Dáil Éireann

An Coiste um Chuntais Phoiblí

An Dara Tuarascáil Eatramhach do 2002
(Éisteachtaí an Choiste Deireadh Fómhair 2003 go Iúil 2004)

An Roinn Airegeadais, na Coimisinéirí Ioncaim & Gníomhaireacht Bainistíochta an Chisteáin Náisiúnta

Meitheamh 2005

Dáil Éireann

Committee of Public Accounts

Second Interim Report for 2002
(Committee hearings October 2003 to July 2004)

Department of Finance, Revenue Commissioners & National Treasury Management Agency

June 2005

(PRN. A5/0782)

Contents

Chairman's Preface

This report, on the Department of Finance, the Revenue Commissioners and the National Treasury Management Agency, is the second in a series of interim reports of the Committee of Public Accounts which detail the Committee's consideration of the Report of the Comptroller and Auditor General, 2002.

Last month, the Committee published its first interim report for 2002, on Transport. In the near future it will consider sectoral reports on:-

Department of Justice and related matters.

Departments of Communications, Marine and Natural Resources; Enterprise, Trade and Employment; Environment, Heritage and Local Government; and E.P.A.

Departments of Education and Science; Health and Children; and Social and Family Affairs.

Department of Arts, Sport and Tourism; and Sport.

As Chairman, I want to thank the relevant Government Departments and agencies for their co-operation in making the compilation of these reports possible. I also want to compliment the members of the Committee for their diligent work throughout the year.

We recommend this report to the Houses of the Oireachtas.

Michael Noonan, T.D.,
Chairman
June, 2005

Members of the Committee of Public Accounts

FIANNA FÁIL

Seán Ardagh T.D.	Dublin South-Central
John Curran T.D.	Dublin Mid-West
John Dennehy T.D.	Cork South-Central
Seán Fleming T.D.	Laois-Offaly
John McGuinness T.D. *(Vice-Chairman)*	Carlow-Kilkenny
Michael Smith T.D. [4]	Tipperary North

FINE GAEL

John Deasy T.D. [2]	Waterford
Tom Hayes T.D. [3]	Tipperary South
Michael Noonan T.D. [1] *(Chairman)*	Limerick East

LABOUR

Pat Rabbitte T.D.	Dublin South-West

GREEN PARTY

Dan Boyle T.D.	Cork South-Central

SOCIALIST PARTY

Joe Higgins T.D.	Dublin West

1 Deputy Michael Noonan replaced Deputy Padraic McCormack by order of the House on 18th June, 2003.
2 Deputy John Deasy replaced Deputy Paul Connaughton by order of the House on 20th October, 2004.
3 Deputy Tom Hayes replaced Deputy John Perry by order of the House on 20th October, 2004
Deputy Michael Noonan elected as new Chairman on 21st October 2004
4 Deputy Michael Smith replaced Deputy Batt O'Keeffe by order of the House on 16th November, 2004.

Orders of Reference of the Committee of Public Accounts

156. (1) There shall stand established, following the reassembly of the Dáil subsequent to a General Election, a Standing Committee, to be known as the Committee of Public Accounts, to examine and report to the Dáil upon—

(*a*) the accounts showing the appropriation of the sums granted by the Dáil to meet the public expenditure and such other accounts as they see fit (not being accounts of persons included in the Second Schedule of the Comptroller and Auditor General (Amendment) Act, 1993) which are audited by the Comptroller and Auditor General and presented to the Dáil, together with any reports by the Comptroller and Auditor General thereon:

Provided that in relation to accounts other than Appropriation Accounts, only accounts for a financial year beginning not earlier than 1 January, 1994, shall be examined by the Committee;

(*b*) the Comptroller and Auditor General's reports on his or her examinations of economy, efficiency, effectiveness evaluation systems, procedures and practices; and

(*c*) other reports carried out by the Comptroller and Auditor General under the Act.

(2) The Committee may suggest alterations and improvements in the form of the Estimates submitted to the Dáil.

(3) The Committee may proceed with its examination of an account or a report of the Comptroller and Auditor General at any time after that account or report is presented to Dáil Éireann.

(4) The Committee shall have the following powers:

(*a*) power to send for persons, papers and records as defined in Standing Order 83;

(*b*) power to take oral and written evidence as defined in Standing Order 81(1);

(*c*) power to appoint sub-Committees as defined in Standing Order 81(3);

(*d*) power to engage consultants as defined in Standing Order 81(8); and

(*e*) power to travel as defined in Standing Order 81(9).

(5) Every report which the Committee proposes to make shall, on adoption by the Committee, be laid before the Dáil forthwith whereupon the Committee shall be empowered to print and publish such report together with such related documents as it thinks fit.

(6) The Committee shall present an annual progress report to Dáil Éireann on its activities and plans.

(7) The Committee shall refrain from—

(*a*) enquiring into in public session, or publishing, confidential information regarding the activities and plans of a Government Department or office, or of a body which is subject to audit, examination or inspection by the Comptroller and Auditor General, if so requested either by a member of the Government, or the body concerned; and

(*b*) enquiring into the merits of a policy or policies of the Government or a member of the Government or the merits of the objectives of such policies.

(8) The Committee may, without prejudice to the independence of the Comptroller and Auditor General in determining the work to be carried out by his or her Office or the manner in which it is carried out, in private communication, make such suggestions to the Comptroller and Auditor General regarding that work as it sees fit.

(9) The Committee shall consist of twelve members, none of whom shall be a member of the Government or a Minister of State, and four of whom shall constitute a quorum. The Committee and any sub-Committee which it may appoint shall be constituted so as to be impartially representative of the Dáil.

The Report

Abbreviations

BMW	Border, Midlands West Region
C&AG	The Comptroller and Auditor General
ESIOP	Economic and Social Infrastructure Operational Programme
GGB	General Government Balance
IFA	Irish Farmers Association
MDU	Medical Defence Union
NDP	National Development Plan
NRA	National Roads Authority
NTMA	National Treasury Management Agency
PMG	Paymaster General
PPP	Public Private Partnerships
SCA	State Claims Agency
The Department	Department of Transport

1. Findings and Recommendations

OFFICE OF THE REVENUE COMMISSIONERS – VOTE 9; and CHAPTERS 2.1 – 2.6 and 2.10

Findings:

1. SSIA tax repayments amounted to €433 million in 2002, which was €177 million more than forecast. This is partly explained by a surge in take up of the scheme before the cut off date in April 2002.

2. Tax debt amounted to €1.3 billion or some 3% of the tax take. The tax debt written off was €178 million due to a clear out of old unrecoverable debt. Revenue expects to collect 80% of outstanding tax debt.

3. In the aftermath of the DIRT inquiry, Revenue conducted a look back audit of 400 cases in a bank and concluded that there were no tax liabilities. That look back audit was inadequate and ineffective. It later transpired, through voluntary disclosures, that 62 clients of the bank declared a tax liability. Following a separate DIRT audit at the bank a settlement of €3.16 million was agreed in respect of DIRT, interest and penalties.

4. Revenue is pursuing three cases where a VAT anomaly regarding the sale of property was exploited through an artificial short-term property letting arrangement. One such case is worth €18 million. The tax loophole was closed by the terms of the Finance Act 2005.

5. Up to December 2003, 483 cases had been investigated in the NIB investigation and €48.5 million has been collected from 284 cases. 62 cases remained to be investigated.

6. In the Ansbacher investigation, there were 289 cases investigated by end 2003 and €25 million collected. The investigation is on going.

7. The introduction of the environmental levy has proved successful. The success from the environment viewpoint can be judged by the modest amount of revenue collected.

Recommendations:

1. The level of tax debt and the extent of debt collected should be managed against performance targets.

2. Revenue should continue its investigations arising from the DIRT investigation and disclosures at tribunals. The Committee would like to be kept informed of progress in these investigations.

3. Future Revenue audits of financial and insurance institutions should be undertaken in a manner that minimises the risk that latent tax liabilities will not be discovered.

4. Revenue should apply more systematic checks on compliance with conditions for wealthy persons claiming non-resident tax status and publish information on the numbers availing of this tax status and an estimate of the tax forgone.

REVENUE RANDOM AUDITS – CHAPTER 2.9

<u>Findings:</u>

1. The self-assessment system depends on a widespread belief that evasion will be caught, and when caught the penalties will be severe. The Revenue Audit Programme is an established and successful means of detecting non-compliance with the self-assessment system.

2. Random audit is a means of giving Revenue a view on the extent of overall non-compliance and the cost thereof. Revenue has moved away from a purely random audit since 1998.

3. There is a 10% per cent chance of having one’s tax affairs considered either in the screening process or in the audit programme for the selection of audit samples.

4. It is a matter of concern that in subsequent re-audits of previously audited cases a substantial number were found not to be fully compliant with their tax liability.

<u>Recommendations:</u>

1. Random audits should be factored into the revenue audit strategy. The Committee supports the decision to revert to a purely random basis for that element of the audit programme for 2004.

2. An overall estimate of the scale of undeclared tax liabilities should be derived from the results of a representative sample of random audits.

PROSECUTION OF TAX EVADERS AND NON-FILERS OF INCOME TAX RETURNS – CHAPTERS 2.7 and 2.8

<u>Findings:</u>

1. Convictions of non-filers show an increase from just over 200 in 1997 to an average of more than 1,000 per annum in the period 1999 to 2002.

2. There was a significant backlog of referrals in the Revenue Solicitor’s Office and it can take up to two years for a referral to be processed.

3. In money terms, of every €100 of fines in tax cases, only €25 to €26 is collected. Approximately one third in number of fines is not collected.

4. The practice of sending warning letters has increased significantly since 1997 and has been developed as a valuable part of Revenue's overall compliance programme.

5. The Committee recognises that very few prosecutions of serious tax evaders are being taken by Revenue.

Recommendations:

1. Revenue needs to increase the number of cases brought forward for prosecution of serious tax offences in order to demonstrate its determination to deal with the tax evasion problem.

2. The Revenue prosecution strategy in relation to non filers needs to continue to be actively managed to improve the effectiveness of its contribution to the overall compliance strategy.

3. There should be more effective co-ordination between Revenue, the Courts Service and the Garda Síochána in the collection of fines imposed for tax offences.

4. The Committee requests Revenue to bring forward a more effective method of fine collection.

REVENUE INVESTIGATION INTO OFFSHORE ACCOUNTS

Findings:

1. The decision to set up a special offshore assets group has been vindicated by the amount of undisclosed taxable income brought to light.

2. A Revenue investigation of trust accounts in the Bank of Ireland Jersey, which began in 2003, resulted in voluntary disclosures from over 100 tax payers and settlements in excess of €100 million.

3. It was notoriously difficult to pursue a successful action for aiding and abetting tax evasion under legislation in force at the time.

Recommendations:

1. The Revenue Commissioner's initiative in meeting the relevant financial institutions should be continued. The Committee would like to be kept updated on the discussions and the likely tax gain which may arise.

2. Revenue should use the new powers conferred by the Finance Act 2005 to pursue aiding and abetting prosecutions.

DEPARTMENT OF FINANCE TAX RELIEFS – CHAPTER 1.1

Findings:

1. It is very difficult, without proper information on costs and benefits, to determine the justification for introducing, extending, curtailing or withdrawing a tax exemption scheme. Insufficient effort has been made in the past by the Department of Finance to obtain the necessary data for a proper cost benefit analysis of incentive scheme proposals.

2. Insufficient data is collected from taxpayers to ascertain the extent to which some schemes are taken up and the amount of tax forgone.

3. The establishment by Revenue of a unit to examine and monitor the tax affairs of the top 250 individual high earners is a positive step.

Recommendations:

1. A tax incentive scheme should not be introduced without both a proper analysis of its potential benefits and its effect on tax revenues. Adequate provision should be made for data collection to monitor the extent of take up and impact.

2. Finalisation of the reviews of the various tax incentives, commissioned by the Department of Finance, should be prioritised to facilitate early detailed consideration of proposals by the Oireachtas.

DEPARTMENT OF FINANCE – VOTES 1, 6, 7 and 12

Findings:

1. To the end of April 2005, payments totaling €200 million have been made from the Exchequer in respect of recent tribunals of inquiry. No realistic estimate of the full cost of those tribunals has been made.

Recommendations:

1. Efforts to control the costs of tribunals should be pursued by the Department of Finance. The Committee would like to be kept informed of these efforts.

2. Future tribunals should be required to furnish an annual report of activities and costs to the Oireachtas.

3. The Department of Finance should prepare annually estimates of the contingent liabilities in respect of each tribunal. The level of uncertainty attached to the

awarding of costs necessarily means that estimates will have to cover a range of scenarios.

NATIONAL TREASURY MANAGEMENT AGENCY: FINANCIAL STATEMENTS 2002; NATIONAL DEVELOPMENT FINANCE AGENCY; STATE CLAIMS AGENCY – CHAPTER 13.1

Findings:

1. The level of the national debt remained static during the period 2000 - 2002, at around €36, billion but the cost of servicing the debt has fallen, to €2.17 billion in 2002. Interest on the national debt has reduced to between 1% and 2% of GNP.

2. The remuneration of senior management of NTMA is not recorded in its annual report.

3. The NTMA achieved a performance in 2002 that was €28 million better than the externally established performance benchmark.

4. The NPRF has made €200 million available for investment in PPPs but this has not been taken up.

5. The number of claims handled by the State Claims Agency fell from 1,001 in 2002 to 544 in 2003. The SCA has taken on the management of litigation for medical negligence claims but is resisting a contingent liability of up to €800 million in respect of claims.

Recommendations:

1. PPPs should only be used where there is a demonstrable economic benefit in doing so. The balance sheet treatment of the PPP should never be the deciding factor.

2. The NPRF should be more proactive in exploring innovative ways of using its funds in PPPs.

3. Monthly reports of savings achieved in servicing the national debt should be provided by the NTMA as an input to the Department of Finance’s monthly statements on the state of the public finances.

2. Office of the Revenue Commissioners – Vote 9; and Chapters 2.1 – 2.6 and 2.10

1. Proceedings of the Committee

1.1. The committee heard evidence from Mr Frank Daly, Chairman of The Revenue Commissioners and his officials, from the Comptroller and Auditor General and from officials of the Department of Finance on 16 October 2003, 11 December 2003 and 25 March 2004.

2. The Background

2.1. Net tax receipts for 2002 were up by €1.25 billion although there was a fall of €339 million in the return from income tax. This reduction mirrors the recent trend of the income tax take falling short of forecasts, a subject referred to in the 2001 report and which was considered by the Committee.

2.2. In 2002 there was a big clear-out by the Office of the Revenue Commissioners (Revenue) of old arrears cases where the amount of tax outstanding was small and uneconomic to pursue. This is part of Revenue's ongoing strategy to concentrate collection resources where the best return will be obtained. Outstanding taxes have shown a reduction and, at 31 May 2003, stood at €1.32 billion. Revenue considers that it will eventually collect 80% of this. Five years ago it would have expected to collect only 40% of the amount then outstanding.

2.3. Section 2.4 considers the DIRT look-back audits of financial institutions and Revenue's campaign to collect underlying tax arising from undeclared income on bogus non-resident accounts. The DIRT investigations have been highly successful in identifying and collecting previously undeclared tax due. A sum of €221 million has been collected from the financial institutions in DIRT arrears, interest and penalties as a result of the look-back audits. The first phase of the campaign to collect underlying tax by way of voluntary disclosure yielded an additional amount of €227 million. Revenue has since collected about €230 million from those defaulters who did not avail of the voluntary disclosure scheme. This amounts to a figure approaching €700 million so far, with the prospect of more to come as Revenue engages with more recalcitrant holders of bogus non-resident accounts.

2.4. When Revenue carried out its look-back audit in one particular bank, it concluded that there were no bogus non-resident accounts and, therefore, no DIRT liability attaching to the bank. The audit reviewed Revenue's papers on the look-back audit in question, and this has led to concerns about the nature and extent of the revenue audit carried out which were communicated to the Accounting Officer in September 2001. In response, the then Accounting Officer outlined the justification for the audit approach adopted and affirmed that Revenue staff were fully satisfied that the 400 accounts examined were authentic. Subsequently, however, it emerged during the voluntary disclosure phase of Revenue's pursuit of underlying tax that 62 persons had disclosed 230 bogus non-resident accounts, of which 102 were stated to be held in the particular bank concerned. The payments to Revenue on foot of these disclosures totaled €8.7 million. Moreover, five of the 62 had been among those accounts examined by Revenue during the look-back audit in the bank and found to be in order, while all but eight of the remaining 49 accounts were not on the list provided by the bank, from which Revenue drew its audit sample. This raises questions about the quality of the Revenue look-back audit in the particular bank and, perhaps, the bank's bona fides in the matter.

2.5. The matter is being followed up by Revenue which obtained a High Court order for the provision of information by the bank This order has been complied with and the material received is being examined with the full co-operation of the institution concerned. It is not possible to obtain a clear view of the possible liability until all of the information is received and reviewed. There is no evidence, at this point, to suggest that the issues which arise in this case have implications for the other DIRT look-back audit settlements.

2.6. Section 2.6 provides some up-to-date information on the progress being made by Revenue in respect of a number of special investigations such as the NIB offshore investment scheme, the Ansbacher and similar arrangements, the so-called "pick-me-up" schemes and matters arising from the proceedings of the Moriarty and Flood tribunals. Solid progress has been made on all fronts. Substantial amounts of back tax have been collected, either as final settlements or payments on account. It is likely that it will be some time before all of these matters are finally resolved but the resolve of Revenue to pursue the outstanding taxes until a successful conclusion is reached cannot be questioned.

3. The Accountability Issues

3.1. The accountability questions examined by the Committee were:

- Income Tax Trends
- SSIA Scheme
- Revenue Staff Complement
- Tax Write Offs
- VAT Write Offs
- Tax Recoveries
- Aftermath of the DIRT inquiry
- The look back audit
- The NIB Inquiry
- Ansbacher
- Tax avoidance
- Residency
- Environmental Levy

4. Examination of the Issues

Income Tax Trends

4.1. Income tax returns were down substantially between 2001 and 2002. The Committee sought explanations for this. The more general explanation was that in 2002 the economy was weaker than had been projected at budget time and than it had been the year before. While employment did increase, there was a difference in the type of employment created. There was a discernible difference in the labour market in late 2001 and in 2002. There were many people in high remuneration employment in the ICT sector. There was also a lot of overtime and bonuses in many sectors. While there was growth in employment, much of this was in the service industry, from which there is a lower level of tax returns. The budget forecasts are made on the basis of analysis of patterns in previous years and also on macro-economic factors such as GDP, GNP and personal consumption expenditure growth. In recent years these have changed dramatically, sometimes mid-stream, because of developments in the global and Irish economy.

SSIA Scheme

4.2. The Committee noted the special savings incentive scheme, under which interest of 25% is paid by the State on savings and inquired about the accounting treatment of the scheme. The interest is paid out of income tax receipts into savings accounts in order that the amounts are not included as receipts of income tax. The savings accounts pay-outs, paid by the Revenue Commissioners on behalf of the Exchequer, are classified as a repayment out of the income tax general collection which is divided into two blocks, the PAYE collection and the non-PAYE collection. A certain fraction of the repayment is taken from the PAYE block and the rest from the non-PAYE block. On an accounting basis, this is another form of repayment made by Revenue to the savers, just as a taxpayer might receive a repayment of tax.

4.3. The SSIA scheme had an extra impact in 2002 when there was a big surge in take-up leading up to the last month in which people were allowed to set up an account in April 2002. One of the factors explaining the dip in income tax receipts is the sudden increase in April which held its level from then on. The 2002 forecast had been based on the normal level of income tax take. The actual figure for repayments to SSIAs in 2002 was €433 million. This turned out to be higher by €177 million than had been budgeted for. In 2003, the SSIA repayments leveled off.

