

Paying Our Way

Progressive proposals for reforming the Irish tax system

A paper by the Community Platform



COMMUNITY PLATFORM
CHALLENGING POVERTY & INEQUALITY

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Introduction

Ireland has the fourth lowest tax take as a percentage of Gross Domestic Product in the European Union. As a society we have come to expect western European levels of social and economic development yet are only willing to pay eastern European levels of taxation. As our recent economic collapse has demonstrated this contradiction is no longer sustainable.

The kind of society we live in is in part determined by our tax system. Taxes provide the revenue used to educate our children, care for our sick, support those out of work or in retirement, and keep our communities safe. Taxes provide support for job creation and economic growth in both the public and private sectors, assisting businesses, providing infrastructure and investing in strategically important sectors of the economy. Taxes are also used to make our society a better place to live, providing public amenities, promoting arts and culture and investing in social inclusion.

The less tax revenue we collect the less money we have to make our society a better place for people to live, work and enjoy life. Equally, the question of who pays taxes, how much they pay and on what, impacts on our levels of equality, and prosperity as both individuals and as a community.

The Community Platform strongly believes that Ireland's low tax regime is one of the reasons why levels of poverty and inequality in our society remain at unacceptably high levels. Indeed, contrary to the arguments of some, we believe that Ireland's low tax regime undermines our economic competitiveness and socio-economic development.

As a network of more than 30 organisations working to end poverty and inequality the Community Platform is convinced that meaningful reform of our tax system is a prerequisite to building a more equal and prosperous society.

As part of our ongoing commitment to inform progressive public and policy debate, in 2010 the Community Platform commissioned TASC to analyse Ireland's tax system. We asked TASC to compare our tax system to our EU counterparts and to provide an outline of what a progressive tax system could look like.

The resulting research, produced by Michael Taft, represents a significant challenge to the prevailing policy consensus on this issue. It challenges many of the myths underlying support for Ireland's current low tax model. It provides much needed comparative and empirical evidence in support of arguments for progressive reform.

Crucially, it outlines in a credible way a realistic set of proposals which would take us from the under-resourced, unsustainable and unfair tax system in place today and in the direction of a modern progressive European tax system.

The need for this research was identified by the Community Platform before the previous government sought external financial support from the EU/IMF in November 2010. However with both the country's deficit and levels of public debt reaching previously unimaginable levels, the need for meaningful tax reform has never been greater.

If as a society we want to invest in job creation and world class public services, the aim of which would be to create a more equal and prosperous society, we can no longer tolerate the current tax regime. It is part of the failed policy consensus that led us into the economic crisis we are currently in and cannot be expected to play any positive part in our recovery.

The Community Platform is delighted with the outcome of this research which we believe will make a real contribution to the public and policy debate, not only on our tax system, but more generally on the kind of Ireland we want to create in the years ahead. We want this report to stimulate debate and discussion, and ultimately to influence policy change.

The new Fine Gael and Labour government has a unique window of opportunity to embrace positive and progressive change in this policy arena. If they do they will have played an important part in assisting Ireland's social and economic recovery. Ultimately a country's tax system is a political choice, based on the kind of society a government wants to foster. The aim of this research is to provide Government, civil society and the public at large with a clear alternative to what we believe is the failed policy of the past.

Key Recommendations

The Community Platform believes that in order to generate sufficient revenue to invest in job creation, public services, promotion of equality and environmental sustainability our tax system needs reform.

High Level Recommendation: To introduce a programme of reform which over the course of a decade would move the Irish tax system towards the EU norm, including a tax take as a percentage of GDP of between 40% and 45%.

In order to achieve this end the Community Platform recommends:

Social Insurance

1_ The creation of a European style social insurance scheme with contribution levels, including employers' contributions, to be raised to European norms over the long-term.

2_ The range and quality of social insurance programmes should be improved in tandem with social insurance rates and increases in contributions be linked to the provision of specific services.

3_ Carers in the home, along with those returning to education and the unemployed, should be brought into the social insurance net.

Income Tax

4_ The introduction of a refundable tax credits system to ensure that all those in the tax system fully benefit from tax credits.

Tax Breaks

5_ The cost of tax expenditures be reduced to the EU average over the medium-term – with the burden of that reduction to be borne by high income groups.

6_ All tax expenditures must be fully quantified and subject to a comprehensive cost-benefit analysis. This would include distributional, equality and economic impact analyses.

Indirect Taxation

7_ VAT and indirect tax revenue as a percentage of GDP should be maintained at current levels.

8_ Lower the reduced VAT rate to the EU average.

9_ Increase indirect taxation on high import goods and services, and on goods and services disproportionately purchased by high income groups, as well as high-carbon products.

10_ VAT and excise taxes should be identified sepa-

rately on all receipts for the purchases of goods and services.

Taxing Wealth

11_ Introduce a Comprehensive Property (Wealth) Tax, to be levied on all assets including global assets. This tax should be applied, in the first instance, to income earners above €100,000.

12_ End Tax Exile loopholes by making citizenship the basis for taxation for high earners.

Corporation Tax

13_ Impose a sunset clause on all corporate and business tax expenditures saving those that have demonstrable social and economic benefits.

14_ Urgently consider ending the carrying forward of unused capital allowances and losses under property tax relief schemes.

Making the Case for a European Tax Model

The design of a tax model is, ultimately, a political choice - how much revenue is taken from which sources to spend on what programmes. There are certain rules, of course, that would be dangerous to ignore: disincentives, misallocation of resources, impacts on supply and demand. Ultimately, however, these rules are less rigid and more open to interpretation than some would lead us to believe. Within and around these rules there are plenty of choices.

For instance, we can choose to rely on private health insurance or private pensions to provide health services and income support. Therefore, the taxation system may be used to provide tax reliefs to allow people to purchase these from private markets – thus, reducing the level of taxation. However, if a society decides to deliver these goods ‘collectively’, through a social insurance system, then people will pay higher taxes/levies to provide these goods. The cost to the individual and the state may be the same (though the quality and equity may vary considerably); but the taxation system will certainly be different.

It will be difficult to construct a new tax model in a recessionary climate. Living standards are declining and joblessness is rising; we face an economic and fiscal crisis unprecedented in the history of the State. If that weren’t bad enough, Ireland is confronted with a number of challenges in the years ahead, best summarised by the group of economists and social scientists who wrote in the Irish Times in 2010:¹

‘We urgently need measures to tackle five key areas which require fundamental reforms:

- *Our substantial physical infrastructure deficits;*
- *Our poor social infrastructure – early childhood education is poorly developed, primary and community healthcare lag behind European norms, housing lists continue to lengthen, while Irish public transport remains inadequate and under-funded*
- *Our high levels of relative poverty and income inequality;*
- *Our under-performing indigenous business sector – which needs appropriate support to contribute to our export base, R&D and innovation capacity;*
- *And our unsustainable reliance on carbon-heavy resources and activities.’*

In the face of these challenges (and after 15 years of unprecedented growth, it is an indictment of past policy that these deficits exist), we must make a political choice – to resolve these problem through public, democratic and accountable markets. This leads us to explore how we can obtain greater resources for this economic and social investment.

“Higher-tax economies out-perform Ireland in terms of economic and business competitiveness, while ensuring that fewer of their citizens are at risk of poverty.”

Ireland’s low-tax model is deeply ingrained in our economic culture. There has been an overwhelming consensus that low taxation is the key to economic prosperity. Part of this can be explained by a chronological confusion. There is a popular notion that tax cuts somehow created the ‘Celtic Tiger economy’ in the mid-1990s. As Paul Sweeney demonstrates, this is not the case. **(1.1)**

As can be seen, both economic growth and employment generation were well embedded in the economy before the first of the major tax cuts were implemented. It should also be pointed out that reduction in the corporate tax rate starting in 1997 had little effect on the main driver of growth and employment creation – the multi-national sector. This sector already benefited from a reduced manufacturing tax of 10 percent while some companies were exempt all together from tax since 1982 under the Export Sales Relief. As Sweeney points out:

‘ . . . economic growth did not follow reductions in the top tax rate. Further, the massive growth in employment was well underway long before the reductions occurred. High GNP growth rates began in 1994, when the top rate stood at 48 percent and it was to remain unchanged until 1999. . . (This) illustrates that there was no real relationship between the top tax

1.1 - Economic Growth & Job Creation Prior to Tax Cuts

Year	Top Tax Rate (%)	GNP Growth (%)	Job Creation (000s)
1992	52	2.3	9
1993	48	3.4	18
1994	48	6.3	37
1995	48	8.3	61
1996	48	7.8	48
1997	48	9.7	50
1998	48	7.9	95
1999	46	8.9	97
2000	46	10.2	80
2001	44	3.8	46
2002	42	0.1	33
2003	42	2.5	34
2004	42	4.3	31

Source: Tax Cuts Did Not Create the Celtic Tiger, ICTU, 2004 ²

rate reductions and the changes in GNP growth.¹³

Yet the consensus prevails, even after the economic collapse. In 2008 the then Minister for Finance re-stated this consensus, identifying as a priority:

‘ . . . the maintenance of our low tax economy so that we are positioned to trade successfully in international markets and benefit from a return in a more favourable external environment in due course.’⁴

This was reinforced by the Commission on Taxation:

‘A core principle of tax policy into the medium term should be to keep taxes on labour and the labour tax wedge low⁵, in order to reduce the costs of employment, stimulate demand for labour and encourage labour force participation.’⁶

In the 2011 general election Fine Gael and Labour campaigned on taxation policies which will effectively maintain this low-tax strategy. Now in government there is no indication, as of yet, of any shift from this position.

It is often asserted that a low taxation regime is needed to encourage entrepreneurship, investment, employment and wealth creation. However, this is not confirmed by European experience. Nations with higher tax regimes are also rated as the most ‘competitive’ economies with lower levels of poverty and income inequality (1.2 overleaf).

Higher-tax economies out-perform Ireland in terms of economic and business competitiveness, while ensuring that fewer of their citizens are at risk of poverty. Higher-tax economies are better placed to invest in infrastructure, labour market programmes and enterprise supports – thus enhancing ‘competitiveness’. In addition, such economies not only experience higher incomes but also more investment in poverty-reduction programmes; thus, they experience lower levels of poverty.

There is no automatic cause-effect relationship between these factors. What it does show, however, is that higher tax regimes are compatible with economic efficiency and social equity. Indeed, we would go further and argue that they are necessary components as a lower-tax economy is not in a position to maintain both economic and social investment at the same levels as higher-tax economies.

So what level of taxation is optimal? If we are to aspire to an average European tax regime, then it

seems reasonable that we should target, in approximate terms, the average European tax take. This coincides with the call by the ESRI’s John Fitzgerald who stated, in line with our opening comments: ⁷

‘Before we can determine the appropriate path of fiscal policy over the next five years we must first decide on what is the long run level of public services that we want. Then the tax level will have to be set at an appropriate level to fund that level of services.

It is essentially a political question as to what level of public services and investment is likely to be “desired” by the public in the next decade. . . . My own preference would be to target a level of expenditure and revenue in the medium term equivalent to 45 per cent of GDP. However, every government has to make its own mind up on this issue. Whatever that target is should inform the composition of the next budget.’

Reaching the European average of tax as a percentage of GDP is long-term target – to be achieved over a number of years. A premature attempt to attain this target in the short-term could overwhelm the economy and undermine our recovery prospects.

The remainder of this report will explore how this increase can take place – in the most socially equitable and economically efficient manner possible.

1.2 - Economic Growth & Job Creation Prior to Tax Cuts			
	Total Taxation (as a % of GDP)	World Ranking inGlobal Competitiveness Index	At-Risk of Poverty (% of total population)
Denmark	48.7	5 th	12
Sweden	48.3	4 th	11
Finland	43	6 th	13
France	43.3	16 th	13
Austria	42.1	17 th	12
Ireland	31.2	25 th	18

Source: Eurostat, World Economics Forum 2008, EU Survey of Income & Living Conditions, 2008

1 - Irish Times, March 8th 2010
2 - <http://tinyurl.com/69kyfny>
3 - ibid
4 - Address by Minister for Finance, Mr Brian Lenihan T.D., at the Annual Dinner of Financial Services Ireland, 25 November 2008. <http://tinyurl.com/6dru37l>
5 - The tax wedge is the difference between before-tax and after-tax wages
6 - Commission on Taxation Report, 2009
7 - ESRI, Fiscal Policy For Recovery, October 2009

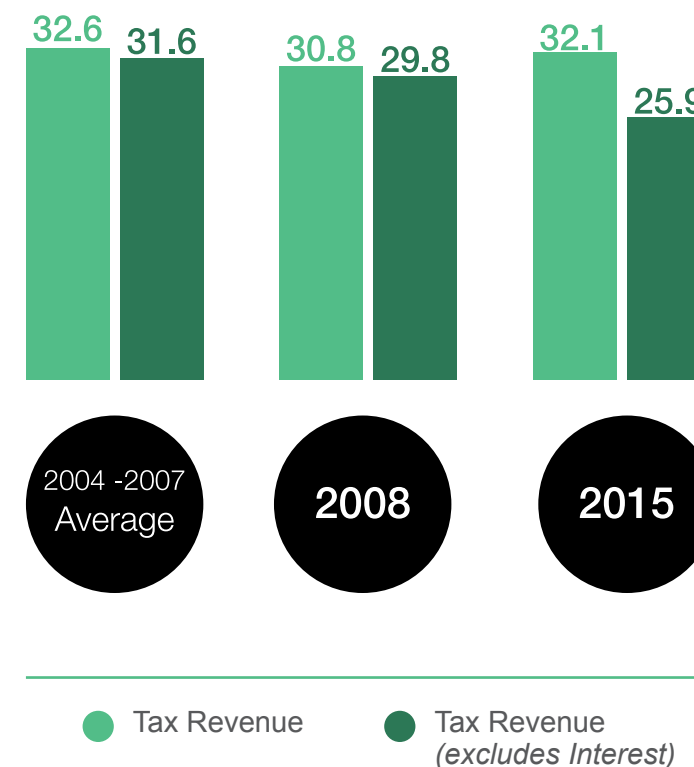
The Continuing Low-Tax Strategy

Moving towards European norms will run counter to the new government's intention to maintain the low-tax economy. Between 2000 and 2007 Irish tax levels, as a % of GDP, averaged around 35.5 percent – the lowest tax level in the EU-15 which averaged around 45 percent.

Department of Finance projections up to 2015 show that the Government is determined to maintain this low-tax regime.⁸ By 2015, Irish taxation is targeted to come in at 32 percent of GDP – which will keep us at the bottom of the European tax league. However, this doesn't tell the full story. (2.1)

Up to 2007, interest payments on our debts were relatively low, reflecting our low-debt status. These payments averaged around one percent of GDP. Therefore, taxation excluding the proportion of tax needed to pay interest averaged around 32 percent of GDP. Out of this, government expenditure was funded.

2.1 - Irish Tax Revenue as a % of GDP



“It is debatable to what extent that public services and the economy can withstand these continuing unprecedented cuts.”

