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Proposed tax changes for local Councils and businesses **June 2020**

The Great Lockdown of 2020 has had a devastating impact on many sectors of the economy. Two such sectors are businesses and our local councils. The forced shutdown of non-essential services has led to many SMEs struggling to pay commercial rates. In response, the central government introduced a three-month rates waiver for those businesses affected by the lockdown. At the same time it promised to compensate local councils for this loss of income from non-payment of rates, estimated at €260m. There is also less income accruing to local authorities from charges on services such as car parking and planning applications due to the contraction in economic activity.

Given that this economic recession is likely to be severe, what is needed in the short-term are contemporaneous changes in taxes on local businesses and revenues of local authorities that will help both the commercial and local government sectors. One such proposal is a reform of the motor vehicle tax (MVT) and the local property tax (LPT). Changes to the MVT and the LPT as outlined below should guarantee local authorities a steady source of income in the difficult times ahead, while, simultaneously, assist local businesses and SMEs by reducing their annual rates liability.

Before the local government reforms and the introduction of the LPT in the mid 2010s, the MVT was assigned to local rather than central government. It was paid into the Local Government Fund, which, in turn, allocated monies to local authorities in the form of central government grants, both general-purpose and also specific-purpose grants for non-national roads. MVT amounts were about €1bn, per annum. The introduction of the LPT and other changes to local government income resulted in a new and improved model of local government finance.

Currently, MVT is collected by the motor tax office of the local authorities but since 2018 it has been paid into the central Exchequer for central government spending. As for the LPT, amounting to annual receipts of just less than €500m, 80% is retained in the administrative area from where it is collected and the remaining 20% is pooled and allocated to those local authorities with weaker property bases. The distribution is based on historical amounts received in 2014, called the baseline which is the minimum level of funding for each local authority as determined by the Department of Housing, Planning and Local Government.

Our proposal begins with the MVT, and receipts of €964m in 2019. Rather than assign this revenue source to one level of government, our proposal is to share the yield between central and local government, on a pre-determined basis. Revenue sharing arrangements between different tiers of government are not uncommon in other jurisdictions. Revenue sharing of tax receipts on ownership of vehicles is also not uncommon (technically, now it bears more resemblance to a grant than a local tax but let's leave that aside!).

Given the nature of motor vehicles, it is not unreasonable for a certain share of the revenue from the tax levied on motor vehicle ownership to accrue to the local authority where the owner of the vehicle resides. A central feature of any good system of local government is the matching or benefit principle i.e. linking the taxes paid with the benefits received. In this case the motor tax accrues to local authorities, and, in turn, used for the delivery of local services including the maintenance of local and regional roads, traffic management, road safety, street cleaning, etc.

As for the actual share, this is a decision for central government. In our calculations we take a modest 25%/75% share, with 25% of MVT receipts accruing to local government on a derivation basis i.e. shared in proportion to the revenue collected in each local authority. With a 25% share to local government, amounting to €241m in 2019, this would have translated into a 15-17% reduction in commercial rates income needed by local authorities to balance their budgets.

In terms of the Annual Rate on Valuation (ARV) which when combined with the rateable valuation of a property determines the annual ratepayer's liability, this would amount to a 20-25% average reduction in the ARV. While urban councils, in Dublin and Cork for example, that depend relatively more on rates for their annual income could see a rate cut of, say 10-15%, some smaller rural councils could implement a reduction in the ARV of up to 30%, while at the same time, continue to maintain local services and manage the local public finances. Whatever the precise cut in the ARV, it amounts to a significant and permanent reduction in the annual rates bills for businesses and SMEs with commercial and industrial properties.

As for the LPT, our proposal involves a change in how the LPT funds local government. Here, the proposal is for a redesign of the LPT that is, on the one hand, simpler and, on the other hand, more transparent. We propose to replace the current 80%/20% split with a 100% retention model where local councils retain the full 100% of LPT receipts from their administrative area. To offset the widening horizontal fiscal imbalances that this will inevitably produce, we propose that central government funds the so-called equalisation or top-up grants. This is the case in many other unitary countries.

In doing so, by separating LPT from equalisation we achieve a less complicated model of local taxation. In addition, the use of a new equalisation formula that is both measurable and objective achieves greater transparency, with more equitable fiscal outcomes across the local authorities. A common methodology used worldwide to distribute fiscal equalisation grants across local councils is the concept of local fiscal capacity and a representative revenue system. In essence, it means allocating equalisation funds based on estimates of revenue-raising capacity or potential revenue, rather than using actual revenue which can have potentially strong disincentive effects on tax collection and local tax bases.

Using this methodology, the formula-determined equalisation fund required for Ireland's local authorities is about €200m per annum, according to our estimates. Similar to the MVT proposal, the combination of the 100% LPT retained with this new vertical equalisation fund would result in less commercial rates income needed (initially budgeted at over €1.65bn for 2020) to balance annual local authority revenue and spending. In turn, the average ARV would be lower but with a very wide variation across the 31 local authorities, with some big winners and also a small number of losers. Careful consideration needs to be given to these distributional changes, and how the losing councils can be compensated during a just transition phase.

So, as economists like to warn that there is no such thing as a free lunch, what is the catch with this proposal? The big loser is the central government, as it would have to sacrifice 25% of the annual MVT and/or over €200m gross for LPT *and* equalisation purposes (net figure is less, as it already contributes an annual sum to fund the distributional pool for financially weaker local authorities). Taking the MVT and LPT changes together, the total annual cost of over €400m to the central Exchequer needs to be weighed up against the combined benefits of a business sector and a model of local government finance that are more stable and sustainable, in the current business environment that is unprecedented.

Although reluctant to use the word desperate, uncertain times call for radical measures, such as the changes to MVT and LPT outlined above. A new government might wish to consider this limited but worthwhile package of tax policy measures aimed at the economic recovery, with potential local and national benefits for our scarred but resilient economy.