March, 1984 and the allowance may be set off only against income from tolls.[13]

7.39 This allowance was introduced to

> "act as a positive inducement to the private sector to become more actively involved in some essential infrastructure requirements".[14]

7.40 Agreements made with local authorities for the provision of toll roads and bridges normally specify that tolls may be levied for a limited period, after which the facility is given over to the local authority. In these circumstances, we recommend that a capital allowance be given on an indexed basis to write off the cost of a toll road or bridge over the period of the agreement.

Dredging

7.41 Reliefs in the form of an initial allowance of 10 per cent and an annual allowance of 2 per cent are available in respect of expenditure incurred after 30 September, 1956 on "the removal of anything forming part of or projecting from the bed of the sea or of any inland water". The expenditure must be incurred for purposes of a trade consisting of the maintenance or improvement of the navigation of a harbour, estuary or waterway or any of the trades to which industrial buildings allowances apply.

7.42 We consider that the allowance for expenditure on dredging should be sufficient to write off the cost of a dredging operation (on an indexed basis) over its estimated life. There is little alternative but to select an arbitrary writing-off period for dredging expenditure.

Research and Development

7.43 The allowances for research and development apply to both capital and non-capital expenditure. In the case of capital expenditure, an allowance equal to the full amount of expenditure incurred is granted, whether or not the expenditure relates to the trade being carried on. In the event that the trade ceases, the relief may be clawed back. Non-capital amounts paid for scientific research and amounts paid to an Irish university for research in marketing and industrial relations or other subjects approved by the Minister for Finance may be deducted in computing trading profits for tax purposes whether or not the research relates to the trade being carried on. In addition, the cost of acquisition of industrial 'know-how' is allowable as

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[13]It is proposed to continue this allowance for a further three year period until March, 1987. Budget Speech, 25 January, 1984.

[14]Budget Speech 28 January, 1981.

a deduction in computing trading profits except where acquired with a trade as part of a going concern.

7.44 The level of research and development carried out in manufacturing enterprises in Ireland is low by international standards. In 1975 manufacturing industry in Ireland spent the equivalent of 0.9 per cent of its turnover on research and development. This compares with 3.4 per cent in the EEC as a whole and 5.7 per cent in the United States. A major part of research and development in other countries is funded by governments and much of it is related to defence. Generally multi-national companies tend to locate their research and development activities in countries in which their head offices are located. Incentives to attract research and development activities of multi-nationals may have limited results. There is evidence to suggest that companies, and particularly a number of American companies, feel that crucial research and development functions should be performed close to home to minimise the risk of spin-off.

7.45 In a submission the National Board for Science and Technology proposed that

> "where a trading company incurs expenditure (capital or revenue) on research and development, whether or not it is related specifically to its own trade, it should be given a credit against its tax liability in respect of the full amount of the expenditure. Any excess of the tax credit over the current years tax liability would not be repaid but would be carried forward to succeeding years. It is believed that the substitution of a tax credit for a deduction would offer some incentive to manufacturing companies which are now effectively chargeable to tax at 10 per cent or less".

7.46 We believe that expenditure on research and development should be allowable as a deduction in computing trading income for tax purposes, whether or not it is related to the trade. This goes beyond normal accounting practice. However, we do not consider that additional tax incentives are an appropriate and efficient means of encouraging such expenditure.

Patent Rights and Royalties

7.47 Expenditure incurred on the acquisition of patent rights may be written off by equal annual instalments over a period of 17 years or over the remaining life of the patent if shorter. In addition, a deduction is allowed in computing trading profits in respect of fees and expenses incurred in obtaining "the grant of a patent or an extension of the terms of a patent". As a corollory to the above provisions, the seller of the rights is charged to tax on the sum realised on their sale, but is given the option to spread the liability over a period of six years.

7.48 We recommend that expenditure on the acquisition of patent rights should be allowed in equal annual instalments (on an indexed basis) over the life of the patent.

7.49 Income derived from patents is exempt from income tax and corporation tax if the research, planning, processing, experimenting, testing, devising, designing, developing or similar activity leading to the invention has been carried out in the state. The recipient must be resident in Ireland and not resident elsewhere. In cases where the work leading up to the invention is not wholly carried out in this country, the practice is that the relief is not lost, provided the main work is carried out here. For example, research may have to be carried out in libraries abroad into works and references not available in Ireland, or it may be necessary to make tests abroad in particular climatic conditions or other circumstances. These would not preclude the relief. It is immaterial where the patent is registered. Since 1975 the exemption enjoyed by a company may also be passed on to its shareholders in dividends.

7.50 The relief was introduced to

> "encourage research and development in Ireland and to stimulate inventions".[15]

No firm statistics are available on the number of cases in which the relief has been granted. However, the Revenue Commissioners estimate that no more than twenty have availed of the relief to date.

7.51 Under present arrangements, it is possible, in certain limited circumstances, for a person resident in the state to write off the cost of acquisition of a 'qualifying patent' and, at the same time, to enjoy exemption from income tax and corporation tax on the income derived from the patent. This treatment is over generous and could lead to a double recoupment of the costs of acquisition in some cases. We consider that total exemption of patent income is unnecessary in the context of our general recommendations and we recommend that the relief be withdrawn.

Rented Accommodation

7.52 A new allowance of 100 per cent in respect of expenditure incurred on the construction of moderate-cost rented residential accommodation was introduced in 1981. Expenditure incurred in the period 29 January, 1981 to 31 March, 1984 on the building of a house or flat for letting is an

[15] Dáil Debates, Official Report, Vol. 265 Col. 1270.

allowable deduction against the rental income of the property or other properties.

7.53 The property must have a certificate of reasonable value issued by the Minister for the Environment, must be used solely as a dwelling and must never be owner-occupied within ten years of the first letting. If, however, within the ten year period, the property ceases to be a qualifying premises, all the allowances already given are clawed back. If the property is sold within the ten year period and is let, the purchaser is entitled to the same allowance as the original owner.

7.54 To qualify for the relief the minimum floor area for a house is 35 square metres and the maximum area is 125 square metres. The minimum floor area for a flat or maisonette is 30 square metres and the maximum area is 75 square metres. Expenditure incurred on the conversion into two or more houses or flats of a building, which prior to the conversion had not been in use as a dwelling or had been in use as a single dwelling, also qualifies for the relief.

7.55 The relief was extended for a further three years in 1983 and will now apply to expenditure incurred on or before 31 March, 1987. Two modifications to the relief were made in respect of expenditure incurred in the extended period. Firstly, the upper limit on the floor area of a flat was increased to 90 square metres. Secondly, the deduction for construction expenditure in any chargeable period is now restricted to the amount of the gross annual rent from the dwelling in respect of which the expenditure was incurred.

7.56 Table 2 shows the number of new apartments started in each year since 1979 classified by floor area.

TABLE 2

Apartment Floor Sizes (Starts)

	1979		1980		1981		1982	
Floor Areas	No.	%	No.	%	No.	%	No.	%
Under 75 square metres	326	41.5	142	41.5	653	83.0	1009	95.7
Over 75 square metres	460	58.5	200	58.5	134	17.0	45	4.3
Total	786		342		787		1054	

7.57 The data show that there has been a significant increase in the number of flats which come within the scope of the relief. In 1982 these accounted for 96 per cent of all new flats compared with 42 per cent before the relief was introduced. This is not surprising, given the generous nature of the relief. For an investor who would otherwise pay tax at 67 per cent on other rental income, up to 50 per cent of the cost of the flat was paid for out of tax savings on other rental income.[16]

7.58 This relief is granted for an activity which is in the sheltered sector. This being so, it is likely that a significant part of the benefit of the relief accrues to developers in increased prices of qualifying assets. In fact the relief may best be seen as a subsidy to the construction industry. Ultimately, it is likely to be reflected in land prices. We do not consider that such a relief is the most efficient method to subsidise the construction industry or that the construction industry should be subsidised. Priority in the provision of incentives should be given to the exposed market sector. We recommend that the relief should be discontinued and that such accommodation be treated in the same way as other rented residential accommodation.

Quarries

7.59 A person carrying on a trade of quarrying is not allowed any deduction in respect of the cost of acquiring the asset or a right of access to the asset. In other words, he is not allowed a deduction for any capital expended in relation to the asset. Since the asset is a wasting asset it does not come within the scope of capital gains tax and no loss is allowed. He is entitled to a deduction for any charge related to the output of the quarry.

7.60 We consider that the present tax treatment of quarries is unfair. We recommend that a depletion allowance be granted on an indexed basis which would write off the cost of the quarry to its residual value over its estimated useful life. The allowance could be given either on a straight-line basis or by reference to the rate of extraction.

OTHER ISSUES

7.61 A number of other issues relating to the question of providing incentives through the medium of accelerated capital allowances remain to be considered. These are

(i) the treatment of grants, and

(ii) initial allowances.

[16] The allowance is given on the construction cost (excluding the site cost) which is normally taken as 75 per cent of the total cost.

Treatment of Grants

7.62 Capital allowances on industrial buildings are given by reference to the net cost of the building after deducting any grants received. In the case of plant and machinery, however, the allowance is given by reference to the gross cost. The effect of this is that relief is given in respect of expenditure which the Exchequer has borne. The Department of Finance informed us that

> "this has always been recognised as anomalous but action to rectify the anomaly has been deferred from time to time because it has been contended that any change to a net basis, as applies in most other countries, might jeopardise particular investment projects".[17]

7.63 It is this provision which is the important element in the existence of negative interest rates in certain leasing transactions. In line with our general approach to subsidies to capital investment, we recommend that capital allowances in respect of plant and machinery should in future be given only by reference to the net cost to the promoter.

Initial Allowances

7.64 Initial allowances are granted in respect of capital expenditure incurred on machinery and plant (other than road vehicles) and industrial buildings, whether or not the assets are in use for the purposes of a trade or profession.[18]

7.65 We do not think it is appropriate to allow tax relief for capital wastage of assets which are not in use for the purposes of a trade or profession. Accordingly, we recommend that the initial allowances be discontinued.

Recommendations

7.66 In the context of the general scheme of taxation in our first report we make the following recommendations:

1. Capital allowances in respect of both new and second-hand machinery and plant should be provided on an indexed basis to write off the cost of the asset to its residual value over its estimated useful life. Residual values and estimated useful lives of assets should be

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[17]Letter of 23 November, 1981.

[18]It is proposed to extend to 31 March, 1985 the 100 per cent initial allowance for plant and machinery and the 50 per cent initial allowance for industrial buildings. These allowances were due to expire on 31 March, 1984. Budget Speech, 25 January, 1984.

set down in regulations, following consultations between the Revenue Commissioners and the relevant professional bodies.

2. Capital allowances on lorries and motor vehicles should be given on an indexed basis at a rate sufficient to write off the cost of the assets to their residual values over their estimated useful lives.

3. The present industrial buildings allowance should be withdrawn and replaced by normal depreciation on an indexed basis.

4. Accelerated capital allowances in respect of hotel buildings should be withdrawn and replaced by normal depreciation on an indexed basis.

5. The farm buildings allowance should be abolished and the expenditure on farm buildings treated in the same way as industrial buildings.

6. The investment allowance in respect of expenditure on new ships should not be restored. Ships should qualify for capital allowances on the same basis as other plant and machinery.

7. Accelerated capital allowances in respect of multi-storey car parks should be withdrawn and such buildings treated in the same way as other commercial buildings.

8. Capital allowances should be provided on an indexed basis for toll roads and bridges, so as to write off the cost of the assets over the period of the agreement between the providers of such facilities and local authorities.

9. Allowances for expenditure on dredging should be sufficient to write off the cost of a dredging operation (on an indexed basis) over its estimated life.

10. Expenditure on research and development should be allowable as a deduction in computing trading income for tax purposes, whether or not it is related to the trade.

11. Expenditure on the acquisition of patent rights should be allowed in equal annual instalments (on an indexed basis) over the life of the patent.

12. The exemption from tax of certain patent income should be ended.

13. The allowance in respect of expenditure incurred on the construction of moderate cost rented residential accommodation should be discontinued and such accommodation treated in the same way as other rented residential accommodation.

14. A depletion allowance should be granted (on an indexed basis) which would write off the cost of a quarry to its residual value over

its estimated useful life. The allowance could, at the option of the taxpayer, be given either on a straight-line basis or by reference to the rate of extraction.

15. Capital allowances in respect of plant and machinery should in future only be given by reference to the net cost to the promoter, after taking account of any grants received.

16. Capital allowances should not be given in respect of assets which are not in use for the purposes of a trade or profession. Initial allowances given on the basis of expenditure being incurred should be discontinued.

CHAPTER 8

INCENTIVES AND EMPLOYMENT

Introduction

8.1 The creation of employment is an important aim of economic and social policy. In this chapter we examine a number of incentives geared directly towards job creation. We argued in our first report[1] that the existing system of social insurance contributions encourages the replacement of labour-intensive methods of production by capital-intensive methods, particularly in those businesses which cannot shift the contributions fully to employees. We proposed that the basis of social insurance contributions be changed from payroll to income.[2]

Background

8.2 It is surprising, given the great importance of increasing employment in Ireland, that so few of the incentives which are provided are aimed specifically at this objective. Training grants and the activities of AnCO — the Industrial Training Authority and the Youth Employment Agency are important exceptions to this general rule, as are the employment subsidy schemes which have been introduced on a limited basis to encourage firms to take on additional workers.

8.3 In general, the main thrust of incentives has been to encourage firms to invest in plant and machinery, both to increase capacity and reduce costs, in the hope that this would increase employment in the long run. The fear that incentives which reduce the cost of capital might encourage the substitution of capital for labour, thereby increasing unemployment, has led to proposals for greater neutrality between labour and capital. However, there has been no significant shift away from incentives which reduce the cost of capital or towards offsetting labour subsidies.

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[1]Paragraph 21.28.
[2]This proposal was the subject of a reservation by Mr. Daniel Murphy and Mr. Donal Nevin.

Submissions

8.4 The Consultative Committee of Accountancy Bodies — Ireland put forward a number of tax reliefs which would be geared specifically to increased employment. The main difficulty with schemes of this kind is that they are of assistance only to firms which increase employment and do nothing to assist firms which are maintaining employment in difficult market conditions. Such schemes are also tied to numbers of employees rather than value-added, as would be preferable.

8.5 Some of the schemes proposed to us suggested reductions in social insurance contributions either for firms in particular sectors or for those which increase employment. We have considerable sympathy with these proposals. However, we think that they do not go far enough. We recommended in our first report that social insurance contributions should be replaced by taxes which do not penalise job creation. In addition to our other proposals which would reduce the incentive to employ capital assets, we think that this would provide an environment favourable to job creation.

Relief in Respect of Increase in Employment

8.6 A new relief was introduced in 1982 to give relief to companies which have increased the number of their employees. A company which was trading on 1 January, 1982 is entitled, in computing its trading profits, to a deduction in respect of any increase in its level of employment in the period 1 July, 1982 to 30 June, 1983 over the level of employment in the preceding twelve months. The relief was extended for a further year in respect of increases in employment in the twelve months to 30 June, 1984. The deduction is £10 per additional employee for each week that he is employed by the claimant company for substantially the whole of his time. This means that one new employee for the full year ending on 30 June, 1983, entitles a company to a deduction of £520. Increases in employment will, broadly, be measured by reference to the excess of the number of employment contributions payable by the company in the relevant period over the number of such contributions payable in the base period.

8.7 This relief, which applies only to companies, is unlikely to be attractive to companies liable to tax at the reduced rate on manufacturing profits. The relief operates as a wage subsidy when employment is increasing. It does nothing to conserve employment in sectors which are not expanding. At a tax rate of 50 per cent the incentive is equivalent to the employers' social insurance contribution in respect of an employee earning £2,239 per annum. The proposal in our first report to change the basis of the employers' social insurance contribution from payroll to profits would operate as a powerful incentive to employers to increase or maintain employment. In these circumstances we do not consider that additional incentives aimed at increasing general employment are justified. We recommend that this relief be phased out in line with reductions in the employers' social insurance contribution.

Training Local Staff

8.8 An allowance spread over the first three years of the trade is granted in respect of certain expenditure incurred before the commencement of trading on recruiting and training local staff with a view to their employment in the trade. The conditions attaching to the relief are that

(i) all or the majority of the persons engaged must be Irish citizens, and

(ii) the trade must consist of the production for sale of manufactured goods.

Expenditure which would not qualify as an allowable deduction if incurred while the trade was being carried on is excluded from the relief, for example, capital expenditure as opposed to revenue expenditure. Also, the allowance is given by reference to the net cost, after taking account of any grants received.

8.9 We consider that the training of staff is a business expense. When a business is trading there is no question but that it obtains a deduction for expenditure on staff training. If a business is prudent enough to have its prospective staff trained before commencement of business, it should not be penalised. We recommend that the existing relief be continued.

Employment Schemes Payments

8.10 Payments made to employers under the following schemes are (or were) disregarded for tax purposes:

(i) Employment Incentive Scheme

(ii) Employment Maintenance Scheme (ceased 31 March, 1980)

(iii) Employers' Temporary Subvention Fund (ceased 27 December, 1980)

(iv) Employers' Employment Contributions Scheme (ceased 5 April, 1982), and

(v) Employment Grant under section 2 of the Industrial Development (No. 2) Act, 1981.

8.11 In line with our approach in the case of capital allowances due on assets which qualify for grants, deductions in computing profit for tax purposes in respect of wages and salaries should be net of amounts received under employment schemes.

Recommendations

8.12 In the context of the general scheme of taxation in our first report, we make the following recommendations:

1. The relief granted to companies which increase employment should be phased out in line with reductions in employers' social insurance contributions.
2. Deductions in computing profits for tax purposes in respect of wages and salaries should be net of amounts received under employment schemes.

CHAPTER 9

MISCELLANEOUS INCENTIVES

Introduction

9.1 In this chapter we examine a number of incentives which do not come under the headings we have set out in earlier chapters. These are tax-related lending and incentives for approved schemes of profit-sharing.

TAX-RELATED LENDING

9.2 Apart from overdrafts and term loans, there are five types of finance which are designed to obtain benefits from certain provisions of tax law. These are

(i) leasing,[1]

(ii) preference share financing,[2]

(iii) section 84 type loans,[2]

(iv) loans to certain farmers, and

(v) house-purchase loans.

These are discussed in Chapter 30 of our first report.

9.3 The tax avoidance involved in tax-related lending is serious and there are insufficient controls to ensure that the tax foregone is applied in a way which improves the productive capacity of the economy. Tax-related

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[1]It is proposed that with effect from 25 January, 1984 accelerated capital allowances, that is free depreciation and initial allowances, will not be available in respect of assets leased to customers by financial institutions, except where new leasing forms part of a grant-aided incentive package by the state industrial promotion agencies. The overall amount of leasing will be maintained at about the present level sponsored by these agencies. Budget Statement, 25 January, 1984.

[2]It is proposed that with effect from 25 January, 1984 new 'section 84' lending and artificial preference share financing will not confer a tax advantage. Budget Speech, 25 January, 1984. In cases where it can be established that negotiations had been in progress before 25 January, 1984 and preliminary commitments or agreements entered into between a lender and a borrower before or on that day, such arrangements will be exempt from the restrictions, provided that final contracts are signed not later than 29 February, 1984. Statement by Minister for Finance, 3 February, 1984.

leasing is particularly expensive for the Exchequer compared with section 84 lending. We asked the Revenue Commissioners and the Department of Finance for information on the cost and spread of tax-related lending. They replied that the latest year for which figures from tax records are available in relation to tax-related lending by banking institutions is for lending provided in the banks' accounting period ending 31 March, 1981. The Exchequer cost of these loans arises in 1982. These show that the cost of all such lending is £70 million, of which £45 million refers to tax-related leasing. Figures from tax records are not yet available for later years. However, it is estimated that the cost to the Exchequer of such lending in 1983 was £110 million, of which £60 million refered to tax-related leasing.

9.4 As regards non-banking institutions, the Department of Finance informed us that[3]

> "while it is known that section 84 lending arrangements have taken place between companies and by companies placing deposits with (tax exhausted) banks the interest on which is paid in a section 84 dividend form, such transactions are so recent that no figures are available from Revenue data for the tax loss involved. Interest on all such lending payable after 9 February, 1983, however, is liable for advance corporation tax. While section 84 lending involving individuals is theoretically possible, there is no evidence of its existence."

