



Horizontal equity in the taxation of income and capital

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For information

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Key Points

Discussions by the Commission to date have raised the issue of horizontal equity, a principle where taxpayers with similar levels of income and assets should pay the same amount of tax irrespective of the source.

This paper sets out some of the differences in the Irish tax code between different forms of income and capital. The areas examined are:

1. The taxation of different forms of savings and investment income, and
2. The taxation of income compared with capital gains.

The purpose of this paper is to inform a discussion by Commission members on whether the differing tax treatment for various forms of income and assets should be continued, removed or modified, and if the latter, to what extent. The paper presents some options for consideration by the Commission to highlight some of the opportunities and associated challenges with reforming these areas.

Note: Whilst every effort is made to ensure the accuracy of the information contained in this document, this material is provided as a guide only and is not professional advice, including legal advice. It should not be assumed that the guidance is comprehensive and the authors cannot be held responsible for any errors or omissions.

Table of Contents

1.	Introduction	3
2.	Taxation of savings and investment income	4
2.1	Tax rate differentials	4
2.1.1	Deposit Interest Retention Tax	7
2.1.2	Investment Undertaking Tax	8
2.1.3	Life Assurance Exit Tax (LAET)	9
2.2	Policy rationale for differences in the rates	10
2.3	Investment via intermediary structures	11
2.3.1	General treatment of investment and savings by companies	11
2.3.2	Savings and investment via other structures	12
2.4	Options for reform	13
3.	Income and capital gains	16
3.1	Capital Gains Tax	17
3.1.1	CGT Rate	18
3.2	CGT and income tax differential	20
3.2.1	Distribution of CGT	21
3.2.2	Realisation basis of CGT and lock-in effects	21
3.2.3	Aligning the treatment of capital gains and income	23
3.3	Wholesale reform of CGT	24
3.3.1	Exemption of normal returns	25
3.3.2	Offset of losses	26
3.3.3	Indexation Relief	27
3.3.4	CGT at death	28
3.3.5	Other considerations	28
4.	Conclusion	29
Appendix 1	Cutting CGT rates and investment	31

1. Introduction

Discussions by Commission members to date have raised the topic of horizontal equity, highlighting the differing tax treatment that can arise depending on the form of work, savings or investment. This paper aims to facilitate a further discussion on to what extent, if any, the Commission wishes to modify or remove these differences in the Irish tax code.

Taxes can influence economic activity through their effect on decisions by households and businesses on labour force participation, employment, investment and savings. Many differences exist within the Irish tax system depending on the source or form of profit or income stream. The concept of horizontal equity suggests that two persons with the same income should pay the same amount of tax regardless of the source of income. It could also be extended to consider whether two persons with the same level of income and assets should be treated equally within the tax system. In an EU context, there is a well-established principle that resident and non-resident taxpayers in similar situations carrying out similar transactions should be subject to a similar taxation treatment. From an economic perspective, taxing forms of income at various differing rates can drive decisions to participate in one activity over another. It is argued that the tax system should not influence decisions that would otherwise be taken in the absence of tax differentials.

The goal of achieving horizontal equity within the tax system can oftentimes conflict with other principles, such as simplicity, efficiency and flexibility. Promotion of horizontal equity must also be viewed in the context of the primary function of the tax system, which is to finance public expenditure. Changing the design of different taxes and how they interact may impact the contribution of different taxes to the Exchequer. Currently, the main contributors to public revenues are taxes on income (personal and corporate) and consumption taxes (mainly VAT) which represented c.66% and 27% of tax receipts respectively in 2020 (see meeting 8).

If it can be accepted that differences in the tax code are broadly justifiable, then the next step is to focus on what specific variances exist that may not be justifiable and to consider solutions for addressing them. This could involve presenting specific options for reform or outlining general principles to guide such reform.

