports for national taxes. Equity should be determined in the context of the overall impact of taxation and public expenditure at both national and local level and not solely in relation to the individual local tax.

1.12 Efficiency requires that local taxes can be levied at different rates in adjoining local areas without giving rise to serious distortions in trade. The possibility of genuinely independent local variation is essential.

1.13 The criterion of simplicity imposes particular constraints in the area of local taxation. The Department of the Environment told us that the county is likely to remain the main unit of local administration and this needs to be taken into account in recommending a system of local taxation. It would not be desirable to establish large and complex systems of tax administration at local level. However, in this context, it is largely irrelevant whether local taxation is collected by the local authority or on an agency basis by the Revenue Commissioners or some other body, provided the individual local authority has the discretion to vary the rate of tax levied in its own area.

1.14 It is also essential that there is a base for local taxes in each local authority area that is capable of yielding adequate revenue. To ensure that there is no conflict between the requirements of adequate revenue and equity, it is essential that government grants to local authorities take account of differences in their needs and resources.

1.15 To ensure accountability, it is essential that if a local authority decides to increase or reduce the rate of local taxation, the impact of such a change bears on the local electorate. It is important that if national and local government share the same tax base, changes in the local rate of tax are not automatically fully offset by national changes. This would be the case if local taxes were fully creditable against national taxes.

Central Government Grants

1.16 In some countries, local authorities are allocated a predetermined share of certain national taxes. The total levels of these taxes and the proportion allocated locally are determined by central government. Allocation of particular revenues to local authorities is one means of determining the level of central government grants to local government. We consider that the amount of central government grants to local authorities should be determined in the light of the overall need for local services, the resources of local authorities and general national policy in relation to the aggregate level of tax and public expenditure. It should not be determined by factors such as the amount raised in particular national taxes. This could inhibit central government from making changes in the structure of national taxation which would be desirable but for their impact on the receipts of local authorities.

1.17 Local authority areas differ markedly even in a small country. The level of income and the growth of income per head vary considerably from one region to another. This means that if local authorities are to be largely self-financing, great local disparities will arise. In poorer areas, the burden of taxation relative to income will be heavier or the level of services will be lower. If these disparities are to be reduced or eliminated, some scheme of equalisation or transfer of resources from richer to poorer areas is necessary. Such an equalisation scheme is a potentially important instrument of regional policy.

1.18 The Department of the Environment told us that

> "there would be a need for a system of equalisation where local authorities had power to collect substantial revenues. This equalisation should take the form of adjusting the grant support rather than taking away the proportion of revenue collected locally. The grant should comprise a needs and resources element. However, the system should be much simpler than that in use in the United Kingdom. However, the Department has not done any detailed work on devising a suitable scheme".[3]

1.19 We consider that central government grants to local authorities should be consolidated into a single local taxation support grant which would be distributed to local authorities on a basis which takes account of differences in their needs and resources.

[3]Agreed note of meeting of 11 June, 1984.

Charges for Specific Services

1.20 About one-eighth of the total cost of local government services is recovered by directly charging the users of those services. Receipts under this heading include rents received from tenants of local authority houses and water charges.

1.21 In 1983, it was announced that charges would be levied at local level for local services such as water and refuse removal. Some of these charges have been introduced. Some local authorities have introduced water charges on the basis of a flat fee per house, while others vary the charge in relation to the rateable valuation of each house.

1.22 We note the view of the National Planning Board that

> "the stage seems set for a proliferation of special charges or taxes which will create confusion by their complexity and resentment at their number. If taxes on property or charges for services supplied to property owners are necessary, a single, consolidated local tax would be preferable".[4]

1.23 Charges should be introduced only where they meet the following criteria:

(i) the charge is related to the services received; for example, the amount of water used and the cost of providing it, and

(ii) the costs of collection are economically justifiable.

Charges which cannot meet these criteria should not be levied. The scope for levying charges is therefore limited.

Recommendations

1.24 We make the following recommendations:

1. Central government grants to local authorities should be consolidated into a single local taxation support grant which would be distributed to local authorities on a basis which takes account of differences in their needs and resources.

2. Charges for services should be introduced only where

   (i) the charge is related to the service received, and

   (ii) the costs of collection are economically viable.

[4]National Planning Board, Proposals for Plan 1984-87, Prl. 2309, Page 93.

CHAPTER 2

THE BACKGROUND

Introduction

2.1 In this chapter we examine the latest available information on the level and types of local taxation in Ireland and certain other countries. Rates are the only form of local taxation in Ireland. An outline of the historical background to the rating system is given in Appendix 1.

Structure of Local Finance in Ireland

2.2 Local authorities in Ireland have three main sources of current revenue. These are rates, grants from central government and miscellaneous receipts. The changes in the relative importance of these sources of revenue over the last ten years are shown in Table 1.

TABLE 1

Sources of Income of Local Authorities in Ireland

	Rates	State Grants	Miscellaneous Receipts[1]
	%	%	%
1976	40.5	38.0	21.2
1980	19.7	59.0	21.2
1984 Estimate	12.2	64.0	24.0

Source: Returns of Local Taxation and Department of the Environment.

Notes

(1) Miscellaneous receipts include items such as rents and part of the proceeds of sales of local authority housing, repayments by borrowers of house purchase and improvement loans, charges for water supplies and sewerage facilities and other miscellaneous fees and charges.

(2) The figures do not total 100 per cent due to rounding.

2.3 Table 1 shows that the share of income of local authorities accounted for by rates has fallen to less than one-third of the level it was in 1976. This has been due largely to the growth in local authority expenditure and the progressive reduction and ultimate removal of rates from agricultural land and domestic dwellings. This means that the only independent source of local revenue is rates on industrial and commercial property. Income from

state grants has risen from about two-fifths to almost two-thirds, while the share of miscellaneous receipts has been relatively stable.

2.4 Table 2 shows local taxes as a percentage of total tax revenue for both federal and unitary OECD countries.

TABLE 2

Local Taxes in OECD Countries as a Percentage of Total Tax Revenue

	1973	1981
	%	%
Federal Countries	11.5	10.1
Unitary Countries	12.7	13.0
Ireland	8.7	2.7
Ireland's ranking (21 countries)	13th	19th

Source: Revenue Statistics of OECD Member Countries [1983 ed.]

Federal countries are Australia, Austria, Canada, the Federal Republic of Germany, Switzerland and the United States.

Unitary countries are Belgium, Denmark, Finland, France, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden and the United Kingdom.

2.5 There is no appreciable difference in the share of local taxes in federal and unitary countries. However, the share of local taxes in Ireland is now among the lowest in the OECD. In 1981, only Italy and the Netherlands were lower.

2.6 Table 3 shows tax revenues from main local taxes as a percentage of total tax revenues of local authorities in OECD countries in 1981.

TABLE 3

Tax Revenues from Main Local Taxes as a Percentage of Total Tax Revenue of Local Authorities in OECD Countries in 1981

	Federal Countries	Unitary Countries
	%	%
Taxes on Income and Profits	34.9	38.8
Payroll Taxes	1.9	Nil
Property Taxes	49.7	29.9
General Consumption Taxes	5.1	2.8
Taxes on Specific Goods and Services	2.7	2.7
Taxes on the Use of Goods	2.0	4.1
Other Taxes	3.8	21.7

Source: Revenue Statistics of OECD Member Countries [1983 ed.]

2.7 The main sources of local revenue are local income taxes and local property taxes. Only in Ireland and the United Kingdom do property taxes constitute the only source of local taxation. However, such taxes account for over three-quarters of local tax revenue in Australia, Canada, New Zealand and the United States.

2.8 Table 4 shows local property taxes as a percentage of gross domestic product in OECD countries in 1973 and 1981.

TABLE 4

Local Property Taxes as a Percentage of Gross Domestic Product

	1973	1981
	%	%
Federal Countries	1.6	1.4
Unitary Countries	0.9	0.9
Ireland	2.7	1.1
Ireland's Ranking (21 Countries)	4th	8th

Source: Revenue Statistics of OECD Member Countries (1983 ed.)

2.9 Table 4 shows that generally local property taxes absorb a very low percentage of gross domestic product. The estimated share for Ireland in 1984 is 0.8 per cent which would have put us in tenth position in the OECD in 1981.

Conclusion

2.10 The proportion of revenue expenditure of local authorities financed from local taxation has fallen sharply and is now at very low levels by international standards. Such a trend is inconsistent with a system of local government with decision making powers regarding the provision of services and is appropriate only to a system of local administration of centrally determined services.

CHAPTER 3

LOCAL INCOME TAX

Introduction

3.1 In this chapter we consider the introduction of a local income tax. We conclude that such a tax would result in the loss of the benefits of simplification which flow from the recommendation in our first report for a single rate of income tax on all income. We recommend against a local income tax.

Background

3.2 The possibility of introducing a local income tax in Ireland was considered some years ago in the context of the existing income tax system. This study[1] showed that the only practicable method of administering a local income tax would be for it to be done on an agency basis by the Revenue Commissioners. However, a local income tax was rejected as impracticable on the grounds that the difficulties in identifying income arising in various local areas would make the administration of the tax very expensive.

3.3 The issue was also examined by the Layfield Committee in the United Kingdom which concluded that

> "A local tax on all personal incomes, the rate being set by the local authorities, is the only feasible major new source of income meriting further investigation. There are advantages and disadvantages, but we conclude that it could perform a major role in local finances".[2]

3.4 The Layfield Committee concluded that a local income tax would be a feasible proposition if operated by the Inland Revenue, making use of the PAYE system for Schedule E incomes and provided the present national

[1] Interdepartmental Committee on Local Finance and Taxation. Third Report 'Rates and Other Sources of Revenue for Local Authorities'. July, 1968 prl. 89.

[2] Local Government Finance Report of the Committee of Enquiry. May, 1976. Cmnd 6453 p. 209.

income tax were simplified. However, the report did identify significant obstacles in the way of a local income tax. These were that it would

(i) add considerably to the present burden of income tax collection and assessment, both for the Inland Revenue and for industry and commerce generally,

(ii) change the circumstances in which income tax is used as a tool of central economic management,

(iii) require special measures to make it clearly perceptible within the individual taxpayer's total local and national income tax,

(iv) require at least five years before it could be introduced, and

(v) depend on a number of important simplifications being made within the national tax system.

3.5 The simplifications of the tax system proposed in our first report go further than the measures identified by the Layfield Committee as prerequisites for the introduction of a local income tax. We are satisfied that the most effective and efficient way for a local income tax to be administered would be on an agency basis by the Revenue Commissioners. We can see no prospect or justification for setting up separate administrative machinery in each local authority area. This means that the base for local income tax would have to be the same as for national income tax.

Forms of Local Income Tax

3.6 There are three possible forms that local income tax might take. The first is an income levy with no allowances or credits. This would have the disadvantage of the present income levies by bearing unduly on those with low incomes.

3.7 The second is a local addition to each of the national rates of tax expressed in pence in the pound. For this second (pence) method to operate, it would be necessary to provide employers with special tables. Special combined tax tables to collect national and local tax would need to be constructed for each rate of local tax. These would require revision whenever national tax rates changed. At present there are eight national PAYE tables.[3] If there were ten different rates of local tax, the present system would require eighty tax tables. While there would be no additional calculations for employers, the selection of the appropriate tax table could give rise to errors. In practice, small employers might not have to deal with much more than the existing eight tables if all their employees lived

[3]Following the proposals in the 1985 Budget statement, the number of tax tables will be reduced to six.

in the same local authority area. Larger employers with computerised payroll operations could be expected to cope better with the additional work involved.

3.8 A third, more progressive, form would be a local addition of a percentage to each individual's national tax bill. If the local rate of tax were expressed as a percentage of national tax, the amount of national and local income tax due in each pay period could be determined by reference to a ready reckoner or conversion table. The employer would have to calculate the national tax as now and apply the percentage addition. This would mean an additional calculation. However, under our proposals for the full integration of social insurance contributions and income tax, the calculations would be no more complicated than those which employers are already expected to perform.

3.9 All three forms of local income tax would allow flexibility between local authorities and in the total sums raised but the third would make the local tax yield very sensitive to changes in the national tax yield. If possible, this sensitivity would be better avoided.

INHERENT DIFFICULTIES

3.10 There is a number of other problems to be overcome before a local income tax could be introduced. These relate to

(i) determination of a taxpayer's residence,

(ii) treatment of investment income,

(iii) treatment of company profits, and

(iv) collection of PAYE underpayments.

Residence

3.11 For a local income tax to operate, it would be necessary to determine the taxpayer's principal place of residence for local tax purposes. Under the present system, the Revenue Commissioners do not necessarily know, or need to know, the location of residence. For PAYE taxpayers, most of their dealings are with employers; the taxpayer's address which may be held incidentally on the Revenue Commissioners' files would not be conclusive evidence for deciding which local rate of tax should be applied. For self-employed taxpayers, the Revenue Commissioners have on record the taxpayer's business address which may be in a different local authority area to his residence. To deal with this problem, taxpayers would have to disclose the local authority area in which they resided.

3.12 A procedure would have to be established for determining each year a taxpayer's place of residence for local taxation purposes. The most practicable scheme would be to set liability each year for the appropriate local rate of tax on the basis of residence at a particular date prior to the tax year. In principle, residence should be established as near as possible to the start of the tax year to ensure that it was as up-to-date as possible.

3.13 The Revenue Commissioners told us that under the present PAYE system there was no interaction between the Revenue Commissioners and employees. The introduction of a local income tax was not feasible because it would require this interaction to determine the residence of taxpayers.

3.14 Even if this difficulty could be overcome, other problems would have to be solved. Some people will change residence after the date of determination and others may be registered in error for some other reason. Procedures would have to be adopted for end of year adjustment of liability in these cases. This would clearly give rise to complications.

3.15 Addresses will change after the date of residence determination and throughout the relevant tax year. If a local income tax were to take account of such changes, taxpayers would have to notify the Revenue Commissioners and employers, thus generating administrative and compliance costs. Although it is not very satisfactory to determine tax liability for a year by reference to circumstances at a particular date well before the start of that year, any alternative system involving assessment by the Revenue Commissioners could not, in our view, be administered sufficiently easily for it to be recommended. However, if self-assessment were introduced for income tax generally, the difficulties in this area would be largely overcome.

3.16 For most taxpayers, determination of residence would be fairly easy. For others, including members of the Defence Forces, seamen, students, those with more than one residence and those with no permanent home, special provisions would be necessary.

Investment Income

3.17 The taxation of investment income at different local rates would be difficult, particularly in the case of PAYE taxpayers. For some types of investment income which is paid gross, for example, interest on government securities, the PAYE system is often used to collect the tax appropriate by reducing personal allowances by an estimate of the income involved. Such adjustments could also operate to collect the correct amount of local income tax on that income.

3.18 Other forms of investment income are taxed at source and paid net of some or all of the full tax liability of the recipient. These include building

society interest, dividends from Irish companies and interest on land bonds. It would not be possible for building societies, companies or the Central Bank to apply variable rates of local tax to investment income paid under deduction of tax. There is no requirement for the beneficial owner of shares to register them in his own name and the payer would not know which rate of tax to apply. It would be possible to charge investment income at a composite or average local rate. This would mean treating investment income differently from other income. It could also create a further difference depending on whether it was paid gross or net. However, the latter problem could be solved by extending deduction of tax at source to all investment income.

Treatment of Company Profits

3.19 Should a local income tax apply to company profits? If the answer were yes, the only practicable means of doing so would be to levy the local tax rate applicable in the area in which the company had its registered office. To allow tax deducted at the company level as a credit against the local tax payable by shareholders on dividends would cause enormous complications. To exempt company profits entirely from local taxation would be unfair and would result in the loss of the very substantial benefits which flow from the single rate of income tax proposed in our first report. We could not advocate such an anomaly.

Underpayments of PAYE

3.20 Underpayments of PAYE tax in previous years are often recovered in the current or future tax years by a reduction in personal allowances. If a local income tax were integrated with collection of the national income tax, this could result in a taxpayer paying more or less local tax than he would if the underpayment had been charged at the local rate prevailing for the year in which the underpayment arose.

3.21 This difficulty could be overcome by directly collecting all PAYE underpayments. We think this would be undesirable as the present system is effective and is more convenient for taxpayers. An alternative solution would be for the Revenue Commissioners to take into account any changes in the rate of local tax and adjust the restriction of personal allowances accordingly. While this would be technically feasible it would be complicated. Taxpayers would have difficulty in understanding the computations and this would give rise to queries and correspondence.