9.5 We are very concerned that the provision of tax-related lending could become widespread throughout the corporate and personal sectors. Indeed, there are indications that this is already happening.

9.6 In the first report we concluded that banks pass on almost all of the tax savings arising from tax-related lending operations to borrowers. This being the case, tax-related lending schemes are methods through which the Exchequer subsidises, via the banking system, projects undertaken by various sectors.

Leasing

9.7 Under a leasing transaction, an individual, a company or a bank buys the asset and leases it to the user. The principal and interest are paid by 'rentals' at regular intervals — usually rentals are paid quarterly over a five-year period. This is called the primary leasing period. The lessor receives any grants which have been negotiated and can offset the capital allowances on the gross value of the leased asset against its taxable profits. The user gets the benefit of low cost rentals where the lessor's tax saving is fully or partially passed on. At the end of the primary leasing period, a

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[3]Letter of 8 September, 1983.

secondary leasing period commences, during which the asset is available for use by the company at nominal rental cost. This period normally covers the remaining useful life of the asset.

9.8 The Industrial Development Authority (IDA) imposes certain controls on leasing transactions. It limits the amount of grant-aided fixed assets which a promoter may lease. Companies can in general only lease 35 per cent of their grant-aided machinery and equipment needs. In each case the IDA enters into a legal contract with the lessor involved, committing the lessor to pass on the benefit of the capital grant it receives in the form of reduced lease rentals which the promoter pays on the leased assets. Lessors remain contingently liable to repay the IDA grant during the primary leasing period. In approving projects, account is also taken of the estimated cost to the state from such leasing.

9.9 Financing a project by means of leasing of plant is now attractive to all manufacturing companies since the introduction of the reduced rate of tax on manufacturing profits. Previously, this type of financing was used mainly by exporting companies and companies unable to benefit from accelerated capital allowances.

9.10 The retention of this form of industrial incentive was supported in some submissions. These argued that the main benefit of tax-based leasing is that it enables the manufacturer to acquire new equipment for his operations without the necessity of using up his scarce capital. In the context of the economy overall, this has major productivity implications as it allows companies to expand faster than would otherwise be possible, thus creating considerable employment and export opportunities.

9.11 The Department of Finance and the Revenue Commissioners considered that

> "The solution might appear to be an amendment to the legislation to ensure that capital allowances could no longer be claimed by lessors by means of either a full or partial restriction. However, this would involve increased costs for industry in that the subsidised leasing referred to above would no longer be available to the same extent. It might therefore be necessary within possible EEC limitations to provide some other subvention to compensate e.g. an increased cash grant or a loan subsidy."

9.12 Other submissions opposed tax-related lending on the grounds that it reduced the tax liabilities of banks and other financial institutions. As noted in paragraph 9.6, we examined this criticism of tax-related lending in our first report and found that it was not valid.

9.13 Leasing has been attractive because many industrial and commercial companies have little or no tax liability due to the operation of incentive reliefs. Leasing enables such companies to benefit from the reduction in the tax liability of financial institutions and others who have surplus taxable capacity to absorb the benefit of incentive reliefs.

9.14 The recommendations we have already made would reduce significantly the attractiveness of leasing. Our proposal that capital allowances should only be given on the net cost of plant and machinery after deducting any grant received would remove entirely the phenomenon of negative interest rates which have been a feature of certain leasing transactions. Secondly, the replacement of free depreciation with normal depreciation on an indexed basis would reduce similarly the benefits of leasing.

9.15 Apart from these changes we see no reason to restrict leasing which is a legitimate business transaction or to deny capital allowances to lessors. If interest-subsidies are thought to be a necessary incentive for business, we consider that these should be provided directly. This would improve public accountability in this area.

Preference Share Financing and Section 84 Loans

9.16 In cases in which companies had little or no taxable profits, mechanisms have been developed to disguise loan capital as preference share capital in order to benefit from tax credits on distributions out of company profits, including preference share dividends. These have now largely been superseded by other mechanisms. In a preference share transaction the lender ranks as a shareholder. The banks which engage in these transactions only make such facilities available to prime customers. For the borrower, preference shares involve extra costs, such as stamp duty, over those incurred on loan capital. They can only be repaid out of profits or new issues of capital made for that purpose. Due to legal and other administrative charges, the minimum amount that is raised in this way is about £0.25 million. The principal is repaid by redeeming the shares in agreed tranches or by one final redemption.

9.17 Tax-related lending through the issue of preference shares is granted usually to companies which qualify for export sales relief on their profits. Dividends on the preference shares paid out of tax-free profits are tax-free in the hands of the recipient. Most of the tax relief is passed back to the borrower in the form of lower charges. Preference share financing grew until 1977 when it was largely replaced by section 84 loans.

9.18 Section 84 of the Corporation Tax Act, 1976 was introduced as an anti-avoidance measure. Section 84 lending exploited this provision in a way that was never intended. It is based on the definition of 'distribution' in the Act. The result is that certain interest paid (e.g. where the return of the lender is to "any extent dependent on the results of the company business") is classed as a distribution. As such, it is tax-free in the hands of the recipient company, though it is not allowable as a deduction for tax to the paying company. Loans arranged so that they come within the scope of section 84 are of benefit to companies which are not effectively liable for corporation tax.

9.19 The introduction of advance corporation tax in 1983[4] did not reduce the benefit of section 84 loans and preference share financing for companies qualifying for export sales relief or Shannon relief. It reduced the benefit of these arrangements marginally for companies qualifying for the reduced rate of tax on manufacturing profits. It had a significant adverse effect on companies liable at the normal rate of corporation tax, particularly when these are loss-making and have no liability for corporation tax on their profits, against which the liability for advance corporation tax may be set. The question which we must consider is whether or not the advance corporation tax should be refunded in these circumstances to preserve the value of incentive reliefs.

9.20 The main arguments in favour of refunding the advance corporation tax are that it is necessary to do so to maintain the benefit of incentives and also to achieve neutrality between retained and distributed profits of companies.

9.21 In line with our general approach that incentives should be as transparent as possible, we do not favour making refunds of advance corporation tax. We believe that artificial preference share financing and section 84 lending are expensive and highly inefficient forms of incentive. We think that it would be in the general interest to introduce legislation to stop these with appropriate transitional arrangements. Any interest subsidies thought to be necessary should be provided directly.

Loans to Qualifying Farmers

9.22 In March, 1982, a scheme was announced by the Minister for Agriculture to assist some farmers in severe financial difficulty. The scheme entails the charging of a lower rate of interest on certain loans to farmers. Under the scheme the Exchequer reimburses a bank in respect of 50 per cent of the loss, after tax saved, attributable to the reduction of the rate of interest. In the case of a bank which is resident for tax purposes in this country, the Exchequer contribution is made by way of a credit against

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[4]It is proposed to extend the transitional period within which advance corporation tax is payable at 50 per cent of the full rate to distributions made up to the end of 1984. Budget Speech 25 January, 1984.

Irish corporation tax which would otherwise be payable. This applies to Allied Irish Banks Limited and the Bank of Ireland.

9.23 A direct subvention is made in the case of the Agricultural Credit Corporation Ltd., since it is considered most unlikely that the Corporation would have significant taxable profits during the period of the scheme against which to set a credit. There are similar arrangements for banks which operate in Ireland but are not resident here for tax purposes.

9.24 We consider that if relief in certain cases is justified it should be provided by direct subvention to individual farmers. We also find it difficult to see any justification for not using a direct subvention for the two major banking groups when this is used in the case of other institutions. We recognise that this scheme arose out of special circumstances and is unlikely to be repeated. However, we would urge that schemes providing reliefs of this nature should be in the form of direct aid rather than tax based.

House Purchase Loans

9.25 Section 28 of the Finance Act, 1976 provided a special concession to approved banks on their housing loan operations. Under the scheme, a bank's income from house purchase mortgages is charged to tax at a rate of 35 per cent (the rate provided for under section 79 of the Corporation Tax Act, 1976) while its costs are relieved from tax at a rate of 50 per cent. The effect of the tax reduction is to enable the banks to receive a commercial rate of return — the A category loan account rate — while at the same time charging a mortgage rate which is significantly lower than it otherwise would be and which approximates to that charged by building societies. The current rate of interest[5] charged by banks on house purchase loans is 13.75 per cent (as compared with 11.75 per cent for building societies) which combined with the tax concession, gives a gross equivalent interest return of 17.88 per cent. The need for the subsidy is because banks are taxed at a higher rate than building societies.

9.26 This arrangement is in effect yet another housing subsidy. In our first report, we drew attention to the fact that housing subsidies to encourage owner-occupation tended to be weighted towards the upper income groups. This applies also to the subsidy granted through the banking system, since those who obtain housing loans from banks tend to have higher incomes than those who obtain loans from other lending agencies.[6] The result of this subsidy is to direct more funds towards the top end of the housing market. This does not contribute effectively to the declared aims

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[5]Effective from the close of business on 23 September, 1983.
[6]Quarterly Bulletin of Housing Statistics, Department of Environment, Table 18.

of the national housing policy. When banks and building societies are charged to tax at the same rate as recommended in our first report, the relief should be withdrawn.

PROFIT SHARING (EMPLOYEE SHAREHOLDING) SCHEMES

9.27 Under an approved scheme[7] of profit sharing an employee may, without incurring liability to income tax, be appropriated ordinary shares up to a maximum value of £1,000[8] in any one tax year. The shares must, however, be held by a trust established for that purpose, and a participant must agree to his shares remaining with the trustees for a minimum period of two years — described in the legislation as the 'period of retention'. Any payment made by a company to the trustees of an approved scheme may be deducted in computing the company's profits for corporation tax purposes. The amount allowable as a deduction is limited, in the case of a company carrying on a trade, to 20 per cent[8] of the company's trading income for any period, after certain deductions and additions are taken into account. A participant in an approved scheme is not liable to income tax on the value of the shares at the time they are appropriated to him. If he disposes of his shares after the end of the 'period of retention', but within seven years of the date on which the shares were appropriated to him, the participant will be liable to income tax on a percentage of the value of the shares at the date on which they were appropriated to him or (if less) on a percentage of the sale proceeds. The percentage is tapered on a time basis as follows:

	%
Disposals before 4th anniversary of appropriation	100
After 4th anniversary but before 5th anniversary	75
After 5th anniversary but before 6th anniversary	50
After 6th anniversary but before 7th anniversary	25
After 7th anniversary of appropriation	Nil

9.28 Where an employee has reached the social welfare pensionable age (sixty-six years of age) or ceases employment with the company employing him on account of injury, disability or redundancy, the shares may be sold at once. In such a case, where the disposal takes place before the sixth anniversary of the date of appropriation of the shares, the percentage charge is 50 per cent and where it occurs between the sixth and seventh anniversaries the charge is 25 per cent. While a participant may enjoy full or partial exemption from income tax in respect of shares appropriated to him, he

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[7]Relief from tax is only provided in the case of employees who participate in profit sharing schemes which have been approved by the Revenue Commissioners.

[8]It is proposed that the restriction on profits under the scheme be removed and that the ceiling per employee be raised to £5,000. Budget Speech, January, 1984.

will be liable to capital gains tax on a disposal of shares if the proceeds of sale exceed the market value at the date of appropriation.

9.29 A government discussion paper[9] argued that financial participation was seen as a means of promoting greater common identity between employees and their enterprise. The present scheme, introduced in 1982, is designed to give positive encouragement to financial participation through profit sharing in the hope that it "will make a useful contribution to the evolution of a better industrial relations environment."[10] To date only one scheme has been approved under the legislation. There is little or no evidence on whether or not the issue of shares contributes to improved industrial relations.

9.30 The main difficulty with introducing tax relief for shares given to employees is that it distorts the tax system in favour of remuneration paid in that way. Such relief is inequitable in so far as it is confined effectively to employees in large and profitable public companies. Employees in other companies and firms and employees in the public sector are not in a position to benefit. The proposal in the 1984 Budget to increase the ceiling per employee to £5,000 would create significant inequities between classes of employees. Furthermore, substantial benefits can accrue to a company in respect of payments made to the trustees of an approved scheme, where the trustees use the funds to acquire unissued shares in the company concerned. In effect the company gets a deduction in computing its profits for corporation tax purposes without incurring the expense.

9.31 As far as profit sharing schemes are concerned, the principles are clear. Shares issued to employees free of charge or below market value come within our definition of income and, strictly speaking, the employee should be charged to tax at the date of issue on the difference between the value of shares and the amount paid for them. Any further gain or loss in real terms would be picked up on disposal.

9.32 This approach causes certain difficulties in practice. Firstly, it is often quite difficult to determine the value of non-marketable shares. Secondly, employees may not have the cash to pay tax on shares which they are prohibited from realising. On this basis we came to the conclusion that the best approach is to charge the employee to income tax on the full amount of the proceeds of disposal at the date of realisation in cases in which the shares were issued free of charge. In cases where they were acquired at less than market value, the employee should be charged to income tax on the difference between the proceeds of sale and the cost at acquisition indexed

[9]Worker Participation, March, 1980.
[10]Dáil Debates, Official Report, Vol. 325, Col. 1173.

to consumer prices at the date of disposal. This treatment should be applied after the averaging arrangements proposed in our first report have been introduced.

Recommendations

9.33 In the context of the general scheme of taxation in our first report we make the following recommendations:

1. Apart from the changes recommended earlier in this report, we see no reason to restrict leasing or to deny capital allowances to lessors.
2. Refunds should not be made of advance corporation tax where the company has insufficient liability against which to set the advance corporation tax paid.
3. Legislation should be introduced to stop the use of artificial preference share mechanisms and the use of section 84 of the Corporation Tax Act, 1976 to provide loans at special rates.
4. Future schemes providing interest relief to farmers should be given directly rather than tax based.
5. When banks and building societies are charged to tax at the same rate of tax, the special tax concession to approved banks on their housing loan operations should be withdrawn.
6. Employees should be charged to income tax at the date of disposal on the full amount of the proceeds of disposal of shares issued to them free of charge under profit sharing schemes. In cases where the shares were acquired at less than market value, the employees should be charged to income tax on the difference between the proceeds of sale and the cost at acquisition indexed to consumer prices up to the date of disposal.

CHAPTER 10

NEW INCENTIVES AND DISINCENTIVES

Introduction

10.1 In this chapter we examine a number of tax incentives and disincentives which have been suggested to us as desirable. A wide variety of tax reliefs to encourage particular activities was proposed in submissions.

10.2 Most submissions received confined their suggestions regarding incentives to further extending or restricting existing provisions. However, a small number of new incentive schemes were suggested some of which have since been included in legislation, for example, the profit sharing scheme introduced in the Finance Act, 1982, which we discussed in Chapter 9.

10.3 In considering the introduction of an incentive, it is not sufficient, in our view, to show that the activity at which the incentive is directed is worthy and would benefit. If this criterion were accepted, virtually all items would qualify for incentives, since there is almost no activity carried on which cannot be shown to benefit from a reduction in taxation. Taxation is a real cost to be borne by the community for the provision of public services which the people are thought to value. If one activity is relieved of its share of taxation, then other sectors must bear a correspondingly higher share or public services must be reduced. In considering the introduction of incentives for one sector, account must be taken of the disincentive effects on other sectors which bear the cost.

10.4 The corollary of an incentive is the application of a charge on resources which are underused. This would penalise those in a position to use resources if they continued to neglect or ignore their potential. Such charges to encourage owners of assets to maximise their use for the benefit of the community are known as resource taxes. The proper use of natural resources is a legitimate concern of government, which must decide to what extent intervention to secure more efficient use of natural resources is justified in the community interest.

AGRICULTURE

10.5 Agriculture makes a major contribution to the Irish economy. It accounts for about 12 per cent of gross domestic product and for about 18 per cent of the total at work in direct employment. A description of the role of agriculture in the Irish economy is contained in Appendix 26 to our first report.

Utilisation of Land

10.6 Underutilisation of land is a serious problem which must be tackled if the potential for increased agricultural output is to be realised. At present, land of similar potential yields widely different returns. A major task is to raise the returns from land where these are significantly less than the potential yield. Some submissions argued that a land tax or resource tax could assist in raising agricultural output.

10.7 The generally low level of output from Irish farms results from the following problems:

(i) technical and professional training of farmers is inadequate,

(ii) a high proportion of farmers are old, many of whom are unable to manage their holdings efficiently and are unwilling to dispose of them,

(iii) farms, particularly in the west and north-west of the country, are generally small and fragmented,

(iv) too low a proportion of investment is being devoted to breeding stock and to the development of land. This may be due at least partly to distortions in the tax and grant systems,

(v) in general, the price of land is higher than the returns from farming would appear to justify. Not enough land comes on the market for either purchase or long-term leasing. As a result, young and progressive farmers find it almost impossible to acquire land except through inheritance, and

(vi) modern methods of production have not been adopted by sufficient numbers of farmers.

10.8 The question of a land tax or a resource tax on agricultural land has been considered by a number of bodies in recent years. The National

Economic and Social Council[1] examined the implications of a rigorous notional tax system as an alternative to tax based on the farmers' actual income. They agreed that such a system had many advantages. It would be cheap to run and would encourage farmers either to dispose of their land or raise their output. The Council "rather reluctantly abandoned the idea of this tax system" in favour of one based on actual income "because of the greater acceptability of this system on the grounds of equity to both farmers and non-farmers alike".

10.9 The Interdepartmental Committee on Land Structure Reform which reported in May, 1978 also considered the question of a tax on agricultural land. They did so in the following terms:

> "The ideal system of land tax in the context of land use would clearly be one which would penalise only those not making efficient use of land but we recognised that there could be no easy means of identifying such landholders or of administering a tax directed exclusively at them. An alternative might be to apply the land tax generally but to grant remission to those who agree to adopt a farm development plan and who proceed to carry it out satisfactorily. This too would present obvious problems of administration.
>
> We eventually came to the conclusion that, despite the difficulties discussed, a general land tax at a reasonable rate applied across the board could still be justified. A reasonable rate would be one which would bear significantly upon the inefficient but would not be unduly harsh on the efficient land user. Our view is that a flat rate of land tax of about £5 per £.R.V. per annum would not be unreasonable. We recommend the introduction of a tax at that rate and that all rates on agricultural land be abolished on the introduction of this tax — the tax to be waived where the owner releases his lands under a long-term lease".

10.10 The Green Paper "Development for Full Employment" published in June, 1978 pointed out that

> "the principle of a resource tax is attractive in that it would ensure the maximum incentive for farmers to farm intensively because the marginal rate of that tax on their additional income would be zero. It would also act as an incentive to release land to those farmers who are prepared to work it more efficiently".

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[1] *The Taxation of Farming Profits*, Report No. 15, National Economic and Social Council, February, 1976.

10.11 The National Economic and Social Council broadly endorsed this proposal in its comments on the Green Paper.[2] As a result a resource tax on agricultural land was introduced in 1980/81 to apply to holdings with a rateable valuation of £70 and over. Charities were exempted from the tax which was charged at the rate of £3.50 for every pound of rateable valuation. The tax was not allowed as a deduction or credit for income tax purposes. As a result of vigorous opposition to the tax by farmers and farmers' organisations, the resource tax was abolished as from 6 April, 1981. Any resource tax collected was refunded.

10.12 Some submissions urged us to make recommendations which would encourage the transfer of land to young people. If they are not properly trained, young farmers are not necessarily more efficient than older farmers. For this reason, we believe that any incentive which operates to put land in the hands of young farmers should apply only in cases where the young farmer has some relevant qualifications or experience or otherwise is on a list of approved persons.

10.13 The proportion of farmers who can be encouraged into more rapid development by new policies is unknown. This will depend, in part, on the type of policies and the method of implementation. Under any set of policies there will still be farmers who will not respond. Others will develop whether incentives are provided or not. Many farms are quite underdeveloped and their owners lack the motivation to improve. Others may be handicapped by lack of resources — often poor management ability and sometimes inadequate land. The greatest single policy measure which would increase agricultural output could be to put land into the hands of qualified young farmers.

Special Tax Measures

10.14 We now examine a number of measures which could operate to increase the proportion of land in the hands of people who would increase output. These are

(i) the introduction of a resource tax,

(ii) the encouragement of long-term leasing of land, and

(iii) the granting of incentives in the capital taxation code which would promote earlier transfer of land to the younger generation.

