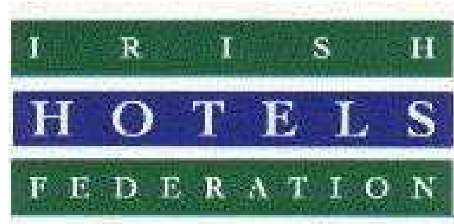

Submission to the Commission on Taxation

Irish Hotel Federation

23 May 2008

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1. Summary

The review of the Irish tax system is timely given the less than favourable economic climate at present and the need for improved competitiveness and productivity in Ireland.

This submission advocates that the tax system be based on a system that promotes fairness and equality and the Irish Hotel Federation (IHF), rejects the imposition of any sector specific taxes which would unfairly burden any particular sector of the economy. Currently Ireland's economy is entering a rebalancing phase and is reorienting itself away from the construction industry and towards new areas of potential growth. During this time it is vital that a balanced taxation system that recognises the challenges facing us all is in place.

In particular:

- **The IHF advocates the retention of the current rates of corporation tax and VAT.** Any increase, in the rate of corporation tax or VAT will damage Ireland's competitiveness at a time when our economy is heavily reliant on the traded sector. Any increase would also act as a disincentive to foreign investment. Given the national priority to maintain our independence in taxation matters within the expanded EU, it would be unwise to use that independence to harm our economy.

- **We submit that the burden of pension payments can be mitigated by providing higher exemptions from capitals gains tax on moneys invested in pension funds when those moneys are derived from the sale of a business.**

- In respect of local government funding, the IHF considers that **the current rates system is based on a notional property valuation system that fails to recognise turnover or profitability. Alternative systems such as tax sharing – as practiced in other EU countries merit consideration.**

- **The IHF objects strongly to local authorities imposing selected local taxes, such as a tourist charge or a hotel bed tax, which are levied on a specific sector.** The IHF has no objection to a system of local taxation in principle, as long as any taxes are fair, reasonable and borne fairly by all sectors.

- **Carbon taxes should be levied on the primary sources of carbon emissions and should provide incentives to act in an environmentally responsible manner. They should not be allowed to damage services such as air travel in an unfair manner. Such services are essential to the economy of an island nation such as Ireland.**

2. Contact Details

This is a submission by the Irish Hotel Federation to the Commission on Taxation covering the broad areas of taxation in Ireland. The submission was prepared with the assistance of Grant Thornton.

We would welcome an opportunity to present our views and expand on them should the Commission wish.

If there are any matters upon which you require clarification of further information please contact John Power on 406 8270 or email powerj@ihf.ie

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Founded in 1937, the Irish Hotels Federation (IHF) is the national organisation of the hotel and guesthouse industry in Ireland. The primary functions of the Federation are to promote and defend the interests of its members. The IHF represents almost 1,000 hotels and guesthouses nationwide, employing over 57,000 people and is a key stakeholder in the Irish tourist sector.

3. Background

The Commission on Taxation was established on 14 February, 2008 to review the structure, efficiency and appropriateness of the Irish taxation system. In setting up the Commission, the then Tánaiste, Brian Cowen, TD, indicated that its work would help establish the framework within which tax policy would be set for the next decade at least, and that it was important that it take a strategic, considered and balanced perspective that recognised the evolving challenges ahead.

The work of the Commission is being conducted in the context of the commitments on economic competitiveness and on taxation contained in the Programme for Government:

- to keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system,
- to ensure that our regulatory framework remains flexible, proportionate, and up to date, to introduce measures to further lower carbon emissions and
- to phase in on a revenue neutral basis appropriate fiscal measures including a carbon levy over the lifetime of the Government, and the guarantee that the 12.5% corporation tax rate will remain.

