

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

CORPORATION TAX (NORTHERN IRELAND) BILL

First Sitting

Tuesday 3 February 2015

CONTENTS

Programme motion agreed to.
Written evidence (Reporting to the House) motion agreed to.
Motion to sit in private agreed to.
Examination of witnesses.
Adjourned till Thursday 5 February at half-past Eleven o'clock.
Written evidence reported to the House.

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Saturday 7 February 2015

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IN GENERAL COMMITTEES

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The Committee consisted of the following Members:*Chairs:* SIR DAVID AMESS, † SANDRA OSBORNE

- | | |
|---|--|
| † Barwell, Gavin (<i>Lord Commissioner of Her Majesty's Treasury</i>) | † Mahmood, Shabana (<i>Birmingham, Ladywood</i>) (Lab) |
| † Dakin, Nic (<i>Scunthorpe</i>) (Lab) | † Menzies, Mark (<i>Fylde</i>) (Con) |
| † Durkan, Mark (<i>Foyle</i>) (SDLP) | † Mills, Nigel (<i>Amber Valley</i>) (Con) |
| † Evans, Chris (<i>Islwyn</i>) (Lab/Co-op) | † Pound, Stephen (<i>Ealing North</i>) (Lab) |
| † Gauke, Mr David (<i>Financial Secretary to the Treasury</i>) | † Rutley, David (<i>Macclesfield</i>) (Con) |
| † Johnson, Gareth (<i>Dartford</i>) (Con) | † Swales, Ian (<i>Redcar</i>) (LD) |
| † Jones, Andrew (<i>Harrogate and Knaresborough</i>) (Con) | † Wilson, Sammy (<i>East Antrim</i>) (DUP) |
| † Lopresti, Jack (<i>Filton and Bradley Stoke</i>) (Con) | Marek Kubala, <i>Committee Clerk</i> |
| † McDonald, Andy (<i>Middlesbrough</i>) (Lab) | † attended the Committee |

Witnesses

Rt Hon Theresa Villiers MP, Secretary of State for Northern Ireland

Mr David Gauke MP, Financial Secretary, HM Treasury

Mike Williams, Director, Business and International Tax, HM Treasury

Jon Sherman, Director, Corporation Tax, International and Stamps, HM Revenue and Customs

Public Bill Committee

Tuesday 3 February 2015

[SANDRA OSBORNE *in the Chair*]

Corporation Tax (Northern Ireland) Bill

9.25 am

The Chair: Good morning, everyone. Before we begin, I have a few preliminary announcements. Could electronic devices be switched to silent or switched off? Tea and coffee are not allowed during sittings of the Committee. The notice period for amendments is three working days. Starred amendments—those tabled with inadequate notice—will not normally be called.

The Committee will now consider the programme motion on the amendment paper. We will then consider a motion to report written evidence, followed by a motion to permit the Committee to deliberate in private. Assuming that the last of those motions is agreed to, the Committee will move into private session. Once the Committee has deliberated, the witnesses and members of the public will be invited back into the room and our oral evidence session will begin.

Ordered,

That—

(1) the Committee shall (in addition to its first meeting at 9.25 am on Tuesday 3 February) meet—

- (a) at 11.30 am and 2.00 pm on Thursday 5 February;
- (b) at 9.25 am and 2.00 pm on Tuesday 10 February;
- (c) at 11.30 am and 2.00 pm on Thursday 12 February;

(2) the Committee shall hear oral evidence in accordance with the following Table:

TABLE

<i>Date</i>	<i>Time</i>	<i>Witness</i>
Tuesday 3 February	Until no later than 11.00 am	HM Revenue and Customs HM Treasury Northern Ireland Office

(3) proceedings on consideration of the Bill in Committee shall be taken in the following order: Clauses 1 and 2; Schedule 1; Clause 3; Schedule 2; Clauses 4 to 6; new Clauses; new Schedules; remaining proceedings on the Bill;

(4) the proceedings shall (so far as not previously concluded) be brought to a conclusion at 5.00 pm on Thursday 12 February.—(*Gavin Barwell.*)

Resolved,

That, subject to the discretion of the Chair, any written evidence received by the Committee shall be reported to the House for publication.—(*Gavin Barwell.*)

Resolved,

That, at this and any subsequent meeting at which oral evidence is to be heard, the Committee shall sit in private until the witnesses are admitted.—(*Gavin Barwell.*)

9.26 am

The Committee deliberated in private.

Examination of Witnesses

Right hon. Mrs Theresa Villiers MP, Mr David Gauke MP, Mike Williams and Jon Sherman gave evidence.

9.29 am

Q1 The Chair: The first witnesses this morning are Her Majesty's Revenue and Customs, HM Treasury and the Northern Ireland Office. Good morning to our witnesses. We have until 11 am for this evidence session. Will the Ministers and their officials introduce themselves for the record?

Mrs Villiers: My name is Theresa Villiers. I am Secretary of State for Northern Ireland.

Mr Gauke: David Gauke, Financial Secretary to the Treasury.

Mike Williams: Mike Williams, director of business and international tax at the Treasury.

Jon Sherman: Jon Sherman, director of corporation tax, international and stamps, in Revenue and Customs.

Q2 Shabana Mahmood (Birmingham, Ladywood) (Lab): I welcome all the witnesses and thank them for coming to give evidence to the Committee. May I start by asking about the conditionality element of corporation tax devolution in the agreement that has been reached? We had a lot of discussion on Second Reading, particularly on the condition that the power will be devolved in 2017 if the finances of Northern Ireland are placed on a sustainable footing. Will the Secretary of State give us a bit more insight into that aspect of the devolution conditions in terms of the expectations of the Treasury, the Northern Ireland Office and the Northern Ireland Executive?

Mrs Villiers: There will certainly be work between the Treasury, the Northern Ireland Office and the Northern Ireland Executive to work out the exact criteria to be applied in this case. That has not been settled yet, but as a matter of common sense, it will be important to see a budget that is stable and on which it is clear that the Executive, when they are looking to the future, are able to live within their means.

We had severe pressure in relation to budget matters before Christmas. The recent agreement on a final draft budget for 2015-16 is a hugely welcome development, as is the commitment by the Northern Ireland Executive to reform the public sector and to take steps to ensure that their budget is sustainable for the longer term. That will involve economic reform—doing things differently in the light of forthcoming austerity—but I believe that it is deliverable for the Northern Ireland Executive. They have shown that they have the determination to sort out their budget for 2015-16, and there is strong political support for a reduction in corporation tax. I believe that they are perfectly capable of sorting out their finances to put the budget on a sustainable basis to make such a change affordable. As I say, the exact means of assessing whether or not that test is met will be determined over the coming months.

Q3 Shabana Mahmood: Do you have a timetable in mind for the agreement on the criteria that are going to be applied?

Mrs Villiers: Clearly, a timetable will need to be determined prior to April 2017, when we hope that the new regime will come into effect. A timetable has not been set as yet, but discussions are continuing between

the Treasury and the Executive on the criteria for a reduction in the block grant. There will be discussions over the coming months about how the criteria on sustainable budgets in the Stormont House agreement will be met.

Q4 Shabana Mahmood: I am a little surprised that the criteria are not in place for measuring a key condition for devolving an important power. The Northern Ireland Executive do not yet know what threshold they will have to meet in order to get this power in 2017. It seems strange that not even the basic criteria have been agreed ahead of the legislation. Is there a particular reason for that? Is it just timing?