However, by 2015 interest payments will increase by nearly six-fold, reflecting high borrowing and growing debt levels. Taxation, excluding the proportion of tax needed to pay interest, is targeted at 26 percent by 2015. This is much lower than in the period preceding the recession. This will put considerable strains on public services and social supports. According to the Government's Stability Programme Update, the real cuts (that is, after inflation) between 2010 and 2015 will be severe:

Current public expenditure is projected to be cut by 14.2 percent. Given that unemployment is projected to be double that of the pre-recessionary period and old age pension costs will continue to rise as our population ages, this cut is likely to fall disproportionately on public services and income supports.

Capital expenditure is projected to be slashed by 29.4 percent. Given Ireland's severe infrastructural deficits and the falling rate of private investment, this will undermine the economy's productive capacity and employment levels.

It is debatable to what extent that public services and the economy can withstand these continuing unprecedented cuts.

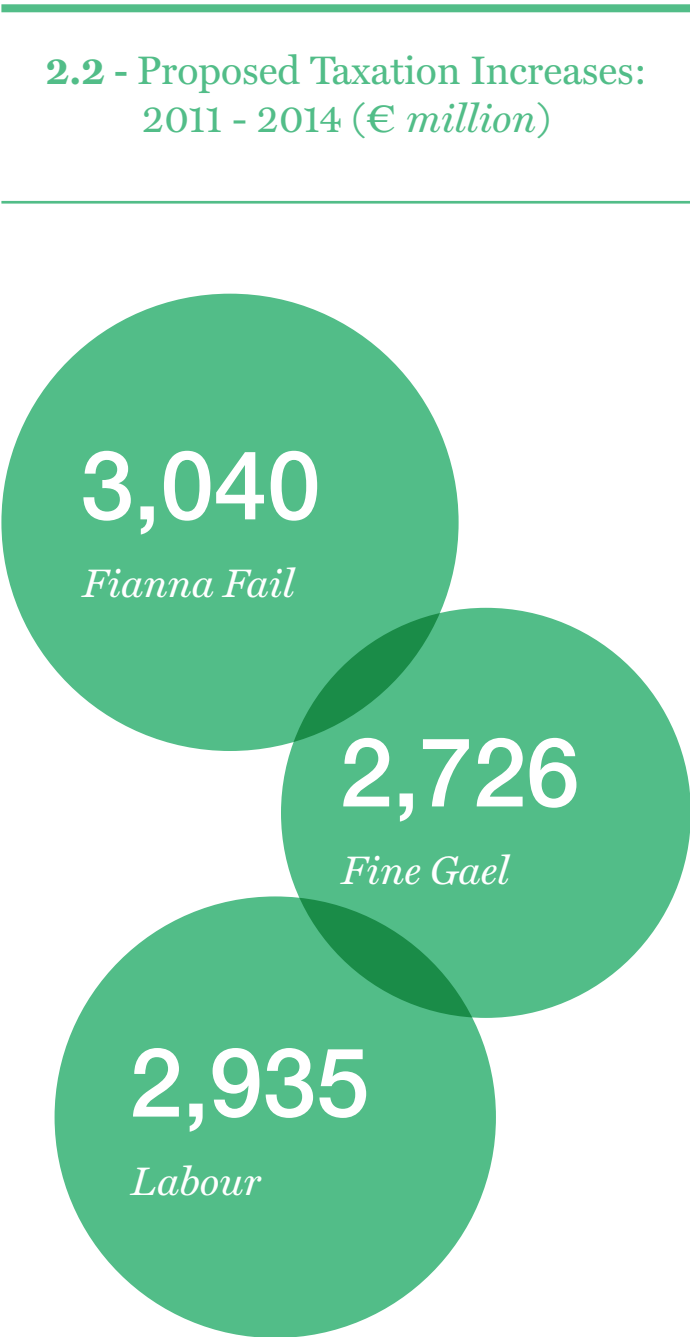
The new Programme for Government is light on budgetary details. The new Government is committed to maintaining the budgetary targets of the last government up to 2012 but is silent on targets after that date. In many respects this is understandable, given the renegotiation of the IMF/EU bail-out and

the unknown fiscal impact of the continuing banking crisis. However, during the election, both Fine Gael and Labour revealed their taxation targets which differed little from the past government’s projections. **(2.2)**

These show that the main parties share a consensus regarding minimal taxation rises – far below what is needed to avoid substantial public expenditure reductions, never mind reaching European taxation norms.

Merely to maintain current level of public services (which are deficient in many areas compared to European norms) will require a higher tax level than that envisaged in the low-tax consensus.

And to reach European levels of standards of living, economic investment and public service provision will require European levels of taxation.⁹



8 - Department of Finance, Stability Programme Update, April 2011 <http://tinyurl.com/6bl22wy>
9 - There is a strong argument that Ireland may need, for a period of time, higher than average EU levels of taxation to achieve EU standards of living and public services because a) we need to invest in services to make up for decades of underinvestment and b) the cost of servicing the debt has to be deducted from out tax take. Ireland may be playing catch-up for a long time.

Irish Taxation in International Comparison

In order to develop a coherent argument to align Irish taxation along European norms, it is instructive to make a comparison of tax structures with our EU neighbours, particularly with respect to the distribution of tax receipts under various headings (income tax, social insurance, VAT, etc.).¹⁰

Overall, Ireland is clearly a low-tax economy. While the average tax take for other EU countries is over 39 percent, in Ireland it is currently a lowly 28 percent – the lowest of any EU country.¹¹ When cyclical factors are removed (fluctuations due to temporary economic phenomenon – in Ireland, tax revenue from the property bubble), Irish taxation still remains substantially behind EU norms.

3.1 - Taxation as a % of GDP

28.2

39.3

Total Taxation

29.8

40.4

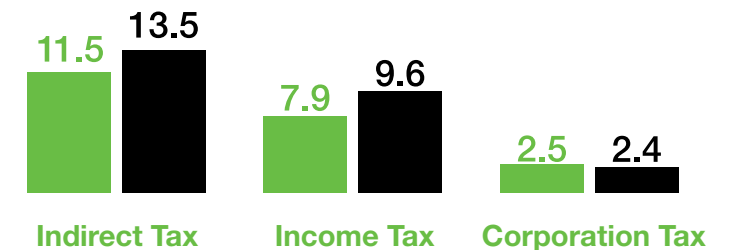
Cyclically-Adjusted Taxation

● Ireland ● EU-15 average

However, when comparing the particular categories of taxation revenue, some interesting comparisons emerge.¹² (3.2)

While Irish taxation under the three main categories (which, in Ireland, makes up over 80 percent of all tax revenue) is below the EU-15 average, we are not substantially so.

3.2 - Taxation as a % of GDP by Various Categories: 2009



For instance, in 2009 Ireland would have only needed to raise income tax revenue by €2.7 billion (through increasing rates, reducing tax expenditures, introducing new taxes on higher income earners, etc.) to reach the EU-15 average.

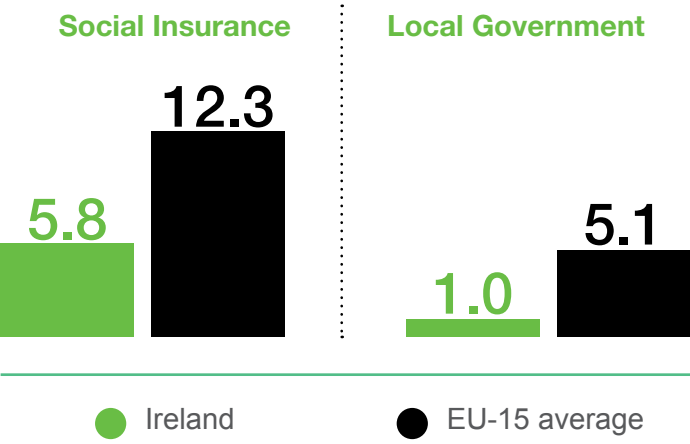
If our comparisons stopped with these tax categories, we would not rank as a low-tax economy. Yet we are. So where does Irish taxation fall down?

The Irish social insurance system, as measured by revenue as a percentage of GDP, is the weakest in the EU-15 (3.3). All components of social insurance – employers', employees' and self-employed – are below average. To put it in perspective, Irish social insurance revenue would have to double just to reach the EU average. Though this need not necessarily mean increasing contribution rates by this amount – it would imply a substantial rise.¹³

Similarly, local taxation is the lowest in the EU, with the exception of Greece. As measured by revenue received by government administration, Irish local government takes in 1 percent of GDP compared to an EU-15 average of over 5. This doesn't include revenue received by regional governments.¹⁴ Local government receipts¹⁵ would have to rise by over five-fold to reach the EU average. This shouldn't be surprising as it has been well established that Irish local government – in terms of powers and responsibilities – is one of the weakest in the EU.

The above analysis should caution us against simplistic approaches to tax reform. At times the debate gives disproportionate attention to personal income tax and, in particular, income tax rates. However, this is only one part of the equation – and a small part at that. In the following sections we will survey all areas of taxation in order to create a progressive agenda – one capable of providing the resources for economic investment and provision for public services and social protection.

3.3 - Taxation as a % of GDP (Social Insurance & Local Government): 2009



10 - EU-15 averages are measured excluding Ireland. This gives a measure of all the other EU-15 countries

11 - Taxation Trends in the European Union, 2011:

<http://tinyurl.com/5vbhknw>

This compares with actual tax receipts, or the tax ratio, as opposed to Government Revenue. The latter includes non-tax revenue. In Ireland, dividends from public enterprises, rents, etc. would be examples of non-tax revenue. Throughout we will use this data source unless other wise stated.

12 - These measure the revenue under the various tax categories as a percentage of GDP

13 - Eurostat include the health levy in social insurance receipts. However, the health levy, though collected through the PRSI system, is paid into central funds (i.e. the Department of Health). If anything, therefore, the above figures over-state the level of social insurance taxation in Ireland

14 - Four EU countries operate fiscal regional governments: Belgium, Germany, Austria and Spain. Even in these countries, local government receipts – which operate below the regional level – are much higher: over 7 percent

15 - Currently, Irish local government receipts are reliant upon business rates and service charges. The historical source of much of the revenue – domestic rates – was abolished in 1978

Is GDP or GNP More Appropriate For Comparing European Taxation?

There is a considerable debate over which comparative measurement should be used— GDP or GNP¹⁶— when comparing Irish taxation with other EU countries. We do not intend to answer this question here, especially as so many economists and analysts are divided over the issue. However, it should be pointed out:

In most EU-15 countries GNP is lower than their GDP. In this respect, Ireland is not an exception. If comparisons are used internationally they should be consistent – rather than comparing Irish GNP with other countries’ GDP.

The reason for using GNP is because multi-national firms export their profits. However, the gap between GNP and GDP is made up of more than just profit-exports: interest payments, Irish firms investing abroad, remittances, etc. If it is intended to compare excluding profit-expatriation, then GNP would not be appropriate as it excludes more than just the profit outflows of foreign companies.

Even if we use GNP we still find Ireland a low-taxed economy. Ireland has the 12th lowest level of taxation as a percentage of GNP – just ahead of Portugal, Greece and Spain. In 2009, taxation would have to increase by 19 percent – or approximately €9 billion to reach the EU-15 average. To reach the average of non-programme countries (that is, those countries not in bail-out), taxation would need to increase by approximately €11 billion. If Irish taxation were at EU levels, even using the GNP measurement, there would be no fiscal crisis and no need for a bail-out.

There is another measurement that can be used: Government revenue per capita. This is derived from the IMF database for 2011.¹⁷

Irish government revenue per capita is well below EU averages. To reach the EU-15 average, Irish revenue per capita would need to increase by 27 percent – or €14.9 billion. To reach the average of non-programme EU countries, Irish revenue per capita would have to increase by 38 percent – or €21.1 billion. While this formulation should be treated cautiously (economies in prolonged recession and low-growth will struggle to generate revenue), it does show the gap between Ireland and other EU countries is probably closer to the GDP, rather than the GNP, measurement. Whichever measurement one uses, Ireland is a low-tax economy.

Government Revenue per Capita 2011

€17,323

EU-15 Average (non-Programme countries)

€15,937

EU-15 Average

€12,594

Ireland

¹⁶ - To measure national income, GNI (Gross National Income) is the proper measurement. GNI is equal to GNP minus EU payments. We will use GNI data for the purposes of GNP.

¹⁷ - IMF World Economic Outlook Database: <http://tinyurl.com/3ezfphm>

How Progressive is the Irish Tax System?

Just how equitable is the Irish tax system? There is considerable disagreement about the extent to which the Irish tax system can be considered ‘progressive’.¹⁸

Many commentators claim that Irish taxation is sufficiently progressive and that further taxes on high income may be counter-productive.¹⁹ These commentators refer to the Revenue Commissioners’ Income Distribution statistics. On the surface, these would appear to substantiate the argument that Irish taxation is sufficiently progressive:

- The top one percent of income earners earned 12% of all income, for the purposes of income tax.
- The top one percent of all income earners paid 25% of all income tax.

But this data should come with a health warning. There is much that is not included in these Revenue tables. For instance, this only assesses income for the purposes of income tax. It doesn’t include capital income (capital gains, inheritances, gifts, etc.). Even for the purposes of income tax, it excludes a considerable amount of income, profits or gains that Revenue lists.²⁰

There are further problems. Some directors have the ability to legally hide income in their business and retrieve it in tax efficient manner – for instance, through pension funds. Such mechanisms can considerably reduce the average tax rate for high income earners. Further, the Revenue tables don’t include social insurance payments, which are reduced for high income earners owing to the exemption of capital income from PRSI. And, of course, the tables don’t include VAT and other indirect taxes.

Using the Revenue tax tables as a measurement for the progressivity of the tax system is, therefore, fraught with problems.

There is no single data source that can measure the progressivity of the tax system. However, the EU Survey of Income and Living Conditions (EU-SILC) can give some pointers as it provides a distributional impact of taxation – the level of taxation and social insurance on different income groups.²¹ To complete this impact analysis we need to add the findings of the recently published, ‘The Distributional Effects of Value Added Tax in Ireland’²² which assesses the impact of indirect taxation. Combining these studies is not wholly satisfactory as we are dealing with different methodologies. So the following should be treated as indicative (4.1).