"Having regard to the commitments on economic competitiveness and on taxation contained in the Programme for Government, in particular, the commitments:

- to keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system,
- To ensure that our regulatory framework remains flexible, proportionate and up to date,
- To introduce measures to further lower carbon emissions and to phase in on a revenue neutral basis appropriate fiscal measures including a carbon levy over the lifetime of the Government, and
- The guarantee that the 12.5% rate of corporation tax will remain,

The Commission is invited, in the context of maintaining an equitable incidence of taxation and a strong economy, to consider the structure of the taxation system and specifically to:

- consider how best the tax system can support economic activity and promote increased employment and prosperity while providing the resources necessary to meet the cost of public services and other Government outlays in the medium and longer term;
- Consider how best the tax system can encourage long term savings;
- Meet the needs of retirement;
- Examine the balance achieved between taxes collected on income, capital and spending;
- Review all tax expenditures with a view to assessing the economic and social benefits they deliver and to recommend the discontinuation of those that are unjustifiable on cost/benefit grounds;
- Consider options for the future financing of local government; and
- Investigate fiscal measures to protect and enhance the environment including the introduction of a carbon tax.

As the introduction of a carbon tax requires a completely new tax charge and structure, the Commission is asked to commence work in this area immediately. The Commission is requested to report on the results of its examination and consideration and to make such recommendations as, and when, it thinks fit to the Minister for Finance but not later than 30 September 2009".

4. Irish Economic Environment

4.1 Overview

The Irish economy is forecast to grow by just 1.8% in 2008; this represents the slowest rate of economic growth in Ireland since 1991. This low growth rate reflects a slowdown in the construction industry and in particular the sharp decline in residential construction and house prices. This weakening of house prices combined with a significant increase in unemployment levels has impacted strongly on consumer spending (which accounts for approximately 50% of GDP) . As a result, consumer spending in 2008 is forecast to grow by just 3% as compared with 6.5% in 2007.

The international economic outlook has deteriorated markedly over the past year. Export growth is expected to slow in 2008 to 5.4% (from 6.6% in 2007), reflecting the appreciation of the euro against the dollar and sterling. The depreciating currencies of our main trading partners should encourage the growth of imports, however predictions are that import growth in 2008 will slow to 4% from 6% in 2007. Forecasts for 2009 indicate that despite an improved performance, the economy will continue to grow below its potential, which is generally regarded as being of the order of 4% per annum.

This slowdown in activity has led to a fall off in government revenues. The exchequer returns for the first four months of the year are €736 million below projections. Capital gains tax revenue for this period was €334 million less than expected primarily due to falling house prices. VAT revenue also experienced a shortfall of €277 million reflecting a sharp decline in consumer spending. This decline in revenue alongside large scale infrastructural investment under the NDP resulted in a budget deficit of €3.74 billion for the first four months of the year. This deficit represents more than three quarters of the target deficit of €4.86 billion for 2008.

This weak performance supports the need for a review of the Irish tax system to ensure that Ireland remains competitive as growth slows.

The emergence of a recession in the United States and slowing growth in Europe is likely to lead to a fall in the number of tourists visiting Ireland. The reasons for this are twofold. First, one effect of slowing growth is to reduce income and perceived wealth. This is especially true for the United States, where recent house price falls have reduced the value of assets and people's wealth. This makes American consumers less likely to spend money on discretionary items, such as overseas holidays. Second, the euro has appreciated substantially against the US$ and against the Stg£, which makes Ireland a more costly destination for visitors from two of our key markets.

Given this background, the review of the Irish tax system should have two main priorities, to promote competitiveness in all business sectors and, at the same time, ensure that sufficient

resources exist at all levels of government for the provision of facilities and services. While the remit of the Commission is to review the taxation system, it must be done in the context of an efficient public service and cost effective delivery of public services.

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5. The Irish tax environment

5.1 Tax Revenues.

The following table shows the key components of taxation revenues in Ireland for 2006 and 2007, with 2003 being used as a benchmark.

Table 1 Tax revenue in Ireland in 2006 and 2007 relative to 2003

	2003 (€ 000)	As % of GNP	2006 (€ 000)	As % of GNP	2007 (€ 000)	As % of GNP	Increase between 2003 and 2007
Customs revenue plus excise revenue	4,708,844	4.00%	5,845,726	3.92%	6,103,782	3.87%	€1,394,938
Capital gains tax, **Capital acquisitions tax** **Stamp duty**	3,345,773	2.84%	7,169,094	4.81%	6,683,446	4.23%	€3,337,673
Income Tax	9,161,767	7.78%	12,389,939	8.31%	13,572,410	8.60%	€4,410,643
Corporation tax	5,161,370	4.39%	66,836,247	4.48%	6,390,625	4.05%	€1,229,255
Value Added Tax	9,720,544	8.26%	13,447,991	9.02%	14,496,588	9.18%	€4,776,044
Total	**32,098,298**	**27.27%**	**105,688,997**	**30.54%**	**47,246,851**	**29.93%**	**15,148,553**