Mrs Villiers: The strong steer from the Northern Ireland Executive was that they wanted this legislation on the statute book. That was their priority, and it is our priority. Everyone accepts that the practicalities of delivering devolution and a reduced corporation tax rate in Northern Ireland will take some time. That is why everyone is working to the April 2017 deadline, which gives us time to get this right. The approach we are taking is not out of line with tax devolution measures in other parts of the United Kingdom. As a matter of common sense, we need to ensure that prior to devolution being switched on the Administration in question is capable of managing the budget reductions needed to deliver the tax cut.

Q5 Shabana Mahmood: To move on to the expected cost of the reduction—how much money will have to be paid back to the UK—a figure of £300 million was discussed on Second Reading. Is that based on a UK main rate of 20% corporation tax or 21%?

Mr Gauke: That is based on 20%. The figure is in the region of £300 million, on an assumption of a 12.5% rate in Northern Ireland. Of course, it has to be accepted that that is a couple of years away at the very least, and other factors could change that number. It is not a precise number; if I were to give one, our best estimate would probably be £325 million. As I say, that number may well change in forthcoming years, depending, for example, on the relative performances of the Northern Ireland and the mainland economies.

Q6 Shabana Mahmood: As a rough and ready estimate—one of your officials could help—if the main rate was 21%, what would be the expected cost? Do we know?

Mr Gauke: I am not sure that we have done that number. I suppose, one could extrapolate. I am not going to attempt to do the mental arithmetic in front of the Committee—

Shabana Mahmood: Fair enough.

Mr Gauke: But it will be more. *[Interruption.]*

Q7 Shabana Mahmood: Someone else can try the mental maths, perhaps. Is there a standard formula for calculating how much money will have to be paid back by the Northern Ireland Executive to meet EU judgments and so on? Is it what happens in other EU countries when a calculation is made of what needs to be paid back?

Mr Gauke: It would be difficult to describe it as a standard formula, given that this is a relatively unusual situation. As you will be aware, it is necessary to comply with the Azores criteria, which in essence means that it has to be self-financing. There are a number of factors in making up the number, and it is necessary to look at each case on its merits. There is not just the impact of the lost yield, as it were, from a lower tax rate, but the impact of the corporation tax that may have moved for one reason or another from the mainland to Northern Ireland. The factors include the impacts of tax-motivated incorporation and so on. This is a relatively unusual thing to do, so I am not sure that there is a standard process.

When it comes to exactly how the block grant will be deducted, that matter needs to be finalised. Although the Stormont House agreement set out broad parameters—there is a consensus on the needs for a reduction in the block grant—the finer details need to be agreed between the UK Government and the Northern Ireland Executive.

Mrs Villiers: I think that we would expect some common elements with the method used in relation to devolved taxes elsewhere. The Stormont House agreement specifically refers to the fact that the so-called second-round effects are not taken into account in relation to the block grant reduction, which is also the case with the devolution of other taxes to other parts of the UK.

Q8 Shabana Mahmood: So it is still a matter for live discussion whether the £300 million or £325 million cost gets taken off the block grant to begin with, or that is in effect done when CT revenues are in Northern Ireland. Are the practical ways in which the money finds its way back into the Treasury still being discussed?

Mr Gauke: Cash-flow matters and finalising how that will work are matters for discussion, but there clearly needs to be a degree of coherence and it needs to happen at the same time. This is not a matter where, some years down the line, the block grant is reduced; it needs to be reduced at the point where there is an impact on the UK Exchequer.

Mrs Villiers: The officials may also want to come in, but there is a degree of reconciliation after the event. There is the up-front deduction, but as the way in which this will happen has not been exactly settled, there is some scope to say that one can look at the numbers after the event again to make sure that they reflect as accurately as possible the direct and behavioural impacts of corporation tax devolution.

Q9 Shabana Mahmood: There is an invitation to the officials there.

Mike Williams: On the one hand, there is the adjustment to the direct grant but, equally, some of the corporation tax will belong to Northern Ireland though it would be paid to Her Majesty's Revenue and Customs. There are two flows and the arrangements have to work for both. We need to finalise those arrangements, but taking into account that there are two flows, not just one, you could envisage a circumstance where they happen at broadly the same time so as to minimise the cash-flow impact. As I said, that is to be determined.

Q10 Shabana Mahmood: That is helpful. Finally, before other Committee members come in, the block grant will be adjusted to reflect corporation tax forgone by the UK Government due to direct and behavioural effects, but it does not take account of second-round effects on other taxes. The direct effect is more obvious, but could you say more about the methodology for working out behavioural impacts—even though it will not take account of second-round effects on other taxation in the UK—and give some idea of the quantum of such second-round effects?

Mr Gauke: The point on second-round effects is that we are not taking into account, for example, increased VAT revenue in Northern Ireland. As you hinted, it is extremely difficult to measure those effects. The purpose is to take into account, for example, any reduction in mainland CT revenues as a consequence of businesses moving their activities to Northern Ireland or profit shifting. We will no doubt come to the measures we have taken to counter that, but any profit shifting from the mainland to Northern Ireland has to be taken into account to comply with the Azores criteria, otherwise there would be a hidden subsidy, which would not be permitted.

Q11 Andy McDonald (Middlesbrough) (Lab): If this is introduced and it is a success for Northern Ireland, has there been an assessment of the potential impact on other areas of Great Britain, such as Scotland, or the north-east of England, which shares much of the economic profile of constituencies such as those of my hon. Friend the Member for Foyle?

Mr Gauke: There are a couple of points on this. First, it is in the interests of the United Kingdom as a whole for Northern Ireland to be a successful economy and to grow. I am sure that all members of the Committee share that view. Secondly, if as a consequence of the lower corporation tax rate, we see Northern Ireland becoming notably more successful, that strengthens the case for a lower corporation tax rate across the United Kingdom with benefits for other parts of the country.

On the concern that there might be a shift of activity from the north-east of England to Northern Ireland, we have made it clear that we will do everything that we can to address profit shifting, brass plating, and artificial activity to the extent that if there is any shift and, as a consequence, loss of tax revenue to the United Kingdom Exchequer as a whole, that has to be taken into account when assessing the block grant adjustment. There are a number of factors there.

Mrs Villiers: The whole regime is designed to minimise artificial shifting of business between Great Britain and Northern Ireland. One would hope that one potential benefit for Northern Ireland is that it is better able to compete for investment that would otherwise go to the Republic of Ireland. It has been a key concern in Northern Ireland for some years since the Republic of Ireland reduced its corporation tax so drastically that many global companies will look across the whole island to make investment decisions. It is not a zero-sum game—Northern Ireland versus the north-east. There are jobs, investment and opportunities, which would not come to anywhere in the United Kingdom, that might come as a result of this. It would be investment that might otherwise go somewhere else altogether and, in particular, this change could help Northern Ireland compete with the Republic of Ireland.

Q12 Andy McDonald: We talked about differentials. This is all about having a different rate in Northern Ireland from that of the rest of the United Kingdom. How will that help? You say that if it is uniform across the globe, this is supportive of a lower rate. Does a uniform lowering of the rate not disappear the differential? How is there an advantage to Northern Ireland if the rate across the whole United Kingdom is standardised, or are you heading towards a Republic of Ireland rate of corporation tax?

Mr Gauke: The point that I was making is that if, as a consequence of a lower corporation tax rate, the Northern Irish economy becomes much more successful, there is a lesson to be learnt for the whole United Kingdom. The world does not end at our borders. As the Secretary of State rightly said, this is not a zero-sum game in terms of the United Kingdom. Businesses have choices about where they locate activity. As a consequence of the changes, it may well be that Northern Ireland offers a much better choice compared with a whole range of jurisdictions than it does currently, but there may be a lesson to be learnt from that. If that turns out to be the case, it strengthens the case for an even more competitive corporation tax at the UK level.

