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POLICY BRIEF:
Economic Equality Series

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Preserving the 41% Higher Rate of Income Tax

It would be regressive to cut the 41% higher income tax rate, or shift the bands, without significant other tax reform at the same time. Average earners in Ireland pay the least direct tax of all EU members of the OECD.

Numerous commentators have argued that Ireland's higher rate of income tax hits lower earners 'too soon' or 'too low'. The argument is that people on average earnings should not pay any income tax at Ireland's higher rate of 41%, which is 52% when PRSI and USC are also included.

There are three major inaccuracies in this argument about Ireland's highest rate or 'marginal rate' of income tax when comparing with other countries:

1. **Headline tax rates are not accurate indicators of the amount of tax actually paid** due to the effect of tax credits, tax reliefs, tax breaks, etc. which are significantly higher in Ireland than elsewhere in Europe. People on average earnings in Ireland in fact pay the least tax of all EU members of the OECD.

2. **Ireland has a relatively flat 'two rate' system** rather than having a more steadily progressive system, with further tax rates and bands for higher salary levels.

It is not very unusual to charge 41% on average earnings, but it is unusual not to charge a higher rate on very high income levels.

3. **Labour costs are low as employers' social insurance is low in Ireland.** The focus on tax and social insurance paid by employees omits the fact that the level of social insurance paid by employers in Ireland is among the lowest in the OECD, and the lowest of all EU members of the OECD.

There are further problems with the economic arguments for cutting the 41% higher rate: a boost in consumer spending or employment is unlikely to occur, whereas cuts to public spending to fund a tax cut will shrink the economy, and take money or services from the majority of people.

Gross Income	'Marginal Tax Rate'	Single	Married Couple (one income)	Married Couple (two incomes*)
€11,000	24%	2.2%	2.2%	0.0%
€13,500	24%	2.5%	2.5%	0.0%
€16,000	24%	2.9%	2.7%	0.0%
€18,500	31%	9.5%	7.3%	1.3%
€22,500	31%	13.3%	8.0%	1.5%
€26,000	31%	15.7%	9.3%	2.5%
€28,500	31%	17.0%	11.2%	2.7%
€32,500	31%	18.8%	13.7%	5.5%
€37,500	52%	23.0%	16.0%	8.2%
€45,000	52%	27.8%	20.0%	11.7%
€55,000	52%	32.2%	25.8%	16.5%
€67,500	52%	35.9%	30.7%	19.8%
€87,500	52%	39.6%	35.5%	27.2%
€125,000	52%	43.3%	40.5%	34.6%
€175,000	52%	45.8%	43.8%	39.6%
€237,500	52%	47.4%	45.9%	42.8%
€275,000	52%	48.0%	46.8%	44.1%

Table 1: Maximum tax payable according to the rules of income tax, USC and PRSI for PAYE workers– not including further tax reliefs/breaks, which can reduce this further.
**** Couple two incomes split 3/5, 2/5***

1. Headline tax rates do not equal actual tax paid.

Any move to raise the threshold at which the 41% income tax rate applies would lower the actual amount of tax paid even further than is already the case, which would imperil Ireland's ability to provide public services, social transfers and public investment.

A single person on €32,800 has a 'marginal tax rate' of 31% (income tax 20%, USC 7% and PRSI 4%) but pays no more than 18.9% of his or her gross income in taxes.

A single person on €33,800 has a 'marginal tax rate' of 52% (income tax 41%, USC 7% and PRSI 4%) but pays no more than 19.8% of his or her gross income in taxes.

In other words, what matters is the effective tax rate as a percentage of gross income, not headline or marginal rates.

Table 1 illustrate the maximum amount of income tax, USC and PRSI payable by income by PAYE workers.

The level of direct taxation paid by Irish employees on average wages is among the lowest in the developed world, and is lower than other EU countries.

Table 2 demonstrates this by comparing average wages (gross income), take-home pay (net income) and actual tax and social insurance paid. All incomes are shown as US dollars on a purchasing power parity basis, using the example of a single person on average wages. The data is for 2013 and is from the OECD's online stat extracts.

As is clearly shown in the table, tax and social insurance on average wages in Ireland is the seventh lowest in the OECD and is the lowest of all 21 EU member states of the OECD. It is simply not plausible to state that income tax and social insurance on average earnings in Ireland is 'too high'.

In terms of comparison with the UK and USA, Ireland only charges roughly three-quarters of the level of income tax and social insurance payable on average wages in those countries, and they also have higher local or property taxes than Ireland.

The main difference in the tax system is that social insurance in Ireland is much lower than in other European countries.