Essentially taxes can be levied on three sources, income, expenditure and capital. The tax revenues can be analysed as follows:

Table 2- Tax revenue as a percentage of GNP

Type of Tax	2003	2006	2007
Capital / Property	2.84%	4.81%	4.23%
Income	12.17%	12.79%	12.65%
Expenditure	12.26%	12.94%	13.05%
Total	27.27%	30.54%	29.93%

From the breakdown of taxes shown in Table 2 there might appear to be an imbalance in the amount of revenue raised from Capital and Property taxes as opposed to Income and Expenditure taxes. However, there is no reason why the revenues from the various types of taxes should be in balance or equal to each other, and in our view, a system based predominantly on two main sources is not inherently unacceptable.

It should also be noted that the tax revenues accruing to the Exchequer and shown in Table 2 do not include certain taxes such as commercial rates or the annual motor tax. These are property taxes, which are paid to local authorities, either directly as in the case of rates, or which are collected and distributed amongst local authorities by the Department of the Environment, Heritage and Local Government, as in the case of motor tax. These are not therefore included in the figures in Table 2.

Combined, these revenues from commercial rates and motor tax account for €2.155 billion, which if included with the Exchequer revenues, would increase the figure for capital and property taxes to €8.8 billion. Consequently, national capital and property taxes are in reality greater than those received by the Exchequer alone.

5.2 IHF submission on direct taxes

The IHF unequivocally supports the retention of the 12.5% Corporation tax in Ireland. While this tax has been central to the attraction of multinational companies to the island it has also encouraged a spirit of entrepreneurialism in Ireland. The effect of maintaining this rate will be revenue neutral. Future variations in corporation tax should be attributable to changes in the taxation base, not on the rate at which tax is assessed.

5.3 IHF submission on indirect taxes

The IHF calls for the retention of the 13.5% rate of VAT on the hotel and restaurant services.

There are three main rates of VAT in the Irish tax system which range from 0% to 21%. These rates cover a series of different goods:

Table 3- The rates of VAT applied to goods and services in Ireland

Rate of VAT	Goods and services included in each VAT group
0%	This group is made up of children's clothing and footwear, certain foods and drinks, oral medicines and certain books.
13.5%	This group is comprised of hotels/guesthouses/holiday accommodation, restaurant services, land and buildings (if taxable), building services, newspapers, periodicals, short term car hire, heating fuel, electricity and waste disposal services.
21%	This rate of VAT applies to all goods and services which are not eligible for the 0% or reduced rates of VAT.

The lower rates of VAT (0% and 13.5%) cover essential goods such as most food and certain drinks and oral medication or recognise labour intensive industries such as the hotel, guesthouse, restaurant and construction industries.

The effect of an increase in the current rate of VAT on the hotel, guesthouse and restaurant industry would impact negatively on the economy as a whole. We believe that the impact would be a reduction in employment in the sector and a reduction in the competitiveness of Irish tourism.

An analysis of the impact of an increase in the rate of VAT from 13.5% to 21% on restaurant and hotel meals is outlined below.

The average expenditure per annum per domestic household on meals in hotels and restaurants in Ireland is €952 (CSO Household Budget Survey). From this it is possible to value the annual expenditure on hotel and restaurant meals at €1.142 billion. This figure is inclusive of VAT at 13.5%. These restaurant figures exclude fast food establishments.

If VAT were increased to 21% and total consumer outlay remained the same; then the revenues prior to VAT would fall from €1,006 million to €944 million, a fall of €62 million.

Total expenditure by "Out of State" tourists in 2006 amounted to €3.988 billion, of which approximately 17% or €678 million was spent on food and restaurants. This €678 million includes VAT at 13.5%; hence the pre-VAT expenditure in this sector is €597.4 million. If the rate of VAT increased to 21% then the value of this expenditure would theoretically increase to €722.8 million, which would represent an increased cost of €44.8 million to overseas visitors.