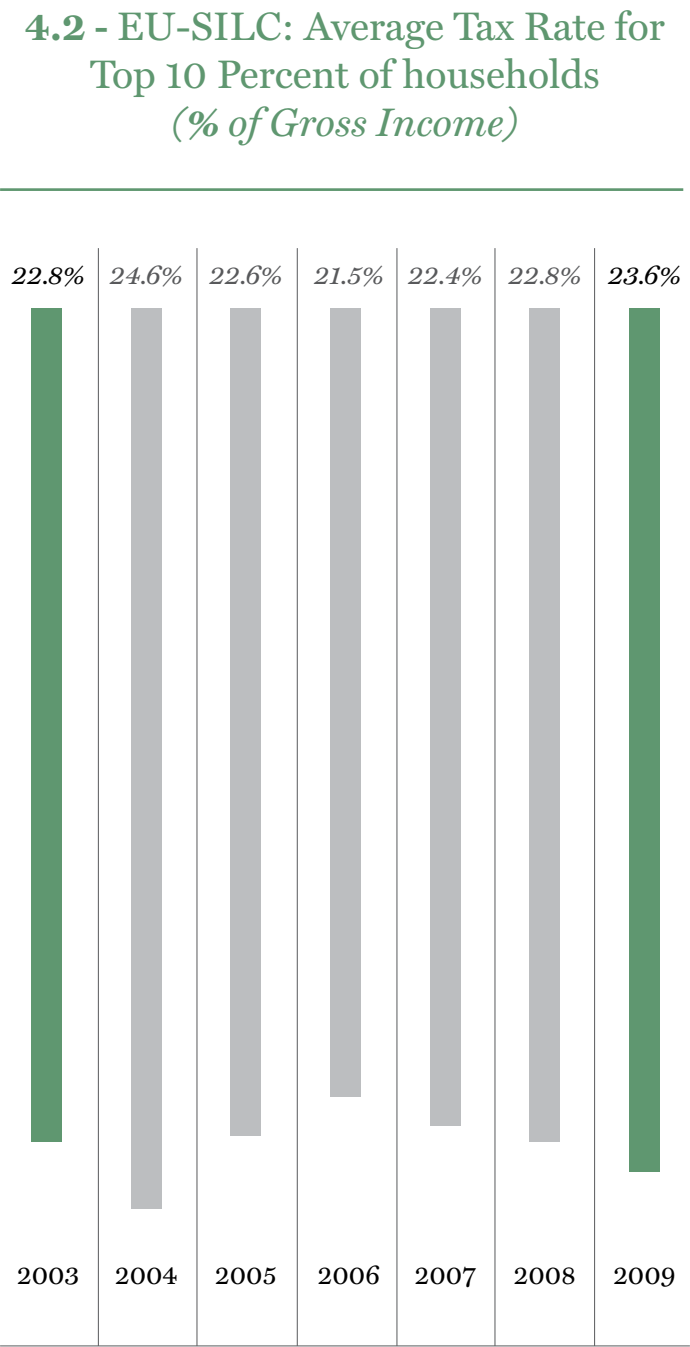
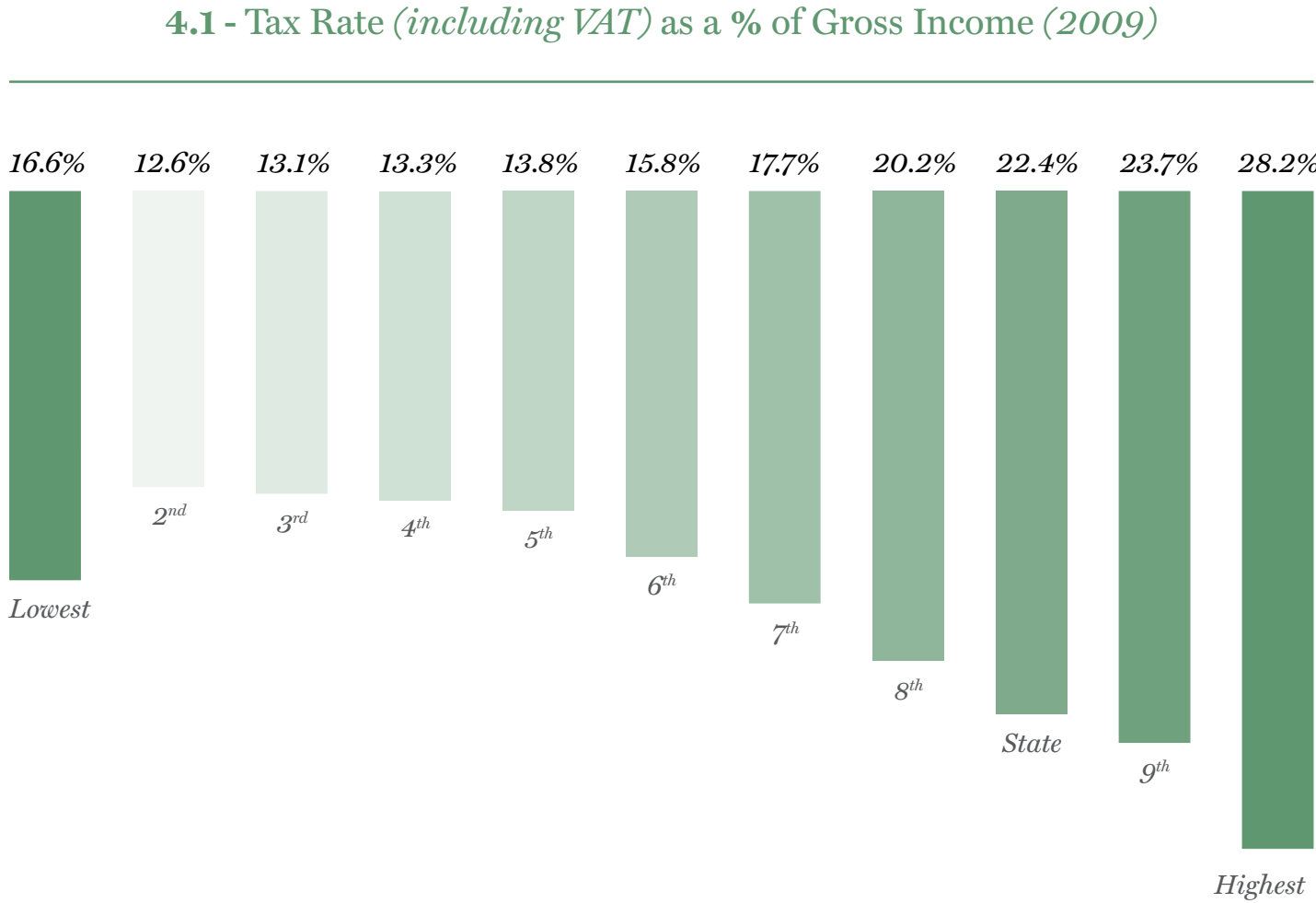
“There is considerable room to build in greater equity and progressivity into the system without being punitive.”

While the highest income group faced a tax rate of 28 percent, this is not substantially above either the state average or the averages of households in the above average ninth decile group.

Further, a historical analysis of the EU-SILC data from 2003 (the first year this data was published), doesn’t indicate a substantially rising burden on the highest income groups. The top 10 percent paid 23.6 percent of their income on tax and PRSI (excluding indirect taxation) in 2009, up a marginal 0.8 percent from 2003 levels. During this same period, these households experienced a 29 percent increase in disposable income (i.e. after taxation) (4.2).

Since 2009 there have been some tax changes, confined mostly to the 2011 budget. The PRSI ceiling has been removed which should see the average tax rates for higher income group’s rise. However, other tax measures – notably the substitution of the Universal Social Charge for the Income and Health Levies, combined with the regressive reduction in personal tax credits, should see lower income groups experiencing a greater increase in their average tax rate.

In conclusion, the Irish taxation system can be described as progressive – but only of the mildest kind. There is considerable room to build in greater equity and progressivity into the system without being punitive.



18 - A progressive tax is a tax by which the tax rate increases as the taxable base amount increases. “Progressive” describes a distribution effect on income or expenditure, referring to the way the rate progresses from low to high

19 - According to some, ‘excessive taxation’ will lead to tax avoidance, reduction in investment and an increase in tax exiles and capital flight.

20 - For instance, superannuation contributions, stallion fees, profits from commercial forestry, patent royalties, investment income arising from personal injuries, child benefit, maternity benefit, unemployment assistance, writers, composers and artists, bonuses or interest paid under Instalment Savings Schemes operated by An Post, interest on certain Government securities, certain foreign pensions, portions of certain lump sums received by employees on cessation of their employment, statutory redundancy payments and certain military pensions, interest income that does not need to be declared or is not recorded (but from which tax has been deducted), unemployment benefit and disability benefit, incomes of certain self-employed persons (including some farmers), etc. This list is far from comprehensive.

21 - Of course, it is a survey – it involved interviewing 5,247 households and 12,551 individuals. It is voluntary and, of necessity subjective. Still, it is accepted as a reliable data source throughout the EU.

22 - *The Distributional Effects of Value Added Tax in Ireland*, Eimar Leahy, Sean Lyons & Richard S. J. Toll, *The Economic and Social Review*, Vol. 42, No. 2, Summer, 2011

05

Taxation in an Economic & Fiscal Crisis

Raising tax revenue in a period of economic stagnation is, if not done carefully, likely to lead to a further loss of output which can undermine the goal of fiscal stability. For instance, the income levies introduced and increased in the April 2009 budget were counter-productive. With consumer spending and the Retail Sales Index already falling, the introduction of these levies only accelerated this decline by reducing people's disposable income which led to further loss of domestic demand, more business closures and higher unemployment. This helps explain why such tax increases, along with public spending cuts, during the 2009 and 2010 period did little to reduce the Exchequer deficit.²³

This is not an argument for suspending tax-based fiscal consolidation. It does, however, call for such adjustments to take place in tandem with economic growth – what the G-20 group of nations called 'growth-friendly fiscal consolidation'.²⁴

There is a consensus in Ireland that public spending cuts are 'better' for the economy than tax increases. This consensus is wrong. In two studies²⁵ the ERSI assessed the impact of tax increases and spending cuts on the economy and Exchequer finances and found conclusively that taxation is (a) less deflationary, and (b) realises more Exchequer gains than spending cuts.

As seen in the table below (5.1), spending cuts are far more damaging and far less fiscally efficient:

In the first year, spending cuts reduce economic growth by twice as much as tax increases.

As a consequence, tax increases are more successful in reducing the deficit than spending cuts – nearly twice as successful.

“There is a consensus in Ireland that public spending cuts are ‘better’ for the economy than tax increases. This consensus is wrong.”

This should not be taken as a call for immediately introducing income taxes, etc. The economy has been pummelled by both spending cuts and tax increases over the last two years. €20 billion has been taken out of the economy (or nearly 13% of GDP). Future fiscal adjustments on the tax side must be based on two principles:

First, in the initial stages tax increases must disproportionately impact on those income groups who will not substantially reduce their spending. This is to ensure that domestic demand is maintained.

Second, general tax/social insurance increases must only be introduced in line with economic growth and rising wages/income.

In this way, economic growth can be protected while pursuing sustainable fiscal stability.

5.1 - ESRI: 1st Year Impact of Tax Increases & Spending Cuts

- Tax Increases
- Spending Cuts



Impact on GDP



Deficit Reduction

*over the last
2 years €20
billion has been
taken out of the
economy
(or nearly
13% of GDP)*

23 - The Government has, since 2009, 'cut' nearly € 20 billion out of the economy in public spending cuts and tax increases – or over 12 percent of GDP. However, the IMF has recently projected that the underlying deficit (excluding special bank payments) will fall from only -11.7 percent of GDP in 2009 to -10.7 percent in 2011:

<http://tinyurl.com/3ezfphm>

24 - G-20 Mutual Assessment Process—Alternative Policy Scenarios, IMF, Toronto, Canada, June 26-27, 2010: <http://tinyurl.com/24eczvb>

25 - ESRI, The Behaviour of the Irish Economy: Insights from the HERMES macro-economic model, 2010 Update <http://tinyurl.com/6d8b32s>. The graph above includes four of the six fiscal measures used by the ESRI. Carbon tax increases are excluded as most of this increase has been implemented already while capital investment cuts are excluded as the ESRI admits the negative impact is under-estimated as they do not factor in supply-side impact. The four measures used, each equalling an adjustment of €1 billion, are (a) public sector wage cuts, (b) public employment cuts, (c) income tax increases and, (d) property tax increases. This paper updates the 2009 paper; there are only trivial changes in the simulation results.

Any programme to substantially raise tax levels will meet with opposition. This is understandable given the extent of low pay²⁶ and the relatively low wage levels²⁷; high household debt levels, recent income tax increases and the increase in the Universal Social Charge, concerns over pension savings and general concerns about the future. In addition, people question the Government's ability to manage the public finances and provide a return (in terms of public services and social supports) for tax paid.

Social insurance, however, has the capacity to be politically acceptable while at the same time raise overall tax revenues. Social insurance, though it acts like a tax (insofar as it is compulsorily levied by the Government), is closer in character to an insurance contract. The Commission on Taxation states:

'We consider that PRSI can be regarded as an insurance arrangement. The purpose of any social insurance system is to fund a range of social welfare benefits to workers and their dependants. While it is a fact that the benefits will not vary by reference to the quantum of contributions made, the system is designed as an insurance-type scheme that provides benefits to those who make contributions.'

For your 'contribution', you will receive a defined set of benefits. Unlike general taxation, where receipts are disbursed over a range of activities, social insurance contributions go into a Social Insurance Fund which is then spent on a narrowly defined set of income support and services.

In Ireland, social insurance contributions (PRSI) 'purchase' a number of benefits: Jobseekers' Benefit, Contributory Old Age Pensions, Maternity Benefit, Injury Benefit, etc.

Of course, these benefits are politically determined and, in this respect, Ireland's social insurance is weak by EU standards – not only in terms of financing but in the range of services provided. In some jurisdictions, most of social spending – health, social protection, and old age pension – is funded through social insurance, not central funding. Ireland, on the other hand, finances most of its social spending through Exchequer funds. This goes a long way to explaining why Ireland suffers from one of the highest levels of reliance on means-tested programmes – because of the lack of universal and insurance-based benefits.

Politically, it would be easier to convince people of the merits of higher levels of taxation if it came

“In Ireland, social insurance contributions (PRSI) ‘purchase’ a number of benefits: Jobseekers' Benefit, Contributory Old Age Pensions, Maternity Benefit, Injury Benefit, etc.”

through social insurance which, in turn, was a contract for specific services. A Health Insurance Contribution, as part of an expanded PRSI system, would 'purchase' free GP care, prescription medicine and hospitalisation. Similarly, an earnings-relation pension contribution would 'purchase' a pension that, in addition to the current flat-rate pension benefit, would be earnings-related – so providing a more comfortable retirement income.

An enhanced social insurance contribution could be extended to include special provision for nursing care, subsidised childcare, educational sabbaticals, earnings-related sickness and unemployment benefits. In short, given the structures and sufficient financing, there is no end of income support and services that can be purchased collectively, based on the 'insurance' principle of pooling everyone's 'savings'. In this respect, social insurance is a 'solidarity contract' – everyone contributes to, and receives benefit from, the system on an equal basis. This system can be extended beyond employees and self-employed – unemployed, home-workers, those returning to education, etc. can be provided with social insurance credits to keep them within the system and allow them to avail of the benefits.²⁸

While many commentators refer to the higher taxes

on working income that prevails in Europe, what they are mostly referring to is higher social insurance. In most EU countries social insurance makes up a much larger proportion of total ‘taxes’ on average incomes than Ireland (in the Netherlands people pay more social insurance than income tax). This reflects the predominant insurance principle or ‘solidarity contract’ in other EU countries.

Moving to an enhanced social insurance system would be a real boost in reducing poverty, improving access to public services, and extending the range of benefits to all people. This would mean increasing expenditure through social insurance, and freeing-up scarce exchequer resources for other programmes – housing, protection, investment, environment, etc. However, underpinning such a development must be a strong financing base. In all three areas – employees, employers and self-employed – the social insurance base would need to be extended while rates would have to be increased.