Q13 Nic Dakin (Scunthorpe) (Lab): How widely did the Government consult on the change before reaching their decision? For example, did they consult bodies such as the Institute for Fiscal Studies?

Mrs Villiers: We ran a full consultation in 2011, and I am just reaching for the number of responses. I think that there were around 400 or so responses but someone may correct me on that. The consultation had a significant number of responses and the vast majority were positive about the change. That, of course, was on the policy decision—whether we should do it—but there was also input on particular issues about, for example, minimising administrative burdens for small businesses. That came through in the responses. The technical work has been informed by those responses, as well as by the work done in the joint ministerial working group between Northern Ireland Ministers and Ministers from the Treasury and from the Northern Ireland Office. In addition, it has been informed by contacts that have continued since then, particularly between the Department of Finance and Personnel in the Northern Ireland Executive and other key stakeholders. I have been handed the information: there were 700 responses to the consultation, many of which were broadly positive.

Q14 Nic Dakin: What about the IFS's criticism when it says,

“Corporation tax is not a good candidate for devolution”, and expresses concerns about profit shifting—we have covered some of that—and tax competition in the UK, suggesting that this adds complexity to the picture, which might not be beneficial overall?

Mrs Villiers: There are risks and there is no doubt that it adds a degree of complexity to the corporation tax regime, but we have listened to response such as that and others in the way that the regime has been constructed. The focus on trading profits, for example, and the exclusion of certain activities where there is greater scope for avoidance—such as financial services, leasing and lending—are designed to address and minimise

abuse of the system. Of course, these are in addition to the general rules that aim to prevent abuse, such as the general anti-abuse rule—the GAAR. There are specific measures to discourage profit shifting, for example, the way in which Northern Ireland losses can be offset against GB profits. There are specific things that are designed to deal with avoidance issues, but in addition the whole structure is designed to ensure that the Northern Ireland tax rate benefits only genuine economic activity in Northern Ireland, rather than the artificial shifting of transactions.

Mr Gauke: I would add to that a point about the specific circumstances of Northern Ireland: the land border with the Republic of Ireland, the legacy of the troubles, and so on. There is a particular case for Northern Ireland, which I do not think applies to other parts of the United Kingdom. The IFS view is more persuasive when looking at Scotland or Wales than at Northern Ireland.

Q15 Nigel Mills (Amber Valley) (Con): May I go back to the second-round effect? There was a paper by HMRC or the Treasury in late 2013, which looked at the dynamic effects of corporation tax, and suggested that, over the long term, about 45% to 60% of the tax revenues were got back from income taxes and VAT. I suppose that by not giving those back to Northern Ireland, there could be a net cost, and actually it is really quite harsh on them. They have to pay all the downsides, but they get back none of the tax upsides. Is that really what is planned in the long term?

Mr Gauke: The difficulty with the second-round effects is the uncertainty. It is difficult to include them. It is worth pointing out that, in the Stormont House agreement, all parties agreed that the second-round effects would not be included. The uncertainty there makes calculating the sums very difficult. I accept the point of the Treasury analysis that was done, but it had quite a significant range for what the second-round effects would be, and it is difficult to quantify that. I come back to my earlier point that, if the Northern Ireland Executive pursue a lower rate of corporation tax, they will do so on the basis of their view that it would benefit the Northern Ireland economy, but there is also an upside for the UK economy as a whole.

Q16 Nigel Mills: I am trying to understand how HMRC will handle the risks of profit shifting, and people moving to Northern Ireland from GB just to get the lower tax rate. In practical terms, how will you spot what is happening and look for any structures being created or any new risky behaviours? Are you resourced to do that? Have you thought yet about how you might spot that happening?

Mr Gauke: I will let Jon come in on this in a moment but, as the Secretary of State said, the focus of the structure we are looking at is on trading profits, the existence of an SME regime that is based on employment, and the application of a well established transfer pricing regime and apportionment, which large businesses are used to. Before we get to the implementation points, it is worth bearing in mind that the structure is designed to prevent brass plating. It excludes those sectors and those types of profits that are easiest to shift into a lower tax jurisdiction for tax reasons. There are quite a lot of safeguards in the legislation.

Jon Sherman: We take a risk-based approach to compliance. We are very conscious of the level of risk that the largest businesses pose, in terms of their tax behaviour and their tax strategies and so on. In the highest risk cases, we do regular, detailed risk reviews that enable us to look in depth at what risks are created by those companies. With others, the relationship will be more tailored, based on the level of risk we think they present. As the Minister has said, the rules are pitched to minimise the opportunities for profit shifting, but we will look at the approaches to routing profits taken by companies that have what we call Northern Ireland regional establishments, to make sure they are in line with agreed international principles. Larger companies will, in many cases, already be taking that sort of transfer-pricing approach and we will already have taken that into account in our risk working with those companies. It is something that we are already doing and we will build on that process.

We devote a significant amount of resource to larger businesses in particular. When it comes to the arrangements with Northern Ireland, the additional costs of compliance that we incur that are caused by the devolved regime will be paid for by the Northern Ireland Executive, so there will be a process of discussion with them as well. We are transparent with them about what we plan to do in terms of the resources that we will be deploying. They will be aware of what we are doing and we discuss it with them.

Q17 Nigel Mills: If you started to see lots of online sales being routed through Belfast, or mail-order sales being based in Belfast, or intra-UK principal structures turning up to try to get trading profits into Belfast, do you think you could spot any trends like that?

Jon Sherman: Clearly, as part of our risk processing, if we see companies that, for example, we know have no Northern Ireland footprint, or very little, and they suddenly start telling us that a high proportion of their profits are Northern Ireland profits, that would trigger alarm bells. Clearly, we will look for signs of artificial arrangements that are intended to generate profit in Northern Ireland. If a retail company has 1,000 stores in GB and 10 in Northern Ireland but 90% of its profit is in Northern Ireland, again, that would certainly trigger alarm bells. We look at the arrangements and try to monitor the risks, but the way we designed the regime, in line with international principles and with additional safeguards built in, puts us in a good starting position.

Mike Williams: It is worth noting, as well, that there is an advantage to the UK here compared with other profit shifting, because HMRC is sitting on both sides of the fence—the Great Britain side and the Northern Ireland side. Often, the difficulty with profit shifting is that you can see what is happening in the UK, but you may struggle to get enough information about what is happening outside. If there was any shifting, HMRC would be getting information on the Northern Ireland element as well as the rest of the UK element, and that would help to counter that risk.

Jon Sherman: It is a significant deterrent for a lot of companies that, when it comes to profit shifting, it is not just the rates that people are looking at, but all the things that go with it: what happens in that jurisdiction, how much scrutiny there will be, and so on. If it is a

classic tax haven, there will be no scrutiny, obviously, of what you are doing, whereas, clearly as Mike has just said, we will be exercising scrutiny at both ends.

Q18 Nigel Mills: Were you tempted just to have an allocation system to split profits between the mainland and Northern Ireland: just to go for sales and employees, rather than the separate-entity approach? Or is this the only way that this could realistically have been done?