Conclusion

3.22 In our first report we made recommendations which would result in enormous and valuable simplification of the income tax system. Simplification is essential before a local income tax can be contemplated. Even if it were feasible, the introduction of a local income tax would substitute a new set of complications for the existing ones. This would be highly undesirable. We believe that the introduction of a fair and efficient local income tax is not possible. We recommend strongly against the introduction of a local income tax.

CHAPTER 4

LOCAL INDIRECT TAXES

Introduction

4.1 In this chapter we consider the introduction of a local sales tax and local motor vehicle duties. We conclude that in a country the size of Ireland, a local sales tax is not desirable because of the distortions caused by variations in the rate of tax from one local authority area to another. While the introduction of local motor vehicle duties would not cause problems of the degree encountered by a local sales tax, we do not recommend that local motor vehicle duties be introduced.

LOCAL SALES TAX

Background

4.2 Local sales taxes have obvious attractions, since most spending is done within the local authority area in which people live. They also provide a means of charging tourists for the use of local amenities. Prior to the introduction of value-added tax in 1972, the Interdepartmental Committee on Local Finance and Taxation recommended[1] that county councils and county borough councils should be given the power to impose a local turnover tax at $1\frac{1}{4}$ per cent if they saw fit. The limitation on the rate was to avoid the dangers of competitive exploitation of the same revenue source by the central government and local authorities. It is clear that almost all local authorities would impose the new tax and it would, in practice, amount to the assignment of a certain proportion of value-added tax. The Committee concluded that the scope for local variation to meet the growth in expenditure would be limited, unless the ceiling on the rate of local taxation were relatively high.

The Options

4.3 There are two main options for a local sales tax: value-added tax and turnover tax at the retail stage. The considerations involving both are

[1]Third Report, paragraph 13.7.

similar. Different levels of local sales taxes in different areas could cause distortions of trade. As a result, the scope for genuinely independent local variation would be very limited indeed as local authorities would come under intense pressure from local traders to maintain competitiveness with adjoining areas.

4.4 In Chapter 4 of our third report, we concluded that value-added tax is preferable to a turnover tax at the retail stage, because the collection of a high percentage of the total tax from manufacturers and wholesalers reduces the danger of evasion. Since the collection of sales taxes is weakest at the retail stage, we could not recommend the introduction of a retail turnover tax. Because our proposals do not involve an increase in the overall level of taxation, this would involve a transfer of tax from the present national value-added tax to a local retail turnover tax. This would result in a big decline in the efficiency of collection and could not be recommended.

4.5 There are two options for a local value-added tax. The first is to have a local VAT separate from national VAT. This would be very complicated and would involve local authorities in making repayments of tax which had been paid to other local authorities. This would be unacceptable. The amount obtained by each local authority from a separate local VAT would be related to the amount of value-added in its area rather than to the amount of consumers' expenditure. This would be undesirable. The alternative is to link local VAT to national VAT. Local and national VAT paid in one area would have to be allowed against local and national VAT paid in another area and refunds given in appropriate cases. This would complicate the national value-added tax structure. It would also militate against accountability in so far as local authorities could increase their revenue from local VAT at the expense of the Exchequer and possibly other local authorities.

Conclusion

4.6 The decisive argument against local taxes is the difficulty of genuinely independent local variation. We do not recommend their introduction.

LOCAL MOTOR VEHICLE DUTIES

Present System

4.7 At present, owners of motor vehicles are required to pay motor vehicle duties to the local authority in whose area the vehicle is ordinarily kept. Owners of fleets of vehicles, that is six vehicles or over, have the option of taxing the vehicles where the head office of the company is located. The local authorities remit the proceeds to central government.

A New Local Tax

4.8 We raised with the Department of the Environment the possibility of introducing local motor vehicle duties. They told us that

> "a car tax could provide a source of revenue for local authorities. However, there is the possibility that fleet operators would then register their vehicles in local authority areas with low rates of tax. Detailed consideration would also have to be given to the feasibility of having a two-tier car tax system, involving the State and local authorities".[2]

4.9 In our third report, we made proposals for the simplification of the unnecessarily complex system of motor vehicle duties which now exists. The present system substantially increases compliance costs as taxpayers rarely know the appropriate rate of tax on their cars. We do not favour a two-tier system of motor vehicle duties which would add to this complexity. In all the circumstances, we do not recommend the introduction of local motor vehicle duties.

[2]Agreed note of meeting of 11 June, 1984.

CHAPTER 5

LOCAL PROPERTY TAX

Introduction

5.1 In this chapter we examine the case for a local property tax. In Chapter 6 we consider the income-related residential property tax which was introduced in 1983. We conclude that property taxation is the only practicable method of raising significant sums in local taxation.

Background

5.2 Property taxes are familiar in Ireland where they have existed for many years. Prior to 1969/70, income from the ownership of buildings was charged to tax on a notional basis under Schedule A of the Income Tax Acts. Rates were a broadly-based local property tax and have been levied for centuries. Rates were levied on all domestic housing irrespective of the type of tenure. Rates on houses were removed in 1978. The residential property tax, (RPT), introduced in 1983, is levied on all owner-occupied housing over a certain value where the household income exceeds a given threshold.

5.3 Of these three taxes, only rates were levied by local authorities. Rates on domestic property were subject to three criticisms which became more widespread as the burden increased. These were

(i) the valuations used were not revised, were not consistent and were unfair,

(ii) rates were not related to ability to pay, and

(iii) the amounts paid were large and had often to be paid in one or two lump sums.

5.4 These valid criticisms could have been dealt with by revising valuations, providing an effective rebate system for those on low incomes and allowing payment by instalments. In the event, these reforms were never made and rates on houses were abolished. This has put greater pressure on central government finances and has led to greater borrowing, higher

national taxes and a lower level of services. The introduction of charges for services in 1983 was an attempt to relieve this pressure.

5.5 Arguments have been raised against property taxes in any form. These arguments centre on the constitutional status of property in Ireland, the equity of a property tax and the failure of property taxes to take account of the principle of ability to pay.

5.6 Article 43 of the Constitution acknowledges the right to private property. However, the exercise of this right is subject to regulation by the principles of social justice. The courts have not held that taxation on property contravenes the right to private property and there is no reason to suppose that a tax on property, provided it is equitable, would be repugnant to the Constitution.

Justification

5.7 In our first report[1], we considered the equal tax treatment of people in the three major categories of housing tenures: those who rent houses, those who occupy the houses they own outright and those who occupy the houses they own subject to a mortgage. There were two possible methods of doing this. The first method would charge owner-occupiers to income tax on their imputed rental income while allowing a deduction for mortgage interest. No deduction would be allowed for rent paid. The second method would disregard imputed rent and allow a deduction for mortgage interest and payments of rent as well. The first method is neutral between those who hold their assets in the form of housing or in other forms. The second favours investment in housing but is neutral as between owners and renters.

5.8 In the event, we endorsed the principle underlying the first method but concluded it could not be implemented without undue administrative difficulty. We recommended a second-best solution. This was to ignore the imputed rent for tax purposes, disallow mortage interest relief and give no deduction for rent. This removes the inequity between those who rent their houses and those whose houses are fully subject to a mortgage, but it places in a favourable position those who own their own houses outright or own them partly. The same applies to those who rent their houses at less than the market rent.

5.9 We conclude that a local property tax can be justified, in principle, as an administratively feasible means of including in the tax base the imputed rental income which arises from the occupation of property.

---

[1]First Report, paragraph 10.9.

THE ISSUES

5.10 In considering property taxes in general, the issues which arise are

(i) the valuation basis,

(ii) the treatment of mortgage interest,

(iii) the treatment of rented residential property,

(iv) the treatment of industrial and commercial property,

(v) the treatment of land,

(vi) the treatment of other real property,

(vii) whether the tax should be charged on the owner or occupier of the property,

(viii) the payment of tax, and

(ix) the method of giving relief to persons with low incomes.

Valuation Basis

5.11 It is essential that the basis of valuation for any system of property taxation commands the confidence of taxpayers that it is equitable and reasonable. This is most likely to occur when the system is on a basis which all understand and there is frequent revision which ensures that valuations are kept up to date.

5.12 We discussed with the Society of Chartered Surveyors in the Republic of Ireland the question of valuation for purposes of a local property tax. They considered that valuation of residential property should be on the basis of capital values and they also recommended a system of broadbanding. Industrial and commercial property should be valued on a rental basis. A simple formula would be sufficient to translate capital and rental values to a comparable basis.

5.13 We favour valuation of residential property on the basis of capital values. This is because, with regard to residential property, there is much more evidence relating to capital than to rental values. Another advantage of capital values is that they are generally more intelligible to the ordinary citizen. A system of broadbanding would minimise the number of disputes. Appeal procedures should also be provided. Should it be decided to include industrial and commercial properties within the scope of a property tax, these should be valued on a rental basis.

5.14 The question arises whether or not the valuations should be on a self-assessment basis. We asked the Revenue Commissioners for their views

on the operation of the self-assessment valuation system under the RPT. They told us that

> "The level of compliance can be gauged to some extent by the fact that the estimated yield from the tax for 1983 was £3 million, while actual payments in that year totalled £1.04 million only. Up to 31 August, 1984, only a further £0.3 million was added to that total despite the issue of estimated assessments (selected on the basis of rateable valuations) by the Revenue from early 1984. (The picture as regards residential property tax is, of course, considerably distorted because of the legal proceedings taken to test the constitutionality of the tax)".[2]

5.15 There are, broadly, three options for determining valuations. They could be carried out on a national basis by the Valuation Office. Alternatively, the valuations could be carried out by local authorities or by consultants. In both cases appeal procedures would be necessary. Thirdly, the valuation could be fixed by self-assessment.

5.16 The main requirement is a system which will enable property taxes to be introduced with minimal delay and cost to both sides. The first method would be far too slow. While the second would be quicker, we consider that self-assessment monitored locally would be cheaper and more effective. We recommend that local property tax be introduced on self-assessed open market capital values of residences assuming that the property is occupied on a fee simple basis. The values should be classified into broad bands and should remain valid for a period of five years. The responsibility for administration of the valuation system, including audit of understated values, should be allocated to local authorities. The most efficient method of doing this may be for them to employ private consultants to assist them. Industrial and commercial property should be valued on a rental basis. Capital and rental values should be related by a formula.

Treatment of Mortgage Interest

5.17 Under the income-related residential property tax and the old rating system, no allowance was made for any debt outstanding on the property. The question arises whether or not there should be an allowance for outstanding debt.

5.18 The correct treatment for debt outstanding can only be understood by going back to examine the treatment of interest paid on borrowings which we proposed in our first report.[3] This was based on two principles.

[2]Agreed note of meeting held on 12 December, 1984.
[3]First Report, paragraph 11.16 to 11.24.

Firstly, any allowance for interest should be confined to real interest, that is, interest paid at a rate in excess of the rise in consumer prices. Secondly, interest should not be allowed as a deduction except in cases in which it was used to finance the acquisition of assets, the income from which was chargeable to tax. On this basis we concluded that interest on personal borrowings used to finance consumption expenditure should not be allowed as a deduction for tax purposes.

5.19 If the property tax on houses is regarded as a proxy for charging to tax the imputed income from owner-occupation, then, strictly speaking, any real interest payment on a mortgage on the property should be allowed as a deduction in computing liability to local property tax. We do not recommend any specific allowance in respect of outstanding mortgage debt against local property tax because to do so would complicate matters unduly. However, if a local residential property tax is introduced on the lines we propose, it would be consistent with the principles set out in our first report, if there were unrestricted allowance of real interest on mortgage debt for income tax purposes. We so recommend.

Rented Residential Property

5.20 The question arises whether or not rented residential property should be subject to a local property tax. If a local property tax is justified on the basis that it is a proxy for imputed income, then, in principle, residential property let at market rents should be exempt from local RPT because the income from such property is already fully chargeable to income tax. We envisage local RPT being a charge imposed on the occupier. In these circumstances we recommend that rented residential property be charged to local property tax on the same basis as other residential property.

5.21 This treatment of rented property would impose a substantial liability to property tax on many local authority tenants. These were also liable to rates. We envisage that the same treatment would apply for property taxes as for rates. In fixing differential rents, local authorities should take account of the liability to property tax. The effect of this for local authority tenants would be that the combined liability to rent and property tax would be graduated in line with income.

Industrial and Commercial Property

5.22 Rates are at present payable only in respect of industrial and commercial property. In the context of the recommendations in our first and second reports which called for full taxation of income from a trade, profession or vocation and the imposition of a comprehensive taxation of capital gains, gifts and inheritances, we recommended that, pending our review of local

taxation, rates on industrial and commercial property should be allowed as a credit against income tax liability.

5.23 It may be argued that a local tax on industrial and commercial property should be maintained as a proxy for charges for services provided. In Chapter 1 we concluded that charges should be introduced only where they are directly related to the provision of services. The balance of public expenditure should be financed from taxation or borrowing where this is appropriate. In our first report[4] we rejected the principle of attempting to levy taxes in relation to the benefits individuals are estimated to receive from goods and services provided by the state. We see no reason to depart from this view in relation to local property taxes.

5.24 If local property taxes are levied on the properties mentioned in paragraph 5.23, equity and efficiency require that these taxes be allowed as a credit against any national income tax payable.[5] An alternative would be to exempt industrial and commercial property from a local property tax. In all the circumstances we think it is preferable that such property should be included in the tax base. We so recommend.

5.25 In our second report we drew attention to the fact that certain parts of the existing tax system constitute binding contractual arrangements between the state and individual entities. Examples of these commitments are the continuation of export sales relief until 1990 and the continuation of the reduced rate of tax on manufacturing profits until the year 2000. We recommended that all existing companies which qualify for export sales relief, Shannon relief or the reduced rate of tax on manufacturing profits should have the right to opt to pay a normal rate of tax under the new system or retain their present entitlements under the old system. We recommend that companies which retain their rights under the old system should continue to have rates, or any form of property tax which may be introduced to replace rates, allowed only as a deduction in computing profits for tax purposes.

Land

5.26 Traditionally, rates were payable in respect of agricultural land. The full impact of rates on land was mitigated by the widespread derating of land under the agricultural grant. Rates on land were abolished following the decision of the Supreme Court that the basis on which they were levied was unconstitutional.

5.27 Since the publication of our third report we note the Government's

[4]Chapter 3.
[5]See First Report, paragraphs 31.43, 32.12 to 32.19.

decision to make changes in the taxation of farm incomes by substituting income taxation of farming profits with a new farm tax.

"The farm tax will be levied and collected by the local authorities. It will be based on adjusted acreage, as used in the past by the Land Commission in the distribution of land, adapted for the purposes of taxation. The concept of adjusted acreage is related to the potential productivity of agricultural land. The new tax will apply with effect from 1986 and ultimately all agricultural holdings of twenty adjusted acres and over will be liable for the tax. Farmers with holdings of eighty adjusted acres and over will continue to be liable for income tax, but a credit will be given against income tax in respect of farm tax paid in the year. Full-time farmers with holdings below eighty adjusted acres will be exempted from income tax with effect from the 1986/87 tax year.

"The new arrangements will be designed to increase the yield from farm taxation in 1986 to about twice the level produced by the present system. It is estimated that this would be achieved on the basis of a rate of farm tax of £10 per adjusted acre. Adjustments to the rate of farm tax thereafter will be determined by reference to the level of farm incomes and the development of total tax revenue. The grant in relief of rates on agricultural land will be reduced by the amount of farm tax collected. The tax will therefore be part of the restructuring of local authority financing now being considered by the Government"[6].

5.28 It appears that this proposed tax will be an assigned revenue and not a local tax in that there will not be scope for independent local variation. We remain of the view expressed in our first report that farming profits should be charged to tax on the same basis as other profits. The proposal for a farm tax is misconceived and should be dropped.

5.29 The question remains whether or not a local property tax should apply to land. We believe that once income from land is charged to income tax, profits on the sale of land are charged to capital gains tax and transfers of land come fully within the scope of taxes on gifts and inheritances, a further charge of land to property tax would be inequitable.

5.30 We considered in our second report whether or not there should be a resource tax imposed on agricultural land, on a temporary basis, to increase agricultural output. We identified certain arguments for and against the imposition of such a tax and put forward a scheme of taxation which,

[6]Building on Reality, 1985-87, paragraphs 6.16 and 6.17.

despite certain drawbacks, would prove most suitable. However, we left open the question of whether or not such a tax should be introduced.[7]

5.31 Whatever about the merits and demerits of a resource tax, we all agreed that such a tax should not form a permanent part of the Irish tax system. If our other proposals are implemented, income from land will be fully taxed. In that context, we do not think that a property tax on agricultural land would be justified. Farm houses and buildings would, of course, be liable to tax on the same basis as similar property.