To reach European norms, Irish PRSI revenue from employers’ would need to more than double with substantial increases from employees and self-employed.

The table overleaf deals with employees / self-employed social insurance. Looking at employers’ social insurance it is clear that Irish PRSI employers’ rates are well below those of other EU countries.²⁹

When one considers that the rate for employers in Belgium and Sweden is over 30 percent (compared to less than 11 percent here) we can see just how far behind we lag in terms of social insurance. Any moves toward EU norms will be a long-term project;

the economy and people’s living standards could not sustain such substantial rises in the short-term. An important consideration is the impact on the ‘cost of labour’. It is often argued that to increase social insurance contributions would be a disincentive to hiring labour. This objection doesn’t stand up to scrutiny:

*If high payroll taxes were a disincentive to hiring people, then how have other EU countries with much higher payroll taxes managed to maintain relatively high employment levels?*³⁰

Many employers already pay high labour costs through voluntary pension and health contribution schemes. Were the state social insurance system to operate these schemes, those labour costs would be reduced among these companies, levelling the ‘competitive playing pitch’ for those companies that do not operate voluntary schemes.

Where employees have to purchase pensions, health insurance, childcare, etc. in the private market, this increases wage pressure on employers. Social provision for these services, at lower cost to the employee, will reduce wage pressures on employers.

The impact of higher employers’ social insurance contributions would be limited.³¹

As seen in the graph below, increasing employers’ PRSI to 16.75 percent (which would still leave it well below EU averages) would mean only small impacts on firms’ turnover base. The impact in the key exporting sector (manufacturing and international services) the impact would be 0.5 on the turnover base. If these increases were phased in over a 5-year pe-

riod, the impact would be incremental. However, this phasing in will have to wait until the economy returns to growth.

Alongside a ‘phasing-up’ of social insurance contributions, there must be a phasing up of benefits – so that people can see the value of their increased contributions. While this is not the place to roll out a schedule of benefits there are three areas worth highlighting:

Health insurance: this would purchase free GP care, free or heavily discounted prescription medicine, comprehensive hospital care, free old-age nursing care and convalescence, etc. The Adelaide Hospital Society has provided a menu of options regarding the funding of a single-tier, universal insurance system.³²

Earnings Related Pension: in addition to a first tier universal pension, this would guarantee everyone up to a certain threshold a pension of 50 percent of final or average salary in their retirement. TASC³³ has provided a model of how this would be funded through the social insurance system.³⁴

Earnings Related Jobseekers’ Benefit: this would guarantee employees up to a certain threshold (e.g. the average industrial wage) 50 percent of their gross income in the first few months of being unemployed – to cushion the loss of income.

A mutual phasing up of rates and benefits could be made more transparent if it is clearly set out what the contribution is for. For instance, in many continental countries a paycheque identifies separately the different elements of the overall social insurance contribution: health, pension, unemployment/sickness, etc. Therefore, a paycheque might show that the health insurance levy is 2 percent; the earnings-related pension levy is 2 percent, etc.

In the first stages of moving towards European tax norms, the least deflationary sources of revenue; namely, high income groups, should be addressed first. This will involve extending the social insurance base (extension of PRSI to capital, investment and other passive income, etc.).

26 - Ireland has one of the highest levels of low-pay in the EU-15. 21.7 percent of Irish employees are officially categorised as low-paid, compared to an EU-15 average of 12.5 percent: OECD Stat Extracts: Deciles ratios of gross earnings.

27 - Irish private sector labour costs are the low end, ranking 10th out of the EU-15. When compared with our peer group (that is, excluding the poorer Mediterranean countries) Irish private sector labour costs are 14 percent below average – Eurostat. Irish public sector labour costs, likewise, are below average: www.klems.org.

28 - In particular, as Mary Murphy shows in ‘A Woman’s Model of Social Welfare Reform’, National Council of Women in Ireland, transformation of the social insurance system needs to take into account the coverage issues for women, the need to include unpaid care work under the SI system and the fact that the current system discriminates against women because women are more likely to have poor coverage and broken insurance records. <http://tinyurl.com/5rbzqhv>

29 - OECD Tax Database: <http://tinyurl.com/6cgkn3n>

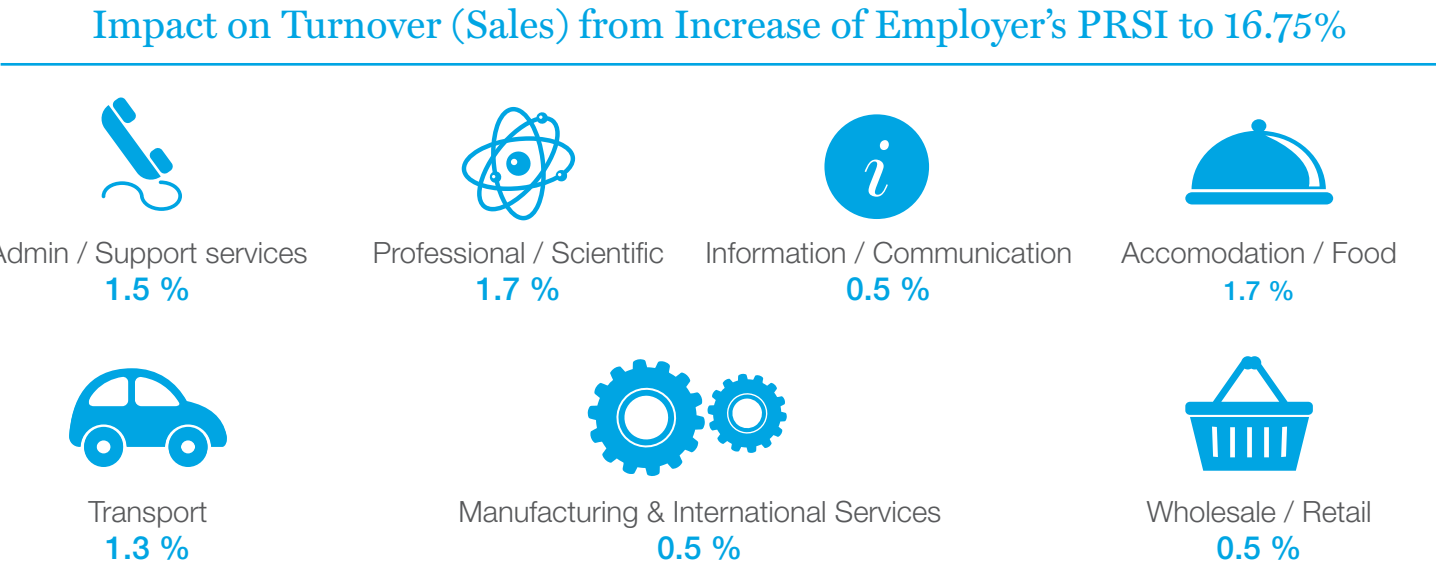
30 - Unemployment rates in Austria mirrored that of Ireland’s rates in the last decade, despite the fact that payroll taxes are more than twice the level of Ireland. Finland, coming out of its deep recession in the early 1990s, managed to reduce its unemployment rate from 16 percent to six percent within 12 years, despite payroll taxes, again, being twice that of Ireland.

31 - Data based on Annual Business Survey of Economic Impact 2009 <http://tinyurl.com/5t6ne5l> and CSO Annual Services Inquiry 2008.

32 - ‘Effective Foundations for the Financing and Organisation of Social Health Insurance in Ireland’ Adelaide Hospital Society, 2010: <http://tinyurl.com/6bu9e3u>

33 - ‘Making Pensions Work for People’, TASC 2010: <http://tinyurl.com/68ka76e>

34 - The National Pensions Board proposed an upward threshold of €65,000 back in 2006 – which would have covered 85 percent of all employees at that time. Earners above that amount could still top up their earnings related pension with private pensions.



Employers' Social insurance Contribution Rate

Luxembourg

14.1%

Upper Threshold: €100,555

Netherlands

18.8%

Upper Threshold: €47,802 / 11.9% above €31,231

Germany

19.6%

Upper Threshold: €64,800 / 11.3% above €44,100

Sweden

31.4%

Upper Threshold: None

Belgium

34.5%

Upper Threshold: None

UK

12.8%

Upper Threshold: None

Ireland

10.7%

Upper Threshold: None

France

40.8%

Upper Threshold: None / 23-27% above €102,924

Spain

29.9%

Upper Threshold: €37,994

Portugal

23.7%

Upper Threshold: None

Italy

32.1%

Upper Threshold: €91,507

Finland

21.0%

Upper Threshold: None

Austria

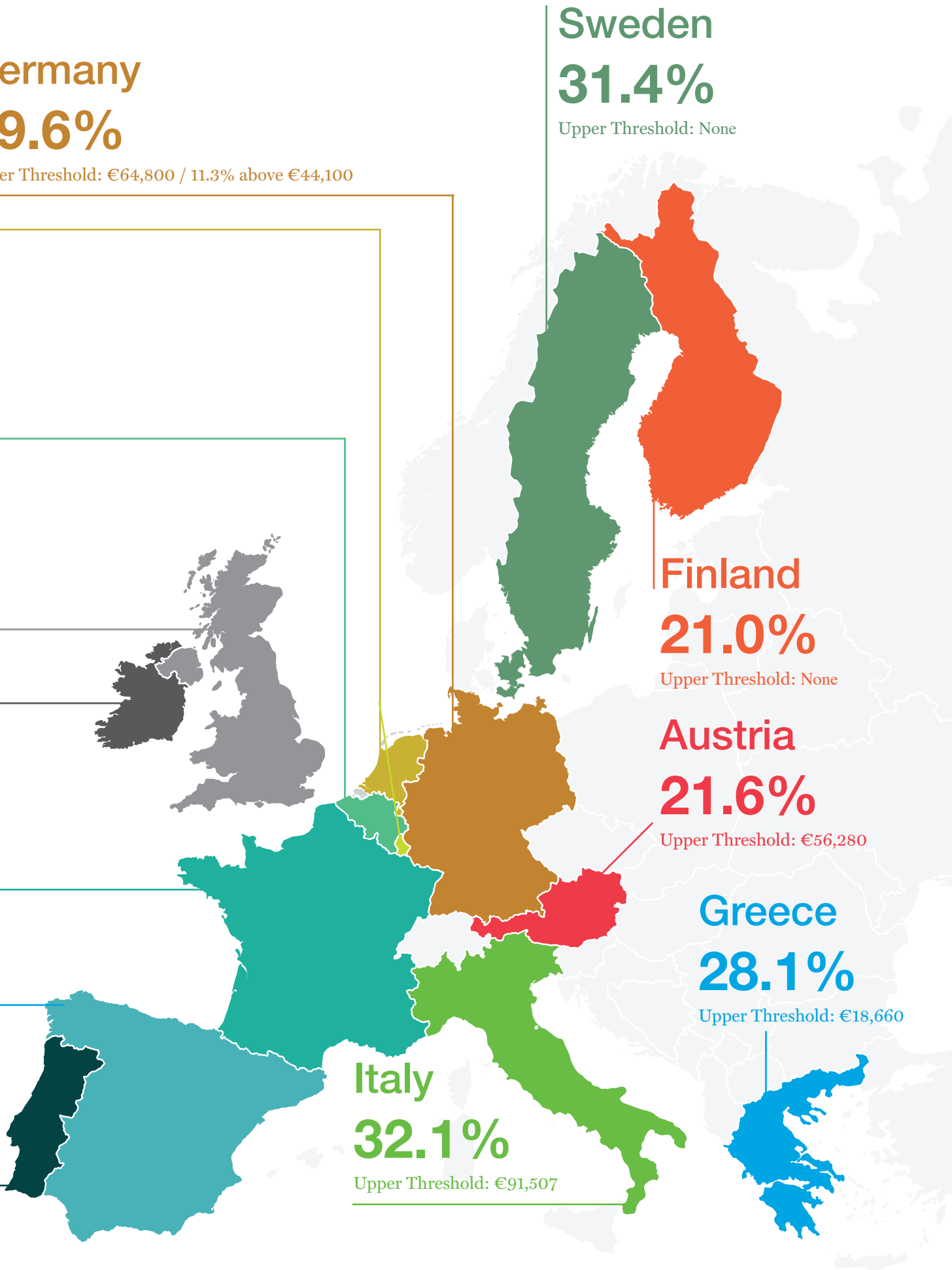
21.6%

Upper Threshold: €56,280

Greece

28.1%

Upper Threshold: €18,660



Universal Health Insurance

The Government intends to introduce mandatory health insurance coverage coupled with free GP care. This could potentially be a significant advance in the provision of healthcare. This could be made more equitable if delivered through the social insurance system.

As outlined in the Programme for Government, people will be required to purchase medical insurance from a range of private and public providers. The state will pay the premia for those on low incomes (e.g. social welfare recipients) and subsidise the premia for those on 'middle incomes'. This system will be fully operational by 2016.

While it cannot be expected that the level of subsidy or the thresholds of middle incomes would be established this early, there are issues in principle to address.

For example, a basic Plan B (VHI) costs €1,100. For those on the average industrial wage, this represents 2.7% of gross income; for those on twice the average industrial wage, it represents 1.4%. This is needlessly regressive and would not exist if it were paid through the social insurance system.

Most importantly, employers are exempted from any contribution. This is strange as Fine Gael campaigned on the 'Dutch model'. Under the Dutch model, employers' pay 50% of the health insur-

ance premia, employees pay 45%, with the state paying 5%. Were employers required to pay half the premia, this would reduce health costs for people and reduce the Exchequer subsidy envisage for those on 'middle incomes', realising a reduced deficit.

A more equitable way of financing this programme would be to introduce a Health Insurance Levy (as part of the social insurance system) on employees, employers and the self-employed. For instance, on 2009 figures, a 2% levy on each would raise almost €2 billion through which to purchase health insurance in line with the individual's choice. This could be supplemented by extending PRSI to capital income. Further, it would introduce progressivity in the system. For those on the average industrial wage, the levy (based on current PRSI thresholds) would amount to 1.7% of gross income, growing to 1.8% for those on twice that wage.

And while concerns might be raised about the impact on international competitiveness from increased social insurance obligations on employers, Forfás³⁴ enterprise statistics show that a 2% increase in social insurance would represent 0.2% of the turnover base of manufacturing and internationally-traded service enterprises. This minimal impact would hardly undermine competitiveness.

Universal Social Charge

In the 2009 and April (2009) budgets, new and additional levies were introduced; namely, an Income Levy and increases to the Health Contribution Levy. These were emergency measures designed to substantially increase exchequer revenue in an attempt to slow the growing fiscal deficit. A levy is a tax on gross income. That the Government used levies rather than increase tax rates shows their lack of confidence in increasing tax rates as a means of substantially increasing revenue. The reason is simple: levies on gross income are not eroded by the plethora of tax expenditures. Therefore, though a stop-gap, levies have proven in certain circumstances to be more progressive than income tax rates.