Ireland is already recognised by tourists as a high cost destination so there is little scope for price increases. The effect of an increase in VAT above its current level would be to reduce the number of tourists visiting Ireland thus reducing tourist revenues.

It is concluded that an increase in VAT would have two impacts:

1. lower revenues from domestic consumers, and

2. higher tourist product prices for visitors.

If domestic consumers maintained their volume of consumption, the VAT increase would mean a diversion of expenditure from other sectors where VAT is most likely at 21%, hence generating no tax benefit to the State. Tourism numbers are very responsive to price increases, and visitor numbers would suffer if an increased rate of VAT was levied on this sector.

In our view an increase in VAT on meals eaten out would affect employment, tourist revenues and is likely to produce no overall benefit.

Assuming that consumers or tourists would not respond to tax induced price increases is overly optimistic. This assumption is particularly unrealistic from the perspective of the tourism industry where the arrival of low cost airlines and budget hotels has not only contributed to the tourism sector, but has also made consumers much more likely to react negatively to increased prices.

6. Carbon Taxes

Ireland is committed to a reduction in carbon emissions by 3% per annum up to 2012. The realisation of these targets will require the implementation of strong measures.

6.1 Ireland's energy use.

Data from Carbon Action Ireland shows that Ireland emits 16.93 tonnes of carbon per capita. This is the second highest level of carbon emissions of the 27 EU members. The Climate Change Performance Index, which monitors the climate protection performance of the 56 countries who are responsible for 90% of world CO_2 emissions, rates Ireland as one of the three countries whose performance, is 'very poor'.

In accordance with the Kyoto Protocol, Ireland has made a commitment to limit its carbon emissions to 63 million tonnes per year, or 315 million tonnes during the first phase of the Kyoto Protocol which spans the period 2008-2012. Failure to meet this target would be costly for the economy. Not alone does pollution affect the quality of life but at a trading price of €23 per tonne the cost to the economy of producing emissions at the 2005 level, which was 6 million tonnes above the Kyoto target, would be €138 million per year (Carbon Action Ireland).

Carbon taxes have been suggested as a way of limiting carbon emissions. In order for these taxes to be effective they must be sufficiently large, reflecting the damage that carbon emissions do without compromising Irish cost competitiveness.

6.2 Approaches to reducing carbon emissions

There are two approaches to reducing carbon emissions, the introduction of a tax on the production of carbon emissions or a carbon emissions trading system.

Under the tax system a rate of tax would be applied per tonne of emissions and this tax would be likely to increase over the years. A tax is deemed by many to be the most cost effective way of reducing the emissions produced.

Under the second approach, the emissions trading system, the Government would set a cap on the amount of carbon that can be emitted. Permits are issued allowing companies/factories to emit a certain amount of carbon for free. Companies who produce an amount of emissions above the limit must buy permits from companies who have kept their level of emissions below the quota. The

benefit of this approach is that it is easier to target the reduction in the level of emissions than using a tax it is also more politically attractive than a tax.

We would suggest that a business which sells their carbon credits should be exempt from VAT or any form and income/corporation tax on the transaction. To encourage this practice further, a system of double tax relief should be applied to the sale.

6.3 IHF views on approaches to reducing carbon emissions

The tourist accommodation sector is aware of the damaging effect carbon emissions have on the environment and have made significant efforts to reduce their production of such gases. In fact a growth trend in the hotel industry in recent years has been the "greening" of hotels and the creation of carbon neutral facilities.

This submission recommends that whichever approach is adopted, it offers incentives to industry and services to reduce emissions.

If a taxation approach is adopted, it should offer incentives such as the inclusion of offsetting provisions for investment in energy saving and reductions in emissions. It is also submitted that the tax should be borne equally by all sectors, relative to emissions and that no one sector should be targeted. The impact of, for example, inappropriate tax levels on air travel could be deleterious to tourism in Ireland, particularly as being an island nation, we are dependent to a very substantial extent on access transport by air.

If a permit approach is adopted, then the national output level should be reduced progressively, so that enterprises that reduce their emissions and can therefore sell their unused allowances will find that a viable market for their permits remains and so there is a real inducement to seek further improvement in emission levels.