Other Real Property

5.32 There are many other forms of real property which do not fall within the classification of residential, industrial or commercial. Examples of these are schools, hospitals, churches and public buildings. We recommend that such property be excluded from the scope of a local property tax.

Owners or Occupiers

5.33 The question arises whether residential property tax should be the liability of the owner or the occupier. In most cases the owner will also be the occupier. However, in other cases, we recommend that tax be levied on the occupier for the following reasons:

(i) the benefit of occupation accrues to the occupier,

(ii) identification of the occupier is easier and would make the tax much easier to administer, and

(iii) the principle of taxing occupiers is well established under the rating system.

Tax on empty properties should be charged on the owner.

Payment of Tax

5.34 A major difficulty with rates was that they were generally payable in two relatively large instalments. Such a system was acceptable when tax payments were relatively low. Payment of tax in large amounts is no longer suitable for most taxpayers and it is imperative that arrangements be made for the more frequent payment in small amounts.

5.35 We recommend that any residential property tax should be payable in a minimum of four instalments. We also recommend that consideration

[7]In a reservation, Mr Daniel Murphy and Mr Donal Nevin proposed the introduction of a resource tax on land to promote the efficient use of land and not as a revenue raiser.

be given to use of payment schemes through bankers' orders, direct debits and credit cards.

5.36 We have considered whether or not taxpayers should be able to opt to have their local property tax collected under PAYE if they so wished. It is most desirable that this option be provided if it were practicable. Amounts of tax under PAYE can be recovered by restricting allowances or credits. We regret that such an option may not be feasible because

(i) under our proposals the property tax due may be in excess of the credits to which a taxpayer is entitled in many instances, and

(ii) the rate of property tax may not be fixed in time for it to be coded-in on PAYE certificates of tax-free allowances.

However, we recommend that the option of having property tax collected by PAYE deductions should be kept under review.

Relief for Persons on Low Incomes

5.37 The residential property tax would apply to all owner-occupied housing if there were no income threshold. It could bear heavily on lower income groups, especially pensioners who live in houses which reflect their past rather than their current incomes. A system of rebates or waiver would be necessary to overcome this problem. We consider that such a scheme of rebates should be operated through the social welfare system.

5.38 In the United Kingdom there is a number of rates' relief schemes. Supplementary benefit provides for an amount for rent which includes rates. The rates' rebate scheme for those on low incomes who are not receiving social welfare is related to household income and family circumstances.

5.39 There is also a number of schemes in the United States which modifies the impact of property taxes on the less well off. Age, income, wealth and length of residence are all eligibility conditions. The relief is often in the form of a credit against income tax or a cash refund if the credit exceeds income tax liability.

5.40 One possibility is that any unused credit for income tax purposes could be set against liability to property tax. There would be difficulties in giving effect to this type of scheme on a current basis for PAYE taxpayers. However, it could operate relatively easily for self-employed persons.

5.41 This method would require the raising of tax credits to a level for all taxpayers which would effectively relieve persons in need from the liability to property tax. It would be very expensive. Most of the problems

caused by payment of a property tax arise because the value of the property occupied is high relative to the cash income of the individual. This suggests that a specific exemption from property tax for persons with incomes below a certain amount should be provided.

5.42 We content ourselves with endorsing the principle of a waiver scheme for those on low incomes, to be operated through the social welfare system. The type of scheme to be introduced should be the one which most effectively and efficiently ensures that cases of hardship are relieved. The precise scheme depends on the level of property tax that is charged.

Conclusions

5.43 We conclude that property taxation is the only practicable method of raising significant sums in local taxation. If it is decided to have a system of local government in Ireland, we recommend that the property tax be devolved fully to local authorities. We do not, for two reasons, favour the concurrent imposition of local and national property taxes. Firstly, it is undesirable in principle for local and central government to share the same tax base. Secondly, it would increase unnecessarily the complexity of the system.

5.44 We do not envisage that the reintroduction of local taxation on the lines we recommend should be used to increase the share of gross domestic product taken in taxation. To the extent that it increases the resources of local authorities, the amounts payable in grants from central government should be reduced, thereby allowing a reduction in national taxation.

Recommendations

5.45 We make the following recommendations:

1. Should it be decided that a system of local taxation is desirable, a local property tax should be introduced on all residential, industrial and commercial property (excluding land).

2. Local property tax should be allowed as a credit against income tax liability where the property is used to generate income charged to national income tax.

3. Companies which retain their rights to incentive reliefs under the old system should continue to have rates, or any form of property tax which may be introduced to replace rates, allowed only as a deduction in computing profits for tax purposes.

4. Valuations for purposes of local property tax should be self-assessed. The values should be classified into broad bands and should

remain valid for a period of five years. Administration and audit of valuations should be the responsibility of local authorities.

5. Valuations for residential property should be open market capital values on a fee simple basis. Other property should be charged on annual rental values. A formula should be used to relate the two sets of values.
6. If a local residential property tax is introduced on the lines we propose, there should be unrestricted allowance of real interest on mortgage debt for income tax purposes.
7. Real property other than residential, commercial and industrial property should be excluded from the scope of the tax.
8. Local property tax should be levied on the occupier of the property. Tax on empty properties should be charged on the owner.
9. Payment of property tax should be in a minimum of four instalments.
10. A waiver scheme for persons on low incomes should be operated through the social welfare system.
11. The introduction of a local property tax should not be used to increase the share of gross domestic product taken in taxation.

Part II

Taxation of Special Areas and Activities

INTRODUCTION

1. In this part of the report we examine the taxation of a number of special areas and activities. The discussion is divided into chapters as follows:

(i) National Property Tax (Chapter 6),

(ii) Taxation and the Environment (Chapter 7),

(iii) Mining and Mineral Development (Chapter 8), and

(iv) Charities (Chapter 9).

CHAPTER 6

NATIONAL PROPERTY TAX

Introduction

6.1 In this chapter we consider the case for a national property tax. We conclude that if a local property tax is not imposed, a national residential property tax is justified in the context of the proposals in our earlier reports. On the basis that a local property tax is introduced, we recommend the abolition of the national residential property tax introduced in 1983. The main provisions of this tax are given in Appendix 2.

Residential Property Tax

6.2 The residential property tax (RPT) was introduced in the Finance Act, 1983. Full details of the tax are given in Appendix 2. Briefly, RPT is an annual tax charged at 1.5 per cent per annum on the market value in excess of £65,000 of a property owned and occupied by a person if the household income exceeds £20,000.[1] It is not a local tax but is set at national level. We have deferred our consideration of this tax until our general examination here of property taxes in the context of local taxation.

Justification

6.3 We conclude that a national residential property tax is justified on owner-occupied residential property and residential property let at below market rents. This is provided that

(i) the imputed rental income from such property is not charged to national income tax, and

(ii) there is no local tax on residential property.

The analysis in the following paragraphs assumes that both these conditions exist.

---

[1]The thresholds are indexed. The market value exemption limit for the year ended 5 April, 1984 is £65,622. The income threshold for the same year is £22,030.

6.4 A number of criticisms can be made of the income-related residential property tax introduced in 1983. These are:

(i) it is based on the gross market value of the property. No account is taken of any debt or mortgage outstanding,

(ii) the fact that it applies only above a certain income threshold gives an unfair advantage to those who can quite legally arrange that their income accrues in a form which ensures that the threshold is not exceeded,

(iii) the fact that it applies only to houses above a certain threshold of capital value distorts the housing market,

(iv) the unit of taxation (the household) is too wide. This includes all family members or other persons living in the house other than those whose employment is connected with the house or those who pay an arm's-length rent, and

(v) it does not apply to other goods.

Debt Outstanding

6.5 We regard a residential property tax as a proxy for charging to tax the imputed income from owner-occupation. In these circumstances there should be unrestricted allowance of real interest on mortgage debt outstanding on any property liable to such a tax.

Income Threshold

6.6 The income threshold is intended to ensure that RPT is paid only by the higher income groups. A major problem with any income threshold is that some taxpayers have a greater opportunity than others to arrange that their income accrues in other forms. For example, it is relatively easy to convert certain forms of investment income into capital gains. Also, taxpayers in control of close companies can decide on the amount of remuneration they withdraw from the company.

6.7 We believe that the provision of an income threshold creates anomalies. This is related to our view set out at length in our first report that the existing definition of income is inadequate. If separate waiver schemes for those on low incomes were introduced, the threshold could be abolished. We discussed options for waiver schemes in paragraphs 5.37 to 5.42.

Capital Threshold

6.8 The capital threshold is intended to ensure that RPT is paid only in respect of the larger and more valuable properties. Some people have suggested that this leads to a distortion in the housing market for houses with a value in the region of the exemption threshold.

6.9 We consider that a property tax on owner-occupied houses is justifiable in principle. However, this should apply to all such houses. Houses of a lower value should attract less tax but should not be excluded completely. The best way to protect those on low incomes is to introduce separate waiver schemes.

Unit of Taxation

6.10 Under the RPT the income to be taken into account in determining whether the owner is liable for tax is the income of the household. This is presumably designed to ensure that income-earning children who live at home and enjoy the benefits of good accommodation make some indirect contribution to the Exchequer under this heading. It can be avoided by moving to another residence. Difficulties result from the fact that the householder has no means of forcing other members of the household to disclose their incomes to him.

6.11 We considered the question of the appropriate unit of taxation in Chapter 15 of our first report. We concluded that a husband and wife living together should be regarded as a basic unit for tax purposes and that the income in excess of £150 per annum of children under sixteen years should be aggregated with the income of the family. We also recommended that the same unit be adopted for all taxes. We see no reason to depart from any of these recommendations in relation to property tax.

6.12 We would, however, point out that if there were no income threshold for property tax, argument about the appropriate unit of taxation would be largely academic.

Other Goods

6.13 In principle, a wide range of durable consumer goods should come within the scope of property tax. This includes furniture, cars, boats and other consumer durables. We do not propose that this be done because of the administrative problems involved. Given that these items must be disregarded, the issue which has to be decided is whether the tax system will be fairer if housing is included or excluded. We believe that since housing accounts for a large proportion of personal capital assets it is better to impose a property tax on housing, regardless of the treatment of other consumer durables.

Rate of Tax

6.14 The rate of a national residential property tax should be related to the average rental yield on houses and the single rate of income tax. For example, if the average yield on houses was 6 per cent of capital value and the single rate of income tax was 30 per cent, a rate of property tax of 1.8 per cent would be appropriate.

Conclusion

6.15 We conclude that a national residential property tax is justified in respect of owner-occupied property and property let at below market rents. The scheme of the tax which it is appropriate to apply to such property is set out in Chapter 5, subject to our comments on the rate of tax in paragraph 6.14. We do not consider that a local and national property tax should co-exist. On the basis that our recommendations for a local property tax are accepted, we recommend that the present income-related residential property tax be abolished.

CHAPTER 7

TAXATION AND THE ENVIRONMENT

Introduction

7.1 In this chapter we examine the case for the imposition of special taxes or excises on activities which cause environmental damage. We endorse the principle that the polluter should pay and we indicate areas in which there is scope for its introduction in Ireland. It is most important that any efficiency taxes are not seen as revenue raisers. Any revenue raised is purely a side-effect from increasing the efficiency of economic decisions. Experience in certain countries has shown that effluent taxes can be used successfully to reduce noxious emissions and to keep them at an acceptable level. The very success of these taxes will reduce their yield. If they are designed to secure environmental improvement, they must not be looked to as substantial sources of revenue. Taxation or regulation is, however, no substitute for community education designed to raise consciousness about the problems caused by pollution.

Externalities

7.2 An externality may be defined as the effect of the activities of producers or consumers on third parties. A classical example of an external cost is where factories use a water course to dispose of effluent. By doing so they shift the cost to users of the water course downstream. A typical external benefit is the pleasure provided by a beautiful garden to neighbours and those passing by. In a totally free market, individuals will tend to provide less external benefits and impose higher external costs than are desirable from society's point of view.

7.3 Each individual bases his decisions on the private costs and benefits that face him — the costs and benefits to himself, not to society. A selfish individual will ignore the costs or benefits to others of his actions; these effects are known as externalities. It has long been established that maximum social efficiency in the allocation of resources is achieved when the marginal social benefit of an activity equals its marginal social cost. Thus, where private and social costs or benefits diverge, the market will lead to a misallocation of resources. To correct such cases of market failure it is often suggested that government intervention is necessary.

7.4 Later developments in economic theory have shown that the existence of externalities need not give rise to a misallocation of resources, provided there are no barriers to trade between the producer and consumer. If there are no transactions costs and property rights are well-defined and enforceable, the producer and consumer of an externality have the normal market incentive to negotiate a mutually beneficial trade between themselves and so remove the externality. The gains from such a trade are greatest at the point where the marginal social cost equals the marginal social benefit. There is then, no misallocation of resources.

7.5 This analysis points to entirely different implications for public policy. Firstly, where there are no barriers to trade between the producer and consumer of an externality, government intervention is unnecessary. Secondly, the analysis implies that the real problem in relation to social costs is not the externalities themselves but rather barriers to trade in the form of high transactions costs and restrictions on property rights which prevent a market solution from emerging. In summary, externalities arise not from market failures but rather from the obstruction to market trading caused by the high costs of transacting agreements in these particular areas.

7.6 Transactions costs take four main forms. These are

(i) the cost of acquiring information,

(ii) the cost of negotiating the price to be paid,

(iii) the cost of charging for the use of resources, and

(iv) the cost or impossibility of excluding 'free riders' from consuming resources for which they have not paid.

7.7 A large proportion of externalities arises in situations in which the 'exclusion' costs are high. This is especially true of externalities affecting the natural environment. Difficulties in preventing people who will not pay from inflicting damage arise either from the lack of private property rights or from the costs of enforcing a private property right. Many serious environmental issues involve resources such as air and water in which private property rights are very limited, ill-defined or non-existent.

7.8 The general conclusion for public policy is that, given the inherent defects, complexity and cost of government intervention, externalities should be dealt with wherever possible by redefining property rights and removing barriers to trade. Government intervention is best kept as a solution of last resort, to be used only when and where high and irreducible transactions costs prevent private individuals themselves from dealing with

the problems. In the cases in which government intervention is the only solution, it must be examined carefully to see if it results in a net improvement in the situation.

Public Goods

7.9 A public good is defined as one which, if it is made available to one person, is automatically available to all. It is difficult or impossible to extend property rights to it. Since the potential providers of these goods cannot easily reap the benefits of providing them, they tend not to provide them. For example, if the quality of the air is improved, all people in the area will benefit. If residents are asked to pay for improving the quality of the air, many will not do so voluntarily since they will benefit whether they contribute or not. In the absence of community spirit or enforced compliance, the amount of financial support for public goods will fall short of the level desirable from society's point of view. The market fails.

7.10 A prerequisite for markets to function well is that all resources are owned. When this is not the case, the resource is liable to be destroyed. This phenomenon has been illustrated by an ecologist, Hardin[1], with regard to a commons. Hardin argued that a commons with unrestricted access will be destroyed inevitably. Each grazier will keep adding stock as long as the benefits exceed the costs to him of so doing. The benefits in the form of additional forage accrue entirely to the grazier, while the costs of the destruction of the resources are shared by all the users. The asymmetry in the incidence of costs and benefits results in over-grazing of the commons and its eventual destruction. In belonging to everyone, it belongs to no one. The problem would be avoided if the commons were owned, since in this instance stock would only be increased to the point where the extra benefits of doing so exceeded the costs.

7.11 The extent to which a commons can absorb additional use depends on its carrying or assimilative capacity. Whether the damage is irreversible depends on the recuperative capacity of the resource and the technical capability and managerial skills applied. Some land areas in the Mediterranean and the Middle East with little recuperative capacity went into permanent decline after generations of commons-type usage, while land in Northern Europe has, in general, proved more resilient. In our own times, the destruction of tropical forest soils and the elimination of some ocean fishery stocks derive from the relatively free access afforded to them.

[1]The Tragedy of the Commons, Garret Hardin.

Environmental Resources

7.12 The air mantle and, to a lesser extent, water resources are commonages. We use them to sustain life and to dispose of waste. As long as the assimilative capacity exceeds usage, these resources — which are self-renewing — can absorb demands without giving rise to problems. However, we are now at the stage where, in many instances, this capacity is already fully utilised. In Dublin, in the winter of 1981/82, eight of Dublin Corporation's thirteen sites failed to comply with the EEC directive specifying limit values for smoke.[2] An Foras Forbartha[3] reports that while in 84 per cent of the main river channels the water is of good or satisfactory quality, in 14 per cent it is moderately polluted and in a further 2 per cent it is seriously polluted. Some lakes in the Midlands are showing signs of serious quality deterioration.

