Irish Tax Institute

Leaders in Tax

Submission to the Select Committee on Arrangements for Budgetary Scrutiny

A Special Focus on the Finance Bill Process

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EXECUTIVE SUMMARY

The Irish Tax Institute welcomes the opportunity to make a contribution to the important work being undertaken by the Committee on Arrangements for Budgetary Scrutiny.

As a stakeholder in the budgetary process for many years, we hope that we can lend our experience and our observations to this Committee and make a worthwhile contribution to the debate and discussions on how to improve the future budgetary process.

Our submission is strictly focused on the challenges with the current Finance Bill cycle, which is a critical component of the budgetary process. In particular, we highlight the limited time available to scrutinise the draft tax legislation and the impact that this can have on the effective operation of new legislative provisions. We also note the OECD's remarks on how quickly the Bill has to be passed despite containing "complex sets of information".

In our submission, we also make a number of practical suggestions on how the Finance Bill process could be improved; central to that is viewing the Finance Bill as a sum of parts as opposed to one block of inseparable legislation.

The Institute fully recognises the challenging environment in which the Finance Bill process takes place, most notably the time constraints imposed by the EU's Two-Pack rules, and our suggestions have been developed with these parameters in mind. We also appreciate that much of the work concerning the Budget 2017 cycle is already in progress and so our comments relate to the budgets thereafter.

In coming forward with our submission on the Finance Bill process, our key suggestions are as follows;

1. Consider changing the approach to the Finance Bill: A sum of the parts approach vs one inseparable block of legislation.

2. Publish draft legislation in advance on an issue by issue basis (similar to the consultation process on the underlying tax policies). With the exception of key income tax changes and other sensitive measures, we believe that tax legislation should be published for consultation in advance of the Finance Bill being published.

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TAX LEGISLATION – A NEW APPROACH

Given the scale and complexity of Irish tax legislation and its important role in underpinning Irish tax policy, the Institute has focused its submission specifically on the Finance Bill process. We appreciate that the process is a major undertaking each year, made possible by the work of many, and that its enactment involves a wide range of interested parties from the Minister and the executive, through to the Joint Committee on Finance, Public Expenditure and Reform and members of the Dáil and Seanad.

We understand that the intention of the Government is:

> *"…to move away from the existing model of parliamentary interaction, which the OECD characterised as a disconnected series of annual set-piece events, towards continuous and meaningful engagement with the Houses of the Oireachtas throughout the course of the Budget cycle. The focus is on early engagement with the Oireachtas, to ensure that the views of parliamentarians can be considered by Government in advance of Budget proposals being presented."* [1]

Scrutinising and agreeing tax legislation is as important as agreeing the underlying policy measures. The policy has to be translated into legislation and that can be the most difficult part of the process; in many ways, the part that needs most scrutiny because of the possible unintended consequences and scope for errors embedded in the detailed sections of legislation. The OECD in its report[2],' *Review of Budget Oversight by Parliament: Ireland*' (2015) notes how quickly the Finance Bill has to be passed, giving the Dáil just weeks to scrutinise this legislation, which they say contains "complex sets of information". It says this "compounds what would be an already challenging timescale for meaningful analysis and scrutiny of the Budget Bills".

In putting forward our proposals, the Institute fully acknowledges the very real time constraints and sensitivities around the Finance Bill process. We hope that the suggestions we are putting forward are practical and workable and that they fully explore new opportunities to improve and enhance the Finance Bill process, while remaining cognisant, at all times, of the environment against which the Finance Bill process takes place.

1. Government Submission to the Select Committee on Arrangements for Budgetary Scrutiny
2. OECD Directorate for Public Governance & Territorial Development, *Review of budget oversight by parliament: Ireland (Autumn 2015)*

We appreciate two major factors which must be accounted for:

- **Time Constraints:** We appreciate that the Budget and Finance Bill process is impacted by the EU 'Two-Pack' rules; the Budget must take place by 15 October each year and the Finance Bill giving legislative effect to the Budget must be enacted by 31 December. Since the Bill cannot be published until after the Budget takes place (normally early October), there is now a very short window of opportunity to scrutinise the legislation before it must be enacted by year end.

- **Exceptions:** Given the sensitive nature of tax policy, we also appreciate that there will be times when Government cannot consult on tax policy proposals, or at least cannot consult fully in the early stages. This can arise if there are concerns over the integrity of the tax base; the measures being taken are aimed at preventing tax avoidance or in cases where there are market sensitivities. This principle is well understood by most stakeholders and clearly applies in cases where specific measures are being taken to deal with specific tax avoidance transactions.