7. Retirement Relief

7.1 Background

The Irish population is ageing. In the past decade the number of people aged 65 or older increased by 54,000. Currently, the ratio of workers to pensioners in Ireland is 6:1. This means that the welfare requirements of each pensioner in the country are supported by the tax contribution of six workers. The number of pensioner is expected to grow substantially in future decades. This ratio of pensioners to workers is expected to equal between 1.5:1 and 1:1 in 2050.

The growth in the number of citizens over the age of 65 will place increased demands on Exchequer resources. The OECD Economic Survey of Ireland emphasised the need for a long term framework to be put in place that would provide for "decent incomes in retirement and fiscal sustainability."

The reality is that state pensions must be supplemented, in as far as is possible, by personal contributions to ensure that those on pensions maintain a reasonable quality of life and that demands on the State are restrained. **This submission calls for an extension of retirement relief on Capital Gains Tax to small family hotels, medium sized businesses and guest houses.**

Currently, a gain of €750,000 from the disposal of a business, including small family hotels and guest houses, or shares in a family business accruing to people over the age of 55, is exempt from capital gains tax. If the proceeds of the sale of the business exceed €750,000 then the amount over €750,000 would normally be taxable at the capital gains tax rate of 20%.

Certain conditions have to be fulfilled for the people to be eligible for this relief, such as having owned the assets for ten years prior to their disposal.

The IHF submits that the threshold for exemptions from Capital Gains Tax should be increased by €1 million to €1.75 million. This exemption should be extended to medium sized businesses, small family hotels and guest houses. The basis for this submission is that many such businesses do not make sufficient profit for the owners to maximise their pension contributions and many are therefore left in a position of much reduced circumstances in retirement and more dependent on the State.

7.2 Implications

Assume a business is sold for €1 million and the money is invested in a pension scheme, this would provide an income of approximately €50,000 per annum, index linked, to the recipient.

Taken over a forty year period, (the time scale over which a retirement fund is often built up) the net present value to the Exchequer of tax foregone through reliefs provided would be to the order of €160,000 so as to build up a pension fund of €1 million.

However if €1 million was exempted from tax and invested in an annuity, then the net present value of the tax revenue foregone is approximately €40,000.

Clearly, the Exchequer would incur lower tax losses from the provision of a pension annuity from the proceeds of the sale of a business rather than from income tax reliefs during the build up of the annuity fund.

The IHF recommends that the scale of the exemption from capital gains tax on the proceeds of the sale of a family hotel or guesthouse should be increased from the current level of €750,000 to €1,750,000 provided the extra €1m is invested in a pension fund.

8. Specific Taxes.

8.1 The tourism sector.

The tourism industry in Ireland is an important contributor to economic growth and employment. The sector sustains approximately 250,000 jobs and has a positive impact on the economy of every locality in the country whether it is rural or urban.

The tourism industry has performed well in recent years, with 2007 marking the sixth successive year of growth. There were 7.8 million visitors to Ireland in 2007 which represented an increase of 5% over 2006 levels. Domestic tourism also grew strongly in 2007; the number of trips by residents grew by 12% and expenditure by this cohort increased by 20% to €1.1 billion. The number of nights spent by domestic tourists in hotels grew by 26% in 2007, representing 62% of nights spent in hotels by both domestic and foreign tourists. Revenue from all tourists, in 2007, totalled €6.5 billion and accounted for 4% of GNP However, 2007 also saw an increase in the number of overseas trips made by Irish residents reflecting in part the expense associated with visiting Ireland as compared with other destinations. This applies in particular to low cost Eastern European countries.

These trends emphasise the need not only to maintain but to make continual improvements in Ireland's cost competitiveness.

Forecasts for the tourist industry in 2008 are no longer positive. Currency appreciation, a difficult credit environment, increasing energy and transport costs and reduced consumer spending all point to a likely slowdown in tourist numbers and tourist spend.

