Commission on Taxation & Welfare
An Coimisiún um Chánachas ⁊ Leas

Briefing Paper

Fiscal sustainability and the balance of taxation

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Subject	**Fiscal sustainability and the balance of taxation**
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Key Points

This paper re-examines the topic of fiscal sustainability and also raises the issue of what the appropriate balance of taxation should be. The set of recommendations that emerge from the final report of this Commission will need to be cognisant of the Terms of Reference request to ensure "*that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term*". The Commission's report will also need to consider "*options for reform on the balance between the taxation of earned income, consumption and wealth".*

The purpose of this paper is to facilitate a discussion by the Commission to agree overall objectives and debate the following questions:

a) Should the Commission aim for a **net revenue raising approach** to taxation in order to address sustainability issues?
and

b) If so, what areas should be prioritised in terms of revenue raising and what is the appropriate balance between the taxation of earned income, consumption and wealth?

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1. Introduction

This paper re-examines the topic of fiscal sustainability in light of the Commission's mandate to ensure "*that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term*." The terms of reference also specifically ask the Commission to consider "*options for reform on the balance between the taxation of earned income, consumption and wealth".* The purpose of this paper therefore is to facilitate a discussion by the Commission to agree overall objectives and debate the following questions:

a) Should the Commission aim for a **net revenue raising approach** to taxation in order to address sustainability issues?

and

b) If so, what areas should be prioritised in terms of revenue raising and what is the appropriate balance between the taxation of earned income, consumption and wealth?

Section 2 of this paper highlights current projections on fiscal sustainability and emerging challenges over the next 20 years. This material builds on topics already discussed at meeting 2 of the Commission and illustrates the funding challenges that will emerge over this period. Section 3 shows what taxes are currently contributing to the Irish Exchequer, how this compares internationally and briefly discusses the means by which additional tax revenues can be raised based on what is considered to be the most optimal from a neutrality perspective.

2. Fiscal Sustainability

Meeting 2 of the Commission presented some of the key challenges that are likely to face the public finances in the next 20 years. The Secretariat paper on fiscal sustainability[1] was produced to give an overview of the economic and fiscal backdrop against which the Commission will be making its recommendations. As Ireland emerges from the Covid-19 Pandemic, significant underlying challenges remain from a fiscal perspective. This paper will build on those discussions outlining some of the Exchequer shortfalls that are projected over the short, medium and long term. Like the first paper on fiscal sustainability, this briefing note is not intended to provide a specific shortfall of funding to the Commission against which to formulate recommendations. It is intended to give a sense of the uncertainties that exist around projected Exchequer shortfalls, while highlighting the broad consensus that there is a need for fiscal consolidation if the State is to respond to future crises and increased

[1] The Meeting 2 paper on the 'Sustainability of the Public Finances' is available on Decision Time

structural expenditure commitments. Housing, health, climate action and potential risks to corporation tax receipts will place increasing demands on the public finances in the short and medium term, while costs associated with an ageing population, in particular, will accelerate further in the long term. The Commission will need to consider whether the recommendations that come out of the final Report add to the pressures facing the public finances (net revenue reducing) or reduce the shortfalls facing the Exchequer in subsequent years (net revenue raising), bearing in mind that implicit preference is given to the latter in the Terms of Reference.

The 2009 Commission on Taxation adopted a broadly revenue-neutral approach. This was in accordance with their Terms of Reference "*to keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system*". They did not seek to increase overall levels of revenues, but rather to broaden the tax base to a wider range of sources while using these new revenue streams to reduce the burden on other sources.

Forecasting is not an exact science and this is particularly the case in the wake of the historically exceptional Covid-19-induced recession. The Pandemic necessitated the abrupt curtailment of both supply and demand and the reopening of society has led to a dramatic rebound in economic activity, creating a highly uncertain backdrop against which to conduct forecasts. Indeed, this is highlighted by the fact that the two most recent forecasts published by the Department of Finance have projected two very different deficit profiles out to 2025. The projected 2025 deficit published in the Summer Economic Statement (SES)[2] is now forecast to be nine times the size of the equivalent in the Stability Programme Update (SPU)[3] published only four months earlier, at €7.4 billion, or 2.8 per cent of GNI*. This is due in large part to the unprecedented expenditure commitments made by government relating to housing and climate action and revised current expenditure forecasts. The most recent forecast was published by the Irish Fiscal Advisory Council (IFAC) in September and estimates a quicker reduction in the deficit to 1.3 per cent of GNI* (€3.5 billion) in 2025.[4]

Figure 1: General Government Balance (as % of GNI*)

	2020	2021	2022	2023	2024	2025
Deficit per SPU (€ millions)	-18,410	-18,060	-11,615	-5,320	-3,130	-805
Deficit per SES (€ millions)	-18,410	-20,285	-14,370	-8,050	-7,630	-7,355
Deficit per IFAC (€ millions)	-18,760	-15,595	-6,414	-4,461	-4,035	-3,542
Deficit per SPU (% GNI*)	-8.9%	-8.4%	-5%	-2.2%	-1.2%	-0.3%
Deficit per SES (% GNI*)	-8.9%	-9.4%	-6.2%	-3.3%	-3%	-2.8%
Deficit per IFAC (% GNI*)	-9.0%	-7.0%	-2.6%	-1.7%	-1.5%	-1.3%

Source: IFAC and the Department of Finance

[2] Department of Finance, Summer Economic Statement, July 2021
[3] Department of Finance, Stability Programme Update, April 2021
[4] IFAC, Pre-Budget Statement, September 2021

