TASC

Think-tank for Action on Social Change

A Defence of Taxation

Progressive alternatives to reducing public services through tax cuts

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Overview

Comparisons of national tax systems can be misleading. We demonstrate that Ireland's higher income tax rate is far less important than other features of the tax system. Section 1 of this report focuses on actual levels of tax paid and overall taxation, rather than theoretical tax rates which some commentators use.

Section 2 shows how tax and public spending have both positive and negative effects on the economy and jobs. There are significant risks to Ireland's economy from cutting taxes in Budget 2015.

Alternative options for tax reform to boost job creation and address inequality are shown in Section 3. These do not decrease Ireland's ability to pay the national debt or maintain public spending. We present six concrete progressive proposals as alternatives to the current tax cutting agenda. Two viable and progressive options are presented to raise tax revenue, either in absolute terms or as a means of allowing other tax cuts on a cost-neutral basis to avoid further harm to public services. Three progressive tax cuts are outlined.

Finally, the report demonstrates clearly that the majority of people in Ireland would in fact be materially better off from maintaining public services rather than they would be from likely cuts in taxation.

Proposals

1. Reduce Ireland's high level of tax reliefs. The system remains highly inequitable, benefitting higher earners and leading to a reduction in public spending. We recommend a cut to the tax break for health insurance premiums (€697.9 million in 2014) which can only benefit those who are in a position to afford health insurance in the first place, and reductions in the tax breaks given to private pensions, which cost the public finances €2,479 million in 2014. We demonstrate that the cost of tax breaks – including tax breaks for private pensions and health insurance – has increased despite the economic downturn. It remains much higher than comparable EU subsidies. Non-basic tax reliefs cost €9.6 billion in 2010 compared to €9.0 billion in 2007. The cost of any tax cut should be compensated entirely or to a greater extent by reducing tax breaks and/or by a third, higher rate of income tax. (See pages 38-45)
2. Introduce a third rate of income tax on high incomes (€100,000) at 48%, which would still result in actual tax paid falling far short of the theoretical 'marginal rate' from income tax, USC and PRSI. This would generate much needed income for public services, would prevent those on average incomes paying the highest rates. Importantly, it would also improve the real progressivity of the overall tax system compared to the current U-shape, where those on the lowest incomes currently pay nearly the same proportion of their incomes in tax as those on the highest incomes. A 48% rate would affect just under 100,000 people, which is less than 5 per cent of all people paying income tax. Given the stark picture of rising income inequality in Ireland, a return to higher income tax rates on the small minority of very high income earners must be seriously contemplated. (See pages 37-38)
3. Increase tax credits, as these benefit nearly all workers equally in real terms. This would benefit low-income workers more than changes to the bands or rates, although some part-time workers would still not benefit. (See pages 31-32)
4. Remove an inequitable 'step effect' in the PRSI system, which badly affects low paid workers. At worst, the current system can require an employer to pay €1,680 in labour costs to give a low paid employee a net annual raise of just one euro. For example, at present, workers on €19,000 have less take home pay than those on €18,000 due to this effect. (See pages 32-37)
5. Lower the VAT rate by 1% at a cost of €350 million, as consumption taxes are regressive and a cut here would benefit far more people than income tax cuts, with most benefit going to the lowest income groups. (Depending on the fiscal position, continued cuts of VAT could be considered in subsequent years to reduce the headline VAT rate to 20%, with some broadening of the narrow base). (See pages 45-47)
6. We show that everyone in Ireland benefits from the 'public value' of public spending and most people in Ireland would be better off maintaining public services than paying less taxes. For the large majority of adults in Ireland, the value of public services is greater than their net incomes. Not all adults would benefit from income tax cuts, but all would be affected by the linked loss of public services. We show that even those who would have slight benefit from tax cuts would experience a greater loss from the linked public service cuts. (See pages 47-51)

Contents

Preface

Ireland's public finances are by no means out of trouble, yet barely six months out of the official 'bailout' most of the political parties across the spectrum are once again using the promise of tax cuts – or outright opposition to some forms of taxation – as a populist attempt to sway voters.

During the boom times, when property-related activity caused a surge in revenue, the tax base was hollowed out through politically-motivated tax cuts as well as the many property-based tax breaks that fuelled the boom. When the boom abruptly ended, tax revenue dropped by nearly one third; from over €47 billion in 2007 to less than €32 billion in 2010, as much of the tax base had been shifted to property transactions and incomes linked to the property boom. Successive Governments have prioritised spending cuts over raising revenue, but it will be impossible to deliver quality public services if the slow and painful process of rebuilding a stable and sustainable tax system is not continued. The difficulty of the task of rebuilding taxation illustrates the depths of the crisis and the true cost of boom-time recklessness in relation to tax policy. Ireland is still far from EU's norms in relation to taxes and social insurance, yet people in Ireland rightly desire services that are as good as those they can receive in other EU member states.

Moreover, for the foreseeable future, Ireland's national debt is once again high at €176 billion[1]. A large proportion of tax revenue and public spending is now going towards annual debt interest repayments (€6.5 billion in 2012)[2], which leaves less money available for public services. And while a sizable part of the national debt is due to the approximately €64 billion cost of rescuing the private banks, the larger share of the debt is simply the accumulated cost of spending more annually than tax revenue. The underlying general government balance deficit in 2014 is €8 billion or 4.8% GDP[3]. While economic growth could help close the gap, there is still a need to reinforce taxation. It is simply not plausible to reduce the public finances by hundreds of millions of euro through cutting or abolishing taxes, and also promise better public services.

The Minister for Finance has indicated that the Government is considering reducing taxes for middle income earners[4]. While it is an undisputed fact that many people are under severe financial pressure, the majority of people in Ireland would be materially better off from maintaining public spending rather than cutting taxes, even those in full-time employment. As demonstrated in this report, the focus on the 41% higher income tax rate is both misplaced and inequitable.

Another argument is sometimes made that cutting income tax would stimulate economic activity, as more disposable income in the economy would lead to more spending, and thus job creation. However, this argument makes the improbable assumption that cutting income tax is the most effective way to increase economic activity, whereas this report demonstrates that this is not the case. Moreover, much modern economic research finds that a more equal society improves economic growth and of course, development. Taxation can and should play a key role in restoring widely balanced prosperity.

With so many voices in Irish politics and the media ignoring inconvenient facts in relation to the public finances, this report articulates the argument on the other side of the equation: the value of public spending and the need to sustain and grown Ireland's tax base, not erode it.

[1] www.ntma.ie
[2] http://www.finance.gov.ie/sites/default/files/Final%20BES%202013.pdf
[3] http://www.finance.gov.ie/sites/default/files/Ireland%27s%20SPU%202014%20Final%2029%20April%202014.2.pdf
[4] Irish Independent (May 2014) 'Noonan: tax cuts on way for squeezed middle'

SECTION 1

Comparing Tax Systems

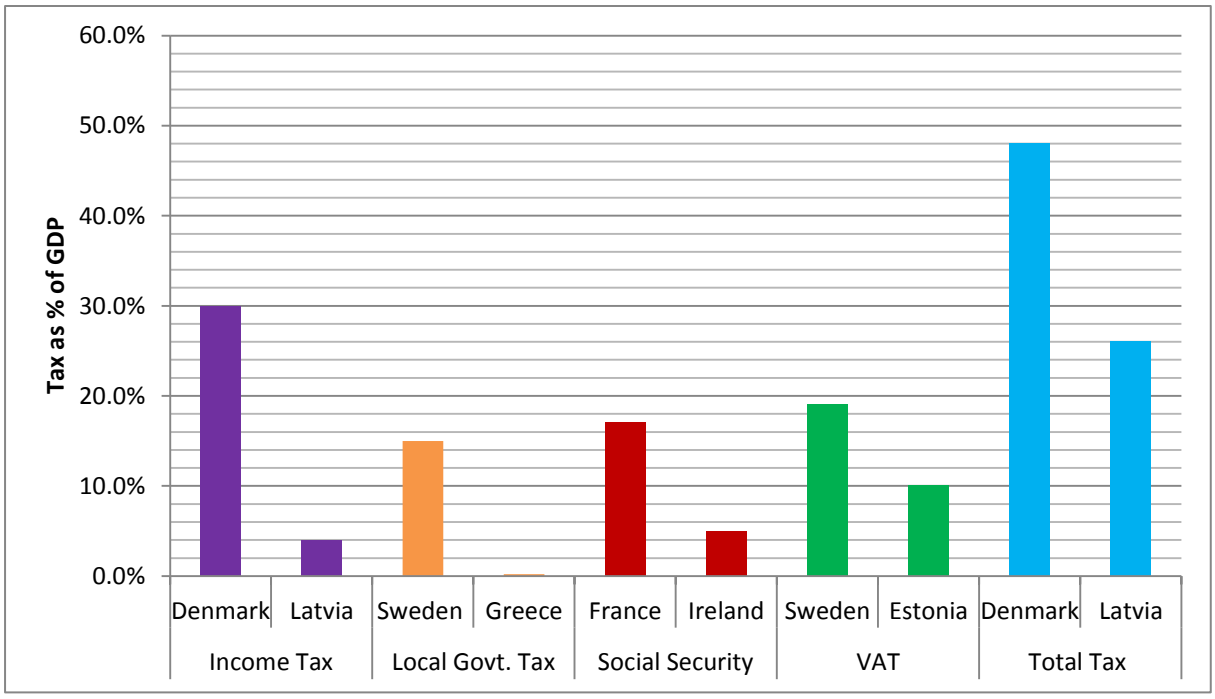
When making observations or recommendations about changes to taxes, comparisons with other country's systems are often used. This can sometimes be illuminating, but great care must be taken. Tax systems are dynamic, made up of many interrelated parts, and must be viewed holistically.

When it comes to making national decisions about changing just one part of the much larger tax system, comparison with other countries often provides an incomplete picture. This is because the balance between income, consumption and wealth taxes, and between direct taxes, indirect taxes and social contributions, as well as between central versus local tax-raising, varies considerably between OECD countries and between EU member states.

Eurostat produce an annual volume called *Taxation Trends in the European Union*, which provides invaluable reference material for understanding EU members' tax systems.

As illustrated in Chart 1, overall tax levels, and the balance between different taxes, differ radically between EU member states. For example, total taxes (including social security contributions) in EU member states vary between 26% of GDP (Latvia) and 48% GDP (Denmark). Indirect taxes, e.g. VAT, are least prevalent in Estonia (10% GDP) and most common in Sweden (19% GDP). However, direct taxes, e.g. income tax, appear least in Latvia (4% GDP) and most in Denmark (30% GDP). Social contributions, e.g. PRSI, are lowest in Denmark (1% GDP) and next lowest in Ireland (5% GDP), but highest in France (17% GDP). Local government receives the largest share in Sweden (15% GDP) but the smallest in Greece (0.2% GDP).

Chart 1: Highest and lowest tax rates in Europe % of GDP by tax type[5]



[5] Eurostat (2013) *Taxation Trends in the European Union, 2013 edition*

Different goods and services are subject to VAT in different countries, and despite EU attempts to harmonise VAT, many partial rates exist to favour different goods or services – such as Ireland's lower VAT rates for livestock or on catering. For income taxation, not only are levels of employment and wages relevant factors, but variations in bands, rates, credits, tax reliefs and exemptions, are all significant. In social security, it is not just what is paid, but what level of welfare incomes are provided as well as whether other public services, like health, are also funded out of social contributions.

Behind the headline tax figures are enormous differences that represent radically different economic models and social welfare systems, as well as different social norms, such as employment patterns versus unwaged work in the home.

Comparison with non-EU countries in the OECD shows even more stark differences. For example, whereas Ireland's tax system relies heavily on VAT and income tax, the USA federal system is more heavily weighted towards income tax and 'payroll tax', which is roughly analogous to employers' social insurance contributions in Ireland. However, both States and local jurisdictions levy sales taxes and property taxes at different rates. At an extreme, seven US States do not have any income tax. For example, Texas has no income tax but the third highest property tax in the USA at 1.81% (ten times Ireland's property tax of 0.18 %).

Not least, taxation is only one part of the equation. More tax typically means more public services and higher social transfers paid by the state. More public services means less out of pocket expenses too. A lower net income in a country with good public services may allow someone to have a higher quality of life than a higher net income in a country that provides much fewer collective services and makes individuals and families carry more of the risk involved in meeting unexpected expenses, like health care.

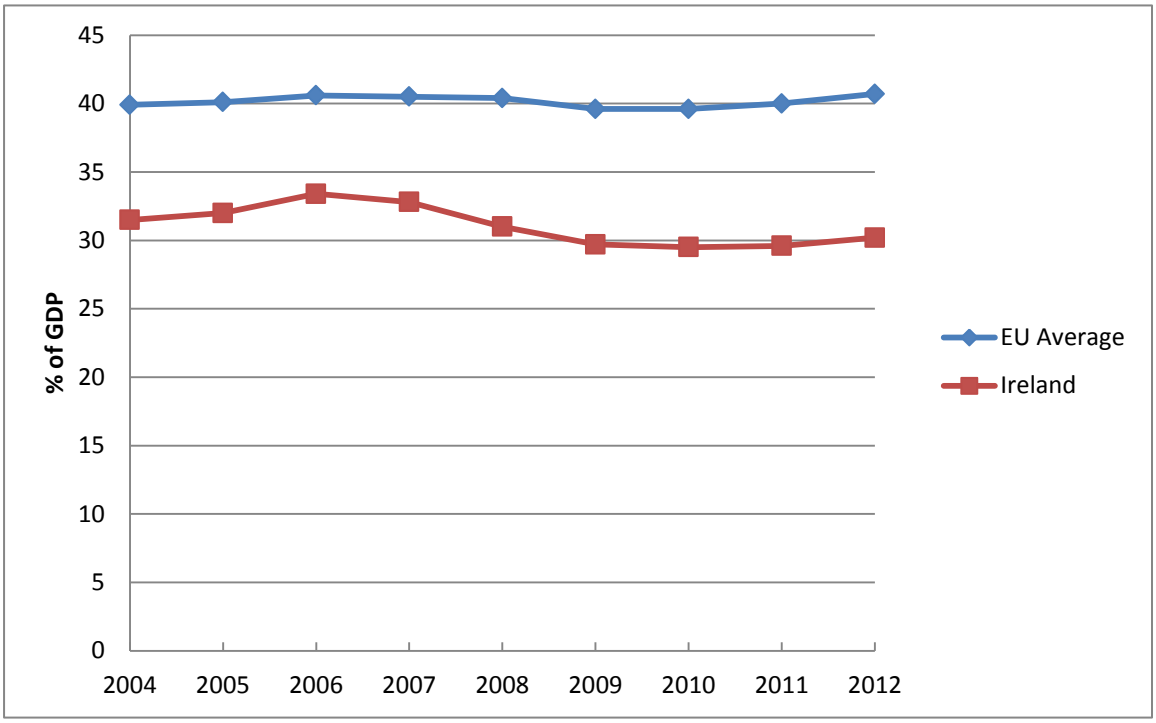
Tax and Public Spending in Ireland

When it comes to making general observations about the size and scope of public services, it can be useful to refer to the total tax take of one country compared to another. In this context, we see that Ireland's total tax take was 30.2% of GDP in 2012, which is three quarters of the EU average of 40.7%[6] and much lower than Scandinavian countries (45-50%) and in France (47%)[7]. This indicates that, on the whole, lower social welfare payments and fewer public services are provided in Ireland than in many other European countries. Ireland has maintained this position throughout the period of growth and collapse in the last decade.

[6] Eurostat Database http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en retrieved May 2014

[7] When it comes to taxation, GDP not GNP is the correct reference point.

Chart 2: Total tax as a percentage of GDP[8]



Ireland experienced increases in tax revenue and public spending during the boom years. The annual increase in public spending averaged 9.7% in the ten years from 2000 until the cuts began in 2010[9]. In that time, tax revenue rose faster than day-to-day spending, averaging a very striking 18.1% a year between 1996 and 2007 inclusive. The result was a large current account surplus (in a number of years there was a surplus even when capital spending was included).

However, these increases were based on increases in VAT, income tax and stamp duty that were largely associated with the construction boom. This meant that tax revenue was funded by debt rather than real economic growth. As a result, tax revenue was artificially swollen through massive borrowing from the future to pay for the present, based largely on the inflated value of property. When this collapsed, it left only massive debt to be repaid from future income.

What we have experienced since then is a reversal from annual increase in public service provision to cuts in services. More importantly, considering the depth of the crisis, tax income as a percentage of GDP has not changed (See Chart 2), nor is there any plan for it to change (see Chart 3). This projection is set out in the government's economic plans[10]. Taxes are planned to remain around 32% of GDP until 2018, despite the fact that growth is expected to be low.

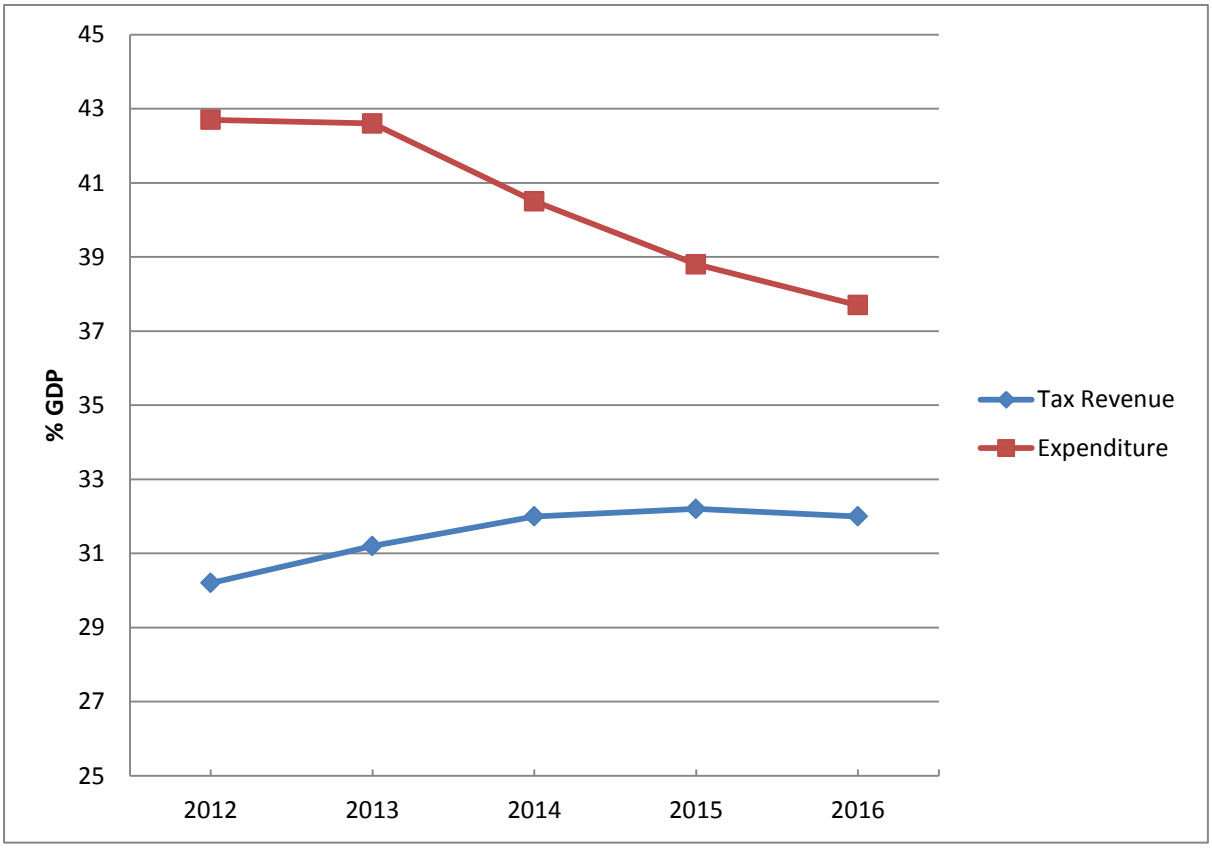
As Chart 2 shows, the net result of budgets to date has been to largely 'flat line' Ireland's overall level of taxation but while reducing public spending considerably. While a low level of tax increase is projected into the future (presumably due to Local Property Tax and water charges), a far larger adjustment continues to be made on the public spending side. Any talk of a 'balance' between tax

[8] Eurostat Database http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en retrieved May 2014
[9] DOF (2013) Budgetary and Economic Statistics, December 2013 http://www.finance.gov.ie/sites/default/files/Final%20BES%202013.pdf
[10] DOF (2014) Ireland's Stability Programme April 2014 Update

measures and spending over the course of Ireland's adjustment is simply not true. The plan as outlined in the Government's Economic and Fiscal Outlook (Budget 2014, page D.19[11]) is to end up with total tax rate of 32.0% of GDP and total public expenditure of 37.7% of GDP by 2016, which is nearly as low as the tax to GDP level of 31.5% in 2004.