7.13 Economists attribute the emergence of such pollution to market failure deriving from the fact that there are externalities imposed — a householder does not bear the costs of disposing of the smoke and sulphur waste products of his open fire. Instead, these are borne by (among others) those who are susceptible to respiratory diseases. The economists' prescription is to introduce market type incentives, usually in the form of tax charges. Thus, prospective polluters are told in effect: pollute as much as you like but for every unit of pollutant (for example, a pound of biochemical oxygen demand (BOD) emitted to water or pound of sulphur emitted to air) you will be charged a tax. Each polluter will cut back to the point where the marginal costs of clean-up just equal the tax. Ideally, the level of the tax would be such that polluters in the aggregate would cut back emissions to the point where the marginal costs of so doing would just equal the ensuing benefits. This approach to environmental management contrasts with the regulatory approach wherein certain emission standards and control technologies are prescribed for every polluter.

Advantages of Tax Charges

7.14 The following advantages have been claimed for using charges as a means of environmental management:

(i) it is more efficient because it encourages polluters who can reduce emissions cheaply to take advantage of this fact, while allowing those who face very high clean-up costs to pollute relatively more. More environmental improvement per pound spent results from this method than from a standard approach where each polluter is required to meet a particular emission standard,

(ii) it allows the producer to decide how emissions are to be reduced. This might be through a change in input mix, for example, using low sulphur coal, a process change, treatment of emissions or some combination. The regulatory approach tends to emphasise 'end of the pipe' technology, i.e. treatment of emissions,

(iii) it puts constant pressure on the polluter to do better,

(iv) it generates funds which can — but of course need not — be used for overall environmental management, including the provision and operation of collective treatment facilities, and

(v) it applies to public sector activities which tend to be exempted from regulatory measures.

7.15 In no country of which we are aware have tax charges been adopted exclusively as a means of environmental management. However, in a number of countries — most notably the Federal Republic of Germany, France and the Netherlands — this method has been applied in combination with regulation in water quality management. In Ireland and the United Kingdom, charges are made in some cases for emissions into local authority outlets and treatment works but not for pollution of open waters.

Disadvantages of Tax Charges

7.16 It may be argued that environmental taxes will increase industrial costs and thereby lead to a loss of competitiveness and a reduction in employment. This possibility must be considered seriously in a small open economy like Ireland.

7.17 There is a number of responses to this argument. Firstly, the costs have to be paid by someone, somewhere, at some time. Thus, in the case of Lough Sheelin — a lake in the Midlands internationally famous for angling which has been almost destroyed by the slurry from adjacent pig farms — some competitive advantage was conferred on the pig farmers in the area by allowing them for a time to use the lake as a free disposal medium for the wastes from their farms. However, the costs of this were borne in the first instance by the tourist and amenity interests, who have suffered as both the aesthetic quality and the attractiveness of the area for angling has been diminished and, latterly, by taxpayers in general who have financed the transport of slurry out of the catchment.

7.18 If Ireland decides to allow the use of its environmental resources without charge while other countries impose costs for so doing, this will give Ireland a comparative advantage in attracting relatively polluting

[2] M. L. Bailey "Urban Air Quality in Ireland — An Overview", in *Resources and Environment: An Analysis of Policy Issues*. Resource and Environmental Policy Centre, University College, Dublin, 1983.

[3] Review 1982/83. An Foras Forbartha, Dublin.

industry. It will not, however, necessarily result in greater employment. This will depend on the employment required to control pollution, compared with that needed to increase output and the economic activity foregone elsewhere in the economy as a consequence of the pollution. Furthermore, international pressure may eventually force the introduction of some control. Thus, while a case can sometimes be made that tax charges reduce competitiveness and output, it is by no means clear that in general such a relationship holds. However, common prudence indicates that a system of charges should be phased in to allow time for adjustment.

7.19 It is argued that it is difficult to identify the appropriate level at which to fix the tax. If it is set at the wrong level, this can impose severe losses. Studies[4] have identified at least one possibility. Tax may induce performance which falls between two thresholds, for example, in the case of water, between a clean-up level that eliminates odour but not to a higher level sufficient to achieve a suitable ambience for desired fish species. Costs may then be incurred which are far in excess of what is necessary to control odour but still not be sufficient to provide the desired habitat for fish. In the absence of a sophisticated monitoring system, this inefficient situation can endure indefinitely.

7.20 There seems to be resistance in many countries to the view (which the use of a tax charge on pollution implies) that some level of pollution is socially acceptable. Thus, it is argued that the polluter will just 'pay the charge and keep on polluting'. However, as long as the costs of reducing an additional unit of pollutant are less than the charge, the rational firm will cut back emission. If a polluter just 'keeps on polluting' exactly as before, it means either that he is behaving irrationally (in which case he will most likely go out of business anyway) or (more likely) the charge is too low. The correct response to this situation is to debate the level of the charge. However, the misgivings of many members of the public may derive not from lack of understanding but from a deeply-felt emotional response that they are unwilling to legitimise what they view simply as wrong. This problem can be met by a combination of charges and regulations.

7.21 Charging for pollution is most appropriate where there are relatively few polluters and the pollution is emitted from readily identifiable sources. Where these conditions do not apply, it is difficult to implement an effective scheme. Taxes on effluent are not appropriate in all instances. However, they are appropriate in cases in which there is a relatively small number of sources of pollution which can be monitored without undue cost. Some of the most difficult environmental management situations arise in cases where

[4]The Uncertain Search for Environmental Quality. Ackerman B.A., Ackerman S.R., Sawyer T.W. and Henderson D.W. The Free Press. New York, 1974.

there are large numbers of polluters, e.g. farmers. In such instances, both tax charges and regulations have severe inherent limitations.

7.22 The Department of the Environment told us that they

> "did not see pollution charges becoming a source of substantial revenue beyond the costs directly arising from control systems (e.g. costs of administration, pollution treatment plant). Existing control provisions under the Water Pollution Act, 1977 allow of charges being prescribed for discharges to waters and of contributions being levied towards costs incurred by the local authority in connection with discharges to sewers. An extension of control systems of this kind (e.g. for air discharges) is envisaged with standards being related to maintenance of acceptable conditions in the receiving media."[5]

Conclusion

7.23 Government intervention to deal with externalities is a solution of last resort to be used only in cases in which the extension of property rights and the reduction of transactions costs is not feasible. In the area of environmental protection in many cases the only alternative to government intervention is to do nothing. In these limited instances the most efficient form of intervention is control through the imposition of taxes rather than setting up large administrative machinery to oversee the implementation of regulations. We conclude that special taxes on activities which cause environmental damage have a role to play in protecting the environment. In the next section, we explore a number of areas where environmental taxes are justified and where they are capable of being implemented without undue administrative cost and difficulty.

Possible Applications

7.24 It is clear that domestic consumption of fuel, and in particular increased consumption of coal, has led to a marked deterioration in the quality of air, particularly in urban areas. We consider that differential excises on various types of domestic fuels could be related to the degree to which they cause pollution. An excise duty on coal would be easy to collect since it is imported through a limited number of distributors. Excise duties on fuel oils are already imposed. We recommend that excise duties on fuels should be related at least in part to the degree to which they cause pollution.

7.25 In our third report we made recommendations in relation to the taxation of motoring based on the principle that the polluter pays. Part of

[5]Agreed note of meeting of 11 June, 1984.

the excise duty on petrol is justified on this basis, as is our proposal that unleaded petrol should qualify for a favourable rate of duty.

7.26 In recent years there has been significant growth in disposable containers used for drinks. This arises because such containers are more economical for the manufacturer than containers which can be recycled. This results in an enormous increase in litter and waste. We consider that a special tax could be imposed on disposable containers used for drinks to encourage greater use of refundable bottles for packing drinks.

Derelict Sites

7.27 Some submissions supported special taxes on derelict sites designed to encourage their earlier redevelopment. We discussed with the Department of the Environment the possibility of imposing such a tax. They drew attention to the difficulties of discriminating between sites which remain derelict for valid reasons such as site assembly and those which are being neglected until their value increases further. A change in economic conditions could also make the application of a tax on derelict sites penal.

7.28 We have concluded that it would be very difficult to design a tax which would apply to derelict sites with sufficient flexibility to ensure that it would not inhibit justifiable and socially beneficial redevelopment. On this basis we do not recommend the introduction of special taxes on derelict sites. Use of planning or other regulations is more appropriate to deal with problems in this area.

Recommendation

7.29 We make the following recommendation:

1. The principle of imposing special taxes on activities which cause environmental damage should be accepted and applied in appropriate instances.

CHAPTER 8

MINING AND MINERAL DEVELOPMENT

Introduction

8.1 In this chapter we examine the question of the taxation of mining and mineral development, including the taxation of off-shore oil and gas operations. In this area, the state has two roles — that of taxing authority and that of landlord. Government must make decisions in the context of all its policies for the exploitation and use of the state's natural resources. Unless the state itself decides to finance such exploitation, it is evident that it is dependent on others to do it — and they are in turn dependent on permission and terms given by the state. In practice, the earlier discoveries are likely to be treated more generously than later ones and the overall package of state investment, terms, participation, royalties and taxation will be more significant than any particular component, including taxation. We therefore confine ourselves to giving general guidelines as to the form tax and royalty provisions should take for later discoveries.

The Context

8.2 Ireland needs to develop its natural resources. Exploration must be encouraged if these are to be found. To ensure that exploration takes place on a sufficient scale, the rewards from discovery and development of natural resources must be in line with those offered in competing countries relative to the risks involved. The risk/reward ratio may be adjusted by reducing risks, by providing tax allowances or grants for exploration expenditure or by increasing the rewards through relatively favourable tax and royalty terms.

8.3 The history of taxation of natural resources follows a similar pattern in most countries. Initially, governments tend to encourage exploration by giving generous allowances and making agreements with relatively low taxes and royalties. At a later stage, when successful discoveries have been made, agreements tend to be revised and heavier taxes imposed. At a final stage, taxes and royalties are reduced in order to encourage exploration and development of marginal resources.

8.4 The incentive to explore will be increased substantially if it becomes clear that Ireland is an area with proven natural resources. As a result, the tax and royalty regime may be tightened up for later discoveries. This implies that any structure prescribed for tax and royalties must be flexible enough to accommodate different state takes from particular discoveries. Negotiations in this area between governments and exploration companies are akin to poker games for very high stakes. Explorers all over the world take the risk that the host country may change the tax rules adversely once projects have been started. For example, the average United Kingdom take from North Sea oil fields rose from 76.9 per cent before 1979 to 89.5 per cent in 1983. While this happens to a greater or less extent in all countries, further exploration ceases if it is overdone.

State Participation

8.5 Under the 1975 terms, the government is entitled to participate up to 50 per cent equity in any development and to have its share of production and development costs financed by the other partners. Where any part of the state's share of expenditure is not paid in cash, it will be repaid out of the state's proceeds from the sale of its share of petroleum produced under the lease and from its share of other income from the deposit. The extent to which the state exercises its option to participate greatly affects the overall state take from any discovery. Since the overall state take is a major factor of interest to those engaged in exploration or development, the issue of state participation creates a degree of uncertainty for them. This uncertain factor also makes it more difficult to devise a taxation regime for off-shore developments.

Principles

8.6 Natural resources found in Ireland or on the Irish continental shelf are the property of the Irish people. While the potential profit must be high enough to encourage risk investment by companies to discover and exploit these resources, the state is entitled to receive an economic rent from the exploitation of the resources, in addition to any normal taxation of profits. This rent should be as high as possible, consistent with the need to encourage exploration for and the exploitation of the resources. We now consider how this principle should be applied in relation to taxation arrangements for off-shore and on-shore developments.

OFF-SHORE MINERAL DEVELOPMENT

Proposed Legislation

8.7 There are as yet no specific enactments in Irish law for the taxation of profits of off-shore oil and gas operations, apart from the provisions

relating to the continental shelf. Subject to treaty reliefs, these provisions charge to Irish tax the profits of non-residents carrying on exploitation or exploration activities related to oil and gas and other minerals in the Irish sector of the shelf outside Irish territory as normally defined. The Minister for Finance, however, made an announcement on 29 April, 1975 indicating the general form of the taxation provisions that will apply. The main proposals were as follows:

(i) the normal system of profits' taxation for companies would apply,

(ii) a company's off-shore petroleum operation would, in effect, be treated as a separate trade. Losses in the operations would not be allowed to be set off against income from other operations and profits from the operations would not be reduced by losses in other areas of activity,

(iii) all exploration expenditure, whether successful or abortive, would be allowed provided it was incurred not more than ten years before the start of trading,

(iv) development expenditure (including the cost of production platforms and pipelines) would be allowed against petroleum profits at the rate of 10 per cent per annum (or over the life of the field if this is less than ten years), and

(v) an immediate write-off of the cost of machinery and plant used in production would be allowed.

8.8 A policy statement[1] was issued by the Minister for Industry and Commerce at the same time as the statement on taxation was made. It said that the state had a right to participate in the activities and that licensing and lease rentals would be payable to the state. In addition, an output royalty, estimated as a percentage of the value of oil produced at the export point or at the point of entry into domestic consumption, was to be related to the average field production attained and would be assessed at the following rates:

Average Field Production Attained in Barrels per Day	Royalty Rate per cent
Less than: 40,000 for a 30 day period	8
Over: 40,000 for a 30 day period	10
Over: 100,000 for a 30 day period	12
Over: 225,000 for a 30 day period	14
Over: 350,000 for a 30 day period	16

Note: If the production rate is reduced for a thirty day period, the rate of royalty will be reduced accordingly but not below 12 per cent.

[1] Ireland, Exclusive Offshore Licensing Terms. April, 1975 prl 4510.

8.9 The royalty rates would apply to total production of the field. Value would be based on the price which the petroleum would realise if sold on an arm's length basis to an independent purchaser. For gas, the royalty rate would be 12½ per cent. The Minister could accept royalties lower than those specified if he were satisfied that production giving a fair return on investment could not otherwise be undertaken. A single payment production bonus might also be required where the output of a field averaged more than 300,000 barrels per day over a thirty day period, at a rate of £1 million for each complete 100,000 barrels of average daily output in excess of 200,000.

8.10 The 1975 policy statement on royalties said that the Government had tried to cater for possible future conditions affecting the industry in so far as those could be anticipated at the time, that it would be unrealistic to expect that the arrangements being made could be guaranteed to remain suitable for the whole future span of the industry's activities and the Government would keep its taxation arrangements under review in the light of developments.

1985 Policy Statement

8.11 A more detailed policy statement by the Minister for Finance on the proposed corporation tax treatment of on-shore and off-shore petroleum activities was issued on 14 January, 1985. The Minister said that he intended to introduce legislation to give effect to these proposals. The main provisions of the 1985 statement are quoted below.

> "*Exploration Expenditure*
>
> The 1975 announcement stated that, subject to the ring fence restricting the set-off of losses, exploration expenditure, whether successful or abortive, would be allowed for tax purposes against profits from petroleum production in the year in which the expenditure was incurred or, if trading had not commenced, in the year it commenced. Abortive exploration expenditure would only be allowed where it was incurred not more than ten years before the commencement of trading. The ten year limit will begin to have effect from 1986 in respect of exploration under the first exclusive licensing round of 1976. As an encouragement to further exploration, the time limit within which abortive exploration expenditure can be deducted for tax purposes will be extended to fifteen years. Where a company which has incurred exploration expenditure is succeeded by another company wholly in the same ownership, the latter company will be entitled to the exploration allowances to which the first company would have been entitled.

Development Expenditure

The 1975 announcement stated that, subject to the ring fence, capital expenditure on development, including the cost of production platforms and pipelines, would be allowed against petroleum profits at a rate of 10 per cent a year, or over the life of the field if this were less than ten years and that free depreciation would be allowed on other new plant and machinery used in production. The Government have decided that all capital expenditure incurred on development or production should be allowed for tax purposes at a uniform rate, thus avoiding the necessity for complex distinctions between different kinds of capital expenditure. The rate will be 40 per cent a year on a declining balance basis and the allowance will apply with effect from the date on which the asset in question is brought into use.