This paper examines some of the differences within the Irish tax code across various income and capital sources, setting out the brief historical context for how the Irish tax regime was designed or evolved this way. The paper then presents some options for modifying or removing these distinctions. The purpose of this review is to facilitate discussion by the Commission on to what extent horizontal equity should be promoted within the tax system, and in what specific areas, as part of its recommendations.

The separate paper titled “Taxation of labour under different legal forms” examines the taxation of labour depending on legal form (employed v self-employed v company owner managers).

This paper examines differences in the tax code for investors under two headings as follows:

1. The taxation of different forms of savings and investment income.
2. The taxation of capital gains compared with income.

2. Taxation of savings and investment income

There are a multitude of factors that influence the form of investment or savings, including the length of time a person wishes to invest, the amount of capital available, appetite for risk, level of expertise or availability of professional advice, etc. This section explores the tax consequences of (or in some cases the tax influences on) the choice of various forms of investment and savings by individuals. In particular, the following topics are discussed:

- Differing tax rates that apply to different forms of investment by individuals, and
- The favourable treatment for investment in funds and other structures under the gross roll-up regime compared with investment through other intermediaries.

2.1 Tax rate differentials

As a general rule, different sources of income are liable to the same rate(s) of income tax and USC, based on the income level and personal circumstances of the taxpayer (e.g. single, joint or separate assessment and age in the case of income tax and age or medical card status for USC). Income from employment, self-employment, rents, dividends, foreign trades, etc. are subject to the same marginal income tax and USC rates.

There are exceptions however and commentary has more recently focused on differing tax rates when it comes to the taxation of different forms of savings and investment by individuals. In particular, the higher 41% rates of exit tax on life assurance policies and Irish investment undertakings have attracted criticism, compared for example with the lower rates of tax charged on the sale of shares (33% CGT on chargeable gains above the annual exemption of €1,270) and deposit interest (DIRT at 33%).

The income tax payable on investment income in the form of dividends or rents may initially seem lower in comparison, at 20% or 40% depending on the shareholder or landlord's level of income.

However this income is also liable to the Universal Social Charge (USC). A further 3% USC surcharge is levied where that investment income exceeds €100,000 (charged on the income above this threshold). It is of note that very few taxpayers actually pay this surcharge, with only 0.5% of all taxpayer units having paid the USC surcharge each year from 2012 to 2018 (for example, c13,500 taxpayer units out of a total of 2.5 million in 2018).¹ Deposit interest income and profits related to investment undertakings and life policies are not liable to the USC or its surcharge.

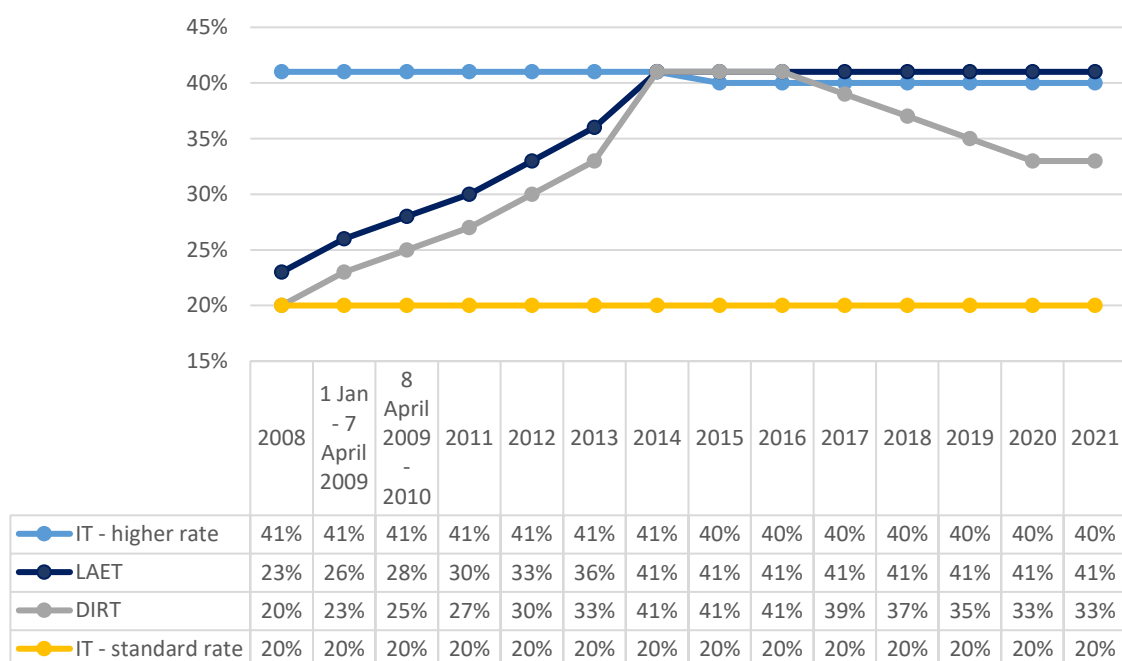
Table 1 Rates of tax on different forms of saving and investment)