In fact, the projected tax level of 32.0% GDP in 2016 plans significantly weaker public services than in 2004, as we now have to service a much larger national debt, including debts associated with bailing out our banking system. Despite the same overall levels of taxation, there will be less public spending for services and social transfers.

Chart 3: Expenditure v. Taxes and Total Revenue in Ireland 2012 - 2016 (projected)[12]



The result of the political choice to favour very low taxation will be that the level of public services cannot be anything like as much as what was delivered in 2004, and thus Ireland will not have the same kind of 'welfare state' as most Western European countries. By choosing a level of taxation that is consistently ten percentage points lower that the EU average, we are choosing low levels of public expenditure which will affect the core elements of the 'social contract' between Ireland's State and its citizens.

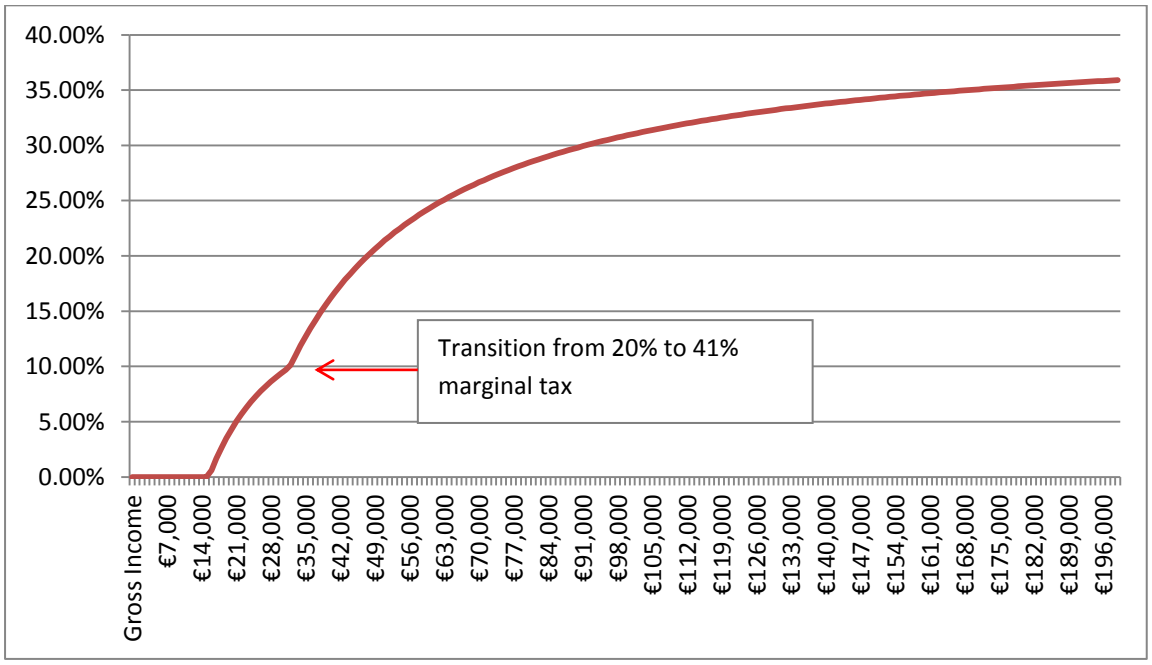
[11] Irish Fiscal Advisory Council (2013) Budget 2014 Economic and Fiscal Outlook
http://budget.gov.ie/Budgets/2014/Documents/Economic%20and%20Fiscal%20Outlook%202014.pdf
[12] DOF (2013) Budgetary and Economic Statistics, December 2013
http://www.finance.gov.ie/sites/default/files/Final%20BES%202013.pdf

Income tax in Ireland

Income tax makes up 42 per cent of the Government's tax revenue[13] and is paid by 38 per cent of the adult population; 1.4 million adults (or 44 per cent, 1.6 million adults, if USC is included). Income tax interacts with a number of key elements of the economy: employment, wages and consumption. As we have seen above, comparing taxes across countries, especially headline rates, is extremely challenging, and often not especially useful.

What we can say is that overall income tax rates in Ireland are low. The average effective rate of income tax in Ireland is just below 14% of gross income for households[14]. The effective tax rate ranges from 0.35% for the lowest earners up to 22.9% for the top 10% of earners[15].

Chart 4: The Theoretical Effective Income Tax Rate (not including USC and PRSI or Tax Break Reductions)[16]



When looking at the rise of theoretical effective income tax payable in Chart 4, it is important to recall that most income tax payers, including the majority of employees, are represented in the first five income levels.

Data from the OECD shows that the so-called 'tax wedge'[17]on a typical family (at 6.8% of labour costs) is the second lowest in the OECD, after Chile and before New Zealand. The tax wedge on a

[13] Revenue Commissioners (2014) Headline Results for 2013
http://www.revenue.ie/en/about/publications/headline-results-2013.pdf
[14] Revenue Statistical Report 2011 (2012), Table IDS18
http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-distribution-statistics.pdf
[15] Collins M and D. Turnbull, (2013) "Estimating Direct and Indirect Tax Contributions of Households in Ireland", NERI WP 2013/8
[16] Authors' calculations.
[17] The ' tax wedge' is defined as the difference between the salary costs of a single "average worker" to their employer and the amount of net income ("take-home-pay") that the worker receives. The taxes included are personal income taxes, compulsory social security contributions paid by employees and employers, as well as payroll taxes. The amount of these taxes is expressed as a percentage of the total labour costs for firms.

single person is higher (at 26.6% of labour costs), but this is still the seventh lowest in the OECD and the lowest among the OECD's EU members[18].

Table 1: The Irish Tax Wedge on Average Wage Levels is Very Low

One earner married couple with two children and earnings at average wage level.	% of labour costs	Single individual without children and earnings at average wage level.	% of labour costs
Greece	44.5	**Belgium**	55.8
France	41.6	**Germany**	49.3
Belgium	41	**Austria**	49.1
Austria	38.4	**Hungary**	49
Italy	38.2	**France**	48.9
Finland	38.1	**Italy**	47.8
Sweden	37.7	**Finland**	43.1
Turkey	37.4	**Sweden**	42.9
Spain	34.8	**Czech Republic**	42.4
Hungary	34.1	**Slovenia**	42.3
Germany	33.8	**Greece**	41.6
Estonia	32.3	**Portugal**	41.1
Norway	31.2	**Slovak Republic**	41.1
Netherlands	30.8	**Spain**	40.7
Poland	29.8	**Estonia**	39.9
Portugal	29.8	**Turkey**	38.6
Slovak Republic	27.6	**Denmark**	38.2
Denmark	27.6	**Norway**	37.3
United Kingdom	27	**Luxembourg**	37
Japan	26.1	**Netherlands**	36.9
Slovenia	23.1	**Poland**	35.6
Czech Republic	20.5	**Iceland**	33.4
United States	20.3	**Japan**	31.6
Mexico	19.2	**United Kingdom**	31.5
Iceland	19.1	**United States**	31.3
Korea	19	**Canada**	31.1
Canada	18.7	**Australia**	27.4
Israel	17.4	**Ireland**	26.6
Australia	16.9	**Switzerland**	22
Luxembourg	14.3	**Korea**	21.4
Switzerland	9.5	**Israel**	20.7
Chile	7	**Mexico**	19.2
Ireland	6.8	**New Zealand**	16.9
New Zealand	2.4	**Chile**	7

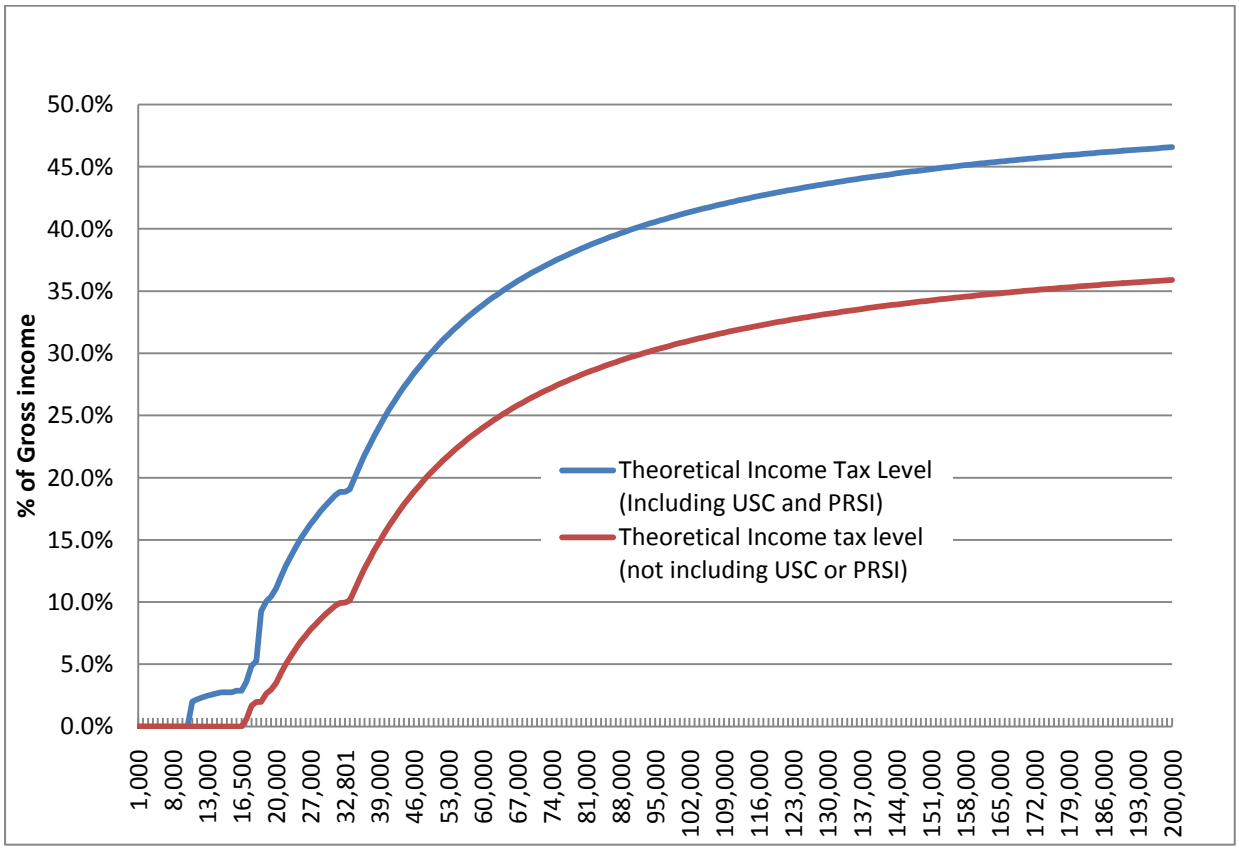
[18] OECD (2014) *Taxing Wages 2014* http://www.oecd.org/tax/tax-policy/taxing-wages.htm Data from Table 0.4

It is sometimes argued that Ireland is unusual in having a system where workers begin to pay the highest income tax rate at less than average wage levels; i.e. the 41% higher rate is paid on income above €32,800. However this argument must be tempered with a number of other unusual features of the Irish income tax system.

Firstly, the income tax system is highly unusual in the EU because of the very high level of tax credits, tax reliefs and tax breaks available (see Section 3). Secondly, Ireland is highly unusual for its very low level of PRSI, especially employers' social security contributions; effectively the lowest level of social insurance in the EU. Thirdly, Ireland's income tax system has also the relatively uncommon feature of only having two rates (20% and 41%) rather than more rates and bands. If Ireland had a third, higher income tax rate (like many other EU countries) the 'marginal' rate would simply be deferred until higher income levels. Conversely, countries with a single rate of income tax do not have progressivity in their income tax system but all income tax payers pay the 'marginal' rate. Finally, not every tax system has tax credits, and the provision of basic tax credits in Ireland lowers the effective tax paid compared to theoretical headline tax rates or headline rates in other countries.

The result of these interactions in Ireland is a smooth progression of theoretical effective income tax payable as incomes rise, which begins to taper off as people start to earn more (see Chart 5). More importantly, there is no sudden increase in tax when people move from the standard rate (20%) to begin to pay tax at the higher rate (41%).

Chart 5: Maximum Theoretical Effective Tax Rate (Income Tax Only and Income tax + USC + PRSI), Not Including Tax Break Reductions[19]



[19] Authors' calculations.

A single person who earns €37,500 is often portrayed as 'paying tax' at the higher rate of 41% (or 52% when PRSI and USC are included). However their theoretical income tax payable is 13.8%. Similarly, they are only liable for a maximum of 23% when USC and PRSI are also included; far less than the 52% marginal rate. Moreover, these theoretical rates (sometimes erroneously called the 'effective' tax rate) do not take into account the use of further tax breaks by many people, which can lower the actual amount of tax paid to below the theoretical maximum.

In order to see actual levels of tax paid it is possible to use Revenue data.

Chart 6: Actual Income Tax Paid [20]

This shows total gross incomes for banded income cohorts and the total income tax revenue in that group. The data is also sub-divided by single earners, married couples (one earner) and married couples (two earners). Using this data we take total gross income and the total income tax paid for each cohort to get an actual income tax rate for that cohort. We assign this data to the mid-point of the cohort. For example, for the group €10,000 to €12,000 we get an average result for a tax unit of €11,000, for €35,000 to €40,000 it is €37,500 and so on. The results are shown in Chart 6

The average rate of income tax paid by all tax cases (individual or couples) is 13.7% on each euro of taxable income (not including PRSI or USC)[21]. For tax units earning €37,500, the average actual amount of income tax paid shown in the Revenue Data is 8.7%; or 17.8% adjusted for USC and PRSI[22]. This is significantly less than the theoretical amounts of 13.8% and 23% discussed above.

Although the marginal personal tax rate of 41% begins at €32,800, even at a gross income of €275,000 actual income tax paid, on average, is less than 30%.

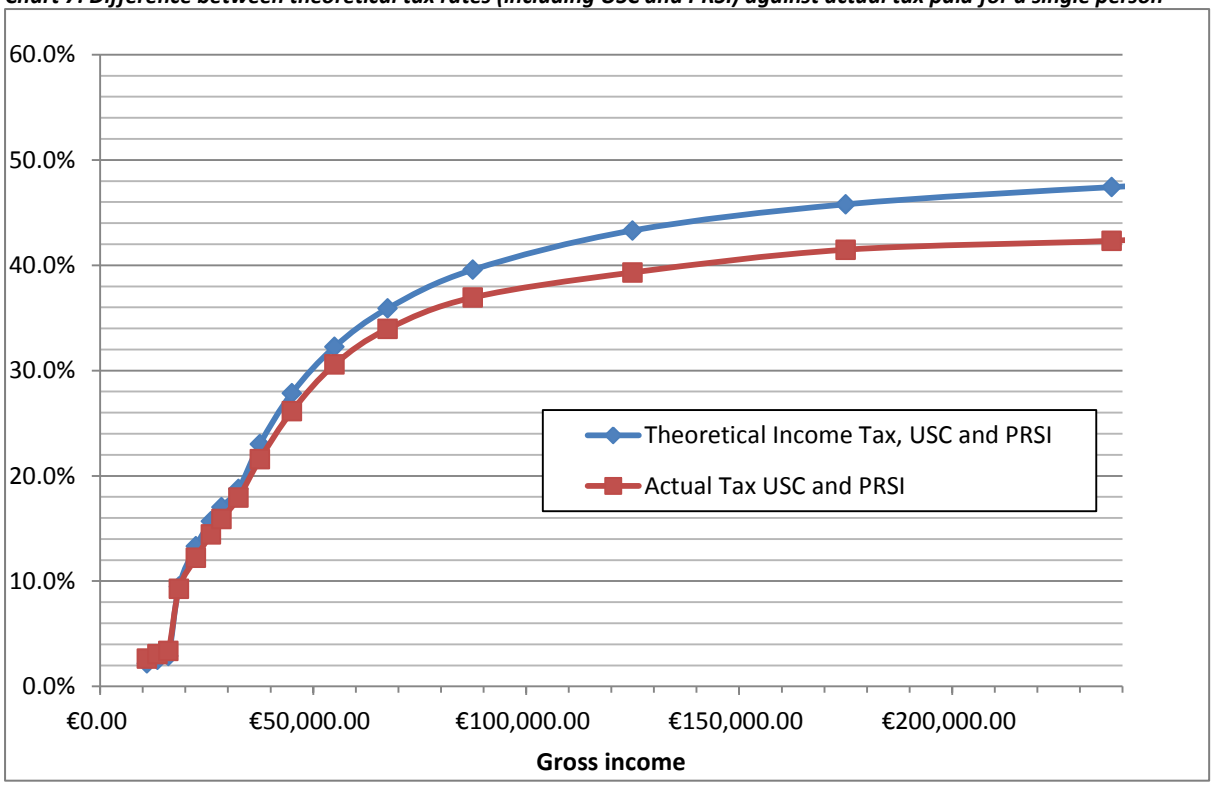
[20] Revenue Commissioners, Revenue Statistical Report Income Distribution Statistics – data for 2011 (forthcoming) Example of earlier data from 2010 available here: http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-distribution-statistics.pdf

[21] Revenue Commissioners (2012) *Revenue Statistical Report 2011*, Table IDS 18

[22] The authors adjusted the Revenue data to account for other personal taxation by adding the rates for USC and PRSI (which are not affected by income tax credits).

Chart 7 illustrates the difference between the theoretical rate of income tax, which is already lower than the 41% higher rate of income tax, and the even lower level of tax actually paid by a single person. We can also see how the difference increases in percentage terms (and thus absolute terms) as incomes rise. This graphically illustrates the disproportionate benefit of tax breaks to those few who earn significantly higher than average gross incomes.

Chart 7: Difference between theoretical tax rates (including USC and PRSI) against actual tax paid for a single person[23]



Based on all of the above, it is now possible to see clearly the real effects of the tax system for a tax unit with a gross income of €37, 500.