The Ring Fence

The 1975 announcement stated that a ring fence would be placed round off-shore petroleum activities. It is now intended that this should apply to on-shore petroleum activities also. Accordingly, all petroleum activities in the state or a designated area will be segregated for tax purposes from other activities so that losses arising from either type of activity cannot be set, either directly or by way of group relief, against profits of the other. The ring fence will embrace all profits and losses, including capital gains and losses. For ring fence purposes, petroleum activities will include petroleum extraction activities and activities related to the acquisition, enjoyment or exploration of petroleum rights. Petroleum extraction activities will include

(i) searching for petroleum,

(ii) its extraction,

(iii) its transportation to dry land, and

(iv) its initial treatment and storage.

Activities such as the refining of petroleum and production or distribution of products derived from petroleum will not be within the ring fence.

The Ring Fence Trade

A ring fence trade will be a trade consisting of petroleum activities and where such activities are carried on in conjunction with other activities the petroleum activities will, for tax purposes, be treated as a separate trade from any such other activities. Normally, a producer of petroleum will be regarded as commencing a petroleum trade when he first makes a firm decision to develop a field. The field will be a geographical area defined by the Minister for Energy. A trade of petroleum extraction may embrace activities in a number of fields. The trade will be regarded as continuing until all production ceases. On the cessation of a petroleum trade, the normal three year carry-back of terminal losses, including losses attributable to abandonment costs, would apply but it may be necessary to review the tax treatment of abandonment costs having regard to the optimal depletion of petroleum reserves towards end of field life.

Rate of Tax

A rate of tax of 50 per cent, that is the normal rate of corporation tax, will be applied to income of the petroleum trade.

Treatment of Interest on Borrowings

In general, interest on loans used to finance expenditure incurred on development and production in carrying on a petroleum trade will be allowable for tax purposes in relation to that trade. However, relief will be restricted to interest at a commercial rate where the lender and the borrower are connected with each other. Interest on loans used to finance exploration expenditure will not be allowable for tax purposes. The use of debt financing generally will be closely scrutinised to determine if limitations should be placed on borrowing levels or if other changes in tax treatment of borrowing would be necessary.

Royalties to the Minister for Energy

Royalties on production, production bonuses and lease rentals paid to the Minister for Energy will be allowable for tax purposes.

Exchange Gains and Losses

In accordance with the normal tax rules, currency exchange gains or losses on current account but not exchange gains or losses on capital account will be taken into account in the computation of trading profits for tax purposes.

Valuation of Petroleum

Where petroleum is disposed of otherwise than by sale at arm's length, its value for tax purposes will be based on the price which it would have realised if sold on an arm's length basis to an independent purchaser.

Consortia, Partnerships, etc.

Each participant in a joint venture for the purposes of extracting petroleum will be treated separately for tax purposes.

Farm-in/Farm-out Arrangements

Changes in licence interests and in particular farm-in/farm-out[2] arrangements are a common means of achieving an acceptable risk spread and of financing prolonged exploration and costly development programmes. Such changes may give rise to a variety of tax consequences under existing legislation. It is intended that changes in licence interests at the pre-production stage, where these changes are approved by the Minister for Energy, will not give rise to chargeable gains if their sole purpose is the furtherance of exploration, delineation or development of acreage licensed under the 1975 terms in a manner which does not materially affect the state's revenue from petroleum production."

THE ISSUES

8.12 We consider that the taxation arrangements which apply to off-shore oil and gas operations should be generally the same as those which apply to other businesses. However, some specific issues have to be considered. These are

(i) the question of a ring fence,

(ii) the treatment of exploration expenditure,

(iii) the treatment of capital expenditure on development and production, and

(iv) the form of royalty payments.

Ring Fence

8.13 One of the features of off-shore operations is that capital expenditure is incurred mainly before production starts. If there were no restrictions,

[2] Once exploration or development of licensed acreage has commenced, the licensee will normally review his licence commitments, including the work obligation. He may conclude, on the basis of poor geological prospects, that he is unwilling to commit further exploration funds or, ironically, where he has a large potentially profitable field he may find that he is unable to finance further exploration from conventional sources on economic terms. The classic industry arrangement for these cases, which has been highly developed overseas, particularly in the United States, is the farm-out. The term applies where a licensee surrenders part of his licence interest in exchange for financial assistance, including cash, but retains some interest in the licence.

it is likely that Irish companies would have substantial capital allowances to set against their income from on-shore operations. Such generous treatment would be very costly to the Exchequer. So consideration must be given to treating off-shore operations completely separately and allowing no transfer of losses and capital allowances between them and other trading operations. This would isolate off-shore operations for purposes of taxation — hence the term ring fence.

8.14 There is no particular logic in applying a ring fence. It is purely an arbitrary device to prevent what is seen to be an unacceptable diminution in cash flow to the Exchequer. It could equally be applied to individual oil and gas fields and to particular on-shore activities. It can be used to prevent on-shore profits being set against off-shore losses and vice versa, or apply in both directions. In the UK North Sea there is a ring fence around each field for purposes of petroleum revenue tax and around the province as a whole for corporation tax purposes. This has had the advantage of providing information regarding the cost, income and profitability of individual fields. This information provides a better measure of whether the state is obtaining a fair share of the profits from each development. British experience indicates that the fortunes of different companies in off-shore developments vary greatly. In these circumstances, the provision of information on each field has provided useful information on the incidence of tax.

8.15 The background to the introduction of a ring fence in the United Kingdom is that many companies operating there had already accumulated substantial tax losses from activities in the Middle East and it was feared that use of these accumulated losses would result in an unacceptable delay in the flow of revenue to the British Exchequer.

8.16 A ring fence was not imposed in Norway where the companies concerned had not accumulated losses to anything like the same extent.

8.17 In a submission to us, the Irish Mining and Exploration Group of the Confederation of Irish Industry argued that

> "the major part of finance for exploration must be attracted from external sources, but we believe that there is also considerable potential for attracting indigenous capital if there was some incentive to invest in this sector. We believe that the best way of providing this incentive would be to allow exploration investment to be offset against taxable profits from non-mining sources."

8.18 We think that the need for a ring fence for corporation tax would be less under the system proposed in our first report than some others. This arises from

(i) the relatively low single rate of tax that we propose, and

(ii) our proposals for a minimum payment of corporation tax in respect of distributions.

8.19 The present proposals envisage a ring fence for corporation tax purposes around all petroleum activities in the state. We endorse these proposals and consider later whether this treatment should be extended to all mining and mineral developments both on-shore and off-shore. However, we recommend that the ring fence be extended to include on-shore distribution of oil and gas.

8.20 The question arises whether there should be a separate ring fence around individual fields. This would restrict the allowance of exploration and development costs to future profits from a particular field. A ring fence which embraced all off-shore operations would have implications for the economics of fields being developed where the operation already had income from an existing field. The capital costs of a second field could then be set against the income from an existing field. The effect would be to postpone payment of tax and so improve discounted post-tax rates of return to the producer. A ring fence increases the cost of entry into off-shore activity but once this hurdle is overcome the successful producer is placed at an advantage compared to newcomers.

8.21 In considering this issue it is important to note that exploration costs are relatively small in relation to the development costs of a particular field. Because heavy development costs could give rise to big fluctuations in Exchequer receipts, a field ring fence may be desirable. A field ring fence would also be neutral between existing producers and new entrants because, in its absence, much of the exploration and development costs of existing producers are effectively financed by the Exchequer. The disadvantages to companies from a field ring fence could be offset by lower royalty payments.

8.22 The case for a ring fence for corporation tax purposes around all exploration and development activities collectively is that this is more consistent with the normal tax rules which apply to other activities.

8.23 There is a clear conflict between the desire to achieve neutrality between existing operators and new entrants and consistency in tax treatment between oil and gas operations and other activities. We recommend that the question of a field ring fence for corporation tax purposes be left open. This provides government with added flexibility which is desirable at this stage in the exploration of off-shore resources.

Exploration Expenditure

8.24 It would be generally consistent with our other proposals that, if exploration expenditure were allowed, it should be allowed on an indexed basis. We do not recommend the provision of any further specific incentive to encourage exploration.

Expenditure on Development and Production

8.25 Capital expenditure on the development of off-shore oil and gas should be allowed on a straight line method over the useful life of the resource on an indexed basis. The useful life of the resource may be measured in years or by reference to the value of proven reserves. We recommend that development expenditure be allowed on an indexed basis and at the option of the taxpayer by reference to the rate of extraction.

ROYALTY PAYMENTS

8.26 Royalty payments come under the definition of taxes in the National Income and Expenditure Accounts. It is necessary, however, to distinguish royalties from other taxes, because they are in fact a payment to the owner (in this case the people of Ireland represented by the state) for a factor of production (minerals). Royalties can be used by the state to achieve other goals such as the orderly development of mines. They are also undoubtedly perceived by mining companies as an integral part of the tax treatment of mining profits and thus can affect the behaviour of these companies.

8.27 Where a special tax or royalty is concerned, over and above normal corporation tax, certain options are open to government. There are basically four decisions to be made:

(i) should the additional tax be levied on a field-by-field or on a company-by-company basis?

(ii) should it be a barrelage tax or a profit-based tax?

(iii) should the additional tax be deductible for corporation tax purposes? and

(iv) should it be charged at one single fixed rate or at progressive rates?

Field Basis

8.28 The United Kingdom decision to use a field-by-field basis for petroleum revenue tax led to a very complex system and the creation of special rules to define properly what constituted a field for the purpose of the tax.

We believe that the advantages set out in paragraph 8.14 are sufficient to justify the use of a field-by-field basis for royalty purposes.

Output v Profit-Based Royalties

8.29 Royalties may be output or profit related. Output royalties may be on the basis of a fixed payment per unit of output or a percentage of sale price. As we have seen, the present Irish scheme envisages a progressive scale applied to the value of daily output.

8.30 Output related royalties have the advantage that they are fairly easy to administer. The government needs only to know and monitor the production and, where a percentage of turnover is being charged, the output price. Because of the scope for manipulation, the price must invariably be decided by government on an arm's length basis. However, output related royalties have disadvantages. Since the company must make the payment regardless of its profitability, the risk is increased. This discourages investment. In addition, the fixed charge per unit of output increases marginal costs of production. As a result, resources which would have been exploited if there were no royalty will be left unexploited. A very serious disadvantage of output based royalties is that they may not qualify as creditable taxes for determining the tax liability of foreign firms in their own countries. A further important disadvantage is that output based royalties may curtail production if the price of oil falls. If the price rises, the royalties may be too low.

8.31 There is some doubt about the treatment of profit-based royalties under double taxation treaties. However, the petroleum revenue tax in the United Kingdom was regarded as a creditable tax in the United States/United Kingdom double taxation treaty. We understand that in order to qualify as a creditable tax, royalties would most likely have

(i) to be paid not to the Minister for Energy but into normal Exchequer funds, and

(ii) to be charged on profits.

We consider that every effort should be made to introduce a system of royalties that would be creditable against foreign tax liability. This will make it easier to ensure the maximum benefit to Ireland of development of natural resources.

8.32 Profit-based royalties do not distort short run behaviour of companies. For a given level of investment, the company will extract every barrel of oil which contributes anything to profits, that is, which yields a return above marginal extraction costs. In addition, since no tax is payable when losses are incurred, royalty does not increase the disincentive to invest by increasing the risk. However, in the long run, a profits royalty reduces investment because it lowers the after-tax rate of return. The administration of a profits-based royalty is much more complicated than one based on output, since the scope for manipulation of profit is much greater. We consider that this manipulation of profit can be dealt with, as it is in Norway, by the state fixing the price at which the resource is deemed (for tax and royalty purposes) to be transferred to the purchaser. Indeed, provision to value petroleum for tax purposes on the basis of arm's length prices to an independent purchaser is envisaged in the 1985 policy statement for corporation tax.

8.33 Royalties may also be progressive. Progressive output royalties, such as those proposed for Ireland, will affect the life of the resource. The firm may reallocate extraction between periods to reduce royalties. This will tend to even out the rate of extraction and prolong the life of the resource.

8.34 Progressive profit-based royalties will also tend to even out extraction rates and prolong the life of the resource. They have the advantage that they recognise costs and do not increase risks as much as progressive output royalties. These benefits are offset, at least in part, by the increase in complexity and higher administrative and compliance costs.

8.35 In the light of these considerations, we believe that the most appropriate form of royalty is a progressive profit-based royalty. In arriving at this conclusion we are particularly influenced by the fact that such a royalty is neutral between very profitable and marginal fields. It should also avoid the need for frequent adjustment of the tax and royalty regime. Such a scheme for resources rent tax has been proposed in Australia and is outlined in Appendix 3. This forms a suitable model for use in Ireland.

8.36 In opting for a progressive profit-based royalty, two issues must be decided. These are

(i) the rate structure, and

(ii) the relationship with corporation tax.

Rate Structure

8.37 We believe that the rate structure for progressive profit-based royalties should be fixed to ensure that the rate of return on off-shore developments is in line with that available in countries in a comparable position, that is, those which do not yet have proven resources.

Corporation Tax

8.38 We consider that the progressive profit-based royalty should be allowed as a deduction in computing profits for corporation tax purposes. This is in line with the treatment proposed in the 1985 policy statement.

LAND-BASED OPERATIONS

Present Position

8.39 At present, profits from mining are chargeable to tax in the usual way. However, some special incentive measures apply. For mining operations involving certain scheduled minerals,[3] exploration expenditure, including abortive expenditure, is deductible and an investment allowance of 20 per cent is also given for such expenditure. Taxable profits may therefore be reduced by 120 per cent of such expenditure. Expenditure on developing a mine is also allowed against mining profits when it is incurred. Capital expenditure incurred after 31 March, 1974 on the acquisition of mineral assets is allowable on a straight line basis over the life of the mine or twenty years, whichever is the shorter period. Finally, expenditure on new machinery and plant incurred on or after 6 April, 1974 attracts an investment allowance of 20 per cent in addition to the full depreciation allowance generally available. The historical background is dealt with in Appendix 4.

8.40 Where it is established that the profits of a mine are such that, if tax were charged on them, the mine would be unlikely to be worked, the Minister for Finance may direct that the tax on the profit is reduced to such rate as he may specify, even to zero.

8.41 For coal mining, capital expenditure on mine development is allowable on a straight line basis over the life of the mine or twenty years, whichever is the shorter period. Tax on the profits of marginal coal mines may be reduced in the same way as is provided for other mines.

PROPOSED TREATMENT

8.42 We consider that the tax and royalty regime applying to on-shore mining and mineral developments should include the following features.

[3] These minerals are barytes, felspar, serpentinous marble, quartz rock, soapstone, ores of copper, ores of gold, ores of iron, ores of lead, ores of manganese, ores of molybdenum, ores of silver, ores of sulphur, ores of zinc.

Ring Fence

8.43 The argument in favour of a ring fence for on-shore mining is as strong as that which applies to petroleum operations both on-shore and off-shore. We recommend that there should be a ring fence around all mining and mineral developments both on-shore and off-shore.

Exploration Expenditure

8.44 We recommend that exploration expenditure should be allowed on an indexed basis against future mining profits. Abortive expenditure incurred ten years before the start of development should be disregarded.

Development Expenditure

8.45 Capital expenditure on the development of a mine should be allowed on a straight line method on an indexed basis. Alternatively, the expenditure could be written off on an indexed basis on a unit of production basis, at the option of the taxpayer. We think such allowance for capital expenditure is sufficient and we recommend that the 20 per cent investment allowance in respect of such expenditure should be withdrawn when this measure has been introduced.

Marginal Mines

8.46 The legislation governing taxation of mining profits allows the Minister for Finance to reduce the tax chargeable on the profits of a mine to the degree necessary to ensure the continued operation of the mine. We consider that such a provision should be retained.

Royalties

8.47 At present, royalties for on-shore mineral development are negotiated on a case by case basis. For base metals, royalties are levied at progressive rates of between 3 per cent and 10 per cent on profits as computed for tax purposes. For industrial minerals there is an output royalty of between 2 per cent and 5 per cent of gross value. We recommend that the royalty regime should be progressive and based on profits. Tax at the single rate should be levied on profits after deduction of royalties.

Recommendations

8.48 We make the following recommendation:

1. The tax and royalty structure for all on-shore and off-shore mineral development in Ireland should have the following elements:
   - (i) a ring fence should be imposed around individual developments for the purposes of royalties,
   - (ii) a ring fence for all on-shore and off-shore mining and mineral developments should apply for corporation tax purposes and should embrace on-shore distribution of oil and gas,
   - (iii) exploration expenditure should be allowed on an indexed basis,
   - (iv) development expenditure should be allowed on an indexed basis over the useful life of the asset or on a unit of production basis if the taxpayer so opts,
   - (v) royalties should be progressive and based on profits in excess of a threshold rate of return,
   - (vi) income tax at the single rate should be levied on profits after deduction of royalties, and
   - (vii) discretionary powers should exist to reduce the tax and royalties payable on marginal mines or fields to the level necessary to ensure that the resources in them are exploited.