Country	Gross Income USD PPP	Net Income USD PPP	Actual Tax Paid as % Gross Income
Belgium	56,171	32,252	42.6
Germany	57,818	34,945	39.6
Denmark	51,772	31,976	38.2
Hungary	22,930	15,019	34.5
Austria	50,322	33,064	34.3
Slovenia	29,528	19,767	33.1
Netherlands	58,252	40,096	31.2
Italy	39,430	27,196	31
Finland	46,748	32,651	30.2
Luxembourg	57,591	40,743	29.3
Norway	59,548	42,166	29.2
Turkey	29,436	21,042	28.5
France	43,984	31,489	28.4
Iceland	44,883	32,168	28.3
Portugal	28,696	20,900	27.2
Greece	31,892	23,756	25.5
Sweden	45,388	34,044	25
Poland	22,968	17,284	24.7
United States	48,463	36,549	24.6
United Kingdom	51,255	38,918	24.1
Australia	52,639	40,481	23.1
Spain	38,278	29,505	22.9
Czech Republic	22,460	17,342	22.8
Slovak Republic	19,716	15,227	22.8
Canada	38,948	30,088	22.7
Japan	47,771	37,452	21.6
Estonia	21,217	17,086	19.5
Ireland	40,175	32,660	18.7
Switzerland	64,298	53,296	17.1
New Zealand	36,381	30,237	16.9
Israel	32,419	27,013	16.7
Korea	47,075	40,782	13.4
Mexico	12,501	11,281	9.8
Chile	18,989	17,660	7
OECD	**40,292**	**29,592**	**26.6**
21 EU members of OECD	**26,558**	**19,832**	**25.3**

Table 2: Single Person on Average Wages (shown as US Dollars, Purchasing Power Parity), Actual Tax and Social Insurance Paid by Employees: Data from OECD.
http://stats.oecd.org/Index.aspx?DataSetCode=AWCOMP#

2. Ireland has a relatively flat 'two rate' income tax system

Many countries have higher rates that only apply to salaries that are several multiples of average wages. Ireland is unusual in having abolished its higher rates.

For example, whereas Ireland charges 41% as its highest rate from €32,800, the UK charges 40% as a middle rate from £31,866 (c.€39,850). The UK's highest rate is 45%, charged above £150,000 (c.€187,500).

If Ireland had a third rate – for example, a 48% rate charged on incomes above €100,000 – the 'highest rate on average earnings' argument would be obsolete.

While a small and decreasing number of countries have 'flat rate' income tax systems and charge the same rate on all earnings, most countries have a succession of tax rates, which those on higher incomes paying an increasingly larger proportion of their income in taxes.

The Rise of the Top 1%

French economist Thomas Piketty, among others, has suggested a return to the higher income rates of the past – to be levied on extremely high salaries (such as €500,000 or more) in order to tackle the rise of income inequality. In the USA, the post-WW2 top income tax rate was 92% on that part of incomes above $400,000. For example, there is little productivity or employment gain achieved from paying someone five million rather than one million, hence taxation can provide a strong incentive for companies to keep money invested rather than pay outlandish salaries to management.

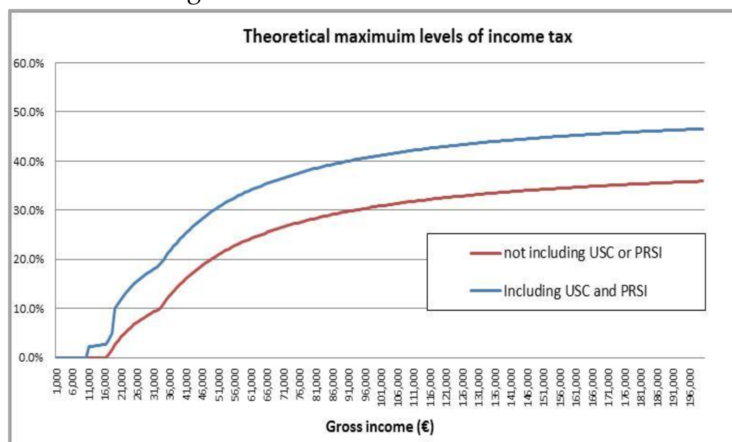
The most progressive tax system in the world?

It is sometimes argued that Ireland's income tax system is 'the most progressive in the world'. This argument has been over-simplified.

The OECD's *Taxing Wages 2013* publication has a special feature on measuring progressivity in direct taxation. They note that there are several technical ways to do this. Recently, a number of commentators in Ireland have just focused on one of the technical exercises undertaken by the OECD, to the exclusion of others.