In this submission the Irish Tax Institute:

- Examines the challenges within the current Irish process and looks at the issues arising out of that process

- Highlights some exceptional examples of useful and constructive legislative scrutiny relating to Irish finance matters that occurred in the past and looks at how these case studies could provide a model for constructive legislative consultation in the future

- Provides an overview of progressive legislative processes in other countries, and

- Proposes some changes to the legislative process in Ireland.

THE CHALLENGES WITHIN THE CURRENT IRISH PROCESS AND THE ISSUES ARISING OUT OF THAT PROCESS

There are broadly three key stages involved in introducing a new tax measure:

- **Stage 1** - Deciding the overall policy objective e.g. addressing a market failure of some type through a tax or expenditure measure

- **Stage 2** – Selecting the best option (tax or otherwise) to achieve that objective and designing the detailed policy measures

- **Stage 3** – Drafting the legislation that will effect the change

Good tax policy design requires engagement with stakeholders and the Oireachtas at all three stages of this process. A study by Oxford University Centre for Business Taxation, *Structures, Processes and Governance in Tax Policy Making: an Initial Report*, shows that fundamentally, there are better outcomes when this engagement is done properly:

> *"...there is much for policy-makers to gain and very little to lose in the consultation process."*[3]

Very important work has been done in Ireland over the past 10 years to improve public and Oireachtas engagement at Stages 1 and 2 of the policy making process. Tax consultations now take place throughout the year and more time and space is given to these consultations. We saw five formal consultations take place in 2013, four in 2014 and five in 2015.

However, taking tax policy proposals forward can be a very complex matter which involves the drafting of legislation giving effect to the tax policy. At the time of writing there are close to 6,000 pages of Irish tax legislation. It is very important that this body of legislation is correct and fit for purpose because tax legislation is a day to day working tool which directly governs the rights and obligations of taxpayers.

A tax proposal can sound quite straightforward but can actually require a very difficult and complex body of legislation to enact it.

3. Christopher John Wales and Christopher Peter Wales, Structures, Processes and Governance in Tax Policy Making: an Initial Report (Oxford University Centre for Business Taxation, 2012)

Example: Introduction of the Knowledge Development Box

It is useful to refer to the introduction of the Knowledge Development Box here, as it is a good example of a seemingly straightforward proposal requiring much consideration and detailed legislation.

In his Budget Speech of 13 October 2015, Minister Noonan stated his policy objective in relation to the Knowledge Development Box:

> *"I will introduce, in the Finance Bill, a knowledge development box – or KDB. This will be the first OECD-compliant KDB in the world. This puts Ireland in a unique position to offer long-term certainty to innovative industries planning their research and development investments.* ***Income that qualifies for the KDB will be subject to a reduced rate of corporation tax of 6.25 per cent.*** *The KDB adds a further dimension to our 'best in class' competitive corporation tax offering, which includes the 12.5 per cent headline rate; the R&D tax credit; and the intangible asset regime."*

On the face of it, a tax measure to provide for a reduced rate of tax of 6.25% on income arising from the commercialisation of certain intellectual property sounds straightforward. However, to actually give legal effect to this objective has required 16 pages of tax legislation as well as Revenue Guidelines running to over 70 pages. The legislation on the Knowledge Development Box also impacts on other provisions in tax legislation including loss relief, transfer pricing and the R&D tax credit, each of which have had to be considered to ensure that the entire body of legislation is correct and effective to meet the policy objective.

Producing effective legislation takes time and it requires careful thought and debate both by the Oireachtas and wider stakeholders. If sufficient time and input is not made available to scrutinise draft legislation then difficult situations, unintended consequences and even unforeseen hardship can arise for taxpayers.

One of the key challenges in the Irish tax policy making process at present is that insufficient time is available to scrutinise tax legislation once the policies have been announced by Government. With some very limited exceptions (page number 8), tax legislation is not published in draft format for discussion in advance of the publication of the Finance Bill. The result is that the legislation only appears for the first time in late October and has to pass through all stages of the Dáil and Seanad and be signed by the President before the end of the year, under the EU 'Two-Pack' rules. This provides only two months for the entire process to be completed and the law enacted[4].