Certain projects, such as the building of a National Conference Centre in Dublin, are expected to act as a large draw for business tourists. The Business Tourism Forum, set up by Failte Ireland, has set a target for this sector to grow from the present level of €470million to €1billon by 2013. The global business tourism market is worth €40 billion a year and to date Ireland has underperformed in this market. The benefit to the economy of the conference centre is projected to attract revenues of up to €50 million per annum .. The attraction of the conference centre is further enhanced by the 2007 change in VAT regulations which allows the VAT on accommodation expenses to be reclaimed by delegates attending qualifying conferences.

In order to reap the benefit of such investments it is vital that the Irish tourism industry remains competitive and attractive to both foreign and domestic visitors.

8.2 The hotel industry

The primary concern of the hotel industry in Ireland is the loss of Irish cost competitiveness in a slowing international market. This is due to the appreciation of the euro relative to both sterling and the US dollar, as well as internally generated cost increases.

An increase in tourism product costs such as hotel costs do not go unnoticed by tourists, who in surveys have ranked value for money and the cost of accommodation as the least satisfactory elements of their visit to Ireland.

Clearly any further increase in the cost of hotel accommodation would act as a deterrent to potential visitors. **Therefore the IHF submits that there should not be specific local or national taxes such as a hotel or bed tax, or indeed any from of specific tax that will make hotel accommodation more expensive.**

8.3 IHF submission on a hotel bed tax

The effect of an increase in the cost of hotel accommodation will be to reduce demand.

The degree to which the demand falls is dependent on the price elasticity of demand or the responsiveness of consumers to the increase in price. Research in the USA (by the American Economics Group) concludes that the elasticity of demand for tourist accommodation is 2.5. This means that each 1% increase in the price of a hotel bed leads to a reduction in demand of 2.5%. There is no reason to suggest that the same level of elasticity does not apply in all leisure tourist markets. Such a level of elasticity would reduce the overall revenues of the hotel sector by a considerable extent.

It is accepted that business travellers, whose need to use Irish hotels might not be discretionary, may not be as sensitive to prices as leisure tourists. Therefore a hotel bed tax may not affect business travellers to the same extent. However, due to cost consciousness, there would be some diversion of business to lower priced hotels, which would reduce the overall revenues of the hotel sector and result in a reduction in national VAT and corporation taxes

The key objection to any proposals for a hotel bed tax is that it unfairly imposes a tax on a specific sector for the sole purpose of providing modest levels of discretionary funding for local authorities.

The economic benefit of the tourist industry to the Irish economy is significant. In 2006, tourist expenditure in Ireland accounted for €6 billion. The government earned €2.4 billion through the taxation of tourism expenditure. Each euro spent by an overseas visitor generates revenue of 48 cent for the government through VAT, excise duty and PAYE. Any local tax, such as a hotel bed tax, would impact substantially on these revenues.

9. Local Government Funding.

9.1 Introduction

Local authorities provide services and facilities which generate significant benefits to the economy. The IHF recognises that local authority resources are limited and they must be remunerated to ensure the continued provision of these services. This submission encourages the compensation of local authorities through their inclusion in a system of tax sharing.

Local government current expenditure in Ireland has increased at an average rate of 12.5% over the last four years, driven mainly by the operating and the maintenance demands of the infrastructure investment under the Nation Development Plans. With projected high levels of investment in the national infrastructure in the current National Development Plan, coupled with the payment of benchmarking awards and other cost pressures, prospects are for continuing high growth levels in local authority expenditure in future years.

The Local Government Fund comprising motor tax revenues and an Exchequer contribution was launched in 1997 as a key source of local government funding. However, despite an underlying buoyancy of close to 5% per annum and three increases in motor tax rates since 2000, the fund has not matched the pace of growth in local government needs.

With the central Government grant funding constrained by fiscal policy and with little direct contribution from the domestic sector, the brunt of funding local government increases has fallen to the commercial sector through a combination of rates and user charge increases.

At present, the IHF estimates that the commercial sector provides almost 40% of local authority day-to-day funding through rates, user charges and levies.

The IHF considers that there are substantial inequities within the rates system, in that the system does not recognise the ability of different types of enterprise to generate substantially different levels of revenue and profits from properties. The system is based on notional property valuations, and progress with the current national revaluation exercise has been so slow as to question its efficacy in addressing current issues with the commercial rates determination.