10.15 We noted in our first report[3] that the economic argument for special tax measures is that farmers possess a valuable and scarce resource and that

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[2]NESC Report No. 44.
[3]Paragraph 32.21

they should maximise the productive potential of the land in the national interest. The case for special tax measures assumes that tax is fixed at a level which makes it uneconomic for inefficient farmers to continue in business. It further assumes that they will dispose of their land to persons who would use it more productively.

10.16 Following the removal of rates from land, the cost in cash flow terms of holding on to land which is not being used productively is nil. Given the high price of land, the opportunity cost is very high, but this may be ignored by the owners because they feel land has an intrinsic value for them. The great difficulty with a resource tax is that in order to operate effectively it would, at least initially, have to bear most heavily on people whose incomes are among the lowest in the country. Many are elderly and have little or no prospect of alternative employment. They could be expected to hold on to their land unless the level of tax were such as to reduce them to circumstances which many would find unacceptable. A resource tax would be unfair since it would not be related to ability to pay. This is a clear case where equity and efficiency come into serious conflict.

Operation of a Resource Tax

10.17 In the following discussion, we do not deal with all the possible variations of resource tax. Broadly, however, there are two ways in which a resource tax could be applied to land. These would have different consequences and both would have advantages and disadvantages. Any resource tax would initially have to be set at a relatively low level to avoid serious disruption to the industry. The economic and social effects of any resource tax could be considerable and it would have to be complemented by other policies, if it were to be implemented.

10.18 The first method is to charge a specific tax related to the productive capacity of the land. This would be payable by all persons having the use of land, irrespective of the actual income derived from the land or the level of output achieved. The tax could be completely separate from income tax or allowed as a deduction or credit for income tax purposes. Except when allowed as a credit against income tax, all farmers, including the most efficient, would pay more than other taxpayers with similar incomes. This would offend seriously against the principles of equity. If allowed as a credit against income tax, it would be ineffective as a means of inducing farmers who earned a taxable income to improve their output over the minimum required. The net effect would be to penalise those whose earnings were below the tax threshold, whether efficient or not.

10.19 The second method would be to deem a minimum net income to each farm, which, in an alternative form, could be determined by deeming a minimum gross income from which expenses actually incurred could be deducted. Farmers would then be charged to income tax on their actual profits, or deemed minimum income, if this were higher. Personal allowances or credits would be granted in the normal way. A resource tax based on deemed minimum income would not penalise efficient farmers. However, its effectiveness would be severely limited because those farmers whose minimum income was less than their allowances/credit would not be liable. It would affect only some farmers and would do nothing to improve the structure of small holdings.

10.20 Any resource tax would be paid by the occupier (not necessarily the owner) of the land. This follows from the purpose of the tax, which would be to operate as an incentive to the person who has use of the land to increase production to an acceptable level.

10.21 One of the main problems in the way of introducing a resource tax is to devise a suitable basis of assessment. One possibility is the National Soil Survey which is being carried out by An Foras Talúntais. Details of this are in Appendix 7. The main problem with the soil survey is that it is not done to a level of detail sufficient for taxation purposes. Soil maps would generally need to have three times the detail of the existing maps. Estimates vary of the length of time required to complete a survey but it could take of the order of fifteen years.

10.22 A simpler alternative scheme of self-assessment would be to base the tax on the capital value of the farm (at agricultural use) as returned by the farmer. Farmers probably have a good idea of the value of their farms and it might be possible for them to assess this fairly easily. The notional income could then be fixed as a percentage of capital value, taking account of the very low income yield on agricultural assets and adjusted annually in line with changes affecting the industry. Any system of self-assessment would have to have checks and controls to ensure that values were not significantly understated.

10.23 Whether or not there should be an appeals procedure to cover cases in which the farmer failed to meet the required level of productivity due to extenuating circumstances, such as illness[4] or damage to crops caused by weather, would have to be considered. These are factors which might perhaps be covered by insurance schemes. On balance, it seems that the assessment to a minimum charge would put farmers in a special category and that an appeals mechanism should be provided.

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[4]We note that regular and specialised farming services are available on a commercial basis to any farmer requiring relief for any length of time. These services are countrywide and enable farmers to maintain output in cases of illness or holidays. Insurance schemes to cover part of the cost of using the relief services are available.

10.24 There are a number of methods of tackling the problem of under-utilisation of land in addition to special taxation arrangements. These include the provision of advice and education, promotion of farm retirement schemes and acquisition of land by state agencies. Each of these methods has different economic and social implications. Whether or not a resource tax is the most effective means of dealing with the problem is a question we leave open.

Leasing of Land

10.25 A further method of transferring land into the hands of young farmers is to encourage leasing. It has been estimated that some one million acres of land are already let. Most of this is on the eleven month system. It is significant that about one-third of this is let to the same people for periods of five years or more consecutively.

10.26 One of the factors militating against the more widespread use of leasing is the real fear among farmers that leasing might put their ownership of the land at risk. Some fear that the lessee will claim a tenancy interest, which might be upheld by the Land Commission, while others fear that the Land Commission itself might intervene to acquire the land.

10.27 We put these fears to the Department of Agriculture and enquired about their attitude to leasing. They replied that

> "the Minister and the Minister of State have, on several occasions, in the Dáil and elsewhere, given unequivocal assurances that the Land Commission will not seek to acquire lands which are the subject of a bona-fide lease or accept any claims for tenancies in respect of leases made in recent times or from now on. As regards any fear that leasing might put the ownership of land at risk, the Minister of State has indicated his intention of bringing forward next season legislation which would revoke or amend any provisions in earlier legislation (mainly that passed towards the end of the last century) which could inhibit the development of the leasing concept.".[5]

10.28 We think it would be helpful if greater publicity were given to the Land Commission's attitude on leasing and if the legal position were clarified. We now consider whether tax incentives should be used to supplement any efforts to increase the amount of land under long-term lease.

10.29 One possibility is that rental income from leased land could be exempted from tax or charged at low rates. However, total exemption of

[5]Letter of 9 August, 1983.

such income would result in certain persons enjoying very substantial tax-free incomes. This would be very inequitable and difficult to justify. We do not recommend tax concessions in this area.

Capital Taxation

10.30 It has been suggested to us that concessions under the capital taxation code should be introduced in order to promote earlier transfer of land. Under the existing system, there is little or no incentive to do so since most farms are completely exempt from capital taxation on their transfer by way of gift or inheritance. This is due to the relatively high exemption thresholds and the valuation concessions which apply to agricultural land. In some instances there is an incentive to actually delay the transfer of land, since death is not regarded as a disposal for capital gains tax purposes.

10.31 At present, conveyances or transfers of agricultural land which operate as voluntary dispositions are exempt from stamp duty where the transferee is under 35 years of age and is the holder of certain qualifications in agriculture. This exemption was introduced in 1982 and applies for a limited period of two years from the passing of the Finance Act, 1982[6].

10.32 Since its introduction the Revenue Commissioners estimate that the exemption has been granted in 1,100 cases. At least some of these transfers would have taken place in the absence of the relief. It is not possible to determine the amount of land involved in the transfers which have take place.

10.33 We consider that the proposals in our first report would increase the incentive to transfer land to young farmers. The main incentive to do this arises through the annuity method of settling liability to tax on gifts and inheritances which we propose. The operation of this incentive can be seen clearly in the following example.

> *Example:* Take the case of a farm which including stock is valued at £100,000 for purposes of tax on gifts and inheritances. Assuming a nil exemption threshold for tax purposes and a single rate of tax of 30 per cent, the tax liability is £30,000. If the farm is inherited by the farmer's 60 year old brother, the annual payment on an annuity basis for the remainder of the donee's life would be about £5,500.[7] However, if the farm were inherited by the farmer's 20 year old nephew, the amount of the annual payment would be about £3,900, or about 30 per cent less.

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[6] It is proposed to extend this exemption for one year. It was due to expire in July, 1984. Budget Speech, 25 January, 1984.

[7] The calculations assume an interest rate of 13 per cent.

10.34 In our first report we recommended the reduction (or elimination) of exemption thresholds for taxation of gifts and inheritances on a phased basis. An announcement that this would be implemented and the enactment of a timetable in legislation would provide a powerful incentive for the transfer of land over the next few years.

Livestock

10.35 Submissions were made to us that incentives are required to increase the size and quality of the national herd. A large number of direct incentives are provided to achieve these objectives. These are summarised in Appendix 8.

10.36 In Appendix 27 to our first report we set out a number of systems which could be used to value farming stock and which would incorporate an incentive element. These were

(i) the New Zealand system of standard and nil values,

(ii) the United Kingdom herd basis, and

(iii) stock relief.

10.37 We also noted certain problems which would arise if these methods were used. We think that the large contingent tax liabilities which are accumulated under the New Zealand nil value system makes it undesirable to introduce such a system here. We consider that the permanent cost of sales adjustment recommended in our first report is superior to stock relief. Of the three schemes, the herd basis, which applies to breeding herds, does not suffer from these disadvantages and is the preferred system if a tax incentive scheme is thought to be desirable. However, farmers who opted for the herd basis would not qualify for the permanent cost of sales relief.

10.38 We have drawn attention in Appendix 8 to the very large number of schemes which exist to provide incentives to improve the quality and numbers of livestock in Ireland. The advantage of such schemes is their flexibility. They are framed by experts in agriculture who have a close knowledge of the changing needs of the sector and they can be adapted to changing circumstances much more easily than fiscal incentives which, of necessity, have to be much more broadly-based. On this basis we consider that the taxpayer is likely to get better value in terms of increased output if incentives for increasing the numbers of livestock and improving their quality are given directly rather than through means of a tax incentive. We recommend that no tax incentives be introduced in this area since the herd basis and the permanent cost of sales relief are sufficient. In making this recommendation we have taken account of the improvement in the incentives for farming inherent in the basic system of taxation set down in our first report. These arise especially from

(i) the single rate of tax at a relatively low rate,

(ii) the introduction of capital allowances for breeding stock,

(iii) the indexation of capital allowances and losses forward, and

(iv) the improved averaging provisions.

Export Salesmen (Treatment of Earnings from Work Done Abroad)

10.39 A number of submissions suggested the introduction of an incentive scheme for salesmen working abroad, particularly in new market locations, such as the Middle East, where Irish salesmen are reluctant to go. It was pointed out to us that a scheme could be modelled on the scheme introduced in the United Kingdom in 1977, the operation of which is described below. The submissions maintained that it is difficult to keep salesmen in the market place when they are in the position that all their income is taxed and they see their British counterparts enjoying tax relief on earnings. The concession was also advocated for seamen.

10.40 In the United Kingdom a special deduction applies after 6 April, 1977 to emoluments from duties performed abroad by persons who are both resident and ordinarily resident[8] in the United Kingdom. To qualify for the special deduction, the earnings must be in respect of an office or employment the duties of which are performed during the tax year either wholly or partly outside the United Kingdom. In addition, there must be at least 30 qualifying days of absence from the United Kingdom during the year. If these two conditions are met, a deduction of one quarter is made from the earnings for duties performed abroad before they are charged to tax. In general, the whole of a foreign pension is chargeable to tax, less a special deduction of one-tenth of the amount of the pension.

10.41 In certain circumstances the earnings are completely free of tax. This arises where the employee's qualifying period of absence from the United Kingdom consists of at least 365 days, whether the period spans a complete tax year or not. Allowance is made, however, for average annual leave being spent in the United Kingdom.

10.42 Córas Tráchtála advised us that

> "there is a direct correlation between the amount of selling effort put into an export market and the export results achieved. Many Irish companies are finding difficulty in recruiting export salesmen and

[8]See Appendix 9 regarding the terms residence and ordinary residence.

when they are recruited getting them to spend a substantial amount of their time in overseas markets. Salesmen can have a much easier life representing their companies locally, and accordingly will travel overseas as little as possible unless the rewards are substantial".

10.43 We consider that a major part of the problem results from the marginal rates of income tax which are levied in Ireland on incomes which are very low by international standards. In Ireland in 1983-84 about 9 per cent of taxpayers will be liable to income tax at a marginal rate of 60 per cent or higher. In other countries such a high tax rate rarely applies to more than 1 per cent of taxpayers.

10.44 We do not think that special measures to exempt export salesmen from the general tax regime are justified. However, we do believe that marginal tax rates need to be reduced as a matter of urgency. The proposals in our first report to widen the tax base provide scope for achieving significant progress in this area in the near future. The need for a tax incentive relief is also reduced by virtue of the fact that Córas Tráchtála operates a grant scheme towards the costs of establishing sales personnel in overseas markets. The grant up to a maximum of £25,000 is paid to employers. However, an employee established overseas under the scheme would undoubtedly benefit from the reduced costs to his employer in the first year. Full details of this scheme are in Appendix 10.

10.45 Any attempt to confine the relief to *bona fide* export salesmen is likely to be opposed by the EEC as being contrary to EEC law. The relief would therefore have to be provided on a broad basis. This would raise serious questions of equity and could lead to abuse. In these circumstances we do not recommend the introduction of special relief for export salesmen.

Employees Working Abroad

10.46 At present the Irish taxation system provides for special treatment of resident employees who exercise their employment wholly abroad and are paid abroad. Where the normal taxation provisions would give rise to hardship, the Revenue Commissioners are empowered to grant such relief as, in their opinion, is just. In practice, liability to tax is limited to the remuneration remitted to, brought into, or received in Ireland (the remittance basis) in the basis year, which is generally the previous year. The thinking behind this treatment is to attempt in some way to allow for the additional expenses involved in living abroad. In the year in which the employee returns to live continuously in Ireland, his liability is on the remittances out of remuneration paid wholly abroad plus any income which he earns in this country on his return for the remainder of the tax year. Thus, any savings accumulated abroad could be taxable in the year in which the employee returns to live in Ireland.

10.47 Leaving aside the question of any special incentive measures, the remittance basis of assessment in respect of earnings from work done abroad is clearly unsatisfactory. It is not easily understood by taxpayers. This causes difficulties for those contemplating working abroad. In addition, it can give rise to substantial tax charges when an employee returns to live continuously in Ireland. For example, take the case of a nurse who signs a contract to go abroad for four years. If she has accommodation available for her use in Ireland and comes home on her annual holidays, she will be charged to Irish tax on the amounts of money remitted to Ireland. In the type of case we are discussing, these remittances are likely to be small. If during her stay abroad she saves £20,000, this will be taxed as income in the year she returns to Ireland if she repatriates it in that year. This can mean that up to 67 per cent of savings made while abroad can be taken in tax.

10.48 We believe that this situation is grossly unfair. It can lead to great hardship in individual cases in which people take up employment in difficult conditions on the understanding that there are substantial financial benefits, only to find on their return to Ireland that these benefits accrue largely to the Exchequer. In addition, we understand that the Revenue Commissioners have difficulty in some cases in determining the amount of remittances.

10.49 In the United States citizens working abroad are liable to tax on their worldwide income. However, for 1983 the first $80,000 of income is free of tax and this amount will be increased by $5,000 each year until 1986 when the maximum annual exclusion will be $95,000. There is an additional deduction for excess housing expenses.

10.50 We recommend as follows in relation to the taxation of foreign earnings:

(a) where the period of foreign employment does not extend over a full tax year, the earnings should be taxed in the normal way, that is, on the basis of income arising,

(b) where the period of foreign employment extends over a full tax year, the individual's residence status for each tax year, or part of a tax year, in the period should be determined by reference to factors other than the 'place of abode' test and,

(i) if he is non-resident but for the 'place of abode' test, the foreign earnings should be ignored,

(ii) if he is resident, the foreign earnings should be taxed in the normal way, subject to a deduction for reasonable additional expenses incurred in living abroad.

10.51 The main benefits of the changes proposed are a substantial increase in the simplicity of the tax system both for employees already working abroad and those contemplating working abroad and tax administrators. The new system would encourage people working abroad to remit their savings to Ireland rather than to spend them abroad. It would also avoid the problems caused by applying progressive rates in the year in which they are remitted to savings accumulated during the period spent abroad.

Earnings from High Productivity

10.52 A scheme was suggested to us that would charge employee earnings from increased productivity in manufacturing at a lower rate than normal.

10.53 There would be difficulties in measuring increased productivity but it was suggested that these could perhaps be overcome if the employer specified the amount of earnings attributable to higher productivity. Higher earnings from longer hours and overtime working would have to be excluded.

10.54 The form of the relief could be a reduced rate of tax on the specified earnings, either by applying only the reduced rate or reducing part of those earnings for tax purposes by some fraction, such as was formerly done for earned income relief until 1974. The relief would have to be given by repayment as it would have to be based on verified improvements in productivity. If large numbers of employees qualified for the relief, the cost of administering it would be very great.

10.55 An incentive scheme along the lines outlined above could succeed in increasing the rate of growth in productivity. However, such a scheme raises questions of equity between wage and salary earners in individual companies and classes of companies within the manufacturing sector, because the scope for increased productivity differs from company to company and from industry to industry. It also differs depending on whether particular markets are expanding or not. More importantly, it raises the question of equity between those employed in the manufacturing sector and those employed in other sectors of the economy. There would be pressure to extend the scheme to all employees, with the result that the scheme could result in a special allowance for Schedule E employees similar to that introduced in 1980. In our first report we recommended the abolition of the special allowance for PAYE taxpayers once Schedule E and Schedule D taxpayers are charged to tax on a similar basis. In addition, judging by past experience, there is little doubt but that the measures suggested would lead to pressure on employers to pay the largest portion of income in the manner that would attract least tax liability for the employee.

10.56 The single rate of tax recommended in our first report should go a long way towards reducing the present disincentive to increase productivity (and thus earnings) caused by the current high marginal rates of income tax. We are not in favour of extending tax relief to earnings attributable to productivity increases.

Tax Incentive to Combat Absenteeism

10.57 It was claimed in submissions that the present income tax system tends to encourage seasonal absenteeism towards the end of the financial year. The result being that, for many industries, absenteeism is a serious problem. The answer to this problem was seen in the provision of a positive incentive to work continuity by means of a special tax allowance. The allowance would be available to employees who, in the previous year, had lost less than a particular number of working days.

10.58 Workers stay away from work for at least two reasons: they are sick and they must, or they decide voluntarily to stay away. The causes of voluntary absenteeism are not fully understood and the rate of such absenteeism may vary depending on the nature of the work, age, marital status, sex, weather conditions or distance from work.

10.59 The introduction of tax relief to discourage absenteeism would be virtually impossible. The compliance costs imposed on the private sector in supplying information to the Revenue Commissioners to enable them to determine whether relief was due or not would be intolerable. Such a relief might not lead to wholly desirable results in all cases. In seasonal employments, it is sometimes in the interests of businesses if some employees take extended periods of leave at particular times of the year.

10.60 In our view this is a clear example of a case in which a tax relief is a most unsuitable means of tackling a problem. Tax reliefs must be set down in legislation to apply to broad categories of taxpayers in particular circumstances. Of their nature, these provisions must be fairly rigid. They cannot readily be adapted to suit individual circumstances. In our view the problem of absenteeism must be tackled by the individual industry or firm providing incentives at that level related to the seriousness of the problem.

10.61 However, to the extent that absenteeism towards the end of the financial year is due to the taxation system, we believe that the situation will be improved by our proposals to reduce marginal rates of income tax and to charge short-term social welfare benefits to tax. We do not recommend the introduction of a special tax allowance related to attendance at work.

Equity Investment in Small Companies

10.62 Submissions drew to our attention the importance of encouraging private investment in small companies. Such investment is often known under the term 'venture capital'. The term venture capital is commonly taken to include not only high risk investment with potentially high returns, but also development capital investment. It can also be used, however, in a more restricted sense, to describe a way in which new technology, entrepreneurial talent and management resources are sought out and combined to exploit market opportunities. In this sense, the venture capitalist is concerned with fast-growing, innovating companies, mainly though not exclusively in high technology. He creates a portfolio of equity investments, that will be illiquid for a number of years, in companies with whose management he will be continuously and actively involved. When successful, such investments will pay exceptionally high returns in terms of jobs, exports and return on capital invested.

10.63 Venture capital schemes first emerged in the United States where they have assumed an important position. The background to such schemes is set out in Appendix 11.

10.64 A tax incentive was introduced in the United Kingdom in 1981 to encourage investment in small companies. This was greatly extended in 1983 and is now known as the business expansion scheme. This scheme is described in Appendix 12.