Mike Williams: It is not the only way. We did contemplate, very briefly, whether we could allocate on that basis. It is what happens in the US where, as you will know, some states have their own state income taxes that piggyback off federal tax, and they have to work out how much of the profits belong to them. They generally use some sort of formula that is based on sales, payroll and inventory. I think it is fair to say that the states in the US are not wholly satisfied with this. Equally, you meet people who explain that they do such things as move inventory around so as to impact the formula to their advantage.

If looked at in isolation, it is by no means an ideal system. However, looking at it in the context of businesses that are already following the normal international rules on such things as transfer pricing, applying those rules to Northern Ireland is not that difficult for them if they are operating in 40 countries and already operate these rules. If we were to say to them that they would have to introduce a special rule for Northern Ireland based on, say, sales, they would then have to track something, which they do not currently track, for that purpose. I think it would add a burden that the approach we are adopting does not add. Plainly, you could do it, but I think it would be more complicated. I do not think it would lead to a better result.

Q19 Nigel Mills: I have one last question. On the UK's moving to having an onshore tax haven—if I can be inflammatory in my choice of language—has that wound up any of our international partners, who are perhaps thinking, “This is not where we thought international agreements were taking us. Why are you potentially risking a much lower rate in a part of the UK?” Are we not encouraging mobile profits to turn up here in an artificial way that perhaps other countries will not like?

Mr Gauke: We believe we have to be competitive when it comes to corporation tax. In April, we will have the lowest corporation tax rates in the G20, but we also believe that such taxes should be paid. We have been leading the way in the OECD's base erosion and profit shifting process and arguing the case for closer alignment between economic activity and tax. As for dealing with artificial and contrived behaviour, we have led the way internationally. At the autumn statement, the Chancellor set out details of the diverted profits tax, which is again an example of dealing with artificial and contrived arrangements. I think the UK should be seen as a country that believes in competitive but fair taxes, which is what we are delivering.

Mrs Villiers: The Northern Ireland regime will be firmly rooted in the UK mainstream regime. We will not see the questionable tax practices that are associated with offshore jurisdictions. It is a targeted measure that deals specifically with Northern Ireland's circumstances, namely that it shares a land border with a very low tax

jurisdiction and has suffered from 30 years of the troubles, which has meant that it is highly dependent on the public sector in terms of its economy. I think the Bill is entirely proportionate and specific to Northern Ireland's particular circumstances.

Q20 Mark Durkan (Foyle) (SDLP): If we can go back to the implications for the block grant, some years ago, the Varney review seemed to try to fill everybody with fear that corporation tax could be devolved only on the basis of a fixed and continuing-for-all-time cut in the block grant: when it is gone, it is gone; this is a dangerous punt and we do not know what will happen afterwards, depending on volatility. The Government seem to have found a modified approach, which will seemingly project what the differential would be and take account of that in the block grant, rather than simply looking at what the reduction in the block grant would be. Would that mean that we are looking at an aspect of tax assignment in Northern Ireland's background, and that a portion of what Northern Ireland will get under the Barnett formula will be directly attributable to what it is presumed it will raise in corporation tax?

Mrs Villiers: I am not sure I understand the question. Certainly the Azores criteria require any tax cut introduced in Northern Ireland to be funded in Northern Ireland.

Q21 Mark Durkan: That must mean you can attribute what the remainder tax is within the block. If you are able to say that the tax reduction means that that amount has to come off the block grant, the corollary is that you can identify how much is in the block grant that is attributable to corporation tax.

Mr Gauke: I suppose that is right. It is a slightly more complicated calculation, because there are also behavioural impacts. It is not simply a question of working out the corporation tax from Northern Irish businesses and saying, “They contribute this, so we just take it off the block grant.” It is more complicated than that. That amount is taken off the block grant—there are some additional elements to it as well—and that source of revenue then goes to the Northern Ireland Executive.

Q22 Mark Durkan: Earlier, the Secretary of State said that some of this might be comparable to tax and devolution in other parts of the UK. Clearly, tax assignment is increasingly talked about as a feature of the Scottish model of devolution. I wonder why we talk only about the drop—what will be taken out of the block grant—and not how we measure what is still in the block grant from corporation tax, and how that might vary over time.

Mrs Villiers: In this context, what do you mean by tax assignment? Is that just looking at the block grant that goes to Scotland and working out which taxes are generating or not?

Q23 Mark Durkan: I did not write the package; the Government and others did. Clearly, there is a strong notion of tax assignment in a number of areas, not just in relation to income tax. It is also there in relation to a portion of VAT being identified within the Scottish block grant.

Mrs Villiers: Oh, I see what you mean.

Mark Durkan: Given that the IFS has said that corporation tax can be volatile, it is about knowing at any time, year on year, the assumption of what will be

in the block grant, and at the end of the year, when we find out what has happened, what adjustments are made. Will there be any consequential adjustments for future block grant allocations?

Mrs Villiers: Forgive me; I have finally worked out the issue. I do not think we need to extrapolate the questions around tax assignment in Scotland to Northern Ireland. It is important to recognise that for devolution settlements to work there are advantages to having different structures for different parts of the UK, because the circumstances are very different. That is particularly true of Northern Ireland. There are important aspects of the Northern Ireland devolution settlement that are there to match Northern Ireland's specific circumstances, which would probably be wholly impractical and undesirable in relation to other parts of the UK.

That is why I chose my words carefully when I talked about the method of calculating the deduction from the block grant in Northern Ireland to pay for this corporation tax change. One would expect some common element between the way that calculation is done in relation to Northern Ireland corporation tax and devolved taxes elsewhere in the UK, but I would not go further than that. We do not need to cut and paste the same approach. One common approach that has been set out in the Stormont House agreement is that second-round effects are not taken into account in the calculation.

On the debate about the assignment of taxes, it is interesting but not necessarily a model that needs to be followed in Northern Ireland. There is nothing in the Bill or what we have said about the block grant that would suggest that we should do the same thing in relation to Northern Ireland.

Q24 Mark Durkan: It could arise in future years. It is one thing to calculate based on the first declared lower rate of corporation tax in Northern Ireland. That calculation can state that that is the reduction in the block grant. However, what about the revenue raised and collected by Revenue and Customs after that? What does that count towards in future? As Northern Ireland attracts a lot of businesses and grows a lot of its own, the corporation tax take will go up. Where does the benefit of that corporation tax take go?

Mr Gauke: In those circumstances, that would go to the Northern Ireland Executive.

Q25 Mark Durkan: Counted how? Would that be counted as an extra on what was the projected Barnett formula block grant, or counted as more of the block grant that it is getting already attributed to corporation tax take under the Barnett formula?

Mr Gauke: We are getting to the detail of what the formula would be. That is something that needs to be agreed between the UK Government and the Northern Ireland Executive.

Jon Sherman: The Northern Ireland tax revenue, which HMRC will collect, will be the Northern Ireland Executive's money.

Mike Williams: You need to distinguish between sources of funding for Northern Ireland: tax revenue and Northern Ireland's share of public expenditure. This is about Northern Ireland getting the corporation tax from the devolution to Northern Ireland.

Q26 Sammy Wilson (East Antrim) (DUP): May I follow up on that? This is important. Whether or not it is cut and paste, the figure of £300 million or £325 million is the headline figure at present. For the future, it is important that the Northern Ireland Assembly and people in Northern Ireland know what the cost of this will be.

To follow on from Mark's question, will the amount of tax attributable to Northern Ireland simply be measured by experience or does the Azores judgment require the Treasury to say, "We expect a certain take every year, so we have a formula for that take"? The base figure cannot stay like that for the next 50 years; there has to be some growth. If Northern Ireland does better than that formula, there is a gain. If it does worse than the formula, there will be a net loss to the block grant. I suppose what we really want to find out is how that will be calculated? Will it be calculated according to corporation tax rise in the rest of the United Kingdom? Will it be calculated according to GDP growth? How will it be measured?