CHAPTER 9

CHARITIES

Introduction

9.1 In this chapter we examine the provisions in the tax code which relate to the taxation of charities. The existing arrangements for the regulation of charities are in Appendix 5. Information on the treatment of charities in other countries and the attitude adopted by other Commissions is in Appendix 6.

Size of the Charity Sector in Ireland

9.2 The amount of tax repaid to Irish bodies by the Revenue Commissioners on the grounds of charity and allied exemptions (for example, friendly society and trade union) was £3.3 million in 1982/83. No breakdown of the figures is available but the Revenue Commissioners consider that the bulk of the repayments relates to charity exemption. It is not possible to estimate the total cost of tax exemption for charities since there is no information as to the amount of untaxed income on which tax is foregone. The Revenue Commissioners do not maintain a register of charities, merely an index of individuals or organisations who have sought charity status. There are 4,432 claimants, though a large number is now dormant. 62 determinations of charitable status were made in 1981, 43 in 1982. We can only conclude that the size of the charity sector widely defined is large.

Present Position

9.3 Charity exemption has been available in Ireland since the introduction of income tax in 1853. A charity is a body of persons or a trust established for charitable purposes only. Charitable purposes is not defined in legislation but has been established by the Courts[1] in the Pemsel case in 1891 to be

[1] Income Tax Special Purposes Commissioners v Pemsel 3TC 53, page 96.

(i) the relief of poverty,

(ii) the advancement of education,

(iii) the advancement of religion, and

(iv) other purposes (of a charitable nature) beneficial to the community, not falling under any other heading.

9.4 The fourth class under the Pemsel decision covers the widest group of charities. Approvals under classes two and three for the advancement of education and religion are only given in cases in which the activities are held to be generally beneficial to the community.

9.5 Charities are exempt from taxation on income applied to charitable purposes. This income includes rents and profits of any property, dividends, shares and annuities or profits and gains arising out of ownership of lands, tenements or hereditaments. It also includes profits of a trade carried on by a charity provided they arise in the actual carrying out of the primary purpose of the charity and the beneficiaries are workers. These qualifications do not apply to profits of a trade of farming.

9.6 In order to qualify for the special tax treatment applied to charities, two conditions must be satisfied. These are

(i) the income must be the subject of a binding trust for charitable purposes only, and

(ii) the income is relieved only to the extent that it is applied to the charitable purposes specified in the trust instrument.

The fact that income is applied to charitable purposes is not sufficient. It must also be so applicable under a trust for charitable purposes only. It is not sufficient that the income is subject to a trust for charitable purposes only: the income must also be actually so applied. Fulfilment of both conditions is essential. The reliefs do not apply to almsgiving.

9.7 Gifts or inheritances received by charities are exempt from capital acquisitions tax provided they are applied to charitable purposes in the Republic of Ireland or Northern Ireland. If applied elsewhere, benefits received from all sources are aggregated and the value in excess of £10,000 is subject to capital acquisitions tax.

9.8 Charities are exempt on capital gains applied to charitable purposes. Disposals to charities by way of gift or at less than full consideration are treated as made on a no gain/no loss basis. Property held in charitable trusts, which ceases to be held in those trusts, is deemed to be disposed of by the trustees with reacquisition by them at market value with a corresponding charge. Gains made up to ten years previously are brought into charge.

9.9 Indirect taxes are payable on goods and services purchased by charities.

9.10 In addition to the main exemptions from tax, covenants in favour of charities were recognised for tax purposes up to 1940. The covenant device enabled the charity to obtain, in effect, a subsidy from the state by having charitable subscriptions paid to it under deed of covenant. The subscriber, if liable to sur-tax, obtained a reduction in his sur-tax liability. The use of covenants in the tax code is now confined to

(i) cases in which a taxpayer transfers absolutely by deed the beneficial ownership of capital, for example, securities such as a holding of national loan to a charity, individual or other person,

(ii) covenants to individuals for more than six years, and

(iii) cases in which specific statutory treatment is prescribed for covenants for certain purposes or those in favour of certain bodies.

9.11 The third category above affords relief for covenants to universities and schools in the state for research in the natural sciences. The effective position as it now stands is that income covenanted to any university, college or school to carry on research or to assist in the teaching of natural sciences is not deemed the income of the person who makes the disposition. This is also the case since 1973 for income covenanted to bodies of persons having consultative status with the United Nations or the Council of Europe and having as their sole object the promotion of the Universal Declaration of Human Rights or implementation of the European Convention for the protection of Human Rights and Fundamental Freedoms. This entitles these bodies as far as they are exempt to receive from the Revenue Commissioners the tax deducted on the covenanted amount.

9.12 We considered the treatment of these covenants in our first report[2] where we recommended that recognition of new covenants for tax purposes should be withdrawn from a current date.

9.13 A further tax relief was provided in 1984 for gifts of over £100 for education in the arts, subject to a maximum of £10,000.

9.14 There is no official register of charities in Ireland. It is up to organisations to apply to the Revenue Commissioners for the charity tax exemption or to the Commissioners of Charitable Donations and Bequests for legal

[2] First Report, paragraphs 10.94 to 10.107.

privilege. The Revenue Commissioners informed us that they have no powers to police charities and do not do so in any systematic way.[3]

9.15 Charities, unlike other corporate bodies, have no owners or shareholders to whom they are responsible for their operation. In many cases neither donors nor recipients have any statutory rights with respect to the operation of a charity and in this regard charities are less closely controlled than other non-profit institutions such as hospitals and schools directly administered by central or local government. There is no method of checking if the money goes where it is intended to go. The onus is placed on self-regulation by trustees or managers, though in the case of a breach or supposed breach of trust, the Commissioners of Charitable Donations and Bequests or any other person (with the consent of the Attorney General) may apply to the High Court for appropriate relief.

Submissions

9.16 We received a number of submissions which dealt with the tax treatment of charities. Many called for the reintroduction of covenanting for charitable subscription and the extension of the charity exemption to charities which do not now qualify. Other submissions recommended the drawing up of a Central Register of Charities and the replacement of deeds of covenant by a system similar to that in the United States under which up to £500 per year in charitable gifts might be allowed as a tax deduction on production of receipts to the Revenue Commissioners.

9.17 Other submissions raised the fact that charities have no means of obtaining credit for value-added tax paid by them.

9.18 A number of submissions raised the difficulties experienced by charities arising from the reduction in the tax credit on distributions made by companies out of profits qualifying for the reduced rate of tax on manufacturing profits. Some argued for an increase in the tax credit on dividends paid to charities while others suggested a lengthy transitional period to assist charities in maintaining investment in manufacturing companies. In our second report,[4] we recommended that profits chargeable to tax at the reduced rate applying to manufacturing profits should carry the full imputation of tax borne at the company level when these are distributed to shareholders.

9.19 The issues which we consider are as follows:

(i) the definition of charities,

[3] Agreed note of meeting of 12 December, 1984.
[4] Second Report, recommendation 33.

(ii) the treatment of charitable donations,

(iii) the treatment of the trading and investment income of charities, and

(iv) indirect tax paid by charities.

Definition

9.20 There is no statutory definition of a charity in Irish or, for that matter, English law. Most of the legal precedents as to what are charitable purposes date back to the days when there was little or no public expenditure on health, education or social welfare. Many of the decisions are difficult to reconcile.

9.21 The United Kingdom Charity Commissioners have commented on the difficulty in interpreting charity law in a contemporary way:

> "We try to interpret the law in a contemporary context and as imaginatively as possible although we cannot be so perverse as to fly in the face of decisions of the Court or to stand them on their head".[5]

9.22 The fiscal privileges which we envisage for charities are limited. We have considered whether there should be a statutory definition of charities and whether this should be more tightly drawn than the existing exemption. We do not propose any restriction of the definition contained in the Pemsel case. We also think there is merit in allowing the Courts some freedom to allow charitable exemption to purposes, which may not even be envisaged today, provided these are of general benefit to the community. We do not recommend the introduction of a statutory definition of charitable purposes even though we would be concerned if the effective definition were widened significantly.

Treatment of Charitable Donations

9.23 Generally speaking, charitable donations are not allowable as a deduction for tax purposes to the donor. The only exception to this is the relief introduced in 1984 for gifts in any year of over £100 and up to £10,000 for education in the arts.

9.24 Receipts applied for charitable purposes are not charged to income tax, corporation tax or capital acquisitions tax.

9.25 It has been suggested to us that individuals should be allowed to waive income in favour of other individuals or organisations including charities. The income so waived would be disregarded for tax purposes in the hands of the original recipient and charged as income in the appropriate manner in the hands of the donee.

9.26 In principle, we see little difference between waived income and other gifts. If waived income were not charged to tax in the hands of the original recipient, there would be a very strong case for allowing a tax deduction for gifts of all types. This would have very wide-ranging implications for the taxation of capital transfers. We cannot accept this line of argument for the reasons advanced in our first report where we dealt with the taxation of gifts and inheritances. Nor do we accept that it is inappropriate to tax income waived in favour of others on the grounds that it does not come within our concept of taxable capacity based on command over resources. If an individual has the ability to direct income to a specific individual or organisation, it is reasonable to say that he has command over that income.

9.27 We now consider whether charitable gifts to approved bodies should be allowed as a deduction for income tax purposes to the donor on production of receipts subject to a certain limit. This might be justified on the basis that it would encourage increased contributions to charities with worthy objectives and reduce the cost of social spending by the state. There is no evidence that this is so, even though there might be a diversion of funds from unapproved to approved charities. We do not favour a tax deduction for such donations for a number of reasons. It would increase administrative and compliance costs. Secondly, our general argument against tax expenditures applies. There is likely to be much greater transparency and accountability if the state contributes directly to charities rather than allowing indiscriminate tax relief. We also think it would be very difficult to resist the extension of the relief to a very wide range of bodies, many of which would not generally be thought to be 'charities'. We also recommend the withdrawal of the relief for education in the arts. The responsibility for aiding such education should fall directly on the Exchequer rather than being met through tax expenditures.

9.28 We consider that receipts of charitable donations should not be chargeable to income tax in the hands of the approved charity if they are not allowed to the donor. We recommend no change in the existing capital acquisitions tax treatment of gifts and inheritances received by approved charities.

9.29 In our first report, when dealing with our proposed progressive expenditure tax, we recommended that gifts and bequests should not be treated as part of the donor's taxable expenditure, except for small gifts which are ignored for tax purposes in the hands of the donee. Small gifts were defined as those of a value up to one-thirtieth of any exemption

[5] Report of the Charity Commissioners, 1982, HMSO.

threshold adopted for purposes of gifts and inheritance tax. We envisaged that small gifts would be charged to income tax in the hands of the donee and that if progressive taxation of these gifts were thought necessary this should be done by means of a progressive accessions tax on the donee rather than a progressive expenditure tax on the donor.

9.30 We consider that gifts to charities should be treated as savings for the purposes of expenditure tax. Otherwise there would be a strong disincentive in the way of such gifts. However, to allow small or trivial donations for expenditure tax purposes would give rise to considerable administrative difficulty. To avoid this, we recommend that gifts to charities, which are within our definition of small gifts, should be included in taxable expenditure for purposes of expenditure tax.

Trading Income

9.31 Profits of a trade carried on by a charity are exempt from tax if the profits are applied solely to the purposes of the charity and *either*

(i) the trade is exercised in the course of the actual carrying out of a primary purpose of the charity, or

(ii) the work in connection with the trade is mainly carried on by beneficiaries of the charity

This exemption includes, for example, profits from a school or college in the case of an educational charity or the profits derived by a charitable hospital from paying patients. The exemption does not extend to profits, even though applied to charitable purposes, which arise from a trade which is not exercised in the course of the actual carrying out of a primary purpose of the charity, for example, a grocery business.

9.32 The facts in each case affect the exemption. In R. G. Davis v the Superioress, Mater Misericordiae Hospital, Dublin 1933[6] it was held that the non-severability of the taxable from the non-taxable part of an undertaking was no answer to an assessment, with the consequence that the respondents were liable to tax in respect of the profits of the trade of carrying on a private nursing home, although the profits were applied to the charitable purpose of a hospital for the relief of the sick poor, also run by the Community.

9.33 A special provision was introduced in the Finance Act, 1981 to provide that the farming profits of charities, which would not have satisfied either of the two conditions set out above, would be exempt from income tax if the profits are applied to the primary purpose of the charity. Profits

[6] (1933) I.R. 480.

arising to charities from farming became liable to tax in 1974. The 1981 provision restored the tax exemption which existed prior to 1974.

9.34 We recommend that except where the conditions in 9.31 are met, profits from a trade, including farming, carried on by charities should be charged to tax in the normal way. In some cases, such charities are in direct competition with other traders who have to pay full tax on their profits.

Investment Income

9.35 As we noted in paragraph 9.5, charities are exempt from tax on income (including investment income) applied to charitable purposes. We recommend no change in this position.

Indirect Taxes Paid by Charities

9.36 Indirect taxes included in the cost of goods and services purchased by charities are not refundable. We received submissions that charities should be able to claim refunds.

9.37 It is very difficult to identify accurately the tax content of any good or service. While this may be done in the case of value-added tax by assuming that VAT is fully shifted to the consumer, it would be virtually impossible to isolate the effect of excise duties and other taxes on inputs on the final prices of output. In practice, any refund would have to be confined to VAT. The making of refunds to a substantial number of charitable bodies would increase administrative costs. The main cause of complaint by charities is the very high VAT rates on some of the goods they have to buy. The solution to this is a more rational VAT system, such as the single rate recommended in our third report, rather than the introduction of additional tax reliefs.

9.38 In any event, we do not think refunds are justified, in principle. State aid to charities and voluntary effort generally will be provided much more effectively if given directly rather than through indiscriminate tax reliefs, the amount of which would be generally unknown to the public. We recommend no change in existing arrangements. There is nothing to prevent the Exchequer from giving grants to particular charities to offset their liabilities, if this is thought to be appropriate.

Conclusions

9.39 The present system of charity tax exemption lacks transparency. The total size of the tax exemption to the charity sector is unknown. Performance cannot be measured. There is no accountability. A coherent and comprehensive state policy towards charities cannot be formulated in such circumstances.

9.40 Private donations to charities are a matter for the individual concerned. It could be argued that the public has a right to some form of supervision over those seeking funds for charitable purposes. However, that is outside our brief. Where tax relief of any form is given, the public is entitled to require that the state provide it in a manner which is fair and efficient. To ensure this we recommend that the Revenue Commissioners should ensure that income which qualifies for tax relief is applied for charitable purposes. Charities which fail to supply accounts should have their relief withdrawn.

9.41 Leaving aside questions of regulation, we consider that the present tax treatment of charities is generally satisfactory. The only change we recommend is that gifts to charities above a specified limit would be treated in the same way as savings for expenditure tax purposes.

Recommendations

9.42 We make the following recommendations:

1. Charitable exemption should be allowed only where the Revenue Commissioners are satisfied that the accounts of the charity show that the exempt income is being applied for charitable purposes. Charities which fail to supply accounts should have their relief withdrawn.

2. The tax relief for gifts towards education in the arts should be withdrawn. The responsibility for aiding such education should fall directly on the Exchequer rather than being met through tax expenditures.

3. Gifts to charities, other than small gifts, should be treated as savings for purposes of expenditure tax. Gifts to charities, which are within the definition of small gifts set out in paragraph 9.29, should be included in the taxable expenditure of the donor for purposes of expenditure tax.

4. Receipts of charitable donations (including inheritances) should not be charged to tax in the hands of the charity, provided the Revenue Commissioners are satisfied that they are applied for charitable purposes.

5. Except where the conditions in 9.31 are met, profits from a trade, including farming, carried on by charities should be charged to tax in the normal way.

6. There should be no change in the treatment of investment income of charities.

7. There should be no change in the existing arrangements for dealing with indirect taxes paid by charities.

Miriam Hederman O'Brien (Chairman)
Donal S. A. Carroll
Derek Chambers
James R. Gallagher
Daniel Murphy
Donal Murphy
Donal Nevin
Patrick P. O'Neill
Raymond O'Neill
W. J. Louden Ryan

Donal de Buitléir
Secretary
Séamus P. Reic
Assistant Secretary
1 March, 1985

Appendices

APPENDIX 1

LOCAL TAXATION — HISTORICAL BACKGROUND

Introduction

1. In this appendix we set out the historical background to the system of local taxation in Ireland.

Rates

2. Rates are the only form of local taxation in Ireland. The rating system is based on the rateable value of real estate as shown in valuation lists. Rating authorities have no valuing powers. The valuing of property for rating purposes is carried out by the Valuation Office under the direction of the Commissioner of Valuation, subject to a right of appeal to the Courts. The amount in rates which each ratepayer, generally the occupier of the property, is required to pay is determined by multiplying the rateable value of the property by the rate poundage, that is, the amount of the rate in the pound fixed by the local authority.