4.. Before the 'two-Pack' rules came in, the window of opportunity for scrutiny was four months (rather than two months) under the Provisional Collection of Taxes Act. This was not a perfect regime because there was no real pre-legislative consultation before the Bill was published, however the four month window for scrutiny after publication made feedback somewhat more manageable than now.

The practical impact of this very tight timeframe is an intense period of two-four weeks during which stakeholders must try to identify the impact of the legislation they are seeing for the first time and consider all the possible effects and potential unintended consequences it could have. After this short period, the door is effectively closed on suggested improvements until the next Finance Bill process a year later.

As Hallsworth and Rutter (2011) state:

> *"Many ideas which look good on paper are not feasible to implement – and often it is too late to change course when the legislation is on the statue book and political capital has been expended".*[5]

At present, the Finance Bill is effectively treated as an inseparable block of tax legislation that is published as one overall Bill, approximately two weeks after the Budget. However viewing the process through this "block" lens can hinder our view of how to improve the scrutiny process within the constraints of the EU's 'Two-Pack' rules.

The fact is that there are always a wide range of different and stand-alone measures contained in any Finance Bill; the Bill is in effect the sum of the parts. In our view, individual proposed measures such as start-up measures for small business or share remuneration could be dealt with on an item by item basis earlier in the legislative cycle and then integrated into the Finance Bill once they have been adequately scrutinised and debated.

5. Michael Hallsworth and Jill Rutter, *Making Policy Better - Improving Whitehall's core business* (Institute for Government, 2011)

EXAMPLES OF CONSTRUCTIVE LEGISLATIVE SCRUTINY RELATING TO FINANCE MATTERS THAT OCCURRED IN THE PAST – THREE CASE STUDIES

When time is given to the Oireachtas and stakeholders for early scrutiny of legislation and comment on impending legislation, it allows all parties to study the detail and ensure that it is meeting the Government's policy objectives without unintended consequences.

There have been some limited examples in the past where time was made available for more comprehensive scrutiny of tax proposals, including draft legislation. In the three case studies selected, we examine how these processes worked and look at lessons that could be learned:

- The case studies illustrate how a consultation process can provide time for debate on the design and features of a policy proposal, as well as advance sight of draft legislation.
- In each case, the result was that only very minor amendments to complex legislation were ultimately required when that piece of legislation was included in the relevant Finance Bill.
- In these cases, the consultation and the period for debate has produced better tax law for everyone involved.
- Although the examples of the KDB and the Tax Appeals regime are very recent, we do know that the VAT on Property legislation has certainly stood the test of time and has required little amendment since its introduction in 2008.

KNOWLEDGE DEVELOPMENT BOX (KDB)

October 2014	Minister for Finance announces decision to launch a KDB in Budget 2015 (subject to consultation)	
January 2015	Public Consultation launched	16 week period of consultation
April 2015	Public Consultation closes	
July 2015	Feedback statement issued containing extracts of draft legislation	4 week period of consultation
August 2015	Consultation on feedback statement closes	
October 2015	Draft KDB legislation published	26 days for legislative scrutiny
November 2015	Minor updates to legislation during Committee Stage	
December 2015	Final legislation issued	
February-May 2016	Consultation on development of KDB guidelines	

TAX APPEALS

October 2013	Public Consultation launched to reform the Tax Appeals regime	12 week period of consultation
January 2014	Public Consultation closes	
January 2015	Heads of Bill made available to the Oireachtas and certain stakeholders for comment	
January 2015	Hearing by Oireachtas Joint Committee on Finance, Public Expenditure and Reform	
July 2015	Finance (Tax Appeals) Bill 2015 published	12 weeks for legislative scrutiny
October 2015	Minor updates to legislation during Committee Stage	
December 2015	Finance (Tax Appeals) Act 2015 signed	

VAT ON PROPERTY

May 2005	Revenue establishes Special Review Group on VAT on Property
June 2005	Review Group invites submissions on VAT on Property regime
December 2006	Public Consultation launched
December 2006	Review Group publish Report on VAT on Property Review Project
February 2007	Review Group publish Goodbody ‘Economic Assessment of the Effect of Proposed Changes to VAT on Property’
March 2007	Draft legislation published
May 2007	Consultation closes
March 2008	New VAT on Property rules introduced in Finance Act 2008

5 month period of consultation

AN OVERVIEW OF PROGRESSIVE LEGISLATIVE PROCESSES IN OTHER COUNTRIES

A number of countries have recognised the importance of legislative scrutiny as part of their tax policy model.