Revenue Staff Complement

4.4. Revenue had 6,463 members of staff at October 2003, up from 6,079 in 1997. Most of the increase came since 2001 when the Minister authorised an increase of 400 staff for the purposes of audit and various other activities. Staff numbers had dwindled to less than 6,000 in 1999. There is a great focus on audit and investigation. Since 1998 there has been a specific programme of putting more resources into audit and compliance and taking them away from routine processing. There are almost 900 staff directly involved in audit and special investigations.

4.5. In the course of a three year programme, Revenue expects to lose 65 staff. Revenue would collect more tax if these staff were retained but recognises the broader issue of public sector staff numbers. There is a strong focus on better productivity by moving staff away from routine processing into compliance and audit activity. Although staff numbers are decreasing, money is provided to outsource some routine processing work and, therefore, release staff into more productive areas. This results in more satisfying work for them.

Tax Write Offs

4.6. The Committee sought to interpret the implications of the overall tax debt balance outstanding which is sometimes taken as a measure of the efficiency of tax collection. On 31 May 2003 the balance stood at €1.322 billion, €186 million less than at the same period in 2002. Tax write-offs amounted to €178 million. The net improvement was only €8 million. It does not look as though, in dealing with balances outstanding, any progress is being made. Revenue clarified that its strategy is to pursue a programme of write-offs that looks extensive because it is eliminating old debt. On the other hand Revenue has moved from a position where debt represented 40% or more of the collection to where it represents just 3%. This represents a good improvement over time.

4.7. Realistically there will always be some level of debt. In the past only 17% of the outstanding debt (€1.3 billion) would have been collected but now at least 80% would be recovered. While the write-off figure, in absolute terms, compared against the worsening debt, does not reflect much improvement, the broader picture in terms of current debt is where the improvement has been made.

4.8. The Committee noted there are a number of headings under which write-offs can be made. The number deemed uneconomic to pursue dramatically increased from 35,000 in 2001 to 152,000 in 2002. This was almost directly related to an automated write-off programme to weed out old and uncollectable debt. Almost all appears in the "uneconomic to pursue" category. Some of the cases date from the pre-1993 period. Revenue wrote off €51 million in 145,000 cases. The average amount written off was about €350. In 2002 there was also an automated write-off in 14,700 cases involving a debt of between 1 cent and €99.99.

4.9. While the tax debt written off was a small percentage of overall activity, the amount involved was €178 million, a big percentage increase on the figure for the previous year. The Committee inquired about the aging of the debt. Of the total, 41% was older than ten years; 33% was between five and nine years old; 19% between two and four years old and just 6.7% less than two years old. Almost three quarters was more than five years old. The first category, liquidation, receivership and bankruptcy included 360 cases but involved more than €31 million, an average of €86,500 per case. The equivalent figure for the previous year was approximately €70,000. Many of the 360 were in debt for a long time. The Committee felt that this brings into question the risk management strategies in place as the companies involved did not find themselves in debt overnight.

4.10. Revenue provided information about its risk management strategy in terms of its approach to debt management. They are intervening earlier than in the past and have entirely restructured the approach to debt. Active pursuit units monitor cases every month and where they see debt accumulating over a certain level, they intervene immediately, commencing with telephone calls. There is an active debt management process where Revenue staff knock on doors and inform companies that they are in arrears and that their debt has reached an unacceptable level. Taxpayers are informed that Revenue will go to a solicitor, the sheriff or use section 214 which deals with insolvency if it is not dealt with. The strategic objective is to have all debt not more than three years old, except that which is under active pursuit. However it is acknowledged that businesses do get into trouble.

4.11. The early intervention measures can lead to putting in place installment arrangements. The intention is for taxpayers not to use Revenue as a banker at any stage. If Revenue thinks a business is not capable of trading, it is considered wrong to let it continue as to do so other creditors may lose money too. The active debt management programme has two strands, one of which is the write-off. The other strand is early intervention to prevent current debt from accumulating. On current debt, for the period May 2002 to May 2003, Revenue expects to collect 98.85% of the charges raised and will allow very little to accumulate. A higher write-off figure for 2003 is a legacy from the past.

VAT Write Offs

4.12. Value added tax write-offs in 2001 amounted to approximately €29 million, but jumped to €80 million in 2002 as 28,261 VAT cases were written off compared to only 1,400 cases in 2001. Most of the 28,261 cases formed part of the automated write-off process. Under this process amounts between almost zero and, in most cases, €999, were written off, most of which dated back to before 1993.

4.13. About €31 million was written off on the grounds of liquidation, receivership and bankruptcy. These cases are examined before they are written off. There is a phoenix programme, developed in recent years, which monitors companies and the people behind them, which are suspected of being involved in this activity. In some cases Revenue forces them into liquidation, rather than letting them trade. The programme is complemented by a commonality programme, watching for situations where an individual is behind many entities. While tax is written off in amounts that seem small, when the whole lot is pulled together, the amount is significant.

Tax Recoveries

4.14. The Committee reviewed the tax recoveries from investigations of various schemes as at the end of 2003. A total of €922 million was recovered in the legacy cases. The NIB-CMI scheme stands at €48.5 million; Ansbacher, €26 million; the Moriarty tribunal, €6.3 million; and the Mahon tribunal, €17.6 million. The figures for the tribunals do not include moneys paid to the Criminal Assets Bureau, which is a multi-agency operation that includes nine people from Revenue who are expert in tax and customs and excise. The figure for the offshore assets group is €126 million and the figure for DIRT and bogus non resident accounts is €697 million.

Aftermath of the DIRT Inquiry

4.15. In the DIRT inquiry, Revenue first conducted look-back audits of 37 institutions. Its purpose was to recover DIRT underpaid together with interest and penalties. This was completed in 1999-2000 and reported back to the Committee in October 2000. €221 million was collected. All DIRT liability due on the accounts was paid by the banks. They were not particularly happy about paying it. In their view it should have been deducted from the interest credited to the account holders. As the DIRT was paid Revenue is not seeking to collect DIRT from account holders. The second phase was to collect the tax, interest and penalties from the account holders and to collect it on undeclared income and profits stored away in the accounts. It was put away by account holders. They say they got advice from time to time but the decision as to whether to put money in a particular account is that of the account holder.

4.16. Action was taken in two phases. The incentive scheme, until November 2001, was the heaviest publicity scheme in the history of Revenue, and it is following through on those who did not avail of that scheme. That is where the other money is coming from. The money collected is the tax, interest and penalties on the income and the profits that were hidden in the accounts by the account holders. Regardless of who was to blame, the final responsibility is with the people who put the money in an account.

4.17. In the voluntary disclosure phase some 3,675 account holders came forward representing about 8,500 accounts. In the post-November 2001 investigation, more than 7,500 taxpayers have made payments and about 25,000 accounts were closed off because they were either nil or marginal liability. Some 91,000 letters of inquiry were issued under the post-November 2001 phase. In many cases there are multiple accounts and more than one signatory, and everybody was sent a letter.

The look back audit

4.18. The Committee noted there had been significant improvements in terms of tax collection and the efficiency of tax administration since 2002. It noted that Revenue was aiming for "a greater culture of tax compliance" and had specifically stated "the tax authority will not go away." However, it was concerned about the sample of 400 cases investigated in a DIRT look back audit in which Revenue originally thought that there was no tax liability but it subsequently transpired, as a result of voluntary disclosures, that there was a significant liability. If the people concerned had not made voluntary disclosures, these cases might not ever have come to light.

4.19. Revenue provided some further background information on the audit. The investigation was planned in line with auditing standard 300. The audit examined the structures, the business and the management of the bank and found it had very strong management and a relatively small number of offices and staff. It claimed to know its customers very well and had internal and external audit procedures in place. Revenue was told that the non-resident problem had been examined and nothing untoward found. It was not a retail bank for much of its time and had started to advertise for retail customers in 1998, long after the bogus non-resident accounts problem had ceased to be a major one.

4.20. Given the risk profile in terms of the structure, management and account base of the bank, Revenue looked for accounts open in October 1998. In most other institutions it had looked at accounts opened in 1990 and 1995. The bank in question did not appear to have the type of business prior to 1998 that would be indicative of a problem. It had a small percentage of non-resident account holders. It did not advertise as a retail bank until the mid-1990s when the bogus non-resident accounts problem was disappearing. It asserted that its auditors had examined this matter and had found nothing untoward. Revenue was influenced by both the auditors' findings and by the bank who stated that it would be impossible to gain access to electronic records for either 1990 or 1995.

4.21. The audit checked 400 accounts, for which there were declarations in place. The declarations and the customer files were examined. Revenue was not able to look at bank statements because they were told that they were unavailable. The problems with the 400 cases investigated did not arise in large numbers. Queries were raised in five accounts with deposits of over €100,000, and 60 of the remainder. The cases looked good. The auditors queried one of the five as it included a faulty undated declaration but the declarant did not have a liability. The remaining four seemed to be in order and the declarations seemed correct; three made subsequent payments of €9,900, €1,317 and €1,083. There had been no evidence of authenticity problems in these cases. The non-resident deposit book of the bank had a high proportion of obviously non-resident individuals. The conclusion was reached that the bank did not carry a high risk factor prior to 1998 and that an assessment of the accounts after 1998 would give a true picture. The bank provided a list of more than 2,500 accounts, of which 400 were examined. Some 62 people have now made voluntary disclosures but only eight were on the list supplied. Some 49 of those who made a disclosure were not on the list of 2,500 given to Revenue by the bank.

4.22. The Committee noted that many of those involved had more than one account with the bank - a total of 52 people had 230 accounts, of which 108 were with the bank in question. That is not unusual in the context of the investigation of bogus non-resident accounts as it is emerging as a pattern that many have held multiple accounts. There are questions about the comprehensiveness of the initial listing provided by the bank. The key question relates to the reason 49 accounts were not included in the original list. The Committee was informed that it is unlikely that there will be any wider implications from this case as the audits of the other institutions were carried out on a different basis from the way the bank under discussion was audited.

VAT anomalies

4.23. The Committee inquired about a scheme exploiting a VAT anomaly that had come to light. In the event of an individual buying a house, irrespective of the 10% rule, the purchase price included the site element, and is generally assumed to be inclusive of VAT. The scheme used a separate contract for the sale of the site and a separate building contract related to the house or apartment. Prior to the sale of the site to the ultimate purchaser, it was let on a short-term basis to an associated company of the developer. That letting ceased or was caused to cease on transfer of the site to the purchaser. At the heart of the scheme is a claim that the short-term letting is an exempt activity which takes this out of the VAT net, so the consideration for the site is not charged to VAT. It was indicated in the Dáil that there is an €18 million liability on one development alone.

4.24. The short-term letting scheme is an artificial mechanism that Revenue would challenge. The loophole was closed in the 2004 budget. Revenue have a developing inquiry which has so far established that the scheme was applied in six cases that are under active investigation. One of those has progressed to the stage where tax assessments were made and it is listed for appeal, while the other five are under investigation.

4.25. The cases where there is factual evidence that it was used, go back two or three years. There are approximately 21 other cases where it is unsure it was used but the particular scheme was marketed. The VAT Act has existed since 1972. The particular sections used in this case were amended in 1995 or 1996. The information on the 21 cases came to Revenue's attention because of an audit carried out on a particular tax adviser. As far as Revenue is aware, there were only two tax advisers marketing this particular variety of scheme.

4.26. Special compliance activities have also been initiated in the special compliance districts to identify other potential cases. In the new Revenue structure the large cases division has a dedicated branch focused on the construction industry. Its sole purpose is to get a better understanding of the industry's activities that would be of interest to Revenue. There is a specialist VAT avoidance unit in the large cases division. The specialist expertise in this unit quadrupled in 2003. If necessary, Revenue intends to resort to the general anti-avoidance legislation in section 8(1) of the Taxes Consolidation Act, which enables them to form a view that any particular scheme is artificial, to assess tax and proceed.

4.27. Revenue has a strong view about the advice given by the accountancy firms on this issue. They view the scheme as a good example of an unacceptable interpretation of the law and consider it a tax avoidance scheme which is at the margins of evasion. However, it is difficult to prosecute these cases. In the C & AG's Report for 2001 on Revenue, property development, particularly the matter of VAT in property development, was identified as a high risk area.

The NIB Inquiry

4.28. The Committee asked if there was a timescale for the conclusion of the investigation into the NIB and related matters. Revenue is in the final stages of its investigation into the NIB. There were some 452 cases, of which 284 were settled with liabilities and 110 with no liabilities. €48.5 million has been collected up to December 2003. 62 cases remain to be finalised, six of which will have little liability. Three cases have been prosecuted - in two of these the defendants pleaded guilty. Fines were imposed in both cases. In the third case the defendant pleaded guilty and received a suspended sentence. One other case is under investigation for prosecution. The investigation was scheduled to be finished in 2004 with some further prosecutions emanating from it which will take some time longer. The same applied to bogus non-resident accounts where there would be a tail-off in respect of people who were not engaging, even where letters were sent as a consequence of the information obtained under the court order but they will be investigated. The indications were that most of those who got letters have engaged with Revenue in a responsible way.

Ansbacher

4.29. The Ansbacher investigation is a more complex operation and is expected to have a slightly longer tail. There were 289 cases in which €25 million has been paid to date. Of these, 55 have been settled and another 40 to 50 cases are in the pipeline for settlement. There were payments on account in respect of 76 cases and these figures were expected to improve as there had been a surge of activity. Revenue is continually challenged in these cases and have to fight off those challenges. Revenue will remain with the Ansbacher investigation for as long as it takes.

Tax Avoidance

4.30. The Committee asked how Revenue makes a judgment on the difficult area of tax avoidance in terms of section 811 of the Taxes Consolidation Act. There are general principles set out in the legislation. It is a general anti-avoidance provision grounded on Revenue being able to take a view that a particular transaction is really an artificial transaction that has no basis in commercial reality. The legislation works by Revenue forming a view and then formally putting it to the taxpayer. Then an assessment is made which leads to the normal appeal mechanism. Section 811 has never been tested in the courts. There are tax advisers who believe it has a very broad base. At present there is a case going through the courts that will test it. The section was used on very selective but important occasions with some success. Sometimes people submit when a challenge is made.

4.31. The conventional shorthand that tax evasion is evading tax and tax avoidance is always legal is not necessarily accurate but this is the subject of much debate, not only in Ireland but in other administrations. There are no black and white rules. The Oireachtas makes legislation and the aim is to draft it as tightly as possible. In most cases there is little doubt in the minds of accountants and taxpayers as to the intention of the legislation. Some of the schemes that have been marketed and challenged by Revenue have drifted beyond the bounds of an acceptable interpretation of the legislation.

4.32. The professions maintain that the law is what is written in statute and that one must not seek to look beyond that. There are rules and regulations on the interpretation of legislation. Revenue's view is that unacceptable tax avoidance pushes the limits beyond what was intended and challenges the tax base. If a group of people avail of a scheme which means they do not pay VAT or tax, ultimately somebody else must make up the shortfall whether through increased taxation rates or in some other way. There is a lot of disagreement between Revenue and the professionals.

Residency

4.33. The Committee asked if Revenue conducted any rigorous examination of non-residency, that is, whether an assertion of living outside the jurisdiction for the requisite number of days per annum, is accepted at face value or whether it is tested in a random sample audit. Revenue tests these assertions by seeking records, log books and flight tickets from time to time but it is not tested in a systematic way. That only occurs when it is decided to investigate the affairs of particular individuals. Most of the individuals also fall into the category of high net worth individuals. A large cases division has been established and will concentrate on these individuals.

Environmental Levy

4.34. In 2003, a sum of €12.7 million was collected in respect of the environmental levy on plastic bags. The amount was expected to increase for 2004. This is a unique levy and its success will be indicated by how little is collected. The money is ring-fenced. It is paid into an environmental levy fund which is associated with the landfill levy. The funds are earmarked for a number of schemes, including the waste capital grants scheme, and the costs incurred in the planning and procurement of major local authority waste infrastructure. Revenue receives an agency fee for collecting the levy. Compliance is quite good. The vast bulk of the money is paid by a relatively small number of major retailers who have been audited and, by and large, have been compliant.

5. Adoption of Reports

5.1 The Committee noted Vote 9 and disposed of Chapters 2.1 to 2.6 and 2.10 of the 2002 Report.

Findings and Recommendations

The Committee of Public Accounts

Finds specifically that:

1. SSIA tax repayments amounted to €433 million in 2002, which was €177 million more than forecast. This is partly explained by a surge in take up of the scheme before the cut off date in April 2002.

2. Tax debt amounted to €1.3 billion or some 3% of the tax take. The tax debt written off was €178 million due to a clear out of old unrecoverable debt. Revenue expects to collect 80% of outstanding tax debt.

3. In the aftermath of the DIRT inquiry, Revenue conducted a look back audit of 400 cases in a bank and concluded that there were no tax liabilities. That look back audit was inadequate and ineffective. It later transpired, through voluntary disclosures, that 62 clients of the bank declared a tax liability. Following a separate DIRT audit at the bank a settlement of €3.16 million was agreed in respect of DIRT, interest and penalties.

4. Revenue is pursuing three cases where a VAT anomaly regarding the sale of property was exploited through an artificial short-term property letting arrangement. One such case is worth €18 million. The tax loophole was closed by the terms of the Finance Act 2005.

5. Up to December 2003, 483 cases had been investigated in the NIB investigation and €48.5 million has been collected from 284 cases. 62 cases remained to be investigated.

6. In the Ansbacher investigation, there were 289 cases investigated by end 2003 and €25 million collected. The investigation is on going.

7. The introduction of the environmental levy has proved successful. The success from the environment viewpoint can be judged by the modest amount of revenue collected.

<u>And recommends in general that:</u>

1. The level of tax debt and the extent of debt collected should be managed against performance targets.

2. Revenue should continue its investigations arising from the DIRT investigation and disclosures at tribunals. The Committee would like to be kept informed of progress in these investigations.

3. Future Revenue audits of financial and insurance institutions should be undertaken in a manner that minimises the risk that latent tax liabilities will not be discovered.

4. Revenue should apply more systematic checks on compliance with conditions for wealthy persons claiming non-resident tax status and publish information on the numbers availing of this tax status and an estimate of the tax forgone.

3. Revenue Random Audits – Chapter 2.9

1. Proceedings of the Committee

1.1. The committee heard evidence from Mr Frank Daly, Chairman of The Revenue Commissioners and his officials, from the Comptroller and Auditor General and from officials of the Department of Finance on 11 December 2003.

2. The Background

2.1. The Revenue audit programme is a key component of Revenue strategy of deterring evasion and ensuring compliance. It is targeted at areas of perceived risk and a selection process was under development to a more sophisticated level, using risk assessment software.

2.2. The audit programme has been increasingly successful in terms of its annual yield, with the yield in 2002 amounting to €256 million, which is nearly double the yield in 2000, from the same number of audits. The increase was largely attributable to verification audits, which brought in €88 million, mainly as a result of targeting taxpayers exercising share options. Random audit is a small but very important part of the overall audit programme, even though, in yield terms, it only brought in €2.9 million in 2002 from 720 audits.

2.3. The basis on which the cases are selected could not be described as random in a statistical sense and, therefore, the results are of little use in attempting to extrapolate the extent to which self-assessed returns understate true liability. Revenue's policy of selecting cases for random audit has changed from year to year. It now involves screening cases to reduce the number producing a nil yield, thereby limiting the amount of unproductive work for Revenue and the associated cost to compliant taxpayers.

2.4. From an administrative efficiency point of view, this is laudable. However, there is a more important consideration to be taken into account. Random audit is a means of giving Revenue a view on the extent of overall non-compliance and the cost thereof. Such an indicator would be a valuable performance measure and could form a key input to Revenue's counter measure strategy. Revenue is examining the possible use of the random audit programme for this purpose.