10.65 The proposals in our first report would go a considerable distance to creating a climate favouring investment in small firms. The most important recommendations leading to this result are as follows:

(i) the single rate of tax at a relatively low rate would allow greater scope for saving out of taxed income in order to finance the setting up or expansion of small business from personal resources. The introduction of a direct expenditure tax would go a major part of the way towards meeting the objective of the proposed incentive, since small companies would be listed assets. Investment in such companies would be regarded as saving and would therefore be free of expenditure tax,

(ii) the removal of the relative advantage which particular forms of saving attract under the present tax system should result in more funds becoming available for direct investment in small business,

(iii) the change to a full imputation system of company taxation should contribute to increased equity investment in firms by eliminating the present element of double taxation of dividend income.

10.66 We consider that these measures are sufficient to create a substantially improved fiscal climate for investment in business generally and small business in particular. We do not recommend the introduction of additional tax measures which would discriminate in favour of investment in small business over other forms of investment.

Inventors

10.67 The National Board for Science and Technology suggested in a submission that

> "Ireland should promote itself as a country of residence for individual inventors who have made a significant contribution to technological discovery. What the Board have in mind is the type of tax exemption at present provided for writers and artists.".

10.68 This submission illustrates a problem with reliefs such as artists' relief. We have no doubt that there are many categories (and inventors may be among these) whom it is desirable to attract to Ireland for the contribution they could make to economic, social or cultural life. The difficulty is that all such exemptions are to some extent arbitrary. Once one is conceded, a refusal to grant others equally meritorious appears unreasonable. In our first report we recommended that artists' relief be withdrawn. We cannot recommend the extension of that relief to inventors or any other category of individuals.

The Film Industry

10.69 The Department of Industry, Trade, Commerce and Tourism which has overall responsibility for the development of the film industry in Ireland, asked us to consider the introduction of tax reliefs to aid this development. In recent times the growth of film making activities have been encouraged by the establishment of the Irish Film Board, which is empowered, *inter alia,* to provide financial assistance to film makers. However, in many other countries taxation policy is used to encourage film making activities and the Department suggested to us that it might prove worthwhile to examine the tax code in its application to film making to see if there are concessions which could be made to encourage the making of films here that would not be detrimental to the economy.

10.70 The Revenue Commissioners advised us that

> "Films produced in the State are regarded as "goods manufactured within the State" for the purposes of export sales relief and the reduced rate of tax (10 per cent) available to manufacturers. They are regarded as qualifying for those reliefs even though part of the shooting or

processing of the films might, for particular reasons, have to be carried out abroad provided that, *on the whole*, the films could be regarded as having been manufactured in the State. There is no fixed percentage of the production of a particular film which, if carried out abroad, would prevent the film from being regarded as goods manufactured in the State. The question is decided by reference to the facts of each case. It is not considered that a film which is entirely or almost entirely shot and developed outside the State could be regarded as qualifying for the reliefs. It is understood, however, that many (if not all) of the films produced here must be sent abroad (usually to the United Kingdom) for processing, because of an absence of home-based facilities.".

10.71 In order to qualify for the afore-mentioned reliefs, there must be a *sale* of goods. Where there is no outright sale, it has been accepted that the reliefs would apply where the normal rental agreement is adapted in such a way that the proceeds from the exploitation of the film could be regarded as instalments of a capital nature spread over a number of years. The following conditions are, however, required to be satisfied in such cases:

(i) there must be a clear transfer of property in the film and not a sale of rights of distribution,

(ii) the instalments must be for a finite term of years, and

(iii) the primary price and the sum payable on delivery of the film must be substantial sums.

10.72 Some countries with which Ireland has concluded tax treaties will take nominal Irish taxation into account when computing the tax to be paid on repatriated profits. However, this is not the case in the treaties which have been concluded with the United Kingdom and the United States (the two principal English language film making countries so far as Ireland is concerned) so the full rates of tax applicable in these countries is applied on profits repatriated there. This tax concession is not therefore widely used by film makers in Ireland.

10.73 An incentive for film directors and other senior film personnel along the lines of artists' relief was suggested to us. We have already recommended the withdrawal of artists' relief and rejected the extension of a similar relief to inventors. We cannot recommend an exception to this approach for film personnel.

10.74 We note that during the last three years of its existence the National Film Studios of Ireland maintained studios at Ardmore at substantial cost to the taxpayer. This was a substantial incentive. However, we can find little indication that this did anything to help establish a native film industry in Ireland.

10.75 We consider that the film industry should be treated in the same way as other businesses. We consider that there is a sufficient incentive element in our basic structure of taxation to encourage all worthwhile economic activity. This arises in particular from

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

(ii) the allowance of losses against other income.

Tourism

10.76 We received submissions which suggested that tax incentives should be provided to encourage the development of export earnings from tourism. No specific schemes were put forward to assist tourism. It was also suggested that the application to hotel profits of the reduced rate of tax which applies to manufacturing profits might reduce the need for incentive grants for hotels.

10.77 Bord Fáilte is charged with the development and promotion of tourism in Ireland. We believe that the maximum development of the tourist industry is likely to be achieved if all state expenditure on tourism now in the form of direct expenditure or tax reliefs is channelled through a single agency. We also consider that direct expenditure is much more flexible than tax reliefs since funds can more easily be switched from one purpose to another. This is particularly important in tourism where expenditure on promotion must react quickly to changes in market conditions. On this basis, we do not recommend the introduction of tax incentives aimed at the development of tourism.

Expenditure on Energy

10.78 We received submissions proposing that expenditure on energy conservation should qualify for accelerated capital allowances. In particular, it was suggested that a 100 per cent first year allowance might be granted to traders for expenditure on thermal insulation of industrial buildings. In addition, it was proposed that an investment allowance should be granted for the cost of provision of plant and machinery which complied with certain energy efficiency standards.

10.79 We are not in favour of extending tax incentives for energy conservation schemes. The high cost of energy should provide sufficient incentive for people to economise in its use.

Conclusions

10.80 In this chapter we have considered a wide range of tax incentives which were proposed to us in submissions. In general, we consider that these should not be introduced. This is not to suggest that they are without value. However, we believe that in most cases the aid suggested would be

(i) provided more efficiently if given otherwise than through tax incentives,

(ii) unjustified when measured against the loss of equity in the system and the cost to the Exchequer, or

(iii) superfluous when set against the background of the reforms proposed in our first report.

Recommendations

10.81 We make the following recommendations for change in the existing system:

1. In relation to the taxation of foreign earnings:

   (a) where the period of foreign employment does not extend over a full tax year, the earnings should be taxed in the normal way, that is, on the basis of income arising,

   (b) where the period of foreign employment extends over a full tax year, the individual's residence status for each tax year or part of a tax year in the period should be determined by factors other than the 'place of abode' test and,

      (i) if he is non-resident, but for the 'place of abode' test, the foreign earnings should be ignored,

      (ii) if he is resident, the foreign earnings should be taxed in the normal way, subject to a deduction for reasonable additional expenses incurred in living abroad.

Part III

Implementation

E

CHAPTER 11

IMPLEMENTATION

Introduction

11.1 In our first report and in this report we have been concerned to establish a system of direct taxation which is fair, relatively simple and makes a contribution to economic development. The principal benefits flowing from the new system will arise from the elimination of distortions arising from the tax system. Our recommendations will take some time to implement in full. In this chapter we outline our views on how the proposals in this report should be implemented and we make certain recommendations which should be introduced in the transitional period.

Strategy

11.2 The relative attractiveness of investment in the internationally trading sector needs to be improved substantially. One of the themes of this report and of our first report is that there are too many incentives for investment in activities which do not directly contribute to exports or import substitution. Much of this investment is virtually risk-free when compared with the hazards of investing in the internationally trading sector. There is an urgent need to redress the balance in the risks and rewards between different forms of investment in favour of the trading sector.

11.3 The balance of incentives provided to the trading sector must also be changed. At present, too many of these are directed at fixed asset investment. Financial institutions are capable of financing a much greater proportion of such investment. Growth will only take place in the Irish economy if new products are developed and sold on new markets. The development of new products and the research necessary to identify opportunities on foreign markets is extraordinarily risky. It is an activity which it is prudent to finance from equity or risk capital. We believe that state aid should be switched away from fixed assets towards market and product development. We see no reason why the state should not receive a return on successful investments in these areas by means of royalty.

11.4 The central aim of economic policy must be to accelerate the rate of growth in national income. This requires sectoral policies designed to favour entities with high value-added over those with low value-added. Aid must be concentrated on achieving export-led growth.

11.5 Secondly, the amount of state aid must be within the control of the Exchequer. Where public money is being spent, directly or indirectly, the government must know where it is going, how much is being spent and why it is being spent.

11.6 Thirdly, the means of delivering state aid must be linked closely with the needs it is designed to meet. If this is done, it is likely that the costs of state aid will be reduced and its efficiency greatly increased. To take a simple example; if a company has a cash flow problem which, in the national interest, is thought to merit help from the Exchequer, aid should be provided by means of loans or loan guarantees. Such aid would be more suitable than tax relief on profits. In this instance, if the primary need is to improve cash flow, there is no need also to improve profitability. To take another example; if the need of a particular firm is for long-term capital because the nature of the investment is one in which the returns are insufficient in the short-term but greater in the long-term, the solution is to enhance current income. This could be done by interest subsidies or by providing deferred capital, that is to say, capital with a moratorium on capital or interest payments. Both these methods would be more efficient than capital grants.

Phasing

11.7 It is not possible to be very precise about the transition towards implementing our recommendations without making certain assumptions about other matters which influence industrial policy.

11.8 The first issue relates to the policy to be pursued by government in relation to the nominal exchange rate. Where the Irish pound has become overvalued, in that it does not reflect movements in relative prices over some period, firms in the exposed market sector will have been squeezed by costs in Ireland rising faster than revenues in foreign markets. Some public sector aid then becomes necessary to avoid the loss of efficient businesses. If exchange rate policy is geared primarily to the requirements of the exposed market sector, the need for aids or incentives for this sector will be less.

11.9 Pay costs, productivity and the value of the currency, all affect competitiveness and the distribution of national income between consumption and profits. Therefore, the precise transitional arrangements with regard to the incentives that are provided must be decided by government in the light of the policies it is pursuing and the developments in these areas. We can only offer some general guiding principles.

11.10 We recommend that the proposals in this report should be implemented in two phases. Phase one should coincide with the implementation of phase one in our first report. It should include measures to increase the relative attraction of investment in the trading sector.

PHASE ONE

11.11 The following measures would be appropriate in phase one:

(i) reduce accelerated capital allowances in respect of multi-storey car parks and new purpose built moderate cost rented residential accommodation,

(ii) replace the special tax concessions for schemes to encourage profit sharing with the measures proposed by us in Chapter 9, and

(iii) introduce direct aid for expenditure on market development.

Key Foreign Workers

11.12 The great difficulty of attracting foreign workers with special skills to work in Ireland has been raised with us. It is argued that this is a serious impediment to growth since new projects or major expansions of existing projects are often dependent on key individuals being prepared to work in Ireland for a period of years. We have been told that to give an executive earning £18,000 sterling in the United Kingdom the same standard of living in Ireland, he must be paid over £40,000 gross in Irish pounds. In certain cases, the full rigours of the Irish tax regime do not apply, for example, where the employee is not domiciled in Ireland and is employed under a foreign (non-Irish and non-United Kingdom) contract of employment and is paid abroad.

11.13 We have considered the possibility of applying the tax system proposed in our first report at an early date to temporary residents with special skills working in Ireland. This system comprises a personal tax credit or allowance, a single rate of income tax (say, the present standard rate) and a progressive expenditure tax. Special tax treatment already applies in Belgium to temporary residents whose functions require special skills and responsibility or to those persons for whom recruitment in Belgium is impossible or at least extremely difficult. The tests used in Belgium to identify those who should qualify for the special tax regime might be appropriate in Ireland. In addition to substantially increasing the attraction of working in Ireland to key foreign workers, such a scheme would have major advantages. It would remove a significant impediment to growth. Secondly, it would enable the Revenue Commissioners to obtain experience in drawing up the legislation for an expenditure tax and operating it. We are confident that this would allay their reservations[1] about the general feasibility of such a scheme and bring to light areas of difficulty which might arise when the tax was being applied generally.

11.14 The best solution to this problem is the early introduction of the proposals in our first report for everyone.

Venture Capital

11.15 We note the proposal in the 1984 budget statement

> "to allow income tax relief up to a specific ceiling each year for individuals who provide long-term risk capital for new manufacturing enterprises.".

11.16 We examined this issue in Chapter 10 and recommended against the introduction of such a relief in the context of the proposals in our first report. In the short-term such a scheme is one method of increasing the attractiveness of investing in the exposed sector. Whether it is the best method of doing so is a matter of debate. Such a scheme would further erode the tax base. If this proposal is implemented, it is imperative that the relief be tightly drawn to prevent tax avoidance. We also think that any relief in this area should be temporary.

Market Development

11.17 Throughout this report we have, by and large, recommended against the introduction of incentives. However, we consider that incentives for market development, particularly overseas market development, are vital and should be introduced in phase one. We do not think that these should be tax-based but rather should be given directly. The state should obtain a royalty on sales.

PHASE TWO

11.18 The following proposals might fall into phase two which should coincide with the implementation of phase two of our first report.

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[1]First report, paragraph 18.25.

(i) Restrict capital allowances on plant and machinery to the net cost after taking account of any grants received.

(ii) Change the basis of allowances for depreciation of plant and machinery from free depreciation to normal depreciation on an indexed basis.

(iii) Replace accelerated capital allowances on industrial buildings and hotels by normal depreciation on an indexed basis.

(iv) Abolish the initial allowance in respect of expenditure incurred on plant and machinery which has not yet been brought into use.

(v) Repeal the exemption of certain patent income and allow the cost of acquiring a patent to be written off on an indexed basis over its life.

(vi) Charge co-operative societies to tax on the same basis as other entities.

OTHER ISSUES

11.19 A number of other issues relating to the transition from the present to the new tax system remain to be dealt with. These are

(i) the transitional arrangements for depreciation,

(ii) existing commitments, and

(iii) the treatment of dividends paid out of manufacturing profits.

Transitional Arrangements for Depreciation

11.20 Many of the changes we recommend in the area of incentives refer to capital allowances. In general, we are opposed to accelerated depreciation which we consider should be replaced by depreciation at normal rates on an indexed basis.

11.21 A major question which arises in considering a change from free depreciation to normal depreciation on an indexed basis is how plant and machinery and other assets should be treated if they had already been fully written off for tax purposes. There are two possible approaches to this issue.

11.22 Table 3 compares the implications for cash flow of free depreciation and normal depreciation on an indexed basis. The example taken is a simplified one. It assumes regular investment of 1,000 in constant year 1 prices. Depreciation is taken over 5 years on a straight-line basis. Inflation is assumed to be 5 per cent per annum. On the basis of these assumptions, it is clear that when investment is increasing, free depreciation is more favourable than normal depreciation on an indexed basis. However, in a 'steady state' that is, assuming a constant rate of inflation and a constant volume of investment, the amounts of relief under the two systems eventually become equal.

TABLE 3

Comparison of Free Depreciation and Normal Depreciation on an Indexed Basis

Year	1	2	3	4	5	6
Investment	1,000	1,050	1,103	1,158	1,216	1,276
Free Depreciation	1,000	1,050	1,103	1,158	1,216	1,276
Indexed Depreciation	200	210	221	232	243	—
	—	210	221	232	243	255
	—	—	221	232	243	255
	—	—	—	232	243	255
	—	—	—	—	243	255
	—	—	—	—	—	255
Total Indexed Depreciation	200	420	663	928	1,216	1,276

11.23 Because normal depreciation on an indexed basis would give a business lower tax allowances when investment is increasing (e.g. in the start-up period), the business would have to borrow more, or invest more equity capital, in order to finance any given level of investment. The shortfall would not be made good until the business ceased (or ceased to invest). Therefore, the net assets of the business would, even in the 'steady state', be less than they would be under free depreciation.

11.24 If normal depreciation on an indexed basis were extended to existing assets on the basis of their written down values, assuming normal depreciation, the effect would be to move the system directly in the transitional year (year 1) to the 'steady state', illustrated by the figures for year 5 onwards in Table 3. Such a scheme would change the total flow of tax between business and the Exchequer only to the extent that there was a change in the total level of investment by business as a whole. However, unless the level of investment by individual businesses was also constant, the level of tax borne by individual businesses would vary substantially. In particular, such a scheme would benefit those who had invested in the past, compared with those who were currently expanding and modernising their business capacity. If the new system were related to the written down values for tax purposes, there would be a significant flow of cash to the Exchequer in the transitional period. While this could be offset by other measures, some businesses would be worse off.

11.25 If the change in the basis of depreciation were confined to new investment only, special provisions would be necessary to allow relief for assets which had not been fully written off. Under this system there would be an additional burden on business in the early years which would reduce thereafter. This transitional cash flow effect could be mitigated by reducing the rate of corporation tax or by other changes in the transitional period. While this would compensate business as a whole, there would still be major shifts in the burden of tax on individual businesses. Most of the benefit would probably go to businesses which had not suffered significantly from the change in depreciation arrangements.

11.26 In general we favour the change which would cause the minimum disruption. It seems to us that this is achieved if normal depreciation on an indexed basis were extended to existing assets on the basis of their written down values, assuming normal depreciation. We so recommend.

Existing Commitments

11.27 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 could not recommend that the state should breach unilaterally contracts of this kind.

11.28 A particular problem arises with our recommendation to change the basis of social security taxation from payroll to profits in that this would certainly breach contractual obligations given to some companies qualifying for export sales relief. In certain cases, it could also be in conflict with obligations under the reduced rate of tax for manufacturing profits.

11.29 We consider 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 to retain their present entitlements to a lower rate of tax under the old system. All new manufacturing companies should be entitled to opt for either the old or new systems until the end of the year 2000. Once a company opted for the new system it could not switch back again.

11.30 Profits for tax purposes would be determined on the same basis under both systems. However, under the old system, employers' social insurance contributions would continue to be chargeable on the basis of payroll. The employees of such firms would be taxed in exactly the same way as all other taxpayers.

Dividends paid out of Manufacturing Profits

11.31 In general, dividends paid out of profits charged to corporation tax at the reduced rate applying to manufacturing profits carry a tax credit of 1/18th of the dividend payable. This credit, which accounts for some 50 per cent of the tax borne by the company on such profits, may be set off against liability to income tax by domestic individual shareholders. The fact that the tax credit is considerably lower than the normal credit of 35/65ths gives rise to an increased bias in the scheme towards the retention of profits rather than their distribution as dividends.

11.32 The Revenue Commissioners informed us that, to secure acceptance by the EEC Commission of the reduced rate of tax on manufacturing profits, it was necessary that the relief should extend to profits earned from both export and domestic sales of goods manufactured in the state. Given, therefore, that the new relief would extend to a considerably larger aggregate of profits than did export sales relief, the Government decided that distributions out of profits relieved under the new scheme should be liable to income tax in the normal way.

11.33 The position now is that profits from manufacturing which are distributed to individual shareholders[2] bear virtually the same amount of tax as other income. It is only if those profits are retained that there is any special tax treatment. Thus, the manufacturing relief may be characterised as a deferral of tax rather than an exemption, unlike export sales relief which was fully passed on to the shareholders.

11.34 The question arises whether or not it would have been better if the relief were neutral between retained and distributed profits. This would have required a higher rate of tax than at present on retained profits. The Revenue Commissioners informed us that the treatment which was adopted was expected "to encourage companies to re-invest their higher post-tax profits".

11.35 We examined the issue of the taxation of retained profits in our first report. We concluded that the system should be neutral in its treatment of retained and distributed profits, on the grounds that we could find no evidence

(i) that a higher rate of tax on distributed profits encouraged retentions, and

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[2]This does not apply to export sales relieved profits which are free of tax in the hands of shareholders.

(ii) that, even if profits were retained, this led to better investment decisions than if they were distributed.

11.36 In our view, the decision to favour retained manufacturing profits was mistaken. Given the cost of aligning the treatment of retained and distributed manufacturing profits, we see little alternative to retaining the relief in its present form.

11.37 We also think that it is undesirable that profits chargeable to tax at the reduced rate should not qualify for full imputation of tax borne at the company level, when these are distributed to shareholders. We recommend that the rate of imputation on such distributions be increased from one-eighteenth to one-ninth.