In Budget 2011 the Government replaced the Income and Health Contribution levies with a new Universal Social Charge. This was, for 2011, revenue neutral. However, it has proven highly regressive with a greater burden imposed on low income earners and greater relief for those on higher incomes. **(7.1)**

While almost all other categories received an increase, this was at the expense of those on lower incomes (the losses increase up to €26,000 where the net increase rises to €619).

There is no argument in equity or economic efficiency for this regressive feature – especially as lower income earners have a high propensity to spend.

However there is an opportunity to enhance the social insurance system, by integrating the Universal Social Charge and PRSI contributions. Levels of rates and thresholds could only be worked out once the desired level of social insurance is agreed upon. A comparison of employee PRSI rates shows how insufficient current rates are and the contribution that integration of the USC and PRSI could make to creating European levels of social insurance. **(7.2)**

European social insurance rates are even higher for the self-employed. In Austria, the rate is 24.6 percent; in Belgium, 22 percent (up to €51,000); in Finland, 21.6 percent; in Italy, 20 percent; in Sweden, 29.7 percent. In Ireland, it is 5 percent.

In Ireland the social insurance contribution of employees and the self-employed to overall government revenue is one of the lowest in the EU-15 as shown.

For employees, PRSI would have to increase by two-thirds while for self-employed, PRSI would have to increase by nearly seven-fold just to reach the EU-15 average.³⁶

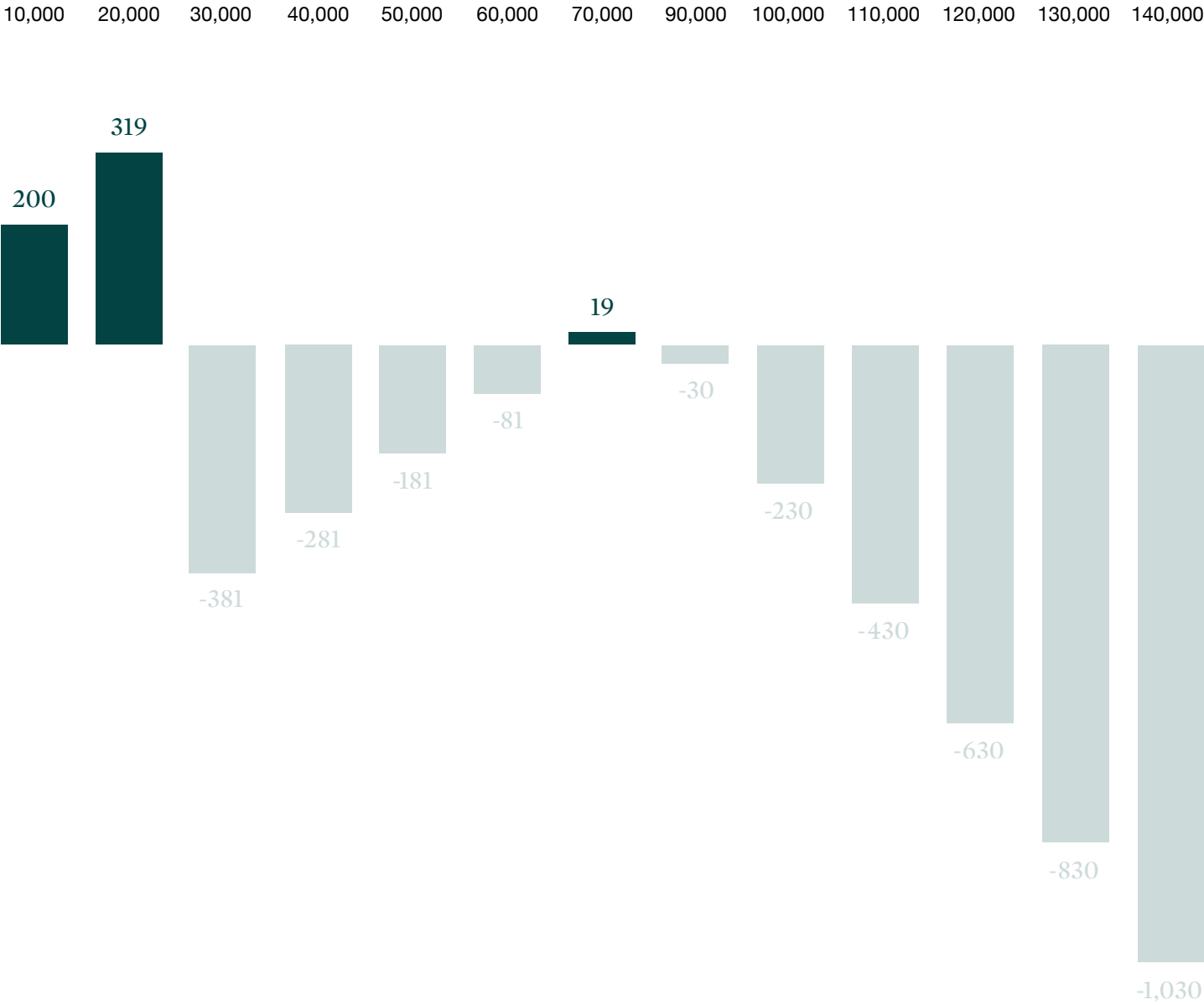
“Integration of PRSI and USC would bring us close to European norms.”

The USC is expected to raise €4.1 billion in 2012³⁷ (the first full year). This is equivalent to nearly 2.5 percent of GDP. Integration of PRSI and USC would bring us close to European norms.

As with employers' PRSI, any integration and eventual phasing up of employee / self-employed contribution levels should only be commenced once economic growth resumes and, in particular, wage/income growth in wages and income. However, in the short-term, USC and PRSI levies should be extended to all income above current thresholds – in particular, capital, investment and passive (inheritances, gifts) income.

Another positive reform would be to align the contribution base of PRSI with the base of USC. It should be noted that there are a number of deductions and reliefs under PRSI contributions that are not allowed under USC. Reforming the PRSI base (and the plethora of classes and sub-classes) in line with the USC would raise further revenue without affecting the rates.

7.1 - Annual Net Increase from Introduction of Universal Social Charge (€)



7.2 - Social Insurance (PRSI) Rates: 2009

Country	% of Income (Main Rates)	Upper Threshold ³⁸
Austria	15 - 18	€56,280
Belgium	13.1	None
Finland	5.2	None
France	19 - 21 <small>(8-11 above €100,000)</small>	None
Germany	21 <small>(11 above €44,000)</small>	€64,800
Greece	16	€5,543
Ireland	4	None
Italy	9 - 10	€91,507
Luxembourg	11	€100,555
Portugal	11	None
Spain	6	€37,994
Sweden	7	€56,000 (approx)
UK	10	€44,000 (approx)

Source: OECD Taxation Statistics 2009 ³⁹

In Ireland the social insurance contribution of employees & the self-employed to overall government revenue is one of the lowest in the EU-15.

36 - <http://tinyurl.com/6egqyj1>

37 - <http://tinyurl.com/6gtc8hf>

38 - This is the threshold above which income is not levied. Ireland used to have a threshold of €75,000 for employees PRSI. This was abolished in Budget 2011.

39 - <http://tinyurl.com/6cgkn3n>

Personal Income Taxation

As we have seen, Irish income tax revenue does not lag far behind European norms. While Irish income tax revenue is lower than the EU-15 average, it still ranks ahead of other high-tax economies such as France and the Luxembourg. Variations will depend on the relationship between income tax and social insurance in a particular country's fiscal composition. But as a rule, when it comes to income tax, Ireland is not a low tax outlier.

There is still a need to increase revenue through increased income tax but it is important that we understand what role income tax revenue plays in the total make-up of Government revenue.

There is much confusion when debating income taxation and, in particular, tax rates. We need to distinguish between two types of tax rates, marginal and effective.

- **Marginal rate:** this is the rate that applies to the next euro that is earned. For example, lower-paid employees will pay a marginal rate of 31 percent for every extra Euro they earn⁴⁰ while high income earners will pay a marginal rate of 52 percent.⁴¹

- **Effective rate:** the effective tax rate is the amount of tax paid as a proportion of total income. Using only personal tax credits we would find the effective rate for a low-paid employee is 17 percent while for the high-income earner it is 39 percent.

The marginal rate is easily quantifiable and is usually the same for all taxpayers in any particular income category. The effective rate is, however, difficult to assess owing to tax expenditures – a regime of tax reliefs, allowances and exemptions that taxpayers can avail of to reduce their tax liability (or reduce the tax base).

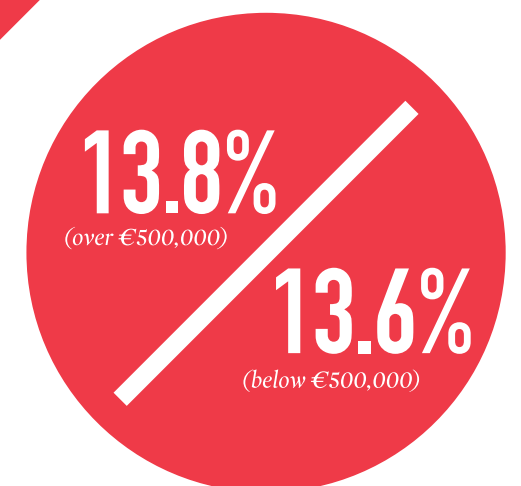
One revealing Department of Finance study of 423 high income earners (individuals earning in excess of €250,000 per annum)⁴² shows the difference between marginal and effective income tax rates. (8.1)

While all high income earners in 2008 faced a marginal income tax rate of 41 percent, many were paying an effective tax rate of less than 14 percent. The Government's commitment to proceed with a 30 percent minimum effective tax rate on high income groups is clearly a positive development. But the number of taxpayers this will affect will be small (only 1 percent of income tax payers earn above €200,000). A more thorough programme of removing or reforming regressive tax expenditures will be

8.1- Average Effective Tax Rates on High Income Earners (survey of 423 Cases) : 2008



2008



2007

necessary to raise the effective tax rate.

Tax expenditures are cash subsidies delivered through the tax system. They are delivered through tax reliefs, credits, allowances and exemptions – in the income, capital and corporate sectors. In essence, they are no different from expenditure subsidies; except that in many cases they are hidden

or their costs and the number of recipients can only be estimated.⁴³

The Commission on Taxation identified over 100 tax expenditure programmes, costing the State over €10 billion every year (that is, they reduce the tax yield by that amount). Unfortunately, the commission only analysed a portion of them and they didn't produce a comprehensive distributional impact study of these expenditures showing which income groups benefited from them most.

The commission did give one example: mortgage interest relief.⁴⁴ They noted that half of the cash subsidies for this relief went to people in the top 20 percent income group. Given that this subsidy cost the state over €700 million in 2008, this means that the highest income group received a cash subsidy of over €350 million from the State.

It would be a mistake to think that all tax expenditures are regressive or primarily benefit high income groups. Personal tax credits are of more value to low and average income groups, for example.⁴⁵ However, for many costly tax expenditure programmes, it's reasonable to assume they benefit high income groups:

- Relief on interest for residential landlords cost over €1 billion.
- Approximately 70 percent of the cash value of pension contribution relief (which costs an estimated €600 million) goes to the 20 percent income groups.
- Capital gains tax exemption from the sale proceeds of principal private residences is likely to benefit higher income groups.

Given their high costs to the economy, it is curious the debate over fiscal policy has not put more emphasis on these expenditures, beyond property tax reliefs.

Unlike social insurance – which will require increased contribution rates – reform of tax expenditure can substantially raise our income tax levels without necessarily increasing marginal tax rates. Reducing tax expenditure raises the effective rate without touching the marginal rate. Indeed, a radical reform and reduction of tax expenditures could facilitate a reduction of the marginal rate and still leave a healthy net surplus for the exchequer. This is why the emphasis should be on effective taxation, and not more taxation.

It is beyond the scope of this paper to detail reforms of particular expenditure programmes. However, there are three broad approaches:

(a) Outright abolition: there are some tax expenditures that have no social and economic rationale for their continued existence and should be eliminated as a matter of urgency. The first that come to mind are any property investment reliefs that still exist. There are others that provide minimal benefit but consume a considerable amount of time to process and monitor. Relief on service charges is one of them. The average cash benefit amounts to only €1 per week and many people are unaware of this relief. The impact on low-income households of the removal of this relief would be minimal as many cannot avail of it (see the next section for a discussion of 'lost credits').

(b) Transforming Tax Subsidies into Expenditure Subsidies or Taxable Credits: another approach is to turn tax expenditures into direct expenditures. For example, if the Government maintains tax relief on medical insurance, rather than allow a deduction at the standard rate, which doesn't take into account the amount of insurance that is bought (e.g. private hospital, etc.), this relief could be transformed into a direct payment by the State (e.g. 20 percent of a basic package which would amount to approximate €220), which would be subject to tax.

(c) Imposing Caps on Tax Expenditures: another simple reform would be to put a cap on certain tax expenditures. The amount allowed would cover the reasonable costs to average income earners.

In one of the few studies into the overall impact on the economy, TASC found that in 2009 the state lost €7.4 billion through tax expenditures.⁴⁶ However, were the level of these expenditures reduced to average EU levels, the cost would be reduced to €2.2 billion. In other words, Ireland spends more than three times the European average on tax expenditures.**(8.2)**

If Ireland moved towards the European norm, the exchequer could potentially raise over €5 billion in tax revenue in 2009 alone – without increasing tax rates.⁴⁷ Personal taxation revenue would rise to the EU average without any additional rate increases (though in reality, such reduction in tax expenditures would need to occur over several years). In the medium term there should be no changes in tax rates or tax bands – merely removing regressive tax expenditures could bring us a long way towards European personal income tax revenue norms.

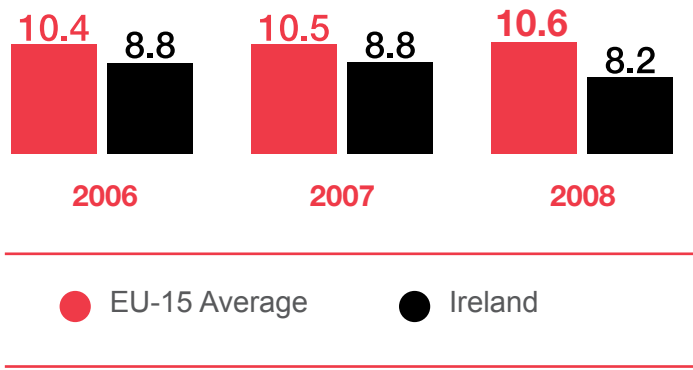
A comprehensive reform programme has the potential to raise substantial amounts of tax revenue and to do so in a non-deflationary manner,⁴⁸ without resorting to increased tax rates. Without reform of tax expenditures, there is no reform programme.

In the last Dáil, the opposition parties supported an amendment to the 2011 Finance Bill put forward by the Labour Party finance spokesperson, Joan Burton, TD:⁴⁹

'The Minister shall within one month from the passing of this Act prepare and lay before Dáil Éireann a report on a cost-benefit analysis of tax expenditures provided for by this Act, setting out the costs of tax foregone, and the benefits in terms of job creation or otherwise.'