2.5. As part of the overall audit programme, Revenue went back and re-audited a number of taxpayers four years after the original audit had taken place and found that more than half of those re-audited had again understated their liabilities. This may suggest that the penalties imposed after the original audit did not act as a sufficient deterrent. A re-audit is an important way of communicating that because one has just been audited, it does not mean that Revenue has gone away for good.

2.6. The revenue audit programme is an established and successful means of ensuring compliance with the self-assessment system. The full implementation of a new computerised risk analysis system for the screening and selection of cases for audit is expected to add considerably to its effectiveness.

3. The Accountability Issues

3.1. The Accountability issues examined by the Committee were:

- Revenue Audit Programme
- ROS
- Self Assessment System
- Random Audit Programme
- People working outside the tax system
- Sectoral Differences
- The re-audit programme
- Compliance Officers

4. Examination of the Issues

Revenue Audit Programme

4.1. The Committee began its consideration of the Revenue audit programme by exploring whether there was an international benchmark in regard to the output of audit activities in terms of the total amount of money collected and the number engaged in this work.

4.2. Revenue considers its performance is reasonable in terms of internationally benchmarked comparisons of the amount of money collected per staff member but does not have any well researched figures. There is a project to develop an advanced revenue performance scorecard report. The first output will appear in the 2003 annual report. The scorecard is designed to come up with the information on the effectiveness of Revenue, the output per head, the trend over time and whether it will extend to international comparisons. It is a major project tied into the management information framework currently being designed by the Government.

4.3. There is a general perception from talking with colleagues abroad that Revenue performance is good. One performance indicator is the cost of administration as a percentage of total amount collected. This is about 0.9%. During the years it has remained roughly at this level which suggests Revenue is maintaining its overall level of efficiency. It was 0.98% in 1998 and 0.95% in 2002. That is the type of information that the performance scorecard will report.

4.4. The targeted audit programme covers about 16,000 returns per year (0.16% of the total population of returns). In selecting the 16,000, there is a screening process which looks at 50,000 to 60,000 other returns. A computerised audit selection system is expected to be launched in 2004. Between screening and audits, there is a 10% chance of having one's affairs looked at in any given year.

4.5. The Committee inquired about the probability of being selected for a random audit. This can be viewed in terms of the ratio of the number of random audits performed to the number of returns received. There are some 349,000 income tax returns each year and 112,000 corporation tax returns giving a total of some 450,000 returns. In 2002, the random audit programme covered roughly 700 returns.

ROS

4.6. The objective is to have 50% of all payments made on-line by the end of 2004. The indications for 2003 were very good. In advance of the pay and file date of 31 October the number of tax returns received through ROS had far exceeded the total number who filed electronically in 2002. Those who file electronically have an extra three weeks in which to pay and file, up to 21 November. That is an incentive for people to sign up. There is also value for money for Revenue because it spreads the huge workload that comes in on 31 October over a number of weeks while the Exchequer still gets the money quickly and efficiently.

Self Assessment System

4.7. The Committee asked if Revenue supported the view that self-assessment works only if people believe they will be caught and punished if they evade tax and cannot work on any other basis. The Revenue position is that in a democracy in which tax rates are set by Parliament, people have an obligation to pay their proper taxes and file their proper returns. Effective Revenue administration, audit programmes and penalties for those who are caught underpaying are important aspects of the system. Over the years, the tax yield from the self-employed sector has increased. Among the 16,000 audits referred to, there are a high proportion of nil-yielding investigations. This indicates that there is compliance in the self assessment system because the audits are effective. There are sectors where there are concerns about non-compliance. The targeted approach is designed to focus revenue audits on those particular areas. The computerised risk analysis system has been introduced to refine the targeting process to get at the sectors in which people are less compliant. That is not to say self-assessment is not working in those sectors.

Random Audit Programme

4.8. A truly random audit programme would give Revenue some estimate of the total understated taxes. This would be important information on which to establish policies and allocate resources to bring these moneys in. The tax system is based on voluntary disclosures and returns. The vast majority of people have a remote chance of being audited, although those involved in special areas may be targeted. The Committee felt it would be a useful exercise for Revenue to have some global feel of the existing amount of understated taxes. It might be unpalatable to place that figure in the public domain, but all the evidence shows that when an audit, or a group of audits, is conducted, a sizeable amount of money is found to be due to the Revenue Commissioners.

4.9. Revenue acknowledged that a true random audit has not been done in recent years, as it has been stratified in one way or another. A random element was involved in comprehensive audits until 1998, but it was later extended to VAT, PAYE and PRSI audits. Cases in which income was less than €127,000 were randomly audited in 1999. The ratio of random audits was increased to 6% of all audits in 2001 and the selection query criteria were refined. This was done because many marginal cases emerged from the truly random approach and it was considered that the cost, including the opportunity cost, to people who are normally compliant taxpayers of having auditors working on such cases when they could be working on other cases was not justified. This does not take from the broader objective of a random audit. There is a deterrent effect if everybody thinks they can be audited.

4.10. It is proposed to revert to a truly random audit programme in 2004. After the random programme has resumed, Revenue will examine what can be gained by attempting to measure the "tax gap". An estimate of the "audit gap", which is the difference between what is returned at present and what might be returned if everybody were audited, is a first step. The critical aspect of the matter is that Revenue uses all information available to refine its compliance and audit programmes. In this context, Revenue is now convinced of the value of having a truly random programme from which it is possible to extrapolate some results. It is not possible to extrapolate from the current programme.

4.11. The Committee noted that it is a fallacy to speak of random audits as if they were a mechanism for collecting tax. It regarded a random audit as one mechanism for keeping the system honest. If the Revenue conducted extensive random audits and collected nothing, it would then know that self-assessment was working. To achieve that, the rate of random audit would have to be far greater than it is currently. People must know there is a high probability that if they evade they will be caught. That is not the case at the moment. For that reason, it supported the announcement that Revenue will return to real random audits and hoped that this will also entail an increase in the proportion of random audits.

4.12. Revenue acknowledged that random audits were designed to make everybody feel they might receive a visit from the revenue auditor. The costs involved applied to the taxpayer as much as to the Revenue. The Revenue audit puts a compliance burden on people. A visible, effective tax administration, audit and compliance programme is a pillar of self-assessment. The focus of Revenue is to demonstrate that it conducts audits and that anybody can be audited through their random audit procedures. When a person is audited and is found to be non-compliant, he or she pays substantial penalties and may be prosecuted.

4.13. The Committee acknowledged that Revenue is now more effective and that improvements have been occurring out of all proportion in recent years. However the system is still not foolproof. From the political perspective, when the public finances become tight, the decisions which impact on constituents and on a Deputy politically frequently involve sums of €15 to €20 million. For example, cuts in social welfare are expected to yield savings of between €60 million and €70 million. Against this background, the C&AG has concluded, with many caveats, that tax outstanding may be far in excess of these amounts.

People working outside the tax system

4.14. The Committee noted that the cases selected for audit are from those taxpayers who have submitted returns for the most recent tax year. It inquired about the approach taken with those who have not been making returns for the most recent tax years and who are not already in the system. It seems as if all the random audits are based on cases already in the system and on Revenue's computers. The Committee felt it would be a more fruitful exercise to ascertain those who are in the black economy and who have not submitted tax returns.

4.15. Under the old structure there were special inquiry branches and in the new structure there are special compliance districts. Those districts are tasked primarily with ensuring that everybody in their local community or business area is on record. A study by the C&AG some years ago concluded that because of special inquiry activity, nobody would be likely to operate in the black economy for any considerable period without it coming to the attention of the Revenue. There are programmes in place designed to bring people into the system. Some are as simple as knocking on the doors on every street in a town at a particular time to make sure everybody with a business on those streets is registered. This is an extensive part of the activities. There are other issues of concern pertaining to the black economy. Revenue has established a black economy group which works closely with the hidden economy monitoring group, which was set up under a programme for Government. It meets regularly and discusses with trade unions and others, the actions to be taken and the sectors that should be targeted. It is better to identify, in conjunction with the other social partners and players, particular sectors that need attention. In recent years attention has focused on the building industry, particularly regarding relevant contract tax and whether people were employees or contractors. Similar concerns existed in the forestry industry and in meat factories.

4.16. In 2002, the walking-the-streets initiative detected 969 people who were not on the record and who are now on the tax database. The same initiative detected 2,600 people who were on the record but who had not made returns on part of their income. These cases will be in the system for audit and screening and in the compliance programme. Many of those that come into the system are not big businesses - there are other regulations that companies must follow to operate as a business. A lot are small start-up businesses. Against what was expected early in the year, a record amount of tax was collected in 2003.

Sectoral Differences

4.17. The Committee asked how sectoral differences are taken into account as examples for corporation tax. There are few random audits on bigger businesses as many of these are automatically screened and selected for audit annually. The same basic principles are applied for all random audits. If the turnover is above a certain level, they are screened as part of the normal process and there is a targeted audit. Below that, they fall into the random process.

4.18. The Committee noted that the specific audits on VAT were quite small in comparison to other taxes but one reason for this is that comprehensive audits cover all taxes, including VAT. The relative importance of comprehensive, VAT and PAYE audits and combine fiduciary audits that would also include VAT is considered. In 2003, for the first time, VAT has outstripped income tax in total take to the Exchequer. VAT is increasing in relative importance as a tax. From Revenue's perspective it is also increasing in relative importance with regard to the opportunity to avoid paying VAT. Accordingly, the VAT avoidance unit has been strengthened. Comprehensive audits are the most difficult type of audit and require the most experienced auditors. In recent years, because of moving auditors to the bogus accounts investigations and the need to train new auditors, the number of comprehensive audits was reduced. There is a desire for a greater number of comprehensive audits to be carried out across all tax heads, including VAT.

The re-audit programme

4.19. The Committee noted the C&AG's report on the re-audit and asked for Revenue's perspective on the results. There is some disappointment. The positive perspective is that more than 40% of those re-audited became fully compliant and a further 39% became more, if not fully, compliant. A better result was expected from the re-audit. In the normal audit, particularly in the case of voluntary disclosure, there is mitigation of penalties depending on the degree of co-operation. In order to address the re-audit issue, if one re-offends, mitigation of penalties is restricted by 50% for the first offence and if there is a second offence, there is no mitigation.

Compliance Officers

4.20. Revenue has re-organised its intelligence in order that it can be harnessed and used to try to reduce the scale of the black economy. There are four regions with a special compliance district in each region. The special compliance district includes people in different towns in which Revenue has offices. They have a broad remit but are focused on being the eyes and ears of Revenue in the areas, getting to know what is going on, doing the types of street surveys which were mentioned earlier and undertaking surveillance from time to time. There are a couple of cases where this has proved fruitful, for example, in the event that a retail business was returning an unusually low amount of tax, the special compliance staff would observe the business for a number of days, noting the throughput and volume of business to buoy up an assessment of a much greater amount of tax.

4.21. There are more than 50 compliance officers. In the restructuring former tax inspectors and customs and excise officers were brought together. Customs and excise officers have been working on diesel sampling, oil laundries, and the policing of vehicle registration but are now coming into the compliance districts, working with their tax colleagues. A great deal of information is given to Revenue by various sources. There is a better system for the internal sharing of information with Revenue.

5. Adoption of Reports

5.1. The Committee disposed of Chapter 2.9 of the 2002 Report on 25 March 2004.

Findings and Recommendations

<u>The Committee of Public Accounts</u>

<u>Finds specifically that:</u>

1. The self-assessment system depends on a widespread belief that evasion will be caught, and when caught the penalties will be severe. The Revenue Audit Programme is an established and successful means of detecting non-compliance with the self-assessment system.

2. Random audit is a means of giving Revenue a view on the extent of overall non-compliance and the cost thereof. Revenue has moved away from a purely random audit since 1998.

3. There is a 10% per cent chance of having one's tax affairs considered either in the screening process or in the audit programme for the selection of audit samples.

4. It is a matter of concern that in subsequent re-audits of previously audited cases a substantial number were found not to be fully compliant with their tax liability.

And recommends in general that:

1. Random audits should be factored into the revenue audit strategy. The Committee supports the decision to revert to a purely random basis for that element of the audit programme for 2004.

2. An overall estimate of the scale of undeclared tax liabilities should be derived from the results of a representative sample of random audits.

4. Prosecution of Tax Evaders and Non-filers of Income Tax Returns – Chapters 2.7 and 2.8

1. Proceedings of the Committee

1.2. The committee heard evidence from Mr Frank Daly, Chairman of The Revenue Commissioners and his officials, from the Comptroller and Auditor General and from officials of the Department of Finance on 11 December 2003 and 25 March 2004.

2. The Background

2.1. An in-depth audit examination was made of the effectiveness of the Revenue prosecution strategy, specifically in regard to those who fail to make income tax returns. This involves establishing the degree to which it is successful as a method of ensuring submission of outstanding returns and as a deterrent against future non-submission. The audit approach was to carry out a general review of the operation of the prosecution process, both centrally and in the districts, and to supplement that review by examining in detail a sample of cases referred for prosecution.

2.2. The Revenue Commissioners' activity in this area has increased dramatically in the past five years. Statistics of convictions of non-filers show an increase from just over 200 in 1997 to an average of more than 1,000 per annum in the period 1999 to 2002. There have also been two amendments in legislation to strengthen the power of Revenue to obtain outstanding returns. New legislation was enacted recently to allow people taken to court previously for prosecutions for non-filing of returns to be brought back to court on the same conviction. As well as taking persons to court and having them fined for not making their return in the first place, the court can order that they make the returns. If they do not do so, Revenue can inform the court that this has not happened. In effect, therefore, prosecution is on a continuing basis.

2.3. The audit raised questions as to whether the strategy, as implemented, was achieving maximum impact. The report concludes that the time limits of the prosecution process need to be improved. At the time of the examination, there was a backlog of cases awaiting summonses in the Dublin district and in the Revenue Solicitor's office. The length of time from receipt of the warning letter to getting a case to court could extend to two years. Although prosecution has proven to be reasonably effective as a means of obtaining outstanding tax returns, it has been less successful in changing compliance behaviour of persistent non-filers. It may be that these must be subjected to a more stringent regime, including audit and the fast-tracking of prosecution action.

2.4. The Revenue strategy could also benefit from better enforcement of the collection of fines imposed, effective follow-up of court orders to ensure the production of returns, improved pursuit of unpaid tax on the returns ultimately made and the publication of the names of all defaulters. All in all, while Revenue can be commended for a more extensive approach to the pursuit of outstanding income tax returns, the report shows that there is scope for making it more effective.

2.5. The prosecution of non-filers of returns is just one of the means used by the Revenue to deal with non-compliance with obligations to file returns. The regionally based restructuring programme will provide greater knowledge of the taxpayer's business through whole case management. This greater knowledge will assist in selecting the most appropriate means of securing outstanding returns and tax. It will aid the raising of realistic estimated assessments in the absence of returns and allow Revenue to target cases for enforcement action with the sheriff, solicitor or attachment. This will ensure that the non-filer will not gain an advantage, but will be disadvantaged, by withholding tax returns.

2.6. The overall conclusion of the audit was that the prosecution of non-filers is an effective method of extracting returns and is a vital part of Revenue's compliance programme.

3. The Accountability Issues

3.1. The accountability issues considered by the Committee were:

- Case for a Revenue Court
- Revenue Solicitor's Office
- Uncollected Fines
- Non-filers
- Prosecution Strategy

4. Examination of the Issues

Case for a Revenue Court

4.1. The Committee considered the case for a Revenue Court in Dublin that would reduce the time needed to prosecute cases in view of the fact that 2,500 referrals for summonses were in the Revenue Solicitor's Office in the Dublin tax district and that cases could take up to two years to be dealt with. It was acknowledged that the general turnaround time in country based campaigns has been reduced to between five and eight weeks but that the sheer volume of cases in Dublin causes problems.

4.2. The idea of a Revenue court was the subject of a study by the Law Reform Commission (LRC), which issued a consultation paper that came to the general conclusion that it was not justified at this time. The question of a fiscal prosecutor was also considered. The view of the LRC was that the different approach being taken by the Revenue towards prosecution needed more time and that the issue of a special court should be considered again after some years.

4.3. On the face of it, the court procedures are not working very efficiently. The number of adjournments is high. Some cases are adjourned five or six times. As a result of the system appearing to be lax and soft, half of the same people return to the court the following year for the Revenue to re-prosecute. Revenue has set about the process of streamlining the system, starting with its own operation.

Revenue Solicitor's Office

4.4. The Committee felt that the Revenue Solicitor's office was under a lot of pressure and sought an explanation for the current position. In recent years, the prosecution programme had expanded extensively but the same office was heavily engaged in going to the High Court for orders under Section 908 on the DIRT inquiry. There was an unprecedented number of these orders and of cases in which the advice of the Revenue solicitor's office had to be sought on challenges and appeals. It is felt that staffing levels are about right but that there was room to further streamline the procedures and achieve more productivity there.

4.5. For the courts and the fines and penalties system to be effective the case should follow quickly after someone has not filed a return but the Committee noted there is quite a long delay before summonses are issued. While it varies from one tax district to another it did not appear to work as a penalty system to ensure compliance. Two extra people were allocated to the Revenue Solicitor's Office in 2003 at general management level to streamline the processes. Prosecutions outside the Dublin area are generally taken by State solicitors rather than the Revenue solicitor's office. The workload there can vary from one area to another and this is under review.

4.6. The Committee noted that the State solicitors are remunerated by the State but if costs are awarded in the District Court the State solicitors do not return them to Revenue, so in effect they are paid twice. The report was critical of State solicitors not applying for costs or collecting costs from the taxpayer and Revenue was also concerned about that. The State solicitor's contracts are under review following the Nally Report of the public prosecution system. The position on costs forms part of that review.

Uncollected Fines

4.7. The Committee was of the opinion that the high level of uncollected court fines did not demonstrate Revenue's determination to see cases through to the bitter end. In money terms, of every €100 of fines in tax cases, only €25 to €26 is collected. Approximately one third in number of fines are not collected. Revenue is not responsible for collecting them. Co-ordination between the Courts Service, the Garda and the Revenue Commissioners is important, as is the fast-tracking of cases through the courts. If people wait up to two years to appear in court it is likely they will have other tax liability issues by the time they get there.

4.8. There is a high level of mitigation in these cases. The maximum fine imposed for non-filer prosecution is €3,000. The legislation provides that District Court judges may mitigate up to 75% of a fine. Even though convictions are obtained, the Judiciary will mitigate the fine or penalty by on average about 62%. There is also a very high level of adjournment - about 40% of cases - which delays the whole system. In a lot of cases, the return is produced on the steps of the court or sent in a few days in advance. It is fair to say that judges do not like convicting people when the reason for which the case has been taken has been dealt with.

4.9. A value for money report on the collection of fines was published in December 2000 and considered extensively by the Committee with representatives of the Courts Service and the Garda Síochána. The pattern of collection of fines for Revenue offences is consistent with the pattern in the general areas of the imposition and collection of fines.

4.10. People who have been prosecuted through the courts have not been audited. While this was the case, all late filers are now put into the screening process to select cases for audit. They are not taken as a block for auditing but are in the selection process. About 200 non-filers emerge from that process.

Non-filers

4.11. In 1997 the Revenue Commissioners sent out 1,917 warning letters, while in 2002 the figure was 9,348. There were two factors for the increase - the population of potential taxpayers has grown enormously in the period concerned and the practice of sending letters was in its infancy in 1997 but has been developed as a valuable part of Revenue's overall compliance programme.