11.38 We also recommend that companies be required to deduct sufficient extra tax on such distributions so that shareholders liable to tax at the single rate would have their tax liability on such income deducted at source. This would significantly reduce compliance costs and ease administration. Persons who were not liable for tax would reclaim tax from the Revenue Commissioners in the normal way.

The Primary Fund

11.39 The legislation providing for a reduced rate of tax on manufacturing profits introduced a new concept of a primary fund to the corporation tax code. This fund consists of a company's profits actually taxed at the new reduced rate, less that reduced tax, plus dividends received by that company which carry the reduced tax credit. Dividends paid by a company enjoying the relief are deemed to be paid initially out of the primary fund for calculating the tax credit attaching to the dividends. The effect of this is to ensure that the reduced tax credit refers to all dividends paid by the company up to the amount of the manufacturing income which qualified for relief after deducting the tax on that income. When the manufacturing income after tax is fully exhausted, dividends are treated as paid out of non-manufacturing income or reserves which did not qualify for relief and the normal rules as to tax credits apply to these dividends. Where dividends paid on a particular date exceed the amount of the primary fund on that date, each dividend is treated as issuing partly from the primary fund and partly from other profits.

11.40 The Consultative Committee of Accountancy Bodies — Ireland submitted that

> "What seems particularly harsh about the "10 per cent" dividend provision is the concept of the "primary fund" whereby dividends are regarded as coming out of profits which have borne 10 per cent

corporation tax. Further, the primary fund is cumulative. It would not seem unreasonable to regard dividends as being paid out of all of a company's profits for a particular year. This would give the fairest result".

11.41 The Institute of Taxation in Ireland advised us that

> "We strongly oppose the present procedure under the 10 per cent rate of tax for manufacturing companies which deems dividends to come firstly out of 10 per cent taxed profits. All companies which have accumulated reserves out of profits which have borne full corporate taxes should be able to distribute these to their shareholders if they so wish. Dividends, payments and consequently the related tax credits attaching to these payments should be treated for tax purposes in accordance with commercial and company law principles. A company has the right to determine which profits it will distribute and tax legislation should not restrict this right".

11.42 We put these points to the Revenue Commissioners who replied that, in the absence of advance corporation tax, it was necessary to establish an order of priority for distributions by companies which qualified for relief under the scheme. Otherwise, companies would have treated distributions as coming primarily out of unrelieved profits, since these would have carried higher tax credits.

11.43 When advance corporation tax is fully operative, priority need not be given to distributions out of relieved profits. Distributions could be treated as coming proportionately from all of the income of an accounting period in respect of which a distribution was made, including relieved profits.

11.44 The introduction of advance corporation tax[3] makes a significant difference to this question. In the absence of advance corporation tax, the primary fund was criticised because it provided for lower tax credits and also because it gave priority to distributions carrying the lower tax credit. While shareholders of manufacturing companies might still wish to have the primary fund removed, so that tax credits would be increased, companies would in such circumstances face a larger liability to advance corporation tax.

11.45 The introduction of advance corporation tax does not remove the need to identify distributions carrying a low tax credit, that is, those out of relieved profits. However, when advance corporation tax is fully operative, so that tax credits are fully matched by corporation tax actually paid, the

[3]Finance Act, 1983.

Revenue Commissioners informed us that consideration could be given to removing the concept of the primary fund. We recommend that this be done.

11.46 Advance corporation tax will not be fully operative until the large body of existing section 84 loans benefitting from transitional provisions have run their course. These loans are those involving financial institutions, where the obligation to pay interest was entered into before 9 February, 1983 or before 9 June, 1983 pursuant to negotiations which were in progress on 9 February, 1983. There are other transitional provisions which ensure that advance corporation tax will only apply fully to distributions made after 8 February, 1984.[4]

Recommendations

11.47 In addition to our other recommendations, we make the following recommendations with regard to the transitional aspects of our proposals.

1. In making the transition from free depreciation to normal depreciation on an indexed basis, normal depreciation on an indexed basis should be extended to existing assets on the basis of their written down values, assuming normal depreciation.
2. All existing companies with entitlements under the legislation providing for export sales relief, Shannon relief or the reduced rate of tax on manufacturing profits should be entitled to opt for either the old or new tax systems until the end of the year 2000. If they opted for the old system, they would pay tax at a special rate but the employers' social insurance contribution would continue to be chargeable on the basis of payroll.
3. Profits chargeable to tax at the reduced rate applying to manufacturing profits should carry full imputation of tax borne at the company level when these are distributed to shareholders.
4. Companies should be required to deduct sufficient extra tax on dividends paid out of profits which have borne the reduced rate of tax on manufacturing profits, so that Irish resident shareholders liable to tax at the single rate would have their tax liability on such income deducted at source.
5. When advance corporation tax is fully operative so that tax credits are fully matched by corporation tax actually paid, the concept of the primary fund, which is established under the legislation provid-

[4]It is proposed to extend the transitional 50 per cent reduction in advance corporation tax for distributions made before the end of 1984. Budget Speech, January, 1984.

ing for a reduced rate of tax on manufacturing profits, should be removed.

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
6 February, 1984

*Subject to Reservations — see pages 143-145.

RESERVATION

by

MR. DONAL MURPHY

Paragraphs 6.18 to 6.20 and 6.36

The agricultural co-operative societies have made major and sustained contributions to agricultural and rural development.

The special tax treatment applying to co-ops has been very significant to the co-ops in assisting them to carry out their role as development agencies. The financial benefits in the hands of all the members are taxable.

The spin off effects of co-op development in terms of employment and ancillary business is as great as the direct benefits to farmers.

As the co-ops differ from private business concerns in their objectives and in their outlook, and as they operate under rules and laws which are quite different to those applying to private business, special tax treatment of co-ops is necessary if they are to be allowed to fulfil their roles.

I do not therefore support the recommendation that co-op societies operate under the same taxation arrangements as other businesses.

Paragraph 10.24

I believe that sustained economic increases in the output from farm land can be achieved only through programmes of education and training of farmers, thereby raising their technical and managerial skills. They cannot be achieved through a resource tax, or through a general tax system that makes increased farm productivity less worthwhile.

Paragraph 10.13 recognised that "The greatest single policy measure which would increase agricultural output could be to put land into the hands of qualified young farmers".

I believe a strong tax incentive is absolutely necessary to achieve this.

DONAL MURPHY

6th February, 1984

RESERVATION

by

MR. PATRICK P. O'NEILL

The recommendation that "the herd basis and the cost of sales relief are sufficient" is correct when the national herd has reached the level desirable to obtain maximum economic advantage for the national economy. In my view, owing to the present level of the national herd, which in its present numbers and quality is not maximising the economic advantages, incentives greater than those recommended in the report will be required to reach the desired level.

PATRICK P. O'NEILL

6th February, 1984

RESERVATION

by

MR. DANIEL MURPHY and MR. DONAL NEVIN

We believe that policies must be devised to ensure the optimum utilisation of our natural resources especially land and that a resource tax can be an instrument to achieve this end. We see a resource tax being introduced as a means of ensuring the full utilisation of the land by farmers. It can not in itself be regarded as a revenue-earning measure. Indeed to the extent that it succeeds in the former objective, it will yield little or no revenue.

It is, therefore, in the context of promoting the efficient use of our land resources that a resource tax should be considered and not as a revenue-yielding measure in itself.

DANIEL MURPHY,
DONAL NEVIN

6th February, 1984

Appendices

APPENDIX 1

LIST OF SUBMISSIONS

The following submissions were received after the publication of our first report.

Bord na gCon.
Bord Scannáin na hÉireann.
Drinks Industry Group.*
Dublin Central Co-operative Society Ltd.
Electrical Industries Federation of Ireland.
Electricity Supply Board.*
Institute of Advertising Practitioners in Ireland.*
Irish Tobacco Manufacturers Advisory Committee.*
National Association for the Protection of the P.A.Y.E. Worker.
Éamon O Smilí, Uasal.

Some organisations which made initial submissions and were listed in our first report raised further points of relevance to this report.

*The asterisk indicates that in addition to making a written submission these organisations also made an oral presentation.

APPENDIX 2

INCENTIVES AND RELIEFS IN THE EXISTING TAX CODE

Introduction

1. In this appendix we set out the historical development of the incentives and reliefs provided in the existing direct tax code. This does not mention detailed changes in the scope of various reliefs over the years. It serves only to indicate the rapid growth in incentives since the mid-nineteen fifties. We also include estimates of the cost of various reliefs. In addition to tax reliefs, the state provides a very large number of direct incentives mainly in the form of grants. The more important of these are summarised in Appendix 3.

Historical Development

2. Certain features of the direct tax code in Ireland, which would now be regarded as incentives, pre-date the foundation of the state. The main relief in this category is life insurance relief introduced in its present form by Gladstone in 1853.

3. The tax system inherited from Great Britain at the commencement of the fiscal year 1923-24 was retained in essence. However, certain changes were made—often in association with similar changes in British legislation. The main developments since 1923 in the provision of incentives are outlined in the following paragraphs.

4. The Finance Act, 1923, exempted from liability to income tax the interest on savings certificates.

5. The change of government in 1932 brought with it a new policy of encouraging the development of a wide range of native industry behind protectionist tariff barriers. As part of this policy, Section 7 of the Finance Act, 1932, provided for a relief to the extent of 20 per cent of the tax payable on interest and dividends arising to individuals resident in Ireland from shares in certain manufacturing companies. This was abolished in 1983. There were no other major incentives provided under the direct tax code until after the end of the Second World War.

6. After 1945 there was an increased use of the tax system to encourage developments which were considered desirable. In 1946, tax relief was given in respect of expenditure incurred on scientific research. The Finance Act, 1953, increased from one-half to two-thirds of the premium the maximum rate of relief allowable in respect of premiums on life insurance policies effected with an insurance company managed and controlled in Ireland. Relief was given in 1955 in respect of payments of medical insurance premiums.

Fiscal Policy and Industrial Development

7. Industrialisation was fostered initially by a policy of production mainly for the home market. This policy led to a considerable increase in industrial employment but, by the middle of the nineteen fifties, it had become apparent that it offered no scope for further expansion. From then on the use of the tax system as an instrument to encourage economic development increased very markedly.

8. Following the report of the Committee of Inquiry into Taxation on Industry[1] a large number of incentives for industrial development were introduced. Some of these were recommended in the Committee's report. The Finance Act, 1956, provided for the granting of initial allowances of 20 per cent of capital expenditure incurred after 5 April, 1956 on the provision of new machinery or plant (excluding road vehicles) or of ships whether new or second-hand. In an effort to encourage savings the Act exempted from tax the first £25 of the total interest arising from deposits with the Post Office Savings Bank, the Trustee Savings Banks or the main commercial banks established at that time.

9. The Finance (Miscellaneous Provisions) Act, 1956, brought in a wide range of provisions to encourage economic development. These included temporary relief from tax on the profits of mining operations and relief from tax on profits of companies derived from increases in exports of Irish manufactured goods. An industrial buildings allowance of 10 per cent of capital expenditure incurred after 24 September, 1956 on the construction of certain industrial buildings or structures (including hotels) was also provided. In 1957, a shipping investment allowance of 40 per cent of capital expenditure on new ships was introduced. Many of the allowances for capital expenditure for industrial purposes were increased later.

[1]Pr. 3512 March, 1956.

Changes Since 1958

10. In 1959, a tax benefit was provided in relation to covenanted subscriptions to a university, college or school in the state or to a trust fund, where the moneys were devoted to the teaching of the natural sciences. Relief was also given in respect of capital expenditure on the acquisition of patent rights.

11. The Finance Act, 1967, introduced a new relief related to a taxpayer's expenditure under certain heads on the provision of health care for himself or any of his dependants. The Act also introduced free depreciation for new machinery and plant (excluding road vehicles) provided for use in designated areas mainly in the western part of the country.

12. In 1968, the tax charges under Schedule A in respect of the ownership of property and under Schedule B in respect of the occupation of land were abolished. Payments made to employees under the Redundancy Payments Act, 1967, were also exempted.

13. In 1969, tax exemption was granted to certain earnings of writers, composers, dramatists, painters and sculptors resident in the state and who produce an original and creative work which the Revenue Commissioners determined to be a work having cultural or artistic merit. Stallion fees and profits from woodlands were also exempted from tax in 1969.

14. Free depreciation for machinery and plant (excluding road vehicles) was extended to the whole country in 1971. At the same time an investment allowance of 20 per cent was introduced for machinery and plant provided for use in a designated area. In 1973, income derived from patent royalties was also exempted, where the work in connection with the devising of the patented invention was carried on in the state. Payments made (by persons carrying on a trade or profession) to an Irish University for the purposes of enabling it to undertake research in, or engage in the teaching of industrial relations, marketing or any other subject approved by the Minister for Finance were allowed as a deduction for tax purposes.

15. In 1974, a number of exemptions were terminated. The tax exemption of profits from certain mining operations was abolished and a new scheme of tax allowances introduced in its place. The general exemption of farming profits was also repealed.

16. In 1975, stock relief was introduced. This provided for relief from tax in cases in which there was an increase in the value of a company's trading stock in an accounting period. The relief took the form of a deduction

calculated on the amount of the increase in value of the trading stock (including work-in-progress) in an accounting period, less 20 per cent of the trading profits for the period before deduction of capital allowances or losses. The relief was confined to Irish resident companies engaged wholly or mainly in manufacturing, construction, or farming, or in the sale of machinery and plant (excluding passenger vehicles) or goods to persons (whether companies or individuals) for use by those persons for the purposes of trading activities falling wholly or mainly within the manufacturing, construction or farming sectors. Stock relief was extended to unincorporated traders in the qualifying sectors in 1976. The Finance Act, 1976, also exempted from tax employment premiums paid under the Employment Premium Act, 1975.

17. From the mid-nineteen seventies, the importance of tax-related lending to the funding of industrial policy grew rapidly. Tax-related lending instruments[2], such as leasing, preference share financing and section 84 loans, enable borrowers to benefit from certain tax incentives which would be of little or no value to them otherwise[3].

18. Free depreciation was provided for capital expenditure incurred by farmers on or after 6 April, 1977, on the construction of fences, roadways, holding yards, drains or on land reclamation. The Finance Act, 1977, also provided a new incentive to encourage the expansion of employment and output in manufacturing industry in the state by way of a temporary reduction of the normal corporation tax rate on the income of qualifying companies to 25 per cent. Subject to certain limitations, the new rate was applied to companies which achieved a 5 per cent increase in the volume of their sales and a 3 per cent increase in their level of employment in the financial year 1977, as compared with the financial year 1976. It was provided that the special rate of 25 per cent would not apply to companies engaged in mining or construction operations.

19. The Finance Act, 1978, extended for a further two years the temporary reduction to 25 per cent in the rate of corporation tax for certain manufacturing companies which achieved specified increases in sales and employment. For 1977, as an alternative to the volume of sales test, it was provided that a company might claim relief if the amount receivable from sales in 1977 was not less than 119 per cent of the amount receivable from sales in

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[2]These instruments are described in detail in Appendix 24 to our first report.

[3]Tax-related lending is analysed on pages 388 and 389 of our first report and is also discussed in Chapter 9 of this report.

1976. For the financial years 1978 and 1979 the sales tests were dropped and it was provided that relief would be given to manufacturing companies which achieved annual increases in employment of 3 per cent in those years.

20. Free depreciation was provided for industrialists and hoteliers in respect of capital expenditure incurred by them on or after 2 February, 1978 on the construction of industrial buildings and hotels (where the hotel was registered with Bord Fáilte) to be occupied for the purposes of a trade carried on by them. A provision was also introduced whereby a trader who, for the purposes of his trade, contributed to capital expenditure incurred by a local authority on an approved scheme of effluent control, became entitled to capital allowances in respect of his contribution.

21. The Finance Act, 1979, provided relief for individuals in respect of the cost of labour, after deduction of any grant attributable to such cost, up to a maximum of £450[4] included in expenditure on work carried out by a registered person on the maintenance or improvement of the residences of those individuals. This relief lapsed in 1983. Provision was also made to allow premiums paid under permanent health benefit schemes subject to certain limitations.

22. A new incentive scheme for manufacturing companies came into operation on 1 January, 1981, whereby the rate of corporation tax charged on their profits was reduced to 10 per cent. This scheme which was designed to replace export sales relief for new companies setting up in Ireland will run to the end of the year 2000.

23. In 1981, a new special allowance of 100 per cent in respect of expenditure incurred on the construction of moderate-cost rented residential accommodation was introduced. The allowances for industrial buildings (with the exception of free depreciation) were extended to capital expenditure incurred on multi-storey car parks. Capital expenditure incurred on toll roads, bridges and viaducts under an agreement with a road authority was granted the benefit of an allowance of 50 per cent.

24. The Finance Act, 1982, provided tax relief for expenditure on significant buildings in the state. The relief applies to the owner or occupier of an approved building for expenditure incurred after 5 April, 1982 on repair, maintenance or restoration. The expenditure is treated for tax purposes as if it were a loss in a separate trade carried on by the owner or occupier and the normal tax treatment of losses is applied.

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[4]This was increased to £900 for a married couple jointly assessed by the Finance Act, 1980.

25. An approved building is one determined by the Commissioners of Public Works to be intrinsically of significant scientific, historical, architectural or aesthetic interest. To qualify for relief, reasonable access to the building must be afforded to the public.

26. In 1982, an incentive was introduced for approved profit sharing schemes under which employees could obtain shares, up to a maximum value of £1,000 in any tax year, without incurring liability to income tax.

ANNEX 1

COST OF EXISTING TAX INCENTIVES IN 1981/82

1. In this annex we set out the latest estimates of the tax foregone through the granting of various tax reliefs and incentives. These estimates relate to the year 1981/82, which is the latest year for which such information is generally available. Where the estimates relate to a different year, this is indicated. It should not be assumed that if a particular incentive is abolished, the amount of tax shown would be collected, since the behaviour of taxpayers could change.

TABLE 2.1

Cost of Tax Reliefs 1981/82

	Tax foregone[1]
	£m
Interest on personal borrowing (including mortgage interest)	52.5
Medical insurance relief	6.5
Life insurance relief	10.5
Health expenses relief (1981)	0.45
Expenditure on residential premises	1.5
Premiums under permanent health benefit schemes	0.25
Artists' relief	0.5
Roll-over relief	0.8
Relief for disposal of farm by person over 55 years	0.2
Compulsory Purchase Order relief	0.1
Shannon relief	10.0
Export sales relief	106.0
Income from certain industrial companies to individual investors	0.4
Reduced rate of tax on manufacturing profits	29.0[2]
Excess of accelerated depreciation over normal depreciation for plant and machinery[3]	74.0
Cost of capital allowances in respect of[4]	
—Industrial buildings	6.5
—Hotels	0.75
—Farm buildings	1.0
Income from stallions	not available
Income from woodlands	negligible
Allowances for certain purpose - built rented accommodation[5]	nil

Source: Revenue Commissioners.

[1]If these reliefs were abolished the revenue foregone would not recessarily accrue to the Exchequer, since some of the activities would not arise at all in the state in the absence of the reliefs.

[2]This is the gross full year cost of the scheme in pure corporation tax terms, based on assessments raised in 1981/82. In terms of pure tax receipts the cost is estimated at nil in 1981, £17 million in 1982 and £39 million in 1983.

[3]The cost of accelerated depreciation for plant and machinery is the cost over and above that of the basic annual allowance which would be conceded if accelerated depreciation were not available.

[4]It is not possible to isolate the accelerated element of the depreciation in the case of industrial buildings, hotels and farm buildings.

[5]The earliest year in which a cost is expected to be incurred is 1983 when the tax foregone is estimated to be of the order of £2 million. The cost of the relief estimated at £2 million for 1983 is a partial cost in respect of dwelling units completed and let since 29 January, 1981. The full cost of the relief in respect of the total qualifying expenditure incurred up to the end of 1982 is estimated to be £18 million but this is expected to be spread over a number of years.

APPENDIX 3

DIRECT INCENTIVES

1. The state provides through direct expenditure a large number of services which could conceivably be provided by people themselves and which could be assisted through the provision of tax incentives. The most important of these, at least in terms of the amount of public money devoted to them, are health and education services. However, in addition to direct state expenditure, significant incentives are provided to private individuals mainly in the form of direct grants and assistance schemes to encourage such individuals to engage in various activities. In this appendix we outline some of these schemes.