While this refers specifically to tax expenditure measures contained in the 2011 Budget, this would be an excellent template for all tax expenditures under all tax headings: income, corporate, capital and social insurance.

8.2 - Personal Income Tax as a % of GDP: 2006-2007



⁴⁰ - €30,000 income earner: Income tax (20%) + PRSI (4%) + USC (7%) = 31%

⁴¹ - €100,000 income earner: Income tax (41%) + PRSI (4%) + USC (7%) = 52%. For high income earners above €75,000 no PRSI is paid on extra income, owing to the PRSI contribution ceiling.

⁴² - <http://tinyurl.com/65767lj>

⁴³ - For instance, the Revenue Commissioners can currently only estimate the cost of pension reliefs. They have identified other reliefs which cannot be costed: exemption in respect of certain income derived from the leasing of farm land; relief for new shares purchased on issue by employees; relief from averaging of farm profits; exemption for income arising from payments in respect of personal injuries; exemption of lump sum retirement payments; relief for allowable motor expenses; tapering relief allowable for taxation of car benefits in kind; reduced tax rate of 10% for authorised unit trust schemes; reduced tax rate of 10% for special investment schemes; exemption of certain grants made by Údarás na Gaeltachta; relief for investment income reserved for policy holders in life assurance companies; relief for various business related expenses such as staff recruitment, rent, legal fees, and other general expenses; exemption in certain circumstances on the interest on quoted bearer Eurobonds; exemption of payments made as compensation for loss of office; etc. The Commission on Taxation identified a list of tax expenditures which could not be costed.

⁴⁴ - Mortgage Interest Relief is being phased out and is intended to be terminated by 2017.

⁴⁵ - The personal credits for PAYE workers make up 13.2 percent of income for someone on € 25,000 a year; for someone on €100,000 a year it makes up only 3.3 percent.

⁴⁶ - TASC calls on Government to cut Tax Breaks, Not Social Welfare: <http://tinyurl.com/64sbw4z>

⁴⁷ - Since a tax expenditure is lost revenue, the removal or reduction of that expenditure results in an increase in tax revenue.

⁴⁸ - This is explained more thoroughly in the Appendices. Suffice it to say here that taxes raised on high income groups (savers) does not deflate the economy as much as low to average income groups who are generally spenders.

⁴⁹ - Dáil Éireann, January 26th, 2011

VAT & Indirect Taxation

It is universally conceded that indirect taxes are regressive.⁵⁰ This is because low to average income groups consume (or spend) more of their income than higher income groups. The policy paper in the Economic and Social Review discussed earlier shows that while the lowest 10 percent pay over 16 percent of their gross income on VAT, the highest 10 percent pay only six percent. In this respect, demands that low-income groups should be brought into the tax net ignore the fact that low-income groups are already in the tax net – the indirect tax net – and paying a higher disproportionate amount of their incomes compared to other groups.

As noted previously, compared to other EU countries, Irish indirect taxes are about average – as a percent of GDP. However, given other taxes are low (income tax, social insurance) we rely quite heavily on indirect taxes. 41 percent of all Irish tax income in 2009 came from VAT, compared to an EU average of 34 percent.

Comparing particular VAT rates can be difficult, owing to the interaction of various rates (standard, reduced, zero-rated) on goods and services. The Irish standard VAT rate is about mid-table compared to other EU countries. It is only slightly higher than average and well below levels pertaining in the Nordic countries. **(9.1)**

This latter point is significant. Denmark, Sweden and Finland have much lower levels of poverty, higher levels of income equality and better public services than Ireland. Yet, their rates of VAT tax are high. This shows that in assessing taxation, it is important to both examine the totality of the impact of taxation and the redistribution of that revenue.

However, Ireland operates a reduced VAT rate of 13.5 percent compared to an average EU reduced rate of eight percent. A more detailed study would be required to identify which goods and services operate at these levels throughout Europe to test their equity.

There are two further issues in regards to indirect taxes:

- VAT rates are governed by complex regulations and the scope for changes in rates is limited because it is governed by EU law.⁵¹
- Many excise taxes are designed to incentivise good behaviour or deter undesirable behaviour. Examples of these are excise taxes on cigarettes and alcohol. Therefore, when considering proposals for indirect

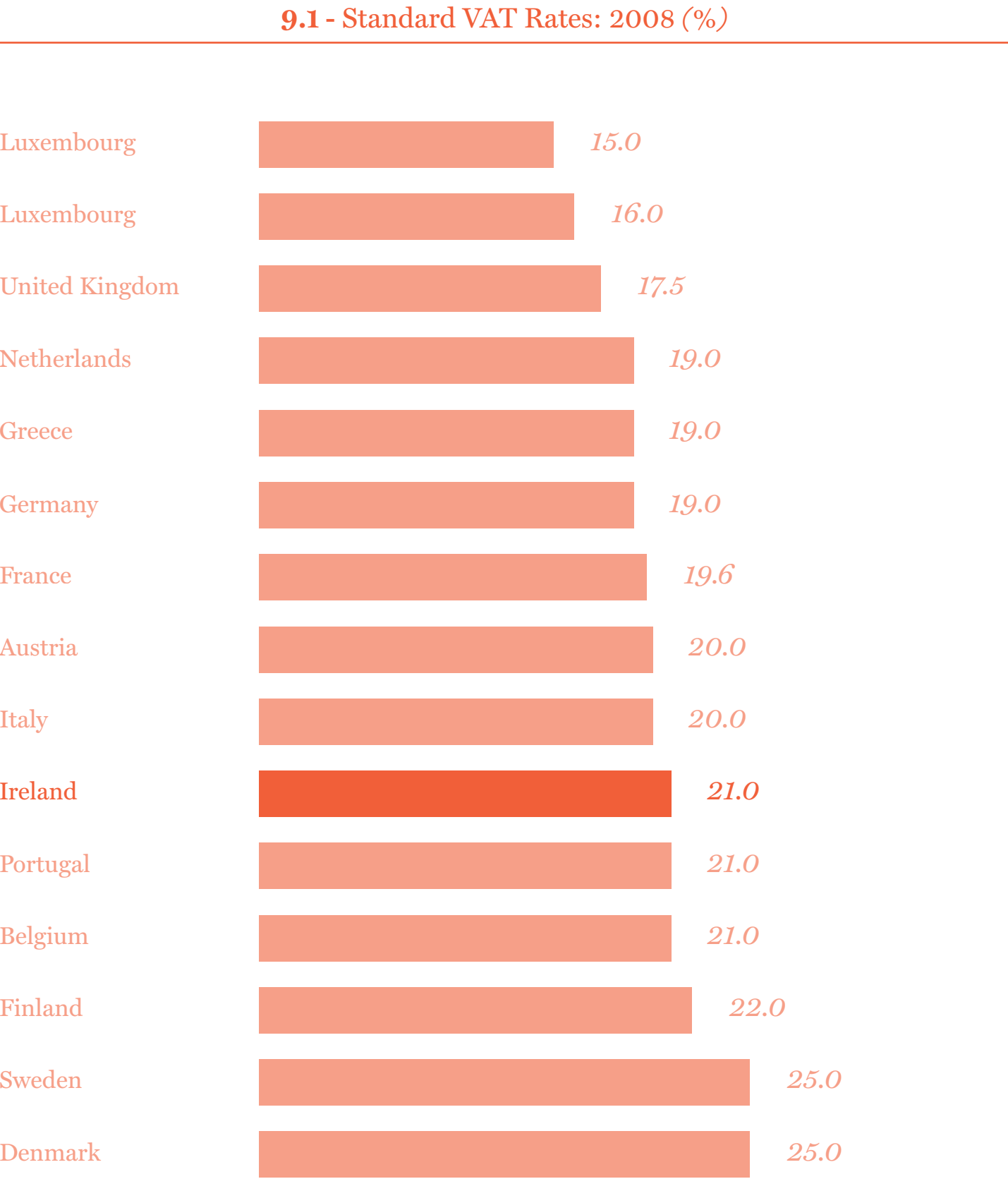
“Regressive as it is, it will be necessary to maintain a strong VAT profile. However, there is room for reform that can impact positively on the economy and living standards.”

tax reform one should be aware of the limited policy choices available and the social impact of changes.

While there are general assertions that reducing VAT rates would lower prices and living costs, we should treat this carefully. When the Government reduced the VAT rate in 2000 in an attempt to stem rising prices, the Department of Finance could not discover any impact on prices and in the following year the VAT rate was increased without any appreciable affect. This suggests the reduction in VAT was not passed on to the consumer.

In the current credit-constrained environment, it is likely that many businesses would not pass on VAT rate reductions but would retain the savings. Many businesses are suffering from severe cash-flow problems arising from the recession and the inability to access bank credit. Retaining VAT reductions would be understandable, in order to relieve cash-flow problems. However, there are better ways to address this problem than by cutting VAT.

Any strategy to cut VAT rates in order to reduce the high cost of goods and services must be accompa-



nied by mechanisms to help ensure VAT reductions are passed on to the consumer. This will be difficult as much of VAT is embedded into the product price itself and not presented separately – as in invoiced items such as ESB or telecom bills.

Regressive as it is, it will be necessary to maintain a strong VAT profile. However, there is room for reform that can impact positively on the economy and living standards. But first, there is a need to identify:

- (a) Those goods and services that constitute a disproportionate cost to low and average income groups.⁵² For instance, nearly 30 percent of all expenditure by low income groups is on food – which emphasises the need for maintaining a zero-rate on these products.
- (b) Labour-intensive sectors that could potentially benefit from reduced VAT rates on targeted inputs such as those introduced by the new Government’s Jobs Initiative (i.e. hotel and restaurant sectors)
- (c) ‘Green’ products and services that could act as incentives to new business opportunities and disincentives to high-carbon products.
- (d) High-import goods and services, and those that are disproportionately purchased by high income groups could be assessed for higher consumption taxes (either VAT or excise).

⁵⁰ - For the purposes of this discussion, VAT will refer to all indirect taxes unless otherwise indicated

⁵¹ - For instance, countries are permitted under EU law to retain a reduced rate of not less than 12% for certain items, provided a reduced rate applied to them on 1 January 1999

⁵² - As exhaustively listed in the CSO’s Household Budget Survey

Irish local government is weak by EU norms. It has few revenue-raising powers and the few it does possess are exercised by managers, not the elected representatives. A major revenue raising source – development levies – has dried up (indeed, the over-reliance on development levies as a revenue source led to the development of unsustainable ghost estates). Apart from rates and charges, most of the financing of local government is determined by central government.

It is beyond the scope of this paper to discuss local government financing reform⁵³ – especially as this will be determined by reform of local structures and powers. Local government has the capacity to be more transparent and accountable to local needs; greater devolution of powers (e.g. education, health, social protection, employment generation) can help people shape policy to their community needs.

This section will touch upon a couple of aspects of local government taxation and explore policies which could be implemented without waiting upon a broader structural reform programme.

Local government will no doubt be relying to a greater extent on service charges – that is, charges for use of local government services.⁵⁴ We already have extensive waste charges, while the Government has made it clear that it will introduce water charges. There is, however, considerable confusion over the intent and effect of these charges. Let's take, as an example, water charges.

It has been argued that water charges should be introduced (a) as an incentive to good behaviour (that is, reduce the use of water); and (b) to increase tax revenue. This shows confusion over what water charges are intended for:

- If they are intended to incentivise good behaviour, then it is theoretically possible that the tax will raise little revenue.. This would occur if all households adopt good behaviour. Cigarettes provide an analogy: if everyone stopped smoking (a social good) then tax revenue from cigarette sales would disappear.

- If they are intended to raise a certain amount of money, it is no longer an incentive but rather an 'economic charge'.⁵⁵ No amount of good behaviour would be allowed to reduce revenue from this source.

It is economic charging that is the driving force behind proposals to introduce water charges. That is why such charges are bound to be regressive and, perversely, have little impact on the behaviour of those who consume more water.

While we don't have a distributional breakdown for water charges, we do have data on the impact of waste charges. **(10.1)** This comes from 2005 so we should expect the figures to change as rates have increased; however, what we are concerned with here is the relationship between the highest and lowest incomes.

This shows a high level of regressivity – low income groups pay five times more of their income on waste charges than high income groups. There is little doubt that water charges will act in the same way – imposing a higher burden on low-income earners. This is certainly the international experience. As can be seen, water charges impose a much higher burden on low to average income groups – in terms of the proportion of their gross income.**(10.2)** This occurs whether charges are flat-rate or based on consumption (that is, metered).⁵⁶

The 'good behaviour' argument is undermined by

10.1 - Waste Charges as a % of Gross Income: 2005

0.5

Lowest Decile

0.1

Highest Decile

“The most progressive tax is a tax on income. And of all taxes on income, a levy on gross income is one of the fairest”

international studies that show that the highest consumer of water – high income groups – will alter their behaviour least.⁵⁷ This is due to the fact that such charges are minimal for those on the highest incomes; therefore they have least incentive to reduce consumption. We will end up in the inequitable situation where low income groups, who use the least amount of water per capita, will bear the brunt of charges and be forced to reduce consumption further, while those on the highest incomes, who use the most water, will not feel the cost and have the least incentive to reduce use.

We need to rethink the role of charges and local government financing. Economic charging is inherently regressive. However, service charges that are aimed at altering behaviour can be useful in incentivising good behaviour. For instance, in regards to water charges, a free allotment of water based on average use, with additional allowances for families with children, could then be supplemented with progressive rates on higher levels of water use. It should be noted, though, that there are no comprehensive studies on water consumption in Ireland broken down by income, tenure and household size. Nor is there any estimate of the amount of ‘good behaviour’ such charges will induce. The Government has announced the introduction of water charges based on claims that have not been substantiated – which can only lead us to believe that it is purely a revenue raising mechanism.

Part of the problem for local authorities is that, in the absence of alternative sources of revenue, managers are forced to rely on the few revenue sources available. Those sources are regressive. What is needed is to provide alternative revenue sources. This would not eliminate the need for charges. But it would mean that such charges would not be based on economic charging but could truly become ‘incentives’ – in which case their regressivity could be radically reduced.

The most progressive tax is a tax on income. And of all taxes on income, a levy on gross income is one of the fairest as there are no deductions, allowances or reliefs. The original Commission on Taxation,⁵⁸ while not proposing a local income tax, pointed out there was no bureaucratic obstacle to its implementation (since it would be collected by the Revenue Commissioners).

This levy would be initially set by the Government and distributed to local authorities on the basis of an agreed formula for revenue-sharing (taking into account demographics, income, demand on public services, etc.). This levy would include ‘all income’ – personal income, rental and interest, capital gains, inheritances and gifts, etc.

Over time, the setting of the rate could be devolved to local authorities as part of a major restructuring of local government to facilitate more powers and responsibilities organised at local level.

In short, if local government taxation is to have credibility, it must be seen to be set in an accountable and democratic fashion.