Mr Gauke: To a large extent, that is a matter for discussion and, I like to think, agreement. We have been very clear that the exact means by which the block grant adjustment will be calculated needs to be finalised. A number of elements have been agreed, but we are not pretending that that matter is complete or final.

Q27 Sammy Wilson: You must have some idea of the kind of formula that is used in other circumstances. If corporation tax does not grow as quickly as it does in the rest of the United Kingdom, either because it is not successful or because other factors influence Northern Ireland's economy, is there potential for the bill as a percentage of the block grant to increase over time? The growth in the formula would not equate to growth on the ground in Northern Ireland.

Mr Gauke: Those are all points that will no doubt be made in future discussions about precisely what the formula will be. It is inevitable with devolution in this area—indeed, it is inevitable if this is going to be consistent with the Azores judgment figures—that there is a risk both ways. That is a choice for the Northern Ireland Executive. If it sets a rate of corporation tax that is different from the rest of the United Kingdom, there is a benefit if that turns out to be more successful than was predicted and a potential loss if it is less successful.

Q28 Sammy Wilson: I suppose that that is the point. What are the requirements under the Azores judgment for predicting or measuring what the contribution should be in future years once the tax has been devolved? Is there a range of options? If so, has any work been done on what the figure could be in five years or 10 years if it is starting from a £325 million base at present, using those particular options?

Mr Gauke: I am sure that Mike will correct me if I am wrong, but I do not think that the Azores judgment specifies precisely what formula is used. We want a formula that is fair to Northern Ireland and fair to the United Kingdom as a whole.

Mike Williams: There has to be an effect of devolution. As the Financial Secretary said, the effect of devolution has to mean that the body to which there is devolution

bears the risk of tax revenues coming in lower but equally it gets the benefit of them coming in higher. If that does not happen, you have not really devolved at all. If there is some sort of hidden hand that holds the devolved body good and protects against loss, you do not have devolution. Equally, if you bear the risk of tax revenues coming in lower, it is logical that you get the benefit of them coming in higher.

Q29 Sammy Wilson: I understand that there has to be a two-way risk. All I am trying to ascertain is whether we have any idea as to how the figure is likely to grow, because that is important when it comes to deciding just how much you reduce the rate by and how much risk you take on.

Mr Gauke: I come back to the point that that is a matter to be finalised. You make a perfectly reasonable point that the Northern Ireland Executive would want to know precisely how that is done before they make any decisions as to the rate they set, but that is a matter on which there is need for further discussion.

Mrs Villiers: It is a useful point to make. It is important that we start to get some clarity on these matters, not least because presumably the Northern Ireland Executive is likely to need to make a decision on budgets after the Assembly election in May 2016 because if they are going to do this from April 2017, they will need to take account of it in the budget they set for the next Assembly term. It is useful input and it is important that we made some progress to ensure that the Assembly, when it makes its choice, has as clear an idea as possible about how much this will cost.

Q30 Sammy Wilson: That brings me to another point that the Executive need to know: the conditionality that has been attached to this. Back home, it is almost seen that, because of the Stormont House agreement, this is now a done deal. I think it is right that conditionality be attached to it, but can you spell out for us, Secretary of State, what that means? Does it simply mean that if the Executive agree the budget for next year, which is currently on the Floor of the Assembly, that is it? If there is a hiccup in getting the welfare reform changes through, does that breach the conditionality?

Part of the Stormont House agreement was that to get the finances on a sustainable footing, there would be a voluntary redundancy scheme, which would involve some 20,000 civil servants taking voluntary redundancy to bring the budget to a level that was sustainable in the long run. Do you expect to see that monitored for a certain period before those conditions have been met? What yardstick will you use to measure whether the conditions have been met for the devolution of corporation tax?

Mrs Villiers: Certainly, to answer one of your questions, there will need to be a monitoring regime to establish whether the conditions are met or not. That is envisaged by the Stormont House agreement in terms of the regular implementation meetings, the first of which took place just a couple of weeks ago. As I said at the start of this discussion, the criteria for exactly how we determine whether the Executive have their finances on a sufficiently sustainable footing that they can take on these powers have not yet been set. It is important that the Government and the Executive work together to come up with the appropriate criteria so that everybody knows where they stand.

The Stormont House agreement is clear that progress on this Bill is dependent on, among other things, progress on welfare reform through the Assembly. The agreement made between the five parties in Stormont castle on this matter is a crucial breakthrough. It is important that they press ahead with implementation of that agreement—welfare reform topped up from the block grant. My understanding from my implementation meeting with the five party leaders last week is that they are on course to do that and are approaching that very seriously. If there is a hold-up and we return to a big dispute about welfare reform, it is difficult for the Executive's finances to continue on a sustainable basis. That was one of the grave concerns pre-Christmas and before the Stormont House agreement. It is important that we see the parties move forward, implementing welfare reform with the top-ups they have agreed among themselves from the block grant.

Q31 David Rutley (Macclesfield) (Con): I want to follow up a couple of points that have been raised, particularly concerning potential safeguards against abuse. Mr Sherman talked about profit shifting and the risk-based approach that was being adopted. I am keen to understand what safeguards will be put in place if there was evidence of abuse, and to have a better understanding of what the sanctions might be.

Jon Sherman: Obviously, from an HMRC perspective, we will be monitoring those risks quite carefully. If we spot signs of abuses that we do not think we can currently safeguard against with our existing legislation, we would alert Treasury Ministers to that and they would take a decision on what needed to be done. At the moment, I think we have quite a lot of safeguards in there.

Q32 David Rutley: Such as?

Jon Sherman: As has been said already, the fact that the regime is limited to trading profits; the fact that it excludes certain high-risk activities such as finance lending; and some of the rules around intangibles—the requirement for a physical presence for regional establishments and the attribution of profits. Rules are therefore built into the regime to make sure that it is not attracting the kind of mobile profits that are easily separated from economic activity.

Q33 David Rutley: So that would be safeguards in terms of trying to anticipate this and prevent people or businesses from doing it in the first place. If there was evidence of abuse, what sanctions are available to Ministers to discourage, dissuade and prevent people from doing this?

Jon Sherman: We would challenge any arrangements that we do not think comply with current law. We would investigate and pursue those arrangements and, if necessary, if we did not get the business concerned to back down, we would litigate. If there was deliberate concealment or involvement, there may be penalties as well in some circumstances. We would pursue that in the usual way, in that we would challenge arrangements that we do not think comply with current law. Obviously, if we think that current law does not give us the protections we need, we would advise Ministers accordingly that there was an issue.

Q34 David Rutley: I have one other quick, slightly different, question. Regarding the impact on GB regions—for example, I am the Member of Parliament for Macclesfield, in the north-west—if significant investment was deemed to be being drawn away from other regions, what remedies would be envisaged to address this potential excessive movement of investment from the mainland to Northern Ireland?

Mr Gauke: I come back to what I was saying earlier. If we are seeing movement of genuine activity—if we are not talking about profit shifting, where the answer is enforcement and potentially changing the rules, but a Northern Ireland corporation tax rate of, say, 12.5%, resulting in a substantial flow of investment into Northern Ireland versus other regions—the response to that has to be a policy one. I would argue—different people and parties may take different approaches—that in those circumstances, the case would be for levelling down rates, rather than levelling up. I do not think there is a case for intervening and saying, “Northern Ireland is doing too well, we had better stop it”. I do not think that would be an advisable course of action.