DEPARTMENT OF AGRICULTURE

2. The Department of Agriculture is involved in the operation of a considerable number of aid schemes for the farming sector. Some of these schemes are purely national and are funded fully by the state, while others are governed by EEC regulations and are paid for wholly or partly by the Community.

Farm Modernisation Scheme

3. The EEC Farm Modernisation Scheme distinguishes three categories of farms as follows:

(i) development farms on which the income per labour unit is currently below that of non-farm workers but which are capable of development so as to yield the required level of income,

(ii) commercial farms on which the income per labour unit is already above that of non-farm workers, and

(iii) farms which at their present stage of development do not come into either of these categories.

The range and levels of aids available under the scheme vary according to the category concerned.

4. The main criterion for determining farm category is the relationship between income per labour unit on the farm and the national average income of all non-agricultural workers. The latter is known as the comparable income and is revised every year. The latest estimates (1983) of comparable income are:

Area	Comparable Income
	£
Co. Dublin	7,068
Eastern Region	5,766
Western Region	4,960

5. Development farmers must submit for approval a farm development plan to show that the farm can be developed within six years so as to yield the required comparable income per labour unit. In addition, the farmer must be clearly dependent on farming as his main occupation and main source of income. He must have reasonable experience and skill in farming and must keep farm accounts.

6. Commercial farmers are required to have farming as their main occupation and main source of income. Farmers who are not in the commercial category and who are not at present in a position to follow a development plan which will achieve the comparable income are eligible for aids provided farming constitutes an important activity for them and yields a significant portion of their income.

7. The aids available under the scheme include, as well as investment aids for the different categories of farmers, priority access to lands released under the Farmers' Retirement Scheme (see Annex I) and launching aids for certain types of farm groups.

Investment Aids

8. Farmers have the option of availing of aids either in the form of a capital grant or an equivalent interest subsidy.

The overall range and levels of aids under the scheme as at January, 1984 are as follows:

Development Farmers

Land improvement	30 per cent capital grant (40 per cent in disadvantaged areas).
Fixed Assets.	25 per cent capital grant.
Buildings.	25 per cent capital grant.

Commercial Farmers

Land improvement. Fixed Assets. Buildings.	An interest subsidy equivalent to a capital grant of 15 per cent.

Other Farmers

Land improvement. Fixed Assets. Buildings.	25 per cent capital grant.

Limitations on Investment Aids

9. No aid is available for the purchase of land or for the purchase of pigs or calves for slaughter or for investment in poultry and egg production. Otherwise investment aid is subject to an overall investment limit of £41,600 per labour unit and subject to such absolute limit as the Minister for Agriculture may from time to time lay down for different types of enterprise.

Farm Groups

10. Certain joint investment works such as common outfall watercourses to facilitate the drainage and reclamation of land which are undertaken by a farm group (i.e. two or more farmers) are catered for under the scheme. A special launching aid is available to groups of farmers set up with the object of providing mutual aid between the members of the group or to bring about a more rational use of investment on the farms of the members of group farming operations. The aid is intended as a contribution towards the initial cost of management of the group. The amount will vary between £2,120 and £6,350 depending on the number of participants in the group, the nature of the joint work they plan to undertake and the extent of the group's organisation and management costs.

PROGRAMME FOR WESTERN DEVELOPMENT

11. A special programme for the stimulation of agricultural development in the West of Ireland applies to the counties of Donegal, Leitrim, Sligo, Mayo, Galway, Monaghan, Longford, Cavan, Roscommon, Clare, Kerry and to parts of West Cork and West Limerick. The following is a summary of the main aids directly available to farmers under the programme.

Land Improvement

12. Grants are available to all farmers for—

(a) Commonage Division — fencing, reclamation, surface treatment and access roads.

(b) Hill and Mountain Pasture improvement — fencing, reclamation, surface treatment and access roads.

(c) Lowland Reclamation (other than drainage which is catered for under the Western Drainage Scheme).

Grants: 70 per cent for land improvement.
80 per cent for necessary roads.

Orientation of Agricultural Production

13. Grants are available for farm buildings and structures. Groups of farmers may also obtain grants for sheep-dipping and shearing facilities.

This measure is open to all farmers who

—practice farming as their main occupation,

—are not able to attain the comparable income under the Farm Modernisation Scheme,

—are not eligible to avail of the Farm Retirement Scheme, and

—undertake to follow a farm improvement plan with the emphasis on the expansion of cattle and sheep numbers and keep simplified accounts in the prescribed form from the start of the plan.

Grants: 35 per cent for farm buildings.
25 per cent for structures.

Calf to Beef Interest Subsidy

14. Farmers following improvement plans orientating cattle production towards an integrated calf to beef system can qualify for an interest subsidy not exceeding 16 per cent on a loan of up to £100 per animal for 2 years on each calf entering the system in the first and second year of the plan.

Shelter Belt Scheme

15. Grant aid is available towards the cost of establishing shelter belts which will lead to the improvement of farms.

Grant: Up to 80 per cent of approved cost of trees and fencing (maximum of £800 per hectare).

INTEREST SUBSIDY SCHEMES

EEC Interest Subsidy Scheme

16. This scheme provides a subsidy of 5 per cent per annum for two years on loans arranged to finance on-farm development. The amount eligible for the subsidy is the net grant-aided investment by the applicant or the outstanding balance of the loan whichever is the lesser. Eligibility for the scheme is confined to farmers classified as Development under the Farm Modernisation Scheme and to farmers following Improvement Plans under the Programme for Western Development. Expenditure incurred under the scheme will be recouped from the EEC at the rate of 50 per cent in the West of Ireland and 25 per cent in the remainder of the country.

National Interest Subsidy Scheme

17. This scheme, which is wholly financed by the Exchequer, applies to farmers participating in the Farm Modernisation Scheme who are not in the Development category. The rate of subsidy is 5 per cent per annum on loans contracted between 1 January, 1976 and 31 December, 1980 to finance on-farm development. The maximum loan eligible for a subsidy is £50,000. The amount which qualifies for subsidy is the net grant-aided investment or the outstanding balance of the loan whichever is the lesser and is limited to a subsidy of one year except for participants in the Reduced Interest Scheme for farmers in severe financial difficulty who qualify for aid up to a maximum of two years.

Reduced Interest Scheme for Farmers in Severe Difficulty

18. This scheme is designed to aid potentially viable farmers (in the Farm Modernisation Scheme) who have borrowed to invest in agricultural development, but who found themselves in severe financial difficulty. It provides an interest reduction of up to $8\frac{3}{4}$ per cent for three years on eligible borrowings taken out between 1 January, 1976 and 31 December, 1980. Borrowing must be for buildings, stock, fixed and mobile equipment, land improvement or working capital. Loans for land purchase may be eligible in some cases. Farmers with net assets in excess of £200,000 will not qualify, and the maximum loan which qualifies for subsidy is £100,000. The receipt of applications closed on 15 June, 1982.

INVESTMENT AID IN DISADVANTAGED AREAS

19. A special aid system designed to improve farming in mountain, hill and other less favoured areas is provided in the Western Region and mountain sheep areas in the remainder of the country.

The following additional aids apply in these areas:

(i) increased investment aids for development farmers only,

(ii) aid to development farmers for investments undertaken by them on the farm in a tourist or craft industry,

(iii) joint investment schemes for silage production, and

(iv) investment schemes for improvement of pasture and hill grazing lands farmed jointly.

OTHER LAND IMPROVEMENT AIDS

EEC Lime Subsidy Scheme

20. An EEC Lime Subsidy Scheme came into operation on 18 May, 1981 and continued for two years from that date. The scheme was subsequently extended to 30 April, 1984. The subsidy is designed for the improvement of pastures and meadows through better liming. The rate of subsidy is £2.76 per tonne on lime delivered to the farm. The subsidy is allowed to the farmer by the supplier at the time of sale and is shown clearly as a separate entry on the sales document.

Soil Testing etc.

21. A soil analysis enables a farmer to ascertain whether his soil is deficient in any of the nutrients or elements needed for successful production and safeguards him against the loss involved in applying fertiliser dressings which are not needed. The results of the tests, with any comments and recommendations, are sent to the local Instructor in Agriculture who will then advise the farmer as to the manuring and liming necessary for the crops intended to be grown.

DEPARTMENT OF FISHERIES AND FORESTRY

22. Grants are available from the Department of Fisheries and Forestry to encourage private planting of trees. A grant of £125 per acre is payable in three instalments over eight years. Additional grants are available for scrub clearance and for the planting of broad leaved species and poplars.

23. The EEC Western Package to stimulate agricultural development in the West of Ireland includes an element to promote forestry. Grants of up to £800 per hectare of the approved costs of the afforestation of land which is marginal for agriculture but suitable for forestry are available. This grant is payable in two instalments over four years.

24. Bord Iascaigh Mhara operates a Marine Credit Plan to help fishermen to buy fishing vessels. Grants and loans are available toward purchase of new and secondhand vessels in addition to fishing gear, electronic equipment and improvement of vessels.

25. Bord Iascaigh Mhara operates a grant scheme to encourage the development of fish farming. Grants are also available from the Department of Agriculture under the Farm Modernisation Scheme to qualified applicants towards the construction of freshwater rainbow trout fish farms. However, this scheme was suspended in February, 1983 and is being reviewed in the Department of Agriculture.

INDUSTRIAL DEVELOPMENT AUTHORITY

26. The following grant schemes are provided directly by the IDA. Expenditure figures shown include activities by the Shannon Free Airport Development Company (SFADCo) in Mid-West Regions on behalf of the IDA.

Capital Grants

27. The most important incentive offered by the IDA comes in the form of capital grants towards the acquisition of fixed assets, which can be granted at the discretion of the IDA Board up to a value of £2.5 million. Any amount greater than that requires government approval. Under Sections 33 and 34 of the Industrial Development Act, 1969, as amended, grant levels range up to 45 per cent of the costs of eligible fixed assets in non-designated areas and up to 60 per cent in designated areas.

28. In 1982, £77.4 million was paid out to firms in capital grants towards acquisition of fixed assets.

Grants for Leased Fixed Assets

29. The IDA is empowered to provide grant assistance towards the capital costs of fixed assets leased by companies on the same terms as capital grants. £19 million was paid in 1982.

Interest Subsidies

30. The IDA is empowered to make grants towards reducing the interest payable on loan capital raised to provide fixed assets, or in the case of Enterprise Development projects, loans for working capital. Until recently the subsidy allowed was generally 5 per cent on interest paid on loans over 5 years. Recently the subsidy has been increased to 10 per cent over the same period. £5.3 million was paid by IDA in 1982.

Loan Guarantees

31. The IDA is empowered to guarantee the repayment of loans borrowed by companies in respect of fixed assets. Working capital may be guaranteed in enterprise development projects. These guarantees are given as part of the overall package offered to a company and by and large are given in the case of companies being grant aided under the Enterprise Development Programme (but not exclusively so). The IDA paid £0.7 million in loan guarantees in 1982.

Re-Equipment Grants

32. The IDA is empowered to give grants towards the cost of fixed assets required for re-equipment, modernisation, improvement etc. This scheme applies to firms undertaking re-equipment and expansion programmes with a view to achieving higher levels of efficiency and productivity by availing of new technological developments in manufacturing processes. The grant rates applicable range up to 25 per cent in the non-designated areas and 35 per cent in the designated areas. In addition, cumulative grants in excess of £1.25 million for any one company require government approval.

33. This programme was discontinued by the Government on 22 January, 1982. Commitments made to companies by the IDA under the scheme before this date will be honoured in full and formal applications for assistance lodged before the discontinuance are being processed as previously. £8.4 million was paid in re-equipment grants in 1982.

Training Grants

34. The IDA may make grants for the training of persons in the process of an industrial undertaking. Training grants are made in consultation with AnCO who assess the training programme and monitor its effectiveness. This is an important incentive for new industries and is usually offered as part of an overall inducement package. Grants can cover up to 100 per cent of the costs. £20.2 million was paid in training grants in 1982.

Research and Development Grants and Feasibility Study Grants

35. The IDA is empowered to make grants towards the costs of research and development projects. These grants are designed to encourage all companies to engage in R & D work so as to improve their existing products or method of manufacture. Grants of up to 50 per cent of non-capital costs such as wages/salaries, materials and consultancy fees are available subject to a maximum of £500,000 expenditure.

36. Feasibility grants were introduced in February, 1979 to encourage existing manufacturing companies or individuals and community groups to undertake feasibility studies or new industrial projects. Grants of 50 per cent are available on expenditure on salaries, travel costs, prototype development and consultancy fees up to a maximum of £30,000 expenditure. Feasibility grants are not available to overseas companies considering Ireland as an investment location. £3.5 million was paid in R & D and feasibility grants in 1982.

Equity Participation

37. The IDA may purchase or take shares in an industrial undertaking out of funds at its disposal. Such shares are registered in the name of the Minister for Finance. £2 million was spent on equity participation in 1982.

Rent Subsidies

38. Rent subsidy grants are available to firms or grantees who rent the premises in which the grant aided undertaking is being carried on. Again, these subsidies are given only as part of an overall grant package.

39. The grant is approved at a percentage rate of the agreed eligible rent and is normally paid over a 3 or 5 year period. The amount of eligible rent depends on the type of building and its location.

40. The grant rates applicable range up to 60 per cent in the designated areas and up to 45 per cent in the non-designated areas, (except in the case of re-equipment grant packages where the rates are 35 per cent and 25 per cent respectively). £2.8 million was paid in rent subsidies in 1982.

Land and Factories

41. The IDA may also provide sites, buildings, services and facilities in any part of the country (excluding Shannon Customs Free Airport). Advance factories and industrial land are a vital part of the IDA incentive package. Factories are provided directly by the IDA to suitable clients either for rent or cash or deferred purchase. Factories are also provided on an agency basis by IDA and rent guarantees are given in respect of factories built under private sector finance arrangement.

42. £68.9 million was expended by the IDA on the provision of land and factories (including work in progress at the end of the year) in 1982.

SHANNON FREE AIRPORT DEVELOPMENT COMPANY

43. SFADCo provide a range of grants and other incentives to companies located in the Shannon Free Zone and to small indigenous projects located throughout the Mid-West Region. These grants can be outlined as follows:

A. *Shannon Free Zone* — the following grants are payable to companies locating, or already located, in the Free Zone, pursuant to Sections 8 and 9 of the Shannon Free Airport Development Company Limited Act, 1959.

Capital Grants are available to a maximum level of 100 per cent towards the cost of sites and buildings, but in practice payments are subject to a limit of 50 per cent of the total cost. Grant payments may also be made in respect of new production machinery and equipment to a maximum level of 50 per cent of total costs.

Training Grants of up to 100 per cent of the cost of approved training programmes for employees of new companies are available. These include the costs of overseas training, travel and subsistence expenses incurred during training, management training expenses and the cost of employing training consultants.

Research and Development Grants are available to a maximum level of 50 per cent of the cost of R & D projects undertaken at Shannon, including the development of new or improved industrial processes or products.

Rent Reduction Grants in the form of a rental subsidy are provided. While there is no limit to the amount of grant assistance that can be provided under this scheme, in practice payments are subject to a maximum of 50 per cent of rental charges.

Feasibility Grants are available to assist existing companies to ascertain the feasibility of manufacturing new products. A limit of 50 per cent of expenditure on salaries, travel and general expenses, including consultancy fees, is applicable.

Energy Conservation Grants are available to companies who purchase allowable equipment to reduce energy costs to a maximum of 50 per cent of the cost of equipment.

Grant payments made to companies in the Shannon Free Zone in 1982 amounted to £4.4 million.

B. *Small Indigenous Industry Projects* —the following grants are payable to small indigenous companies (defined as companies with fixed capital investment not exceeding £500,000 and projected employment of less than 50 people) in the Mid-West Region pursuant to the terms of an IDA/SFADCo Agency Agreement which operates within a legal framework as afforded by IDA legislation.

Capital Grants are available towards the cost of fixed assets such as sites, buildings and new production machinery and equipment. The limit on grant payments of this type varies from 45 per cent of total costs in non-designated areas (i.e. east of Shannon) to 60 per cent in designated areas (i.e. west of Shannon).

Training Grants are provided on the same basis as for Shannon Free Zone Companies.

Research and Development Grants are available on the same basis as for Shannon Free Zone Companies but the limit of the grant varies from 45 per cent to 60 per cent of total costs depending on the designation of the area in which the project is located.

Rent Reduction Grants are available on the same basis as for Shannon Free Zone Companies but the limit of the grant varies from 45 per cent to 60 per cent of total costs depending on the designation of the area in which the project is located.

Feasibility Grants are available on the same basis as for Shannon Free Zone Companies.

Energy Conservation Grants are available on the same basis as for Shannon Free Zone Companies but the limit of the grant varies from 45 per cent to 60 per cent of total costs depending on the designation of the area in which the project is located.

An Enterprise Development Programme is also available to help suitably qualified people to start their own small businesses. Professional persons such as accountants, engineers, scientists and experienced managers are the most likely to qualify for this type of assistance. Projects must be in the manufacturing area with the end products being either consumer or industrial goods. All the grants provided under the Small Indigenous Industry Programme are available under the scheme but additional incentives comprise:

(i) Loan guarantees in respect of working capital and

(ii) Interest subsidies in respect of working capital.

SFADCo equity investment can also be arranged in certain circumstances.

DEPARTMENT OF ENERGY

44. The Department of Energy administers a number of energy-related incentive schemes. Under the fuel efficiency survey scheme, grants are provided to cover up to one-third of the cost of engaging consultants to manufacturing and service industries and hotels.

45. A scheme of grant assistance to encourage the development of privately-owned bogs was introduced by the Turf Development Act, 1981. This scheme which is administered by Bord na Móna is to cover the cost of access roads, bog drainage and the purchase, lease or hire of turf development equipment to be used for bog development. The scheme provides for a grant of up to 60 per cent for development by groups of persons. In other cases the grant does not exceed 45 per cent.

46. The EEC Western Package incorporates an element providing grants of up to 80 per cent to cover the cost of extension or improvement of electricity supply.

47. Grants are available for the installation of bottled gas equipment in rural households. The scheme was introduced in April, 1982 to assist householders in rural areas who, because of their remote location, are unable to obtain electricity at reasonable cost. The maximum grant of £35 is payable in respect of initial installations. Householders with bottled gas equipment already installed may be eligible for a grant up to a maximum of £15 for the purchase of additional bottled gas equipment.

DEPARTMENT OF FINANCE

48. The Department of Finance administers the Western Development Fund. This Fund is designed to promote economic development in thirteen western counties that is all Connacht, Donegal, Cavan, Monaghan, Longford, Clare, Kerry, West Limerick and West Cork. The Fund seeks to assist projects of an economic rather than a social nature, for which the promoters will provide part of the capital costs involved and which have a sound prospect of being viable. Assistance is given only in the form of grants.

49. Where projects are identified as fitting within a particular sector, an attempt is made to keep the grant in line with the general level of state assistance in that sector. Quasi-industrial projects qualify for grants up to the limit of 60 per cent available from the Industrial Development Authority for eligible industrial projects in the West. Quasi-agricultural projects are aided within the limits of the Farm Modernisation Scheme (30 to 40 per cent). These are not set limits. A project could qualify for a higher grant if the circumstances warranted it.

50. Examples of projects assisted from the Fund are

—various agricultural and handcraft co-operatives, in respect of capital costs and expenses of management,

—co-operatives engaging in turf cutting, in respect of the cost of turf cutting machines,

—local airports, Shannon ferry, Dursey Island Cableway,

—regional studies, county promotional campaigns in Great Britain,

—Outdoor Pursuits Centre, Sherkin Island,

—demountable factory buildings, and

—fishery research station.

DEPARTMENT OF THE ENVIRONMENT

51. The Department of the Environment administers a number of schemes to assist in the provision and improvement of housing and sanitary services.

Housing

52. A grant of £1,000 is payable to all first-time buyers of new homes which qualify for a Certificate of Reasonable Value issued by the Department. A £3,000 mortgage interest subsidy is also payable over three years to all first-time purchasers of new houses. Purchasers of second-hand houses who were on a local authority approved housing list are also entitled to the interest subsidy.