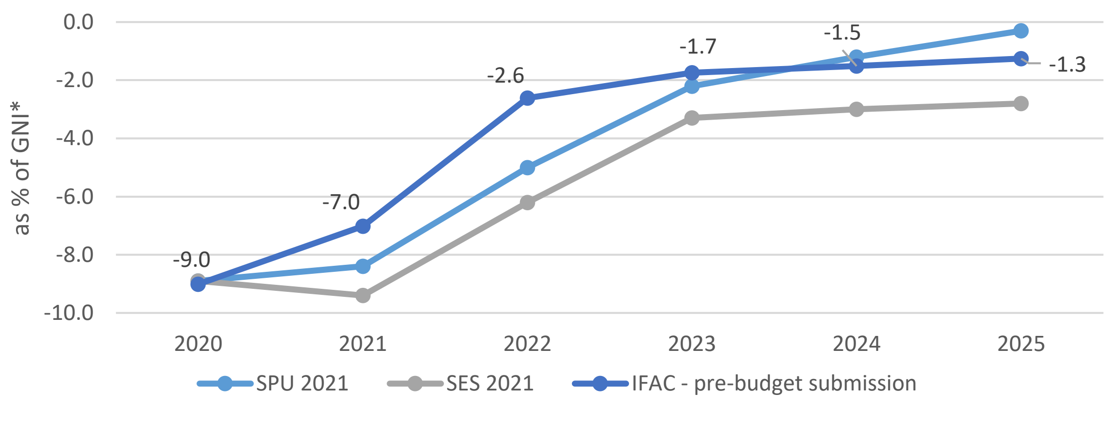
The Department's Economic and Fiscal Outlook, due to be published alongside Budget 2022, will likely have a further revised set of forecasts for the short and medium term. Similarly, the SPU published next spring will provide the most up-to-date set of official forecasts ahead of the publication of the final Report of this Commission. This paper is therefore, intended as a broad overview of the current state of the public finances. Formulating tax and welfare policy exactly around the moving targets that are projected deficits is a near-impossible exercise.

The remainder of this section will explore the range of deficit estimates that have been produced by IFAC and the Department of Finance between 2021 and 2025. It will also explore the estimated longer-term costs associated with an ageing population.

2.1 Short and medium term

IFAC's recently published Pre-Budget Statement presents lower deficit projections than the SES for the short and medium term. IFAC projects that the permanent (scarring) effects of the Pandemic on the economy will likely be less severe than what the Department of Finance forecasted in the SES. IFAC estimate that the economy will recover to 1.5 per cent below its pre-pandemic trend by 2025; in contrast with the Department's latest estimate of approximately 5 per cent scarring by 2025.

Figure 2: General Government Balance (as % of GNI*)



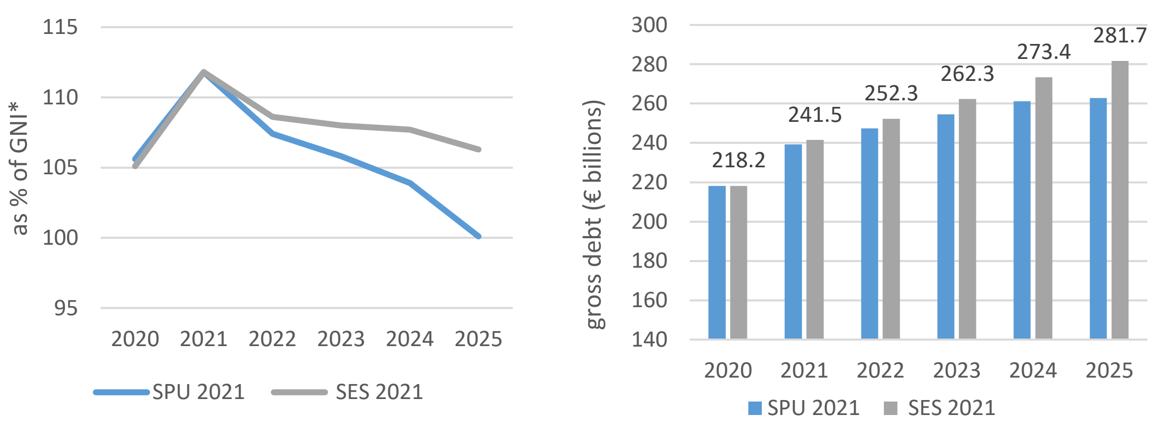
Source: IFAC and the Department of Finance

Figure 1 shows IFAC deficit forecasts over the next five years alongside the last two forecasts of the Department, the nominal figures of which are published in Table 1. IFAC's more optimistic forecast, particularly in 2021 and 2022, is predicated on both higher growth and higher-than-expected income tax and VAT receipts. However, IFAC forecast greater deficits in 2024 and 2025 than those that were presented in the SPU in April 2021. This is due in large part to the Government's commitment to ramp up public investment in the intervening period in areas such as housing and climate action, details of which will be provided in the forthcoming National Development Plan (expected in October 2021). IFAC estimate that a structural deficit of around 3 per cent will persist from 2022-2025. Crucially, this suggests that forecasted deficits are not merely cyclical in nature and there is limited ability for economic growth to reduce the deficit over the next five years.

Both IFAC and the Department of Finance stress the uncertain nature of short-term forecasts. A caveat to any deficit forecast must also be made with regards to downside risks associated with new variants of Covid-19, the uncertain duration of business supports and 'temporary' VAT cuts. Potential upside risks include a faster-than-expected return to full employment.