4.12. The non-filer regime is just one of many compliance initiatives. Return filing compliance rates have been improving over recent years. The general rate is 75%, which is an improvement on 2002, and an even bigger improvement is expected in 2003. There are other effective methods, not least the 10% surcharge that applies to late filing.

4.13. While it could be argued that people who have been through the courts to persuade them to file returns, may have something to hide, in many cases, they are relatively small businesses which do not get around to filing returns. However, within that there is a hard core of perpetual non-filers. The changes to the legislation in 2003 enable Revenue to get a court order to require the return and then to go back to court if the return is not made. The whole programme is under review because it is not enough to bring a few thousand people to court every year. Revenue needs to review its effectiveness. This is part of a greater compliance programme which includes audit, enforcement, assessment and sending material to the sheriff and solicitor.

Prosecution Strategy

4.14. Revenue’s approach to prosecutions is changing. In the past the focus was to settle cases on the basis of the payment of tax, interest and civil penalties which are quite significant and inflict a lot of pain. The majority of cases will still be dealt with through settlement as this is the most effective approach. There is a strong burden of proof and enormous resources needed to sustain a successful prosecution strategy. Revenue acknowledges the need for a number of criminal prosecutions each year where the nature of the evasion deserves this and where, regardless of the resource implications, it is necessary to drive home the message that tax evasion is a criminal act which society condemns and deplores. Over the years a few people have gone to jail for tax evasion, although not for a long time. Revenue would like to see custodial sentences.

The Investigations and Prosecution Division at Revenue is staffed by people who have skills and experience which they are building as they go along. There were six successful convictions in 2003 which is twice as many as the year before. The sentences are usually fines but there was a six months suspended sentence in one of the six cases in 2003. The prosecution pipeline at March 2004 was two cases in the courts, 12 cases with the Director of Public Prosecutions and 34 under investigation. The general objective is to have a steady flow of cases going to the courts for prosecution for criminal tax evasion. In addition, Revenue prosecutes approximately 1,400 cases each year for other offences on the Customs and Excise side and for failure to file tax returns, etc. Some cases can take a year and a half or two years to investigate.

5. Adoption of Reports

5.1. The Committee disposed of Chapters 2.7 and 2.8 of the 2002 Report

Findings and Recommendations

<u>The Committee of Public Accounts</u>

<u>Finds specifically that:</u>

1. Convictions of non-filers show an increase from just over 200 in 1997 to an average of more than 1,000 per annum in the period 1999 to 2002.

2. There was a significant backlog of referrals in the Revenue Solicitor's Office and it can take up to two years for a referral to be processed.

3. In money terms, of every €100 of fines in tax cases, only €25 to €26 is collected. Approximately one third in number of fines is not collected

4. The practice of sending warning letters has increased significantly since 1997 and has been developed as a valuable part of Revenue's overall compliance programme.

5. The Committee recognises that very few prosecutions of serious tax evaders are being taken by Revenue.

<u>And recommends in general that:</u>

1. Revenue needs to increase the number of cases brought forward for prosecution of serious tax offences in order to demonstrate its determination to deal with the tax evasion problem.

2. The Revenue prosecution strategy in relation to non filers needs to continue to be actively managed to improve the effectiveness of its contribution to the overall compliance strategy.

3. There should be more effective co-ordination between Revenue, the Courts Service and the Garda Síochána in the collection of fines imposed for tax offences.

4. The Committee requests Revenue to bring forward a more effective method of fine collection.

5. Revenue Investigation into Offshore Accounts

1. Proceedings of the Committee

1.1. The committee heard evidence from Mr Frank Daly, Chairman of The Revenue Commissioners and his officials, from the Comptroller and Auditor General and from officials of the Department of Finance on 22 July 2004.

2. The Background

2.1. Revenue initiated an investigation into offshore accounts and trusts in 2003, focusing initially on trusts held in the Jersey-based institution owned by the Bank of Ireland and subsequently on accounts held in an Isle of Man-based institution owned by Irish Life and Permanent plc.

2.2. In November 2003 Revenue wrote to the CEOs of ten financial institutions, banks and building societies which have or had subsidiaries offshore in the Isle of Man, Jersey or similar places inviting them to discuss the matter of tax evasion using offshore accounts. By December 2003 five meetings with CEOs were held. The purpose of the meetings was to make clear that Revenue will deal with the matter of evasion using offshore accounts and to invite co-operation from the financial sector so that this can be done in the most effective, pragmatic and timely manner. The aim was to convince the financial industry that it was time that this matter was finalised and that it is in everyone's interests - taxpayers, Revenue, the financial sector and the entire country – that it is brought to a satisfactory conclusion. There are no special deals, rather the pursuit of tax, interest and penalties that are appropriate.

2.3. The institutions signalled that they would co-operate with the comprehensive inquiry by Revenue into all offshore accounts. Revenue gave account holders until 29 March 2004 to make voluntary disclosures. The deadline for payments was initially 28 May 2004 but this was extended to 10 June. During this voluntary phase the total amount collected up to July 2004 from over 14,000 individuals is €677 million, of which €546 million was collected in 2004, while €131 million was collected in 2003. The likely final yield from the voluntary disclosure phase is expected to reach €1 billion.

2.4. The response to this initiative, when compared with results from the voluntary disclosure phase of the bogus non-resident accounts investigation indicates that there is a growing recognition that Revenue is focused and determined in pursuing outstanding tax liabilities. The individuals who failed to avail of the voluntary disclosure opportunity are the focus of attention in the next phase of the investigation. Applications to the High Court were being prepared for autumn 2004 to seek to have the full list of account holders disclosed to Revenue by the financial institutions. Individuals identified during this phase will face additional penalties and publication; and will be considered for prosecution.

2.5. The latest figures from the other major Revenue investigations as at July 2004 were that the bogus non-resident accounts investigation has now collected €759 million, made up of €222 million in DIRT paid by financial institutions, €227 million paid under the voluntary disclosure scheme and €310 million paid in the investigations since then. The collections from the NIB-CMI investigation were €51 million and from the Ansbacher investigation were €43 million. The follow-through from the Moriarty, Mahon and Flood Tribunals was €25 million. Taking into account the €677 million collected on foot of the offshore accounts investigations the total for all investigations in July 2004 amounted to €1.6 billion.

2.6. Following the voluntary disclosure phase of the bogus non-resident accounts, information emerged that led Revenue to review the position of Anglo-Irish Bank in relation to the DIRT look back audit. The review included a full re-audit of Anglo-Irish Bank for DIRT purposes which was finalised in July 2004, resulting in a DIRT liability, including tax, interest and penalties, of €3,162,136 which was settled.

3. The Accountability Issues

3.1. The accountability issues examined by the Committee were:

- Bank of Ireland Trusts – Jersey
- Irish Life and Permanent
- Access to information held by foreign banks
- Communication between a financial institution and an account holder
- The voluntary disclosure phase
- The Prosecution Phase
- Pursuit of aiding and abetting of tax evasion
- Penalties

4. Examination of the Issues

Bank of Ireland Trusts – Jersey

4.1. Revenue reported that a further €111 million has been received as a result of an investigation into off shore accounts, principally in a Bank of Ireland subsidiary in Jersey. Revenue is also investigating other financial institutions which have similar offshore subsidiaries in Jersey and the Isle of Man. The investigation is at early stage. The operation of the activities on the Isle of Man and in Jersey was carried out by wholly owned subsidiaries of institutions in Ireland which are managed and controlled on the Isle of Man and in Jersey. As such, they have no obligations to the State, notwithstanding the fact that some proportion of the accounts in question may represent funds on which tax has been evaded in the State. The trusts in this case were managed and controlled in Jersey. From the information available, in that case officials of the Jersey subsidiaries may have secured the funds on visits to the State, as opposed to officials located in Ireland advising people specifically to put money in Jersey. The arrangements involved the placing of money in so-called discretionary trusts where the settlers of the trusts had not distanced themselves from it.

4.2. It should be noted that there are indications that there are trusts and accounts in both the Isle of Man and Jersey where the underlying moneys and the income accruing from them were properly treated for tax purposes. There are economic reasons for placing money there in that one gets a better return. People may have a genuine business reason for placing money offshore. It emerged in the course of the investigation that some put money abroad which was taxed income and were honest and up front about returning the interest for tax purposes. In the majority of cases the underlying income had never been declared. In almost all cases the interest on the income had not been returned for tax. However, the majority of such investors did so in order to evade tax. It is fair to conclude that in many cases the impetus must be to hide money from Revenue.

4.3. The Committee asked how such a large amount could be allowed to accrue. There had been concern for some time about Irish residents using the facilities of offshore subsidiaries of Irish financial institutions in order to hide money in trusts or deposits. Revenue have monitored events in this area since it established the offshore assets group and conducted analysis and research. Articles in the financial press and the type of advertising engaged in by some of the institutions during the years were examined and it was concluded there was something worthy of investigation.

4.4. The initial focus was on the Bank of Ireland trusts in Jersey. When the bank became aware of Revenue interest in the trusts, it wrote to its customers to remind them of the standard voluntary disclosure arrangements available to anybody who had a tax problem. The immediate consequence of these developments was a significant disclosure from 254 individuals who have paid €100 million. Another 30 individuals who became aware of the inquiry paid another €11 million.

4.5. Two other financial institutions are under investigation. It is possible that other institutions were involved but a certain degree of evidence or backup material is needed before an investigation can be started. It is not unreasonable to speculate that the final figure will be a multiple of the €111 million collected to date. The fact that the Bank of Ireland drew its customers' attention to the voluntary disclosure arrangements was good from its point of view. It is not bad advice to be aware of the fact that a voluntary disclosure regime is in place. Responsibility always lies with the individual who hides money and makes the arrangements. A high standard of proof is required before Revenue can take any action. Strong evidence and support from people who are prepared to go through the process of siding with Revenue is needed for any action taken against banks. The bogus non-resident process has shown that this is very difficult.

4.6. The Committee welcomed the establishment of the offshore assets group. Almost all of the developments can be attributed to the 1999 powers which allow Revenue to examine financial institutions in a way that was not previously possible. The decision to establish the offshore assets group was a response to the new powers and to certain analysis conducted and concerns that had been expressed. The general philosophy of Revenue is that they will pursue inquiries into matters such as Ansbacher, bogus non-resident accounts or offshore accounts.

Irish Life and Permanent

4.7. The Committee was surprised with the number of voluntary disclosures (1,200) in the case of Irish Life & Permanent. Revenue felt that it explained the reason for the work of the offshore assets group and the reason it is conducting a major investigation into the use of offshore accounts in the Isle of Man, the Cayman Islands, Jersey and elsewhere. The voluntary disclosures are checked against people who might have availed of one or other of the amnesties. There is a Chinese wall between Revenue and the chief special collector, as he was called in the amnesty legislation. That wall can only be breached on a case by case basis, if there is reason to believe that an amnesty declaration was deficient. There has never been a prosecution by Revenue resulting from this work.

Access to information held by foreign banks

4.8. The Committee inquired as to whether Revenue could obtain information from foreign banks with holding companies in the State. The application to the High Court uses either the section 908 power, which was successful in the bogus non-resident investigation, or a new section 87 of the Finance Act, or section 908 (*b*) of the Taxes Consolidation Act, which enables Revenue to seek records under the control of an Irish-based institution, even though the records might be held abroad. Revenue does not have a direct entrée to banks that have no established presence in Ireland but there are many different sources of information available to Revenue in regard to financial records and transactions. These range from information under the EU savings directive, which comes into effect on 1 July 2005 to information which will become available under tax information exchange agreements, which are under negotiation with several countries. A developing source of information is from money-laundering reports. Money-laundering or suspicion transaction reports are a feature in almost every country. In building relationships with counterpart Revenue institutions in other administrations, including the USA, and their access to information in their countries, there will be opportunities to gain information about deposits held in banks which are not established in Ireland.

Communication between a financial institution and an account holder

4.9. There is an obligation on a financial institution to notify the individual concerned, except in the case of a High Court order under section 908 in regard to DIRT, when Revenue is seeking specific information on a taxpayer. There is no general requirement on institutions to notify a taxpayer that Revenue is undertaking an inquiry or investigation, although generally they do. There is an exception under the money laundering legislation which prohibits an institution telling the individual concerned about the reporting of a suspicious transaction and requires it to report to both Revenue and the Garda if it has any suspicions about particular transactions.

The voluntary disclosure phase

4.10. The Committee was impressed by the overall total amount collected to date (€1.5 billion) and asked about the socio-economic background of the 14,000 individuals who made voluntary disclosures. This analysis is not yet complete but it included people from business, farming and the professions. They lived in all areas of the country and in all counties. Dublin had the highest number of cases and Donegal and Monaghan followed closely. Cork and Louth also figured prominently. The taxes involved were mainly income tax and sometimes capital gains tax and VAT.

4.11. The Committee examined the amounts collected to determine the once-off amount from the recurring amount. The Exchequer finances have improved significantly. Indications are that instead of borrowing €2.5 billion in 2004 the

Exchequer borrowing requirement was likely to be €1.5 billion. One half of the improvement of €1 billion is accounted for by the €500 million collected which is non-recurring, except to the extent that the non-voluntary disclosure phase of the current investigation from the autumn of 2004 may be €1 billion.

4.12. The Committee noted that in the case of bogus non-resident accounts, voluntary disclosure was €227 million and the Revenue Commissioners' investigation brought in another €310 million. In the current investigation there were 14,000 voluntary disclosures compared to 3,700 cases under the bogus non-resident investigation. The banks wrote to more than 100,000 people with offshore accounts. Those figures should be approached with great caution because in some cases there was more than one name on the account and in other cases people would have closed an account and opened another one. Among the 14,000, many people had accounts in more than one institution. Most of them were in the tax net already. In addition to the 14,000, there were about 10,000 disclosures or people who indicated they had accounts in Northern Ireland. These were very small accounts shopping accounts, or student accounts and not of interest to Revenue.

The Prosecution Phase

4.13. Revenue explained the next phase of the process. The applications to the High Court are looking for orders to require the banks to give a full list of all offshore account holders. There must be a case in court that there are reasonable grounds for making these applications. This is built up from the information received under the voluntary disclosure measure. The Revenue argument is that it is reasonable for the court to assume that there are more accounts out there, that there are people who did not make disclosures and it is reasonable to require the banks to furnish the lists.

4.14. Since the meeting between Revenue and the chief executives of the ten institutions in December 2003, co-operation from the banks has been good. The banks wrote to all holders of offshore accounts held in branches or subsidiaries of their institutions. They could not force anyone to come to Revenue nor could they make the call that because someone had an offshore account, they also had a tax problem. This information is privy only to the individual. The necessity to go after the lists is not a sign of non-co-operation on the part of the banks. It is likely that in terms of cover for whatever disclosure they might make, the banks need the protection of a court order rather than volunteering the lists.

4.15. The Committee inquired whether there was any legal impediment preventing the banks from supplying the information for which Revenue were seeking a court order. The first step is to ask the banks to furnish the lists to Revenue. There may be issues of client confidentiality. It would create too high an expectation to say they would voluntarily produce the information. Even in the court process, there are degrees of co-operation in respect of the way the banks may oppose, or not oppose the court applications. The Committee noted that it expects the financial institutions to co-operate fully with all Revenue investigations.

4.16. The Committee asked whether any specific investigations into foreign institutions were currently being undertaken. Revenue is creating a database of all the information they have been able to glean from the voluntary disclosures. There are preliminary indications that people have voluntarily disclosed in cases where the accounts are held in foreign banks or in banks that do not have an establishment here. If, as a result of an analysis of these cases, it is felt that a particular bank, country or city held a substantial number of these accounts they will try to progress that quickly. The section 87 powers would be of limited use in those cases but the co-operation that exists between tax administrations, not just across Europe but globally, is encouraging.

Pursuit of aiding and abetting of tax evasion

4.17. The prosecution programme seeks to bring a reasonable number of prosecutions for tax evasion before the courts each year. The senior management decided it wanted a broader range of offences considered by Revenue including aiding and abetting. Having reported to the Committee on the collection of DIRT, interest and penalties, Revenue considers the issue is probably closed but in terms of taking aiding and abetting cases in future, Revenue would bear the costs of the court case. Time will tell whether an aiding and abetting case can be made on other evidence such as documentation and correspondence. The strongest evidence always comes from the person who did the evading but was aided and abetted in the process.

4.18. The evasion mechanism used in Jersey was a significant use of trusts. In one institution alone, the Bank of Ireland Jersey Trust, 254 individuals had trusts. In many areas the mechanism used was an offshore account. There were a significant number of accounts in Northern Ireland, which were deposit accounts. Of the 14,000, approximately 60% were in Northern Ireland and 30% were in the islands (Guernsey, Jersey and the Isle of Man). The other 10% were in various places, including the UK mainland.

4.19. The issue was not deposit interest retention tax on the amount invested but that no tax was paid on the capital sums originally. In most of the Irish Life and Permanent accounts in the Isle of Man the issue was interest on the capital rather than the income itself being untaxed in the first place. In the more recent offshore accounts there was a mixture of interest on capital not being returned and, in some quite significant cases, of tax not being paid on the money in the first place.

4.20. As the sums are so big and it is a recurring issue, the Committee considered, if a tax evasion industry is operating in the country. Generally, working forward from the DIRT investigation and the investigations into Ansbacher, NIB, CMI and the current one, Revenue hopes that a behavioural change is being created. The numbers of people who voluntarily disclosed under the current offshore investigation is three or four times the number who voluntarily disclosed under the bogus non-resident account investigation. One of the dividends of all of the investigations is that there has been an increase in tax compliance generally and an improvement has occurred with people who want to get their affairs in order. The determination to follow through on investigating people who did not disclose bogus non-resident accounts has helped this. It is equally important to follow through on non-disclosures to show that it is not a question of taking the easy option and the people who come to Revenue being the ones who pay. Revenue will pursue those who did not come forward.

4.21. The Committee argued that a tax evasion industry has operated for a long time. Trusts would require some expertise or advice, unless one happened to work in the financial sector. The other mechanisms would need contacts or one might need details of accounts or institutions in which one could place money. There is a widespread belief that the individuals, many of whom are farmers, publicans, solicitors and barristers, would not have the particular expertise to be involved in a trust in Jersey if they were not aided and abetted by financial advisers of one sort or another. This widespread public belief, reinforced by statements from persons who have been caught in evasion, is that they were advised by their banker, accountant, financial adviser or insurance broker, or by a number of those, on how best to evade tax. The Committee was concerned that the experts driving the evasion are avoiding prosecution while those evading, on their advice, suffer extraordinary heavy penalties, especially if they do not make a voluntary disclosure.

4.22. Revenue agreed that the anecdotal evidence was that the individuals were advised along the way. If a complex set up such as a trust were involved, most people would need advice. If it concerned the opening of a deposit account abroad in a branch or subsidiary of an Irish financial institution, a person would still need assistance to be pointed in the right direction. Revenue would like to get some examples of aiding and abetting cases against individuals who gave such advice. The real difficulty, because of the manner in which the legislation is structured, is that it is an onerous process to provide the proof required in aiding and abetting cases to bring a successful charge. In all investigations cases are examined to identify people who might have aided and abetted with a view to a successful prosecution. Revenue and the State would benefit from convictions on aiding and abetting. In cases of voluntary disclosure there is no indication in the information given to Revenue of who might have aided and abetted or been involved.

4.23. The Committee asked if Revenue will pursue the people who made voluntary disclosures with regard to how they may have been aided and abetted. In so far as individuals who made voluntary disclosures are concerned, it is a closed book. There are some very large settlements in the voluntary disclosure phase that will be examined to see if there is a possibility of discovering those who aided and abetted. A key part of any case for aiding and abetting involves the co-operation of the individual who evaded but once people make a settlement with the Revenue Commissioners, they prefer closure on the issues involved.