In this exercise, which compares the amount of tax paid by a single person on relatively low pay (67% of average earnings) with the amount paid on relatively high pay (167% of average earnings), Ireland scores highest. The amount of tax paid by someone on 167% of average pay is much more than the amount paid by someone on 67% of average earnings. But this is not because people on 167% of average earnings pay the most tax in the OECD. On the contrary, it is because people on low earnings levels do not pay much tax or social insurance compared to their counterparts in other countries. Although USC is unpopular in Ireland because it affects people on low incomes, people on low wages do pay more social insurance and tax in many other European countries (and receive a wider range of public services or risk protection through health care services and social welfare).

There are many other measures of progressivity. The following chart shows the extent to which direct taxes increase as earnings increase. The curve is initially steep, but for those earning more than 200% of average earnings, the curve begins to slope more gently – in other words, the progressivity of the tax system becomes less for those on higher earnings.



Progressivity of the direct tax system is further eroded by tax reliefs and tax breaks, as outlined in detail in TASC's publication *A Defence of Taxation*.

3. Labour costs are low in Ireland

Labour costs are the sum of gross wages plus additional social insurance contribution made by employers. The OECD has gathered data on the total 'tax wedge', which show that Ireland has among the lowest levels of employer's social insurance in the OECD and the lowest among EU members of the OECD.

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It is argued that highly mobile workers will not be located in Ireland because direct tax levels are too high. This argument is based on faulty premises.

Firstly, when investment decisions are made, including the question of locating high salary workers in Ireland, employers will look at total labour costs not just marginal tax rates. High paid workers in Ireland will pay less tax here than in most of the EU, and their employers will pay less social insurance (which is analogous to payroll taxes in the USA).

A second flaw in this argument for cutting the 41% tax rate is that changes to the rate will also benefit many professionals and other high paid workers who are not globally mobile.

However, it is plausible that some highly paid employees would pay less direct tax in the UK or USA. But in those countries there are higher levels of State, local and/or property taxes. Moreover, these countries have higher levels of economic inequality than in Ireland or much of the EU. There is therefore a 'race to the bottom' issue in relation to this argument. If Ireland reduces income tax on high pay in order to attract mobile workers, this will both exacerbate income inequality and lower the amount of resources available for public services here, which people on low pay are much more reliant on.

Paying 52 cents in the euro?

There is a clever rhetorical argument being widely used to agitate for cuts to the 41% tax rate. Commentators talk about a psychological barrier to accepting overtime. For example, if someone is given €1,000 for overtime, on a base salary that is already above €32,800, he or she can be portrayed as 'paying' €520 in direct taxes and receiving take-home pay of €480 extra. This is portrayed as a 'disincentive' to take overtime or promotion.

However, total tax paid at the end of the month or year is the real indicator of tax. The 'overtime scenario' is a rhetorical trick. It is only valid to say that a person pays 52 cent per euro of overtime if one also says that he or she pays no tax whatsoever on most of his or her salary.

More accurately, a person on €32,800 pays €6,187 in tax/USC/PRSI, which is an effective rate of 18.9%, or nearly 19 cents per euro.

Given €1,000 overtime, albeit paying some tax at the 'marginal rate' of 52% for the first time, on €33,800 he or she pays €6,707 total tax/USC/PRSI, which is 19.8%, or not quite 20 cents per euro.

Even on €75,000, where a single person pays a substantial amount at the marginal rate for a total of €28,131 in tax/USC/PRSI, the rate of direct taxes paid is still only 37.5%, or less than 38 cents per euro.

A lack of incentive to do overtime is not a problem for public policy. If employees have genuinely no incentive to take extra hours, that gives employers' an incentive to hire more workers. With record levels of joblessness, there is a stronger public interest in expanding the distribution of work than in improving the pay of middle income earners.

Cutting the higher rate of income tax would be socially regressive and economically damaging

Cutting the higher rate of income tax is not a well-targeted measure to help middle-income families who are struggling with high debt. It is not possible to target a reduction of the 41% rate of income tax on 'middle income' earners, unless further measures are taken at the same time – such as reduction in existing tax reliefs and/or the reintroduction of a third rate of income tax applicable to higher income levels.

Moreover, according to Revenue data, only a third of those paying income tax have sufficient eligible income to pay anything at the 41% higher rate, so many low to middle income households would not benefit from any changes to the 41% rate or bands.

It would be regressive to target tax cuts at middle income earners if those on lower incomes are being asked to pay the same amount of tax as previously. It would be even more regressive to cut public services and social transfers to fund such tax cuts, as this would have a disproportionately negative effect on low income households.

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TASC is an independent, progressive think-tank (CHY 14778). Our vision is of a flourishing society based on economic equality and democratic accountability.

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