Q35 Chris Evans (Islwyn) (Lab/Co-op): The entire corporation tax base, including reliefs and allowances, will remain with the UK Parliament. We know how complicated corporation tax is in terms of reliefs and allowances. Is this really a halfway house? Why have you not gone the whole hog and allowed the Northern Ireland Executive to set the reliefs and allowances?

Mr Gauke: Our view is that that would create much greater complexity and open up some of the profit-shifting risks that the Committee has rightly been asking about today. By focusing on the rate and trading profits, we believe we have the balance right. The incentives are there: if the Northern Ireland Executive want to lower rates to attract investment and increase economic activity, they can do so. If we start getting into reliefs and allowances and so on, which is a more complex part of the tax regime, we end up with much greater complexity. That would open up some of the profit-shifting risks we are trying to close down.

Mrs Villiers: One of those risks is to the Northern Ireland Executive. A system that devolved many more decisions over rates would give rise to the risk that the changes become more expensive for the Northern Ireland Executive than the regime we are proposing in the Bill.

Q36 Chris Evans: I come from Wales, where we have a lot of discussions about devolving tax. The crux of the issue is that if there is, as we hope, a reduction in corporation tax that competes with the Republic of Ireland, there will be an immediate reduction in the block grant. I assume that the effect of a reduction in corporation tax will take quite a bit of time to be felt in Northern Ireland. What adjustments are going to be made for that reduction in block grant while we are waiting for the benefits of reducing corporation tax?

Mrs Villiers: The deductions would need to start when the tax is reduced—I assume that would be required by the Azores judgment—but businesses will start taking decisions on the basis of the rate to be introduced in the future. If the Bill goes through and there is every prospect that Northern Ireland will meet the conditions on financial sustainability, I would expect businesses

around the world to start planning and making their decisions on the basis that they expect a low corporation tax to be introduced in Northern Ireland.

I do not think that the date of implementation is completely year zero; there will at least be a run-up where everyone knows that it will happen. Even now, when we cannot be absolutely certain that it will happen, I have no doubt that Invest Northern Ireland is, as we speak, talking about the opportunities in Northern Ireland to people around the world who, in previous times, might have headed off to Poland or invested in Dublin. Now there is a greater prospect of them coming to Northern Ireland to invest because there is a real possibility of a reduction in corporation tax. I hope that that will very soon become a definite outcome.

Mr Gauke: That is a very good point. One can look at what we have done with corporation tax rates in the UK, where in 2010 we set our corporate tax road map and set out plans to reduce corporation tax over a number of years. I think that businesses found that extremely helpful as they could see the sense of direction and could start adjusting their decisions in anticipation of future reductions, rather than waiting for them.

It is a very fair question but, largely, it is one for the Northern Ireland Executive: are they persuaded by the case to lower corporation tax, given that there is, inevitably, an adjustment to the block grant and that there will be a debate on the time scale for seeing benefits for the Northern Irish economy? That is a matter for the Northern Ireland Executive to consider.

Q37 Chris Evans: This last question is more a question for the Northern Ireland Executive, but do you believe, Secretary of State, that they will be able to fix a budget that can take account of the impact of corporation tax devolution in the next three to four years?

Mrs Villiers: I think, yes, the Northern Ireland Executive are capable of setting a budget that is sustainable and can accommodate a reduction in corporation tax. As David has said, ultimately, that will be their decision and they will need to decide on their priorities, but I think they are capable of doing that, not least because of the decisions they have been taking in recent weeks to reform the public sector and put their budget for next year on a sustainable basis.

Q38 Stephen Pound (Ealing North) (Lab): I apologise, Mrs Osborne, for being about 10 minutes late. Unfortunately, the grim grip of winter holds Hanwell in its hand and a light dusting of snow inevitably led to delays throughout the Central line. I can only apologise for that.

The Secretary of State referred to a possible relocation north from Dublin, and to 700 consultees. What is the extent of the north-south aspect of that consultation? The Finance Minister in Dublin obviously will not make a formal statement or express an opinion, but does the Secretary of State or any of her officials anticipate any change in fiscal policy in Dublin if corporation tax is lowered in Northern Ireland?

Mrs Villiers: As you say, the Irish Government are the only ones who can answer that, but certainly they have given no indication that they will change their tax policy as a result of devolution of corporation tax in Northern Ireland. They have said repeatedly that they

would like to see this change take place and they are supporters of the Stormont House agreement, which sets the pathway for devolution to take place.

Q39 Stephen Pound: With the greatest respect—as politicians often say—you are talking about the devolution rather than the reduction. I do not think that anyone would object to the devolution, but were the consequences of a reduction in corporation tax to be significant, the 30-years-plus low corporation tax regime in Dublin would inevitably have to be reconsidered. Does the Secretary of State think that that is a valid statement?

Mrs Villiers: Again, for all sorts of reasons, I feel reluctant to speak on behalf of the Irish Government.

Stephen Pound: I am talking about the implications for their own—

Mrs Villiers: My understanding from my conversations is that they would be content with a reduction in corporation tax in Northern Ireland to meet their own corporation tax levels, because they believe that a prosperous and successful Northern Ireland is good for the Republic of Ireland as well. They are very keen to see both jurisdictions flourish, so my understanding is that they would not be unhappy with a reduction in Northern Ireland to 12.5%. No doubt, you can direct that question to them when you have the opportunity.

Q40 Stephen Pound: Secretary of State, you referred to the possibility of relocation from the Republic of Ireland to Northern Ireland. Was that a throw-away comment or has it been factored into the discussions?

Mrs Villiers: I am not sitting here saying that suddenly there is going to be a huge exodus across the border or that Apple and whoever else are going to be setting up in Belfast rather than in Dublin. However, devolution and a potential rate reduction is an opportunity for Northern Ireland to be a more attractive location for business. That investment could come from businesses currently located in the Republic of Ireland or from many parts of the world. Northern Ireland has a hugely positive offer already: good infrastructure, low-cost base, very high-quality and consistent work force. Businesses consistently say that when they come to Northern Ireland and train people up, those people stay rather than heading off to a rival employer. There are all sorts of reasons why Northern Ireland is a great place in which to do business. A low corporation tax bill will be a particularly attractive addition to that.

Stephen Pound: I am grateful. I cannot believe that anyone in the Committee would disagree with that percipient analysis of the benefits of Northern Ireland and its skilled work force.

Q41 Shabana Mahmood: May I go back to the question about allowances and credits and the fact that they are not part of the devolution measures? I agree with the Financial Secretary's points about complexity and the increased risk of profit shifting. How does the UK's allowances regime compare with that of the Republic of Ireland—is there perhaps a future scenario where the Northern Ireland Executive might be pushing for devolution of allowances so that they can better compete with the

Republic of Ireland, which may have a more favourable regime? Is that something that you have considered, and does our regime currently compete quite well with the Republic, notwithstanding the difference in the headline rate of corporation tax?

Mr Gauke: There is an important point there. It is worth acknowledging that the differences between the tax regimes in the UK and the Republic of Ireland are not just about rates. However, we are also conscious that, perhaps as part of the base erosion and profit-shifting process, there may be a number of changes in how the tax system works in several jurisdictions.

To answer your point directly, we are strongly of the view that the proposal in the Bill is the right approach. It strikes the balance between providing greater power and responsibility to the Northern Ireland Executive and the ability to go out and make a case internationally that Northern Ireland is a good place in which to invest—for corporation tax as well as for the reasons that the Secretary of State has identified—and not creating a great deal of complexity or providing opportunities for profit shifting. We are of the view that that is the right position.