As a result of forecasted deficits having been revised upwards, gross debt is also projected to be greater over the next five years. According to the SES, the projected debt ratio will stand at 106 per cent of GNI* in 2025, as opposed to the 100 per cent of GNI* projection consistent with the first Fiscal Sustainability paper presented to the Commission in June. In nominal terms, gross debt is now projected to be €20 billion higher in 2025 than it was in the SPU, standing at €281.7 billion. This increased level of debt is not insignificant, as Ireland already has the highest level of debt per capita in the EU at €44,000 per person in 2020, and one of the highest in the world.[5] In 2025, the debt per capita ratio is likely to be €53,000.[6]

Figure 3*: Gross debt i) as % of GNI* ii) in nominal terms (€m)*



Source: IFAC; Department of Finance

For a small open economy, placing the debt ratio on a downward path is important. A relatively low debt burden gives the State sufficient room to borrow in the face of future crises. Similarly, while

[5] Department of Finance – Annual Report on Public Debt 2020, 2021
[6] Secretariat calculations based on Eurostat population projection for 2025

interest rates are currently at historically low levels, there is a risk that they may rise in future years, making the future issuing of debt more costly.

2.2 Long Term

Long-term structural costs associated with ageing, healthcare, and the carbon and digital transitions will require, among other measures, a combination of increased government revenues, decreases in expenditure in other areas or an increase in the pension age. This section will not go into detail on the nature of these issues, as they were addressed in the previous Secretariat paper on fiscal sustainability.[7] It should be noted that the Commission will be required to take account of the recommendations of the Pensions Commission. Any policies adopted on foot of these recommendations will have implications for future expenditure projections related to an ageing population.

A recently published report by the Department of Finance gives detailed insight into the nature of Ireland's ageing population and associated costs.[8] While Ireland currently has a relatively young population, those aged 65 and over are growing rapidly as a share of the total population. Currently, there are four working age persons for every over 65 year old; in 2050, the equivalent figure will be just over two. This will bring with it significant pension, health and long-term care costs over and above what is provided for through existing revenue streams.

Table 2: Age-related expenditure 2019-2040

	2019	2030	2035	2040
Age-related expenditure if no demographic pressures i.e. 21.4% of GNI* (€ billions)	45.7	67.6	81.2	97.9
Projected age-related expenditure (€ billions)	45.7	78.0	98.2	124.5
Additional expenditure due to age-related costs - currently unfunded (€ billions)	-	10.5	17.0	26.6
Projected age-related expenditure (as % of GNI*)	21.4%	24.7%	25.9%	27.2%

Source: Department of Finance
Note: Long-term macroeconomic projections consistent with the European Commission's spring 2020 forecasts

Table 2 gives an overview of the estimated costs of an ageing population. The first row shows nominal age-related expenditure if demographics were to remain as they are i.e. to continue to command 21.4 per cent of GNI* in expenditure into the future. The second row shows estimated age-related expenditure associated with projected estimated ageing in nominal terms. The difference between

[7] See Meeting 2 paper ~~here~~
[8] Department of Finance, Population Ageing and the Public Finances in Ireland, 2021

these two estimates gives an idea of what the additional (and currently unfunded) costs associated with these changing demographics might look like (row 3). Future revenues are not estimated here, however as annual age-related expenditure increases over the next half a century, economic growth – and by extension revenue growth – will slow as the working-age proportion of the population declines.[9]

It should be noted that this baseline estimate assumes that the State Pension Age remains at 66 years over the time horizon. It is also worth noting that there are many assumptions underpinning these estimates relating to life expectancy, migration, and fertility projections, not to mention a myriad of macroeconomic assumptions. The purpose of this exercise is to give an indicative estimate of what the likely shortfalls will be with respect to an ageing population.

These estimates do not factor in long-term costs associated with other risks such as climate action and digitalisation. Estimates of some of the potential costs associated with these risks are addressed in the previous paper on Fiscal Sustainability, however, to our knowledge a comprehensive set of expenditure and revenue projections taking into account all of these risks over the next 20 years has not been conducted, owing to significant uncertainty. Details of some of the planned expenditures will be in the new National Development Plan and Climate Action Plan.

2.3 Conclusion

Covid-19 has placed significant pressure on the public finances. Necessary supports that were put in place to alleviate reduced incomes associated with job loss and commercial activity are now being unwound leaving debt elevated. Yet, the Exchequer faces increasing demands relating to essential infrastructural investment in the areas of housing, health and climate action in the short and medium term. Structural reform will also have to take place to account for an increasingly ageing population. The Terms of Reference state the need to ensure "*that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term*". The set of recommendations that emerge from the final report of the Commission on Taxation and Welfare will have to be cognisant of this.

Having considered the outlook above, are Commission members satisfied that the general aim for this Commission should be to adopt a net revenue raising approach to taxation in order to address fiscal sustainability?

[9] Barnes et al. - Managing government debt at high altitude, 2021

3. Balance of taxation

This section examines the balance of taxation currently contributing to Irish revenues, how this compares internationally and briefly discusses the means by which additional revenues can be raised based on what is considered to be the most optimal from a neutrality perspective.

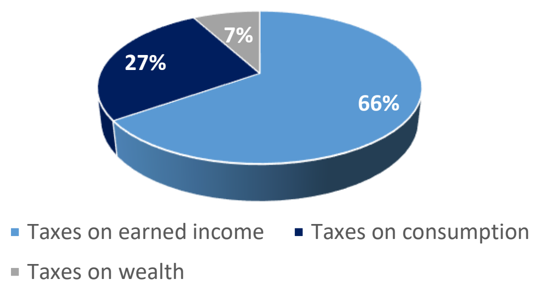
3.1 Breakdown of Irish tax receipts

The terms of reference specifically ask the Commission to consider "*options for reform on the balance between the taxation of* ***earned income, consumption,*** *and* ***wealth***". The Secretariat has interpreted these terms as meaning the following:

- **Taxes on earned income**: This relates to all taxes and levies, such as income tax, USC, PRSI and corporation tax, on labour (both employed and self-employed) and business trading income.
- **Taxes on consumption**: This covers taxes on spending such as VAT and excises including carbon tax and vehicle registration tax (VRT).
- **Taxes on wealth**: This covers taxes on income derived from ownership of a capital asset (e.g. shares, property, deposit accounts, etc.), together with taxes on the gains from disposal of assets, or taxes on the acquisition, holding or occupation of such assets. For example, this includes income tax, DIRT, USC, PRSI and corporation tax on investment, savings and passive income,[10] as well as capital taxes such as stamp duty, CAT, CGT and LPT.