"Headline" income tax rate	41%
Maximum theoretical level of income tax payable	13.8%
Average level of Income tax paid (single person)	12.4%
Average level of income tax actually paid (all)	8.7%

"Marginal" rate of personal tax (income tax, USC and PRSI)	52%
Maximum theoretical level of personal tax (income tax, USC and PRSI)	23%
Average level of personal tax actually paid – Single person (income tax, USC and PRSI)	21.6%
Average level of personal tax actually paid – All (income tax, USC and PRSI)	17.9%

[23] Data from Deloitte Tax Calculator, www.deloitte.ie/tc/ and the Revenue Statistical Reports with calculations by the authors. Revenue data adjusted by authors to adjust for USC and PRSI. Deloitte Tax Calculator data plotted in intervals that correspond to the revenue data intervals. The theoretical rate (e.g. for 30,000) is plotted against the lower bound (e.g. 30-40,000) of the revenue data.

Income taxes and wages

Another reason why income tax rates are often the subject of discussion is because they can affect employment decisions, not least by companies with large workforces. These are guided by a combination of income tax rates, social insurance contributions (both employer and employee), and wage levels. As we have seen above, the introduction of the highest marginal tax rate at around average wages is neither a strange anomaly nor particularly important. It is merely one feature of many in Ireland's tax system. Investors will examine many features of Ireland's tax system and wider economy as part of making investment decisions.

Combining the tax wedge information with relatively competitive wage levels, we see that overall labour costs, including tax and social security contributions, are lower in Ireland than in many comparable countries. In the annual OECD publication *Taxing Wages*[24], investors can see that Irish average wages are 11th lowest out of the 21 EU member states that are also members of the OECD, and significantly lower than Northern and Western European wages. They are 9th lowest when including social security and adjusting for purchasing power parity. In so far as Ireland is competing with Nordic and Western states for foreign direct investment involving higher value add and higher skilled labour, which is certainly how the Government has positioned Ireland, wages are competitive.

If Ireland is competing with Mediterranean labour costs, Irish gross wages are higher. However, as shown in the final column, employers' social security contributions make labour costs higher in Italy and Spain than in Ireland, and these close the gap between Ireland and Greece and Portugal too.

Table 2: Wage and Labour Cost Differences between EU Members of the OECD

Numbers paying income tax

When estimating the impact of possible changes to income tax it is important to know how many people are likely to be affected in order to fully appreciate the distributional impacts. Two key pieces of information are needed. Firstly, we need the numbers of people in employment. Secondly, we need to look at the distribution of income to see how many people pay income tax and at what levels.

Looking at data for the population in Table 3, there is a stark reminder that in Ireland the number of adults in employment is nearly matched by those who are not, whether due to unemployment, full-time education, inability to enter the labour force, or old age (although employment has risen since Census 2011). More than one million adults of working age are beneficiaries of a weekly social welfare payment (e.g. not including those at work in receipt of Child Benefit), and the vast majority of over half a million older people are entitled to a State Pension. For many people in retirement, the State Pension may be their only source of income, with public transfers representing 78 per cent of older people's income in Ireland[25], alongside occupational pensions for those that have them.

Children and many older people do not pay income tax, but do rely on public services, as do people of working age who cannot work due to disability, caring or family responsibilities or lack of job

[24] OECD (2014) *Taxing Wages 2014* http://www.oecd.org/tax/tax-policy/taxing-wages.htm
[25] OECD (2013), Pensions at a Glance 2013, OECD and G20 Indicators, OECD Publishing http://www.oecd.org/ireland/OECD-PensionsAtAGlance-2013-Highlights-Ireland.pdf

opportunities. The lack of jobs is clearly illustrated by the fact that there were 26 people unemployed for every job vacancy that arose in 2013[26].

Member state of both the EU and the OECD	Gross wage in national currency (2013)	Gross wage in Euro[27]	Total labour cost (inc. employers social security) in USD PPP[28]
Hungary	2,914,514	9,418	$29,465
Poland	41,442	9,855	$26,822
Slovak Republic	10,015	10,015	$25,867
Czech Republic	298,770	10,893	$30,096
Estonia	11,664	11,664	$28,430
Portugal	17,335	17,335	$35,511
Slovenia	17,611	17,611	$34,282
Greece	20,604	20,604	$40,650
Spain	26,027	26,027	$49,723
Italy	29,704	29,704	$52,080
Ireland	32,381	32,381	$44,494
France	36,980	36,980	$61,648
Austria	41,693	41,693	$64,980
Finland	42,493	42,493	$57,406
United Kingdom	35,548	43,133	$56,797
Sweden	391,990	43,243	$59,649
Germany	45,170	45,170	$68,962
Belgium	46,810	46,810	$72,974
Netherlands	48,109	48,109	$63,585
Luxembourg	52,902	52,902	$64,680
Denmark	395,722	53,014	$51,772

Average Incomes and Income Tax

When examining the issue of income tax cuts, it should be clear that the majority of adults will not benefit whatsoever from any reduction in income tax because they do not earn sufficient (or any) income to benefit from tax cuts.

Of the nearly 1.9 million people in employment, the average (mean) earnings of €36,278 are skewed by higher salary levels and the majority of people in employment earn less than this amount. This is an important consideration, because the cut-off point for paying the higher rate (41%) of income tax is €32,800 for a single person, somewhat lower than the average level of pay but probably not far from the median level of pay (i.e. the point at which 50 per cent of people in employment earn more or less). The point at which an employee pays no income tax is €16,500 (although a person on that level of pay would be liable for €474 in USC).

[26] NERI (2014) *Quarterly Economic Facts*, *Spring 2014,* http://www.nerinstitute.net/download/pdf/qef_spring_2014_final_reduced_size.pdf

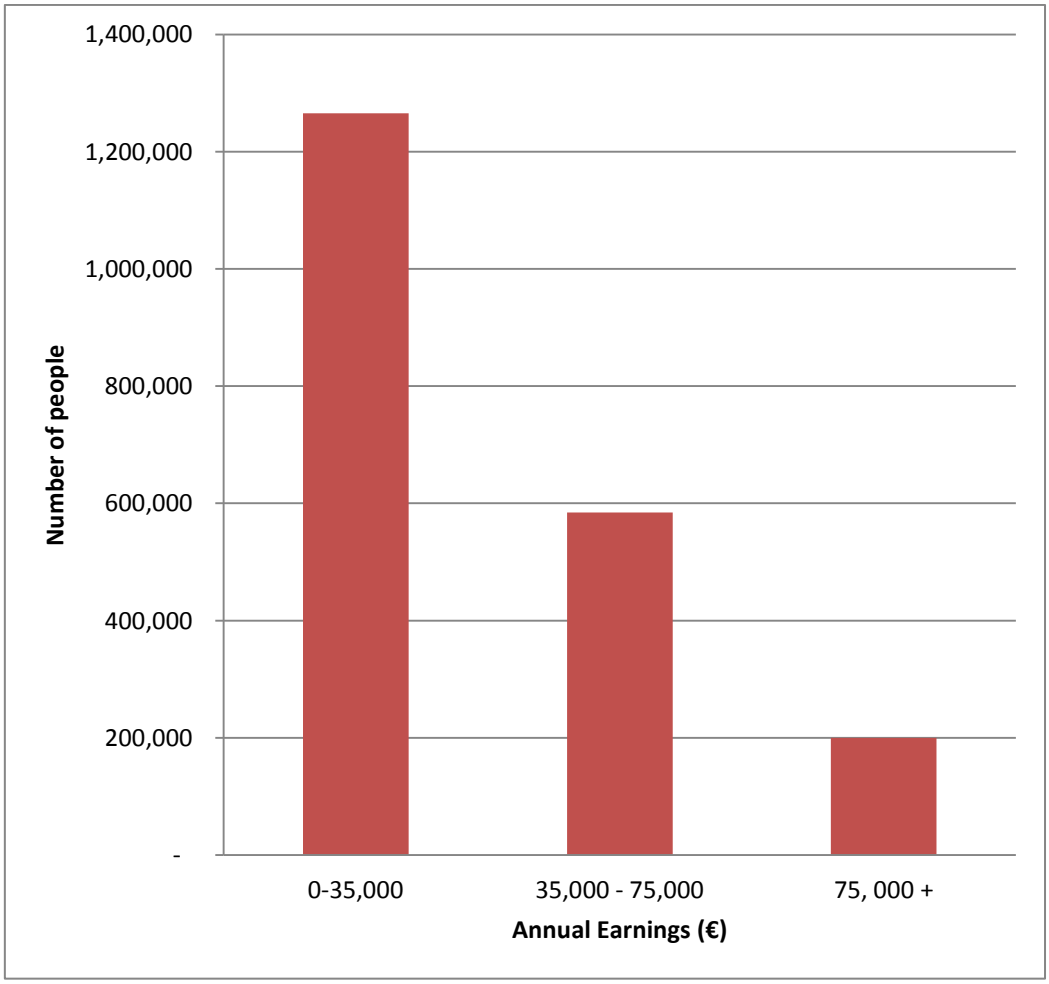
[27] OECD (2014) *Taxing Wages 2014* *http://www.oecd.org/tax/tax-policy/taxing-wages.htm* Data from Table 0.2 and Table 0.5 Exchange rates for Euro column from www.xe.com [accessed: 28 April 2014].

[28] Labour costs shown in US dollars with purchasing power parity

Census of Ireland 2011[1]	Numbers
Population	4,588,252
Households	1,654,208
Children (0-14)	979,590
Adults (15+)	**3,608,662**
Of whom, aged 65+	535,393
Of whom, in work	**1,807,360**
Of whom, unemployed, inactive or retired	1,801,302
Of whom, in education	408,838
Total in education (adults in education plus children)	1,388,428
Social Protection Annual Report 2012[2]	
Weekly recipients, of Social Protection Payment	1,469,202
Weekly beneficiaries	2,259,807
Weekly adult beneficiaries	1,671,980

Table 3: Ireland Population Data

Chart 8: Number of Tax Units in Ireland by income group[29]



[29] Revenue Commissioners (2012) *Revenue Statistical Report 2011*
http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-distribution-statistics.pdf

Numbers paying higher rate tax

Given this distribution we can calculate that very few people actually pay the 41% higher rate of income tax to any significant degree. As such, rather than benefiting 'middle income earners' – as some commentators have suggested – raising the onset of the higher rate of income tax would disproportionately benefit higher earners.

Analysis of Revenue data[30] on declared income allows us to show how many people earn what levels of income. The income distribution in Chart 8 shows that the majority of people earn less than €35,000. The data can be broken down into three categories; single earners, couples with one income and couples with two incomes.

From this, we estimated, for example, how many single people earned between €43,733 (the point at which you pay 25% of gross income at the higher rate) and €65,600 (the point at which a single person pays half their income at the higher rate). The same was done for those paying nothing at the higher rate (below €32,800) and more than half (above€65,600).

This method was adjusted for the different cut offs for married people, whether one income or two income. In those instances the tax unit is doubled to give an accurate reflection of the number of people paying that rate, either directly or as part of a couple. The results are shown in Table 4.

Percentage of gross income taxed at higher rate	**Single Person's Income**		**Married – One Income**		**Married – Two Incomes**	
	from	to	from	to	from	to
Nothing at higher rate	0	32,800	0	41,800	0	65,600
0-25% at higher rate	32,800	43,733	41,800	55,733	65,600	87,467
25%-50% at higher rate	43,733	65,600	55,733	83,600	87,467	131,200
50%+ at higher rate	65,600+		83,600+		131,200+	

Table 4: Cut off points for higher rate (41%) tax

Using Revenue data on the number of individuals in each group we can estimate, for example, how many single people earned between €43,733 and €65,600, and as a result paid between a quarter and a half of their income at the higher rate. Combining these figures for all the relevant groups give us the data in Table 5 and Chart 9.

Percentage of total income at higher rate	Number of People	% People
Nothing at higher rate	1,844,172	65%
0-25% at higher rate	559,913	20%
25%-50% at higher rate	263,980	9%
50%+ at higher rate	184,277	6%

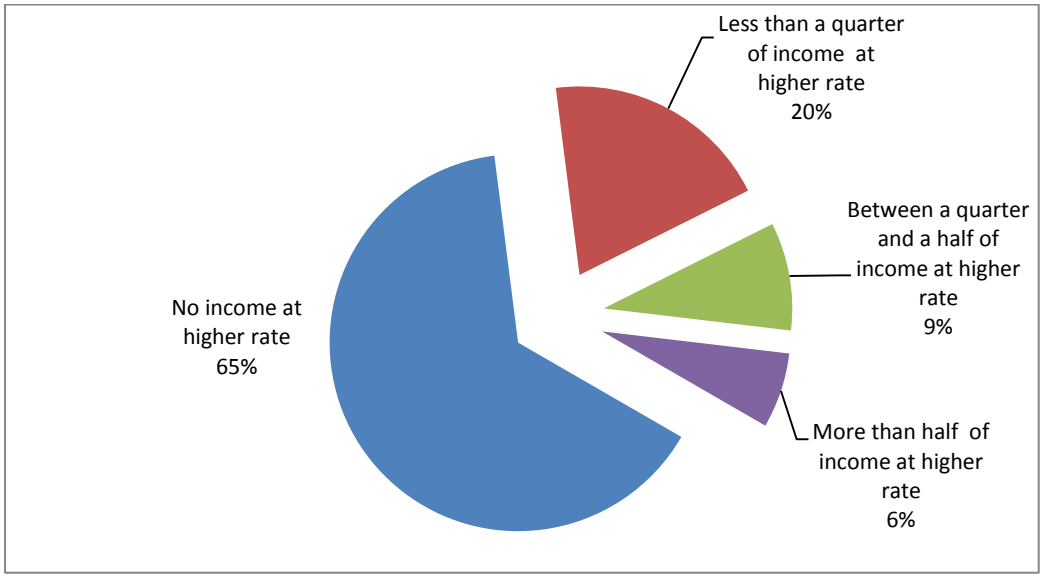
Table 5: Numbers paying levels of higher rate tax

As shown, two-thirds (65%) of income tax payers do not pay any income tax at the higher rate, and 85% pay less than a quarter of their gross income at the higher rate. Conversely, only 6 per cent of

[30] Revenue Commissioners (2012) *Revenue Statistical Report 2011*
http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-distribution-statistics.pdf

income tax payers pay are liable for the higher rate on more than half of their gross incomes. As such, those discussing cutting income tax, especially reducing Ireland's 41% higher tax rate, must recognise that the proposed beneficiaries of any changes are both few in number and are those who already gain most from Ireland's economic system.

Chart 9: percentage of people and their amount of higher rate tax



SECTION 2

The Goals of Taxation

The previous section described the key features of the Irish income tax system in order to quantify actual tax rates and to look at the distribution of incomes and income taxes paid. A discussion on taxation also needs to consider a number of different and often competing goals and policy choices.

Tax reform involves improving the design of individual taxes. However, it also involves changing the balance of taxation between different sources. For example, we can increase economic efficiency and promote a fairer distribution of income by switching the balance of taxation away from labour taxes on low income workers and instead increasing taxes on economic rents, including land, natural resources and financial sector rents. Improving the design of individual taxes and improving the balance of taxation between sources should be seen as complementary. Context also matters. The effect of a tax increase, or indeed a tax decrease, depends upon the starting point. Tax changes can have complex effects on the wider economy.

There tends to be diminishing returns to adjusting taxes upwards, while taxes tend to have smaller negative effects on employment and growth when they start from a low base, which is the case in Ireland for labour taxes (especially PRSI). One implication is that low tax economies such as Ireland and Slovakia are likely to obtain a larger net benefit from raising taxes than will high tax economies such as Denmark and Sweden.

In this section, we highlight the choices for Ireland under three key themes: considerations of equity, efficiency and inequality; promoting growth and job creation; and meeting Ireland's fiscal targets.

Efficiency, Equity and Inequality

All taxes influence behaviour in different ways, and consequently they also impact upon economic efficiency, employment and economic growth in a variety of different ways. The tax system also heavily influences the distribution of income in the economy. With the growing interest in rising economic inequality, it should be equity, not just competitiveness, which informs taxation policies. In order to tackle inequality, tax policy should favour progressive taxation of incomes, strong taxation of inheritances and of real property and rents.

A major UK study of the tax system, by Mirlees et al., found that "the pre-tax distribution of earnings matters a great deal for the appropriate structure of the tax system" and that income and wealth distribution has become much more unequal in many countries over the past thirty years. It therefore argues that equity and fairness has to be a major consideration in the taxation system.[31] The OECD, IMF, ILO and other international bodies and numerous economic reports are now returning to focus on equity because it is clear that the system of re-distribution has broken down.

It is difficult to design a good income tax system, as the need to raise revenue and redistribute can impose a cost on economic efficiency. However, despite many claims to the contrary, there need not be a trade-off between taxes and growth. For example, economic theory and the results of

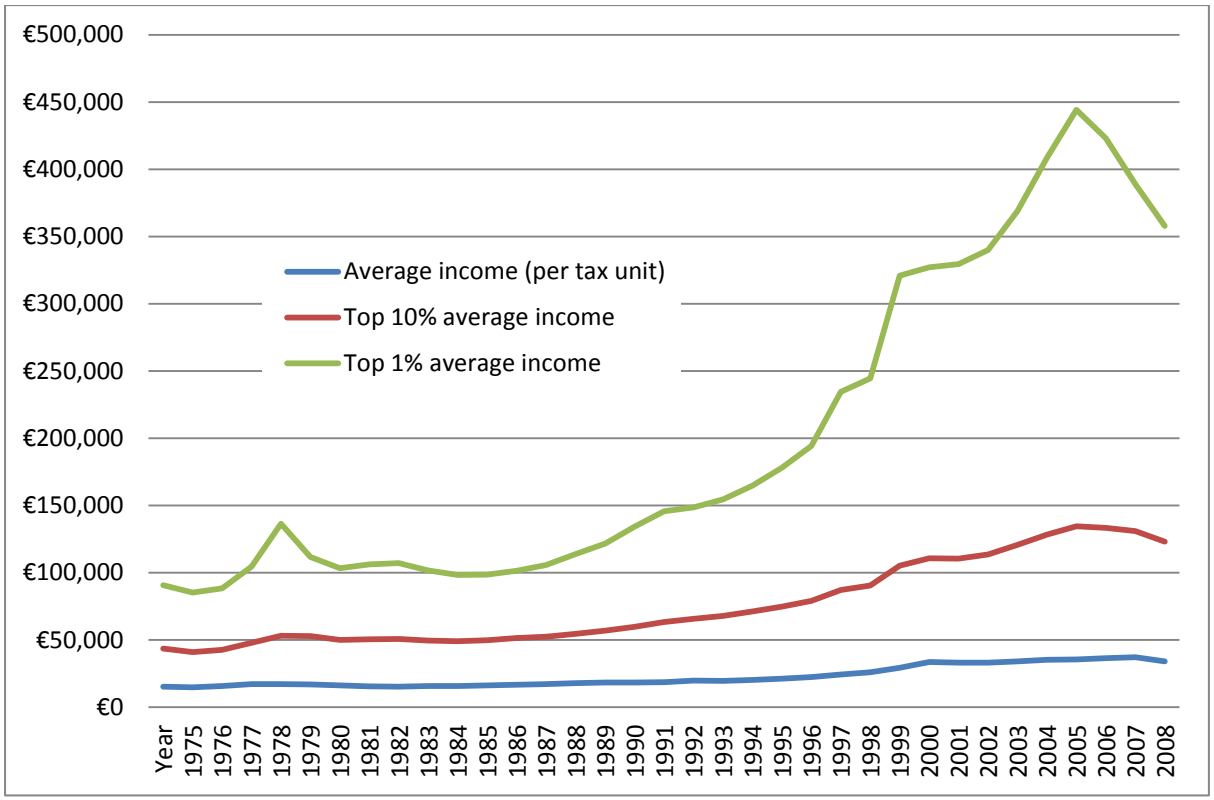
[31] Mirlees Review, "Tax By Design," Part 2 of "Reforming the Tax System for the 21st Century", Institute for Fiscal Studies, 2014, London. ("The Mirlees Review brought together a high-profile group of international experts and younger researchers to identify the characteristics of a good tax system for any open developed economy in the 21st century.")

numerous empirical studies[32] suggest that taxes on immovable property are efficient because they have less of an effect on growth and employment than taxes on income or consumption. Annual taxes on immovable property are consistently shown to generate minimal negative impacts on long-run economic growth.