In a way, you are asking whether it is possible that in future this debate will evolve in a slightly different way and whether there will be further requests and so on. It is impossible to rule that out. I cannot speak for what the Northern Ireland Executive will be lobbying for in five, 10, 15 years, but we believe that this is the right proposal, which strikes the right balance and puts in place a position that can last for many years.

Q42 Shabana Mahmood: Do you agree that the current regime, in particular for allowances, is competitive when compared with the Republic of Ireland's regime, notwithstanding anything that might be in the offing in relation to BEPS and so on?

Mr Gauke: It is not for me to spend a lot of time discussing the Republic of Ireland's tax regime. There are aspects of the Republic of Ireland's tax regime, which they themselves recognise are perhaps no longer appropriate in the modern world. They have made announcements on the "Double Irish" and so on. We are not proposing to allow that type of arrangement to work through Northern Ireland. We do not believe that that is in the interests of Northern Ireland or the UK. It is worth noting that the Republic is moving away from that type of position. At least, they have made that very clear in their public statements.

Q43 Shabana Mahmood: You have pre-empted my question on the "Double Irish".

You have probably seen the written evidence that KPMG Belfast submitted. I wanted to pick up a point about the definition of back-office functions. The Bill excludes,

"trades consisting of lending activity, relevant regulated activity and insurance activity",

but back-office activity is carved out of that. KPMG Belfast raises the prospect of definitional difficulties for back-office functions. What are your comments on that? What is the experience of the definition of back-office activity in other taxation legislation and do you expect the same problems potentially to carry over into the Bill?

Mr Gauke: I will let Mike and Jon come in on this. There are very good reasons for excluding financial activities. We have touched on those in terms of vulnerability to profit shifting.

Back-office activity is the type of activity in which Northern Ireland might want to be competitive. It is genuine activity and employs lots of people. We would want to support that, so it would be a mistake to try to exclude that from the regime. It is a different argument and set of circumstances from financial activity as a whole. We have tried to strike that balance in the definition.

Mike Williams: We thought about defining back-office functions and we have ended up with no definition, so it takes its normal commercial meaning, but with the scope, if it seems appropriate, to add more definition. In my experience of dealing with the financial sector, I suspect most of them know what the back-office functions are, not least because they are in what they would regard as cost centres rather than areas of the business that make profits. Very broadly, it is the people who are supporting the carrying out of the business, such as the administration. I am not sure that writing that into the legislation would add clarity. It might in some circumstances be slightly too restrictive. We are open to the proposition that we should put more definition around it. I do not think we are getting many suggestions from stakeholders that we should do that. As I said, if we need to, we have built in the escape valve. If people say it is not clear enough, we could define it. Equally, there is scope for HMRC to provide guidance to be clear about what counts as back-office function and what does not.

Jon Sherman: We are focusing specifically on guidance in this area to be as helpful as we can in providing direction. As Mike says, we have the power to fall back on if there are issues where we feel we need more guidance and legislation.

Q44 Shabana Mahmood: That is helpful. The Financial Secretary recently met the Chartered Institute of Taxation to discuss the Bill. I understand there was discussion about the legislation being complex, the lack of time for consultation on its measures and the prospect of its being kept under review, given the time before it comes into force. It would be helpful to hear the Minister's views on that.

Mr Gauke: I will make a couple of points. As the Secretary of State made clear earlier, there was significant consultation going back to 2011. There has been work on the project for many years. I cannot think of anything else that has had the lifespan of this legislation in the five years I have been doing this job. There has been a lot of debate and discussion. I would also say that there is clearly a desire in Northern Ireland for this to be legislated for in this Parliament. It is right for us to respond to that; it played an important role in the Stormont House agreement. It is right to legislate for that.

In the event of particular technical points emerging over the next few months that are not addressed during the Bill's passage, there will be the opportunity in future Finance Bills to make such changes. We do not go into this with that intention but, given that there is a strong case for moving quickly, for those who are concerned that we are acting more quickly than normal, there is an opportunity to make changes. We do not think that that

will be necessary, and nothing we have heard in representations suggests that we are off the mark. Being pragmatic, if something were to emerge in the next few months, there is an opportunity to fine-tune the Bill.

Mrs Villiers: At about 86 pages the Bill looks relatively complex. The realities of modern capitalism and tax systems mean that you do not often get a short tax Bill. There have been significant efforts to minimise complexity as much as possible, not least with the focus on trading profits and the regime for small businesses. We hope that, for the businesses involved, that will be relatively straightforward.

Although there are lengthy parts of the Bill about how larger businesses apportion their profits, because that is lifted from international rules, much of it is not new principles and complexities. It is just applying broadly the same approach in a slightly different context.

Q45 Shabana Mahmood: I have one final point. Some stakeholders and businesses have raised the scenario of an SME that is close to the boundary of large-company rules and may move in and out of that area. Have you considered allowing such firms to opt in to the large-company rules?

Mr Gauke: We did consider that. I notice that Mr Mills has tabled an amendment that will give us an opportunity to debate the matter at greater length. On balance, we took the view that, where you offer a choice in those circumstances, to some extent you are inevitably increasing the complexity of the regime because, where you have a business that currently falls within our SME regime but that might want to consider opting in to the apportionment arrangement for larger businesses, they will almost feel duty bound to investigate what their tax payment would be under both regimes and then take a view as to which regime they want to be in. It might be a little cynical to make this point, but very often businesses that call for greater choice are the first to complain about too much complexity, which is driven by the choice that is available to them. On balance—it is a perfectly respectable argument, and it is a finely balanced judgment—we concluded that it is better to have that regime as it is and not provide the choice. It is also worth pointing out that we do not think that that many businesses fall into those circumstances. Although I can see the theoretical point, we certainly have not been presented with a lot of evidence of businesses that only just fall outside the larger business regime and might want to use the apportionment arrangement, but are constrained from doing so. We do not think that will apply very often.

Q46 Mark Durkan: To go back to the points that were raised about companies—for instance, the Secretary of State referred to small and medium-sized enterprises. Obviously, Revenue and Customs will want to ensure that everyone is conforming and that those who are benefiting from the reduced corporation tax rate are those for whom it is appropriate. How far do you see there being any difficulties on things such as 75% or more of working time and 75% or more of working expenses, et cetera? Is there any concern that there will be artifice on the part of firms just to maintain that position?

Mr Gauke: First, I am not sure that that many businesses are particularly close to the threshold. The number of businesses that could, if you like, manipulate it in the first place is probably relatively small because

either nearly everybody is in Northern Ireland or around half or less are in Northern Ireland, rather than being close to the boundary. As to whether there is artifice in this area, I think it would be quite difficult to do. I might ask Mike and Jon to come in here, but I would not have thought that that will necessarily be a particularly high risk, given that most businesses will not be near the boundary.

Mike Williams: That is right. I think it will be quite difficult, and potentially expensive, to create artifice. You could envisage a business hiring extra people who do not do very much in order to shift their percentage but, on the other hand, they still have to pay for the extra people they have hired, so it would not be very tempting. Most avoidance is predicated on the idea that it does not cost you very much to do it, and in this case it would be costing you quite a lot.

Q47 Mark Durkan: How is the expense measured? Is it employees who are employed in Northern Ireland—that is where their address and their wage is—but who might be spending a lot of time over here? How far does it go?