4.24. The Committee noted that in the section of the Finance Act that makes aiding and abetting a criminal offence, the level of proof required from Revenue is onerous because of the manner in which the Act was drafted and asked if Revenue felt the Act is amenable to amendment. It is expected that the issue will be covered in the forthcoming Finance Bill. The amendment would not have retrospective effect as it is not possible to create an offence retrospectively.

4.25. The Committee considered if tax payers might have redress against their advisers or the institutions. If one assumes a change in the legislation that makes it easier for the Revenue to build a case, the most likely cases would be the ones caught in the post-voluntary disclosure phase. It is also reasonable to assume that if there were people or institutions advising people in respect of the evasion of tax, they are the same ones who advised both the people who have voluntarily disclosed and those who have not done so and who will be pursued in the next phase.

4.26. The range of penalties for aiding and abetting are a monetary penalty, a fine, and a possible jail sentence of up to five years. Section 10 states that, on summary conviction, the court may impose a fine of €3,000 which may be mitigated or, at the discretion of the court, imprisonment for a term not exceeding 12 months or both or, on conviction on indictment, a fine not exceeding €126,970 or, at the discretion of the court, imprisonment for a term not exceeding five years or both. A jail sentence was imposed for the offence in one case in recent years which was taken against an accountant.

Penalties

4.27. The interest rate charged in Ireland is punitive when compared to that charged in similar circumstances in other European jurisdictions but it should be borne in mind that Revenue pays a high rate of interest on overpaid tax. The Minister published for consideration and consultation, the report of the revenue powers group that met and reported in 2003. It noted that the interest rate is quite high and recommended that it should be reduced. The interest rate works out at approximately 12%. A considerable proportion of the €225 million paid by banks after the DIRT investigation comprised interest payments.

4.28. If people paid their taxes, there would be no need for penalties. Many people struggled over the years to pay their taxes at times of high tax rates. Some people may have paid interest to institutions to get the money to pay their taxes. Interest was the most significant factor in the most recent investigation for many people. The Committee is aware that penalties in general were reduced to 10% of the tax.

Findings and Recommendations

<u>The Committee of Public Accounts</u>

<u>Finds specifically that:</u>

1. The decision to set up a special offshore assets group has been vindicated by the amount of undisclosed taxable income brought to light.

2. A Revenue investigation of trust accounts in the Bank of Ireland Jersey, which began in 2003, resulted in voluntary disclosures from over 100 tax payers and settlements in excess of €100 million.

3. It was notoriously difficult to pursue a successful action for aiding and abetting tax evasion under legislation in force at the time.

And recommends in general that:

1. The Revenue Commissioner's initiative in meeting the relevant financial institutions should be continued. The Committee would like to be kept updated on the discussions and the likely tax gain which may arise.

2. Revenue should use the new powers conferred by the Finance Act 2005 to pursue aiding and abetting prosecutions.

6. Department of Finance Tax Reliefs – Chapter 1.1

1 Proceedings of the Committee

2.1 The committee heard evidence from Mr. Tom Considine, Secretary General, Department of Finance, and his officials and from the Comptroller and Auditor General on 22 April 2004.

2 The Background

2.1. Chapter 1.1 of the C&AG's 2002 report addresses a concern about the need for policy decisions in financial matters to be informed by a sufficiency of relevant information. It draws attention to the dearth of information on the operation of many of the tax reliefs and incentives available to qualifying taxpayers.

2.2. Tax expenditures and incentives represent a significant overall cost to the Exchequer. They are a legitimate policy instrument in many areas, including the stimulation of activity and investment in certain sectors of the economy. By nature, they are diverse, varying from SSIAs to film industry incentives but one feature most of them have in common is the fact that there is a cost to the Exchequer in terms of tax forgone. It is important that they are subject to regular review to ensure they are having the intended effect at an acceptable price and, if not, that they are amended in some way or even abolished. While this is recognised by all concerned, achieving the desirable objective has been hampered by the lack of information on individual schemes.

2.3. The current availability of information about cost and other matters relating to individual schemes varies considerably. Information about some reliefs or exemptions, such as medical expenses relief, is captured on tax return forms in a way which allows for specific costs to be captured. Almost all the information relating to the artists' exemption, such as the numbers of claimants and the amounts exempted from tax, can be obtained.

2.4. The cost of certain other reliefs is captured not by means of tax return forms but by Revenue by means of separate claim mechanisms which are used. Tax credits under the special savings incentive account scheme, for example, or for mortgage interest relief, are paid at source to the financial institution and credited to the individual or his or her account. Similarly, the health insurance provider sends in the claim in respect of health insurance relief. Information on costs is readily available in all these cases. Specific refund claims must be made from Revenue in other cases, such as the refund of excise duty relating to public transport. Therefore, the relevant costings are to hand in such cases.

2.5. It is sometimes possible to estimate the cost of reliefs on the basis of other information available. It is possible to make a good estimate of the cost of the exemption from tax on child benefit payments, for example, from the information that is available on child benefit and from general information available from the income tax file. The costs of film relief or the business expansion scheme can be estimated from information caught by the certification process, together with information supplied on tax returns.

2.6. Information is not available in many areas. In the pensions area the only information captured in tax returns relates to tax relief for pension contributions for the self-employed. As employer and employee contributions are dealt with under a "net pay" system, they are not returned. Some highly aggregated figures which are sourced from within the industry are available and allow for some tentative estimates. Capital allowance information is aggregated in tax returns under the four broad headings of "plant and machinery", "industrial buildings", "rental" and "miscellaneous". A range of tax incentive schemes such as urban renewal, rural renewal, reliefs for nursing home investment and child care facilities include accelerated capital allowances. Such costs are reflected in the aggregate data in this area.

2.7. In the case of capital allowances which cost an estimated €1.65 billion in 2001, taxpayers were not required to give details on their tax returns of the particular schemes under which such allowances were being claimed. Accordingly, it is not known how much incentives for items such as urban renewal, child care facilities, private hospitals and hotels are costing the Exchequer. Furthermore, the aggregate figures for the estimated cost of capital allowances in 2002 will not be available because a change was made to the tax form for corporation tax for that year which had this unintentional outcome. Some 80% of the cost of capital allowances was claimed against corporation tax and the oversight was rectified for 2003. Certain reliefs have been assessed on occasion on a more extensive basis but this is no substitute for a systematic approach to evaluating their efficacy and effectiveness.

2.8. While capital allowances are classified under tax expenditures it is part of any normal system of taxation and should be clearly distinguished from tax expenditures where non-tax public policy objectives are pursued through the tax system. It is not reasonable to attempt to add up the estimated tax foregone for any particular heading and to assume that it would accrue to the Exchequer if certain reliefs were eliminated. In such a scenario, there is little doubt that persons who wish to limit their overall liability to tax will examine their choices with a view to a migration of their investments. Correspondingly, they will almost certainly alter their decisions. That includes taking steps to avail of any remaining tax-based schemes.

2.9. The Department of Finance (the Department) and Revenue are concerned to improve data on tax expenditure to facilitate the review of such expenditure. A great deal of the overall cost of the incentives and expenditures is accounted for by ordinary business reliefs and by pension reliefs for employees, employers and the self-employed. Such reliefs could not be removed without severe and unintended consequences for business, employees, employment and future pension costs for the private sector and the Government.

2.10. The impact on the tax payer must be considered when a change in the way in which information being gathered is being examined. The effect is also considered on Revenue's current strategy of keeping compliance costs for taxpayers as low as possible by means of the ongoing simplification of forms, procedures and regulations.

2.11. The priorities for information collection focuses on the tax expenditures for which the availability of cost information would make a contribution to evaluation and policy-making that would justify the additional burden of collecting it. For example, a relief like the exemption from tax on the investment income on court awards for thalidomide children was given because of their particular status and there is not necessarily an "outcome" to be measured. The likelihood of the availability of cost information affecting the continuation of the relief seems so low that it might not be justified to require an annual return of such exempt income.

2.12. The issue of tax expenditures and, specifically, the need to improve cost information has been discussed and considered in the Department since 2001. Tax reliefs and their cost have been a regular item on the agenda of the tax strategy group since it started its work in 1994. As well as changing the tax incentive schemes that were announced in the 2003 budget, the Finance Act 2003 required the return of certain exempt income that was not previously returnable.

2.13. Following preliminary exploratory work, a senior level group was convened in 2003 to discuss the practicalities of improving data capture via the tax return forms. Agreement has been reached that information will be captured from tax return forms by Revenue on 22 significant reliefs, including property based incentives, donations and superannuation contributions. The Department considered that the priority in such work should be to obtain more information about tax expenditures provided by way of accelerated capital allowances on buildings and about employee pension costs. As a result, Revenue will introduce a number of changes to the forms relating to the annual return of income by PAYE and self-employed individuals and companies as well as to the P35 form, which is returned by employers at the end of each year with totals for earnings and deductions for each employee.

2.14. Over time, the changes to the return of income forms will yield additional information on the cost of various tax reliefs, particularly in the area of capital allowances. The P35 return will supply additional data concerning tax relief on pensions. To underpin this work, the Finance Act 2004 included legislative changes which required an employer to provide the aggregate pension data sought on the P35 form. This means that if a taxpayer declines to fill in the additional sections of the return of income form, he or she will be liable to the usual surcharge and penalties for making an incomplete return. Concerns were voiced on Committee Stage of the Finance Bill 2004 and by practitioners about the possibility that genuine misunderstandings and errors in this area might be punished without an opportunity to revisit and complete the tax return as required. To address these concerns, the provisions were further clarified through a Report Stage amendment to the Bill. The amendment stipulated that the surcharges and penalties would not apply unless the matter had come to, or been brought to, the taxpayer’s attention.

2.15. As well as trying to improve the availability of data on existing schemes, the Department is conscious of the need to bear in mind data capture considerations in introducing new schemes. The legislative provisions for the new research and development tax credit introduced in the Finance Act 2004 require that the credit be identified separately by the claimant. The Department and Revenue will continue work in this area. In addition to work from paper-based returns, information technology developments are expected to facilitate improvements. Recent technological developments in Revenue, such as electronic filing through ROS are likely to be helpful in this regard. Returns filed in this way can readily accommodate information data captured on tax reliefs being claimed while keeping the extra compliance burden for taxpayers to a minimum.

2.16. Data on costs is needed to assess and review tax expenditures. The question of how best to evaluate tax incentives or expenditures raises similar issues to those raised in evaluating public expenditure schemes depending on the nature of a scheme and the outputs and outcomes expected. Some schemes readily lend themselves to evaluation with the benefits being clearly identifiable and measurable against their objectives. Others are more difficult to assess as the benefits are not easily quantifiable from a cost-benefit analysis perspective. For example, tax relief for expenditure on heritage houses has tourism and heritage policy objectives as does a grant scheme for such houses. Accordingly, while there may be some quantifiable indicators such as tourist numbers, much of the assessment in both cases must rely on more qualitative indicators. Broadly, the same criteria of efficiency and effectiveness should apply when measuring tax expenditures as public expenditure items and, in assessing whether tax instruments or public expenditure or other policy instruments are more appropriate in achieving a policy objective. It often seems the taxpayer's mind-set is such that reducing the tax payable seems more attractive than the simple financial or economic benefit would suggest.

2.17. Tax-based schemes are kept under constant review, especially in the context of the annual budget and Finance Bill process, to ensure they continue to meet the purpose or purposes for which they were introduced. Detailed reviews of the costs and benefits of various tax reliefs are also carried out from time to time. Examples are the urban renewal scheme, the film relief scheme, the seed capital scheme and the business expansion scheme. As data on costs improves, it is hoped to develop and improve analysis accordingly. However, many decisions in these areas come down to a policy call at a practical level when political decisions are being made.

3 The Accountability Issues

3.1. The accountability questions examined by the Committee were:

- Cost Effectiveness of tax reliefs
- Data Capture Proposals
- Report on Top Earners
- Uncosted reliefs
- Property based and other relief schemes
- Stallion Fees Exemption
- International Comparisons

4. Examination of the Questions

Cost Effectiveness of tax reliefs

4.1. The Committee noted that up to €68 million is deducted from the tax liability of the top 400 earners who benefit from tax relief schemes and asked why a detailed report on the various incentives which appear to benefit the super-rich was taking so long. If one has incentives such as the ones outlined, those who will be in a position to benefit from them will be those with significant income. Whether it is film relief or urban renewal, the same issue arises. The incentives will not work unless they are claimed by people and the people who can claim them are people with high incomes. It is an unavoidable fact that if one uses tax incentives, one will enable people with high incomes to reduce the amount of tax they pay.

4.2. The Department has been concerned about the matter for some time and, originally, requested Revenue to undertake the study. The indications are that matters are improving. Over the years, the schemes introduced have made moves towards broadening the tax base. Almost every Finance Act in recent years has contained measures designed to accomplish that goal. Some of those measures have had a particularly significant impact, including the €31,750 annual cap on the amount of capital allowances on buildings an individual passive investor could set against employment or other non-rental income. Another example is that in the cases of certain hotels, the capital allowance was ring-fenced to rental income for passive individual investors. A further measure was disallowing the offset of losses and capital allowances of partnership against the non-partnership income of passive partners. This measure was also applied to passive individual investors investing in various activities generating losses for capital purposes. The tax credit on dividends paid to shareholders was abolished and a withholding tax on such dividends was introduced. The capital gains tax base was widened. The studies carried out and the work of the tax strategy group and others have led to the introduction of significant changes in virtually every Finance Act of recent times.

4.3. The Committee noted the difficulty in justifying the extension, curtailment or withdrawl of a scheme without proper information on the costs involved. When one considers the range of schemes benefiting the multi-rich and the relief on private pensions, it appears tax reliefs are greater than the level of investment in the pension fund for ordinary taxpayers. Reliefs benefit people on high incomes with little or no benefit to people on low incomes. In Ireland, the United Kingdom and the Netherlands the private sector makes a large contribution to pensions and ordinary individuals largely look after their own pension scheme when they can afford it. This does not tend to be the case in other countries of the European Union. The policy decision to give an incentive to people to do this has been made. In the case of other schemes, it is very difficult to quantify the extent of the uptake when they are introduced. If a scheme should be introduced to give an incentive to taxpayers to operate in a particular manner, one can only make an estimate in most cases of the likely impact. Once the schemes are up and running, they are examined. Termination dates were set for at least 11 of these schemes in the previous two budgets. Consultants are examining other schemes to form a view as to whether they should be continued. In the case of industry schemes, the relevant Department is involved.

4.4. The Committee was of the opinion that as the estimated total cost of tax reliefs is greater than investment in State pensions it is a clear indication that reliefs are being utilised by exceptionally wealthy people who have disposable cash. Of the 91 schemes and allowances operated by the Department, 28 major schemes cost more than €20 million each per annum, which amounts to €500 million per year. It also indicates that no substantial information is available on the cost of 63 additional schemes. The Committee was concerned that the 28 major schemes did not provide economies of scale. Incentive schemes available for hotels, car parks and in other areas were being availed of by exceptionally wealthy people, who receive massive tax breaks.

Data Capture Proposals

4.5. The Department summarized the proposals for data capture. For the property based incentive schemes Forms 11 and 12 will capture the urban renewal, town renewal, seaside resorts, rural renewal, multi-storey car parks and living over the shop schemes, as well as enterprise areas, park and ride, hotels, holiday cottages, nursing homes, associated housing for elderly or infirm and convalescent homes, student accommodation, qualifying private hospitals, including qualifying sports injury clinics, and buildings used for certain child care purposes. The corporation tax form CT1 will capture donations to designated charities and sports bodies, patent income and research and development tax credit. Information on pensions will be captured on the retirement benefits scheme employer contributions and employee contributions as well as personal retirement saving accounts and retirement annuity contributions from the self-employed.

4.6. The Committee asked whether it would be possible to provide a detailed report on the actual tax relief under all those schemes in future. For the self-employed taxpayer, the information needed will be captured on the 2004 Form 11, which will be filed by the end of October 2005. Preliminary information should become available some time after that date, probably in early 2006. In respect of PAYE taxpayers, Form 12 and the associated system for accepting recording and processing information from PAYE taxpayers is being redesigned. Changes similar to those being made to Form 11 will also be made to Form 12. The objective is for this to apply in respect of the 2004 tax year but the capture of the relevant information is dependent on the system redesign being completed. It will be available in respect of the 2005 tax year.

4.7. Given the time lag involved in any PAYE taxpayer making returns, it could be about a year after the tax year before information is available. However, it may be useful to note that a person earning significant non-PAYE income above €3,175 moves into self-assessment for this type of income, while remaining on PAYE in respect of his employment income. Many of the major reliefs and incentives are therefore likely to be in the Form 11, which will come through in 2004.

4.8. As regards corporation tax, Form CT1, information will be captured in respect of accounting periods ending after 31 December 2004, and will begin to become available nine months after that date, that is, in September 2005. The superannuation information will be captured in the P35 form to be filled out in February 2006 and preliminary information should become available in mid-2006, bearing in mind that Revenue must carry out a programme to check the quality, consistency and accuracy of the returns. The Committee was disappointed that it would need to wait such a long time for the process to come on stream. From a return on investment perspective, it would be beneficial to obtain information much sooner than envisaged, irrespective of the cost of the IT upgrade.

Report on Top Earners

4.9. Top earners are a separate issue. The reorganisation of Revenue will result in the establishment of a unit which will examine the top 250 high earners on the personal side. This will apply to people with wealth in excess of €50 million. Revenue will, from now on, examine the total situation on an ongoing basis from now on and will also separately examine the 350 largest corporations. The changes being made on the return forms cover the whole spectrum, but they are not in any way delaying or interfering with the focus on high net earners. That process is proceeding all the time. One obtains this information by examining the file on each case and the person's overall business position, not by examining the returns as such.

4.10. The finding of the Revenue report on the top 400 corporations was that the effective tax rate that were assessed for these companies was 15%, as opposed to 20% for PAYE taxpayers. In all, three years were examined. The first study was based on the 1993 to 1994 tax year. The second one was based on the 1994 to 1995 tax year and the last one was based on 1999 to 2000. Of the 400 in 1999, 52 companies (13%), had a tax rate of 45% or higher; 231 companies (58%) paid a tax rate of between 30% and 44% and 117 companies (29%), had a tax rate of less than 30%, including 29 companies with an effective rate of 0%.

4.11. The Committee held that the information required can be categorised into three different levels. There is a need for certain information to support the collection of existing taxes and how to collect future taxes. In terms of public discourse, certain information is desirable, not only for elected representatives but to inform public debate on the issue. The third category relates to information for the public good. This may not require the same level of scrutiny as the first two categories. The Department agreed with this analysis.

Uncosted reliefs

4.12. The Committee noted the listing of 33 uncosted reliefs and exemptions in the report of the C.&A.G. and inquired whether any additional information had been gathered. Work was ongoing at the time within the Department on tightening up the whole system – a fact brought to bear subsequently through the Finance Act.

4.13. Other reliefs are not seen as a priority for a first phase, for example, the grants made by Údarás na Gaeltachta, which are exempt in a company's account. One could make an estimate by applying a corporation tax rate to such grants. The big areas from which the high earners report indicates that information is needed are the major property reliefs that fall within the capital allowances sector. On the pension reliefs, the high earners' and self-assessed side is covered, but a large block of money on the employee-employer side is not covered. These are the areas on which the Department is focusing, plus the exemptions that would have been dealt with previously, including those associated with woodlands and stud fees.

4.14. It is expected that better information will be available either because the schemes have changed and the payments are being dealt with in a different way or because of the changes made on the tax forms. There are others for which little information will be obtained. Additional information, that is not just financial or cost information, may be needed when the people who are claiming in some of the big schemes are identified. The tax form would be a bad way of doing that, but it would be used to identify the people involved so that one can follow up with a targeted survey. In this regard, one of the difficulties encountered with the urban renewal scheme was that the only information available was from the local authorities rather than coming from the taxpayers' side.