House Improvements

53. Grants are available for the carrying out of certain improvement works as follows:

(a) £200 for the provision of a water supply (non-group scheme),

(b) £200 for the installation of sewerage facilities (non-group scheme),

(c) £600 for the building of a chimney and the provision of a fireplace with back boiler in a house without a chimney,

(d) £600 for the provision of a bathroom (or fixed shower),

(e) £600 for the provision of an extra bedroom to relieve overcrowding, and

(f) £600 for major necessary repairs to the basic fabric of the house, mainly roofs, walls and floors.

Where the scheme of work involves the provision of both a bathroom and a bedroom the combined maximum is £1,000. The amount of the grant may not, in any case, exceed two-thirds of the approved cost. In order to qualify for these grants an inspection of the house must be carried out before work is commenced.

Group Scheme Installations

54. The grant is assessed at a rate of two-thirds of the estimated cost of the work subject to a maximum of £300 per domestic water supply, £200 per potential farm supply and £250 for a sewerage installation.

In certain Western counties the grant is assessed at a rate of 80 per cent of the estimated cost of the work subject to a maximum of £600 per domestic water supply and £400 per potential farm supply where work commenced on or after 15 April, 1981. The scheme runs until 30 June, 1985.

Special Grants

55. Adaptation of houses to facilitate handicapped or severely mentally ill occupants: A County Council or County Borough Corporation may pay a grant of up to two-thirds of the cost of necessary structural works up to a maximum of £4,000. In the case of a rented local authority house the grant may be up to the full cost of the works.

Essential Repairs: A County Council may pay a grant for certain essential repairs to prolong the life of a house in a rural area that is not capable of being brought up to the full standard at a reasonable cost.

Loans

56. In addition to the loans available from commercial agencies (e.g. building societies, commercial banks and assurance companies), local authorities may in certain cases advance loans for the erection of new houses, the purchase of previously occupied houses and the reconstruction of existing houses. Loans of up to £14,000 are normally available to farmers whose total valuation does not exceed £44 and other persons whose income in the tax year prior to application for the loan does not exceed £7,000.

Local Improvements Scheme: Road and Drainage Works

57. State grants are made available to County Councils to carry out certain improvement works which jointly serve groups of two or more landholders. These include the construction and improvement of accommodation (i.e. non-public) roads serving farmhouses or lands and also bog roads and the cleaning of small water courses serving lands or bogs.

ANNEX I

THE FARMERS' RETIREMENT SCHEME

1. In this annex we set out details of the retirement scheme for farmers which is operated by the Land Commission.

Purpose of Scheme

2. The scheme is designed to enable farmers, particularly those over the age of 55, who are either unable to continue in or who wish to give up farming, to retire with the help of special financial aids. Their land would thus be made available for structural reform to farmers participating in the Farm Modernisation Scheme or for afforestation, recreational activities, public health or other public purposes.

Eligibility

3. Farmers are eligible to participate in the scheme who are the owners or occupiers of agricultural land and can show to the satisfaction of the Land Commission that they

—have worked in agriculture on that holding for a period of at least five years immediately prior to application,

—have devoted during this period at least half their working hours to work in agriculture on the holding,

—have derived from work in agriculture on the holding during this period at least half their earned income, and

—have owned or occupied the holding continuously for a period of five years prior to their application.

4. A resident farmer who, by reason of age or infirmity or, for any other compelling reason, has had to let his holding during the qualifying period and who has no other earned income, is eligible provided he meets the other qualifications. In the case of a widow, farming must have become her main occupation through the death of her husband and she (or she and her late husband between them) must have worked in agriculture on the holding for at least five years prior to her application.

Limit on Size of Holding

5. For widows and disabled farmers there is no area limit. For other farmers there is an upper limit of 18 adjusted hectares on the size of holding which can qualify. If no other suitable land to meet the needs of a development farmer in the area is available the Land Commission may include a larger holding. This can also be done if it is proven that the income derived from the holding is substantially lower than a normally worked farm of 18 hectares.

Conditions to be met

6. To qualify, an applicant must sell his holding or lease it for a minimum of 12 years to a farmer whose approved development plan under the Farm Modernisation Scheme provides for the acquisition of more land, subject to the approval of the Land Commission.

7. Applicants must undertake to cease agricultural activity leading to marketing of agricultural products and not to hold, take, lease or otherwise acquire any holding of agricultural land or employ any person in agricultural activity. If the applicant is married the spouse must give a similar undertaking.

Financial Incentives

8. If the applicant is under 55 years of age a premium is granted of 10 per cent of the purchase price subject to a maximum of £1,500 or twice the annual lease rent subject to a maximum of £3,000.

9. If the applicant is over 55 years of age the same premium is granted plus a life annuity of £2,016 for a married applicant or £1,344 for a single person, widow or widower. Should a married applicant in receipt of an annuity die, the surviving spouse will receive a life annuity of £1,344. The annuity may be increased from time to time to take account of increases in the consumer price index.

10. Where a holding is occupied by a person other than the owner, then the occupier, if he is over 55 years and his main occupation is farming will, on vacating the holding, qualify for a life annuity of £2,016 or £1,844 provided the owner sells or leases the holding as outlined in paragraph 6. The owner will then qualify for the premium.

11. The dwellinghouse and an accommodation plot of not more than one hectare may be kept by the owner, or by the occupier with the owner's consent.

12. A grant not exceeding £100 may be paid to vendors to resolve title difficulties.

13. The lands offered for sale must be judged by the Land Commission to be suitable for the purposes of structural reform.

APPENDIX 4

EEC MEMBERSHIP AND INCENTIVES

Introduction

1. In this appendix we set out the obligations arising from Ireland's membership of the EEC in regard to the provision of incentives.

The EEC Dimension

2. Since Ireland joined the EEC in January, 1973, state aids granted by Ireland are subject to the provisions set out in Articles 92 to 94 of the Treaty of Rome. These are set out in Annex I. Article 92 (3) states

> "The following may be considered to be compatible with the Common Market
>
> (a) Aid to promote the development of areas where the standard of living is abnormally low or where there is serious unemployment".

3. Protocol 30 to the Treaty of Accession specifically recognised that

> "in the application of Articles 92 and 93 of the Treaty, it will be necessary to take into account the objectives (in Ireland) of economic expansion and the raising of the standard of living of the population".

On this basis it is clear that Ireland has a right to grant significant incentives to secure economic development.

4. The EEC Commission has a role to play with regard to the level and type of aid granted. Firstly, it may determine the basic compatibility of the type of aid with the provisions of the Treaty of Rome. Secondly, it may co-ordinate the level of aids granted in different regions depending on their development needs.

5. If the EEC Commission finds an aid incompatible with the Treaty of Rome, it may direct the member state to abolish it. In the case of non-compliance with such a directive, the matter can be referred to the EEC Court of Justice. In the late nineteen seventies, there was concern that export sales relief granted in Ireland was incompatible with the Treaty of Rome but no decision to that effect was ever taken. The EEC Commission

agreed to the arrangements for the phasing out of export sales relief which ensure that no firm will benefit from the relief after 1990. Given this agreement, there is now no question as to the broad compatibility of the type of aids granted in Ireland with the Treaty of Rome.

6. The EEC Commission is also entitled to set ceilings on the level of aid granted in a particular type of region. The objective is to prevent wasteful bidding between member states or regions. The highest ceiling is allowed in the areas where the need for investment is greatest that is, Ireland, Northern Ireland, the Mezzogiorno (Italy), French overseas territories and West Berlin. The present rules governing the ceilings on state aids came into effect in January, 1978 and were due to be reviewed after a period of three years. This review has not yet been completed and the 1978 guidelines are still in force.

7. Under the provisions for limiting state aids, ceilings are set as to the net grant equivalent[1] of initial investment or cost per job which may be granted in the different regions. The present ceilings are

—for the Central Regions a ceiling of 20 per cent net grant equivalent or 3,500 European units of account (EUA) per job created,

—for intermediate regions e.g. development areas in France, assisted areas in the United Kingdom, a ceiling of 30 per cent net grant equivalent or 5,500 EUA per job created,

—for Ireland, a ceiling of 75 per cent equivalent of initial investment applies to aids linked and fixed directly in relation to initial investment or 13,000 EUA per job created. In addition as from 1 January, 1981, for projects with an initial investment exceeding three million EUA, a further net grant equivalent of 25 per cent of initial investment or a net grant equivalent of 4,500 EUA per job created can be paid in other aids and must be spread over a minimum of five years. This gives a possible total of 100 per cent net grant equivalent of initial investment.

8. These rules mean that the Industrial Development Authority cannot give a combination of grants, rent subsidies, interest subsidies and loan guarantees which exceed 75 per cent of the initial investment in terms of net grant equivalent. We have been informed that this does not restrict IDA activities in practice since even the most attractive incentives the IDA would offer would not exceed this ceiling.

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[1] The net grant equivalent is calculated by expressing aids granted net of benefits foregone, e.g. tax allowances, in terms of their net present value and dividing by the total fixed asset investment.

9. The additional aids which have been brought within the 100 per cent net grant equivalent ceiling with effect from 1 January, 1981 as noted in paragraph 7 are

(i) export sales relief,

(ii) 20 per cent investment allowance in designated areas, and

(iii) remission of rates.

Export sales relief in respect of new trades being established and the investment allowance in designated areas have been terminated since 1 January, 1981. Since rates remission is not significant in terms of net grant equivalent, the ceiling on these additional aids causes no difficulty for the IDA.

10. The ceilings on state aids do not cover training grants, equity participation by the IDA, enterprise development incentives, restructuring incentives, research and development grants and capital allowances up to 100 per cent.

11. In principle, the limitations on the level of state aids that may be provided should benefit Ireland by limiting the incentives offered by our competitors. In practice, a number of loopholes allow the ceilings to be exceeded. Firstly, the limits apply only to regional aids. Thus, if a country has an aid scheme for a specific sector, it can grant the aids allowed under the sectoral scheme in addition to the regional aids and so exceed the regional aid ceiling. Secondly, an aid which is taxable is deemed to have been taxed in the year it is paid whereas in practice, with start up losses and capital allowances, tax will not be paid for some time afterwards. Thirdly, the availability of loan finance from public funds can of itself be an incentive to a firm to invest. (France, for example, offers up to 70 per cent of fixed and working capital from state sources).

ANNEX 1

ARTICLES 92-94 OF THE TREATY OF ROME

1. In this annex we reproduce articles 92 to 94 of the Treaty of Rome which constrain the state aids which may be granted in Ireland. These should be interpreted in Ireland's case in conjunction with protocol 30 of the Treaty of Accession.

AIDS GRANTED BY STATES

Article 92

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

2. The following shall be compatible with the common market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

Article 93

1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market.

2. If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 92, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 169 and 170, refer the matter to the Court of Justice direct.

On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the common market, in derogation from the provisions of Article 92 or from the regulations provided for in Article 94, if such a decision is justified by exceptional circumstances. If, as regards the aid in question, the Commission has already initiated the procedure provided for in the first subparagraph of this paragraph, the fact that the State concerned has made its application to the Council shall have the effect of suspending that procedure until the Council has made its attitude known.

If, however, the Council has not made its attitude known within three months of the said application being made, the Commission shall give its decision on the case.

3. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 92, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

Article 94

The Council may, acting by a qualified majority on a proposal from the Commission, make any appropriate regulations for the application of Articles 92 and 93 and may in particular determine the conditions in which Article 93 (3) shall apply and the categories of aid exempted from this procedure.

APPENDIX 5

RELIEF OF PROFITS TO ENCOURAGE INDUSTRIAL DEVELOPMENT

1. In this appendix, we outline the main reliefs of profits given in Ireland to encourage faster industrial growth. These schemes are

   (i) export sales relief,

   (ii) Shannon relief, and

   (iii) relief of manufacturing profits.

Export Sales Relief

2. Tax relief for profits from exports was introduced in 1956. When bringing in the measure, the Minister for Finance said that it was occasioned by the paramount necessity at the time for everything possible to be done to stimulate production and exports arising out of increased production. With the exception of cases in which assurances have been provided by the Industrial Development Authority, no company commencing to trade after 1 January, 1981 will qualify for the relief.

3. Full relief is given for fifteen years. The relief declines steadily to 15 per cent over a further period of five years. In no case will relief be granted in respect of any period after 5 April, 1990. Where a company was exporting when the relief was first introduced, the relief was restricted to the tax attributable to the excess of the export sales in the relevant accounting period over those of a 'standard period' — year ended 30 September, 1955 or year ended 30 September, 1956 as the company elected.

4. Export sales relief was confined originally to profits from the export of goods manufactured in the state by the exporter. The scope of the relief was extended on a number of occasions. These were

   (i) fish produced on a fish farm (1958),

   (ii) cultivated mushrooms (1958),

   (iii) the repair of ships (1959),

(iv) design and planning services rendered in the state in connection with engineering works executed abroad (1968),

(v) the publisher of books (1958) and greeting cards (1959) who exports such goods which have been printed by another person,

(vi) a company selling wholesale in the export market goods not manufactured by it (1960),

(vii) licensed bacon-curing companies and manufacturers of milk products whose goods are sold for export to the Pigs and Bacon Commission or Bord Bainne (1964). This provision now relates to milk and pigmeat products sold to and exported by, respectively, An Bord Bainne Co-operative Ltd., and the Pigs and Bacon Commission,

(viii) a company carrying out in the state any manufacturing process on materials belonging to a foreign concern, which were imported, provided that the finished products were exported while remaining in the ownership of the foreign concern (1966), and

(ix) sales between associated companies in the state where the goods are ultimately exported (either as components of other goods or otherwise) and where neither company sells goods in the home market save to the other. In this connection, companies are deemed to be associated where one controls the other or both are controlled by a third person (1968).

5. Because the span of relief was due to end for all companies in 1990 and because of obligations arising from membership of the EEC, Ireland decided to cease offering this incentive for new investment from 1 January, 1981, and it has now been replaced by a reduced rate of tax on all profits arising from manufacturing.

Shannon Relief

6. The profits of a company from trading operations carried on in the customs-free area of Shannon Airport and certified by the Minister for Finance to be 'exempted trading operations' are exempted from corporation tax up to 5 April, 1990. Exempted trading operations include

(i) the sale for export of

(a) goods produced, manufactured or processed in the area, and

(b) imported goods which have been packaged or handled there,

(ii) the repair or maintenance, within the airport of aircraft,

(iii) the rendering, within the airport or outside the state, of services entailing the use of aircraft or air transport,

(iv) other trading operations to which the Minister is of the opinion, after consultation with the Minister for Transport and Power (now Minister for Communications), that they contribute to the use or development of the airport, and

(v) trading operations ancillary to those described above.

7. With the exception of cases in which assurances have been provided by the Industrial Development Authority, no company commencing to trade after 1 January, 1981 will qualify for relief. The relief scheme has been replaced by the reduced rate of tax on manufacturing profits which replaced export sales relief.

Reduced Rate of Tax on Profits from Manufacturing

8. The Finance Act, 1980 provides for a reduced rate of tax on manufacturing profits. The relief takes the form of a reduction of 4/5ths of the corporation tax otherwise payable by a company on its income from the sales of goods manufactured by it in the state. This means that, in respect of such income, a company liable to corporation tax at the 50 per cent rate is effectively taxed at 10 per cent. (The effective rate of 10 per cent was achieved in 1981 by granting a reduction of 7/9ths of the corporation tax then payable at the rate of 45 per cent). The scheme applies to income derived by companies from sales of goods manufactured by them in the state (including Shannon Airport), whether the income arises from domestic or export sales and to income from the rendering in the state of manufacturing services which involve the subjecting of goods not owned by the company providing such services to a process of manufacture. As in the case of export sales relief the word 'manufacture' has not been defined. However, the relief has been extended to the following activities which were deemed also to qualify for export sales relief:

(i) fish produced within the state on a fish farm,

(ii) cultivated mushrooms cultivated within the state,

(iii) repairs carried out within the state to a ship, and

(iv) certain design and planning services.

9. A change in the provisions concerning design and planning services now requires that they must relate to engineering works to be executed outside the territories of the member states of the European Community. To qualify for export sales relief it was sufficient only that such works were

to be executed outside the Republic of Ireland. Companies carrying on trades in respect of which they are entitled to export sales relief may opt irrevocably into the new scheme at any time during their span of export sales relief, provided, such companies are eligible for relief. Where the option is not exercised, a company eligible for relief can claim under the new scheme on the expiry of its span of export sales relief. Relief under the new scheme is due to expire in all cases of 31 December, 2000.

10. Following discussions with the EEC Commission, it proved possible to extend the relief to certain non-manufacturing services at Shannon Airport. However, in the case of companies with fifty or more full time employees, limitations were placed on the amount of relief which could be granted in accordance with the principles for the time being applied by the Commission of the European Communities under the powers vested in it by Articles 92 to 94 of the EEC Treaty. The new scheme is applied by means of a certificate which may be issued by the Minister for Finance in respect of the following classes of trading operations within Shannon Airport:

(i) the repair or maintenance of aircraft,

(ii) trading operations in regard to which the Minister is of the opinion after consultation with the Minister for Communications, that they would contribute to the use or development of the Airport, and

(iii) trading operations which are ancillary to (i) and (ii) above or to any operation consisting of the manufacture of goods.

11. The Minister is prohibited from issuing a certificate in respect of

(i) the rendering of

(a) services to embarking or disembarking aircraft passengers, including hotel, catering, money changing or transport (other than air transport) services, or

(b) services in connection with the landing, departure, loading or unloading of aircraft,

(ii) the operation of scheduled air transport service,

(iii) selling by retail, or

(iv) the sale of consumable commodities for the fuelling of aircraft or for shipment as aircraft stores.

Furthermore, trading operations in respect of which the Minister has given a certificate under the old Shannon relief, shall not be certified to be relevant trading operations for the new scheme unless the Minister is satisfied that these operations arise from an initial investment. In determining what constitutes an initial investment, the Minister shall have regard to the principles for the time being applied by the EEC in accordance with the powers vested in it by Articles 92 and 94 of the EEC Treaty. Certificates issued by the Minister are valid through until 31 December, 2000 unless revoked before that date.

12. Some of the countries with which Ireland has double taxation treaties operate the exemption system of relief from double taxation. Thus in certain circumstances under the terms of these treaties, profits earned in Ireland (including those which benefit from the relief on manufacturing profits) can be repatriated in the form of dividends to these countries without liability to tax on first receipt. However, these profits may be included with other income in the home countries for the purpose of calculating the tax rate applicable to such other income. In addition, where profits are distributed in the home country a local liability may arise.

APPENDIX 6

TAXATION OF AGRICULTURAL AND FISHERY CO-OPERATIVES

1. This appendix describes the special tax provisions which apply to agricultural and fishery societies. Certain trading profits of these societies are exempt from tax and special provisions apply in respect of discounts and share and loan interest paid.

2. An agricultural society is one with fifty or more members, the majority of whom derive the main part of its income from farming or a society, which is certified by the Minister for Finance to be an agricultural society. The trading profits of such a society are exempt from tax, but only in so far as they arise from the selling by wholesale of farm produce, seeds, fertilizers, farm machinery and many commodities and articles used in farming and from the provision of certain services associated with agricultural production. The exemption does not apply to sales to intervention.

3. A fishery society is one with twenty or more members, the majority of whom derive the main part of its income from fishing or a society, certified by the Minister for Finance to be a fishery society. The trading profits of such a society, in so far as they arise from the selling by wholesale of fish, the auctioning and transportation of fish and the selling of commodities or articles used in catching fish are exempt from tax.

4. The proportion of the net trading profit of co-operative societies which is exempt from tax is arrived at by applying to the total profit the fraction of which the numerator is the exempt sales and the denominator the total sales. The taxable amount arrived at by this method is liable to corporation tax as corporate income.

5. Discounts to those trading with co-operatives are treated by legislation as trading expenses to the co-operatives. In addition, dividends and interest paid on share capital are allowable deductions in computing profits provided the share capital is used in connection with the trade. Dividends received by companies and individuals from co-operative societies are taxable as investment income and in the case of individuals the dividend is not increased by a tax credit and no deduction by way of tax credit is made in calculating the individual shareholder's ultimate liability.

Historical Background

6. Co-operative societies derive their legal status from registration under the Industrial and Provident Societies Acts, the first of which was passed over a century ago. The words 'Industrial and Provident' were apparently intended to connote that registered societies should be "industrial as making their profits by the mutual personal exertions of the members and provident as distributing their profits by way of provision for the future".