3. Rating in Ireland began with the tithe charges early in the fifteenth century. Church authorities were empowered to levy a tax on lands in each parish in order to provide for certain public and ecclesiastical works. The rating system as it exists in Ireland is derived from the system that operated in England. In England, rates for the relief of the poor and other local purposes have been levied locally since the fourteenth century. For example, in 1378 a royal letter ordered the inhabitants of Chichester to contribute to the cost of repairing the walls "according to their ability and possessions".[1]

4. It is generally accepted that the English rating system, as it is known today, began with the Poor Relief Act of 1601. This Act authorised parish overseers to raise the money they required for poor relief "according to the ability of the same parish". The Act did not specify how the tax was to be assessed but the basis used was the value of the property occupied. Originally, all possessions and not only real property were assessed but the

---

[1]Report of Committee of Inquiry into the Impact of Rates on Households, HMSO, 1965, CMND. 2582, paragraph 17, quoting Edwin Cannan, History of Local Rates in England.

practice was established of rating only real property and disregarding stock-in-trade. This practice was given statutory recognition by the Poor Rate Exemption Act of 1840 which confined liability to immovable property. So the poor rate, which was originally intended to be a type of local income tax, became a tax on a particular class of property.

5. Present-day Irish local administration may be said to date back several hundred years to a crude system based on each county and concerned mainly with the administration of justice. The grand jury, consisting of a number of individuals in each area, was given the duty of administering justice by the English authorities. With the passage of time, the grand jury assumed, in addition to its judicial functions, duties relating to roads and bridges, asylums, infirmaries and other county buildings.

6. The fiscal powers of the grand juries date from 1634, when they were enabled by statute to "taxe and set every inhabitant to such reasonable ayde and summe of money as they shall think fit by their discretions convenient".[2] Grand jury cess was a county rate struck on property which was payable by the occupier. At first the cess appears to have been assessed according to the area of land occupied, as shown in surveys made from the middle of the seventeenth century. To overcome the difficulties caused by inequalities in the value of land, an allowance was made for poor land by entering a reduced number of acres on the list.

Local Taxation

7. The first of the annual summaries of local taxation was made for the year 1865. These returns show that the principal local taxes at that time were the grand jury cess, the poor rate and the various rates raised in boroughs and other towns. The grand jury cess, spent mainly on roads and lunatic asylums, remained until the grand juries were relieved of their powers as county fiscal authorities in 1898. The charges on the grand jury cess were transferred to the poor rate, leaving only two rates — the poor rate and the municipal rate. From the latter, all charges were defrayed for paving, lighting, sewerage and municipal administration in towns. From the new poor rate, which was levied by county councils, all other local charges were defrayed, not merely the expense of poor relief but all county and rural district expenditure. In 1946 the poor rate was given the name county rate.

Grants-in-Aid

8. In 1846, when the first grant-in-aid of poor law expenditure was given

[2]Quoted in H. A. Street, The Law Relating to Local Government, Stationery Office, Dublin, 1955, Appendix C.

in England, the union[3] organisation in Ireland had only just come into full operation and it was not until 1897 that a similar grant was given in Ireland to provide for the cost of medicines, medical appliances and the salaries of union medical officers. Since then, a system of grants has been devised with the dual purpose of relieving the ratepayer and encouraging particular forms of expenditure. Without these grants, the financial resources of the local authorities (derived mainly from a tax on immovable property) could not have borne the strain of new and expanded services.

9. In 1888, half the proceeds of the Death Duty Grant was assigned to the Local Taxation Account and in 1894 a corresponding sum of the Estate Duty Grant was so assigned. The Local Taxation Account was abolished by the Finance Act, 1962. The grants formerly payable through the Account were terminated, with the exception of the agricultural grant.

The Valuation System

10. The first of the general valuations for rating purposes was made under an Act of 1826. Prior to 1826, land was the only rateable hereditament, except in the seven boroughs of Dublin, Cork, Waterford, Limerick, Drogheda, Kilkenny and Clonmel. The valuation was undertaken by Richard Griffith. It began in 1830 and was completed in 1846 with six counties still to be valued, namely, Limerick, Cork, Tipperary, Waterford, Kerry and Dublin. Land was valued by reference to the general average prices for farm products and houses at two-thirds of the rent. The valuations were made by townlands and not by separate tenements. Griffith undertook a further general tenement revaluation in the period 1846/52.

11. The townland valuation which commenced in 1830 did not meet the requirements of the Poor Relief Act of 1838 and consequently, for the purposes of the poor rate, the boards of guardians were empowered to make a valuation based on the net annual value of every tenement. The valuations made by the guardians were very much below the letting value of the land and different standards applied in the various poor law unions.

12. For a time there were two different valuations, one for grand jury cess and the other for the poor rate. This divergence was brought to an end by the Valuation Act of 1852.

[3]In 1839, the English system of poor law relief was extended to Ireland and 'unions' were created, in each of which a workhouse was erected where any able-bodied person looking for relief would have to earn it in conditions which would be less desirable than those of the poorest labourer outside. These workhouses were supervised by boards of guardians, half of whom were elected by ratepayers and the other half justices of the peace resident in that union. In 1871, the Local Government Board absorbed the Poor Law Commission in Ireland without affecting the basic system.

The 1852 Valuation Act

13. The basis of rateable valuations in Ireland is contained in the Valuation (Ireland) Act of 1852, which set out to provide "one uniform valuation of lands and tenements which may be used for all public and local assessments and other rating".

14. The basis of the valuation of hereditaments other than land is the net annual value, which is defined as the annual letting value over and above rates, cost of repairs, insurance and maintenance.

Griffith's Valuation

15. The valuation under the 1852 Act, which was conducted under the direction of Sir Richard Griffith, is generally known as 'Griffith's Valuation'. It began in 1852 and was completed in 1865 at a total cost of £325,133. The average rateable valuation of land for the whole country turned out to be forty one pence per acre and the average for the different counties ranged from nineteen pence per acre for County Donegal to £1.04 for County Dublin but in Donnybrook, near the city of Dublin, lands were valued as high as £4.00 per acre.

16. Since 1983, following a Supreme Court decision declaring the existing system of rateable valuations unconstitutional as it applied to land, agricultural land has been fully exempt from rates.

Revisions of Rateable Valuations

17. The valuations of buildings fixed by Griffith over a century ago are still in force as a basis for rates, except in so far as revisions have been made since then. Rates on domestic dwellings were abolished in 1978 and only industrial and commercial property is now liable for rates. The nature and extent of the revisions that have been made since Griffith's Valuation can be gauged by an examination of the statutory provisions for the making of revisions of valuations.

18. Section 34 of the Valuation Act, 1852, as amended, provides that any county council may apply for a general revaluation of its area at or after an interval of fourteen years has elapsed since the last general revaluation. No county council has ever applied for a general revision of valuations.

19. Section 65 of the Local Government Act, 1898 empowered the corporations of the cities of Dublin, Cork, Limerick and Waterford to apply for a general revision of valuations every fourteen years.

20. Dublin city was revalued in 1908/15 and Waterford city was revalued in 1924/26. In Waterford the basis of revaluation was 1913/14 rental values and in Dublin these values were reduced by 10 per cent. As a result of these revisions, the total valuation of Dublin was increased by 15 per cent and that of Waterford by 48 per cent.

21. Section 4 of the Valuation (Ireland) Amendment Act, 1854 and Article 37 (d) Local Government (Adaptation of Irish Enactments) Order, 1899 provide for an annual revision of valuations by enacting that each secretary or clerk to a local authority shall send for revaluation to the Commissioner of Valuation a list of specific items of property, including cases reported to him by rate-collectors, or by any ratepayer in the area concerning his own property or that of any other ratepayer.

22. In connection with the annual revision, an important point to be noted is that the Commissioner of Valuation has no power of initiative in selecting items for revision; he is strictly confined to those items which appear on each local authority's annual list. Apart from the general revaluations of Dublin and Waterford cities, the only effective revaluation of buildings has been those made on an annual revision.

23. The statutory basis of valuation is the net rent at which the property could be reasonably expected to be let at the time of the striking of the valuation. Since 1865, on an annual revision, valuations have always been fixed at lower figures than those represented by the values current at the time of fixing the valuation. This practice has been followed in order to preserve a semblance of uniformity with existing valuations. Since 1947, the practice has been broadly to fix the valuation

(i) in the case of rented properties, at about one-third of the current net reasonable rental value, and

(ii) in the case of properties not rented (and these constitute the majority) or for which rents are not readily ascertainable, at one-third of 4 per cent, where occupied for trade or professional purposes, or one-third of 3 per cent, where occupied for residential or farm purposes, on the estimated reasonable capital value of the property.

This formula excludes "the excessive post-war increase in rental values".[4] Alternative methods of assessment are often used, such as the calculation by reference to a fraction of an actual current net rent. However, the valuer is allowed to use his discretion in each case and, in making his calculations, to have regard to the valuations of similar properties in the same area.

---

[4]Valuation for Rating Purposes, First Report of Interdepartmental Committee on Local Finance and Taxation, Stationery Office, Dublin, October, 1965, Pr. 8536, paragraph 15.

Defects in the Operation of the Valuation System

24. The defects in the operation of the valuation system are highlighted by the results of the revisions of buildings' valuations carried out in Galway and Buncrana. In the period 1946/50, comprehensive annual revisions, excluding land and railways, were carried out in Galway borough and urban districts on the basis of 1914 letting values which were substantially below the current letting values. This resulted in an increase of 52 per cent in the total valuation of Galway borough.

25. In 1951, most of the properties in Buncrana urban district were revalued on an annual revision. This resulted in a total increase of 58 per cent in the valuation of buildings. As a result, the sum which Buncrana had to pay in county demand was increased by 20 per cent, since the expenses of a joint contributory area are levied in proportion to total rateable valuations. Special legislation[5] was necessary, providing for an adjustment of the method of calculating the county demand on Buncrana.

26. The revisions in Galway and Buncrana exposed the lack of relativity within the rating areas of valuations of buildings. Some valuations were doubled while others remained unchanged. The prevalence of a similar lack of relativity in other areas is borne out by the experience of the Valuation Office when old buildings' valuations are listed for revision. Usually these valuations have to be increased because of their antiquity, in addition to the normal increase which could be expected to result from the improvement which occasioned their reference to the Valuation Office. The factors which necessitate such sharp increases in old valuations are not only the depreciation of money or the increase in property values but the presence of previous improvements or the extension of amenities in cases where the valuations have not been previously revised to take these factors into account.

27. It is often claimed that valuations are so out of date that they must inevitably lead to anomalies and inequities in the incidence of rates. Conversely, it may be argued that old buildings involve heavy outlay in repairs and are not only costly to maintain but to service with heat and light. Since extensions and improvements generally give rise to revaluations, commercial and industrial buildings are more likely to be up to date than residential property.

---

[5]Local Government (Temporary Reduction of Valuation) Act, 1953.

Failure of the Valuation System

28. The valuation system failed because valuations have been allowed to get significantly out of line, due to the fact that the statutory provisions for the undertaking of general revaluations have remained almost inoperative. Various factors have operated against the frequent revision of valuations — a revision which is essential if the system is to work in a fair manner.

29. The fact that the expenses of a joint contributory area are based on a proportion of aggregate valuations discourages individual local authorities from seeking revisions. A fear exists that the lower rate poundages, which would result from an increase in valuations after a general revaluation, would make increases in rates easier for local authorities. The fear of an increase in income tax liabilities under Schedule A also militated against frequent revision. Since the abolition of Schedule A in 1969, this difficulty no longer arises. Finally, there is a general inertia in local authorities and a desire to 'let sleeping dogs lie'.

Conclusion

30. The valuation system is designed to provide a measure of the ratepayers' ability to contribute to local authority expenditure. It should ensure that occupiers of similar premises pay rates on similar valuations. The discrepancies in values in Galway and Buncrana have shown clearly that serious anomalies have arisen and that the present valuation system is inequitable in its operation. The White Paper, Local Finance and Taxation, published in December, 1972, admitted that

> "there is a widespread lack of relativity among valuations in particular areas and as between one area and another. The arrangements for annual revisions of buildings' valuations have failed to operate effectively and there is no provision for the revision of land valuations. The defects in the system have given rise to inequities which have become more pronounced with the passage of time and have been aggravated by the constant and substantial increases in rate poundages."[6]

---

[6]Local Finance and Taxation, Stationery Office, Dublin, December, 1972, Prl. 2745, paragraph 5.1.2.

APPENDIX 2

RESIDENTIAL PROPERTY TAX

1. The residential property tax was introduced by the Finance Act, 1983 and is payable by an individual on the market value of residential property owned and occupied by him on 5 April in each year beginning 1983.

Property Liable to Tax

2. All residential property within a market value of £65,000 and over on 5 April 1983 is subject to the tax. A residential property is defined as a building or part of a building used or suitable for use as a dwelling, together with any land attached to it used for enjoyment such as a garden or grounds of an ornamental nature. The person who is liable for the tax must own and occupy the property. The market value of a property is defined as the price which the unencumbered fee simple of the property would fetch on the valuation date. For valuations after 5 April, 1983 the market value exemption limit of £65,000 will be adjusted in line with the trends in Private New House Index Number published by the Department of the Environment. Where an individual owns a share in a residential property the exemption limit can be less than £65,000.

3. Where two or more persons jointly own a property, the market value attributable to each is calculated by simple apportionment regardless of the proportions in which they share ownership of the property. Separate properties owned by separate persons, including husbands and wives, are not aggregated for the purposes of the tax. Each owner is entitled to his own exemption limit in relation to his own property.

4. Ownership is defined in the legislation and is framed very widely. Generally speaking, a person will be treated as 'owner' if he has any legal right to occupy the property. However, he will not be treated as 'owner' if he is paying a rent which, when the agreement for payment of the rent was made, represented the 'arm's length rent', that is, the full rent which a letting of the property would have been expected to get on the open market when the agreement was made. There are also special provisions regarding living accommodation made available by an employer for a director or an employee. It should be noted that the ownership must be beneficial, that is, a person must have the ownership for his own use and

benefit. A trustee of property, for example, is not the owner of that property for residential property tax purposes. The definition of owner includes a person who beneficially holds property at the will and sufferance of any other person or under any trust. Liability for the tax, therefore, may attach not only to the occupier who has an absolute interest in residential property but also to the occupier who has a limited interest in such property. A life-tenant may be liable to the tax as well as a person who is allowed by the trustees to occupy a residential property under a discretionary trust.

5. If a person is domiciled in Ireland and owns property abroad which he occupies, each of these properties will form part of his residential property for tax. Persons not domiciled in the state are chargeable only in relation to their residential property in the state.

Exemptions

6. There is a number of exemptions to the tax:

(i) property valued at under £65,000 on 5 April 1983 and for subsequent years the relevant indexed limit is exempt,

(ii) where the total household income is less than £20,000 on 5 April 1983 (for subsequent valuation £20,000 indexed to the All Items Consumer Price Index) the tax is not payable. Household income includes all income from children and dependants residing at the property but does not include income of an employee whose employment is connected with the property e.g. a live-in-maid or income of a person who pays a full rent for such residence (i.e. a rent which would be chargeable to income tax for the owner occupier). Income for the purpose of this tax is defined as total income estimated in accordance with the Income Tax Acts. No deduction is allowable for

(a) income which is exempt from income tax, for example, dividends from the operation of export sales relief,

(b) losses in respect of rents or trade,

(c) retirement annuity payments,

(d) initial allowances and free depreciation,

(e) interest paid including mortgage interest,

(f) contributions to occupational pension schemes,

(g) free depreciation on farm improvements,

(h) expenditure on construction of rented residential property, or

(iii) a building which is of significant scientific, historical, architectural or aesthetic interest which gives reasonable access to the public is exempt.

Reliefs

7. Two types of relief are available:

(i) marginal relief is allowable where the aggregated household income limit is exceeded by no more than £5,000, and

(ii) child relief is allowable for a child or children residing with the owner/occupier and qualifying for income tax child allowance. The tax is reduced by one-tenth for each such child.