53 - The Programme for Government makes the following commitment: ‘Consider, arising from the previous government’s deal with the IMF, various options for a site valuation tax. Any site valuation tax must take into account the significant number of households in mortgage distress and provide local government with a reliable stream of revenue.’ <http://tinyurl.com/62ebx7v>

54 - In 2007, charges for local government services made up approximately 17 percent of all local government revenue; 36 percent excluding Central Government Grants: CSO, National Accounts 2008

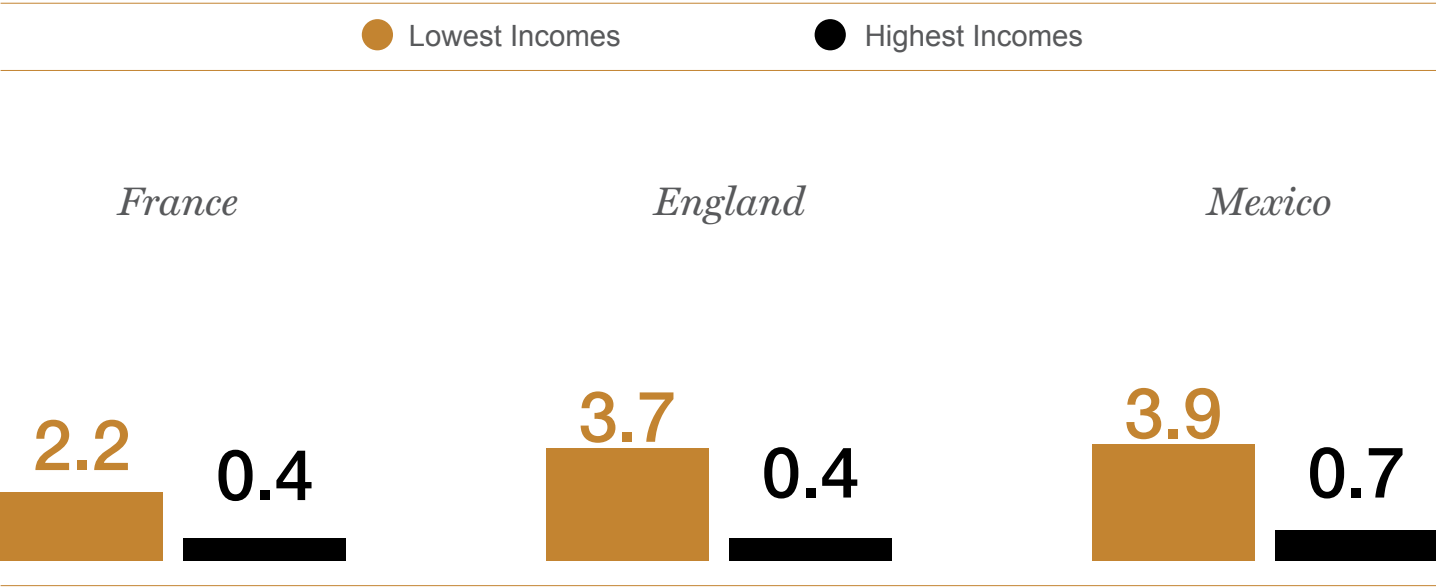
55 - An ‘economic charge’ means that the charge covers the cost of providing the service. Good or bad behaviour is incidental.

56 - OECD, Distribution of Costs and Environmental Impacts of Water Services, 2007

57 - OECD, Determinants of Residential Water Demand in OECD Countries <http://tinyurl.com/6zjbt8c>; Equity, Price Elasticity and Household Income; and Under Increasing Block Rates for Water, American Journal of Economics and Sociology <http://www.jstor.org/pss/3486079>

58 - The Commission on Taxation, 1984

10.2 - OECD: Water Charges as a % of Gross Income: 2007



11

Comprehensive Property Tax

Many commentators have argued for the introduction of a property tax. For many, it is synonymous with local government taxation – but there is no logical reason why such taxation should be applied at local level.

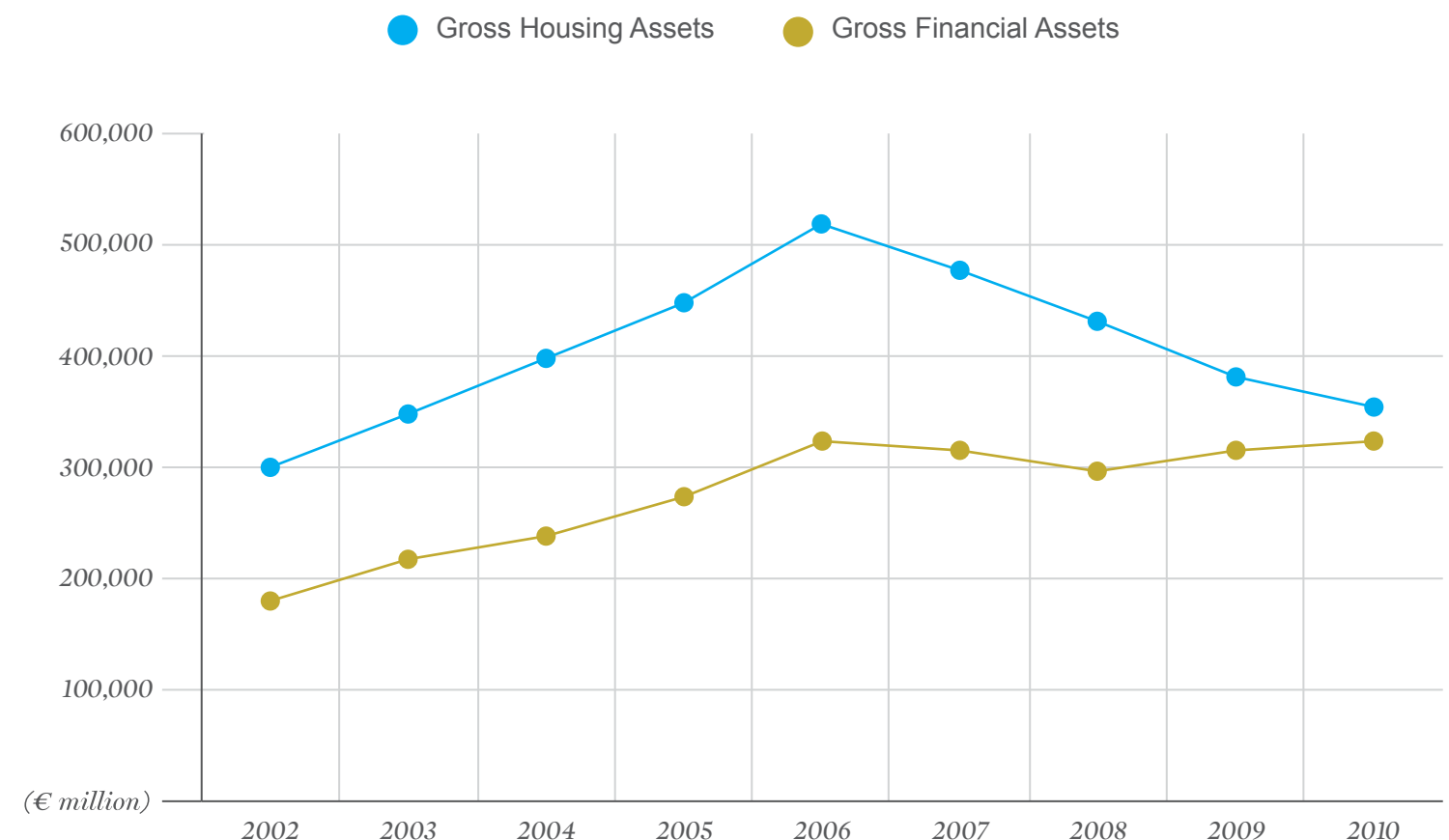
The Government has announced that it is proceeding with a site-value tax – a particular type of property tax.⁵⁹ However, in all these discussions there is one crucial element that is over-looked: they are only partial-property taxes and in some cases only house-property taxes. This could result in serious inequities and a reduced tax take.

All assets are property, whether it is a house, a farm, a bank deposit account, a car, stocks and bonds, a business. Therefore, a property tax should attach itself to all property, accepting that different kinds of property may attract different treatment (a pension fund has to be treated differently than multi-house ownership). For the purposes of this section we will use the term ‘property’ to encompass all forms of wealth – housing and land – unless otherwise specified.

The Central Bank/Goodbody Stockbrokers⁶⁰ breaks down assets into housing and financial property. (11.1) What is noteworthy is that while house property values have declined substantially, the value of financial property has been fairly resilient to the downturn. Financial property makes up nearly half of all property values. This shows that to exclude financial property would seriously erode a property tax base.

Another reason why excluding financial assets from a property tax is regressive is that such assets tend to be highly concentrated among a relatively small number of high-income households. While contemporary data is scarce, a rule of thumb internationally is that the top 1% of households can own between 25 and 40 percent of all financial wealth. Clearly, Ireland has a large financial property holding. The Allianz Global Wealth Report,⁶¹ shows that Ireland ranks 5th in the EU-15 in financial wealth per capita (2009). Excluding financial assets from a comprehensive property tax would constitute a significant subsidy to high-income groups.

11.1 - Value of Assets (Property) 2002-2010 (€ million)



The data on the distribution of wealth holdings throughout income groups (or deciles) is sparse. Brian Nolan⁶² estimated, based on a survey, that in 1987 the top 10 percent ‘reported’ that they owned 42 percent of all wealth, or property, with the top 5 percent owning 29 percent. More recently the Bank of Ireland, Private Banking⁶³ estimated that in 2007 the top 5 percent owned 40 percent of wealth, with the top one percent owning a third of all financial wealth. However, this was based on UK distributions and was not based on data derived from Ireland.

International surveys suggest that in recent times comprehensive property is, indeed, quite concentrated. One international study reports the following.⁶⁴

11.2 - Households

Top 1%	Next 4%	Top 5%
Denmark (1996)		
27.2	25.8	53.0
France (1994)		
21.3	23.3	44.6
Norway (2002)		
25.4	21.5	46.9
Sweden (2002)		
18.4	22.3	40.7
Switzerland (1997)		
34.8	23.2	58.0
UK (2003)		
21.0	19.0	40.0
US (2001)		
33.4	25.8	59.2

Using the above figures as a guide, the Bank of Ireland estimate for Ireland – that 40 percent of wealth is owned by the top 5 percent – is broadly accurate, if possibly an understatement. However, before a Comprehensive Property Tax (CPT) is levied, there should be a detailed study on the amount of property held by households domestically and abroad, broken down by income deciles. Such information is vital to ensure that a CPT is equitable and robust.

In terms of constructing a CPT – and assessing the amount of revenue it could generate – we should be wary of a one-size-fits-all approach. Different types of assets would need to be treated differently, in particular housing, pensions and insurance funds. Different thresholds, different rates, appropriate reliefs (especially for those with distressed mortgages) and exemptions would need to be addressed. However, there are two means by which we can assess the potential revenue raising capacity of a CPT.

(a) Gross and Net Property

11.3 - Estimated Household Property Holdings: 2010

343.1
Housing Property
310.9
Financial Property
654.0
Total Gross Property
181.7
Liabilities
472.3
Total Net Property
Source: Goodbody Stockbrokers

A CPT could be levied on gross property (that is, without taking into account liabilities); this is the basis upon which most house-property taxes are proposed. Or it could be levied on the basis of net property, factoring out liabilities (this would benefit households in negative equity or with little equity in their principal house). Either way, there would be a significant tax base.

(b) ESRI and Commission on Taxation Revenue Estimate

Both the ESRI and the Commission on Taxation have provided estimates of revenue arising from the introduction of a house property tax. The ESRI⁶⁵ estimated that such a tax, levied at 0.4 percent of value, could raise €906 million while exempting adults with disposable incomes of less than €15,000 per year. The Commission on Taxation⁶⁶ projected that a 0.3 percent tax on housing value could raise €1.1 billion with the operation of a waiver scheme for those on low-incomes.

Given that financial property is equivalent in value to house property, we should expect that similar levies would raise the equivalent amount of revenue. If there was a progressive rate, more revenue could be raised. In any event, a modest target of between €1.5 and €2 billion could be raised through a CPT.

Objections have been raised that a CPT would create ‘capital flight’ – that is, households would move capital abroad and thus deprive the economy of its benefits. This is easily resolved. The CPT would be a global tax – that is, regardless of where the asset is located (a shopping mall in Munich, an equity fund in Tokyo) it would be subject to tax. This is how the French assets tax operates. Indeed, such a global CPT would be of real assistance to the Revenue Commissioners. It would provide a new audit base to assess past tax compliance.

Setting up such a tax, with new Revenue powers and compliance oversight (especially given that it would be self-reporting), will take time. There is also the issue of undermining domestic demand – with average income groups already being burdened by income tax increases, the Universal Social Charge and social welfare cuts (e.g. Child Benefit, Early Childcare Supplement). Therefore, a CPT should be phased in over a period of 3-4 years. In the first year, only those income groups with individual incomes exceeding €100,000 should be subject to this tax. In the following years, the threshold can be lowered.

A related issue is the treatment of tax exiles. Up to recently citizens could avoid tax if they organised their affairs to such an extent that they were in the country for less than 183 days per annum, or less than 280 days, in aggregate, in a tax year and the preceding tax year. The Government has introduced a flat rate charge of €200,000 for such individuals but the residency rules still remain and the cost of enforcement is high (Revenue assigns staff to monitor the travel arrangements of people availing of this relief).

There is a simple way around this – to bring Irish citizens into the tax net regardless of where they live by making citizenship an additional criterion for taxation. To ensure this is targeted at high-income groups, a high income threshold (e.g. €250,000 annually) could be used which would mean the provision only affects taxpayers with incomes above this. In effect, this measure would only affect tax exiles availing of tax havens. This citizen based tax system is operated by the US. The income of a US citizen is taxable without regard to the citizen’s place of residence or where the income is earned or produced above a certain threshold. A US citizen can eliminate her / his tax liability only by both moving abroad and renouncing citizenship.

This would still mean that foreign-national residents in Ireland would be taxed.

There are three further areas of capital or wealth taxation to examine:

Capital Gains Tax: there is a strong argument that income from capital gains should not be treated any differently than income from labour. Currently, capital gains are taxed at 25 percent. This is below the rate of taxation on labour: a low-paid worker faces a marginal tax rate of 30 percent while average income earners pay a marginal tax rate of 51 percent. Consideration should be given to eliminating capital gains tax for individuals and treating income received from capital gains as part of income tax – with appropriate reliefs for productive investment which has identifiable economic benefits (e.g. employment, enterprise development, etc.)

Capital Acquisitions Tax (Inheritances and Gifts): currently, inheritances and gifts are taxed at a single rate of 25 percent. Exemption thresholds for children are quite high: €332,084.⁶⁷ This means that only inheritances/gifts above that amount are taxed.⁶⁸ There is a strong argument for radically reducing the

‘children’s threshold’ while eliminating exemptions for all other recipients. Inheritances and gifts would be taxed under the income tax system.

In both cases, as in the case of income from labour, the gross capital gain and inheritance/gift could be liable the USC and PRSI contributions.