9.2 The IHF views on Local Government Funding

The IHF submits to the Commission on Taxation that:

A system of funding local government through a combination of

- **Fair and reasonable local taxation that applies across all sectors of the community**
- **User charges for services where the levels of use can be determined and the charges reflect the cost of providing the service, and**
- **Central government funding provided through a system of tax sharing**

should be strongly considered for adoption.

Our views on a fair and reasonable system of local taxation have been expounded in Section 8 previously. We do not propose to repeat these views here.

Charges on both domestic and commercial users should fund services such as water and sewerage and waste collection and disposal.

Care has to be taken to ensure that user charges imposed on commercial businesses reflect the cost of providing these services to the sector and that there is no cross subsidisation of the domestic or non paying users of the services. It is essential that there is absolute transparency on how business user charges are calculated.

However, there is an imperative to change the applicability of VAT in the local authority sector and bring it into line with the provisions of the EU VAT Directive, which says that where a local authority is carrying out an activity at such a level as would render it "commercial", then the local authority should be required to become registered for VAT in respect of that activity. In the UK, "commercial" is defined as revenues in excess of £1,000 per annum. The relevant provisions of the EU Directive should be transposed into Irish law. At present, revenues gathered by local authorities by way of rates – a form of tax – are passed on to the Exchequer and the EU by virtue of the local authorities not being able to register for VAT in respect of activities that are effectively commercial.

VAT registration would also encourage local authorities to look to outsourcing, to allow private firms to compete on a level playing field with the public sector for outsourcing business.

Local services such as parks, libraries and street cleaning, could be funded through a system of tax sharing. Models for such a system exist in other EU countries. Tax sharing could apply to personal income tax; capital and property taxes as well as expenditure taxes. A system of tax sharing would meet the key criteria of equity, ability to pay, promoting efficiency in the use of services and strengthening of local democracy, as well as addressing the short comings of the current funding system.

The new funding system should be complemented by proposals to provide improved value-for-money, but this may be outside the Commission's terms of reference.

Such proposals could include:

- Amalgamating small local government units such as towns and boroughs with Counties to generate improved economies of scale, and

- Generating operational efficiencies such as the establishment of financial shared service centres for financial accounting and reporting or outsourcing housing loan administration.

Appendix 1

Trends in Local Government Expenditure

Table 1 below shows Local Government expenditure in Ireland under the eight programme groups in 2000 and 2007.

The table shows that Local Government expenditure increased by 84% from €2.4 billion in 2000 to €4.7 billion in 2007. This period, coincides for the most part with the National Development Plan 2000-2006 (NDP) which provided a major impetus to local authority expenditure needs over that period.

Table 1- Trends in Local Government Current expenditure 2000-2007

	2000 € million	2007 € million	Change 2000 to 2007 € million	% Change
Housing and Building	380.5	716.9	336.4	88.4%
Road Transportation and Safety	769.5	1252.4	482.9	62.7%
Water Supply and Sewerage	271.0	651.2	380.2	140.0%
Development Incentives and Controls	107.6	252.9	145.3	135.0%
Environmental Protection	399.8	874.9	475.1	118.0%
Recreation and Amenities	205.5	405.0	199.5	97.0%
Agriculture, Education, Health and Welfare	135.7	295.0	159.3	117.0%
Miscellaneous Services	134.7	270.8	136.1	101.0%
Totals	**2404.3**	**4719.0**	**2314.7**	**96.3%**

The table shows that the key drivers of local government expenditure in 2000-2007 were Housing and Building, Road Transportation and Safety, Water Supply and Sewerage and Environmental Protection.

Housing and Building expenditure: Expenditure in this area has increased by 88% from a base of €380.5 million in 2000 to €717 million in 2007. This increase is a result of more local authority housing being built to answer the demands for more affordable housing coupled with additional loans provision under various schemes to promote home ownership, such as the Shared Ownership Schemes. In August 2005 the Government established the Affordable Homes Partnership which aimed to accelerate the supply of affordable homes in the Greater Dublin area. They aimed to commence in the region of 23,000 social housing units between 2006 and 2008. Provisions have been made for substantial investment in housing under the NDP 2007-2013, therefore this programme group should witness continued expansion.