Source of income	Rate of tax
Deposit interest	DIRT @ 33% and potentially PRSI @4%*
Life assurance gains	LAET @ 41%
Fund gains	IUT @ 41%
Other investment income	Income tax @20% / 40% USC @ 0.5%/ 2% / 4.5% / 8% / 11% PRSI @4%*

*Where an individual has unearned income above €5,200, Class K PRSI applies at 4% on all unearned income

Figure 1 below shows the movement in the headline rates of income tax, deposit interest retention tax (DIRT) and life assurance exit tax (LAET) over the period 2008 to 2021.

Figure 1 Movement in rates of deposit interest retention tax (DIRT), life assurance exit tax (LAET) and income tax (IT), 2008 - 2021



Source: Revenue

¹ Revenue statistics, [Income earners by USC rates](#)

Note: IUT is not included in the figure above. Different rates of exit tax on investment undertakings have historically applied for individuals depending on whether the payment was a regular or non-regular payment and whether or not the individual had correctly included details in a timely return to Revenue. Exit tax of 41% has applied since 2014.

Table 2 shows the annual tax receipts from DIRT, LAET and investment undertaking tax (IUT) over the last decade.

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
DIRT	446	473	581	499	435	300	170	118	96	64	37
LAET	31.2	43	43.4	58.7	130	247	228	184	165	128	124
IUT	5.9	17.9	6.9	9.1	28.6	37.6	37.4	39.6	45.3	53.3	120.5

Source: Revenue [Net Receipts Statistics](#)

Note: The figures for exit tax on investment undertakings (IUT) were requested directly by the Secretariat from Revenue. Normally these are published as part of the "Self-Assessed Income Tax" receipts.

DIRT receipts have collapsed over the last number of years, likely due to interest rates having decreased much more than the increase in deposits. The interest rate on new household term deposits stood at 0.02% in September 2021.² The estimated interest income for private households declined from over €1,100 million in 2013 to €90 million in 2019. As such, Revenue have noted that the indicative tax liability for private households fell from €376 million to €32 million.³

The yield of LAET has also been falling. The Department of Finance suggests LAET which is being received now is likely to be in respect of taxation on investments made eight years ago (assuming that most individuals have treated such products as a medium to long term investment and have not encashed before the eight year gross roll-up period). The current reduction in yield may therefore reflect the investment market from eight years ago rather than today.⁴ The Tax Strategy Group papers note the lagged impact of SSIA schemes, which would have been invested following maturity of the scheme in 2007/08, appear in the LAET yield figures around 2015/16.⁵

The next section outlines the main rules and rates applying to the taxation of various sources of investment income, including deposit interest, investment undertakings (funds) and life assurance policies.