4.15. The Committee asked for a list of allowances and how they might be applied to both income tax and corporation tax. There are different ways of approaching this. The C&AG started with Revenue's table, which is an income tax and corporation tax table. The tax strategy group focused on the allowances estimated to cost more than €20 million and looked at certain matters pertaining to the indirect tax side, like some of the stamp duty exemptions for first-time house buyers, which one could also regard as tax reliefs. If one were to add up all the items that could be regarded as exemptions in the tax code, there are approximately 170. The difficulty lies in defining a tax expenditure or relief. If one regards items like the PAYE tax credit as inherent to the tax system rather than as a form of tax expenditure aiming to achieve a public policy objective outside the tax system, the number would be much less than 170.

4.16. The Committee noted that the amount of forgone taxes in respect of capital allowances alone in 1999 and 2000 would have been the equivalent of the amount of corporation tax collected at the time. The Department do not consider many of the big items as tax expenditures. For example, the principal private residence has an exemption from capital gains tax. In this regard, the table lists a figure of nearly €800 million per annum. The child benefit allowance is €272 million. The exemption of income of approved superannuation funds, net of pension payments, is €1.27 billion. These are large items that are well known in the public arena. Capital gains tax on the principle private residence and pensions are the big ones. Other contributions to the superannuation schemes are of similar importance.

Property based and other relief schemes

4.17. The Committee noted that a decision was made to reduce the number of property based reliefs. Many of these were supposed to finish at the end of 2004 but was subsequently extended to 2006. The Committee asked whether the cost implications of the proposed extension were considered before the decision to extend was made. Given that the schemes are property based and property prices and valuations differ throughout the country, the unit benefit in terms of tax exemption given varies in different parts of the country. The Committee asked if this was taken into account in how the allowances are given. The Committee also sought to find out if there was any measurement of the unit provision on schemes such as multi-storey car parks, in terms of the number of car park spaces provided, or holiday homes.

4.18. The Committee further noted that 11 schemes with termination dates had new termination dates established. The film relief scheme termination date was extended from 31 December 2004 to 31 December 2008. Other changes were also made to that scheme. The ceiling for tax relief per film was changed from €10.48 million to €15 million from 1 January 2005. The urban renewal scheme is extended to 31 July 2006. The Committee asked if the Department determined the cost of the extensions. It can be hard to estimate these costs because the information received is not broken down in a way which would allow for costings. In some cases arguments can be advanced that more time is required for one reason or another because of delays, for example, in getting the schemes up and running. Many issues, besides costs, are considered in deciding whether there should be an extension.

4.19. The Department stated that it did not collect cost information on these reliefs, or other data. Cost information will be collected under the new tax form changes. Certain specific studies were done on the urban renewal scheme and the seaside resort scheme a number of years ago but these were not matched with the tax cost because it was done from another viewpoint. It will be possible in future, once it is known who is claiming relief, to try to obtain more detail on those reliefs. However, as an initial phase, it would be difficult to obtain through the annual tax form an idea of whether capital allowances are claimed in respect of 10, 20 or 30 units and where they are geographically. That is the type of information that is gathered through more in-depth surveys on a less regular basis by targeting the taxpayers known to be collecting the reliefs.

4.20. Revenue's approach to these schemes is now effective. The only problem is that some of these schemes are costing money but have not been costed and their termination dates, as a result of the last Finance Act, have been extended in most cases from 2004 to 2006. The Accounting Officer said that information about the cost of these schemes will not be available until 2006. Costing information should be available to assist the Minister and policy makers in future property based schemes.

4.21. The Committee asked what costing procedures are undertaken by the Department when a proposal or policy decision is advanced into the Finance Bill process. It noted that Members of the House only became aware of these decisions at Report Stage of the Finance Bill, and many of the exemptions have become part of the Finance Act without being discussed at all in the House. The Committee sought information about the number of these reliefs that have been introduced on Report Stage of Finance Bills. This would allow the Committee to know whether the reliefs had been properly considered by the elected Members by checking the Official Report.

4.22. The Committee referred to the Beaumont Hospital car park scheme that had availed of the multi-storey car park tax relief and the double rent relief which was available at the time. It noted the tax forgone - the tax subsidy per parking space provided was €50,000 per car space. The end date of this scheme has just been renewed in the Finance Act. The Department observed that much of the cost of that arose from the double rent relief, which has been abolished. What has been extended in the Finance Act is the capital allowance element of the multi-storey car park allowance, which is only one element of what gave rise to the tax cost. Following the report on major tax incentives by the tax strategy group, the Department is identifying those that have serious costs attached and the group has been identifying those where the availability of additional information would make the greatest contribution to decision making.

4.23. The Committee acknowledged the strategy to keep compliance costs for taxpayers as low as possible through ongoing simplification of forms, procedures and regulations but noted that many of those involved in the larger schemes, such as multi-storey car parks, hospitals, hotels and holiday camps, would have accountants for tax purposes. It was disappointing that the schemes had been in place for so long without capturing the information needed to monitor them, although this is now being addressed. The Department noted that the seed capital scheme, the business capital scheme, the urban renewal scheme and the film relief scheme had been reviewed. The difficulty with the reviews was that while information could be obtained from the tax return it was not as easy to identify the benefits accruing.

4.24. The Committee noted that the urban renewal scheme had been extended by 18 months in the 2003 budget but that there was no allowance for new entrants. Projects had to be initiated and 15% of the capital had to be spent. While an estimate of the costs would have been made the Department did not have the basic data for a proper analysis. The Department noted that the amount to be allowed is a policy decision. When limiting it to the pipeline cases, the cost is reduced because new people cannot enter the scheme. The Department admitted that the lack of information prevented it from calculating the exact cost.

4.25. The Committee asked for a list of schemes with fewer than 100 beneficiaries. There are not many people investing in private hospitals, sports clinics or the bloodstock industry in the State. The tax exile scheme is for approximately 400 people. An extra justification is required for a tax concession when the number of potential beneficiaries is very few. A distinction is made between benefits and reliefs available to the generality of taxpayers and those that are so focused that one might be talking about only half a dozen people. Revenue is trying to address the schemes that are costing the most money. That does not mean it will ignore the schemes with small numbers of participants that might not cost large sums. It is starting off with limited numbers of very important schemes. Over time Revenue will extend data capture to other schemes that may be of interest or drop schemes which turn out to be of limited importance. A major report is under preparation on the types of schemes that high wealth individuals are using. Specifically, Revenue is capturing data from a wide number of people availing of the schemes while homing in on those high-wealth individuals.

4.26. The Committee noted that the debate on the Committee Stage of the Finance Bill, both outside and inside the Oireachtas, has been about identifying those schemes from which the greatest tax is lost. The other debate is about a fair society. The issue is not the amount of tax being lost but whether there is an inside track and whether schemes are being designed for certain categories of individuals so that they can avoid tax. Revenue has the data to address this issue and will have a review of high wealth individuals available in the short rather than medium term.

4.27. The Committee noted that if there is a high risk to an investment, it has a better entitlement to a tax relief than where there is no or low risk. It recalled the BES scheme for venture capital which, when initiated, was high risk. If the investment failed one had to accept the loss. However, very quickly bricks-and-mortar activity was included which lessened the risk. If an investment went bust, one owned the asset, which was probably making capital gains. The Committee sought information on the risk profile of reliefs.

4.28. The operation of a number of other schemes and benefits requires further consideration in order to optimise their impact. These include, for example, the tax benefits claimed for leasing, purchasing and the buy-back on equipment; nursing home relief; and park and ride schemes.

4.29. The Department circulated to the Committee a list concerning additional information that it will capture in the forms for the self-employed and PAYE workers as well as all the incentives available for urban renewal and seaside resorts. This information will be gathered on the 2004 forms and will be due to be submitted by the end of 2005. The Department will have that information in 2006. The Committee asked the Department the number of schemes that will expire in 2006. The Department reminded the Committee that the priority was to capture information on schemes that were particularly relevant in the context of looking at the 400 top earners and what they actually use as tax shelters. The other priority is for information on the general schemes like pensions which extend beyond 2006. The information is also sought in a consistent manner from people outside the top earners for two reasons: first, the cost of the capital allowances; and second, Revenue is focusing very strongly on managing risk within its remit. A further benefit of capturing information on schemes that are finishing in 2006 is that it will still be of interest for some 12 or 13 years after that date and will be a major input into the Department's risk analysis and assessment system. This will enable Revenue to focus on the cases that may be of highest risk. The Committee felt that the Department should concentrate on schemes that are not due to expire soon so that it might be able to take future decisions on the basis of the information collected.

Stallion Fees Exemption

4.30. The Committee noted that a measure introduced in the Finance Act requires the industry to file returns in respect of chargeable periods from 1 January, 2004. The amount of tax that has been forgone on this exemption over the years is not known. Revenue follows the legislation implemented in this case and is satisfied that, going forward, once the tax return information is available, it will inform future policy decisions.

International Comparisons

4.31. In terms of international comparisons, the position in other European countries is reviewed when a relief is proposed. A systematic comparison of their list of tax reliefs relative to Ireland has not been done. It can be quite difficult to get this information as it is sometimes regarded as being commercially sensitive. There are problems in probing to that level of detail. Various committees at European level look at individual tax items. From these the Department has a detailed knowledge of what obtains elsewhere but would not be able to say, as regards the 170 reliefs, that some exist in one country or another.

4.32. Proposals for a change in VAT or any of the property tax incentives such as urban or village renewal, must be cleared through the European Commission. Precise agreements are in place between the various member states and the Commission as to what may or may not be done in the area of VAT. There is also the issue of whether a particular tax might be construed as a State aid. In that case it is necessary to determine whether the Commission has ruled on the matter and the countries where it exists. Ireland has fought long and hard to ensure that as much freedom as possible is retained as regards taxation policy.

5. Adoption of Reports

5.1. The Committee disposed of Chapter 1.1 of the 2002 Report.

Findings and Recommendations

<u>The Committee of Public Accounts</u>

<u>Finds specifically that:</u>

1. It is very difficult, without proper information on costs and benefits, to determine the justification for introducing, extending, curtailing or withdrawing a tax exemption scheme. Insufficient effort has been made in the past by the Department of Finance to obtain the necessary data for a proper cost benefit analysis of incentive scheme proposals.

2. Insufficient data is collected from taxpayers to ascertain the extent to which some schemes are taken up and the amount of tax forgone.

3. The establishment by Revenue of a unit to examine and monitor the tax affairs of the top 250 individual high earners is a positive step.

<u>And recommends in general that:</u>

1. A tax incentive scheme should not be introduced without both a proper analysis of its potential benefits and its effect on tax revenues. Adequate provision should be made for data collection to monitor the extent of take up and impact.

2. Finalisation of the reviews of the various tax incentives, commissioned by the Department of Finance, should be prioritised to facilitate early detailed consideration of proposals by the Oireachtas.

7. Department of Finance – Votes 1, 6, 7 and 12

1. Proceedings

1.1. The committee heard evidence from Mr. Tom Considine, Secretary General, Department of Finance, and his officials and from the Comptroller and Auditor General on 22 April 2004.

2. The Background

2.1. The Finance Accounts is the name given to the annual account that records all the receipts and payments which go through the Central Fund, together with the supporting financial statements and schedules in Part 1 and the national debt account in Part 2, which also forms part of the National Treasury Management Agency set of annual accounts.

2.2. The Exchequer account is the main account on which the other statements are based. There was a large surplus for the year on the current account but, in broad terms, this was offset by a deficit of similar magnitude on the capital account. The non-tax revenue was up considerably on the previous year, mainly due to windfall receipts from the Central Bank totaling €600 million as a result of the introduction of the euro, that is in respect of the notes and the currency under the old regime, and also a transfer from the social insurance fund of €635 million.

3. The Accountability Issues

3.1. The accountability questions examined by the Committee were:

- Revenue from Citizen Certificates
- Election postal charges
- Regional Assemblies
- Other Subhead Items
- Contingency Fund
- Control of Tribunal Costs

4. Examination of the Issues

Revenue from Citizen Certificates

4.1. In 2001 the State received €199,000 for citizen certificates and that figure more than quadrupled to €871,000 in 2002. The Committee sought information on the number of citizen certificates that were issued in 2002 compared with 2001 and some background detail on this item. The Department advised that the 2002 figure for citizenship certificates is over-stated due to the timing of bringing to account some of the fees for 2001. Therefore, the difference between the two years is less than that shown. The amount collected for citizenship in 2001 was slightly more than €500,000 and was more than €600,000 in 2002. There was an increase in the number of applications for citizenship. In 2001 there were 1,427 applications and 1,048 certificates issued, while in 2002 there were 3,577 applications and 1,332 certificates issued. Revenue collect money and remit it to the Department at various times. In this case, some of the money collected in 2001 was not remitted until 2002. Revenue have their own accounts system. There was a timing issue in the entry into the Finance accounts.

4.2. The Committee sought clarification regarding the balances held at 31 December 2002. Revenue have operational accounts to allow them to work efficiently. In respect of the main body of revenue, ie tax revenue of €29 billion, there might be €10 million, €15 million or up to €100 million which had not been transferred over at the end of the year. That is held in an account in Revenue and represents the amount that has been collected but not paid over to the Exchequer due to timing differences. This is noted in the C&AG's annual report as a footnote on the revenue statement in respect of the annual report.

4.3. Money received in Departments is usually not in large amounts. The largest amount would relate to the main revenue pay-over which on material grounds is noted in the C&AG's annual report. For other matters such as motor fines and so on, depending on the magnitude of the pay-over, it is paid over every few days, monthly in respect of small amounts, and for administrative reasons it may be only paid over quarterly. The amounts would have been credited to a suspense account and it is good practice that all substantial amounts involved should be paid over. However, the C&AG assured the Committee that there were no hidden funds hanging around in Departments that had not been paid over to the Exchequer.

4.4. The Committee noted that more was held than was transferred in the full year for this revenue stream. It was a large figure relative to the amount under discussion while it is small in the national context. Good accounting practice would be that if the cut-off date is the end of December, there should not be that amount of money left under a heading. The cut-off arrangements should be sharper.

Election postal charges

4.5. The Committee considered other non-voted current expenditure. In 2002, a general election year, €13.73 million was spent on election postal charges. At 48 cent per item this would be equivalent to 28 million items of literature. There are approximately 2.8 million on the electoral register. Each of the parties and candidates has a facility to send a *litir um toghcháin*. The candidate fills in a certificate at the post office which states the letter has been sent to, for instance, the people on the electoral register in the constituency. An Post is reimbursed by the Exchequer on production of these certificates.

4.6. The Committee noted that the leaders' allowances amounted to €5.7 million while allowances to Independents for expenses amounted to €419,000. Payments to political parties under the Electoral Act 1997 amounted to €4.3 million while payments to candidates for expenses in Dáil elections came to €189,000. This amounts to approximately €10.7 million. By comparison, a relatively minor aspect of the overall election campaign amounted to €13.7 million and an extraordinary amount of money went to An Post to pay for a minor aspect of the election campaign. There were also two referenda in that year. The Committee asked for a breakdown by campaign and by party of the amount reported under electoral postal charges.

Regional Assemblies

4.7. The Committee noted a reference to an estimate for technical assistance costs of regional assemblies amounting to €823,000 but the outturn was only €452,000 and inquired why the expenditure was so low. The Department clarified that up to the end of 2001 certain costs associated with the EU related activities of the eight regional authorities had been reimbursed from a measure of the 1994-99 technical assistance programme which was managed by the Department and funded from subhead J1. The regional authorities submitted their claims for reimbursement to the Department, where they were processed and paid from the subhead. The 1994-99 technical assistance programme ceased on 31 December 2001. The following 2000-06 technical assistance programme did not include a measure for the reimbursement of the EU related activity costs of the eight regional authorities. From 2002 these costs were funded under the technical assistance measures of the Border, Midland and Western, BMW, and South Eastern regional operational programme managed by the BMW and south-eastern regional assemblies, respectively. Subhead J2 provides the funding for the measures.

4.8. The regional programmes receive EU funding under the 2000-06 Community Support Framework, CSF, in respect of which the EU regulations governing the eligibility of expenditure for 2002 are different from those under the 1994-99 CSF. It took until the latter half of 2002 for the regional assemblies to finalise the application of the 2000-06 CSF regulations to the eligible costs incurred by the regional authorities and establish the arrangements for the reimbursement of regional authority expenditure. Due to this delay the full costs of the reimbursement of the regional authorities estimated for 2002 were not realised and led to a saving on the subhead.

Other Subhead Items

4.9. The Committee noted that there were two entries for consultancy costs. Subhead A7 relates to administrative work and is part of the management of the Department. Subhead B refers to consultancies connected with individual programmes or projects. There were also consultancy costs running through a number of other subheads, namely. D, H2, M, J1, J2 and P. What is being attempted is the division of the consultancy under the most appropriate heading. The euro changeover and the benchmarking body were two main areas of expenditure.

4.10. The Committee noted that the public service benchmarking body was estimated to cost €984,000 but actually cost €2.7 million. The cost of the related consultancy was higher than anticipated because at the time of preparation of the original Estimate it was anticipated that all invoices relating to the consultancy in 2001 would be cleared for payment and paid in 2001. The payments which had been expected in 2001 did not arise until 2002. The activity levels comprised a huge task that was undertaken. It was carried out within a tight time-frame.

4.11. Another section of the accounts includes item 12, EU funding where there was a considerable underspend on the peace programme. Of the €8 million allocated, only

€3.7 million was spent. In addition, there was estimated expenditure of €5 million under the North-South INTERREG programme, yet only €500,000 was spent. As regards other Community initiatives, a sum of €1.7 million was allocated but only €414,000 was spent. There was an underspend of €11 million from EU cross-Border Structural Funds. The Department advised that the 2002 outturn for the peace programme reflected lower than anticipated levels of activity in that year. The saving resulted from later than anticipated approval of the programme by the European Commission. The new peace 2 programme was approved on 22 March 2001. Delays were also experienced in putting in place the implementation arrangements for the programme, with elements being subject to public tender. The programme became fully operational in early 2002.

4.12. In respect of cross-Border development, the peace programme and the North-South INTERREG programme, a source from which many community based schemes sought funding, the Committee noted that it was regrettable when so much money is being spent in the North to find that there is an inability to draw down funds for the southern six border counties. Many applicants for such funding are frustrated because schemes are announced but not implemented. The problems stemmed from delays in having schemes approved at European Commission level. The schemes are now operating.

4.13. The Committee noted that in the secret service Vote, €538,000 from a budget of €900,000 was surrendered back to the Exchequer. The whole business of the secret service dates back to the early days of the State. There was general agreement that a generous Estimate should be made to avoid the need to come back to the Dáil to request a further small sum. That is a feature of this Vote. It is the one area in which the C&AG does not actually see the details, except in so far as the approval system is in place, the money is requested for the appropriate purpose and signed off by the appropriate people.

4.14. Subhead H of Vote 7 relates to pensions paid to resigned and dismissed members of the Royal Irish Constabulary, including widows. Given that the force was stood down in 1921, the Committee inquired how many are involved. The outturn was €2,000 more than estimated. There is a €1,000 compensation allowance under Article 10 of the treaty of December 1921. The C&AG informed the Committee that this was the last time this item would be covered. It was included under what is called the Wigg Cochrane arrangement. Some of the people concerned were 103 years old.