Figure 4*:* Breakdown of tax receipts 2020 (%)

Using the above categorisation (as far as available data allows), the total receipts from 2020 show a strong reliance on public funding from taxes on earned income (66% of total receipts), followed by taxes on consumption (27%) and lastly taxes on wealth (7%).



Due to limits in the way data is collected, it is not possible to separately present the corporation tax receipts from trading income, passive income and chargeable gains. Revenue has stated[11] that as certain reliefs can be offset against profits taxable at the higher rate before off-setting them against

[10] Passive income is income that is earned without much active involvement e.g. from dividends, royalties, etc.
[11] Revenue, Corporation Tax – 2020 Payments and 2019 Returns

income taxable at the 12.5% rate, the bulk of corporation tax paid was attributed to trading income in all years. Data is also not available on the breakdown of income tax, USC and PRSI receipts from self-employed income compared with investment/non-trading income.

Figure 5 Breakdown of tax receipts 2020 (€) – Total €68 billion

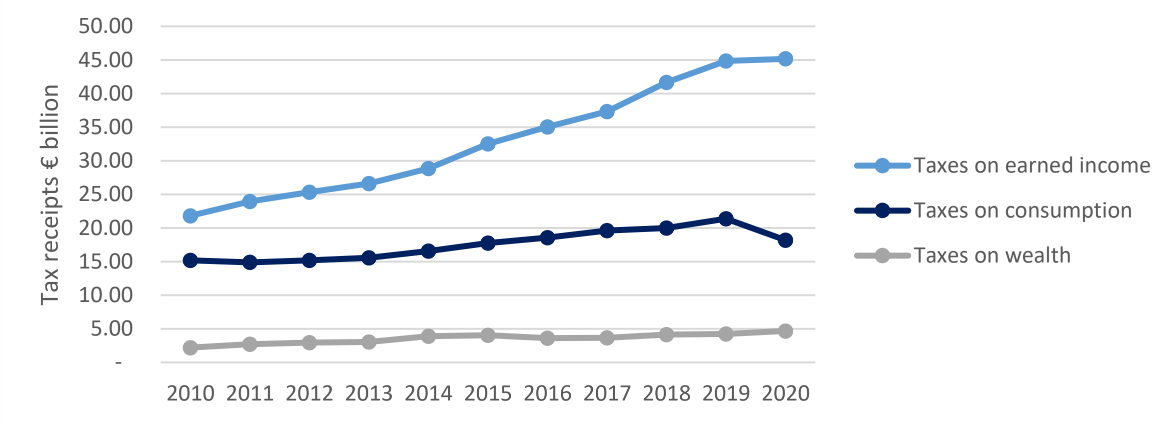
Taxes on earned income	€m	Taxes on consumption	€m	Taxes on wealth	€m
Income Tax* *PAYE 15,576* *Self-assessed 1,828*	17,404	VAT	12,474	Stamp Duty *Other*** 1,006* *Shares 569* *Property 519*	2,094
Corporation Tax**	11,833	Excise	5,427	Capital Gains Tax	950
Employer PRSI	7,929	Customs	273	Capital Acquisitions Tax	505
USC* *PAYE 3,260* *Self-assessed 572*	3,832	Plastic Bag Levy	4	Dividend Withholding Tax	487
Employee PRSI	2,773			Local Property Tax	480
Professional Services Withholding Tax	759			Life Assurance Exit Tax	124
Self-Employed PRSI*	647			Deposit Interest Retention Tax	37
				Other Income Taxes	4
Total	**45,177**		**18,178**		**4,681**

Source: Revenue, the Department of Finance and Department of Social Protection
Notes: For ease of discussion PRSI is referred to as a tax.
** Data is not separately available for income tax, USC and PRSI on trading/self-employed income and non-trading/investment income.*
*** Data is not available for tax collected under each of the 12.5% (trading income), 25% (passive income) and 33% (capital gains) rates of corporation tax, however Revenue have stated the bulk of corporation tax paid is attributed to trading income in all years. Therefore, corporation tax receipts from 2020 have been included in the taxes on earned income category above.*
**** Other stamp duty includes the non-life levy and life assurance levy, levy on certain financial institutions and duties from insurance policies, cheques, credit cards, etc.*

3.2 Trends in Irish tax receipts

Figure 5 below demonstrates the trend of Irish tax receipts over the last decade, with a notable increase and reliance on taxes collected from earned income (income tax from employments and corporation tax from multinationals in particular).

Figure 6 ***Irish tax receipts from earned income, consumption and wealth 2010 to 2020***



Source: Secretariat calculations based on data from Revenue, the Department of Finance and CSO

Taxes on earned income

Income tax receipts collected under the PAYE system have consistently represented the single largest source of tax to the Exchequer, which is reflective of the high volume of employments registered in the country (grown by 28% from 2.5 million PAYE taxpayers in 2015 to 3.2 million in 2020). Income earners generally begin paying income tax on incomes above €16,500 (single PAYE workers) and progress to the higher 40% rate relatively swiftly at €35,300 of income. In 2018 nearly 35% of income earners (887k out of 2.5m taxpayer units[12]) were exempt from income tax.[13] Over 29% of income earners were exempt from USC in 2018, with just over a million of taxpayer units paying a 4.75% top rate of USC and approximately 10% of taxpayer units paying a top rate of 8% or 11%.[14] In 2021 it is projected that:

- the top 1% of income earners (income >€200,000) will pay 25% of total income tax and USC collected,
- the top 6% (>€100,000) will pay 51%, and
- the top 25% (>€50,000) will pay 83%.[15]

It is clear, therefore, that the burden of income taxation mostly falls on higher paid tax units. While the progressivity of the income tax system is positive from an equity perspective, the reliance on a small proportion of income earners could be a source of vulnerability.