Other efficient taxes include taxes on other forms of property, taxes on passive and rental income, and taxes on wealth transfer including, for example, inheritance taxes. Inheritance taxes are an important complement to net wealth taxes. These taxes have a minimal impact on economic growth and play a critically important redistributive role in the economy. Gift taxes are a necessary supplement to inheritance taxes, as otherwise it is straightforward to avoid the inheritance tax.

As demonstrated through the empirical research of Thomas Piketty[33] and others, there has been a steady rise in inequality in recent decades, with the growth in the concentration of high incomes and wealth in few hands. The World Top Incomes database provides data that shows the pattern of the growth in inequality in Ireland mirrors that of other Anglo-Saxon/Liberal economies, albeit less starkly than in the USA.

Chart 10: The rise of Top 1% and Top 10% Incomes in Ireland is greater than average income growth (income figures are adjusted for 2010)[34]

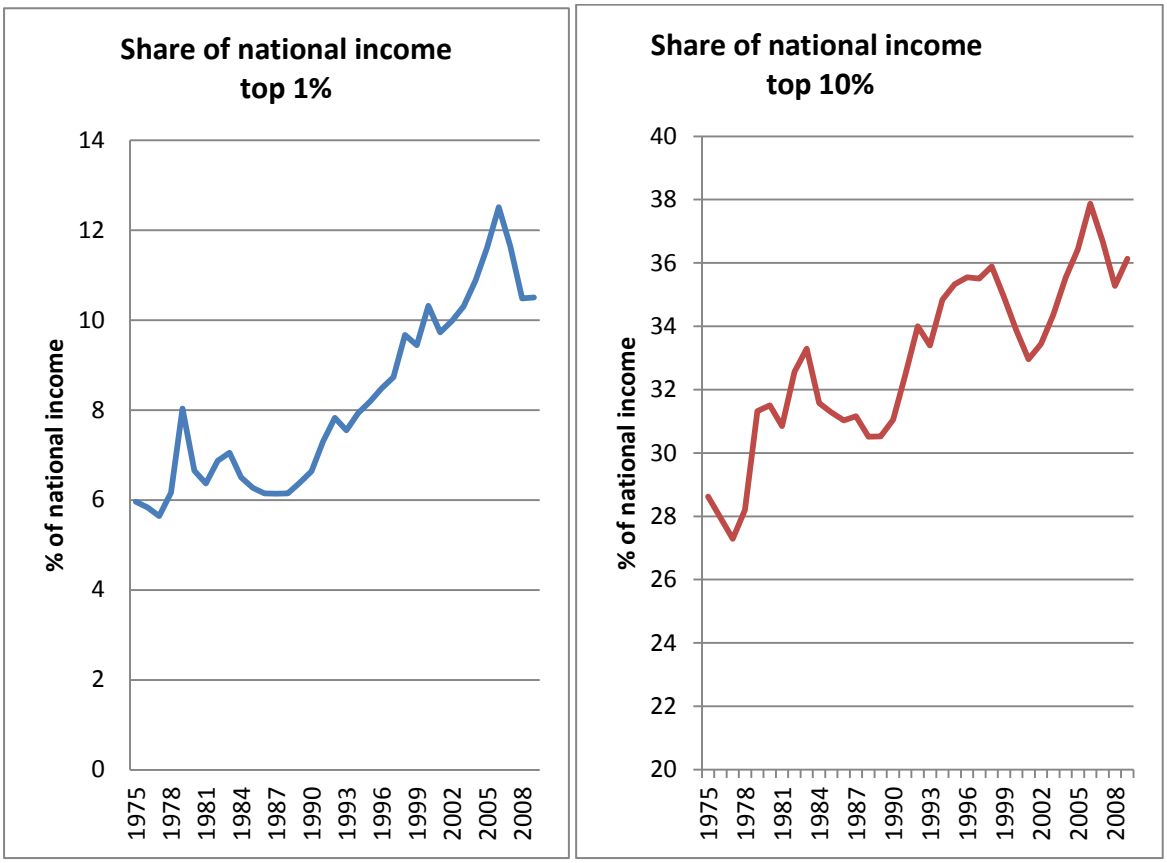


[32] See for example: Eurostat (2012) *Taxation Trends in Europe 2012*; Johansson, A., Heady, C., Arnold, J., Brys, B., and Vartia, L. (2008) *Taxation and Economic Growth*, OECD Working Paper Series No. 620; Heady, C., Johansson, A., Arnold, L., Brys., and Vartia. L. (2009) *Tax Policy for Economic Recovery and Growth*, University of Kent School of Economics Discussion Papers

[33] http://www.hup.harvard.edu/catalog.php?isbn=9780674430006

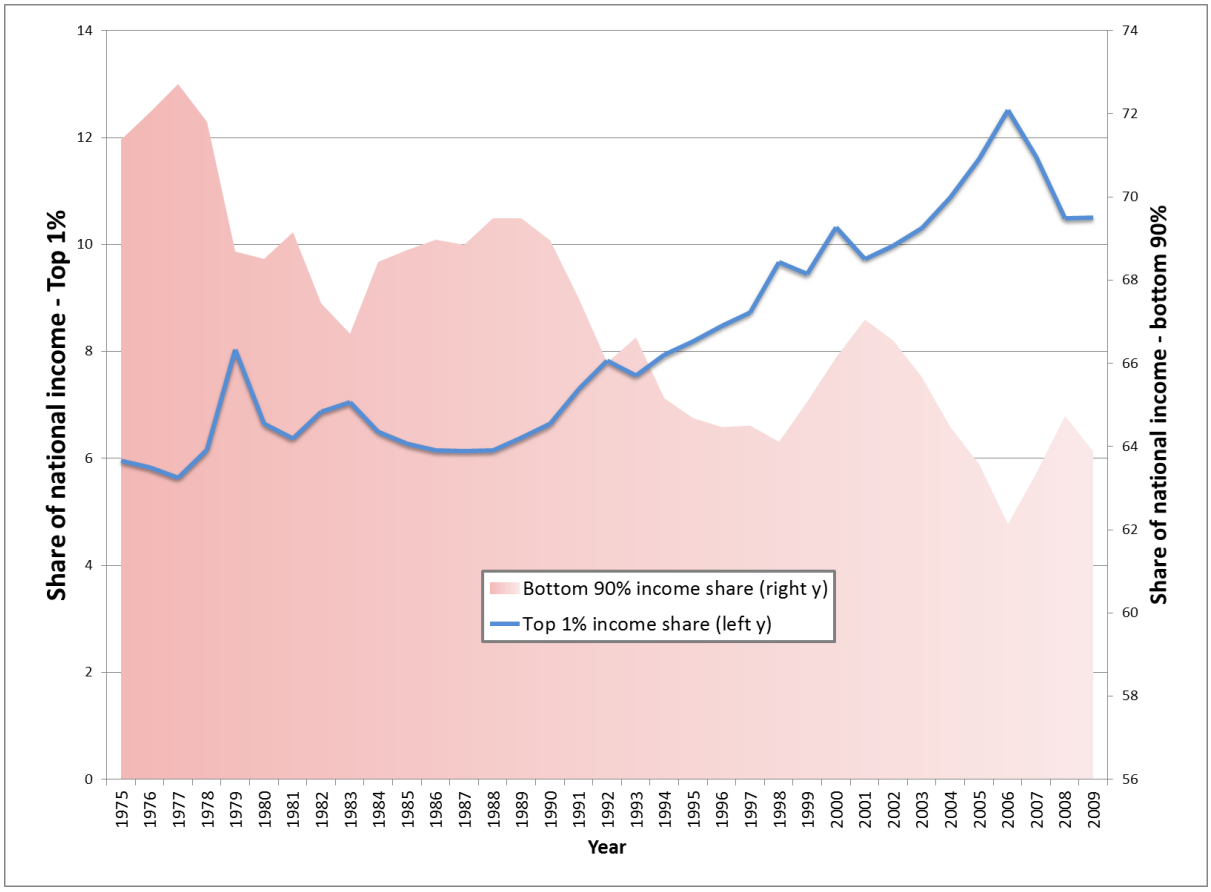
[34] World Top Incomes Database http://topincomes.g-mond.parisschoolofeconomics.eu/ accessed May 2014

Chart 11: The Top 1% in Ireland have over 10% of all Income, and the Top 10% has over 35% of all Income[35]



[35] World Top Incomes Database http://topincomes.g-mond.parisschoolofeconomics.eu/ accessed May 2014

Chart 12: Top 1% and bottom 90% share of national income in Ireland - 1975-2009 (different Y-axes)[36]



Charts 10 and 11 illustrate the disproportionate rise of higher incomes above average income growth, with the share of income of the top 10 per cent growing from 28% of all income in 1975 to 36% in 2009. Similarly, the top 1 per cent have nearly doubled their share of income, from 6% in 1975 to over 10% in 2009. As Chart 12 illustrates, the incomes of the bottom 90 percent reduced from 1975 to 2009, from over 73% of all income to less than 64%.

The trend of growing inequality is likely to be similar in relation to the share of wealth in Ireland, with even higher concentrations at the top.

In the context of growing income and wealth inequality in Ireland (and elsewhere), taxes on high incomes and wealth, including inheritance taxes and net wealth taxes, have an increasingly important role to play to avoid further deepening social divisions.

Getting the balance right between labour (income) taxes, corporate taxes and consumption taxes is also crucial. While labour and corporate taxes can impact on economic activity, consumption taxes are generally far less progressive. Shifting the composition of taxation from personal income to personal consumption is likely to be regressive overall.

[36] World Top Incomes Database http://topincomes.g-mond.parisschoolofeconomics.eu/ accessed May 2014

Consumption taxes in Ireland are already greater than the weighted EU average, while tax rates on labour income and capital income are well below the EU average. A heavy reliance on consumption taxes as opposed to other taxes such as capital taxes (as is the case in Ireland) will lead to greater wealth inequality over time because it increases the real value of wealth assets and shifts the taxation onto those on low incomes.

Promoting growth and job creation

Taxes and public spending have both positive and negative effects on the economy and job creation. However, the discussion of tax cuts often ignores the positives associated with public spending. Government expenditure is a component of the overall economic output (measured as GDP). Hence, all things being equal, tax cuts will lower GDP from public spending and raise it from private spending. But there are reasons to believe that private spending will involve more imports than public spending, which would lead to an overall shrinking of the economy. Public spending on the other hand is not only a component of economic output, but it provides essential services – like health and education – and also provides infrastructure that business needs, from roads and broadband through to training (for 'human capital') and university research (for innovation). Also, social transfers ensure that there is strong consumer demand in the economy. If pensions or welfare are cut, than there will be less spending as people go without basic goods and services, again shrinking the economy.

Government investment and government consumption impact directly on aggregate demand while increases in transfers and reductions in taxes operate mainly through their effects on personal disposable incomes. It is widely accepted in the literature that fiscal measures that have direct effects on aggregate demand have larger multipliers than those whose initial impact operates through their effects on private-sector spending behaviour[37]. In other words, tax and spending measures that directly impact on demand in the economy (such as government spending increases) have a greater impact on economic growth than those that rely on private sector spending to boost demand (such as tax cuts).

A recent IMF study[38] drew a number of key conclusions that are instructive in this area. First, they found that multipliers from government investment and consumption, which are roughly similar in size, are larger than the multipliers from transfers, labour income taxes, consumption taxes and corporate income taxes.

Second, multipliers are small for general transfers, labour income taxes and corporate income taxes, and somewhat larger (but still small relative to government spending) for consumption taxes. Third, only targeted transfers come close to having multipliers similar to those of government spending.

An analysis of national economic output (GDP) shows that public spending in Ireland is obviously a major component of GDP. As such, reducing tax (and therefore public spending) will have an immediate, negative impact on the economy and on jobs, which may be have a greater impact than the positive effects of increased disposable incomes.

[37] IMF Research Department (2010) *Effects of Fiscal Stimulus in Structural Models* http://www.imf.org/external/pubs/ft/wp/2010/wp1073.pdf
[38] IMF Research Department (2010) *Effects of Fiscal Stimulus in Structural Models* http://www.imf.org/external/pubs/ft/wp/2010/wp1073.pdf

National economic output (GDP) can be measured as the components C + I + G + (X - M), where C is household/personal consumption, I is investment, G is government consumption/investment, and X-M is exports less imports (i.e. net exports).

In 2013, public spending in Ireland represented 42.9% of GDP[39]. Any reduction in public spending will either reduce the G component of GDP or reduction in social welfare payments will be reflected in a reduction in the C component. It is not that cutting public spending may lead to a reduction in GDP, public spending is a component of GDP; hence, tax cuts will lead to public spending cuts that – all things being equal – will shrink GDP.

As public bodies purchase a huge volume of goods and services from the private sector in Ireland, it is likely that cuts to public expenditure will result in reduced business and job losses in the private sector too.

On the other side of the equation, reduced taxation will increase disposable incomes allowing people to spend (C) or save; and savings provide financial institutions with funds for lending, and investment (I). Investment (I) in Ireland is currently extremely weak, at 10.7% GDP gross fixed capital formation, which is the lowest in the EU.

There are two challenges here. Firstly, as Ireland is both a small open economy and has many gaps in the range of goods and services produced domestically, there is a large probability that a large proportion of increase disposable income will be spent on imports (M), which reduces rather than boosts Ireland's GDP. The dysfunction of Ireland's banking system, combined with high levels of private debt, is another problem. If people have higher disposable incomes they may simply pay down debt, rather than provide banks with new funds for lending.

Moreover, even if the banks have new deposits, there is no guarantee that these funds will be lent to Irish companies and entrepreneurs and used for investment in Ireland.

On the contrary, if the Government wishes to boost private consumption (C), the most effective way to do so is by increasing social transfers, as people on low incomes will disproportionately spend their income on goods and services in local businesses. There is a risk of increased imports (M) here too, but given that over a quarter of households now report material deprivation, it is likely that the majority of increased consumption by lower income households will be basic goods and services that Ireland produces. The IMF models confirm that spending of 'hand-to-mouth' households responds strongly to transfer changes, while other households respond to the temporary nature of the transfer change largely by adjusting their saving behaviour[40].

The IMF study concludes that 'hand-to-mouth' households have a much higher marginal propensity to consume out of current income than other households. This has two implications. First, countries that have a high share of 'hand-to-mouth' households have a higher multiplier for general transfers

[39] Eurostat Database – accessed May 2014
http://epp.eurostat.ec.europa.eu/tgm/refreshTableAction.do?tab=table&plugin=0&pcode=tec00023&language=en
[40] IMF Research Department (2010) *Effects of Fiscal Stimulus in Structural Models*
http://www.imf.org/external/pubs/ft/wp/2010/wp1073.pdf

(and also for taxes). Second, transfers that can be targeted to 'hand-to-mouth' households provide a much more powerful stimulus than general transfers.[41]

Of course, it is not possible to increase Government's contribution to GDP unsustainably. Public spending is limited by available revenue and the size of the public debt, which in turn result from the strength of the economy. What is required is an efficient balance between public spending and private sector activity, with both being mutually reinforcing. The private sector relies on the quality of public infrastructure such as roads and broadband, as well as education, training, public transport and other services, all of which create an environment in which private business can thrive. The public sector also purchases goods and services from the private and not-for-profit sectors.

Investment

Investment in Ireland is currently extremely weak. Measured as Gross Fixed Capital Formation (GFCF), at 10.7% GDP, the combination of public and private investment in Ireland is the lowest in the EU. The next lowest are Greece (13.2% GDP) and the UK (14.4% GDP). The EU-28 average is 17.9% GDP[42] and the highest level of investment is in Romania (23.6% GDP), followed by Estonia (25.2% GDP) and the Czech Republic (23.1% GDP).

The low level of investment in Ireland can partially be explained by the slump in construction, as well as by lack of access to credit and high corporate indebtedness. There may also be a perception of low returns on investment given the low growth in the economy.

Tax cuts seem to be accompanied by the assumption that they are 'cost free' but they will need to be paid for through reduction in public spending. Not only will this reduce public services and social welfare, but public bodies are likely to slow down or cease tendering or procurement from the private sector in Ireland, if they have reduced budgets for goods and services – everything from office equipment to bricks and mortar. Continued pressure to achieve maximum value for money may also lead to more tenders going abroad, which creates an illusion of saving money. Although a public body might pay less for something, the whole Irish economy will shrink from the import of foreign goods and services. The Government's new Office of Government Procurement[43] has a clear focus on reducing cost and achieving better value for money[44], which is of course welcome, but the Government should also be aware of the dynamic interplay between the whole economy and public spending.

After peaking at €8.5 billion in 2008, gross public expenditure on capital items has already declined to just €3 billion in the 2014 estimates[45]. Every euro of that €3 billion that goes abroad boosts imports and shrinks Irish GDP to the same extent. In 'normal' times, this would be part of the give and take of international trade, and efficiencies would be expected to result. But in a time of prolonged recession, long-term impairment to Ireland's business infrastructure may result from lack of public purchasing from Irish providers.

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[41] IMF Research Department (2010) *Effects of Fiscal Stimulus in Structural Models*
http://www.imf.org/external/pubs/ft/wp/2010/wp1073.pdf
[42] Eurostat Database (all figures for 2012)
http://epp.eurostat.ec.europa.eu/tgm/refreshTableAction.do;jsessionid=9ea7d07e30e88f7d7b847ce34372b3e9e6df91b6325b.e34OaN8Pc3mMc40Lc3aMaNyTbhaKe0?tab=table&plugin=0&pcode=tec00011&language=en
[43] http://www.procurement.ie/
[44] http://www.per.gov.ie/public-procurement/
[45] http://databank.per.gov.ie/Expenditure.aspx?rep=NetVA

Again, there is no magic formula of tax cuts leading to economic growth, nor is it possible to provide infinite growth through increased taxation. However, given the overall low level of taxation in Ireland (30.2% of GDP in 2012[46]), the balance of probability is that more taxation and greater levels of public spending are more likely to achieve sustained economic growth at this time than tax cuts.

Cuts to tax means cuts to public spending. This will reduce investment, as successive budgets have disproportionately targeted capital spending over current, radically reducing Ireland's investment in infrastructure, which is the backbone for future economic activity, including in education ('human capital') and research (for innovation).

The opportunity exists to maximise investment opportunities presented by the low level of investment – and hence lower prices/higher multipliers that could be gained by investors. Rather than cutting taxes, if the Government has identified available funds, these could be used to fill the void of private investment, and potentially 'crowd in' private investment to key infrastructural projects – both increasing economic growth in the immediate term and putting in place the necessary infrastructure to foster long-term growth and further private sector activity.