Australia's "*In Principle*" Approach to Tax Consultation[6] contains eight key principles, two of which specifically address the importance of dealing with the legislation (as well as the policy formulation):

- Seeking technical and other input from external stakeholders (including the Australian Board of Taxation[7]) in the development of policy and legislative detail, and
- Thoroughly road-testing draft legislation and related products prior to implementation.

New Zealand's model also deals with the importance of the legislation. Its Generic Tax Policy Process (GTTP) as outlined in Figure 1 would be regarded internationally as very progressive. There is a lot of focus in the GTTP on two way engagement between policymakers, stakeholders and Government committees throughout the legislative phase as well as during earlier stages when policy and strategy are being designed.

6. The Board of Taxation, Improving Australia's Tax Consultation System – A Report to the Treasurer (2007)

7. The Board of Taxation is a non-statutory advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation

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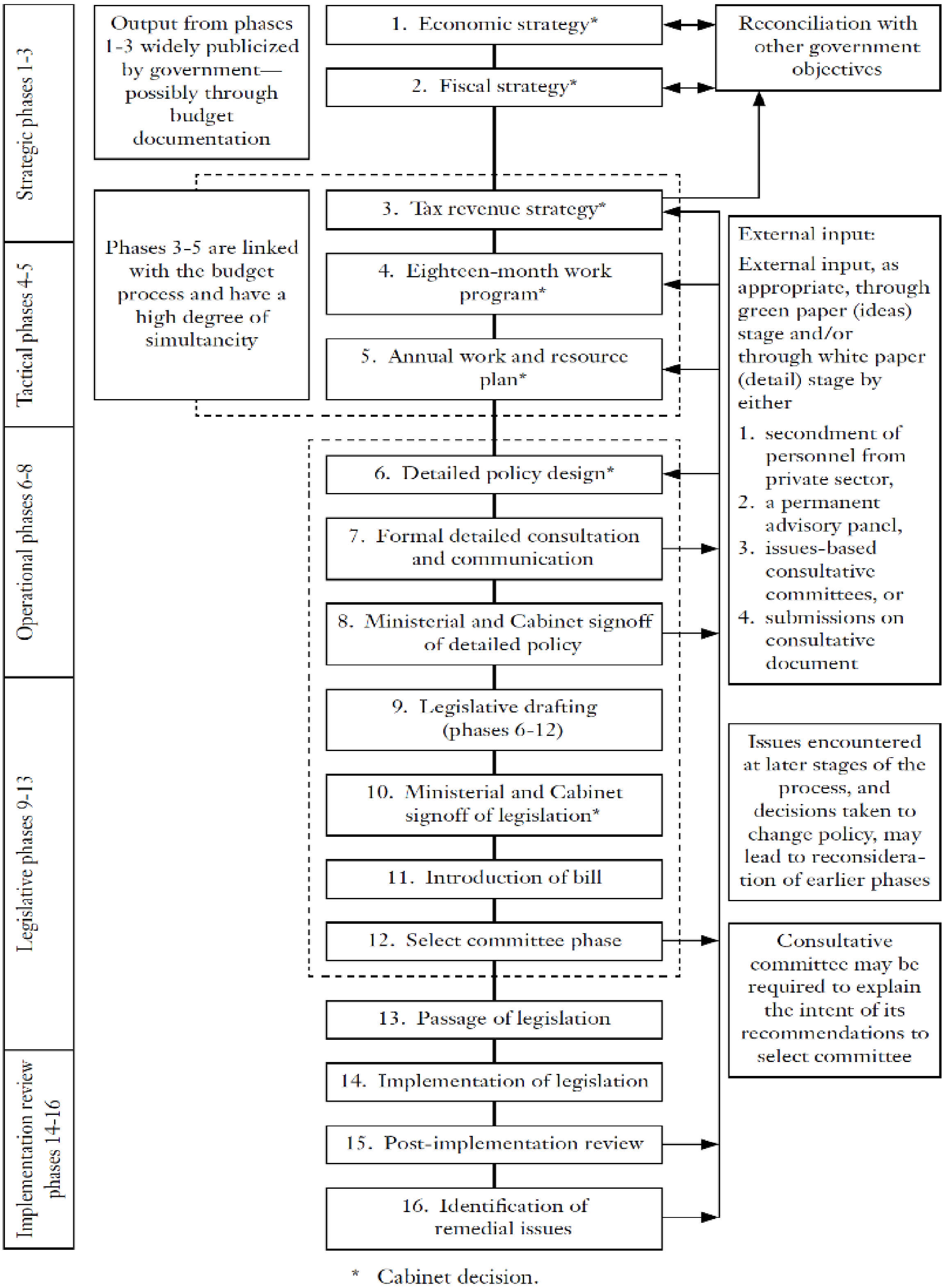
Figure 1: New Zealand's Generic Tax Policy Process (GTTP)[8]



8. Struan Little, Geof D. Nightingale, and Ainslie Fenwick, Development of Tax Policy in New Zealand: The Generic Tax Policy Process (2013)

The UK also places much focus on engagement at both policy development and legislation stages. Their five stage approach to tax engagement on draft legislation is a key component of overall policy design and implementation.

UK Tax Consultation Framework

Stage 1	Setting out objectives and identifying options
Stage 2	Determining the best option and developing a framework for implementation including detailed policy design
Stage 3	**Drafting legislation to effect the proposed change**
Stage 4	Implementing and monitoring the change
Stage 5	Reviewing and evaluating the change

SUGGESTIONS FOR CHANGE TO THE FINANCE BILL PROCESS IN IRELAND

Suggestion 1: Consider changing the approach to the Finance Bill: A sum of the parts approach vs one inseparable block of legislation

We fully appreciate that the Committee may have concerns about major reform of the Finance Bill process in light of the EU timing constraints. However, we believe that the timetable for publishing the Bill could remain as it is now, provided key separate elements of legislation were debated in advance before being incorporated into the final Bill.

Not all items currently in the Finance Bill need to, or indeed are suitable for advance legislative scrutiny. We are only referring here to measures that would have a significant impact on the tax system, where the legislation is likely to be complex and have far reaching consequences.

Suggestion 2: Publish draft legislation in advance on an issue by issue basis (similar to the consultation process on the underlying tax policies)

Tax legislation could be published for consultation in advance of the Finance Bill being published. This could be done on an **issue by issue basis** throughout the year in the same way that consultation takes place throughout the year on important policy matters such as share options, the tax treatment of entrepreneurs and travel expenses. The result would be a continuous flow of scrutinised law throughout the year that is then incorporated into the Finance Bill reducing the risk of the policy objective not being achieved or unintended consequences arising.

We appreciate that there are exceptions:

- key budgetary proposals with major financial implications (e.g. key income tax changes) and,
- sensitive anti-avoidance changes.

The financial risk is low

Again we appreciate that concerns may arise about publishing draft legislation in advance, in terms of the impact on the Budget itself.

However, looking at Finance Bills in previous years, the cost of the technical tax measures that would benefit from advance legislative review is generally very small when compared with the total Budget package. Therefore the financial risk of publishing details in advance of the Budget is low. The two most complex measures in Finance Bill 2015 were the introduction of the Knowledge Development Box and Entrepreneurs' Relief. These measures together were only forecast to cost **3.6%** of the total Budget package. This compares to the income tax changes in Finance Bill 2015 which cost 40%.

The Institute believes that if these suggestions are adopted, the Oireachtas committees, the new Independent Budget Office and the Dáil will be better informed about tax legislation before important decisions are taken.

The Ministers for Finance and Public Expenditure and Reform have stated the Government's objective:

> *…to improve the debate about and scrutiny of budget proposals in the legislative phase that follows budget day in terms of the Finance Bill, the Social Welfare bill and the Estimates"*[9]

However, the debate on new systemic legislative measures should ideally begin before Budget Day and not after it, because there simply is insufficient time between the Budget and the enactment of the legislation to properly scrutinise the legislation. If release of draft legislation on key policy measures does not form part of the consultation process in advance of the Budget then the combination of no sight of advance legislation coupled with the short period of scrutiny could result in legislation being implemented that does not meet the policy objective.

To undertake budgetary reform without changing this critical component of the budgetary process would, we believe, be an opportunity missed.

9. Government submission to the Select committee on Arrangements for Budgetary Scrutiny

Irish Tax Institute
Longboat Quay
Grand Canal Harbour
Dublin 2

Tel: 01 663 1700
Email: info@taxinstitute.ie
Web: www.taxinstitute.ie