[12] The figures are based on a taxpayer unit. A married couple that is jointly assessed is counted as one tax unit and their incomes are aggregated in the statistics.
[13] Revenue, Income earners by Income Tax rate – See Appendix 1
[14] Revenue, Income earners by USC rates – See Appendix 1
[15] Tax Strategy Group, Income Tax 21/02, September 2021

There were nearly 221,000 companies registered for corporation tax (CT) in 2020 and receipts from this tax-head were the third largest source of public funding (at €11.83 billion). CT receipts in 2020 represented the ninth consecutive year of annual growth from a low point of €3.5 billion in 2011. The growth is attributed to a number of reasons, including improved trading conditions, the exhaustion of historical losses from the recession, positive currency fluctuations together with increases in the numbers of companies of all sizes paying tax and across most economic sectors. Around 25,000 companies used losses in 2019 totalling €11.9 billion, at a cost to the Exchequer of €1.5 billion. CT receipts are highly concentrated, with CT returns for 2019 showing that foreign-owned multinationals accounted for 82% of the total CT liability and 49% of employment taxes, while employing around 32% of company employees. The equivalent figures for 2018 were 77%, 44% and 27%. Over 84% of the almost 56,000 companies paying net CT in 2020 paid a liability of less than €40,000, accounting for less than 3% of total CT receipts. The ten largest CT payers in 2020 accounted for €6 billion (over half) of net CT receipts in 2020. Notwithstanding the current strength in CT receipts, the risk of future volatility remains as Ireland's corporate tax strategy is increasingly being driven by international factors. The Department of Finance's working estimate is that the overall risk from proposed BEPS-related changes could be up to €2 billion annually. [16]

Taxes on consumption

Value Added Tax (VAT) is the second largest contributor to the Exchequer and the primary tax on consumption, followed by excise. VAT receipts increased by an average of 7% per year from 2013 to 2019, largely driven by increased consumption. In addition to the nearly €12.5 billion net VAT collected in 2020, a further €1.1 billion in VAT liabilities were warehoused by Revenue. A decline in VAT receipts and excise was witnessed in 2020, to a larger extent compared to other taxes, reflecting both the impact of the pandemic on consumption levels and tax warehousing relief measures. In 2021 there are already signs of recovery and increased consumption in the economy. Of the 263,490 traders registered for VAT in 2020, 197,400 of these are considered 'active' traders regularly supplying taxable goods. There is some degree of concentration in VAT receipts, with the largest 1.5% of VAT traders accounting for 38% of receipts and 45% of repayments in 2020. Around 30% of traders were in a net repayment situation in 2020. Of traders making a payment, 80% paid less than €40,000, with these traders accounting for just 7% of the value of VAT payments in 2020. The largest sectors in terms of the value of VAT payments are the Wholesale & Retail Trade sector (€5bn in 2020) followed by the

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[16] Source: Tax Strategy Group, Corporation Tax 21/05, September 2021 and Revenue, Corporation Tax – 2020 Payments and 2019 Returns

Professional, Scientific & Technical sector (€1.7bn) and the Information & Communication sector (€525m). Receipts from nearly all sectors were impacted by the pandemic.[17]

Excise contributed €5.4 billion to the Exchequer in 2020, with excise on alcohol and tobacco products accounting for a large proportion of this (€1.2bn from alcohol and tobacco each). Excise on heavy oils, which include auto diesel, marked gas oil, kerosene and fuel oil, provided the largest yield at almost €1.4 billion in 2020. There are a number of taxes and duties on motor vehicles, diesel, and petrol, some based on CO2 emissions. With an intended increase in the purchase of electric vehicles over the long term this should narrow the current tax base and reduce revenues from motor and fuel taxation.

Taxes on wealth

Stamp duty is currently the largest source of tax on wealth. Stamp duty receipts from shares and property make up the majority of stamp duty receipts (total €2.09bn in 2020). As a transactional tax stamp duty receipts fluctuate moderately every year, with an exceptional €580 million increase in 2020 (from €1.5bn in 2019). Receipts from Capital Gains Tax (CGT) have more than doubled since 2011 but remain well below their pre-recession peak (€950m collected in 2020 compared with €3.1bn in 2007). High stamp duty and CGT receipts were an important driver of tax revenues in the 2000s. However, the revenues from these mainly transactional taxes were, incorrectly, used to fund increases in expenditures and reductions in personal taxes rather than more sustainable measures.[18]

Capital Acquisitions Tax (CAT) receipts are largely from inheritance tax (€430m out of €505m CAT receipts in 2020), followed by gift tax (€71m) with the balance coming from discretionary trust tax and probate tax.[19] Local Property Tax (LPT) receipts (€480m in 2020) are stable year to year, with some small variations from Local Authority rate decisions. The recent reforms to LPT are expected to generate a modest increase in LPT receipts in 2022 (to €560m).[20] Revenue analysis indicates an overall trend that the share of taxpayers engaging in capital tax transactions increases as incomes increase.[21] Regarding wealth taxes on savings, receipts from DIRT on deposit interest income have collapsed in recent years, reflecting the low interest rates available from financial institutions. A relatively high level of life assurance exit tax (LAET) is collected from life assurance policies (€124m LAET compared with €37m DIRT collected in 2020).