Contingency Fund

4.15. The contingency fund deposit account has been in place for many years. Its purpose is to enable business to be done in a situation where the Dáil is not available to pass an Estimate or grant as expected. In this case the Department received a request from the secretary to the Commission on Electronic Voting on 10 March to provide funds from the Central Fund for the expenses of the Commission. The decision to use the contingency fund deposit account to fund the Commission was based on the fact that the Dáil was going into recess from 11 March, the Commission was operating to a deadline of 1 May and sought to incur expenditure on advertising from early March. Advertising seeking the views of the public appeared in the Sunday newspapers on 13 March.

4.16. Given the resolution of the Dáil on the examination of the electronic voting system, the funding of an independent commission to look into the secrecy and accuracy of the proposed system was not considered, in itself, to be controversial. The Government informed the Commission that payments to it would be discharged by the Department from an appropriate allocation out of the Central Fund. The letter went from the Secretary to the Government, appointing the judge, dated 1 March 2002. However, the Commission did not look for money to fund their expenses until 10 March.

4.17. On 10 March a letter was received and the Dáil was going into recess on the following day. Accordingly, the contingency fund mechanism was used in this instance for one of the shortest recesses the Dáil takes to make a decision that otherwise would have been made by a full vote of the Dáil. The Committee felt that there are serious questions as to whether this was an appropriate use of the fund. It is clear from correspondence that decisions had been made about money being allocated in a general way which would have allowed plenty of time for an appropriate resolution to be brought to the Dáil.

4.18. The Department stated it did not receive a request for the money until 10 March and the Dáil went into recess on 11 March. It was known from 1 March that the money would come from the Central Fund. The use of the contingency fund is a central question. The Committee questioned the use of the contingency fund in this way, that is when there was enough time for the matters to be dealt with appropriately and in accordance with standard procedures and when the nature of the recess was rather short.

4.19. The highest amount paid from the fund, before this case, was £91,000 in 1995. The Committee considered how it should deal with this matter in the future, specifically the means of continuing to do business when the Dáil is in recess. In this case, a Bill was going through Parliament which passed a resolution indicating that it was putting legislation through to make provision for this. The concern is about instances where appropriate measures could have been taken when the Dáil was sitting and the legislation had been properly passed. The future use of the fund is an important issue because the Committee is involved in the process. The fund should only generally be used in the summer and Christmas recesses. If stricter criteria for use of the fund were in place, this issue would have been avoided.

4.20. The Committee accepted that this was an unusual case. The normal procedure is that an Estimate is introduced. In this case, because the funding for the new commission was not to be channeled by way of Estimate, it had to become a direct charge on the Central Fund. This meant that primary legislation had to be introduced to give effect to it. It is more difficult to introduce and have legislation passed than it is to introduce and have a Supplementary Estimate passed. It was, therefore, an unusual feature of this case which added to the difficulty of bringing it through the House. While the Committee accepted this point it was concerned that the use of the fund was a case of legislative pre-emption. The Department agreed to consider the issue. There was no doubt that in this case the amount was larger than those relating to previous instances.

Control of Tribunal Costs

4.21. The Committee asked about the measures being contemplated by the Department in connection with the control of tribunal costs. To the end of March 2004, the total cost to the Exchequer of completed and sitting tribunals of inquiry and other public inquiries was €144 million. Of this, €102.66 million was paid in respect of legal costs while €41.2 million related to other costs. The figure for legal costs included some €25.5 million in respect of third party legal costs awarded at three completed tribunals of inquiry. This represented 68% of the total cost of these tribunals. With regard to sitting tribunals of inquiry and public inquiries, the total cost to the end of March 2004 was €106.4 million, of which €71 million relates to legal costs. The latter only refers to the costs of the tribunal of inquiry legal teams as the issue of third party costs has not yet been adjudicated in any instance. Given the significance of these costs in completed tribunals and inquiries, there is scope for a sharp acceleration in Exchequer costs if third party legal costs follow the pattern of those relating to completed tribunals. In the light of the considerable actual and potential costs arising, there was growing concern about the ongoing resultant burden on the Exchequer. At the invitation of the planning tribunal, the Minister for Finance made a submission to it in respect of the liability of the Exchequer for third party legal costs.

4.22. At the time there were a number of proposals under consideration aimed at reducing costs. That followed liaison with the Attorney General and the Minister for Justice, Equality and Law Reform. They were aimed at addressing a number of issues affecting future tribunals, including tightening and better focusing of the terms of reference, with a view to minimising duration and costs; streamlining the operation of tribunals; and a review of the basis of payment for legal representatives. The Commission of Investigation Act offers an alternative to tribunals of inquiry. It is also designed to address concerns such as those relating to the time and cost of public investigations. Overall it will provide a more effective and flexible way of investigating matters of public concern while balancing the issues of cost, time and fair procedures and the rights of affected parties.

4.23. The main differences between the proposed commission of investigation and tribunals of inquiry are that a commission will be designed, by virtue of its means of operation and provisions on cost, to be less costly than a tribunal. It will encourage and facilitate voluntary co-operation while having full compellability powers in reserve. The carrying out of investigations and the taking of evidence in private are likely to provide more suitable means of operating in some circumstances. A commission will have entry and search powers not available to tribunals and by making its evidence available to a subsequent tribunal, if one is appointed, it will enable such a tribunal to be more narrowly focused and complete its work in a more expeditious manner.

4.24. As a statutorily based body, the actions and decisions of a commission will be subject to judicial review. The Bill provides that certain specific matters may be referred to the High Court which, overall, will have a supervisory function similar to that exercised in relation to tribunals. The Commission may refer cases to it where a person fails to comply with directions to attend or give evidence. Referral will also arise when a person considered to have delayed or obstructed the work of the Commission is required to pay the additional costs incurred by the Commission or other witnesses as a result of that delay or obstruction. A witness or other affected party may make application to the High Court where he or she can test the determination of the admissibility of material that is protected by the rules of privilege or where the Commission does not alter a final report as sought by an affected party. The relevant Minister may refer reports to the court where he or she seeks directions as to whether they impinge on ongoing or prospective legal proceedings.

4.25. The Committee expressed its concern at the level of costs. It welcomed the Department's statement that there is a more effective way in terms of time and costs but which would also be fair. This is important to the taxpayer because when accelerated third party costs are adjudicated upon the figures could be quite small. The Committee asked about the likely amount for third party costs. In the three tribunals which have completed their work third party costs amounted to €25.5 million, while the State's legal fees totaled €6.19 million. One is talking about third party costs being four times greater than the State's legal costs. If that was to translate into the sitting tribunals, the amounts could reach €300 million. The State's legal costs for the sitting tribunals amount to €71 million. If one multiplies this figure by four, one is talking about a sum of just under €300 million.

4.26. The Committee was concerned that, given the number represented or seeking representation at the various tribunals, the contingent liability estimate of €300 million could be conservative. There is a liability where it has not yet been confirmed whether the taxpayer will have to pick it up, but bar exceptional circumstances in the majority of cases in which people co-operate with the tribunals, under natural justice, they will tend to have their costs awarded. Some of the tribunals, which have been in place for several years, are not even halfway through their work. The final costs could be significantly higher by the time they have finished their work.

5. Adoption of Reports

The Committee noted Votes 1, 6, 7 and 12 of the 2002 Report.

Findings and Recommendations

<u>The Committee of Public Accounts</u>

<u>Finds specifically that:</u>

1. To the end of April 2005, payments totaling €200 million have been made from the Exchequer in respect of recent tribunals of inquiry. No realistic estimate of the full cost of those tribunals has been made.

<u>And recommends in general that:</u>

1. Efforts to control the costs of tribunals should be pursued by the Department of Finance. The Committee would like to be kept informed of these efforts.

2. Future tribunals should be required to furnish an annual report of activities and costs to the Oireachtas.

3. The Department of Finance should prepare annually estimates of the contingent liabilities in respect of each tribunal. The level of uncertainty attached to the awarding of costs necessarily means that estimates will have to cover a range of scenarios.

8. National Treasury Management Agency: Financial Statements 2002; National Development Finance Agency; State Claims Agency – Chapter 13.1

1 Proceedings of the Committee

1.1. The committee heard evidence from Dr. Michael Somers Chief Executive, National Treasury Management and his officials and from the Comptroller and Auditor General on 29 April 2004.

2 The Background

2.1. Five major legislative provisions affect the NTMA. The agency was originally established at the end of 1990 to manage the national debt and deal with the borrowing activities of the State, at a time when the State's financial problems were very acute. At this time, the paying of the interest on the debt required about 8% of our GNP. This has now reduced to between 1% and 2%.

2.2. Ireland was the first country in the world to set up a separate entity to deal with the national debt in modern times. Before this, the debt was dealt with by the Central Bank and the Department of Finance but there were problems with obtaining staff. Many countries have copied the Irish approach. They have realised it is a business and not an administrative activity. Most countries have not gone so far in terms of setting up an agency outside the Civil Service. The NTMA is the only agency in the State in which, by law, a civil servant cannot work. It was designed to focus people's minds. For anybody who wanted to join the Civil Service, there was no going back; one resigned and that was it. In many other organisations in the State one can go on secondment from the Civil Service which allows for the possibility of return. This was not an option regarding the NTMA.

2.3. The audit reporting arrangements for the NTMA are unusual in that the audit of the agency accounts is reported in conjunction with the C&AG's annual report on the audit of the appropriation accounts.

2.4. A satisfactory audit opinion was given on the accounts. Additional information on the remuneration costs of the agency have been provided in the interest of transparency. Salaries and superannuation costs showed a dramatic increase from 2001 to 2002, up from €5.77 million to €8.74 million. There were two main factors: first, the hiring of new staff to meet the demands of the additional work arising from the agency being given responsibility for the operation of the State Claims Agency and for activities connected with the National Pensions Reserve Fund, as well as some other activities such as central treasury services; second, large increases in the remuneration packages of senior management as a result of a review commissioned by the agency of the top positions by reference to remuneration levels in other Irish financial institutions.

2.5. The level of the national debt remained static over the period 2000-02, at around €36 billion but the cost of servicing the debt has fallen, to a level of €2.17 billion in 2002.

2.6. Additional powers were given to the agency, mainly due to the fact that it had the commercial freedom to operate, namely, to hire people and to pay them the required rate to achieve the agency’s objectives. One of the first tasks received was the securitisation of the State's mortgage book under the Government prior to 1997. The State had lent a lot of money to local authorities for on-lending to lower income groups to buy their houses and it needed its money back. Legislation was enacted to enable a company called Ulysses Securitisation plc to be established. Ulysses issued bonds and got the money for the State. In return the mortgage payments were made to the company.

2.7. Several other accounts come under the aegis of the NTMA, the most important of which are the capital services redemption accounts, which serve as a supplementary Central Fund account. Also included is the small savings reserve fund, where moneys are set aside to partially meet the accrued interest on the small savings schemes.

2.8. The State Claims Agency, came into existence at the beginning of 2001 and is staffed with claims managers, engineers and medical doctors. In more recent times, because of problems in the health area, the remit of the claims agency has been extended to deal with hospitals, doctors and health boards. The first full year account for 2002 reflects the modest level of claims settlements and the related expenses in its start-up phase.

2.9. There had been no fund in existence to cover the accumulated liabilities in respect of those employed in the public service or those who are entitled, in due course, to the old age contributory pension. The National Pensions Reserve Fund was set up to make some provision for this liability, which is containable at present. The NTMA looks after the public interest in arranging the management of the fund, which is now worth €10.5 billion.

2.10. The NTMA was granted control over the National Development Finance Agency (NDFA) when it was established at the beginning of 2003. There was no model nor existing agency for this function. Up until that stage, if a Department had a project, it would hire a pool of experts at high cost who would develop the expertise needed for a specific project. When the project was completed, the group dispersed and the expertise was lost. The idea was that the NDFA would develop a pool of expertise available to the State that could be reused for different projects.

2.11. The Act to establish the NDFA provided that the NTMA would run the agency, it would advise on the optimal way of financing major infrastructure projects and it could borrow or guarantee up to €5 billion for those projects in the event that it was cheaper for the NTMA to fund them instead of the private sector. The NTMA could also set up special purpose companies. This is an attempt to find out if it could remove projects from the State's balance sheet as there was a view that many desirable infrastructure projects were held up because of EUROSTAT rulings. If these projects could be taken from the balance sheet they could proceed

2.12. The NTMA also undertakes a number of other activities. It acts as a central treasury service for local authorities, health boards and VECs. This initiative seeks to prevent these bodies from paying too much to banks. If they had spare cash they placed it with banks but got a poor rate of return and if they wanted to borrow money they paid more than the norm. The NTMA gives them a reasonable rate of return and will lend to them when needed. It can do that on a short-term or long-term basis.

2.13. The NTMA also funds the Housing Finance Agency. This agency had been borrowing on the market in its own name with the State's guarantee. There was no point in having two State entities borrowing, especially since this agency was paying more than the NTMA for money. The NTMA also manages the social insurance fund on behalf of the Minister for Finance, which is worth more than €1billion. They manage the dormant accounts fund on behalf of the board that has been established to do it. They manage liquidity on behalf of the European Central Bank (ECB). The ECB requires a five day forecast of the amount of cash that the NTMA has in the Central Bank on behalf of the Government. It requires this information to manage liquidity within the eurozone. The amount of money that is in surplus or deficit has to be put in the market. It frequently finds itself in the situation late in the day with a surplus or a deficit of between €500 million and €1 billion. Its options are to either place it in the market or alternatively to raise that money in order to maintain a deposit with the Central Bank. That is one of those awkward jobs where one has to search the market around the world and try to find out if there is money available or alternatively a demand for cash.

3 The questions

3.1. The accountability questions examined by the Committee were:

- Remuneration of Senior Officials
- National Pension Reserve Fund
- Ethical Shareholdings
- State Claims Agency
- Dormant Accounts Balances
- Local Authority Finance
- Debt Servicing Costs Percentage
- Performance against benchmark
- Profile of National Debt
- Investments in PPPs

4. Examination of the Questions

Remuneration of Senior Officials

4.1. The Committee acknowledged the importance of the work that the NTMA is carrying out for the economy and the need to have executives who are on an equivalent par with the best international financial institutions. It expressed concern that the remuneration of senior officials is not more transparent and pointed out that the salaries of the CEOs of commercial banks and other institutions are out in the open and that it is possible to calculate the average pay of senior executives.

National Pension Reserve Fund

4.2. The Committee noted that the NPRF stood at over €10.5 billion. Slightly more than €1.1 billion was invested in 2003. The fund was started with the proceeds from the share flotation of Telecom Éireann. Since then, the Minister for Finance has invested 1% of GNP each year. This is to be invested until 2025. No money can be drawn out until that time and it is hoped that it will, at that stage, amount to roughly 30% of the accumulated liabilities in respect of public service pensions and old age pensions. There is an obligation to carry out an actuarial survey to ascertain whether the fund is on track. There are huge imponderables involved in trying to calculate the level of both the liabilities and the size of the fund at that stage.

4.3. The real increase in the value of the fund since its inception is about €800 million on a fund value of €10.5 billion. This is the performance over three years, plus the period of the temporary holding fund. The gain is not large because there was a dreadful first year. The fees to the commission, including the investment manager fees, amounted to €14 million in 2003 or €28 million since its inception. Much of this money is paid to fund managers. On the internationally recognised basis for calculating returns, the fund has gained just 1% per year. This does not take inflation into account. It is not generally understood that the performance is so low. Given that the 2003 figure was such a good one, there has been an impression that the fund is €1 billion larger in total when, in fact, it is just recovering past gains. The agency has received dreadful press on the matter, as have other pension funds. If the shares go down because of international problems, there is not much that can be done about it.

4.4. There is a move within the ECB to examine more closely the true liabilities of governments. This is because debt is only part of the equation and un-funded pension liabilities are enormous. A survey in this area in the mid-1990s showed that Germany had much higher un-funded pension liabilities than Ireland. Ireland and the UK are in reasonably good condition in contrast to the Germans, French and others who will face difficulties in the future. This is increasingly seen as an indicator of budgetary and financial policy.

4.5. The NPRF was launched onto the market in difficult times. There were market performance issues at that time. The equity market has gone through a terrible time over the last few years. That has stabilised and the fund is performing well. The one action taken that was highly beneficial was to average in the investment, that is, all the money was not invested from the beginning. Even adopting this approach, what happened with the equity market fall was unbelievable and a great deal of wealth was lost. The market is still jittery and is up one day and down the next. Interest rates are at historic lows and there is pressure on the European Central Bank to drop them a little more. In the United Kingdom and the United States, interest rates are beginning to increase somewhat. If interest rates rise, the value of equities will drop. A proportion of the fund amounting to over €1 billion has been kept in cash.

Ethical Shareholdings

4.6. There was some concern about the lack of an ethical dimension to the investment strategy. The fund managers working on behalf of the fund were ethically blind to the way in which the investments were made – their efforts were concentrated on getting the maximum possible return. The Committee asked if there had been any reassessment of that position. Much of this money is invested through passive fund managers who track an index and it is virtually impossible to get them to exclude specific companies. The Commission did not involve itself in the issue of shares being bought in tobacco or missile companies. Some of these companies make substantial amounts of money and the fund has benefited from investments in tobacco companies. The State is pulling in over €1 billion a year in tobacco taxes.

4.7. People might be prepared to argue that acquiring shareholdings in companies should be done on a neutral basis. The Committee asked what the pensions reserve fund is doing in regard to acquiring shareholdings. The largest shareholding fund has 47 million shares in Exxon which will have an extraordinary general meeting in May on the governance of the company. The Commission has decided that the fund managers should exercise the proxies on the fund's behalf at AGMs. There is a physical problem as there are shares in approximately 1,200 companies. It is not possible to keep track on all of them. The Committee argued that to hold 47 million is very influential in terms of what that company does and the kind of influence that can be exerted on it. One cannot stand aside whilst knowing the way the company is governed and the policies it puts into practice without questioning these actions. The fact that the agency is doing it on behalf of the country is an added responsibility. People would be very concerned if they were aware of this type of leverage being exercised on their behalf. Up to 30 additional staff would be required for the Commission to undertake that role.

State Claims Agency

4.8. The State liability for medical negligence was covered by a commercial insurance company, the Medical Defence Union (MDU). It was reported that the Quantum report, commissioned by the Department of Health and Children, estimated the current cost of these liabilities at €400 million. From 1 February 2004, the NTMA took over responsibility for managing litigation. The Statute of Limitations for litigation dealing with obstetrics extends until an individual reaches the age of 21. The Committee asked if there was an estimate of the full value of such claims for the next 20 years, based on the estimated €400 million in the Quantum report.

4.9. The Committee was informed that the estimate of €400 million in respect of incidents which occurred to date was correct. There is the possibility of another €400 million because of the involvement of the other medical body, the Medical Protection Society. That would be a total of €800 million. These bodies got premia over the years from consultants and others. In many instances, up to 80% or 90% of those premia was paid by the State. The Medical Defence Union is based in the United Kingdom and is resisting Irish claims. Doubts exist, due to the way the M.D.U. operates, as the reserves, if any, that have been built up.

4.10. The Committee noted that a claim for €4.5 million was made against obstetricians. An agreement was reached which caps the premia paid by obstetricians and provides that the excess cost of their premia will be met by the State and considered if this area was a specialised one within the State Claims Agency that would lead to a high level of liability in the future. The SCA has hired two medical doctors and intends to avail of further medical expertise on these cases. Some of the cases are tragic and there is a view that they should be compensated on the basis of no fault.

4.11. A website has been set up to enable all hospitals throughout the country to report all incidents which occur to the SCA. Since the NTMA took responsibility for the medical area, approximately 28,000 incidents have been reported. Many of these are trivial, for example, when a patient experiences bruising following an injection. There are 540 claims on the medical side at April 2004 and another 60 about to come in. The aim is to minimise risk because this also falls within the area of responsibility of the SCA. It is hoped to deal with the way in which claims arise and the actions that can be taken to prevent them. The database will make it possible to identify areas where risks occur and to prevent problems.