Exemption of the Sale of Principal Residences from Tax: Currently, the sale of a principle residence, or house, is exempt from tax. There is no reason in equity for this exemption (the Commission on Taxation stated: ‘ . . the efficiency and equity of this tax expenditure is debatable . . ’). The exemption should be abolished and all net gains from the sale of a housed (after, mortgage repayments, maintenance/repair and inflation) should be taxed under the income or capital gains tax system. Fine Gael has estimated that a small capital gains tax – 5 to 10 per cent on the sale of principal residences could raise €250 million.⁶⁹

These measures would extend the tax base, increase tax revenue and introduce greater progressivity into the overall tax system.

59 - A site-value tax is a tax on land only, excluding buildings and use
60 - Recovery in Sight’, Goodbody Stockbrokers, October 2009.
61 - <http://tinyurl.com/32wvflt>
62 - The Wealth of Irish Households’, Combat Poverty Agency, 1991
63 - Wealth of the Nation, Bank of Ireland, 2007
64 - ‘Long Run Changes in the Concentration of Wealth: An Overview of Recent Findings’, Henry Ohlsson, Jesper Roine, Daniel Waldenström <http://bit.ly/ow6j2i>
65 - <http://tinyurl.com/5wzkoqah>
66 - <http://tinyurl.com/nxp49a>
67 - For a parent, grandparent, grandchild, great-grandchild, brother, sister, nephew or niece the threshold is €33,208 while for all others (‘strangers’) the threshold is €16,604
68 - For instance, a son or daughter receiving an inheritance from a parent of €500,000 will only be taxed on that portion above the threshold – that is, €167,916. Their CAT liability would, therefore, be €41,979; or an effective tax rate of 8.4 percent
69 - Fine Gael, ‘Perspectives on Budget 2011 and the 4-Year Plan’: <http://tinyurl.com/69u8fel>

Corporate & Business Taxation

As pointed out previously, while Irish corporate tax rates are low by EU standards, the level of corporate tax revenue (as a % of GDP) is average. The reason for this is that our low-tax regime attracts profits produced in other countries. In other words, we are taxing profits that were not generated here. This is inequitable (why shouldn't French or Dutch workers, who work to produce the profits in their country, be entitled to tax those profits in order to sustain their public services).

However, in the medium-term, raising the corporate tax rate would be a major disincentive to foreign investment and could lead to overall loss of tax revenue as a result of profits seeking an alternative tax 'home'. Given Ireland's over-reliance on foreign investment and its weak indigenous enterprise base, this could seriously undermine economic recovery. For instance, in 2004 Forfas found that foreign-owned companies made up over 90 percent of the total corporate tax yield in the manufacturing sector.

Simply put, our indigenous sector is too weak to generate recovery on its own. Therefore, raising the corporate tax rate should be a long-term goal and should only be entertained when the indigenous sector is strengthened and other factors to attract foreign investment can be put in place – physical infrastructural upgrading, skill upgrading, reduction of cost inputs into business, etc. The long-term issue for the economy is not necessarily the low-level of the corporate tax rate but the low level of indigenous enterprise activity.

There is still a need to reform corporate and business taxation; in particular, the proliferation of tax expenditures. There is an almost knee-jerk reaction that every 'enterprise challenge' must be met by new tax breaks – despite the fact that business taxation is already low.

First, for most enterprises – especially in the vital small and medium-sized sector (SMEs) – the obstacles they face to growth has nothing to do with taxation but rather enterprise supports. Of the ten main obstacles that SMEs face entering international markets (a crucial issue for Ireland's small open economy), none of them involve taxation. Indeed, SMEs will require increased resources to make them competitive⁷⁰ – resources that will have to be paid out of increased taxation.

A reform programme should analyse all tax expenditure in the business sector and test their benefit and deadweight, their impact on employment, value-add-

“A reform programme should analyse all tax expenditure in the business sector and test their benefit and deadweight”

ed generation and export expansion, their distributional impact, etc. To date, this assessment has not taken place. In many instances, we do not know the cost of business tax expenditure or even how many companies or individuals may be benefitting from them. For instance, the Commission on Taxation's examination of business tax expenditure (a small selection) showed that of the 28 tax reliefs examined, they could not estimate the cost of 16 of those reliefs nor could they estimate the number benefitting in 23 of those reliefs. This lack of information is detrimental to forming policies determined to get the best value for expenditure. The Government could introduce a sunset clause for all corporate and business tax expenditures whereby such expenditures would be ended unless they could be shown to be economically efficient.

There is also the continuing drain on the exchequer from property tax reliefs. While almost all of these reliefs have been discontinued for new entrants, high-income earners will still be able to benefit for years to come through carrying forward losses and unused capital allowances. While the principle of carrying forward allowances and losses is legitimate for enterprises, there is considerable difference between productive and speculative activities. To continually subsidise past speculative activities in the property market raises profound questions of social equity and economic efficiency.

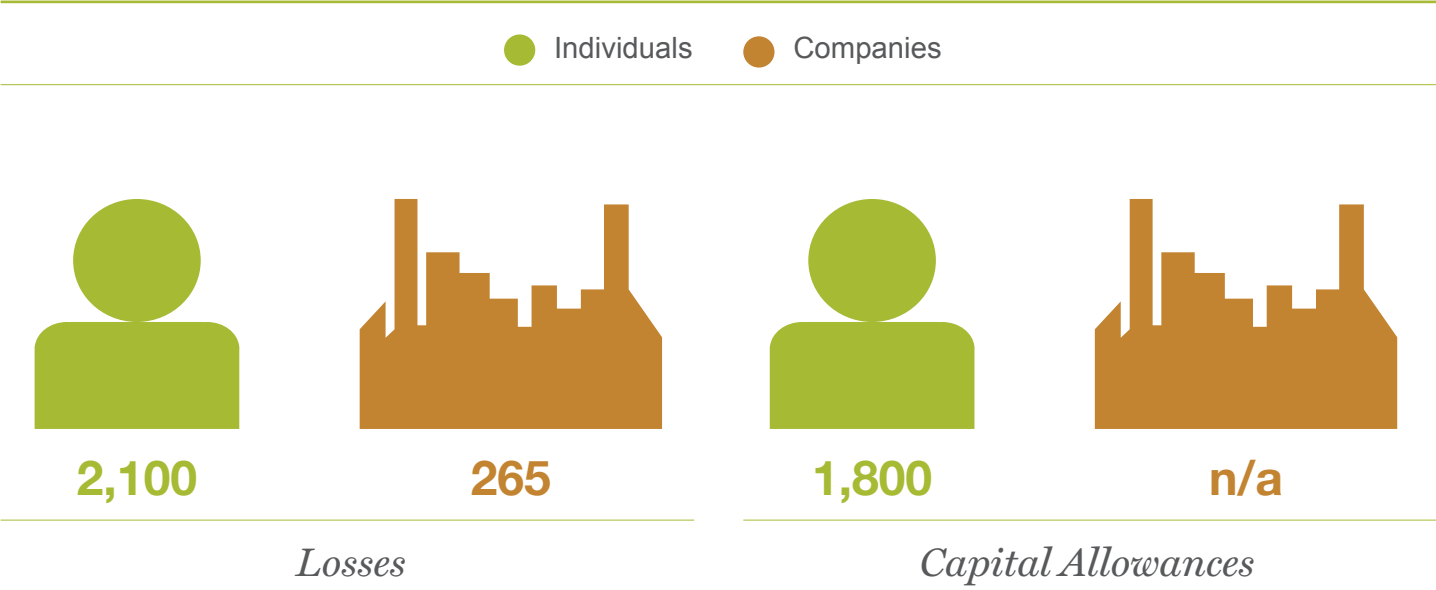
The extent of these unused allowances and losses under property tax relief schemes was revealed by the Minister for Finance.⁷¹ **(12.1)**

In total, there is over €4 billion worth of allowances and losses ‘in the tax system’ – tax reliefs that individuals and companies can continually claim up to 2020 and beyond in some tax reliefs. This will represent a substantial drain on exchequer resources in the future.

The Tax Strategy Group⁷² has already canvassed the option of ending all carrying forward of unused allowances and losses under property tax relief schemes. This is an option that the Government should urgently consider.

⁷⁰ - ‘Catching the Wave’, A Services Strategy for Ireland Services Strategy Group Background Report, Department of Enterprise, Trade and Employment, September 2008.
⁷¹ - <http://tinyurl.com/5wpgg6p>
⁷² - <http://tinyurl.com/5w7nj89>

12.1 - Property-Related Allowances and Losses Carried Forward: 2009 (€ million)



Appendix One

Phasing in the Reform Programme

The reform programme outlined above – bringing the Irish taxation regime into alignment with European norms – is a long-term project. It cannot be achieved in the short-term. This is particularly so as the economy will struggle to create growth for a number of years to come. Therefore, the introduction of our proposals must work with, not against, the grain of economic growth and a vital part of that growth is to protect the disposable income of those on low and average incomes so that they can maintain the domestic demand upon which most of our enterprises depend on. Below a broad outline is provided of how such a programme could be phased in through three stages, each lasting approximately 2 to 3 years.

First Stage

Social Insurance

- Apply PRSI and the USC to all income; namely capital income
- Agree the social insurance programmes – universal health insurance, earnings-related pension insurance, earnings-related unemployment / sickness benefit
- Begin the integration of the USC into PRSI

Income Tax

- Commence reduction of tax expenditures to EU average
- Phase in refundable tax credits

Indirect Taxation

- Reduce VAT on labour-intensive sectors where such reductions will be (a) passed on to consumers, and (b) benefit low-average income groups
- Increase VAT, where possible, on goods and services with high import content

Local Government Finance

- Remove economic charging as the basis for service charges and change to ‘incentivising good behaviour’
- Introduce a Local Government Levy on all personal income (labour and capital) above the income tax threshold – starting at 1 percent

Taxing Property

- Introduce a Comprehensive Property Tax, starting with individuals earning over €100,000 per annum and phasing in the remainder of property-owners over the next few years, consistent with economic growth
- Apply taxation on the basis of citizenship, not location
- Remove exemption of capital gains from sale of houses

Corporate & Business Taxation

- Sunset clause for all reliefs, allowances and exemptions, accompanied by a fact-based and transparent analysis of each expenditure item against a benchmark of economic efficiency and social equity to assess which should be maintained.
- Priority consideration be given to ending the carrying-forward of all unused capital allowances and losses under property tax relief schemes.

Second Stage

In this phase, the emphasis should be on embedding the reforms into the new taxation base and to slowly phase in general tax/social insurance increases consistent with economic and wage growth.

Social Insurance

- Continue integration of the USC into social insurance
- Slowly phase in increases in employers’ social insurance contributions

- Begin phasing in new social insurance benefits (health, pensions, pay-related unemployment, etc.)

Income Tax

- Complete reduction of tax expenditures to the EU average
- Complete introduction of refundable tax credits

Indirect Taxation

- Continue monitoring the potential of reducing VAT on labour intensive sectors and increasing VAT on goods and services with high import content

Local Government Finance

- Continue increasing Local Government Levy

Taxing Property

- Continue phasing in the Comprehensive Property Tax

Corporate & Business Taxation

- Maintain tax expenditures that have passed a fact-based and transparent analysis benchmarked against economic efficiency and social equity.

Third Stage

The final phase will see the consolidation and completion of the reform programme with the goal of stabilising public finances at a new Government revenue level of 45 percent of GDP.

Social Insurance

- Completion of the new social insurance model with contribution levies fully integrated and optimised for employees, employers and self-employed

Income Tax

- The tax base fully optimised with low levels of tax expenditures and more people entering the tax net as wages grow

Indirect Taxation

- Complete reforms of VAT and excise with the option of reducing VAT rates that impact disproportionately on low to average income earners where it is fiscally sustainable

Local Government Finance

- Complete the full introduction Local Government Levy and devolve the setting of the levy to a reformed local government sector

Taxing Property

- The Comprehensive Property Tax fully established with all households earning above a certain threshold now subject to it and low rates introduced for low income earners as appropriate

Corporate & Business Taxation

- Having completed the reform of tax expenditures and capital allowances, begin phasing in higher corporate tax rates to the EU average consistent with an expanding indigenous enterprise sector

It should be emphasised that this programme of implementation is highly stylised. It is difficult to predict the progress of the economy over the years to come. For instance, higher growth may allow for a quicker implementation of many elements of this programme while low growth may slow progress. However, by giving us a ten-year time span it will be easier to implement the programme on an incremental basis towards the end goal of creating a European style taxation regime.

Appendix Two

Moving Towards European Norms

While proposing that Ireland should move towards a European level of taxation, it is important to acknowledge that this may not be achievable in the short-term. Increasing the overall levels of taxation at too fast a rate may undermine growth. However, even moving towards this goal will allow for extra resources to be devoted to public investment, public services, social protections, etc. The following charts the amount of resources that would be released – increasing the overall level of taxation above the Government's intended low-tax target by 2014.

If the Government's strategy is maintained (keeping tax levels low at 32.1 percent) public expenditure will fall by nearly -€4.8 billion between 2011 and 2015. However, as the tax level rises, so does the capacity to invest in the economic infrastructure, public services and social protection.

Slight rise to 34 percent: - this would limit the need for expenditure cuts to approximately €1.3 billion over the four years.

Rise to midway point to European norm – 36 percent: this would provide for an increase of €2.3 billion above 2011 levels.

Substantial rise towards European norm – 38 percent: this would provide for an increase of nearly €6 billion.

Were Irish tax levels to reach European norms by 2015, an extra €9.6 billion would be released for economic and social investment.

It should be noted that this is a static calculation. An increase in public expenditure – particularly investment in the physical and social infrastructure (public services) – would generate more employment and growth thus reducing unemployment costs and, so, public expenditure. This, in turn, would release even more resources.

The Effect on Public Expenditure Increases between 2011 and 2015 from Different Tax Levels in 2015 (€ million)

Tax Rate as
a % of GDP
(2014)

32.1

34.0

36.0

38.0

40.0

(current Government Projection)

(European norm)

Extra Public
Expenditure
(€ million)

-4,795

-1,323

2,331

5,986

9,640

(current Government Projection)

Community Platform

Founded in 1996, the Community Platform acts as a mechanism to facilitate solidarity amongst organisations in the community sector that work to address poverty, social exclusion and inequality.

The objective motivating the establishment of the Community Platform was two-fold:

- To facilitate the sector's participation in the national social partnership negotiations
- To create a collective critical voice for equality, rights and anti-poverty interests at a national level

Current Members

The Community Platform is currently made up of a network of over 30 national networks and organisations. They include:

Age Action Ireland
ATD 4th World
Community Action Network
Community Workers' Co-operative
Cairde
Debt and Development Coalition
European Anti-Poverty Network Ireland
Focus Ireland
Gay and Lesbian Equality Network
Immigrant Council of Ireland
Irish Association of Older People
Irish National Organisation of the Unemployed
Irish Penal Reform Trust
Irish Refugee Council
Irish Rural Link
Irish Traveller Movement
Migrant Rights Centre Ireland
National Adult Literacy Agency
National Network of Women's Refuges and Support Services
National Traveller Women's Forum
National Women's Council of Ireland
Older Women's Network
OPEN
Pavee Point Travellers Centre
Rape Crisis Network Ireland
Simon Communities of Ireland
Threshold
Voluntary Drug Treatment Network
Vincentian Partnership for Justice
Women's Aid

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