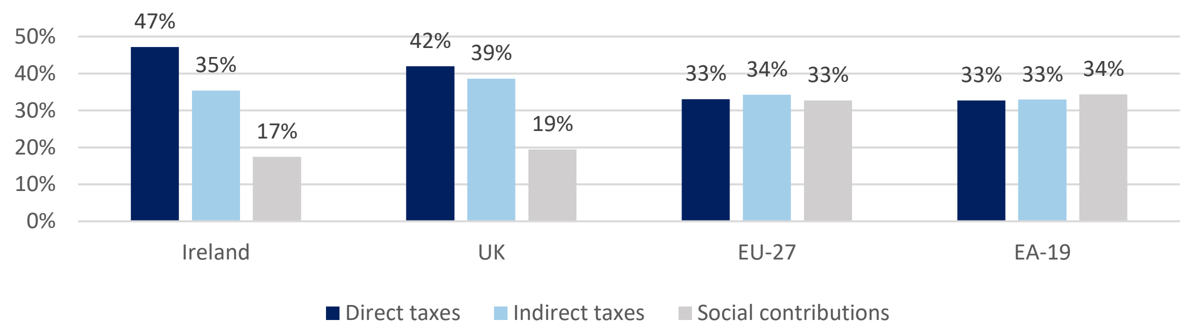
[17] Revenue, VAT Payments and Returns 2020, April 2021
[18] Department of Finance, Annual Taxation Report 2021, August 2021
[19] Revenue, Breakdown of CAT receipts
[20] Gov.ie
[21] Revenue, Profile and distribution of capital taxes, April 2018

3.3 International comparison

Taxes can be categorised into a number of headings (e.g. 'income, capital and spending', or 'labour, consumption and capital' or 'direct taxation and indirect taxation') depending on the author. The discussion below references the base used by the European Commission in its most recent comparison of taxation trends in the EU, Norway, Iceland and UK.[22]

Data from 2019 shows that taxation structures remained stable in the EU over the last decade, with tax revenues (including social contributions) significantly higher than 2010 levels and compared with the OECD average. EU-27 revenue was almost equally distributed among direct taxes, indirect taxes and social contributions in 2019.[23] Compared with 2009, the relative share of direct taxes has increased by 1.3 pp while the relative share of social contributions has decreased by 1.8 pp. The structure of taxation varies significantly across the EU Member States. Ireland has the second highest share of direct taxes (47% of total tax revenues) after Denmark (66%) and before Malta (44%). The share of social contributions is correspondingly low in these countries. Differences in social contributions can reflect the large variances in the benefits received in return from different countries. Ireland's share of tax revenues from indirect taxation is largely consistent with the EU and Eurozone (EA-19) average.

Figure 7*: Structure of tax revenues by major type of taxes, 2019 (% total taxes)*



Source: Eurostat

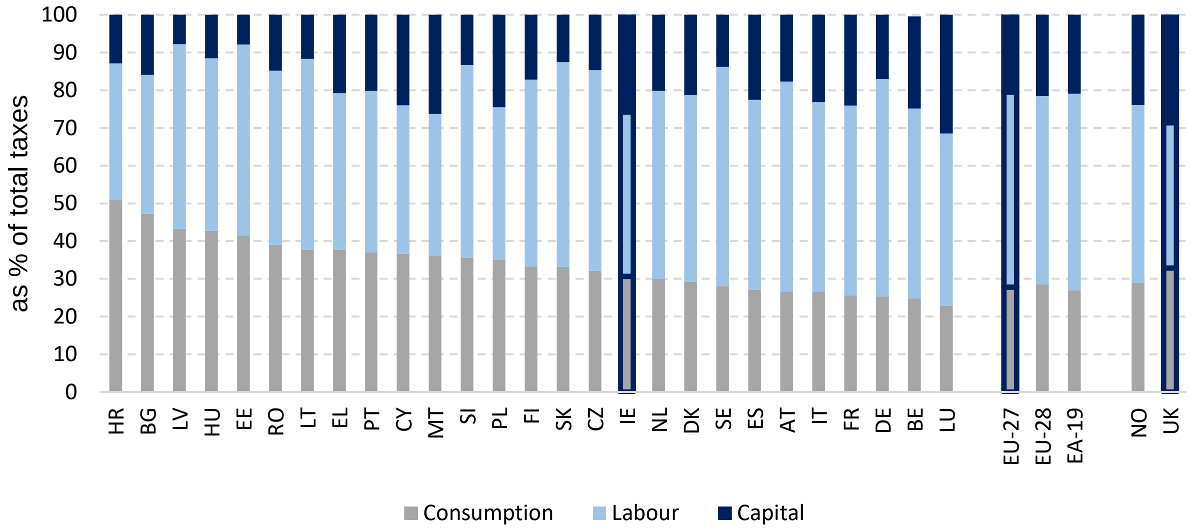
The distribution of EU revenues when the tax base is categorised into taxes on labour, consumption and capital in 2019, was very similar to those of previous years (around 52% from labour, 28% from

[22] European Commission, Taxation trends in the European Union, June 2021

[23] Direct taxes for this purpose include personal income tax, corporate income tax and other income and capital taxes. Indirect taxes include VAT, import levies and excise duties.

consumption and 20% from capital).[24] The distribution of taxes is markedly different across Member States, as shown in Figure 7.

