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Box E:

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The role of Corporation Tax in driving Irish Tax Growth, 2015-2018

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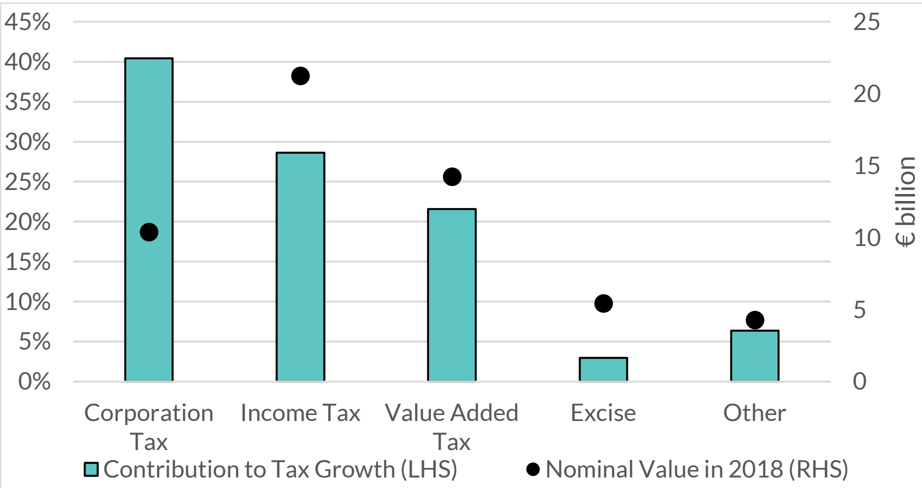
Corporation tax receipts have grown rapidly in recent years and have played a key role in driving total government revenue growth. This box compares recent corporation tax developments with residential construction based receipts in the early to mid-2000s. This was the last time a large transitory revenue stream drove total government receipts. While it remains unclear if recent corporation tax flows are unsustainable, lessons can still be learnt from the previous episode.

The significant role that corporation tax (CT) inflows have played in supporting Irish revenue growth in recent years - and the risks associated with this reliance - are well documented[1]. The tax head has more than doubled since end-2014, with receipts surpassing €10 billion last year, and has consistently performed ahead of expectations. As Chart 1 shows, it has driven 40 per cent of total tax revenue growth over the four-year period from 2015 to 2018, despite it being a considerably smaller tax base in nominal terms than both income tax and VAT. In 2018, meanwhile, CT represented 19 per cent of total tax revenue, up from 16 per cent a year earlier and just 11 per cent five years earlier. This followed significantly higher than expected annual inflows – receipts were 22 per cent ahead of profile last year – albeit some of which has been identified as reflecting timing factors[2]. Even excluding this temporary component, however, CT receipts as a percentage of tax revenue would still have reached its highest level in two decades, 17 per cent.

[1] See for example 'Box C: Risks related to corporation tax flows', Central Bank Quarterly Bulletin 4, October 2018; 'Annual Tax Report', Department of Finance, January 2018; 'Fiscal Assessment Report', Irish Fiscal Advisory Council, November 2018.

[2] The Department of Finance notes that €700m of the €1.9bn higher than expected receipts is temporary and is not expected to recur in 2019.

Chart 1: Contribution of Tax Heads to Tax Growth, 2015-2018



Source: Department of Finance Databank

Against this background, and with uncertainty over how stable some of the CT flows received in recent years are[3], this Box compares developments since end-2014 with revenue linked to residential construction in the early to mid 2000's - the last time a large transitory revenue stream played a key role in driving tax growth. To identify the direct impact that residential construction had on tax revenue over this period we use data constructed by McQuinn and Smyth (2010)[4]. They estimate the direct impact of residential construction on the three tax components heavily influenced by activity in the sector - stamp duty, capital gains tax (CGT) and VAT – with their results replicated in Table 1. We focus on the five years to 2006 as this is the year when direct housing related revenues peaked. As the Table shows, by the end of this period, value added tax on new housing accounted for around a quarter of total VAT receipts, with one-third of CGT and 80 per cent of stamp duty driven by the sector. As a result, residential construction was generating around 16 per cent of total tax revenue in 2006. The Table also outlines the data in nominal terms, showing the total impact increased from €2.3bn in 2002 to €7.2bn in 2006.

[3] See, for example 'Box 3.1: How much of the corporate tax surges should be prudently set aside?', Irish Post Programme Surveillance Report, European Commission, Autumn 2016.
[4] Kieran McQuinn and Diarmaid Smyth, 'Quantifying revenue windfalls from the Irish housing market', Economic and Social Review, Volume 41 No 2, Summer 2010.

Table 1a – Individual Tax Components Residential Contribution (€m)

	2002	2003	2004	2005	2006
Stamp Duty	666.1	1075.50	1461.90	2003.00	2988.10
VAT	1439.40	1876.10	2331.10	2840.90	3241.00
CGT	199.1	464.7	436.5	584	964.1
Total	**2304.60**	**3416.30**	**4229.50**	**5427.90**	**7193.10**
Source: McQuinn and Smyth (2010)					

Table 1b – Individual Tax Components Residential Contribution (per cent of tax head)

	2002	2003	2004	2005	2006
Stamp Duty	57.1	63.7	70	73.5	80.4
VAT	16.2	19.3	21.8	23.5	24.1
CGT	31.7	32.2	28.8	29.8	31.1
Total	**7.9**	**10.6**	**11.9**	**13.8**	**15.8**
Source: McQuinn and Smyth (2010)					

How do the two periods compare? As Chart 2 shows, while CT has driven 40 per cent of growth in total tax revenue in recent years, residential construction taxes drove a lower 30 per cent of growth in tax receipts between 2002 and 2006. Direct residential construction taxes peaked at 16 percent of total tax revenue in 2006, below last year's adjusted figure of 17 per cent. From a broader perspective, it is important to note that the residential construction boom had a wider impact on the overall economy, from an employment, output and fiscal point of view. The data above excludes indirect revenues linked to residential construction - such as VAT receipts from purchases of furniture, household goods etc. - while employment in the construction sector accounted for 11 per cent of total employment in 2006 and played an important role in driving income tax receipts. On the other hand, recent developments in CT appear more exogenous, and with around 40 per cent of CT revenues coming from just 10 companies it is clear that exposure risks are high.

Chart 2: Contribution of Tax Component to Tax Growth

Source: McQuinn and Smyth (2010), Department of Finance Databank, Authors' Calculations

The high degree of reliance on construction revenues in the early to mid-2000s proved to be unsustainable given underlying dynamics in the sector. With regard to CT, on the other hand, it is not yet clear whether the flows we have seen in recent years are unsustainable in the future. From a public finances perspective, it is important not to become overly reliant on any tax head in driving total revenue growth.