Rate of Tax

8. Residential property tax is charged at 1.5 per cent on the market value of a property in excess of the market value exemption limit (£65,000 for 5 April, 1983) and falls due six months after valuation date. Interest is payable at 1.25 per cent per month on overdue tax or on overpayments of tax.

Assessment

9. Every person liable to the tax is obliged, under penalty, to make a return with a self-assessment of the tax payable i.e., the owner assesses the market value of the property and the total household income and calculates his liability. If the Revenue Commissioners disagree, they make their own estimate of the market value and charge the tax accordingly. The Revenue Commisioners have power to nominate a valuer to inspect the property and report on its value. There are appeal procedures both in relation to property valuation and assessment of the tax in general.

Penalties

10. Penalties are substantial and are made in cases where

(i) no returns or incorrect returns are made,

(ii) no return is made after request by the Revenue Commissioners, or

(iii) a valuer appointed by the Revenue Commissioners is prevented or hindered from carrying out assessment.

APPENDIX 3

AUSTRALIAN RESOURCES RENT TAX

Introduction

1. In this appendix we outline the proposals made in Australia for a resources rent tax (RRT).

Background

2. In December, 1983 the Australian Government released a Discussion Paper proposing a resources rent tax. It was to form the basis of consultations with the mining sector and the various state governments. Although, initially, the tax was only to apply to the petroleum mining industry, it was intended that the tax would serve as a model for replacing the Commonwealth and State taxes levied on other parts of the mining sector. However, since 1983 the focus of the Government's RRT proposal has been narrowed to new off-shore petroleum projects ('new oil'). On-shore projects have been excluded altogether. The Government will maintain the current excise and royalty arrangements for existing off-shore and on-shore petroleum projects ('old oil') and for new on-shore petroleum projects. At this stage none of the RRT proposals has been implemented. It is not currently known when the legislation will be introduced to Parliament.

Philosophy

3. The new tax arrangements are aimed at providing not only encouragement for marginal projects and therefore maximising petroleum extraction but introducing long-term stability to the petroleum mining sector.

4. The Government considers that the nation's natural mineral resources are community property and, as such, the community is entitled to be rewarded for the depletion of those resources. This is particularly so where this activity produces exceptionally high returns on the investment in these industries. Australian governments have believed that exploration for and extraction of these minerals is achieved more efficiently by allowing private organizations exclusive rights to explore or mine particular areas. The restrictions associated with this policy (and those needed to produce efficient patterns of exploration and mine development) have produced profit levels

well above those necessary to attract economically efficient levels of investment in such projects. Previous taxing arrangements have not taken into account the profitability of a project and therefore its capacity to pay. They have concentrated on the size of the operation, which acts as a disincentive to marginal producers. The resources rent tax will be based on an individual project's capacity to pay and not the volume of its production.

Structure

5. The tax will apply to profits from new off-shore petroleum mining which exceed a minimum or 'threshold' level. Profitability will be determined from actual expenditures including items of both a current and a capital nature. Excess expenditure in any year will be carried forward to the following year at a 'threshold rate'. A deduction for interest and expenses in servicing capital will not be available in determining the tax base.

6. A project will be liable for RRT only when it has recouped its outlays together with the threshold rate of return compounded from year to year. Further net receipts will be liable for tax at the relevant tax rate. If in subsequent years expenditures exceed revenues, then these losses or capital expenditure will be treated in the same way and could result in the project temporarily ceasing to pay RRT until the threshold rate had been earned on these new expenditures.

7. The 'threshold rate' aims at maintaining the value of future years' deductions until sufficient income is available. Where at the time of investment it is certain that any excess costs will eventually be written off in full, the threshold rate will correspond to the year-by-year cost of future recoupment of that certain value.

8. Generally the RRT tax rate will be 45 per cent of relevant net revenue applying at a threshold rate of return equal to the long-term bond rate plus 10 per cent. When the threshold increases to the total of the long-term bond rate plus 25 per cent, the RRT tax rate increases to 60 per cent.

9. The tax unit is to be the individual project and not the company. It is to be restricted to the profits derived within the boundaries of the petroleum development project. Deductions will be limited to those necessary to produce a marketable commodity and so realise the resource rent. The rules already established in the Income Tax Assessment Act are generally thought to be sufficient to determine what constitutes 'petroleum mining'.

10. At this stage it appears that the RRT will be levied prior to company income tax and allowed as a deduction in determining the company's taxable income.

APPENDIX 4

TAXATION OF MINING

1. In this appendix we set out the historical background to the present system of taxation of profits arising from mining in Ireland.

Historical Background

2. Tax relief in respect of profits from certain mining activities was introduced in 1956. Mining production had gradually declined from a peak attained about one hundred years previously and many mining undertakings had ceased operations. The justification for this special treatment was that mining differs from other industries in that capital must be committed to the enterprise with a greater risk of failure than would be associated with a normal commercial enterprise. It differed also in that it could not be afforded protection by tariff or quota or other import restrictions. It was clear that an incentive was necessary to stimulate prospecting and exploration and to interest business people in working and developing such non-bedding ores as might exist in the country. The only satisfactory broad incentive appeared to be by way of a tax concession, a method already adopted in some other countries. The tax relief originally took the form of exemption from income tax and corporation profits tax of the profits for the first four years of operation and thereafter 50 per cent exemption for a further four years. The relief was given for the mining of non-bedded deposits of a large number of minerals such as barytes, felspar and ores of all the most common metals and was to apply to mining companies which commenced trading operations within five years from 6 April, 1956. This 'commencement' period of five years from 1956 was extended to ten years in 1959 and to twenty years in 1965.

3. With the passing of time and the growth of interest in the possibility of mining ventures in the state, it appeared that a significant further expansion in exploration and development could be stimulated by additional tax incentives and that a large volume of outside investment might be forthcoming. Many different types of tax allowances and incentives had been suggested but instead of having complicated new provisions the decision was taken to substitute for the existing reliefs a twenty year period

of complete exemption of profits from mining operations which would commence before 6 April, 1986.

4. However, in 1974 the Government decided to withdraw the twenty year tax exemption and replaced it with the present system of corporation tax plus special capital allowances. When repealing the exemption in 1974, the Minister for Finance stated in his Budget Speech

> "that this exemption is now unnecessarily generous and that the same economic benefits could be secured for the country, together with additional benefits from increased tax revenue, by less prodigal incentives".

APPENDIX 5

REGULATION OF CHARITIES IN IRELAND

Introduction

1. In this appendix we set out the position in relation to regulation and control of charities in Ireland.

Regulation

2. Unlike the United Kingdom, Ireland has no register of charities. It is up to organisations to apply to the Revenue Commissioners for the charity tax exemption or to the Commissioners of Charitable Donations and Bequests for legal privilege. The decision on charitable status for tax purposes is made by the Revenue Commissioners. Appeals may be made to the Appeal Commissioners and the High Court. Claimants are required to submit to the Revenue Commissioners a copy of the instrument creating the charity, accounts for the period covered by the claim, together with copies of any printed statements that may have been published by the organisation.

3. The Revenue Commissioners informed us that they have limited scope on policing charities and do not do so in any systematic way.[1] The basic tax exemption applies to investment income. Most charities have recurring repayment claims and these are repaid on the basis of a declaration by the trustees that the moneys were applied for charitable purposes. If there were evidence of accumulation of assets by a charity, this would be questioned. Some charities have gross income derived, for example, from investments in government securities. These are not normally required to make returns of income. In general, the Revenue Commissioners said that they had no reason to suspect abuses of the charitable exemption.

4. In practice, inspectors of taxes do not initiate an enquiry into the affairs of voluntary fund-raising bodies. It seems to be the case that a number of such bodies has no dealings whatever with the Revenue Commissioners.

[1]Agreed note of meeting of 12 December, 1984.

5. The Commissioners of Charitable Donations and Bequests do not maintain a register of charities with which they have been or are involved. The Commissioners are a statutory body, appointed by government. They give their services voluntarily. Their main functions are of an administrative nature: they act as trustees of some charitable trusts and hold funds on behalf of others. They invest and can authorise charity trustees to invest in securities outside the ordinary range of trustee securities. Their other main functions include the appointment of new trustees, the authorisation of the sale of charity property and the framing of cy-près schemes[2] up to £25,000. The Commissioners say that a number of charities is dormant at present: the funds cannot be applied to the charitable purpose because, for example, the trustees who administered the charity are deceased and had not been replaced.

6. Charities, unlike other corporate bodies, have no owners or shareholders to whom they are responsible for their operation. In many cases neither donors nor recipients have any statutory rights with respect to the operation of a charity and in this regard charities are less closely controlled than other non-profit institutions such as hospitals and schools directly administered by central or local government. There is no method of checking if the money goes where it was intended to go. The onus is placed on self-regulation by trustees or managers.

7. CONGOOD (an umbrella organisation for sixteen Irish voluntary development agencies) in its address to the Joint Oireachtas Committee on Development was concerned that

> "There has been a number of questionable agencies appealing in public for funds for the Third World. They tend to operate on an ad hoc basis without proper structures, accountability or policy. The activities of such agencies can have a detrimental affect on the work of *'bona fide'* development agencies and can undermine the confidence which the public in general has in them".

8. The regulation, licensing and legal administration of house-to-house, street collections and lotteries for both charitable and non-charitable purposes are matters for the Gardaí and the Courts. Permits for house-to-house, street collections and lotteries are issued by the Gardaí. There is a right of appeal to the District Court. Permits are refused on the grounds that the applicant is a subversive, has a criminal background or has misapplied moneys collected in the past. There is no provision, however, in the Street and House to House Collection Act, 1962 for checking by Gardaí of accounts. Regulations governing the issue of lottery licenses[3] provide for submission to Gardaí of accounts at the end of the period; administrative expenses are not to be greater than 40 per cent. The controls are not comprehensive. The regulations are not enforced. Only a minority of accounts is received by the Gardaí. It has been suggested "that the law relating to charities in Ireland is very lax and that it seems too easy to get a collection box and go ahead and raise funds"[4].

[2]Cy-près means as near as possible. A gift is applied as closely as possible to the intentions of the donor or testator, where those intentions cannot otherwise be carried out.

[3]The Gaming and Lotteries Act, 1956, Section 28 (2) (e).
[4]The Irish Times, 17 March, 1984.

APPENDIX 6

TAX TREATMENT OF CHARITIES IN OTHER COUNTRIES

Introduction

1. In this appendix we set out the tax treatment of charities in certain countries. We also note the views of other Commissions in this area.

Income of Charities

2. Trade carried on by a charity is not taxed in the United States or Canada if the work is carried out by volunteers. In the United Kingdom, such trade is exempted provided the profits are applied solely for the purposes of the charity and either the trade is exercised in the course of the actual carrying out of the primary purpose of the charity or the work is mainly carried out by beneficiaries of the charity. In the United States, unrelated business income is assessable for tax. A business is unrelated if the trade is not substantially related to the essential charitable function of the organisation. This does not include the first $1,000 rents from real property, royalties and dividends, interest and annuities.

Charitable Donations

3. In the United States, West Germany, Canada, Belgium, the Netherlands and Australia, gifts to charities are allowable as deductions on the assessable income of the donor. In each case this allowability is subject to restrictions which vary from country to country. In New Zealand, exemptions for donations and school fees were replaced in 1978 by tax rebates for the actual amount of the donation or fee. This amount must not exceed the lesser of $175 or 50 per cent of the amount. The aggregate of all rebates cannot exceed the total tax payable in any tax year.

4. In Canada, gifts are allowable up to 20 per cent of the donor's income. In Belgium, they are allowable up to the lesser of 10 per cent of net total income or 10,000 Bfr. The minimum allowable is 1,000 Bfr. In Australia, donations of money or of property, within one year of purchase, are deductible to the extent of income remaining after all other deductions. In the Netherlands, deductions are allowable to a limited extent. In West Germany, donations to charitable, religious, scientific and political purposes

are allowable up to 0.2 per cent of turnover plus payroll of a business or 10 per cent of income for scientific and political purposes and 5 per cent for charitable and religious purposes. In the United States, contributions and gifts to charity are tax deductible up to 10 per cent of taxable income for corporations. Individuals are allowed to deduct up to 25 per cent of charitable donations but not more than $12.50.

5. In the United Kingdom, there is a convenanting system similar to that in operation in Ireland until 1940. Charities receive from the Inland Revenue the income tax which the donor has paid on the amount convenanted. A certain annual sum must be paid for not less than four years. New and used goods sold by a charity for the relief of distress are zero-rated for VAT.

REPORTS OF COMMISSIONS

New Zealand

6. The report of the Taxation Review Committee, 1967 accepted the special position charities traditionally have in the western world. Tax exemption on income and the deductions allowable from an individual's income were fully supported by the Committee. It was felt that charitable organisations engaged in industry and commerce and competing with private enterprise for labour and materials had an advantage which to some extent conflicted with the general principle of equity in taxation. The Committee therefore recommended that profits from trading derived directly and indirectly by charitable organisations and dividends from companies 'substantially owned' (i.e. more than 40 per cent) by charities should be assessable at normal income tax rates. The recommendation was not implemented.

Canada

7. The report of the Royal Commission on Taxation, 1966 stated that if it was thought to be socially desirable to encourage taxpayers to make charitable donations, then a tax on the income of charitable organisations would be a negation of that objective. It was accepted as reasonable to exempt charities from income tax on donations received. As far as business income exemption was concerned, the Committee recommended taxing income flowing from non-portfolio investment (defined as including any interest of 10 per cent or more including the ownership of real property). Sales of work and gift shops should be exempted.

8. The setting up of a supervisory body representative of the Departments of Health and Welfare and National Revenue to grant tax exempt status to charitable organisations was recommended. While annual certifying of statements by an auditor was felt to be too great a burden on small charities, it was recommended that a special certificate be submitted annually, signed

by officers of the charity and the auditor, to state that books were in existence and were maintained in a proper state. The books should be available for inspection by the tax authorities and an annual financial statement should be published.

9. While tax credits were more equitable, relating only to the size of donation not the income of the donor, the Commission felt that their introduction would "tend to stifle charitable donation by upper income individuals". Because it was felt to be important to encourage private philanthropy, the deduction of charitable donations from income should be continued. To avoid abuse, receipts in triplicate should be issued for donations, one to the donor, one to the tax authorities and one for the donee. Complete receipts of donations should be kept and annual returns of gross receipts filed.

10. It was recommended that charitable bodies outside Canada should be recognised and deductions for donations to them permitted. An increase in the total amount of income allowable in respect of charitable donations from 10 per cent to 15 per cent was recommended once the administrative changes outlined above were implemented. The Commission recommended that gifts in kind should be allowable above a certain minimum ($500 at that time). Smaller gifts would involve too much administrative work.

Australia

11. The report of the Taxation Review Committee, 1975 stated that charitable organisations were regarded in most developed countries as playing an important part in the social structure. It accepted therefore that there was a case for subsidies for them from public funds and asked whether tax concessions by way of allowable deductions from the tax base or exemption of the income of the charitable organisations were the most effective way of encouraging and supporting private philanthropy.

12. The Committee considered whether a tax credit system would overcome the objection to the tax deductibility scheme of vertical inequity. No empirical evidence was available to suggest at what percentage rate the credit would have to be set so as not to discourage giving by high-income donors. A scheme of grants, matching private donation with public funds equal to whole or part of the gift was considered. This is similar in principle to the United Kingdom convenant scheme but has a broader application. Objections were delay to the charity in getting the money, possible increased administrative costs and a psychological disincentive to give. Such a scheme would overcome vertical inequity and allow greater government flexibility in dividing the amounts going to particular charities.

13. Exemption of income favoured bigger charities more than smaller ones. A number of methods of taxing business profits when they are in competition with private enterprise was considered. Each one had difficulties, for the charities and the revenue authorities, in segregating assessable income from exempt income. In cases of unfair competition with non-exempt persons, the introduction of qualifying measures was recommended. Exemption where the work was carried out by beneficiaries of the charity should be retained. Investment income should be taxable when the charity held more than a specified interest. A prohibition on deductible gifts from such a business to the charity would be then needed.

United Kingdom

14. The Royal Commission on the Taxation of Profits and Income, 1955 considered a change from the covenant system to one of tax deductibility, subject to a maximum limit. It did not recommend this, however, as it feared a sharp fall-off in gifts to charities and increased administrative costs. It also recommended a new and more restrictive definition of charity. This recommendation has not been implemented.

Summary

15. In all the countries looked at, private philanthropy is encouraged by the state through deductibility or convenating or, in the case of New Zealand, a tax rebate system. In Ireland this is not so, except for universities or colleges engaged in research and universities and schools teaching the natural sciences and for gifts towards education in the arts.