7. In the course of time less stress has been laid on these characteristics, and various amendments of the relevant Acts have had the result that, subject to certain conditions, there may now be registered under them any society

> "for carrying on any industries, businesses or trades specified in or authorised by its rules, whether wholesale or retail.".

8. The rationale behind the legislation governing Industrial and Provident societies generally appears to be that special corporate status should be given to groups of individuals who come together for the purpose of providing provident benefits. In Ireland, such societies were exempt from income tax in respect of their trading profits and investment income up to 1963 and although chargeable to corporation profits tax the charge did not extend to the surplus arising from trading with members.

9. The Commission on Income Taxation[1] made a number of recommendations with regard to Industrial and Provident societies, the principal of which were as follows:

(i) that instead of the general exemption from income tax now enjoyed by co-operative societies, the profits of co-operative societies from marketing the products of Irish agriculture, whether sold as bought or in processed form, and whether sold to members or non-members of these societies, should be exempted from income tax so far as purchases are made direct from the agricultural producer, or from any co-operative society which has in turn purchased them direct from the producer,

(ii) that the profits of co-operative societies from cattle-marts and artificial insemination services should be exempted from income tax,

(iii) that exemption from corporation profits tax should apply to precisely the same profits as are exempted from income tax — whether

[1]pr 6033 Fifth Report, March, 1961.

or not a society's profits arise from "trading with its own members",

(iv) that total exemption from income tax should be granted to non-agricultural societies registered under the Industrial and Provident Societies Acts, which are primarily of an educational, cultural, or charitable nature and which are not carried on for private gain, and

(v) that the provisions regarding exemption from income taxation of all other non-agricultural societies so registered should be withdrawn.

10. The Government in considering these recommendations concluded in the Second White Paper on Direct Taxation,[2] "that it would be undesirable to withdraw completely the exemption from income tax which the societies at present enjoy". However, it recognised that, even in relation to agricultural societies, there had been a branching out into commercial and industrial spheres where the business of the societies was in competition with that of ordinary traders and where the direct connection with agricultural producers as such was not always apparent. It was decided therefore "that some narrowing of the present exemption appears to be justified and can be effected without impairing the exercise by co-operative societies of their functions in regard to agriculture". Agricultural co-operatives were afforded extensive tax exemptions, exempting them from income tax and corporation profits tax on all activities of an agricultural nature, leaving tax liability only on income derived from retail sales, sales of non-agricultural goods of all types and extraneous income such as investment income and deposit interest.

11. These tax exemptions continued until 1976 when they were removed for a period of two years. When withdrawing the exemptions in 1976, the Minister for Finance stated in his budget speech that

> "Agricultural and fishery co-operatives now include some of the largest businesses in the country and the scale of operations is now such that the continuance of the exemption is both difficult to justify and inequitable to the general body of taxpayers as well as the ordinary traders who are subject to the normal tax regime".[3].

12. The tax exemptions were restored in 1978 on the grounds that

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[2]pr 7024 April, 1962.
[3]Budget Speech 28 January, 1976.

"this Government have always recognised the importance of the activities of co-operatives in the development of Irish agriculture and fisheries. We gave a commitment to restore an exemption from corporation tax in respect of such activities."[4]

However, sales to an EEC Intervention Agency were excluded from the scope of the exemption.

[4]Budget Speech 1 February, 1978.

APPENDIX 7

THE NATIONAL SOIL SURVEY

1. In this appendix we set out details of the National Soil Survey which is being undertaken by An Foras Talúntais.

2. Soils are classified on the basis of their more permanent properties such as texture and drainage and mapped on the basis of the soil profile character. For this reason the maps serve as a permanent record.

3. Field mapping is carried out on 6 inches to 1 mile (1:10,560) maps. The frequency of soil profile examination is dependent on the degree of spatial variation in profile character, and could vary from 1 to 100 observations/square mile. During the survey of an area, profiles typical of each soil series are selected for special study. Fresh profile pits are opened for this purpose with a depth of 4 to 5 feet. Each profile is examined, described and analysed.

4. Where soil series are recognised but where their distribution pattern with contiguous series is so intricate as to defy clear-cut delineation on the map, a soil complex is mapped. The component series within the complex are named and where possible their relative proportions are given. In the counties mapped to date, complexes occupy approximately 3 to 12 per cent of area. In two counties, the proportions were exceptionally high at 19 and 23 per cent. An increased scale of mapping would virtually eliminate these complexes.

5. The soil maps are published on a scale of one-half inch to 1 mile (1:126,720). The minimum average shown on this scale is 25 acres and so any uniformly coloured area on the published map may theoretically include enclaves of less than 25 acres.

6. A major problem in mapping soils is the delineation of boundaries between different series. Typically profiles representative of two different soil series may differ widely but where the series are contiguous, it is usual for them to merge, sometimes over a considerable distance. Consequently, a line on the map very often defines the merging zone between soil series but may not imply a sharp change in the soil character.

7. To date, soil survey bulletins and maps (1:126,720) have been published for Wexford, Carlow, Limerick, Clare, Kildare, Leitrim, West Cork, West Donegal, West Mayo, Westmeath and Meath. It is expected that North Tipperary, Laois and Offaly will be published within the next four years. This would bring the total area of the country covered to 40 per cent.

8. While the equalisation of land taxes should rationally be based on soil maps and potential crop productivity, the present maps may not be sufficiently detailed for this specific purpose. To improve tax assessment of lands, a first step would be the preparation of soil maps at a more detailed scale. Ideally these maps would aim to show subdivisions of soil series into soil types and more importantly, soil phases. The latter would cover variations in features such as slope, depth or stoniness that are important in soil behaviour and land use. The expenditure involved and the time required to cover the entire country at the intensity of mapping necessary would be very considerable. It could take 750–1,000 man years.

APPENDIX 8

DIRECT INCENTIVES FOR INVESTMENT IN LIVESTOCK

1. In this appendix we outline the main schemes and incentives which are available to farmers in the form of direct grants and subsidies and services in order to improve the size and quality of their livestock herds. We refer only to livestock improvement schemes even though substantial state expenditure on disease eradication may also be regarded as expenditure devoted to improving the quality of livestock.

CATTLE

2. The main objectives of the cattle improvement schemes administered through the Department of Agriculture or the Committees of Agriculture are to increase milk yields and the production of high quality store and fat stock for the export trade.

Artificial Insemination

3. An artificial insemination service is run by nine organisations under licence from the Department of Agriculture. For two years from 18 May, 1981 an EEC assisted subsidy at the rate of £4.94 per insemination is payable to the operating bodies who in turn reduce their fees to the farmer.

Milk Recording

4. The Department of Agriculture operates a milk recording service for owners of pedigree cows and for farmers who want to upgrade their herds. Under the service, all milking cows in participating herds are recorded for milk yields and sampled for butter fat and protein content. The annual fees payable for the service are £25 herd fee and a headage fee of £5.50 per cow.

Weight Recording of Pedigree Beef Cattle

5. An On-Farm Recording scheme for Pedigree Beef Cattle is operated by the Department. Calves are weighed every 100 days and results processed and issued to herd owners. The annual herd fee is £10 and subject to certain conditions £1 per animal recorded.

Cattle Headage Grants in Less Favoured Areas

6. Schemes operate to encourage the continuation of farming in those areas of the country designated as disadvantaged in order to maintain the level of population and ensure the continued conservation of the countryside. Payments are issued to participants who occupy and farm at least 3 hectares of utilised agricultural land and who undertake to continue in farming for at least 5 years. The Cattle Headage Payments scheme operates in areas designated as Severely Handicapped. The Beef Cow scheme operates in areas designated as disadvantaged and the Scheme of Headage Payments on sheep operates in all the designated areas.

Premiums for Maintaining Suckler Cows

7. A scheme is open to herd owners who practice farming as their main occupation. To qualify for the premium a farmer must have ceased commercial milk production on the date of application, must not engage in commercial milk production for a period of 12 months from that date, have cows all recognised as belonging to a beef breed and maintain for 6 months a number of cows equivalent to the number for which a premium has been approved.

Calf Premium Scheme 1983/84

8. It is open to each herd owner to apply for premium in respect of any calf he owns provided the calf was born in the state on or after 16 June, 1983 and before the end of the 1983/84 marketing year, was eartagged, was issued with a certificate of birth and has reached the age of six months within the state.

Assistance for Expansion of Cattle Breeding Herd

9. A scheme operates for the payment of aid in the form of an interest subsidy in respect of each calved heifer verified on inspection after 30 June, 1982 as being present in the herd and additional to the basic herd at 30 June, 1981. The scheme was continued in 1983. It is at the rate of 14 per cent on an estimated value of £500, i.e. a total of £70 on each additional calved heifer up to a maximum of 40 heifers per applicant. The subsidy is paid to the herd owner who is required to furnish on his application form a certificate from the lending agency showing borrowings in connection with the expansion of the breeding herd together with an estimate of additional expenses on the purchase of inputs.

PIGS

Accreditation

10. The Accredited Pig Herd Scheme provides a reservoir of top quality breeding stock for dissemination to commercial producers. Participating herds must have a minimum of twelve breeding sows and attain high standards in litter records and gradings of pigs slaughtered. Substantial financial incentives are available to participants in the scheme.

Certified Hybrid Gilt Scheme

11. A financial incentive is available to participants in this scheme which aims to make genetically superior hybrid gilts available to commercial pig producers. Herds participating acquire their foundation stock from accredited herds and use top performance tested boars.

Premium Boar Scheme

12. County Committees provide a grant of £65 towards the purchase of boars selected by the Inspectors of the Department of Agriculture. These boars are located by the County Committees with selected farmers who undertake to maintain them properly and to let them serve a prescribed number of sows during an 18-month period.

SHEEP

Scheme of Premiums for Good Quality Ewes

13. Under the Common Organisation of the Market for sheepmeat there is provision for the payment of a compensating ewe premium in the event of the average market price for lambs falling below a reference or guaranteed price during any marketing year. The amount of the premium is dependent on the level of sheepmeat production in the previous year and the average market price for lamb in the year in question. The level of the premium payable for the 1982/83 marketing year was set at £7.35 per ewe. The first instalment of the premium for the 1983/84 marketing year is £5.06 per ewe.

Premium Ram Schemes

14. Premiums ranging from £30 to £50 are paid to selected farmers towards the purchase of good quality premium rams of a number of specified breeds.

APPENDIX 9

RESIDENCE AND ORDINARY RESIDENCE

1. In this appendix we explain what is meant by residence and ordinary residence. These terms are not defined in legislation. However, they have been interpreted by the Courts.

Residence

2. Residence is essentially related to physical presence in the country, though the extent to which actual presence constitutes residence for tax purposes depends in some degree on other factors, such as the existence of accommodation available for use.

3. If a person is to be regarded as resident in Ireland for a given tax year, he must generally be physically present in the country for at least part of that year. He will always be resident if he is here for six months or more in the year. If the person is here for less than six months, the decision whether or not he is resident depends on other circumstances. For example, a person who has accommodation available for his use in Ireland may be regarded as resident for any tax year in which he visits Ireland, however short the visit may be.

4. Even if he has no accommodation available he will be regarded as resident if he comes here regularly year by year and spends substantial periods of time here. For this purpose, an average annual period or periods amounting to three months is regarded as substantial and the visits as becoming regular after four years.

Ordinary Residence

5. Ordinary residence is broadly equivalent to habitual residence. A person who has his home here and spends his life here apart from occasional short visits abroad for business or pleasure, is clearly ordinarily resident here. Ordinary residence is related to a way of life and to intention and to acts which manifest intention. It is thus less clear-cut than 'residence' alone. Moreover, a person can remain ordinarily resident even though physically absent from the country throughout the year.

6. Whether a person whose home is or has previously been abroad is to be treated as ordinarily resident in Ireland from the date of his arrival will depend on the particular circumstance, for example, whether or not the person concerned intends to stay here for a long period. This may not be clear at the time he arrives in which case he may not be treated as ordinarily resident until the beginning of the tax year in which the third anniversary of his arrival falls. But if it was clear when he arrived that he intended to take up permanent residence here or to stay for at least three years, he would be regarded as ordinarily resident from the date of his arrival.

APPENDIX 10

SALES PERSONNEL RECRUITMENT GRANTS

1. In this appendix we describe the grants payable by Córas Tráchtála towards the cost of establishing and, where necessary, training additional export marketing/sales personnel in overseas markets. The allocation for this scheme is £1 million spread over a number of years.

Operation of the Scheme

2. The scheme applies to establishing and, where necessary, training additional permanent full-time export marketing/sales employees who must spend a minimum of 30 per cent of their working year in the export market.

3. Payment ceases if the export marketing/sales employee leaves the company. If the salesman is replaced the payment may be continued at the discretion of Córas Tráchtála.

4. Claims for payment must be made quarterly, in arrears, and should be accompanied by

(i) an auditor's certificate detailing salary and sales commission for the quarter being claimed, and

(ii) detailed report on the salesman's progress to date.

5. The validity of the grant expires if the project has not commenced within six months of the date of approval.

6. Recipient companies must submit a declaration to the effect that it is their intention to retain the grant-aided post after the period of the grant has expired; that they will be in a position to pay all costs involved from their own resources and that they will not seek public assistance towards the costs.

7. The contract of employment must be approved by Córas Tráchtála in advance.

8. All grants approved under this scheme are subject to the general regulations of the Córas Tráchtála grants scheme.

Scope of Scheme

9. For an overseas based executive the grant payable will be up to 125 per cent of salary (including commission and bonus tied to sales) subject to a maximum of IR£25,000.

10. For a home based executive, the grant payable will be up to 85 per cent of remuneration, subject to a maximum of IR£20,000.

11. The maximum payable towards recruitment costs will be 50 per cent of the costs up to a maximum of IR£2,000, payable on appointment of the executive.

APPENDIX 11

VENTURE CAPITAL SCHEMES IN THE UNITED STATES

1. The United States has a flourishing venture capital industry concerned with fast growing, innovative companies, often in the field of high technology. In this appendix, we describe the experience of the industry in the United States, where it first emerged, and where it has assumed an important position.

Background

2. Before the Second World War, venture capitalism in the United States was undertaken by wealthy individuals. It has subsequently become the province of venture capital firms. Of these there are now three kinds. Firstly, there are some 360 private and public small business investment companies (SBICs). These institutions, set up under the Small Business Act of 1958, encompass a great variety of types of ownership and of investment strategy, though in broad terms they consist of groups of investors seeking to make long-term loans to small companies, or to acquire an equity stake in them. Secondly, there are perhaps 100 venture capital offshoots of large companies and banks. These are sometimes merely divisions within the companies concerned, and sometimes venture capital subsidiaries. Thirdly, there are about 130 private venture capital companies. Occasionally these are family firms, but predominantly they are limited, private partnerships.

3. In the narrower sense of venture the third group of companies is of paramount importance. Most SBIC investment consists of loans, or loans with equity; of the remainder, probably only a small portion is venture capital investment. This is probably the position also with the second category, the venture capital offshoots of banks and companies. The limited private partnerships are quite different.

4. These partnerships commonly have between two and four general partners. The investors are the limited partners. The general partners are fund managers, with unlimited liability for the obligations of their partnership. The limited partners are commonly representatives of pension funds (much the largest single source of funds, accounting for some 29 per cent in 1981), major industrial companies, insurance companies, endowment funds, wealthy individuals and foreign investors. The general partners

usually begin raising a venture fund with a fixed life of between ten and twelve years. The size of the fund might vary from $15 million to $100 million. Typically, with a fund of, say, $20 million and four general partners, each partner might actively finance and manage some half a dozen companies, investing between $250,000 and $1 million in each at any one time.

5. Very few of the large number of proposals presented to venture capitalists are accepted. The small number of portfolio managers available as venture capitalists is one of the reasons for this. More important are lack of management talent of the right calibre in which to invest, and the strictness of the investment criteria supplied by venture capitalists, who commonly expect to make profits of up to 1,000 per cent from investments in companies that will either be traded on one of the securities markets, or be merged in larger companies, within five to seven years.

6. The main reasons why limited, private partnerships dominate the US venture capital market appear to lie in the flexibility of partnerships and, above all, in the overall incentive provided to the general partners by an arrangement under which it is normal for them to take at least 20 per cent of any capital gains, in addition to annual fees of 2 to 3 per cent of the venture fund.

7. At the end of 1981, the three groups of venture capital organisations had committed about $6 billion to the US venture capital pool (on a wide definition of venture capital). Some $2.6 billion had come from private, limited partnerships, $1.6 billion from SBICs, and $1.6 billion from companies. Much, if not most venture capital investment is syndicated — to bring in expertise rather than finance.

8. New private capital committed to venture capital companies (broadly defined) declined from about $175 million in 1969 to some $25 million in 1975, but rose to about $200 million in 1979 and about $1 billion in 1981. A major cause of the US venture capital market developing so unevenly appears to have been changes in government policy, and especially in securities regulations and taxation. The increase in capital gains tax between 1969 and 1976 is thought to have been one of the prime reasons why the supply of private venture capital fell over this period: the reductions in capital gains tax in 1978 and again in 1981 are similarly believed to have been an important factor in the recent increase in supply.

9. About 20 per cent of all venture-backed companies in the United States achieve market success, a further 40 per cent achieve success through upward mergers, about 20 per cent become profitable but continue as small, privately-owned businesses, and only some 20 per cent are deemed failures.

APPENDIX 12

UNITED KINGDOM BUSINESS EXPANSION SCHEME

Introduction

1. In this appendix we give details of the tax incentive in the United Kingdom to encourage the growth and development of unquoted companies. The incentive was introduced in 1981 to encourage business start-ups. The scheme was greatly extended in 1983 and now applies to existing businesses.

Outline of the Scheme

2. The scheme allows United Kingdom resident individuals subscribing for new equity share capital in unquoted companies to write off their investments against income tax. The maximum amount that an investor can write off in any one year is £40,000 and the scheme extends, at present, to the end of 1986/87.

3. A taxpayer liable at the top rate of tax of 75 per cent (including investment income surcharge) can therefore make annual investments under the scheme of £40,000 at a net cost after tax of £10,000. If the relevant shares are retained for five years, their sale does not give rise to any withdrawal of this relief. Capital gains tax is charged only on any gain over the gross original cost.

4. The whole emphasis of the scheme is on new outside investment rather than proprietorial investment. Thus, working shareholders, or those owning more than 30 per cent of the company do not qualify for relief.

5. There is no limit to the proportion of a company's equity which can qualify for tax relief. Thus, four or more (to ensure the 30 per cent test is satisfied) investors can set up a company together, the initial capital of which has all been set off against income tax. However, a company must satisfy certain conditions if its investors are to qualify for and retain relief. These conditions must be satisfied throughout a three year period beginning with the issue of the shares or, if later, the date that trading begins. The most important of these conditions are

(i) the company's activities must consist of a commercial trading activity carried out wholly or mainly in the United Kingdom. Most trades qualify except that most financial services are excluded e.g. leasing or hire purchase,

(ii) the company can be a holding company, but if so, all of its subsidiaries must be wholly owned and must be carrying out trading activities which would themselves qualify for relief. Minority shareholdings in, for example, associated companies do not affect the relief. However, partly owned subsidiaries, or associated companies where there is an arrangement to achieve majority control, disqualify the holding company from being eligible. Conversely, the scheme is not available to subsidiaries directly, since an eligible company must not be under the control of any other company,

(iii) the scheme is designed to promote investment in United Kingdom business. Consequently, the company must be incorporated and resident in the United Kingdom as must all its subsidiaries. While the majority of its business must be carried on within the United Kingdom, the existence of substantial export business does not prejudice eligibility,

(iv) there is no limitation on size, but the company must be unquoted. This means that no class of the company's shares or loan capital must be quoted on The Stock Exchange, including the Unlisted Securities Market. By restricting the relief to unquoted companies, it is ensured that those companies with direct access to capital markets cannot take advantage of the scheme. Unquoted public companies, however, may be eligible, and

(v) the classes of capital that can be raised under the scheme are very wide. Essentially, provided that true equity capital is being raised, relief is available. However, the company must not have in issue any partly paid shares. Also, shares which give some form of preference to their holder (for example, in terms of assets on a winding up) cannot qualify for relief.