An Roinn Airgeadais
Department of Finance

Oifig an Aire
Office of the Minister

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14th June 2018

Deputy Colm Brophy
Chair, Committee on Budgetary Oversight
Leinster House
Kildare Street
Dublin, D02 A272

Dear Colm,

I refer to the recent report of the Committee on Budgetary Oversight entitled "Report on Ex-Post Scrutiny of Budget 2018: Commercial Stamp Duty", which you sent to me with your letter dated 25 April 2018.

I would first of all wish to thank the Committee for its report and their consideration of this particular matter.

The Committee's report makes four principal recommendations, which are set out in the "Conclusions" section:

1. That the Committee is provided with an update, no later than the end of May, to include ex-post analysis of the impact of the Commercial Stamp Duty changes made in Budget 2018

2. That in future, revenue projections for significant budget measures should provide estimates over a longer time (3 – 5 year) period

3. That where significant budget measures are proposed to the Finance Bill by way of Amendment, the Committee on Budgetary Oversight should be briefed on the measure, and the proposed costs involved

4. That in advance of Budget 2019, the Department of Finance takes steps to improve the quality of costing information and modelling available for significant budget measures. This could be achieved by providing more detailed information in the Tax Strategy Papers, and budget papers setting out:

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- Assumptions used to calculate Budget Measures;
- Base – baseline figures used in calculations;
- Multi-year forecasting; and,
- Information on data quality where this is an issue.

I will address each of these in turn, but before doing so, I would like to briefly set out my rationale for making the changes to stamp duty that were provided for in Budget 2018/Finance Act 2017.

Rationale for stamp duty changes

In my Budget 2018 statement I announced an increase in the stamp duty rate for all non-residential property transactions, including agricultural land, from 2% to 6%.

In 2011 the rate of stamp duty applying to non-residential property transactions was fixed at a flat rate of 2% as a supply side measure. This new rate is still below the maximum rate of 9% charged between 2002 and 2008.

While the commercial property market has now recovered strongly, the recent sharp increase in investment in construction activity poses a risk that this could, if left unchecked, give rise to overheating in the sector and in the domestic economy generally.

In this context, I considered that an adjustment in the rate of stamp duty on non-residential property beyond the then current rate of 2% to be appropriate, and that remains my view. In addition to providing additional yield, the increase to 6% is intended to support the desired re-balancing of construction activity towards residential investment and also help to address potential overheating in the construction sector. Though I would emphasise that this structural shift will not happen "overnight" and any effect of this nature will take time to emerge.

A more detailed version of this rationale was published on Budget Day in Annex C of the document "Tax Policy Changes" [1]

I will now move on to addressing the Committee's recommendations.

1: The impact of the Commercial Stamp Duty changes made in Budget 2018.

Budget 2018 included a change to the rate of stamp duty on non-residential property from 2% to 6%, which was projected (at Budget time) to raise an additional €376 million in 2018. This was based on estimates in Revenue's Pre-Budget Ready Reckoner, which showed the estimated effect of a 0.5% increase in the rate on non-residential property, a €47 million increase in yield – this was then multiplied up to €94 million for a 1% increase, or to €376 million for a 4% increase.

[1] http://www.budget.gov.ie/Budgets/2018/Documents/Budget_2018_Tax_Policy_Changes.pdf

Projected Yield

The yield projection for 2018 was based on receipts for previous years, combined with an ongoing assessment of expected receipts for the end of 2017 and for 2018 as well as the impacts of earlier policy changes. This process included an assessment of significant once-off transactions that positively increased receipts in 2016 but which are not expected to reoccur on a regular basis. Failure to account for these once-off transactions would have led to a higher estimate for 2018. Revenue advised that adjusting for possible once-off transactions in 2016, receipts in the three year period 2014 to 2016 were quite stable and Revenue's assessment is that it seems reasonable to expect this level of activity to continue. The estimate provided at budget time is therefore considered to be conservative and prudent.

Following Budget 2018, Revenue updated the Ready Reckoner to a Post-Budget basis, taking account of budgetary changes and revised growth forecasts from the Department for 2018. The Post-Budget Ready Reckoner indicates that each 0.5% increase in the stamp duty rate applying to non-residential property would result in an estimated €49 million increase in the overall yield. This would indicate that the estimated additional yield from the increase in stamp duty rate on non-residential property could be in the region of €392 million rather than €376 million.

In the absence of precise and accurate forecasts for transaction volumes in 2018, basing receipts on 2016/2017 levels and trends is the most reasonable option. The estimate also assumes current exemptions and other reliefs remain unchanged.

2018 Receipts

To end-May 2018, €539m in stamp duty was collected in Exchequer receipt terms. This is up 40.2 per cent (€154million) year-on year, albeit 4.2 per cent (€23m) off the headline target.

Revenue report on a net receipts basis and, while different from the Exchequer cash account, these data provide a useful guide to tax performance.

Of the receipts collected, €167.01 million relate to non-residential property, so that in terms of year-on-year performance, non-residential stamp duty receipts have more than doubled from the €71.5 million received to end-May in 2017. This represents a significant annual increase.

While stamp duty receipts from property are admittedly slightly below forecast to date in 2018, the forecast made relates to the full year. It is still too early to reach any conclusion regarding how the full year receipts will compare to the forecast for 2018. In this regard, it should be noted that elements of stamp duty receipts are non-linear, with over three quarters of this heading based on property and share transactions, which themselves can be "lumpy" in nature.

The property market is transaction based and if the level or values of transactions falls significantly below that seen in previous years, then stamp duty tax receipts from property may be lower. Tax receipts under all heads are monitored closely and reported on in the monthly Fiscal Monitor which incorporates the monthly Exchequer Statement.

It should also be noted that in preparing the yield costing for the Budget 2018 commercial stamp duty measures, the base was prudently adjusted for previous large transactions. This all serves to provide a degree of comfort that the non-residential stamp duty forecasts for 2018 are achievable, particularly given that, with only 4 months data to hand, we are still at a relatively early point in the year.

Impact on Property Transactions

The most recent evidence of activity in the Irish commercial property market indicates that investment continues to expand in 2018. Looking at transactions of over €1 million in value, market participants report transactions in the range of €930 million in the first quarter of 2018, up 200 per cent on the first quarter of 2017.

As stated above, transaction volumes are not smooth from quarter to quarter and so strong inference of full year volumes should not be based off quarterly results. Notwithstanding this proviso, transaction volumes in the year to date indicate that the change in the rate of stamp duty has had a limited impact on commercial property investment. Other counterweighting influences on activity such as economic growth, interest rates and overall confidence in the Irish economy appear to be having a far greater impact on investment levels.

Looking forward to the rest of the year, expectations among market participants are for overall transaction levels of properties worth €1 million or more to be broadly similar to 2017.

2: Revenue projections for significant budget measures should provide estimates over a longer time (3 – 5 year) period.

The Department of Finance compiles and publishes macroeconomic and budgetary forecasts on a medium term basis. At present, our forecasts currently relate to the Parliamentary term which, as you will be aware, runs to 2021. The alignment of the forecast horizon with the Parliamentary term is normal practice in many Member States of the European Union.

There is, of course, a legal requirement to produce forecasts covering a three-year horizon (i.e. t +3) in the annual update of Member State's Stability Programmes. In relation to the Draft Budgetary Plan (which is required of euro area Member States), the legal requirement is for forecasts covering the following year (i.e. t+1).

The Department is, therefore, currently going beyond its legal requirements, as the forecasts extend to 2021 in both the Stability Programme and in the Budget.

In the absence of any change to the Parliamentary term, the recent Stability Programme Update included, and the forthcoming Budget 2019 will set out, medium-term forecasts covering the period to 2021.

The April 2018 Stability Programme Update[2] included (in Table 9 on page 19) a four year forecast (including the current year) for the yield from all stamp duties (including stamp duty on non-residential property transactions), as follows, and also for other taxes.

Table 1: Stamp duties revenue, € million

	2017	2018	2019	2020	2021
Stamp duties	1,205	1,675	1,805	1,920	2,025

On the possibility of providing forecasts beyond this timeframe, I would emphasise that it is an accepted fact that the further out one forecasts, the less precise those forecasts become. Therefore, medium to longer term forecasts result in figures which, to an increasing degree, cannot be stood over with any significant degree of certainty the further out they go. This in turn could act to weaken public confidence in the Department of Finance's forecasts as a whole, and as such is not a course of action that my Department intends to pursue.

3. Where significant budget measures are proposed to the Finance Bill by way of Amendment, the Committee on Budgetary Oversight should be briefed on the measure, and the proposed costs involved.

The Oireachtas committee which is responsible for scrutinising the Finance Bill at Dáil Committee Stage is the (Select) Committee on Finance, Public Expenditure and Reform, and Taoiseach. It therefore follows that where it is necessary to seek committee scrutiny of amendments introduced after Dáil Committee Stage, it would be to that Committee that the matter would be referred.

It should also be noted that the schedule for the publication and enactment of the Finance Bill is very tight each year, with a requirement in place that it should be enacted no later than 31 December of the year concerned. Referring amendments to a committee could potentially derail that timetable, and therefore the practice has been for such amendments to be scrutinised by the Dáil, sitting in committee form, rather than at a separate sitting of the relevant committee.

4. In advance of Budget 2019, the Department of Finance takes steps to improve the quality of costing information and modelling available for significant budget measures. This could be

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[2] http://www.finance.gov.ie/wp-content/uploads/2018/04/20180417-SPU-2018-for-website.pdf

achieved by providing more detailed information in the Tax Strategy Papers, and budget papers setting out:

- **Assumptions used to calculate Budget Measures;**
- **Base – baseline figures used in calculations;**
- **Multi-year forecasting; and,**
- **Information on data quality where this is an issue.**

While the preparation of the Tax Strategy Group (TSG) papers for the 2018 meeting is already underway, I will instruct my Department to examine the scope for providing increased transparency in the forecasts it provides to the Oireachtas. This exercise will involve both my Department and Revenue, will be complex. It will also need to ensure that any potential outcomes from it are carefully considered so as to avoid the risk of placing a considerable additional burden on both my Department and Revenue. This examination will be carried out with a view to being able to give effect to any new or amended practices that might arise in time for the 2019 TSG papers, which will be prepared in advance of Budget 2020.

I would also refer you to my comments above concerning the risks involved in making medium to longer term estimates on the revenue that will be derived from budget measures, as these also apply to the provision of costings.

As a general point, I would ask you to note that both my Department and Revenue have always accepted the invitations of the committee to attend and discuss costing and forecasting issues, and remain available to do so in the future.

In conclusion, I trust that the above information will be of assistance and satisfaction to the Committee.

Yours sincerely

Paschal Donohoe TD
Minister for Finance and Public Expenditure and Reform