Meeting Fiscal targets

There are many reasons to be sceptical about the idea that tax cuts in an already low tax economy like Ireland are going to provide a major boost to spending or economic activity, particularly given the low numbers of people who will benefit. Aside from political issues, and the ever-present question of distribution of limited resources, there are also a number of longer-term risks to the tax cutting strategy.

The budget adjustment that has been taking place since 2008, of cuts and tax rises, has been undertaken to reduce the deficit. The target is to reach a deficit of just 3% by the end of 2015. The Government indicates a deficit of 4.8 per cent planned for 2014, which is €8 billion[47]. Although hoped-for economic growth may reduce this, major decisions still need to be taken to ensure that Ireland's public finances are on a solid and sustainable footing. The EU Fiscal Compact also requires Ireland to further lower the deficit and begin an inexorable process of reducing the national debt to 60 per cent of GDP, with annual targets.

In 2015, the government is still pledged to take a very substantial €2 billion out of the economy[48]. It plans to do this by a combination of public spending reductions and increases in taxation. In 2013, taxes rose by 3.2% and spending was cut by 4.2%, though there was still a deficit of €12 billion (7.2% GDP)[49]. In 2014, taxes are budgeted to rise by 6% (including through the first full-year implementation of Local Property Tax) and spending will be cut by a further 4%, according to the Budget.

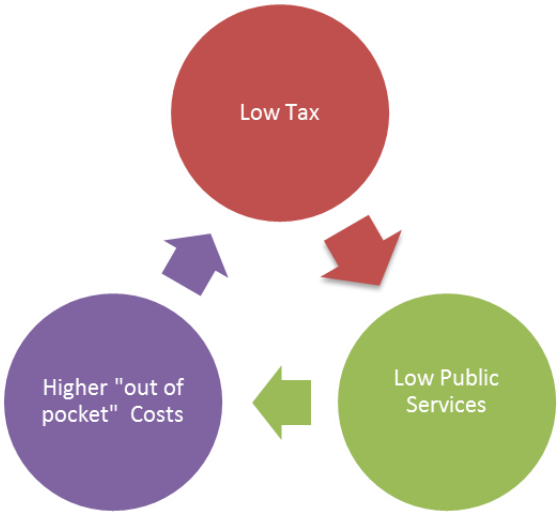
However, this is not the end of the adjustment or austerity programme. Under EU rules, the national finances have to be brought into balance by 2018. Historically, most countries have run up deficits in bad times and replenish the coffers in good times, but such a Keynesian approach is barred by

[46] Irish Fiscal Advisory Council (2013) Budget 2014 Economic and Fiscal Outlook http://budget.gov.ie/Budgets/2014/Documents/Economic%20and%20Fiscal%20Outlook%202014.pdf
[47] http://www.finance.gov.ie/sites/default/files/Ireland%27s%20SPU%202014%20Final%2029%20April%202014.2.pdf
[48] Department of Finance, *Ireland's Stability Programme*, April 2014, p.3
[49] Ibid p.12

current EU agreements. From the end of this year on, in spite of the impact of the crisis, Ireland will continually run a primary budget surplus in order to inexorably reduce the national debt[50].

Ireland's targets for reducing the debt and deficit in the public finances have not gone away. The Department of Finance's optimistic growth forecasts for 2013 did not come to pass, and any tax cuts based on the assumption of strong economic growth in 2014 or 2015 run the risk that, given the continued sluggishness in the Euro zone economies, that Ireland's growth will not be as great as hoped. The IMF's World Economic Outlook[51] points to low investment and continued double-digit unemployment in Ireland to 2016. Likewise, the IMF project Government net debt will rise in 2014, and only fall to less than 100 per cent of GDP in 2017.

As we have seen, Ireland has much lower levels of taxation than the EU average. The result is higher costs as people pay for services that would otherwise be provided by the state. As a result people do not see value in public services, and thus are unable to afford higher rates of tax, without improvements in public services. In this context, in order to preserve and if possible increase public services, Ireland should be planning how to build up the tax base, not continuing to erode it.



[50] This means that if we were not paying interest on our debts, we would have more in revenue than government spends in total. Interest is substantial at 13% of government revenue. Further, we have pre-funded borrowing into early 2015 with cash deposits of almost €19bn. However, we are paying substantial interest on this at over €850m a year. By the end of 2014, it is expected that this cash and deposits will be sufficient to prefund government borrowings until early 2016. Put another way, Ireland's net debt is considerably lower that the gross debt, but all EU and other international bodies focus on the latter.

[51] IMF Database, accessed April 2014 http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weorept.aspx?sy=2012&ey=2019&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=69&pr1.y=6&c=178&s=NGDP_R%2CNID_NGDP%2CLUR%2CLE%2CGGR%2CGGR_NGDP%2CGGSB%2CGGSB_NPGDP%2CGGXWDN%2CGGXWDN_NGDP&grp=0&a=

SECTION 3

Alternative options for tax reform

The main findings of this report make the case against any tax cuts. Ireland's tax take is already far too low to provide an adequate welfare state, and the fiscal position in relation to the deficit is still too precarious. Also, debt interest repayments have eroded the amount of public spending available for services and welfare. While there is an understandable desire to "give something back" to the people of Ireland, the evidence demonstrates a strong case that most people would benefit more from maintaining public services.

Unfortunately, the lure of 'cash back' through tax cuts can seem more tangible in the short-term, whereas the substantial benefits of public services are sometimes not as visible until someone has children in school, requires medical treatment or seeks social welfare income supports. The short-term nature of electoral politics tends to favour proposals to cut taxes rather than to build quality public services, which is both unsustainable and inherently self-defeating as a large bulk of public dissatisfaction with political parties tends to be based on people's experience of public service deficiencies.

Government spending also boosts investment and drives aggregate demand, both of which are components of GDP that would be decreased if tax revenue is reduced, with no guarantee that the domestic economy will grow to compensate for this loss, net of imports. Based on the evidence presented in the paper, we have provided several options to promote growth and job creation and tackle inequality without risking Ireland's fiscal position or undermining public services and social transfers.

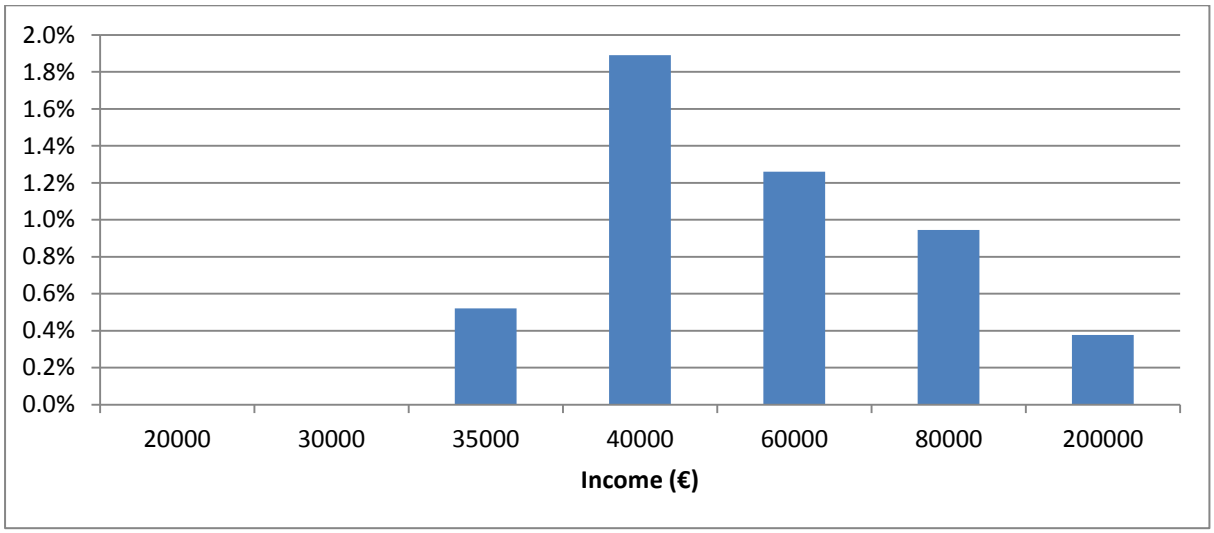
Income Tax Changes

There is a discourse in the media – and from political parties – about cutting income taxes, which often focuses on widening the tax bands in order to raise the threshold before the higher rate of taxation takes effect. Although those liable to pay the higher rate of income tax have a theoretical marginal tax liability of 52% (comprising 7% USC, 4% PRSI and 41% income tax), this does not radically alter the level of effective tax paid, which is what really counts. As shown in detail in Section 1, the transition from the standard rate of income tax (20%) to the higher rate (41%) produces no 'step effect', and the curvature of effective taxation is smooth. For example, someone on €32,000 pays a theoretical effective tax rate of 18.6%, whereas someone on €33,000, who has begun to pay some income tax at the higher rate, has a theoretical effective tax rate of 19.1%. In fact, actual tax paid is less, than these rates.

A decrease in the top tax rate only benefits those paying tax above that rate. As we have seen in Section 1, only 6% of households pay more than half of their income at the higher rate, whereas 85% of people pay less than a quarter of their income at this higher rate and most – two-thirds of income tax payers – do not pay any tax at the higher rate.

Modelling a hypothetical raising of the threshold from €32,800 to €36,400 (illustrated in Chart 13), shows that the benefits for those on €35,000 are much lower, even in percentage terms, than for those earning between €40,000 and €80,000[52].

Chart 13: % tax cut from a €3,600 increase in marginal tax threshold



The differing impacts on income groups can be shown by looking at the distributional impacts of changes to the income tax system. Social Justice Ireland (SJI) recently published an analysis of three different changes to the tax system: a decrease in the top tax rate; an increase in the personal tax credit; and changing the entry point to the top tax rate[53]. Although all of the income taxation options in their model have the same cost, they each carry different effects on the income distribution, with increasing tax credits having the least regressive impact.

Increasing Tax Credits

Increasing tax credits provides the same value to all taxpayers across the income distribution provided they are earning sufficient income to pay more taxes than the credit increase. Therefore, if the increase was €108 (as in SJI's model) the increased income received by a single earner on €25,000 and on €125,000 is the same; an extra €108.

SJI also suggest making tax credits refundable, ensuring that every beneficiary of tax credits would receive the full value of the tax credit. This system would improve the net income of the workers whose incomes are lowest, at modest cost, without an additional administrative burden placed on employers[54]. This would ameliorate the fact that some part-time and low income workers would not benefit from an increase in tax credits as they do not earn a high enough gross income to benefit from all of their tax credits.

[52] http://www.progressive-economy.ie/2014/04/widen-band-widen-gap.html
[53] Social Justice Ireland (2014) *Steps Towards a Fairer Future* http://www.socialjustice.ie/sites/default/files/file/SER/2014-04-22%20-%20Socio%20Economic%20Review%202014%20-%20Full%20text%20and%20cover%20-%20FINAL.pdf
[54] Social Justice Ireland (2014) *Steps Towards a Fairer Future* http://www.socialjustice.ie/sites/default/files/file/SER/2014-04-22%20-%20Socio%20Economic%20Review%202014%20-%20Full%20text%20and%20cover%20-%20FINAL.pdf

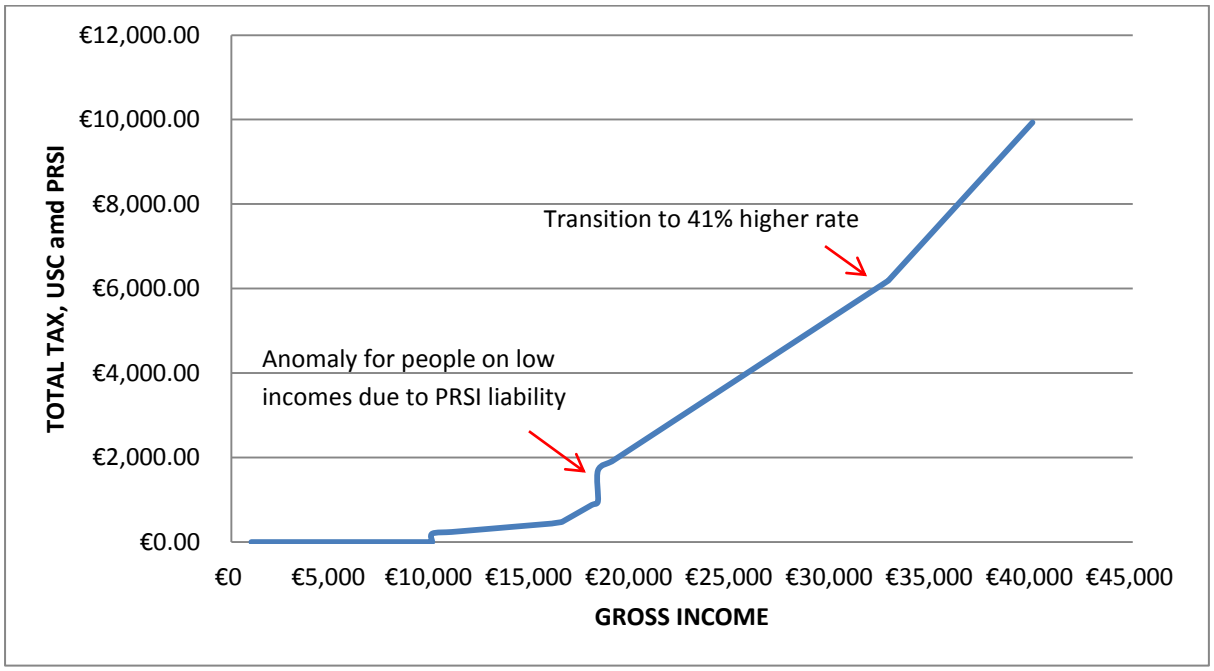
Fixing an inequitable 'step effect' affecting lower income earners

Another option for the Government when considering tax cuts would be to remove a currently inequitable 'step effect' in personal income taxation, which affects people on low incomes.

As Chart 14 shows, under the current system, anyone earning below €10,000 pays no tax at all (from income tax, USC or PRSI), while someone earning above €10,000 begins to pay a small effective rate of tax. For example, someone with gross pay of €11,000, will pay an effective rate of 2% tax (from USC), which increases to an effective rate of 4.9% by the time he or she earns €18,000.

However, while someone earning €18,304 pays an effective tax rate of 5.25%, someone who is paid one euro more will pay an effective tax of 9.25%, due to the onset of PRSI. This has the perverse consequence that a person earning €18,000 has higher net pay than someone earning €19,000. The figures are detailed in Table 6, and plotted in Chart 15.

Chart 14: Effective Tax Rates including Income Tax, USC and PRSI payable on Wages up to €45,000[55]



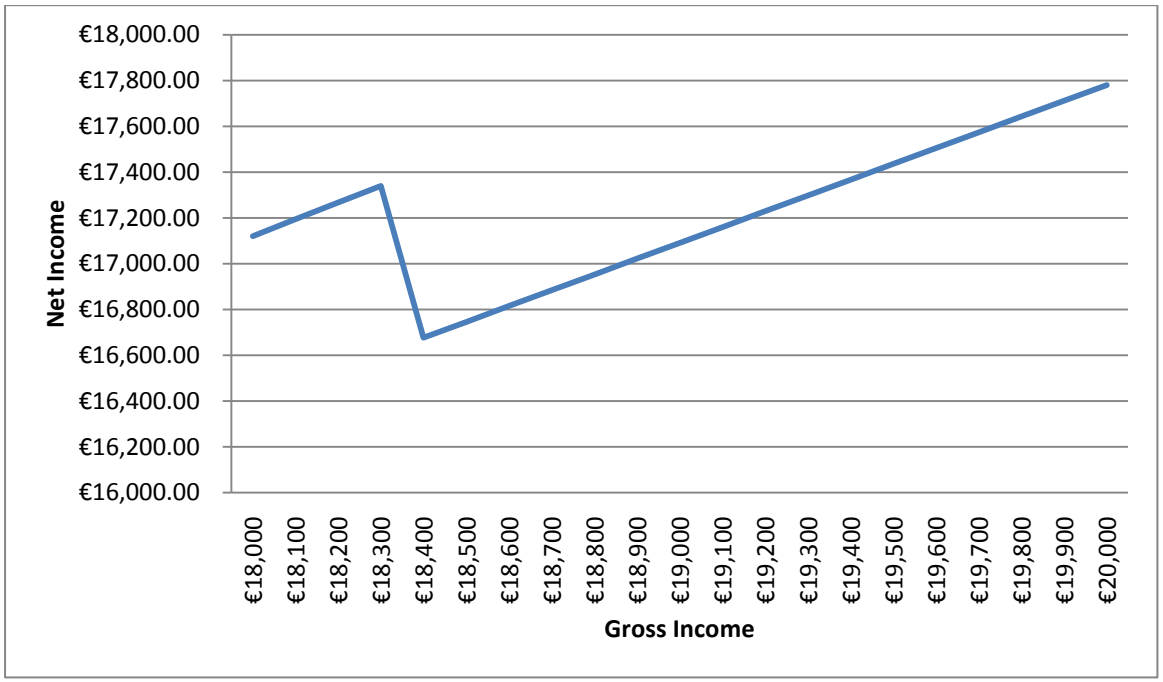
While the PRSI system currently exempts many part-time and low-paid workers from PRSI, the anomaly occurs because once someone is earning slightly more than the minimum wage full-time, he or she begins to pay PRSI on all earnings.

[55] Calculated from the Deloitte Tax calculator http://www.deloitte.ie/tc/ and verified using payroll software.

Table 6: Gross pay versus net pay between €18,304 and €19,366

Gross Pay	USC	Income Tax	PRSI	Net Pay	% Effective Tax
€18,000	€579	€300	€0	€17,121	4.89%
€18,304	€600	€361	€0	€17,343	5.25%
€18,305	**€600**	**€361**	**€732**	**€16,612**	**9.25%**
€19,000	**€649**	**€500**	**€760**	**€17,091**	**10.05%**
€19,366	€674	€573	€775	€17,344	10.29%
€20,000	€719	€700	€800	€17,781	11.10%

Chart 15: Change in net pay (blue line) as gross pay increases



Looking at this in more detail, the anomaly persists between wages of €18,304 and €19,365. Only at €19,366 is a person's net pay higher (by one euro) than it would be at €18,304. As it stands, it effectively means that someone on close to the minimum wage needs a gross pay rise of over €1,000 to achieve any increase in their take-home pay. This is a disincentive to employers to increase wages, or for employees to accept extra hours of work.

There is also a risk that this situation encourages cash payments 'under the table' to work around the flaw in the system. This is not an argument against PRSI or other taxes on low income workers, but the anomaly is unjust and should be removed through technical changes to the operation of the tax system for those on the income levels affected by the step change.

With the current policy focus on increasing employment, and ensuring that work always pays better than welfare, it would make sense to remove this anomaly.

Employer's PRSI

The disincentive to employers to pay higher wages is further compounded by the fact that the employer's contribution to PRSI changes from 8.5% to 10.75% on all earnings above €18,512, creating a further step effect. Continuing with the example of someone on low gross annual pay of €18,304, not only does gross pay need to be raised by €1,062 before he or she receives one euro extra in net pay, but additional employer's PRSI must be paid too. This means that an employer must pay a total additional of €1,680 to give an employee in this position one euro extra take-home pay in his or her annual wages. This undermines the ability of SME employers to provide better wages to their staff and to use small wage increases or overtime as an incentive.