Road Transportation and Safety: Expenditure in this area increased by 62.7% across this period from €769.5 million in 2000 to €1,252.44 million in 2007. This increased expenditure can be attributed in part to the need for investment in non-national roads and in part to the high level of buoyancy in motor tax receipts, driven in turn by the growth in the national vehicle fleet. The funding of €618 million announced recently by the Minister for Transport for 2008 for the non national road network is the highest level of funding yet made available for non-national roads. . The National Development Plan 2000-2006 invested heavily in roads which had a strong impact on the level of expenditure and further substantial investment is expected in the period of the 2007-2013 NDP.

Water supply and sewerage. In percentage terms, this programme group has been the strongest driver of Local Government expenditure over 2000-2006, increasing by 140% from €271 million in 2000 to €651.23 million in 2007. The reason for the growth in expenditure has been the installation of major water treatment and waste water treatment plants around the country. The operation of these plants has either been carried out by local authorities or carried out by private finance consortia under contract to local authorities. As in other areas of operation, further invest is planned for the period 2007-2013 and so this programme group should show continued increases in expenditure.

Environmental protection: The increase in local government expenditure in the area of environmental protection over the period 2000 to 2007 is, in percentage terms, the second highest factor in increased expenditure. This growth in expenditure reflects the substantial changes in waste collection and disposal that occurred over the 2000-2006 NDP period. There have been substantial developments in waste management infrastructure, in waste recovery and disposal operations and the imposition of higher standards in specific areas such as landfill. The four programme groups referred to above accounted for over 70% of the increased expenditure of local authorities over the 2006-2006 period.

Trends in Local Government Funding

Table 2 following is derived from Department of Environment, Heritage and Local Government (DoEHLG) data and shows that the share of funding provided by Government grants and the Local Government Fund (LGF) have fallen from a combined total of 49% in 2000 to 42% in 2007, with the reduction being made up by commercial rates and user charges.

Table 2- Local Government funding by source

	2000	2007
Government Grants and subsidies	27%	22%
LGF General Fund	22%	20%
User Charges	29%	31%
Commercial rates	24%	27%

The increase in commercial rates has been 95% over the period 2000-2007. This increase has arisen from two sources, rates buoyancy and increases in the Annual Rate on Valuation. Data published by the DoEHLG shows that the Net Effective Valuation of rating authorities in Ireland rose by 44% over 2000-2006. From this it can be deduced that the Annual Rate on Valuation increase has been just over 35% over that period - an annual average in excess of 5%.

The increase in revenue generated by User Charges increased substantially in 2006 and arose from a greater pressure on local authorities to achieve full cost recovery on services provided to the non-domestic sectors.

Table 3- Breakdown of Local Government funding source by sector 2006

	Funded by Central Government €mn	Funded by the Commercial sector €mn	Funded by households. €mn
Central Government grants	1055.93	--	--
Motor tax component	--	382.0	574.0
Charges for services	--	737.7	737.7
Commercial Rates	--	1245.22	--
Total	**1055.93**	**2,364.92**	**1,311.7**

Table 3 above shows the different elements of local government funding by contributor. Central Government Grants are provided by the Exchequer. Motor tax revenue is drawn from both commercial and domestic sectors and we estimate that commercial vehicles and company-owned cars provide just over 40% of motor tax revenues. We estimate that User Charges are drawn in approximately equal proportions from the commercial and domestic users of services, whereas commercial rates are payable by the commercial sector alone.

The table estimates that the commercial sector accounts for half (49.9%) of Local Government funding, while the domestic sector contributes 27.7% and central government contributes the balance of 22.3% of the funding.

The dependence of local authorities on the commercial sector may be gaining increasing recognition and in particular there is a trend amongst local authorities of late to recognise the sensitivity of their annual rates charge. Limerick City Council reduced its rate on valuation in 2007 while Limerick County Council maintained theirs at a constant rate for 2008.

However, recent media reports say that the Minister for Transport, Mr Noel Dempsey wants local authorities to increase their "own resources" funding for non national roads from 20% to 30% of the road grants they receive. This implies an additional contribution of €80 million per annum at current expenditure levels. This would be drawn from the only true discretionary source of local government funding, namely commercial rates, if it is to occur.