Figure 8 Distribution of tax revenues according to type of tax base, 2019 (% of total taxes)



Source: European Commission, DG Taxation and Customs Union, based on Eurostat data

Of the EU-27, Ireland has the 17th highest proportion of taxes from consumption, the 20th highest proportion of tax receipts from labour and the third highest proportion of taxes from capital (which under the European Commission's classification includes taxes on business income). The balance of taxation from consumption, labour and capital in Ireland was 31%, 43% and 26% of total tax receipts, compared with the EU-27 average of 28%, 52% and 20% for the year 2019. The distribution of tax revenues in countries such as the UK was 33%, 38% and 29%, compared with 23%, 46% and 31% in Luxembourg and 30%, 50% and 20% in the Netherlands.

The OECD has examined Ireland's environmentally related taxes, which account for a relatively high share of tax revenue in international comparison. In 2018, about 7% of Ireland's tax revenue came from environmentally related taxes, which was in the top half of OECD member countries.[25] Of the 2019 revenue from environmentally related taxes, taxes on energy products, e.g. mineral oil taxes and carbon tax, accounted for 60% of revenue. This was followed by nearly 40% from taxes on motor

[24] Taxes on labour comprise all taxes directly linked to wages and mostly withheld at source, paid by employers and employees, including actual compulsory social contributions. Taxes on consumption mainly derive from VAT, but also import levies and excise duties (including energy taxes). Capital is broadly defined, including physical capital, intangibles, and financial investment and savings. It is comprised of capital and business income taxes, together with taxes on stock /wealth. See Annex B of the EU taxation trends report.

[25] OECD, Environmental Performance Reviews: Ireland 2021, May 2021

vehicles e.g. VRT and motor tax, which is one of the highest shares among European OECD countries. Taxes on pollution and resources, e.g. landfill tax and the plastic bag levy accounted for 0.5% (with the low revenue resulting from a decrease in the tax base over time).

3.4 The optimal balance of taxation?

Various literature exists on the effects of individual taxes on economic growth and taxpayer behaviour. Following the financial crisis of the late 2000s, the OECD recommended a hierarchy of taxation for countries facing the challenge of restoring public finances while still supporting growth.[26] Their analysis suggests corporate taxes are the most harmful type of tax for economic growth, followed by personal income taxes and then consumption taxes, with recurrent taxes on immovable property being the least harmful tax.

While this represents a useful starting point, there are limits to the usefulness of cross-country studies of this kind.[27] Country specific factors may also be highly relevant. There may be differences in short-run versus long-run impact of individual tax changes, and the OECD analysis relates only to the impact on economic growth. Nonetheless, the OECD study provides a useful set of headings under which to consider the balance of taxation.

Clearly there are different pros and cons to be weighed when considering raising additional revenues under each tax head.

Taxes on earned income:

Higher taxes on labour have the potential to discourage labour supply. Higher taxes on people with low income risks encouraging withdrawal from the labour market (especially when factoring in the interaction with the social welfare system) or reducing the number of hours people are willing to work.[28] On the other hand, increasing rates on higher earners increases the vulnerability of income tax revenue to a shock.[29]

Consumption taxes:

Consumption taxes also influence decisions and change economic outcomes, but they are less likely to influence decisions to work or invest. Changes in the VAT rate can impact inflation on a once-off

[26] OECD, Tax Policy Reform and Economic Growth, November 2010
[27] See http://www.siepweb.it/siep/images/joomd/1485942065Baiardi_et_al_WP_SIEP_718.pdf for a critique of the OECD paper.
[28] The impact of taxation, including Ireland's tax wedge on labour income relative to other OECD countries, is discussed in the Secretariat papers on Facilitating Employment (available on Decision Time).
[29] Parliamentary Budget Office, Pre-Budget 2022 PBO Commentary, September 2021

basis. From an equity perspective indirect taxes tend to be more regressive than other taxes, taking up a larger proportion of the income of lower income taxpayers.

Environmental taxes are often used as a tool to influence behaviour from an environmental perspective, but they also have a contribution as a revenue source. The sustainability of environmental tax revenue is a challenge when simultaneously pursuing a policy of decarbonising the economy.[30]

Taxes on wealth:

Taxes on wealth currently comprise a low proportion of Irish tax receipts. Wealth is typically highly concentrated, and income flows from wealth generally increase the level of inequality. Taxation of wealth, therefore, tends to increase the overall progressivity of the system. Taxes on inheritance, tend to approximate to a 'windfall' tax which is economically efficient, because it does not distort behaviour (unless there is room for avoidance behaviour). With regards to CGT, research indicates that it can impact risk-taking, although there is not wide agreement as to what extent. The treatment of capital gains can also impact the level of savings and enterprise. The level of tax on gains relative to income can influence firm decisions on whether to reinvest or distribute profits, or CGT levels can affect a firm's financial policy based on the relative cost of debt finance to equity.[31] Differences between rates of tax on capital gains and on income can open up an opportunity for tax avoidance.

Stamp duty receipts are dependent on transaction levels and values and are particularly subject to fluctuations, especially in times of buoyant prices and markets. More recently commentary on stamp duty has focused on its impact on the Irish housing market, with a punitive 10% rate introduced in 2021 to deter bulk buying of residential properties by institutional investors. Recurrent taxes on real-estate property have attracted increasing attention from policymakers in many countries because they are low and therefore a potential source of increased revenue. Moreover, they are viewed as a viable option, as they are considered less detrimental to economic growth given the physical immobility of the tax base.[32] Immovability also makes them a highly sustainable source of revenue.