² Central Bank of Ireland, [Retail Interest Rates](#), November 2021

³ Revenue, [Review of DIRT receipts](#), December 2020

⁴ Department of Finance, [The taxation of DIRT and LAET](#), December 2018

⁵ Tax Strategy Group, [Capital and Savings Taxes 20/10](#), September 2020

2.1.1 Deposit Interest Retention Tax

Deposit interest income is liable to Deposit Interest Retention Tax (DIRT) at a rate of 33%. DIRT is deducted from the interest paid on all deposit accounts held by Irish-resident individuals. This includes deposit accounts with banks, credit unions and building societies. The rate has steadily declined in recent years from the 41% rate that applied for 2014 to 2016. This is a reversal of the position prior to 2014, where the DIRT rate had regularly increased in 2% to 3% increments from the 20% rate that applied for 2002 to 2008. The rationale behind increasing the tax rate to 41% was to raise revenue and to encourage consumer spending to boost economic activity. As consumer expenditure increased over time, it was decided to lower the DIRT rate to encourage saving and improve the return for savers.³ Since the onset of record low interest rates, any behavioural effect of rate changes to DIRT is likely to have been dramatically reduced.

A higher rate of DIRT (standard rate plus 3%) applied up until the end of 2013 where interest was not paid annually or more frequently, or not determined until the date of payment of the interest. In effect, this applied to “tracker type”, or “hybrid” deposit products where the return on the investment was linked to the growth in a particular group of stocks or shares. The rationale for taxing these products at a higher rate (equivalent to the exit tax rate at the time) was because while DIRT was deducted annually on standard deposit accounts, tax on these “hybrid” products would not be deducted until a chargeable event occurred. These “hybrid” products have not been identified by the Department of Finance as available in the market in recent years.⁶

Interest from EU Member State accounts is liable to DIRT at 33% if the taxpayer has made a timely return. Otherwise the income is subject to a higher rate of 40%.

Interest from non-EU Member State accounts is liable to DIRT at 33% if the individual is a standard rate taxpayer and has made a timely return. Higher rate taxpayers or those who have not made a timely return are liable to a DIRT rate of 40%.

Certain savers are exempt from DIRT, for example, companies that pay corporation tax, individuals aged over 65 whose total income is below the income tax exemption limit⁷, and those who are permanently incapacitated due to a physical or mental illness. Revenue do not calculate the cost of these tax exemptions. Age-based exemptions will be examined in a future Secretariat paper.

⁶ Tax Strategy Group, [Capital and Savings Taxes 20/10](#), September 2020

⁷ €18,000 for single individuals and €36,000 for married couples/civil partners. These limits are increased for individuals with dependent children.

DIRT is a “final liability tax” in that the amount deducted by the financial institution satisfies the individual’s full liability to income tax in respect of deposit interest (i.e. at the 33% rate of DIRT rather than the 20% or 40% rates of income tax). Deposit interest income is not subject to USC. PRSI is however payable in some circumstances under Class K.⁸

2.1.2 Investment Undertaking Tax

Investment Undertaking Tax (IUT) is also referred to as “exit tax” and it applies to Irish collective investment vehicles (i.e. funds).

Finance Act 2000 introduced the “gross roll-up” tax regime for domestic investment undertakings. Irish collective investment vehicles which the Central Bank of Ireland authorise and regulate are generally exempt from tax on the income or gains arising to the fund. Instead, the profits roll up within the investment undertaking until a “chargeable event” occurs. A chargeable event happens when, for example, the fund makes a relevant payment (which includes a dividend) to a unit holder, on the redemption of units and on the transfer by a unit holder of their entitlement to units. The fund is responsible for deducting exit tax on the profit element of each chargeable event. In order to prevent indefinite or long-term deferral of this exit tax, a disposal is deemed to occur every eight years.

Any tax collected on a deemed disposal is available as a credit against any tax that arises on a subsequent chargeable event, e.g. on the ultimate disposal of the investment. Any overpayment of exit tax is refunded to the unit holder.

Since 2014, the rate of exit tax for unit holders who are individuals is generally 41%. If the fund is considered a Personal Portfolio Investment Undertaking (PPIU), broadly meaning the selection of the property of the undertaking can be influenced by the unit holder or certain connected persons, then the rate of exit tax is 60%. