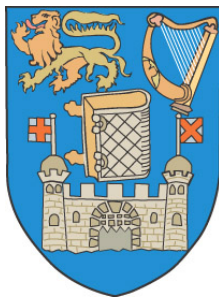


**TAX EXPENDITURES: REVENUE AND
INFORMATION FORGONE – THE
EXPERIENCE OF IRELAND**

Micheál L. Collins and Mary Walsh

TEP Working Paper No. 1211

August 2011



Trinity Economics Papers

Department of Economics

Trinity College Dublin

TAX EXPENDITURES: REVENUE AND INFORMATION FORGONE – THE EXPERIENCE OF IRELAND

Dr Micheál L Collins
Department of Economics
Trinity College Dublin
mcollin@tcd.ie

Mary Walsh
Chartered accountant
walshglenree@gmail.com

Keywords: Tax Expenditures, Tax Reform, OECD, Ireland
JEL Classifications: H21, H24, H29

ABSTRACT

Tax expenditures are perceived to represent a ‘pervasive and growing’ (OECD, 2010) element of many national taxation systems. Despite this, in many countries, there remains a critical lack of understanding of their impact and scale. A 2010 OECD analysis produced data for only seven of its thirty-four member states. Internationally and nationally, such an information deficit undermines the ability of taxation systems to function efficiently and compromises the ability of policy makers to design, control and evaluate taxation interventions. The latter is all the more relevant in the context of recent economic challenges.

This paper derives from the results of the first comprehensive exploration of Ireland’s tax expenditure system. It highlights the previously unknown scale of that system, points towards a series of information deficits and compares the Irish system to that of other OECD countries. Based on this analysis, the paper offers a series of administrative and structural reforms relevant to all tax expenditure systems.

Dr Micheál Collins is a lecturer at the Department of Economics, Trinity College Dublin. Mary Walsh is a Chartered Accountant. Both are former members of the Government of Ireland’s Commission on Taxation.

TAX EXPENDITURES: REVENUE AND INFORMATION FORGONE – THE EXPERIENCE OF IRELAND

1. INTRODUCTION

Tax expenditures are a formal method for taxpayers, individuals or companies, to reduce their tax liability below that which would otherwise apply. The OECD (2007) defines them as:

“a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure”

while Anderson (2008) states that they represent:

“provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax”

Conversely, tax expenditures represent a method for government to reduce its current tax take, perhaps (and ideally) for specified reasons, below what it would otherwise collect. Therefore, a consequence of such policy initiatives is that a tax expenditure requires government to redistribute the burden of taxation across others not availing of that tax expenditure or to decrease the provision of tax-funded public services given the tax expenditure induced reduction in the overall tax take.¹

This paper derives from the results of the first comprehensive exploration of Ireland’s tax expenditure system.² The paper first reviews the impact, advantages and limitations of tax expenditures as public policy tools. It then considers the previously unknown scale of that system in Ireland, points towards a series of information deficits and compares the Irish system to that of other OECD countries. Based on this analysis, the paper offers a series of administrative and structural reforms relevant to all tax expenditure systems.

¹ See also OECD (1984 and 1996) and Bratić (2006).

² See also Collins and Walsh (2010a and 2010b).

2. TAX EXPENDITURES: IMPACT, ADVANTAGES & LIMITATIONS

The transition in nomenclature over the 25 years between the two most recent Irish Commissions' on Taxation, from "tax incentives" to "tax expenditures", reflects a closer attention to the real impact of these measures. However, this is not to imply that tax expenditures should never be used. For example, few would argue about the effectiveness of the Irish government's export sales relief or its 10% corporation tax rate in attracting foreign direct investment and in transitioning the Irish economy from agricultural to industrial.

In an ideal and fully integrated world, the role of tax expenditure is to correct market failure and to remunerate merit goods. In the real (and somewhat less integrated) world, tax expenditure is also used extensively to attract mobile investment, necessarily from places where it might otherwise locate. Research and development tax credits serve as an example here. Within the European Union (EU), State Aid rules have curtailed the extent to which Member States may use tax expenditures to encourage investment in a particular Member State. Because of this, there is evidence in Ireland (and other states) of "benchmark adjustment" – if it is not possible to introduce a tax expenditure, then policies can be adopted to change the benchmark tax system so that all taxpayers are eligible for what would otherwise be a tax expenditure. In Ireland, recent examples include the transition from 10% corporation tax on some activities to 12.5% tax on all activities and the introduction of a participation exemption for capital gains tax (CGT) available to indigenous and foreign-owned companies.

Comparative advantages of tax expenditure

By comparison with the alternative of direct expenditure, tax expenditure has three advantages:

- It is generally easy to administer and the cost of administration is low. In most cases, the taxpayer claims the appropriate expenditure and obtains tax relief either in a tax assessment (for those making tax returns) or via a refund or a tax credit/allowance adjustment. For example, the now-repealed tax expenditure which gave a standard rate credit to taxpayers paying refuse or water charges could be claimed by sending a SMS text message to the Irish tax authority, the Revenue Commissioners. This was undoubtedly easier to

administer than a system that required a duplicate reporting system, checked whether a payer of refuse charges was in the tax net and then generated a direct payment. Efficient though the tax expenditure process was, it is hard to see a convincing reason for spending public funds on those payers of refuse charges who happen to be payers of income tax.

- There is a reduced risk of fraud. This is particularly the case for tax expenditure involving parties other than the taxpayer, since fraud then requires collusion. For example, the Irish “tax relief at source” (TRS) tax expenditures, medical insurance relief and mortgage interest relief, rely on data from insurance providers and mortgage lenders and thereby provide a third party check on taxpayer claims.
- Tax expenditure facilitates a greater range of taxpayer choices. This is evident for tax expenditures such as pension provision or health expenses, where a broad range of expenses qualify for tax relief and it is left to the taxpayer to determine which type best suits individual circumstances.

Limitations of tax expenditures

Tax expenditures are at best imperfect policy instruments. They suffer from inherent disabilities but more importantly, if they are not appropriately controlled and measured, they lead to systemic degradation of the tax system. Inherent disabilities include:

- Tax expenditures involve a departure from the equity principle and improve the financial position of the beneficiaries of the tax expenditure. Where the tax system is progressive, this involves greater benefits for those with higher incomes.
- Both the efficiency and effectiveness of tax expenditures are difficult to evaluate, in absolute terms and by comparison to an alternative of direct expenditure. This is inherent in having separate measurement and evaluation systems for direct expenditure and tax expenditure. While it is possible to argue about the effectiveness of reviews of spending programmes at government department, national audit agencies or parliamentary level, all are likely to be superior to an *ex-post* review of tax expenditure with poor data, little clarity on objectives and no clear measure of outputs. The inherent

difficulty in making a robust measurement of the costs and benefits of tax expenditure has been well summarised as the challenge of counting “might have beans” rather than the normal beans.

- The equivalent of a “demand led” direct expenditure programme is uncapped, non-time-limited tax expenditure. The direct expenditure budgeting process is such that demand-led expenditure can be curtailed with a sunset date. However, most tax expenditures outlive their utility. Whatever policy attractions there were in introducing the Irish Urban Renewal Relief scheme in five cities in 1986, it is manifestly clear that property tax incentives cost too much, expanded too widely, lasted too long (over two decades) and played a central role in fuelling the Irish property boom and bust in the period 2000-2010.³
- Tax expenditures and related regulations to control their use range from complex to incomprehensible. The OECD’s description is particularly good (2010:29):

“Aspects of tax expenditures can cause the resulting complexity of the whole to exceed the sum of the complexity of the parts, in public perception as well as reality. As legal provisions, regulations, instructions and forms are piled upon one another, the body of tax wisdom needed to navigate the system can grow beyond the capacity of many non-experts. The marginal added provisions, even if they do not apply to a particular taxpayer, obscure that taxpayer’s field of vision of what he or she needs to know. From a simple systems perspective, the potential interactions among additional tax expenditures could grow geometrically as more are added.”

A prime, though far from unique, example in the current Irish system is the Seed Capital Scheme, designed to refund prior tax paid by unemployed taxpayers to enable them to set up as self-employed, which requires navigation skills to chart 52 pages of complex legislation.

Other taxes must be increased to finance tax expenditures and thus general tax rates are higher. This may increase the burden of a particular tax (if the compensation is within a particular tax head) or may shift the relative burden of taxes on income, consumption and capital in an inappropriate way. In

³ Drudy and Collins (2011) outline the scale and principal reasons for this property boom.

Ireland, tax expenditures and the interaction between them have been used opportunistically by taxpayers and their advisers, thereby increasing the cost to the exchequer. Property construction, particularly in the hotel sector, has involved the creation of pools of “investors” with substantial income taxable at high rates, whose only function in the investment process was to strip out tax allowances at maximum tax benefit. The return to these participants was largely by way of the tax reduction and the “real” investor, whose tax capacity was smaller, could re-acquire the property at a lower price. This “productisation” of tax expenditures, which is endemic in Ireland, means that the cost of tax expenditure is always maximised.

The impact on tax expenditures when tax rates are increased

Increasing tax rates is often the first response of a state to a fiscal crisis. This has the inevitable consequence that the cost of any tax expenditure in the system that is based on exempting income or allowing expenditure against income automatically increases. Apart from the equity aspect of this effect, it may also make tax increases even less palatable to the general body of taxpayers that are ineligible for tax expenditures. Thus any programme to increase the overall tax burden must consider limiting tax expenditures as well as introducing new taxes and increasing existing tax rates. In the Irish system, seven of the top ten tax expenditures depend on the tax rate (see section 3), and thus automatically increase, in the absence of corrective action, when the tax rates increase.

3. TAX EXPENDITURES: THE EXPERIENCE OF IRELAND

In the Irish context, assessments of the costs and socio-economic implications of tax expenditures have, for the most part, represented a little-explored policy wilderness. One reason for this is that the exchequer costs of such measures have essentially been invisible - ‘revenue forgone’ – and as a consequence often perceived as costless. Furthermore, in the case of many, if not most, tax expenditures the Revenue Commissioners are not required to collect information on the use and cost of these expenditures while the Department of Finance, in its annual reports, monitor only a handful of high profile, and high cost, tax expenditures. As the 2009 Commission on Taxation report generously concludes: “official publications to date have not

comprehensively set out all the tax expenditures in the Irish taxation system” (2009:238).

Overall, limited data and understanding of the nature and extent of the Irish tax expenditure system have impeded detailed examination of these policies by academics, government agencies such as the Comptroller and Auditor General or by various parliamentary committees.⁴ Essentially, discourse in the area has been dominated by demands for introductions, expansions and extensions but with very limited economic evaluation to base those decisions upon. Given this invisibility, the system would seem to have operated throughout the last two decades on the basis of beneficiary-induced demand.

The 2009 Commission on Taxation report represents a significant step forward in our understanding of Irish tax expenditures. It established for the first time a comprehensive list of all the tax reducing measures in the Irish system. This list was then divided into those measures that may reasonably be regarded as part of the normal functioning of the taxation system (the benchmark taxation system) and those measures that are tax expenditures. The latter comprise a total of 131 tax expenditures which we classify into nine groups in Table 1.⁵

Given the data deficits, a comprehensive assessment of the cost of these expenditures is impossible. However, the Commission on Taxation report does provide estimates for the revenue foregone cost of as many of the individual tax expenditures as it was possible to find. While most of the data is from 2006, some costings are from other years earlier and later in that decade. These figures derive from a number of sources including published data from the Revenue Commissioners, Department of Finance reports and estimates presented to the Irish Parliament to accompany the announcement of these schemes, or their extension, in various Finance Bills. In the case of the latter, it is not possible to distinguish between costs derived from detailed empirical analysis and those assembled in a less robust fashion. Overall, some form of

⁴ An exception is the tax break on pension contributions which has been examined by NESC (2003) and the ESRI (Callan et al, 2005 and 2009). However, such analysis is principally based on data from national income surveys rather than administrative data associated with the expenditure.

⁵ See part 8 of the Commission on Taxation Report 2009 for a description and analysis of each of these tax expenditures. Collins and Walsh (2010b) have subsequently updated this list.

data is available for 89 of the 131 tax expenditures in the Irish system (68%) – for the other 42 expenditures no *ex-post* or *ex-ante* costing or estimates exists.

Table 1 – Distribution of Ireland’s Tax Expenditures

	Number of tax expenditures
Children	8
Housing	6
Health	10
Philanthropy	16
Enterprise	28
Employment	28
Savings and investment	8
Age-related and other	7
Property investment	20
Total	131

Table 2 summarises this data – a full list of these expenditures and the related measures classified as part of the benchmark taxation system has been provided by Collins and Walsh (2010b: 36-56).

Focusing on the 42 tax expenditures without any cost information, in June 2011 the Irish Minister for Finance was questioned in Dáil Eireann (the Irish parliament) on the details of these schemes. In his reply, the Minister informed the Dáil that five of these schemes have recently been abolished (no previous costs or cost estimated provided), one measure had zero costs as the scheme was not to be commenced and a further three measures had some limited costing information available (Houses of the Oireachtas, 2011).

Table 2 – An Estimate of the Annual Cost of Ireland’s Tax Expenditures

	Number of tax expenditures	Number with available costs*	Estimated Cost €m**
Children	8	8	723
Housing	6	6	3,256
Health	10	7	579
Philanthropy	16	7	89
Enterprise	28	12	457
Employment	28	18	2,816
Savings and investment	8	6	2,995
Age-related and other	7	5	144
Property investment	20	20	435 [#]
Total	131	89	11,494⁺⁺

Notes: * Data is generally from the 2009 Commission on Taxation Report and part 8 of that report provides more details on the costs for each tax expenditure category. The figures from the Commission’s report have been used even though the estimates are based on different years (mainly 2006). Data on property investment is for 2007 from Dáil Question Ref 32811/09

** The category costs are the sum of the costs for those tax expenditures where some costing estimate is available.

Although these schemes have been discontinued, they incur ongoing annual costs as the capital allowances associated with them can be set against taxable income for a defined number of years. Under current arrangements, costs will continue to arise, though at a reducing rate, for much of this decade.

++ It is important to remember that no cost estimate is available for many tax expenditures and that the quality of the estimation process varies widely.

Unsurprisingly, the largest individual tax expenditures account for most of the exchequer cost. Table 3 profiles the top 10 tax expenditures in the Irish system and reports their individual costs. It also compares these costs versus national income and the total tax take in 2006 (the year of origin for most of the estimates). Overall, the top 10 tax expenditures imply an annual revenue forgone cost of more than €10b, equivalent to 5.6% of GDP and 17.5% of the total tax-take. Putting the figures in the context of government expenditure in 2006, in that year the current account social welfare budget totalled €12.5b, the current health budget totalled €12.5b and the current education budget totalled €7.2b (Budget 2006).

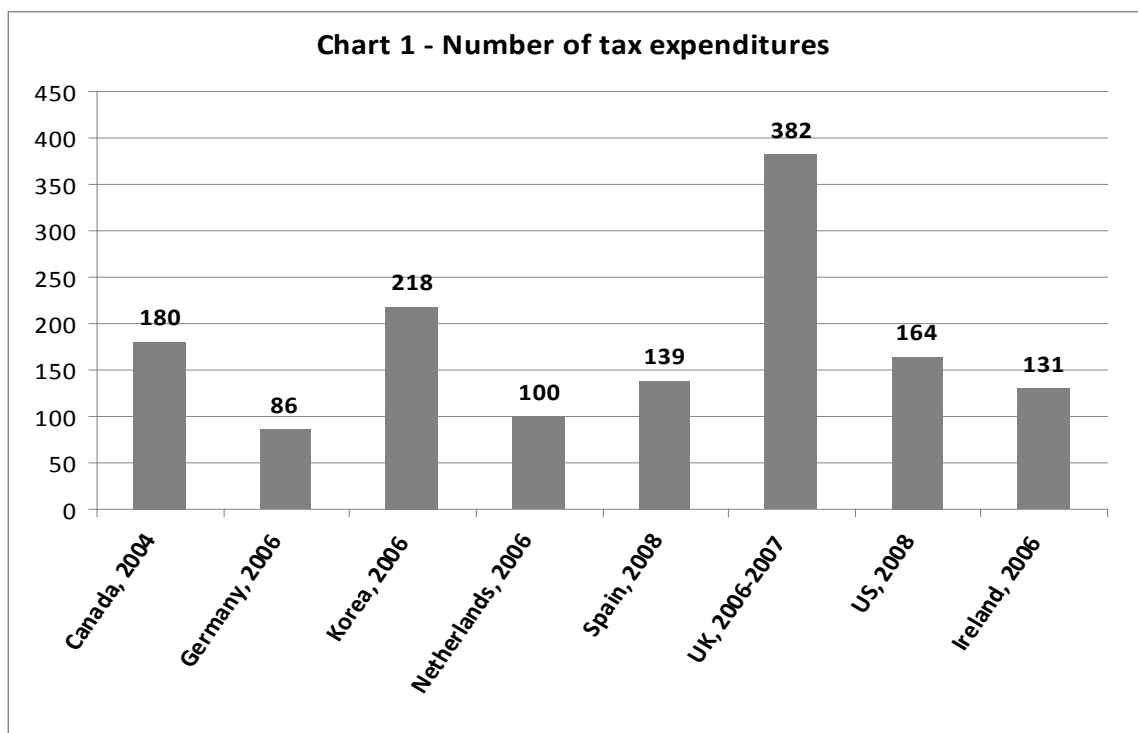
Table 3 – Annual Cost of the Top 10 Tax Expenditures in Ireland

	€m*	% GDP	% Total Tax Take
1 Tax reliefs on contributions to pension schemes	2,900	1.64	5.09
2 Tax credit for employees	2,522	1.42	4.43
3 Capital gains tax exemption on principal private residence	2,440	1.38	4.29
4 Mortgage interest relief on principal private residence	705	0.40	1.24
5 Tax incentives for property investment in Ireland	435	0.25	0.76
6 Tax exemption for universal social insurance payments for children	427	0.24	0.75
7 Tax relief on medical insurance premiums	321	0.18	0.56
8 Relief from gift and inheritance tax on agricultural property	100	0.06	0.18
9 Tax exemption on patent royalties developed in the European Economic Area	84	0.05	0.15
10 Stamp duty (transaction tax on land acquisition) relief for young trained farmers	71	0.04	0.12
Total	10,005	5.64	17.58

Notes: National Income data from CSO (2010) and total tax take data from Eurostat (2009). Both are for the year 2006.

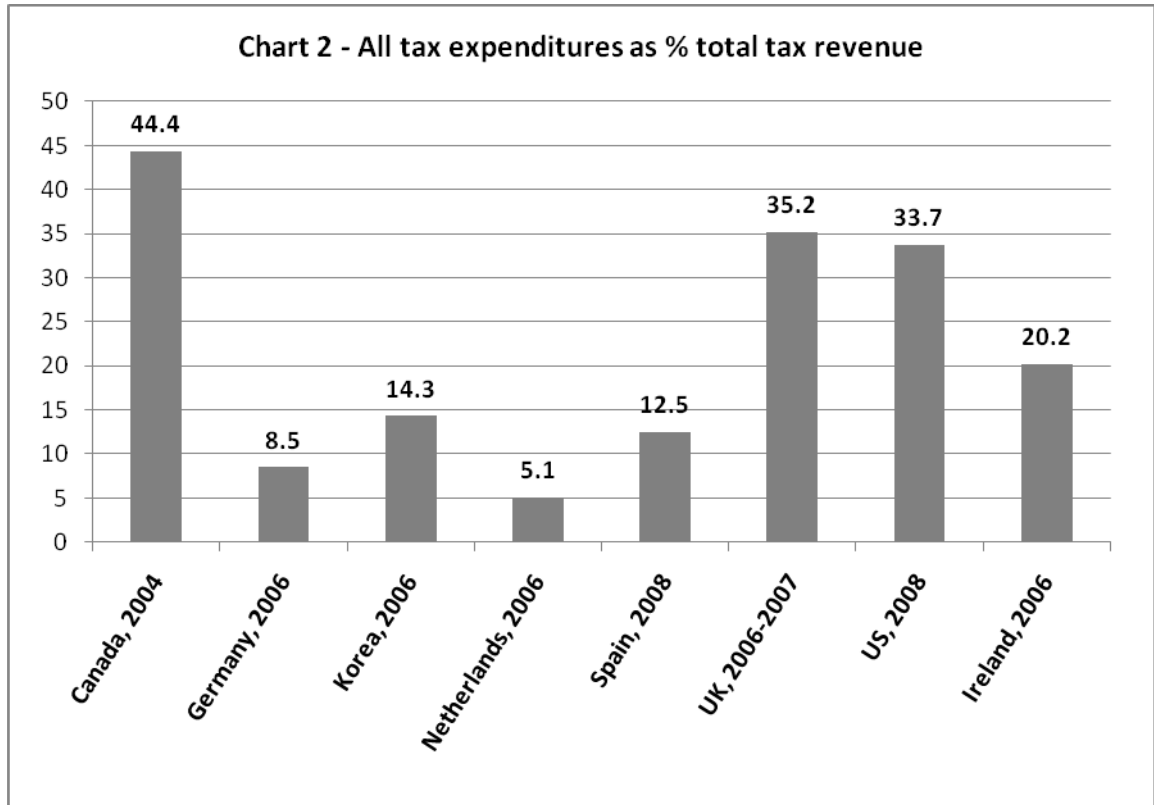
* Data is generally from the 2009 Commission on Taxation Report and part 8 of that report provides more details on the costs for each tax expenditure category. The figures from the Commission's report have been used even though the estimates are based on different years (mainly 2006). Data on property investment is for 2007 from Dáil Question Ref 32811/09

A recent OECD publication, *Tax Expenditures in OECD Countries* (2010), offers the possibility of comparing the aforementioned Irish tax expenditure system with that which they detail in a selected number of other OECD member countries.⁶ Chart 1 compares the overall number of tax expenditures in seven of the countries featured in that report against the data for Ireland in table 1. Overall, the number of Irish tax expenditures sits midway between the higher levels in the UK, Korea, Canada and the US and lower numbers in continental European countries. Subsequently, chart 2 compares the cost of these tax expenditures versus the total tax take in these countries – the Irish data is calculated using the €1.49 billion estimate in table 2.



Note: Calculated using OECD (2010: 233) and data from table 2 above.

⁶ The study did not examine Ireland.

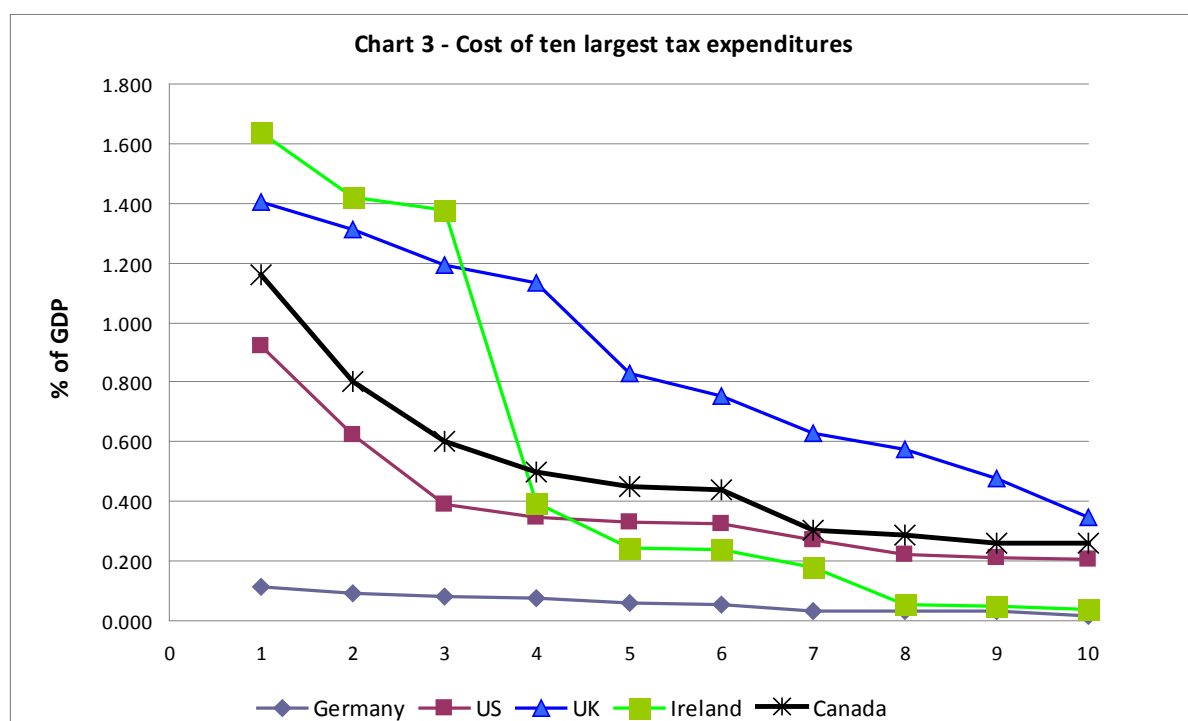


Note: Calculated using OECD (2010: 236) and data from table 2 above.

While the number and proportional cost of Ireland’s tax expenditures are high, they do not represent an outlier given the data in charts 1 and 2. However, this is not the case when we compare the relative size of the top 10 tax expenditures in Ireland versus that in the six other OECD member countries where disaggregated data is available (OECD, 2010: 237). Table 4 and chart 3 compare the scale of these high revenue forgone tax expenditures and show that in an international context, the cost of Ireland’s top three tax expenditures stand out.

Table 4 – Cost of Top 10 Tax Expenditures as % GDP

	Germany	Netherlands	Korea	US	Canada	Ireland	UK
1	0.113	0.248	0.244	0.922	1.160	1.635	1.405
2	0.092	0.207	0.163	0.622	0.805	1.422	1.313
3	0.080	0.123	0.139	0.393	0.600	1.376	1.193
4	0.073	0.119	0.132	0.346	0.497	0.398	1.132
5	0.057	0.101	0.123	0.331	0.448	0.245	0.830
6	0.056	0.073	0.112	0.324	0.438	0.241	0.755
7	0.032	0.067	0.106	0.269	0.306	0.181	0.627
8	0.031	0.054	0.095	0.222	0.290	0.056	0.574
9	0.030	0.046	0.091	0.212	0.259	0.047	0.476
10	0.017	0.044	0.080	0.205	0.258	0.040	0.347
Total	0.582	1.081	1.284	3.844	5.060	5.642	8.651



4. REFORMING TAX EXPENDITURES

Given that there are 131 tax expenditures in the Irish system, it would be impossible in a short paper to suggest reforms for each of them.⁷ Instead, in this section we focus on some general ways in which the tax expenditure systems, such as the Irish one, can be reformed. These reform proposals are relevant to all tax expenditure systems.

4.1 Abolishing tax expenditures

The most basic approach to reform of tax expenditures is to repeal the legislation giving rise to the tax expenditure. It is often stated that existing tax expenditures must run their course. This is rather like saying that tax rates cannot increase. While investment may have been made by reference to the tax rules in a particular year, it would be disingenuous to think that a country's Government or parliament is in some moral or legal sense barred from changing legislation on tax rates and tax expenditures, particularly in the context of dramatic changes in a country's fiscal situation. Holding or changing tax rates and tax expenditure amounts remains an annual policy choice. While abolition is an option, many tax expenditures involve deductions over a future period to taxpayers who have incurred capital expenditure. Abolishing tax expenditures for expenditure incurred from a particular date does not immediately reduce the cost of tax expenditures which grant tax preferences for capital expenditures over a number of years. Considerations of legitimate expectation on the part of taxpayers cause political and policy difficulties in removing tax deductions on capital expenditure incurred in the past. Tax deductions granted over a number of years on capital expenditure investment commits the state in advance to tax expenditure, although fiscal conditions may change. This particular case, where abolition may not eliminate the cost of a tax expenditure for a number of years into the future, is considered further below.

4.2 Reducing tax credit rates

Of the ten largest tax expenditures in Ireland, three (employee tax credit, mortgage interest relief and medical insurance relief) are given by way of tax credits. These are, in effect, fixed payments to eligible taxpayers and, in the case of mortgage

⁷ Part 8 of the 2009 The Commission on Taxation presents a summary of the Commission's considerations of all these schemes and its recommendations for each of them (2009: 228-323). Collins and Walsh (2010b) also provide a detailed set of reforms focused on the top ten tax expenditures.

interest relief and medical insurance relief, are available whether the individual with the medical insurance premium or mortgage interest liability is taxpaying or not.⁸ While no reduction in tax expenditure is painless to the taxpayer involved, a gradual reduction in the quantum of the credit over time would be an effective way of reducing the cost of tax expenditures that are granted by way of an income tax credit.

4.3 Limiting tax expenditure – the AMT (alternative minimum tax) approach

Another possibility is to limit tax expenditure so as to require taxpayers to pay a minimum effective tax rate on total income. For some tax expenditures in Ireland the introduction of the high income restriction in 2007 had the effect of limiting the total tax expenditure benefits to affected individuals so as to ensure a minimum tax burden on high income individuals. Expenditure not allowed because of these restrictions is carried forward to subsequent years, subject to the re-application of the restriction in these years. A very concentrated summary of the 2010 version of these restrictions might read:

- The relief limits the use of some, but not all, tax expenditures where income before tax expenditures is more than €125,000.
- There is no restriction if eligible tax expenditures do not exceed €80,000
- Full restriction (to impose an effective tax rate of 30%) applies for incomes in excess of €400,000 and partial restrictions apply for incomes between €125,000 and €400,000.
- Restricted reliefs are carried forward and can offset income tax in future years
- Unlike most elements of the income tax system, the control is individualised and applies separately to husband and wife.

These limits distinguish between high-income individuals and others (companies, low- and middle-income individuals) using tax expenditures to reduce tax liability. For high-income individuals, the controls are applied to a broad range of tax expenditures but there are a number of expenditures that are ignored in applying the restriction. These include tax expenditure on pensions (pension contributions and lump sum payments from a pension scheme on retirement), on termination payments (both statutory and ex gratia), on tax-favoured employer share schemes and on foreign

⁸ In that sense they differ little from a targeted negative income tax or refundable tax credit.

source income qualifying for the remittance basis of taxation where the taxpayer is non-domiciled (individuals resident in Ireland but subject to a special tax regime because they were not born in Ireland).

This is the most generous (from the perspective of the state) variant of the AMT regime, since deductions are preserved for future periods. The alternative is for tax expenditure deductions and credits to expire, where they produce liabilities below the AMT target tax rate.

4.4 Tax expenditure “holidays” by the state

Where tax revenues fall catastrophically, as happened in Ireland in the 2008/9 period, there is a need to limit the tax expenditures that are inbuilt in the system.⁹ In these cases, abolishing tax expenditures for amounts incurred in future does not have an immediate effect, since there may be an accrual of many years of deductions for expenditures incurred in the past. In these circumstances, it may be appropriate for the state to take what might be considered a “tax expenditure holiday”, whereby deductions based on prior capital expenditure are postponed for a number of years. From the taxpayer perspective, the tax expenditures are not abolished but their timing is postponed to a future date (when the fiscal position improves). From the state’s perspective, tax revenue for periods where the fiscal position is under strain is not diluted by tax expenditure.

4.5 Recapturing tax expenditures at higher income levels

The high income restrictions are probably sufficient controls for the tax expenditures that are within their ambit. However a range of other tax expenditures are claimed by a large number of taxpayers with widely varying income levels. Examples would include the employee tax credit (available to all employees), the tax exemption on child benefit payments (available to all families with children and receiving a non-means tested and untaxed universal monthly child support transfer) and relief for health expenses (expenditure on specified health costs can be claimed from pre-tax income).

⁹ See Collins (2011) for details of the rapid reduction in Ireland tax revenues over this period.

An approach that has been followed in some countries is to provide for recapture of tax expenditures at higher income levels. This has the advantage of collecting more tax from those most able to pay while not affecting the marginal tax rate of most taxpayers.

Using the employee tax credit as an example, we can see that abolishing the credit would cause a large number of lower-income taxpayers hitherto not subject to income tax to come within the tax net and would also increase substantially the tax burden on lower to middle income taxpayers. As an alternative to increasing the top rate of tax, we could contemplate recapturing the credit by correspondingly increasing the tax liability of those earning more than, for example, €75,000 per annum until the benefit of the credit has been withdrawn. Although this produces a spike in the marginal tax rate for those earning marginally above the limit, it has the advantage of retaining the existing marginal tax rates for other affected taxpayers, while increasing their average tax burden. While spikes in the marginal rate at particular levels are not attractive, a spike at €75,000 (or whatever level is chosen) might not be inappropriate until financial circumstances enable a more thorough reform of the tax system to be implemented.

4.6 Structural reform of tax expenditure systems

While sections 4.1-4.5 have concentrated on an exploration and reform of the current system of tax expenditures, there is also merit in highlighting the need for a reform in the way policy makers approach the introduction and supervision of tax expenditures. The first five recommendations from the 2009 Commission on Taxation's review of tax expenditures highlight the approach and components of such a structural reform. These are reproduced in Box 1 below and would serve as a useful approach to underpin future approaches to the introduction and reform of tax expenditures.

**Box 1: First five recommendations on Tax Expenditures from the 2009
Commission on Taxation Report (Part 8)**

- 1 The OECD definition of a tax expenditure - as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure – should be adopted.
- 2 Measures that are part of the benchmark tax system should not be considered as tax expenditures.
- 3 In general, direct Exchequer expenditure should be used instead of tax expenditures.
- 4 There are three instances where it would be appropriate to examine the possibility of introducing a tax expenditure. These are:
 - To correct market failure
 - To attract mobile investment
 - To offset shortcomings in other areas of public policy

Where a tax expenditure is proposed, or an existing expenditure's timescale extended, the following questions should be asked, in sequence:

- does the expenditure fall within one or more of the three instances outlined above?
- If so, does the proposal adhere to each the following principles:
 - Efficiency;
 - Stability; and
 - Simplicity
- If so, can a departure from the equity principle, which the tax expenditure invariably necessitates, be justified?

A tax expenditure should only be introduced, or extended, if it answers affirmatively to each of these questions.

- 5 For all future tax expenditures and reforms of tax expenditures, there should be:
 - *An ex ante evaluation process* in advance of decisions to implement or extend any tax expenditure, including an assessment of the costs and benefits of proposals and consideration of the alternative of a direct expenditure approach.
 - *Better measurement and data collection on the costs and benefits* associated with the introduction or extension of the tax expenditure and the review of its impact.
 - *Publication of an annual tax expenditures report by the Department of Finance* as part of the annual budget process and subject to Oireachtas (Parliamentary) scrutiny.

Spending through the tax system should be controlled by, for example, the imposition of thresholds and ceilings and reductions in the rate at which tax relief is given or in the quantum of a base figure to which tax relief might apply.

Source: Commission on Taxation Report (2009:230).

CONCLUSION

Across the members states of the OECD, national assessment of the costs and socio-economic implications of tax expenditures have, for the most part, been less than adequate. One reason for this is that the exchequer costs of such measures have essentially been invisible - 'revenue forgone'. Furthermore, comprehensive data is often not collected to allow an assessment of the nature, distribution and scale of the tax expenditure; meaning that both revenue and information is forgone.

Using Ireland as a case study, this paper has shown that it, like many OECD countries, possesses a large and expensive system of tax expenditures. A total of 131 individual expenditures account for in excess of €1 billion per annum of revenue forgone to the exchequer - equivalent to over 5.5% of GDP and more than 20% of the total tax-take. Overall, within the Irish system, data is available for only 68% of the tax expenditures and in many cases the available data is far from robust. Despite its size, the tax expenditure system has been subject to limited detailed examination over much of the past two decades; indeed the majority of attention given to the system has been focused on extensions and expansions to existing tax relief schemes, and introductions of new ones, rather than on evaluations of the appropriateness of this forgone exchequer income vis-à-vis its benefits.

Drawing on our assessment of the Irish system, the paper has outlined a series of administrative and structural reforms relevant to all tax expenditure systems. In the context of current economic challenges, such reforms offer the possibility to make significant contributions to the fiscal reforms facing many countries.

REFERENCES

- Anderson, Barry (2008). Presentation at the Asian Senior Budget Officials meeting, 10-11 January 2008, Bangkok, Thailand, www.oecd.org/dataoecd/40/6/39944419.pdf
- Bratić, Vjekoslav (2006). *Tax Expenditures: A theoretical Review*. Zagreb, Institute of Public Finance.
- Callan, T., C. Keane and J.R. Walsh (2009) *Pension Policy: New Evidence on Key Issues*. Dublin, ESRI.
- Callan, T., J.R. Walsh and K. Coleman (2005) 'Tax Expenditures' in T. Callan and A. Doris (eds.), *Budget Perspectives 2006*. Dublin, ESRI.
- Central Statistics Office (2010). *National Income and Expenditure Accounts*, Dublin, Stationery Office.
- Collins M.L. (2011). "Taxation". In O'Hagan, J. and C. Newman (eds.), *The Economy of Ireland* (11th edition). forthcoming.
- Collins, M.L. and M. Walsh (2010a). *Expenditure Cuts: The bell also tolls for tax expenditure*. Paper to the Dublin Economics Workshop, Kenmare October 2010.
- Collins, M.L. and M. Walsh (2010b). 'Ireland's Tax Expenditure System: International Comparisons and a Reform Agenda' in *Studies in Public Policy* No. 24. Dublin, Policy Institute Trinity College Dublin.
- Commission on Taxation (1982). *Commission on Taxation First Report*. Dublin, Stationery Office.
- Commission on Taxation (2009). *Commission on Taxation Report 2009*. Dublin, Stationery Office.
- Department of Finance (2005). *Budget 2006*, Dublin, Stationery Office.
- Department of Finance (2010). *Section 1 of Finance Act 2010: Report on Tax Expenditures*. Dublin, Stationery Office.
- Department of Finance (2010). *Tax Incentives/Expenditures: TSG 09/20*. Dublin, Stationery Office.
- Department of Finance (various). *Annual Report*, Dublin, Stationery Office.
- Department of Finance (various). *Finance Bills*, Dublin, Stationery Office.
- Drudy, P.J. and M.L. Collins (2011). 'Ireland: From Boom to Austerity'. *Cambridge Journal of Regions, Economy and Society*, forthcoming.
- Eurostat (2009). *Taxation Trends in the European Union*. Luxembourg, Eurostat.

Houses of the Oireachtas (2011). *Dail Question Reference 14499/11*.

Houses of the Oireachtas (2009). *Dail Question Reference 32811/09*.

National Economic and Social Council (2003). *An Investment in Quality: Services, Inclusion and Enterprise*. Dublin, NESC.

OECD (1984). *Tax Expenditures: A Review of Issues and Country Practices*. OECD, Paris.

OECD (1996). *Tax Expenditures: Recent Experiences*. OECD, Paris.

OECD (2007). *Tax and Growth: Issues for Discussion*. Paris, OECD.

OECD (2010). *Tax Expenditures in OECD Countries*. Paris, OECD.

Revenue Commissioners (various). *Statistical Report various years*. Dublin, Stationery Office.