Jon Sherman: It is where the time is spent between Northern Ireland and the rest of the UK. It is not just the number of employees; it is the cost, too. If, say, you had a large number of high-value employees who were actually working in Great Britain and a small number of lower-paid employees who work in Northern Ireland, you take that into account, too. The fact that you are covering both time and cost means that there is very little scope for manipulation. Clearly there could be cases where people get the figures wrong or where people do not comply, which is a risk that we need to think about along with any other risks. We would want to think about the extent of that risk and how we would respond proportionately.

Q48 Mark Durkan: What about a business that starts in Northern Ireland, but expands and develops into a wider UK market? Will there come a point where that business has to say that its growth means that it has grown out of this eligibility?

Jon Sherman: If you no longer meet the conditions, in the first year in which you no longer do so you would not fall out of the regime, but you would after that.

Mr Gauke: If the business is growing very rapidly it could well be taken out of the SME scheme altogether, at which point it will then go into the apportionment arrangements and a different regime. That will not necessarily be the case, but those could be the circumstances.

Q49 Mark Durkan: On back-office activities, and the interpretation or the adjustments that may be made to the understanding and interpretation of that—and it is not the only area in relation to some of the consequences on behavioural effects—we have heard today that Revenue and Customs has powers to fall back on. There seems to be a sense that you think that, come what may, you will always have something in the bat belt to deal with any abuse or risk that may arise. However, you said that you might have to look to Ministers for further legislation. Will you colour in for the Committee exactly what powers you have to fall back on, and what you envisage with those powers? They are not particularly well defined

in the legislation—there are simply lots of indications that measures may have to be taken or things may have to be looked at. What powers are you relying on?

Jon Sherman: Do you mean what is contained within the legislation to limit the scope for abuse or profit shifting?

Q50 Mark Durkan: You said you have powers to fall back on. It is not simply what is within the legislation, so will you colour in some of what you are referring to, which might be in the legislation?

Jon Sherman: As well as the structure of the Northern Ireland rules, provisions such as the general anti-abuse rule and the new diverted profits tax could apply in certain situations where there are artificial transactions and a lack of economic substance. Other anti-avoidance rules built into the existing mainstream corporation tax rules will apply equally in Northern Ireland and the rest of the United Kingdom.

The point I was making earlier is that the regime has been designed to minimise the risk of abuse and profit shifting. We can never predict every risk that will materialise in future, but that is something that we will monitor. If we saw that there were further abuses and that the rules were being exploited in ways that we had not anticipated or predicted and therefore did not have protection against in the legislation, we would talk to Treasury colleagues about that and advise Ministers on it to see whether there was a need for action. Inevitably, we cannot predict every risk that might come up in the future when introducing new tax legislation, but we will monitor the risks and if we meet behaviours that we do not think we are protected against, we will want to take that up with Ministers.

Q51 Mark Durkan: Would it be the case that any interpretive measures that you took in response to what you had observed would apply only on the basis of guidance that would then be published, rather than being imposed retrospectively?

Jon Sherman: I am not completely sure that I understand the question.

Mark Durkan: In some other legislation we see a lot of references to guidance that will be issued or made available. There is less specifically about guidance in the Bill, perhaps on the basis that you are saying that the references to guidance are elsewhere in the tax code. There seem to be a number of provisions in the Bill that allow either the Treasury or HMRC to take steps in response to what they see. When those steps are taken, if they reinterpret or redefine what is to be interpreted, will that apply retrospectively, without having been the subject of guidance in advance?

Jon Sherman: Oh, I see. If we were in a dispute with a company about how it was applying the legislation, that would be about our interpretation of current law. Although this is obviously a matter for Ministers, where we think there are abuses that we do not have protection against under the current law, and we legislate against those abuses to provide such protection, most commonly that legislation applies prospectively, not retrospectively. There have been exceptions where retrospective legislation has been introduced for particular abuses when certain criteria were in play. That is obviously a matter for Ministers to

decide, but that has been very much the exception. On the whole, new anti-abuse legislation has applied prospectively.

The Chair: Two Members have indicated that they wish to speak. I urge them to be mindful of the time: I have no wish to interrupt anyone mid-sentence if it can be avoided.

Q52 Sammy Wilson: On the Northern Ireland employer regime, there could be some difficulty with construction industries in Northern Ireland, some of which undertake quite a lot of work outside Northern Ireland. It is probably a temporary thing caused by the stalled construction industry in Northern Ireland, but much of their profit in one particular year during a contract may be made outside Northern Ireland, or they may have more than 75% of their work force outside Northern Ireland, just for a short period. Given the criteria, could we find a situation where small and medium-sized enterprises drop in and out of qualification for the lower corporation tax in Northern Ireland, or will it be taken over a longer period?

Jon Sherman: We are not looking at short periods within a year, but at the year as a whole. As I said, there is a period of grace, so that if you are in and then in the following year you would drop out, you do not immediately drop out of the regime.

Q53 Sammy Wilson: Just taking the construction industry, some firms may find, because a contract may well last longer than a year, that they are in the regime one year and out of it the next year, even though they would normally qualify as small and medium-sized enterprises with 75% of their work force in Northern Ireland.

Mr Gauke: To be more precise, I think they would find themselves in it for one year, in it for a second year, even though they do not qualify—because, as Jon has pointed out, there is a year's grace—then in the third year, if they do not qualify as Northern Irish for these purposes, yes, they would fall out of the regime. However, it is worth making the point that if we did not have tests of this sort, or if we tried to have a more complicated regime, then the opportunities for abuse would become greater. The opportunity for someone to claim to be a Northern Irish business, even though the reality is that their activity is conducted overwhelmingly elsewhere, would become greater. There is a trade-off between providing a robust regime for dealing with avoidance activity on the one hand and, on the other, accepting

that it may well be the case that a business will move from one regime to another, or one jurisdiction to another, reflecting where the activity takes place.

Q54 Sammy Wilson: Once they have fallen out, is it just as easy for them to fall back in again? This is a big question, especially in the construction industry. Lots of firms may well have to seek work in Scotland or in London, but that could disqualify them for the period in which that contract, which may be a major part of their income, is being fulfilled.

Mike Williams: That may be an area, going back to Ms Mahmood's point, where we need to look again at not allowing an election in. As the Minister said, we are looking to see how many people are affected by this. If it looks as if the construction industry will be particularly affected, it will be helpful to know that as soon as possible. We need to get a feel for the numbers affected, which impacts on those that will be disbenefited as a result of having to do lots of these calculations.

Q55 Nigel Mills: Mr Sherman, you seem to be suggesting that if new abuses come to light you might want to change the Bill. You have not put a targeted anti-avoidance rule in the Bill—quite uniquely. Are you tempted to suggest that there ought to be one, to have that protection from the start, rather than trying to add it later?

Jon Sherman: I think the Bill is designed in a way that provides the protection we need. The point I was making was simply that one cannot foresee everything and that every year Governments introduce new legislation to protect against particular abuses and to close down particular avenues of avoidance.

Nigel Mills: All new regimes have an anti-abuse format to try to catch those unknown future planning ideas from the start, in order to avoid having to add them later.

The Chair: Order. I apologise for interrupting the hon. Gentleman. That brings us to the end of the time allotted for the Committee to ask questions. I thank the witnesses, on behalf of the Committee, for their evidence. We shall meet again on Thursday 5 February to begin line-by-line consideration.

11 am

The Chair adjourned the Committee without Question put (Standing Order No. 88).

Adjourned till Thursday 5 February at half past Eleven o'clock.

Written evidence reported to the House

CT01 KPMG Belfast