Gross Pay	USC	Income Tax	PRSI (employee)[56]	Net Pay	PRSI (employer)[57]	Total labour cost
€18,000	€579	€300	€0	€17,121	€1,440	€19,440
€18,304	€600	€361	€0	**€17,343**	€1,464	**€19,768**
€18,305	€600	€361	€732	€16,612	€1,464	€19,769
€18,512	€615	€402	€740	€16,754	€1,481	€19,993
€18,513	€615	€403	€741	€16,755	**€1,990**	€20,503
€19,000	€649	€500	€760	€17,091	€2,043	€21,043
€19,366	€674	€573	€775	**€17,344**	€2,082	**€21,448**
€20,000	€719	€700	€800	€17,781	€2,150	€22,150

Table 7: The employer's cost to give a worker on €18,304 just one euro extra net pay is €1,680

Numbers of people affected

In the context where 20.7 per cent of workers in Ireland are classified by the EU as 'low paid' (earning less than €12.20 per hour)[58] and given that many workers may not be getting full-time work sufficient to bring them outside of this anomaly in the tax system, this should not be seen as an isolated issue affecting only small numbers of people.

This point is reinforced by Revenue data on the income distribution among tax units[59]. They report 85,966 single men and women with gross incomes between €17,000 and €20,000 as well as 36,637 couples or widows/widowers. Although the latter have different income tax credits, the anomalous step change in PRSI remains the same. This represents 122,603 tax units (151,038 people) within the tight gross income band of €17,000 to €20,000 who are potentially affected by this issue, as well as those (many part-time) workers earning less than €17,000 who have this road block on their earnings horizon. In stark contrast, the much discussed transition from the standard rate of income tax (20%) to the higher rate (41%) produces no such anomaly.

[56] nil or 4%
[57] 8.5% or 10.75%
[58] NERI (2013) *Quarterly Economic Observer December 2013*
http://www.nerinstitute.net/download/pdf/neri_qeo_december_2013.pdf
[59] Revenue Commissioners (2012) – Income Distribution Statistics
http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-distribution-statistics.pdf

Possible Solution: PRSI Refund Scheme for Low Income Households

The main reason for the extreme nature of the 'step effect' is that PRSI is payable on a person's entire income once he or she passes the threshold. The only way to remove this kind of step effect is to remove this feature from the tax system. Ideally, this should be achieved without major loss of revenue for the social insurance fund, as the PRSI 'step effect' may be costly to fix.

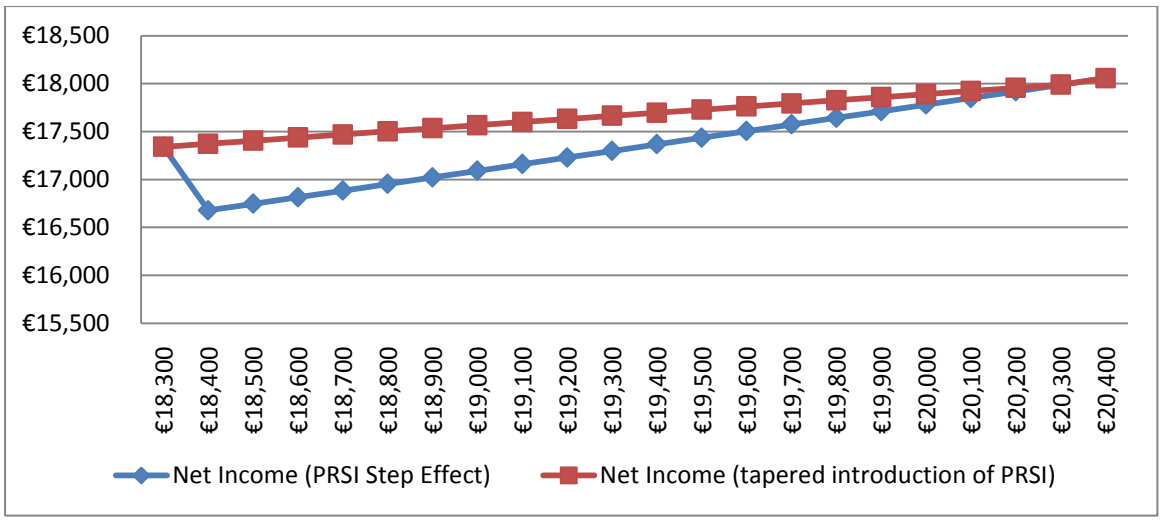
As we have seen in revenue data there are 122,603 tax units with gross income of between €17,000-20,000. Assuming each paid an average of €750 in PRSI, they would contribute nearly €92 million to the social insurance fund every year. However, this is unlikely to be the case. If we assume half of the €17,000-20,000 group earn less than €18,304, they will currently not pay any PRSI (the mid-point in this income group is €18,500, nearly exactly the point where the anomaly occurs). Assuming the other half make an average PRSI contribution of €750, the social insurance fund would gain €46 million every year from this cohort. Hence, €46 million is an estimate of the maximum cost of fixing the step effect; however, as shown below, it can be fixed for around half of that cost.

In order to keep the cost of adjustment down, the solution must be contained within this income group. Simply exempting the first €18,000 from PRSI, and beginning payments at €18,100, would benefit almost all income tax payers and prove much more costly in terms of lost social insurance revenue. A full 'refund' would simply move the step effect further up the income distribution, which is not a solution. To contain the cost, the refund solution should be targeted only at the affected low income cohort.

A modified solution therefore is to provide the refund by tapering the PRSI contributions made between €18,304 and €20,300. Tax payers (units) on gross income of €20,300 would continue to pay €812 in PRSI, as at present. However PRSI for someone on €18,400 would be reduced from €736 to €40.60, with an additional increase of €40.60 for every €100 of additional earnings.

We estimate that this would benefit half of the group of 122,603 tax units. The total amount of refunds required under this proposal would be less than under a complete refund scheme. The overall effect would be to lessen the step effect within the affected income group, at around half the cost of a full refund (circa €23 million).

Chart 16: PRSI Step Effect versus Tapering Introduction of PRSI on Low Earners



The advantage of this solution is that the step effect is entirely removed. The disadvantage is that, while theoretically simple, this would require a new administrative process to be established, in parallel to the standard system and standard rates of employee PRSI. However, this would be no more onerous than the previously existing PRSI 'disregard' system in terms of paperwork for affected employers or changes to payroll software. Specifically, employers would calculate employees' PRSI liability as normal (at 4%), but starting at €18,400. Those employees earning a gross annual income of between €18,400 and €20,300 would be entitled to claim some of that PRSI back as a refund – see Table 8 below. Given the preponderance of part-time and temporary work in this income group, a monthly scheme might be more appropriate than asking employees to wait for an annual refund. Alternatively an annual refund could be complemented by a 'hardship scheme' where people who need the refund sooner could make a special application to have the funds released earlier. The final column in Table 8 shows the refund as a percentage of the taxpayer's annual net income, which helps convey the financial importance of this step effect anomaly to those affected.

Gross Income	PRSI liability (current 4%)	Net Income (current)	PRSI to be paid by employee	PRSI Low Income Refund	Net Income (proposed)	Refund as % net income
€18,000	€0.00	€17,120.50	€0.00	€0.00	€17,120.50	0.0%
€18,100	€0.00	€17,193.50	€0.00	€0.00	€17,193.50	0.0%
€18,200	€0.00	€17,266.50	€0.00	€0.00	€17,266.50	0.0%
€18,300	€0.00	€17,339.50	€0.00	€0.00	€17,339.50	0.0%
€18,304	**€0.00**	**€17,342.42**	**€0.00**	**€0.00**	**€17,342.42**	**0.0%**
€18,305	**€732.20**	**€16,610.95**	**€0.00**	**€0.00**	**€17,342.65**	**0.0%**
€18,400	€736.00	€16,676.50	€40.60	€695.40	€17,371.90	4.0%
€18,500	€740.00	€16,745.50	€81.20	€658.80	€17,404.30	3.8%
€18,600	€744.00	€16,814.50	€121.80	€622.20	€17,436.70	3.6%
€18,700	€748.00	€16,883.50	€162.40	€585.60	€17,469.10	3.4%
€18,800	€752.00	€16,952.50	€203.00	€549.00	€17,501.50	3.1%
€18,900	€756.00	€17,021.50	€243.60	€512.40	€17,533.90	2.9%
€19,000	€760.00	€17,090.50	€284.20	€475.80	€17,566.30	2.7%
€19,100	€764.00	€17,159.50	€324.80	€439.20	€17,598.70	2.5%

€19,200	€768.00	€17,228.50	€365.40	€402.60	€17,631.10	2.3%
€19,300	€772.00	€17,297.50	€406.00	€366.00	€17,663.50	2.1%
€19,400	€776.00	€17,366.50	€446.60	€329.40	€17,695.90	1.9%
€19,500	€780.00	€17,435.50	€487.20	€292.80	€17,728.30	1.7%
€19,600	€784.00	€17,504.50	€527.80	€256.20	€17,760.70	1.4%
€19,700	€788.00	€17,573.50	€568.40	€219.60	€17,793.10	1.2%
€19,800	€792.00	€17,642.50	€609.00	€183.00	€17,825.50	1.0%
€19,900	€796.00	€17,711.50	€649.60	€146.40	€17,857.90	0.8%
€20,000	€800.00	€17,780.50	€690.20	€109.80	€17,890.30	0.6%
€20,100	€804.00	€17,849.50	€730.80	€73.20	€17,922.70	0.4%
€20,200	€808.00	€17,918.50	€771.40	€36.60	€17,955.10	0.2%
€20,300	€812.00	€17,987.50	€812.00	€0.00	€17,987.50	0.0%

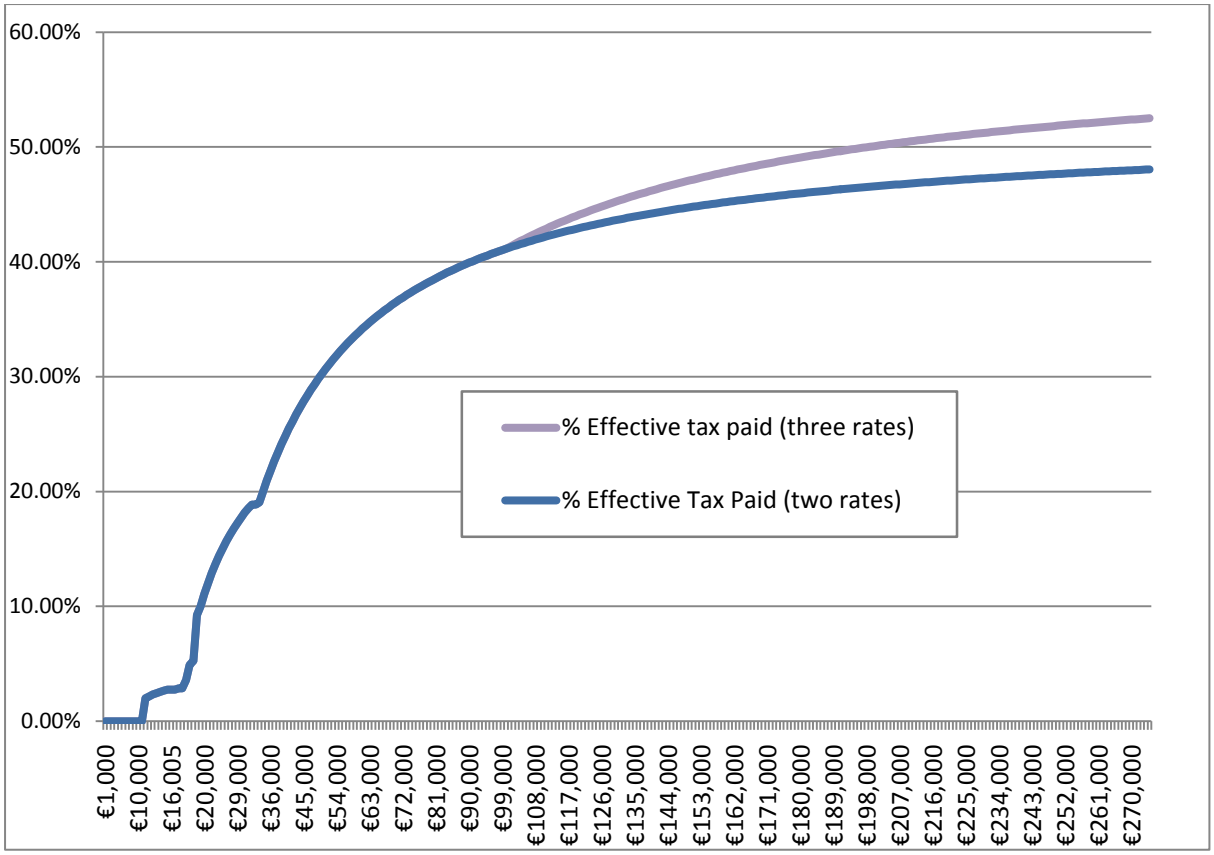
Table 8: Detail of Proposed PRSI Refund Scheme for Low Income Tax Units

A third rate of income tax

We have seen that there is progressivity in the Irish income tax system in that the proportion of gross income that is paid as income tax increases as income rises. However, the extent of progressivity is significantly reduced by the effect of tax reliefs above and beyond basic tax credits. It should be noted that the standard OECD definition of progressivity in income tax is based on the theoretical level of tax payable, not on Revenue data of the actual amount of tax paid. In this context, commentators who have noted the 'high' progressivity score of Ireland's income tax system under the OECD's method have ignored important aspects of the real effect of the system.

Given that there are only two rates of income tax (20% below €32,800 and 41% above) progressivity begins to decline as incomes increase. The point of decline begins at around €70,000 which is roughly around twice the average wage. At this point, the progressive increase of income tax as a percentage of actual tax paid rises increasingly more slowly.

Chart 17: Theoretical effective tax rates under two and three bands[60]



Introducing a third rate of income tax would improve equity, while increasing progressivity and flexibility. A rate of 48% on incomes above €100,000 is illustrated in Chart 17. It would have no impact on earnings below €100,000, involve a steady increase in effective rates between €100,000 and €200,000 and a much slower increase on gross incomes above that level. It would affect just under 100,000 people, which is less than 5% of all people paying income tax.

A third rate of income tax is consistent with an equitable incidence of income taxation. In 2009, the Commission on Taxation found that a third rate of income tax could involve an upward or downward adjustment of the levels of the existing two rates with the third rate included in the structure either above, below or between the adjusted rates. The Revenue Commissioners advised the Commission that a third rate of tax is feasible subject to an appropriate lead-in period being provided[61.]

Historically Ireland had more than two tax rates as set out in Table 9. At the same time as the number and rate of income taxation has declined, Ireland has also seen a rise in gross incomes. This is not to imply a correlation, as gross income is obviously due to market incomes rather than taxation. However, seeing the combination of two is instructive, as not only were gross incomes on the rise (despite the prolonged recession of the 1980s) but decreases in income tax were likely to have benefitted high earners disproportionately compared to the rest of society.

[60] Data from Deloitte Tax Calculator, with additional calculations by the authors
[61] Commission on Taxation Report 2009

Year	Number of rates	Intervals	Gross income share of top 10%	Gross income share of top 1%
1977	6 rates	20%, 25%, 35%, 45%, 50% and 60%	27.3%	5.6%
1979	5 rates	25%, 35%, 45%, 50% and 60%	31.3%	8.0%
1983	6 rates	25%, 35%, 45%, 50%, 60% and 65%	33.3%	7.1%
1984	5 rates	35%, 45%, 55%, 60% and 65%	31.6%	6.5%
1985	3 rates	35%, 48% and 60%	31.3%	6.3%
1989	3 rates	32%, 48% and 56%	30.5%	6.4%
1992	2 rates	27% and 48%	34.0%	7.8%
2014	2 rates	20% and 41%	36.1% (2009)	10.5% (2009)

Table 9: Historical Tax rates in Ireland relative to gross income shares

The historical data shows the real opportunity to introduce a third rate of income tax to be applied on the portion of taxable incomes in excess of €100,000, without altering the existing income tax rates or bands. The Revenue Commissioners estimate the full year yield to the Exchequer, estimated by reference to 2013 incomes, of the introduction of the new income tax rates of 48%, 49% or 50% would be of the order of €365 million, €415 million and €470 million respectively[62].

The introduction of significantly higher rates of income tax on high gross incomes is almost certainly necessary to stem the rise of income inequality in Ireland. Introducing such a change in Budget 2015 would provide the Government with one source of funds to allow tax cuts in other areas without undermining the sustainability of the national finances.

Remove Tax Breaks

Tax expenditures (tax breaks) play a very prominent role in the Irish tax system. Tax breaks should be seen in the same way as government spending programmes. Each tax break will have its own costs and benefits and these costs and benefits will not be uniform across the population. Public spending in the form of tax expenditures tends to deliver larger benefits to higher income households. For example, reliefs that allow a tax deduction at the individual's marginal rate of income tax are more valuable to, and will disproportionately benefit, those with the highest income tax rates. The ESRI has shown that 80 per cent of the benefit of pension tax reliefs goes to those in the top 20 per cent of the incomes distribution[63].

TASC has often pointed out the many problems with tax breaks ('tax expenditure'), which form a much larger part of Ireland's tax system than the European norm. Another option for tax reform, that would raise revenue to allow more equitable tax reduction in other areas, would be to reduce Ireland's high level of tax expenditure.

Not all of these tax breaks are necessarily socially or economically harmful, and each needs to be judged on its merits. However, in general terms, drawing on a wide literature on this topic, we have identified eleven economic, fiscal and equity issues with tax expenditure:

a. Tax breaks are regressive (that is, they increase economic inequality). They disproportionately benefit those with higher incomes or more resources. Tax

[62] Written response from Finance Minister, June 2013 http://www.kildarestreet.com/wrans/?id=2013-06-11a.369
[63] ESRI (2009) *Pensions Policy – New Evidence on Key Issues* - *http://www.esri.ie/UserFiles/publications/20091124152236/RS014.pdf*

expenditure measures on income tax erode the progressive structure of that tax, especially where costs can be off-set against tax at the higher marginal rate;

b. Tax expenditure is often less effective than direct expenditure in achieving social and economic goals;
c. Tax breaks and other tax expenditure are seen as costless or 'revenue neutral' by governments, whereas giving tax breaks is the same thing as the State spending money. Tax forgone through tax expenditure is money lost that the State could have spent elsewhere;
d. Tax breaks and other tax expenditure are effectively subsidies and can have anti-competitive effects;
e. Excessive tax expenditure erodes State revenue to an unsustainably low level;
f. The cost of tax breaks is difficult to calculate and is often underestimated;
g. The effects of tax breaks are often 'diffused', whereby they are extended to cover more people or more firms than originally intended, or are extended for longer periods of time or to new areas. This can dilute the incentive effect while also shrinking State revenue;
h. Tax breaks are sometimes given to incentivise activities that would have occurred regardless. This is called 'deadweight';
i. Tax expenditure measures can attract unintended users or have unexpected consequences, such as the construction of many more buildings than the economy can use in the near future;
j. Tax expenditure rules can distort markets by shifting incentives from long-term business goals to short-term minimising of 'tax exposure';
k. Decisions to extend or expand tax breaks, tax credits or other tax expenditure, including the detail of how they operate, are not fully integrated into the annual Budget process and their creation and/or extension are often not subject to rigorous cost-benefit analysis.