The 2009 Commission on Tax concluded that the appropriate balance of taxation in terms of revenue raising in Ireland should firstly be property taxes, followed by spending taxes (especially environmental taxes) and then income taxes. It recommended this approach should be taken in tandem with broadening the base within each tax head.[33] This is consistent with findings from other

[30] For further commentary see OECD, Climate change and long term fiscal sustainability, February 2021
[31] OECD, Taxation of Capital Gains of Individuals: Policy Considerations and Approaches, 2006
[32] European Commission, Taxation trends in the European Union, June 2021
[33] See Section 3 of Part 4 of the 2009 Commission on Taxation report

economic literature, which is that taxes levied on the factors of production (labour and capital) are more distortionary than taxes on consumption and wealth.[34]

3.5 Conclusion

Ireland's tax receipts are already highly reliant on taxes from earned income and to a lesser extent, consumption. There would appear to be merit in examining the scope for raising additional revenue from the taxation of wealth. This could be justified given the relatively less distortionary impact on behaviour, particularly the incentive to work or promote enterprise. A balance would need to be struck between recurring taxation of wealth and the less stable receipts that could be gained from transactional-based wealth taxes. As consumer behaviour changes, particularly in relation to environmental factors, it is clear the design of taxes on consumption will also need to be examined. In terms of prioritising areas of the tax base for reform, therefore, **there is merit in firstly examining the taxation of wealth, followed by consumption and lastly the taxation of earned income**. As advocated by the 2009 Commission, this should ideally be done in tandem with broadening the base within each tax-head. Consideration of equity issues is essential in any review.

Discussion prompt:

- Does the Commission agree the final report should recommend a net revenue raising approach to tax reform?
- Is the Commission agreed on which taxes should be prioritised for reform as part of a revenue raising policy objective (e.g. taxation of wealth, followed by consumption and lastly the taxation of earned income)?
- Are there new forms of taxation that should be explicitly considered by the Commission (or historical taxes that should be reconsidered) as part of this approach?

[34] For example, see discussion in the ESRI's paper Effective Tax Rates In Ireland, September 2020

Appendix 1 Additional Information

For information, every year Revenue provide projected Exchequer costs and yields of proposed changes to rates, bands and so on, for a range of taxes. Revenue's Ready Reckoner (pre-Budget 2022) is available at the link here.

Other information on various tax-heads and the tax base is presented below.

The current number of taxpayers for the main registration types are set out in the following table:

Table 9: Number of taxpayers in each year

Registration Type	2015	2016	2017	2018	2019	2020
Employments (PAYE)*	2,511,198	2,622,300	2,754,491	2,960,162	3,183,789	3,223,595
Self-Assessment (Income Tax)	665,516	686,863	710,157	729,983	793,221	811,772
Companies (Corporation Tax)	175,928	183,628	193,710	201,223	211,931	220,722
Employers					203,869	214,352
VAT	249,406	252,006	255,541	259,988	255,991	263,611
Property Owners (LPT)**	1,364,084	1,374,490	1,386,560	1,399,814	1,413,201	1,426,530

Source: Revenue, Annual Report Headline Results
** Includes multiple employments and recipients of occupational pensions. ** Designated liable persons.*

Table 10: Exemptions from income tax and USC (% of total income tax payers in brackets)

	2012	2013	2014	2015	2016	2017	2018
Exempt from income tax	843,053 (40%)	838,164 (39%)	857,394 (39%)	893,665 (39%)	875,436 (36%)	882,745 (36%)	887,072 (35%)
Exempt from USC	573,968 (27%)	591,687 (28%)	612,996 (28%)	701,387 (30%)	746,101 (31%)	735,838 (30%)	740,770 (29%)

Source: Revenue, Statistics on income, tax and duties

Table 11: Tax units across i) income tax and ii) USC rates (2018)

Income tax	Tax units	% of total
Exempt	887,072	35%
Marginal relief	28,447	1%
Standard rate	1,106,568	44%
Higher rate	516,744	20%
Total	**2,540,849**	

USC	Tax units	% of total
Exempt	740,770	29%
2%	448,492	18%
5%	1,093,086	43%
8%	242,948	10%
Surcharge (3%)	13,535	1%
Total	2,538,831	

Source: Revenue, Statistics on income, tax and duties

Companies face three rates of tax: trading income (taxed at 12.5%), passive income (25%) and capital gains (33%). The taxable income subject to these rates is presented below. Revenue have stated that as certain reliefs can be offset against profits taxable at the higher rate before offsetting them against income taxable at the 12.5% rate, the bulk of CT paid was attributed to trading income in all years.

Table 12: Corporation Tax – Taxable income or gain by tax rate

	2017	2018	2019
Trading income (€m) – rate of 12.5%	75,246	86,898	96,284
Non-trading income (€m) – rate of 25%	4,409	9,151	10,155
Capital gains (€m) – rate of 33%	602	696	812

Source: Revenue, Corporation Tax – 2020 Payments and 2019 Returns

CSO and tax return data is used annually to estimate total expenditure across a number of key activities (important items of consumption where significant VAT is generated). This is known as the VAT base. The table below presents some of the main items in the 2019 VAT base and corresponding VAT receipts. These items accounted for around 43% of VAT base expenditure, but only 36% of VAT receipts as a result of expenditure on zero rated items such as food and medicines.

Table 13: VAT base 2019 – main expenditure areas and VAT yield

Product	Estimated Expenditure (€m)	Estimated Expenditure (as % of total)	VAT Yield (€m)
Food	6,854	7.42	0
Alcohol	5,194	5.62	1,195
Private New Housing	5,190	5.62	701
Restaurants, Canteens, Chip Shops, Fast Food etc	4,019	4.35	543
Private Housing - Repair & Maintenance	2,951	3.19	398
Other Building	2,569	2.78	347
Telecommunications	2,437	2.64	560
Electricity	2,337	2.53	316
Cars	2,285	2.47	526
Motor Fuel	2,152	2.33	495
Oral Medicine	2,097	2.27	0
Adult clothing	1,995	2.16	459

Source: Revenue VAT Payments and Returns 2020