4.12. The Committee asked what provision had been made by the SCA regarding the possible liability for €800 million in the future and whether, given that the State now has total responsibility for medical negligence claims, a reserve fund was in place. The State has not accepted responsibility for the €800 million. There is no fund. When the SCA was established it proposed and discussed with the Attorney General that it would set up a captive insurance company to which Departments would pay an annual premium. That would enable the establishment of a fund to meet such liabilities. The proposal raised all kinds of issues and in the end the SCA activities were focused on the claims business in the hope that in the future, money would be collected from those who were incurring the risks and put into a fund to meet these liabilities.

4.13. The State has not agreed to take on a €400 million or €800 million liability. It will fight it. There was a question of doing so in the courts in England as the body in question is English based. No agreement has been reached between the Minister for Health and Children and the medics in the MDU whose attitude appears to be that claims in this country are settled at a much higher level than in the UK and that it has been subsidising the Irish operation. It is no longer prepared to do so. They find themselves with accumulated liabilities but no cash to meet them. Going forward, it will be the NTMA's responsibility to manage this kind of issue.

4.14. The Committee asked if the reversal of fortune on the asbestos claims represents a turning of the tide in terms of the compensation culture. It proved the that State will not be an easy touch where there is not a genuine case. The fact that the SCA has sought costs has sent a particular message to certain firms of solicitors. A small number of firms have specialised in this area and one finds that all claims tend to be dealt with by them. There were about 500 accumulated cases at the time the Fletcher case was decided. Many of them have pulled back and very few are left. They have tended to disappear. If a person manifests some physical ailment down the road, he or she can come back again.

Dormant Accounts Balances

4.15. The Committee asked about the total balance of dormant accounts for the financial institutions for 2003. These should be transferred not later than 30 April in the following year. The total figure involved is €174,831,000 covering both bank and insurance accounts. There were withdrawals of €24 million of the original €196 million transferred to NTMA in 2003. A 15% reserve fund is maintained which was not fully used. Administrative costs are recouped to Area Development Management Limited (ADM) which has responsibility to disburse €30 million a year. There is also approximately €40 million from the dormant insurance policies.

Local Authority Finance

4.16. There is an obligation on both local authorities to seek and the NTMA to give financial advice. Furthermore, under the guidelines promulgated to all Departments and other bodies involved, local authorities are no longer at liberty to appoint financial advisers from elsewhere. Whilst no organization is obliged to take the advice offered rejection of the NDFA advice requires an explanation. The NDFA go into considerable detail with a view to preparing the public sector benchmark. This is a rigorous exercise that used to be carried out by the various large firms of accountants.

Debt Servicing Costs Percentage

4.17. The percentage of GNP which meets debt servicing costs has fallen from 8% a few years ago to approximately 1.5% now. That has freed up a great deal of cash for other purposes including the reduction of the level of the deficit to move to a surplus. The Committee noted that this was a dramatic improvement by any standards. Interest rates have fallen and the public finances have been brought under control. There has been a huge benefit to the State. Apart from Luxembourg, Ireland has the lowest debt-GDP ratio within the European Union.

4.18. In terms of the management of the national debt, a substantial chunk of the floating rate debt was converted into fixed rates since 2002. It was felt that low fixed rate levels of interest could not survive. A long bond was issued earlier in 2004 which will not mature until 2020. This raised a substantial amount of money which is essentially fixed at a rate of approximately 4.5%. This will safeguard the State against a rise in short-term interest rates.

4.19. Total debt service expenditure in 2002 was €2.16 billion which was €315 million less than the budgeted figure. The Committee questioned the reason that the budget was so generous in the first instance in view of the fact that if the Minister for Finance had an additional €315 million available to him in the budget, it would represent a significant sum for use as expenditure.

4.20. In general terms the interest on the national debt must always be paid. It is a charge on the Central Fund and the first charge on the revenues of the State. The estimate is done repeatedly on a fairly conservative basis. It is discussed between the NTMA and the Department, who agree on projections and a significant number of estimates are involved. The savings against budget were that favourable market rates on the bonds issued saved €70 million. In addition, interest rates have been historically low. A bond exchange programme where bonds with one rate of interest were swapped for bonds with another rate, saved €40 million.

4.21. The Exchequer account in recent times has been extraordinarily buoyant in that revenues come in at a rate greater than anticipated whilst expenditure has been less than expected. When surplus equity (sometimes billions of euro) is available at the end of any day, it is placed on the market to obtain the best rate of interest on it. Gains were also made on foreign exchange, including €30 million due to movements in sterling. At the time the budget was estimated officials may have been conservative and expected that rates might increase slightly. In reality the opposite happened they have fallen to around 2%. This yielded €65 million as a result. The Exchequer surplus was higher than expected, which delivered a gain of €15 million. A further €20 million was saved on the interest on small savings such as the Post Office savings schemes. Miscellaneous other savings amounted to a further €30 million.

Performance against benchmark

4.22. The annual report notes that savings of €28 million were achieved against an externally audited benchmark. This refers to an attempt to measure the value added by the NTMA over the years. At the beginning of each year, the Department and the NTMA agree the best way of funding the Exchequer during the following 12 months in terms of types of borrowing and the timing of borrowing. A benchmark for the year is established as regards the optimal way of doing business. The €28 million is the performance of the NTMA over and above what the benchmark would have done. The figures are audited by PricewaterhouseCoopers and until now the computations have been done by UBS in London, which produced the figure. It is a time consuming business which involves going through every transaction made and obtaining the net present value of all the sums paid out and those that would have been paid if the benchmark had been adhered to. These two figures are then subtracted from one another to ascertain the performance against the benchmark.

4.23. Fees and expenses of the NTMA amounted to €13.5 million for the year. Salaries and pensions accounted for the largest element of this figure. The cost of €13.5 million to run the organisation achieved the savings against an external benchmark of €28 million and also ran all the other businesses as well. When the NTMA was set up the proposition was that it could save £20 million per year and would cost £10 million to run. In the early years it cost much less than £10 million. The figure of €13.5 million is not very much higher than £10 million. That was 1990 and it is now 2004.

Profile of the National Debt

4.27. It was noted that 76% of the national debt is now fixed. This implies that the majority of the debt is medium- to long-term debt. The Committee asked if this meant that, in terms of managing the national debt for 2004, almost 76% of the work was done at the start of the year. The complicated answer is that no matter what happens NTMA would need to raise €4 billion or €5 billion every year. To do so they must get overseas investors to buy all its bonds. NTMA aims pay as close as possible to what Germany is paying because that is the benchmark. In order to do that, one has to have marketable bonds that can trade on EuroMTS. To get on EuroMTS one has to have at least €5 billion outstanding in a bond. When fund managers are buying bonds, they look for bonds that have five years, ten years and maybe 15 or 20 years to run. These are the benchmark bonds. Given that time moves on, a bond that has ten years to run this year will only have eight years to run in two years' time. If NTMA want to issue a new bond, it needs a ten year bond. To have this in place they have a swap programme from the eight year bond into a new ten year bond. This is happening all the time. NTMA takes advantage of the fact that it locked the money in at fixed rates of interest when swapping an old bond for a new bond. The economic cost is locked in. If NTMA were to issue the bonds it issued over the past 18 months today, it would cost about €35 million more because interest rates have moved up.

4.28. The Committee considered if the extra work is being taken on because the NTMA has the expertise and the management of the national debt is under better control. The turnover in cash in 2003 was €400 billion, which is about three times the GNP of Ireland, a huge amount of money. There is money coming in and out every day. As was mentioned, NTMA is borrowing up to 2020, but it is also borrowing over night and putting money out over night. There is a huge swathe of cash moving in and out of our books every day of the week and the aim is to make a little money on every deal.

4.29. The average interest rate on the national debt over 2002 and 2003 was between 4% and 5% including items such as savings certificates. The average rate pertaining only to the national debt of €38 billion for 2003 was 4.1%. One of the dilemmas concerns the amount of risk taken on. When the euro was adopted NTMA had borrowed in many countries and had considerable foreign exchange exposure. Over the years, the exposure regarding foreign currencies had not been good because the Irish punt constantly devalued. When Ireland joined the EMS, a question arose as to whether unnecessary risk should be taken in terms of foreign exchange bearing in mind the other huge risks being taken. This was widely discussed at the time and it was concluded that interest rates in the eurozone would be much lower than anything seen in Ireland. NTMA had no particular experience in foreign exchange. In terms of foreign exchange, there was a benchmark, which was supposed to be an optimal benchmark of the spread of currencies. It was a question of not putting all one's eggs in the one basket. This was done very scientifically, but after the euro, the risk was unacceptable given the low interest rates and that NTMA was acting on behalf of the people.

4.30. The Committee noted that the NPRF takes a different approach. It has a fund of €10 billion, a large proportion of which is invested in equities. Very little of it is invested in the Irish stock market. The commission has essentially hedged 50% of its foreign investment. It has taken a very different approach to the NTMA in investing some of its funds in foreign currency. The Committee asked where the consistency on behalf of the State was. The nature of the two businesses is entirely different. The national debt has liabilities in foreign exchange, but these have been closed off by hedging the full risk.

4.31. The commission deals with the policy. It received advice to put 80% in equities and 20% in bonds. Of the equities, half was to be put in the eurozone and half outside the eurozone. Of the half outside the eurozone, the currency risk was to be closed but remained open in the other half. There are many arguments both in support and against that strategy. Most of these companies are multinationals and if the dollar falls their earnings in dollars will rise because they are making money in Europe and the Far East. Therefore the risk should not be hedged. Other people will say that the risk should be hedged. This is a different type of activity to managing the national debt. The commission decided to hedge half the foreign exchange risk but there was a strong body of opinion that held that it should not be hedged. NTMA made some money by hedging it as the dollar fell but it is virtually impossible to predict how the currency is going to go.

4.32. During the course of the year, the NPRF released its funds into the market on a phased basis. Its report states that the average return on its cash of over €1 billion was 2.4%. The NTMA was paying 4.1% on average. The Committee did not borrow from the NPRF as opposed to going to the Central Bank. It is just the interest rate curve, as short term money can be obtained at cheap rates. If it needs to be fixed for a longer term more must be paid for the money. Up to 20% was paid for fixed rate money years ago.

Investments in PPPs

4.33. The NPRF is anxious to invest some of its portfolio within the State but, so far, that has not been possible. €200 million was made available for PPP projects. The NPRF does not want to become involved on its own because it is a fairly small entity. In order to investigate the potential projects in great detail, one would need a squad of people. Other entities such as the National Roads Authority and those involved in the Luas light rail project are doing this and there is no point in duplicating what they are doing. It is difficult to find projects in which to invest as the number of PPPs is, in fact, quite small. There are particularly few such projects which are self-financing apart from the toll roads. The other projects do not provide sufficient return and there are other structural reasons for projects not proceeding

4.34. The Government is committed to spend 5% of GNP on capital projects, which is about twice the average in Europe. That is about €5-6 billion per annum. The policy for the Minister for Finance is that other projects which are self-financing can also go ahead. There are many agencies involved in getting projects started but there does not seem to be the culture of progressing projects quickly. This is in contrast to other countries such as France. The emergence of the NDFA improved the situation. NTMA does not have the same autonomy as the NDFA because it cannot initiate projects and may only advise on the funding end and let it be known that NTMA can put up the funding. It cannot authorise others to go ahead unless it is authorised to do so.

4.35. Officials from the Department of Finance came before the Committee recently to discuss PPPs. The point was made that private sector sources are indicating that PPPs have never worked in Ireland. Following the recent EUROSTAT ruling, the impression was that there was clarity as to where the risk was being transferred to the private sector. The expectation was that a number of projects could be got up and running under the new dispensation. However, according to IBEC and other sources that is not happening. Also, constraints remain and the Department wrote to various other Departments to instruct them of this so that they would not think that because the statistical rules had changed they could begin projects. The main constraint is the

5% of GNP limit. It is Government policy that it spends no more than 5% of GNP on capital projects, unless the project can pay for itself. EUROSTAT rulings have ceased to hold up. The argument the Government would use to justify the 5% limit is that this is the maximum level of capacity with which the State can cope.

4.36. A departmental document stated that challenging targets will see the PPP-NDFA contribution increase from 3% of total investment in 2004 to 15% in 2008. In monetary terms, this amounts to €3.6 billion. This is in addition to a target of €1.35 billion for PPPs funded by user charges over the same period giving a total target of PPP-NDFA funded investment of almost €5 billion by 2008. There is an element of disillusionment among those in the private sector about this. To win a contract in the State one must tender for it. There is a view that our tendering process is much more rigorous than is the case in other countries; there are more stages to the process and it is quite expensive to submit a tender.

4.37. On moving through the tender approval stage, the best and final offer (BAFO) stage is reached. Even if a company was in a two horse race at this stage it would still cost a substantial amount of money to prepare a BAFO. If the company does not win the contract, all that money is lost as the State does not cover any of the costs of submitting a tender. The view has been expressed that this is acceptable if there is a stream of projects coming along - if a company did not get one project, it would have a reasonable chance of getting the next. However, there is not a stream of projects as these are generally one-off in nature. Companies would have spent a lot of money submitting tenders but have got nothing from them. When another project is advertised, they may not tender again because it would cost more money with no guarantee of success.

4.38. The other side of the argument on PPP projects is associated with the fear that the private sector will take advantage of the public sector, which will then be pilloried for paying too much. The five schools project is a case in point. There is extreme caution about paying over the odds to the private sector to carry out a PPP project. The cheapest way to fund a project would be to get the money from the NTMA because no-one can borrow cheaper than the State. By definition, the cost of obtaining funding from the private sector will be higher. The offset is the extent to which the risk is transferred to the private sector and the amount that sector will be paid for taking on additional risk such as construction or operational risk - for example, the risk that expected traffic on a toll road does not materialise. There are huge uncertainties in this regard and everything must be paid for. For example, a charge for protests and demonstrations had to be built into tenders if the private sector was to be persuaded to bid for projects. The alternative is that the public sector would undertake the projects and carry the risk of protests. There would be a cost if protests occur and none if they do not. The private sector will factor in every cost, including the finding of human bones on a road route, and these must be paid for. There is a genuine fear on the part of the public sector that it will end up paying money and finding, with hindsight, that the project could have been completed far more cheaply if it had carried it out.

4.39. There is a view that one should not take unnecessary risks. If one does nothing, one cannot be blamed. However, if one does something and it goes wrong, one could end up in a lot of trouble. The culture of blame causes the problem that things do not get done. Every other country seems able to build vast infrastructure projects. For example, France is laced with motorways. Other countries are moving much faster. One of the projects looked at was a railway from northern to southern Italy costing €29 billion. Somehow, the project is off the Italian state's balance sheet and appears set for completion by 2009. The examples are there to copy but it is not being done.

4.40. With regard to the structure of repayment on any given project, the understanding of the Committee was that it is like a mortgage which could be paid back over a given period, for example, 25 years. This is the type of structure the PPP committee of IBEC would like. Where a project involves the private sector and the finance is coming from the private sector, a mixture of debt would be involved. There would be senior debt coming from a mix of foreign and Irish financial institutions and banks. The senior debts rank ahead of other debts, which are also raised from banks and financial institutions. As the banks consider some projects risky, and because risk varies between different projects, the banks prefer the promoters of projects to take some risk, for example, by putting up equity so that they take on potential liabilities. In between these types of debts, there is mezzanine financing, which can be a strange mixture of share capital coming from the private sector.

4.41. Where a company approaches the Department of Finance PPP unit to offer to build, say, five schools by PPP rather than in the conventional way, the repayment of debt is scheduled by unitary payments which are made by the Government on an annual basis. The EUROSTAT treatment of a project involving payment by the State - to which the latest changes refer - would mean that the construction costs would not appear in the general Government balance. They would, however, appear in the Irish accounting on the Government balance sheet. Therefore, EUROSTAT would then look to the amount of the payments of capital and interest made over time.

4.42. EUROSTAT recognised that there was a trade-off between the risk that could be transferred to the private sector and the advantage accruing to the State. It provided that if the construction risk associated with the project and one of two other risks, namely, availability risk or demand risk, were transferred to the private sector, it would be treated as being off the Government's balance sheet. For this purpose, construction risk means late delivery or delivery not in accordance with the specifications. An example of availability risk would be a six-lane motorway delivered with just four lanes in operation. Demand risk is the major risk and the one which is frequently transferred to the private sector, especially in connection with roads such as tolled roads. An example of this risk would be that the public would not use a road, affecting toll revenue. That risk is taken from the State and transferred to the private sector.

4.43. If one were minded to build a school, one would do so out of public funding in the normal way. One might look at it differently if one had to build ten schools. The Committee asked if there is clarity in public policy in terms of whether PPP is a useful instrument and whether the State is seriously trying to get PPP projects up and running. There is a difference in the expectations of the private and public sectors. Both sides need to give the other a good hearing. It is fair to say that Ireland is a recent entrant to the PPP market. The two key pieces of legislation, the National Development Finance Agency Act and the State Authorities (Public Private Partnership Arrangements) Act, were only introduced in 2002. If the example of other countries is to be considered, they also had teething troubles when they first entered PPP markets.

4.44. There is much scope for improvement in the relationships between the public and private sectors in Ireland. It would be sensible not to be fearful of what the private sector can provide. Although we do not have the relevant statistics for Ireland as this is a recent phenomenon, the statistics on speed of delivery are favourable to PPP. For example, in one of the most mature PPP-PFI markets, that of the UK, the private sector has a very low failure rate of approximately 20-25% for delivering on time and on budget. The UK public sector, which is a weather vane for other countries also, has a comparable failure rate of approximately 70-75%. It can be seen that there are huge advantages to PPP if speed of delivery is factored in.

4.45. Rolling 5 year mutli-annual capital envelopes for public capital investment were introduced in 2004. The level of overall investment represented by the envelopes is set at or close to 5% of GNP or about twice the EU average to accelerate the tackling of Ireland's infrastructural deficit. In budgetary terms where a PPP is off balance sheet under the EUROSTAT accounting rule the capital cost will not impact on the General Government Balance but the annual payments will.

4.46. A large number of very interesting projects are proceeding under the remit of EUROSTAT. There is a need, however, for EUROSTAT to implement its rules on off balance sheet treatment on a consistent basis across all countries. A knowledge base of projects being undertaken and their financing structures is being developed and is being brought to the attention of the relevant State organisations.

5. Adoption of Reports

5.1. The Committee disposed of the NTMA Financial Statements for 2002 and disposed of Chapter 13.1 of the 2002 Report.

Findings and Recommendations

<u>The Committee of Public Accounts</u>

<u>Finds specifically that:</u>

1. The level of the national debt remained static during the period 2000 - 2002, at around €36 billion, but the cost of servicing the debt has fallen, to €2.17 billion in 2002. Interest on the national debt has reduced to between 1% and 2% of GNP.

2. The remuneration of senior management of NTMA is not recorded in its annual report.

3. The NTMA achieved a performance in 2002 that was €28 million better than the externally established performance benchmark.

4. The NPRF has made €200 million available for investment in PPPs but this has not been taken up.

5. The number of claims handled by the State Claims Agency fell from 1,001 in 2002 to 544 in 2003. The SCA has taken on the management of litigation for medical negligence claims but is resisting a contingent liability of up to €800 million in respect of claims.

And recommends in general that:

1. PPPs should only be used where there is a demonstrable economic benefit in doing so. The balance sheet treatment of the PPP should never be the deciding factor.

2. The NPRF should be more proactive in exploring innovative ways of using its funds in PPPs.

3. Monthly reports of savings achieved in servicing the national debt should be provided by the NTMA as an input to the Department of Finance's monthly statements on the state of the public finances.