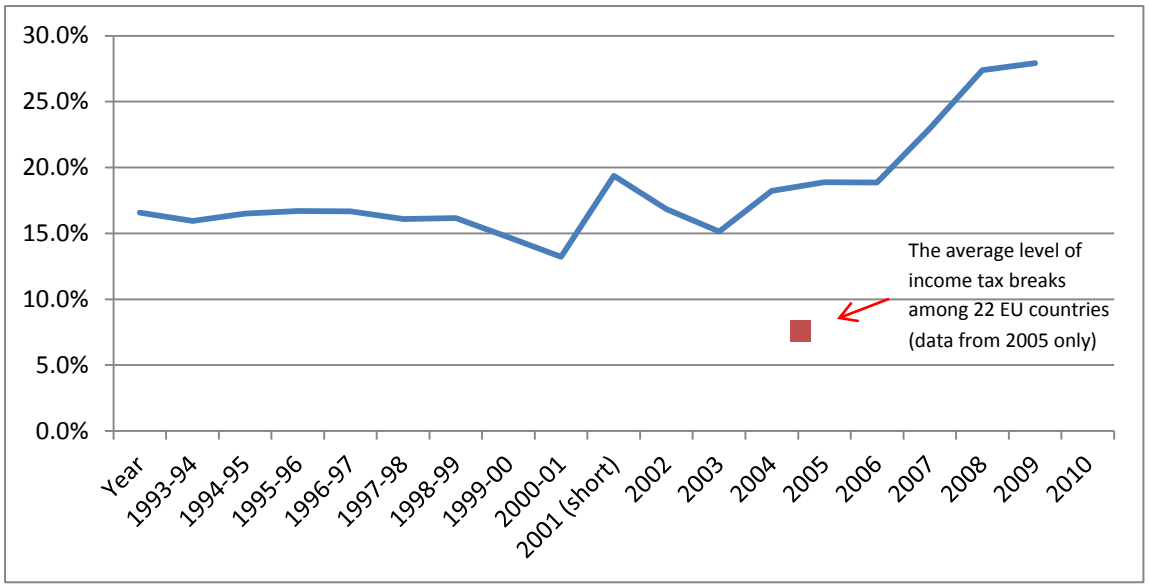
A very basic but crucially important principle that is often forgotten or ignored is the need to ensure that all classes of asset and all types of income are treated the same way for tax purposes. Exempting or preferring certain classes of asset is inequitable, assists tax avoidance, and is often damaging to long-run economic growth. Preferential treatment through tax reliefs and/or exemptions can even encourage asset price bubbles as happened to great cost in Ireland in the property bubble. Exempting or giving favourable treatment, such as reduced rates, to certain asset categories and types of investment, such as pensions or housing, distorts investment decisions (thereby reducing the efficiency of the investment decisions in allocating resources) and provides an obvious mechanism for tax avoidance. A common strategy is for an individual to borrow money to reduce his or her net wealth, and then use these borrowings to purchase tax-exempt assets.

The OECD's Economic Survey Ireland 2009 included a very pertinent calculation. The average EU level of tax breaks in the income tax system (not including basic credits and allowances) was equivalent to 5.6 per cent of total taxation, whereas the equivalent number for Ireland was over three times greater at 18.3 per cent, based on 2005 Revenue data[64].

[64] OECD *Economic Survey Ireland 2009*, Table 2.5, page 60

Chart 18 shows the replication of this finding, using both past data and more recent data, which demonstrates that not only has the use of tax breaks continued into Ireland's recession, but it increased dramatically from 2008 (due to the fall in overall tax revenue as the denominator).

Chart 18: Total tax breaks in income tax, as % of all tax revenue[65]

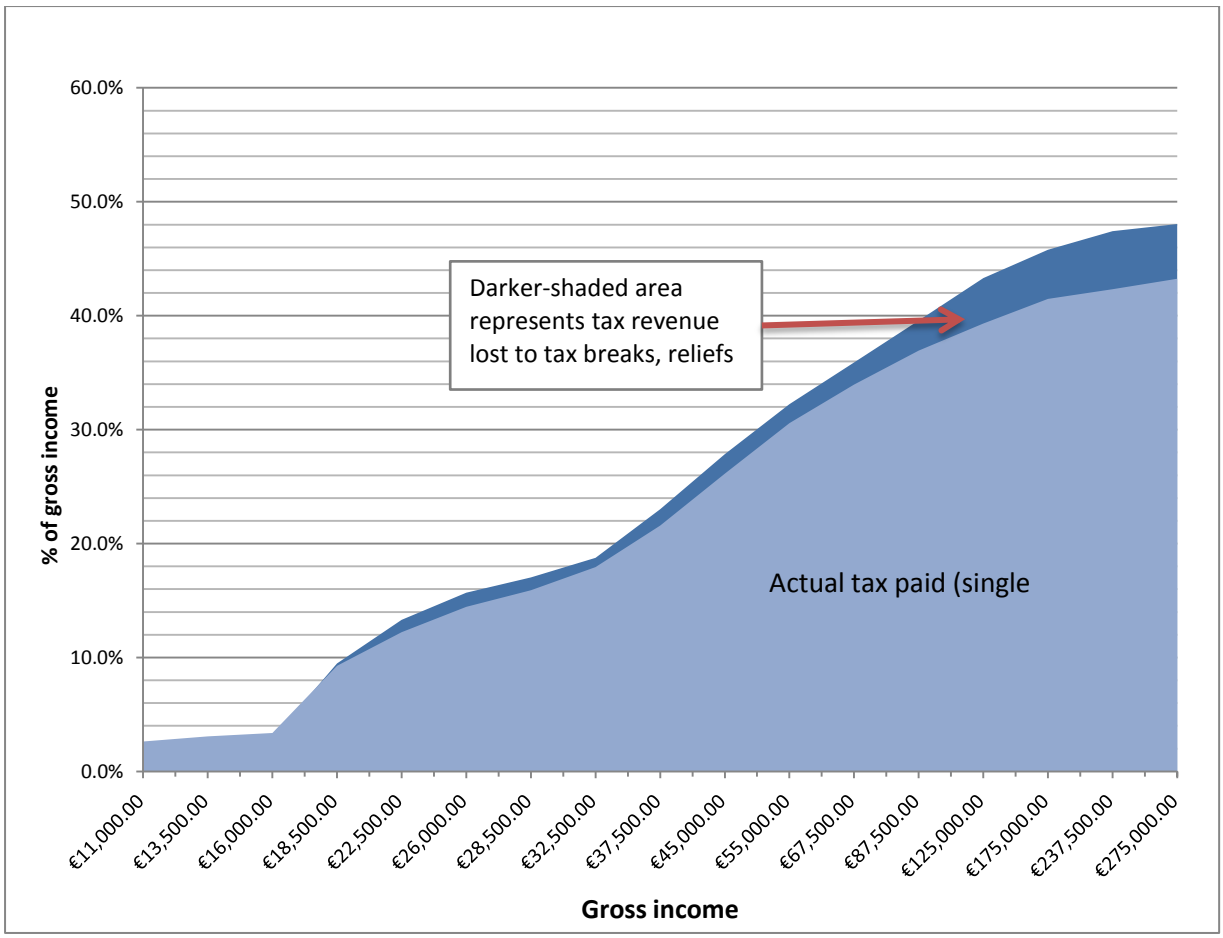


Tax breaks on income tax (not including those that are also eligible for use against corporation tax) came to 27.9% of the value of total tax revenue, from all sources, in 2010. While some tax reliefs are used by many who pay income tax, the benefit of many tax breaks accrues to top earners. Tax breaks continue to provide a large 'back door' through which many people on high incomes can continue to avoid paying a large part of their share of income tax.

The high level of tax expenditures explains why effective income tax actually paid is significantly lower than theoretical effective tax levels, as shown in Chart 19). The darker shaded area shows the disproportionate benefit of tax breaks to those on higher gross incomes.

[65] Authors' calculations replicating the OECD method. There is a break in the data at 2001, when Ireland moved to calendar years for tax purposes.

Chart 19: Gap between theoretical and actual levels of income tax for a single person



Revenue statistics for income tax (Table 10) provide further evidence that tax breaks continue to be just as costly now (in terms of lost tax revenue for the public finances) as they were before the economic collapse when the predominance of property-based tax breaks was severely criticised as one of the harmful influences on Ireland's economy.

Allowance/Relief	€million (2007)	€million (2010)	Difference €million
INCOME TAX ONLY			
Age Exemption with child addition	75.5	92.1	16.6
Married Person's Credit	2776.7	2619.7	-157.0
Single Person's Credit	2392	1956.3	-435.7
Widowed Person's Credit	171.3	178.7	7.4
Additional Credit to Widowed Person in Year of Bereavement	4.8	4.9	0.1
Additional Bereavement Credit to Widowed Parent	6.6	5.6	-1.0
Additional Personal Credit for Lone Parent	199	141.9	-57.1
Homecarer Credit	68.5	67.8	-0.7
Additional Credit for Incapacitated Child	31.7	39.1	7.4
Employee (PAYE) Credit	3153.1	2968.6	-184.5
Dependent Relative Credit	1.8	2	0.2
Person Taking Care of Incapacitated Taxpayer	4.6	6.9	2.3
Age Credit	33.7	46.3	12.6
Blind Person's Credit (incl.Guide Dog Allowance)	2	1.9	-0.1
Medical Insurance Premiums	300.3	697.9	397.6
Health Expenses	225.7	126.6	-99.1
Contributions Under Permanent Health Benefit Schemes, after Deduction of Tax on Benefits Received	3.6	3.9	0.3
Employees' Contributions To Approved Superannuation Schemes	590	598.5	8.5
Employers' Contributions To Approved Superannuation Schemes	150	141	-9.0
Exemption of Investment Income and Gains of Approved Superannuation Funds	900	835	-65.0
Exemption of employers' contributions from employee BIK	540	515	-25.0
Tax Relief on "tax free" lump sums	130	136	6.0
Retirement Annuity Premiums	407.9	180.1	-227.8
Personal Retirement Savings Accounts	61.1	73	11.9
Interest paid: Loans relating to Principal Private Residence	542.7	374.6	-168.1
Interest paid: Other	46.9	17.5	-29.4
Rent Paid in Private Tenancies	82.1	82.8	0.7
Expenses Allowable to Employees under Schedule E	69.8	66.5	-3.3
Third Level Education Fees	18.1	19.4	1.3
Exemption of Certain Earnings of Writers, Composers and Artists	27.4	9.6	-17.8
Dispositions (Including Maintenance Payments made to Separated Spouses)	20.5	19.3	-1.2
Exemption of Interest on Savings Certificates, National Instalment Savings & Index Linked Savings Bonds	130.3	48.7	-81.6
Rent a Room	4.7	5.3	0.6
Exemption of Income of Charities, Colleges, Hospitals, Schools, Friendly Societies, etc.	30.7	35.5	4.8
Retirement Relief for certain Sports Persons	0.2	0.3	0.1
Exemption of Irish Government Securities where owner not ordinarily resident in Ireland	240.8	660.8	420.0
Exemption of Statutory Redundancy Payments	87.6	214.3	126.7
Service Charges	24.4	26.2	1.8
Top Slicing Relief - Reduced Tax Rate for Payments in Excess of Exemption Amounts Made as Compensation for Loss of Office	27.8	36.7	8.9
Revenue Job Assist allowance	0.3	0.5	0.2

Allowance/Relief	€million (2007)	€million (2010)	Difference €million
Allowance for seafarers	0.3	0.3	0.0
Trade Union Subscriptions	20.7	26	5.3
Exemption From Tax of Certain Social Welfare Payments: Child benefit	355	385.8	30.8
Exemption From Tax of Certain Social Welfare Payments: Early childcare Supplement	84.3	0	-84.3
Exemption From Tax of Certain Social Welfare Payments: Maternity allowance	15.2	40.1	24.9
Foster Care Payments	29.4	29.2	-0.2
Exemption of Income arising from the Provision of Childcare Services	0.7	0.8	0.1
Approved Profit Sharing Schemes	107.6	41.9	-65.7
Savings-Related Share Option Schemes	11.9	1.3	-10.6
Approved Share Option Schemes	3	0	-3.0
Relief for New Shares Purchased by Employees	0.2	0.2	0.0
Investment in Corporate Trades (BES)	17.5	24	6.5
Investment in Seed Capital	2.3	1.8	-0.5
Stock Relief	2	2	0.0
Exempt Rental Income from Leasing of Farm Land	n/a	5	5.0
Relief for expenditure on significant buildings and gardens	5	3.9	-1.1
Donation of Heritage items	5.3	0.2	-5.1
Donation of Heritage property to the Irish Heritage Trust	1.9	0	-1.9
INCOME TAX and/or CORPORATION TAX			
Donations to Approved Bodies	47.6	51.1	3.5
Donations to Sports Bodies	0.4	0.5	0.1
Employee Share Ownership Trusts	4.4	3.3	-1.1
Total Capital Allowances	2019.2	2262	242.8
Rented Residential Relief - Section 23	133.6	22.9	-110.7
Effective Rate of 10% for Manufacturing and Certain Other Activities	406.9	403.2	-3.7
Double Taxation Relief	610.8	677	66.2
Investment in Films	31	65.4	34.3
Group Relief	254.4	408.8	154.4
Research & Development Tax Credit	165.6	223.7	58.1
Start-up Relief (Section 486)	n/a	4.6	
TOTAL	**17,920.5**	**17,741.8**	**-178.7**

Table 10: Comparison of Allowances/Reliefs on Income Tax and Corporation Tax 2007 and 2010[66]

[66] Revenue Commissioners, *Revenue Statistical Reports 2009 and 2011*
http://www.revenue.ie/en/about/publications/statistical/archive/2009/income-tax.pdf
http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-tax.pdf

In overall terms, the cost of tax breaks on income tax was €17.9 billion in 2007 and €17.7 billion in 2010. Arguably, the first 14 line items could be counted as part of Ireland's basic allocation of credits that are part of the tax system – although the OECD method (illustrated in Chart 18 above) only allows three of them. These equate to €8.9 billion in 2007 and €8.1 billion in 2010. Removing these, the cost of other tax breaks and exemptions was €9 billion in 2007 and €9.6 billion in 2010. In other words, the cost of non-basic tax reliefs (in terms of lost tax revenue) actually increased during the period of Ireland's economic crisis and the collapse in public finances.

The Australian Treasury produces an annual Tax Expenditures Statement[67], which is one example of international best practice in ensuring rigorous cost-benefit analysis and parliamentary scrutiny of tax breaks to ensure their social and economic value outweighs the cost of lost tax revenue. The Irish Tax Strategy Group also publishes some useful information that could form the basis of an annual report on tax expenditure, and could possibly build on the one-off report on tax expenditures that the Department of Finance produced in July 2010[68].

In terms of the most expensive of the above tax breaks, the tax relief on statutory redundancy payments (costing the public purse €214.3 million in 2014) might be seen as intuitively fair. However, the tax break for health insurance premiums (€697.9 million in 2014) can only benefit those who are in a position to afford health insurance in the first place, and the tax break lowers public funds available for the public health services that benefit everyone, and acts against the Government's stated policy of moving towards a single-tier health system. In Budget 2014, the Government recognised the cost of the health insurance tax break and took steps to reduce its cost to the public finances[69]; however, public money, including the taxes of people who cannot afford health insurance, continue to be used for this subsidy.

The most unequal and socially divisive tax break is that given to private pensions, which is actually seven different reliefs listed above, with a total cost to the public finances of €2,479 million in 2014, down slightly from €2,779 million in 2007. The ESRI has shown that 80 per cent of the benefit of the pension tax break goes to the top 20 per cent of earners[70].

Inequitable tax breaks are undoubtedly one of the engines that has driven the growth of income and wealth inequality in Ireland. Reducing or removing tax breaks would not only address the inequality, but would provide public funds which could enhance public service delivery and/or fund a more equitable tax cut without undermining the public finances.

Reduce Consumption Taxes

In discussions on taxation, there is a significant focus on income tax, but it is also vital to look at the effect of consumption taxes which also affect income, redistribution, consumption and employment. Last year in Ireland, consumption taxes (including VAT, excise and some customs taxes), raised as much revenue as income tax. Both raised over €15 billion for the exchequer last year.

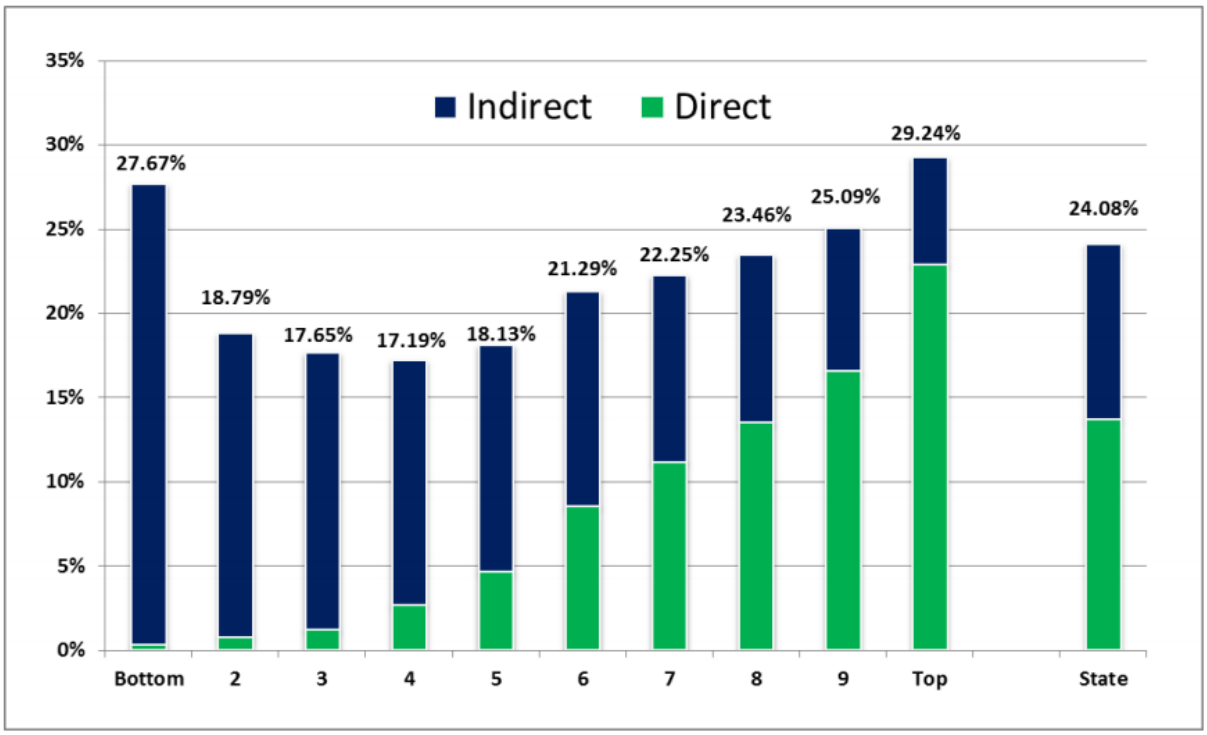
[67] Australian Government Treasury (2014) TAX EXPENDITURES STATEMENT 2013
http://www.treasury.gov.au/PublicationsAndMedia/Publications/2014/TES-2013
[68] http://www.finance.gov.ie/sites/default/files/Section1ofFA2010ReportonTaxExpenditures.pdf
[69] http://www.irishtimes.com/business/budget-2014/budget-to-affect-53-of-health-policies-1.1566130
[70] ESRI (2009) *Pensions Policy – New Evidence on Key Issues* -
http://www.esri.ie/UserFiles/publications/20091124152236/RS014.pdf

Looking again at the number of people and how much they earn raises another important point. Of the 2.8 million people captured in the revenue data, we see that 415,064 (14.5%) are earning less than €10,000 and thus do not pay USC, while 713,687 (25%) do not earn enough to pay any income tax. However all of these people, along with the 1 million working age adults who are unemployed or inactive, are still tax payers.

As we have seen above, Ireland's income tax and social security contributions are largely progressive. However, while the average person may pay as much in consumption taxes as they pay in income tax, people on low incomes pay a much higher percentage of their income on consumption taxes.

This is demonstrated in Chart 20, taken from Collins and Turnbull's paper where they show that those at the very top of the income scale (top decile) pay most tax overall, contributing 29.4% of their income in taxation, mainly through income tax. However, the second highest contribution in percentage terms is not from the second highest earner decile, but from poorest households. The bottom decile of households in Ireland pays a very high 28% (27.67%) of their total gross income in direct and indirect taxation.

Chart 20: Direct and Indirect Taxes as a % of Income by Decile [71]



Those on high incomes pay more of their gross incomes in direct personal taxation, while those on low incomes pay more of their gross incomes through indirect consumption taxes. Thus, increases in consumption taxes affect those on low incomes most.

[71] NERI (2013) Collins M and D. Turnbull, (2013) *"Estimating Direct and Indirect Tax Contributions of Households in Ireland"*, NERI WP 2013/8
http://www.nerinstitute.net/download/pdf/neri_wp_household_tax_contributions_collins_and_turnbull_nov_2013.pdf

In Ireland, the standard rate of VAT (23%) is one of the highest in the world. Ireland, Greece, Finland Portugal and Poland are at 23% while only Denmark, Iceland, Sweden and Netherlands have a higher rate. VAT is the largest source of indirect tax with the average household paying €3,360 in 2010, or 6.3% of the average gross income. It is also highly regressive with the bottom income decile contributing 98% of their taxes in indirect taxes, while the top decile pays less than 23% of their total tax in consumption taxes.

In 2012, the government increased the standard VAT rate by two percentage points. This raised €670 million in revenue in 2012. However, it also added to the downward pressure on domestic demand, as personal consumption fell by 6% between then and 2014. Domestic demand is expected to begin to rise shortly and a reduction in VAT would help this recovery while alleviating an unjust distortion.

Reducing VAT would boost domestic consumption and help kick-start the economy while boosting the income of the lowest decile of households. This is a progressive tax reduction which is far more equitable than a reduction in income tax which would only benefit some better-off citizens.

If a break is to be given to citizens, it is best done equitably, for it is those at the bottom who fared worst and who are still paying a disproportionately high level of their incomes in indirect taxes.

A 1% cut in the standard rate of VAT could be introduced in this year's Budget (it takes effect in 2015) and a further 1% the next year (2016) and 1% the year after to bring the standard rate down to 20%. A 1% cut in standard rate VAT in 2015 would cost under €350 million and a similar amount in each of the following years, depending on recovery in the economy.

Maintain Public Spending

The importance and value of public services, and social transfers (income supports and state pensions) is the other side of the coin in the argument about tax cuts, but insufficient attention has been paid to the value of public services and the vital role they play in balancing out the inequalities in the market and providing many people with better quality of life.

It is possible to crudely estimate the monetary value of public services to different groups in society by simply dividing the different parts of expenditure among the main user groups[72]. For the purpose of an illustrative exercise, gross public spending for each of ten top-level functions is aligned with the major beneficiary group in Table 11 below.

For the purpose of making this illustration, data on total public expenditure was taken from the Eurostat database[73], and divided out across the Irish population – either on an even basis (per person, per adult or per household) or else weighted towards those who most directly benefit – such as children and adult students who benefit from education spending.

Caveat: In future, it is intended to greatly refine this analysis, so the data used here should be seen as illustrative rather than a definitive measure of the value of the public services.

[72] For a more scientific analysis based on micro-simulation and survey data see TUC (2010) *Where the money goes: How we benefit from public services.* http://www.tuc.org.uk/sites/default/files/extras/wherethemoneygoes.pdf

[73] Public spending data for Ireland is broken down into the UN statistical Classification of the Functions of Government (COFOG), which allows comparison across EU countries in Eurostat data.

Expenditure is divided by the total number of beneficiaries in each case, with different beneficiary groups used to illustrate the more targeted nature of this public spending towards those who use these services most or whose income is based on social transfers (welfare or pensions).

This information (shown in Table 11) allows one to illustrate, in broad brush strokes, the material value of public services to people in Ireland. For example, everyone benefits from the existence of a safety net of public health services, whether or not they need to avail of them. This value can be illustrated as €2,277 per person, doubling to €4,554 as an illustration of the higher value and necessity of health and personal care services for older people (65+).

Everyone in the public education system as a pupil or student benefits from an average expenditure of €6,157 per annum. For example, the value to a family with two children/young people in education is €12,314 of public spending. Pupils in private fee-paying secondary schools gain this benefit too, as their teachers' salaries are paid by the public purse.

The public debt payments are shown separately from other public spending, as €3,573 per household. Although one might question the public value in these payments, they illustrate the use of public funds on everyone's behalf to manage and reduce the public debt. Note that this is not the total national debt, but just that part of General Public Services categorised as annual debt payments.

Area of public spending (COFOG)	**Major beneficiaries**	**Public Expenditure (€m)**	**Number**	**Amount per beneficiary**
Education	All pupils/students	€8,549	1,388,428	**€6,157**
Health	All persons, especially those aged 65+	€11,667	4,052,859 *(<65)* 535,393 *(65+)*	**€2,277** *(<65)* ***€4,554*** *(65+)*
Social Protection – weekly income supports/pensions	All adult beneficiaries of weekly social welfare or pensions	€20,600 (est.)	1,671,980	**Social transfer income*** €9,776 welfare €11,975 pension
Social Protection – Child Benefit	All children	€2,000 (est.)	1.3 million (est.)	**€1,560**
Social Protection – other spending (e.g. secondary benefits/allowances)	All adult beneficiaries of weekly social welfare or pensions	€4,235 (est.)	1,671,980	**€2,533**
Public debt payments	All households	€5,912	1,654,208	**€3,573**
All other public spending categories	All households (other public spending)	€16,848	1,654,208	**€10,185**

Table 11: Public Expenditure divided by the Number of People in the Major Beneficiary Group

** Typical weekly welfare incomes: Jobseekers Allowance, Jobseekers Benefit, Disability Allowance, etc. are €9,776 per year for a single person and €16,266 for a couple, with an additional €1,550 per child per year. Payments are less for young people or people on insurance payments who have insufficient PRSI. The full contributory State Pension is €11,975 for a single person and €19,958 for a couple.*

The TUC's analysis of public spending in the UK identifies 'public value' as "the missing link in our tax and spending debates"[74]. Citing Alan Hedges, the TUC paper notes "People tend to think of services like health and education as just 'free', and usually have little notion what these might be worth to them…They don't have anything approaching a synoptic figure in their heads that says 'this is the amount I get back from the state in return for paying my taxes'…Thus, there is no vivid sense of a quantum of benefit to offset the more sharply visualised quantum of pain that paying tax causes."[75]

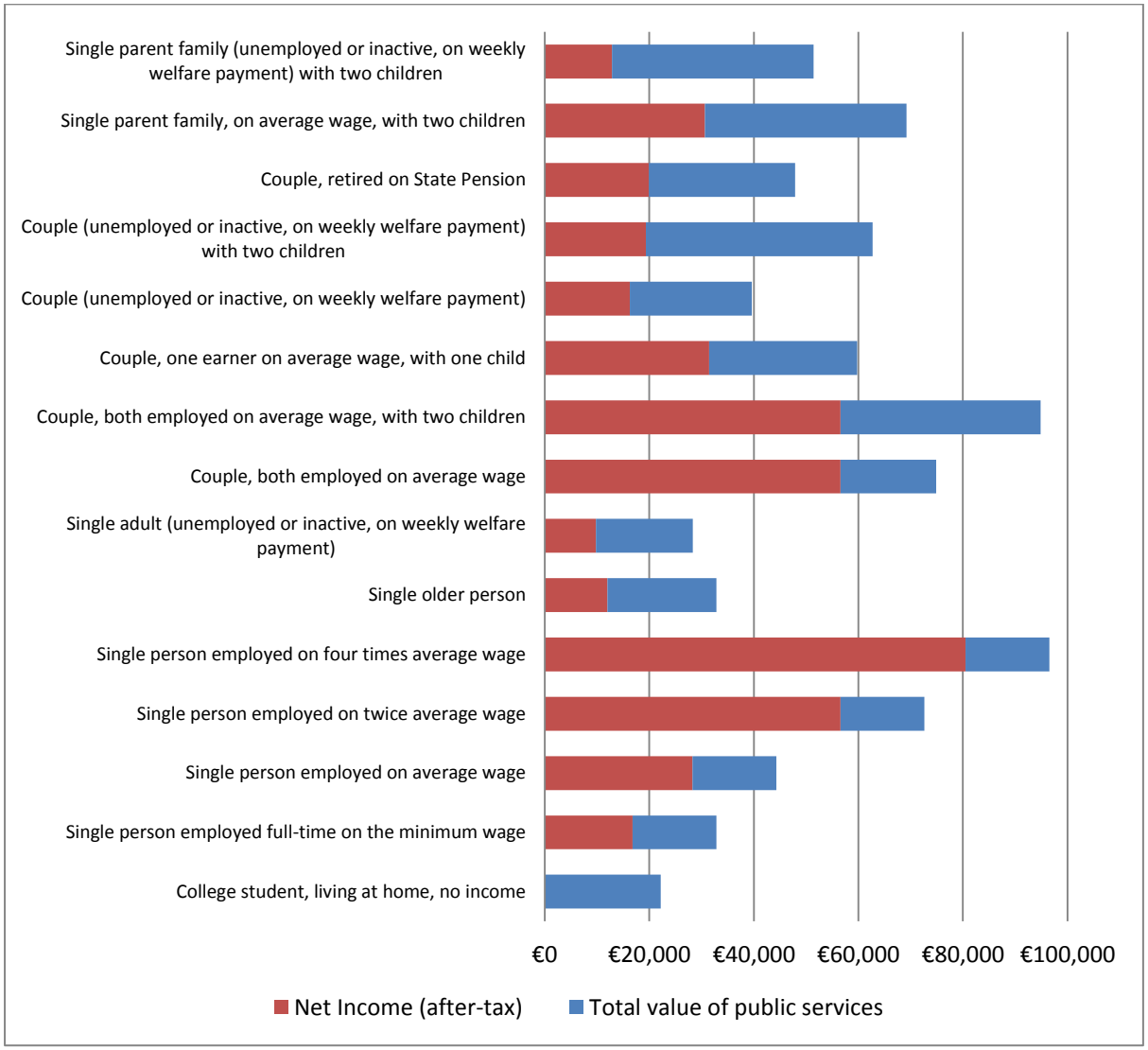
The TUC found that the public often underestimate the value of public services received, and experienced a 'disconnection' between taxation and public services. Moreover, policy makers were not immune to these effects and also exhibited a lack of detailed analysis of the distribution of public spending across households[76].

The TUC's analysis provides a much more scientific analysis than what follows, but nonetheless it is possible to illustrate the 'public value' of public services in Ireland in average terms, bearing in mind the simplicity of the method used.

In the following two charts, social welfare and pension incomes (i.e. social transfers) are counted as part of net incomes alongside employment income, however Child Benefit and other supplementary welfare payments are counted as part of public services in order to more clearly illustrate the additional gain from Child Benefit on top of employment incomes.

[74] http://www.tuc.org.uk/sites/default/files/extras/wherethemoneygoes.pdf pp.11-15
[75] Alan Hedges, *Perceptions of redistribution*, 2005 cited in http://www.tuc.org.uk/sites/default/files/extras/wherethemoneygoes.pdf pp.11
[76] http://www.tuc.org.uk/sites/default/files/extras/wherethemoneygoes.pdf pp.12-13

Chart 211: Net Income (red) combined with Value of Public Services and Secondary Welfare Benefits (blue) by Household Type



There are two immediately striking findings from Chart 22. Firstly, everyone clearly receives 'value' from public spending – in many cases on a scale that rivals or exceeds the value of their net incomes.

It is also clear that for those on lower incomes – including pensioners, low paid workers and people unable to work – the value of public spending is proportionately much higher than for the minority of workers in employment at or above average wage levels. Conversely, while those on the highest incomes still receive considerable value from public spending, this is smaller in proportion to their net incomes. As shown, the net incomes of those on twice or four times average wage levels already gain more total 'benefit' from the economic system than what is received by many other people in society from the combination of net income and public services.

The chart clearly illustrates the lower incentives that exist for people on high incomes to preserve public spending, which benefits them proportionally less, whereas they have a stronger incentive to advocate for cuts to income tax, especially to the 41% rate, as this would benefit them proportionally much more than anyone else.

Chart 222: Detail of Value of Public Services by Household Type

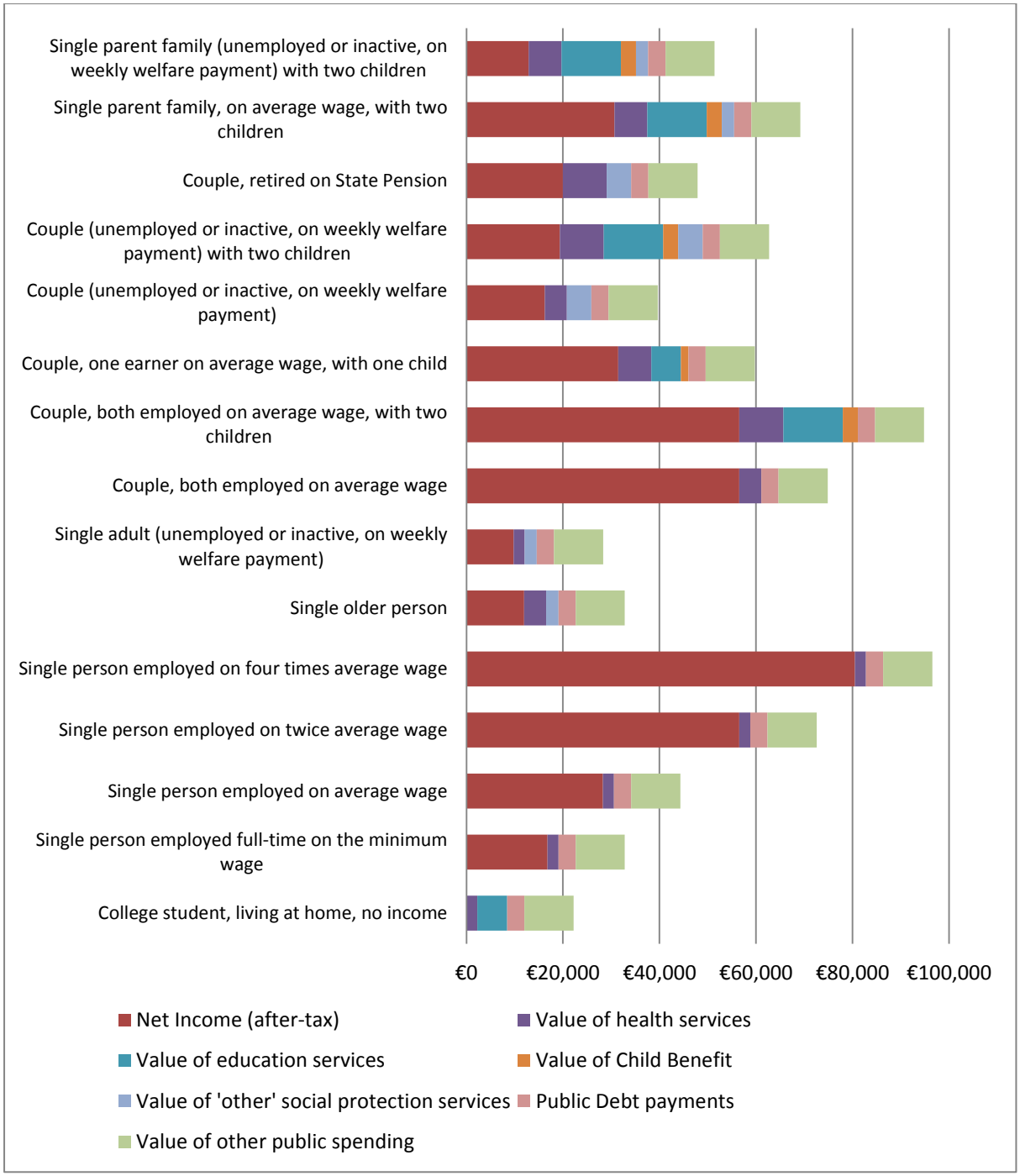


Chart 22 provides a more detailed breakdown of the public services and secondary welfare benefits component, which allows one to see that education spending benefits those who have children more than others, and health spending have greatest benefit to larger families and to older people. This is intuitively obvious, but the illustration helps to make this real with respect to the return on taxation.

In this context, we can see that most people benefit more from maintaining public services than they would gain from tax increases. This is especially true for people on low incomes or unemployed, people with health issues or disabilities, the elderly and the vulnerable.

Given the rising levels of inequality in Ireland and the enormous strain placed on our public services, another option for serious consideration, instead of tax cuts, should be maintaining and if possible increasing public services without cutting taxes. The two options given earlier (around a 48% higher rate of income tax and reducing tax breaks) would provide significant revenue that would permit the increase of the provision of public services and improvements in its quality.

Ireland is an extreme outlier in a European context, due to its low levels of taxation and weak provision of public services and social transfers. As part of the discussion of a new model for Ireland, much more detailed analysis is required of the value of public services and the real levels of tax paid, in order to allow a more equitable balance to be struck between taxation and public spending, for the benefit of all of society.

Annex: data used to construct Chart 21.

Household	Gross Income (employment or social transfers)	Net Income (after-tax)	Total value of public services/ spending	TOTAL (Income plus Value of Public Services)	Public spending as % of Total
Single parent family (unemployed or inactive, on weekly welfare payment) with two children	€12,876	€12,876	€38,556	**€51,432**	**75%**
Single parent family, on average wage, with two children	€36,278	€30,663	€38,556	**€69,219**	**56%**
Couple, retired on State Pension	€19,958	€19,958	€27,932	**€47,890**	**58%**
Couple (unemployed or inactive, on weekly welfare payment) with two children	€19,366	€19,366	€43,366	**€62,732**	**69%**
Couple (unemployed or inactive, on weekly welfare payment)	€16,266	€16,266	€23,378	**€39,644**	**59%**
Couple, one earner on average wage, with one child	€36,278	€31,473	€28,306	**€59,779**	**47%**
Couple, both employed on average wage, with two children	€72,556	€56,565	€38,300	**€94,865**	**40%**
Couple, both employed on average wage	€72,556	€56,565	€18,312	**€74,877**	**24%**
Single adult (unemployed or inactive, on weekly welfare payment)	€9,776	€9,776	€18,568	**€28,344**	**66%**
Single older person	€11,975	€11,975	€20,845	**€32,820**	**64%**
Single person employed on four times average wage	€145,112	€80,523	€16,035	**€96,558**	**17%**
Single person employed on twice average wage	€72,556	€56,565	€16,035	**€72,600**	**22%**
Single person employed on average wage	€36,278	€28,283	€16,035	**€44,318**	**36%**
Single person employed full-time on the minimum wage	€17,542	€16,787	€16,035	**€32,822**	**49%**
College student, living at home, no income	€0	€0	€22,192	**€22,192**	**100%**

Table: Illustrative Households, Net Income and Value from Public Services

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TASC is an independent, progressive think-tank.

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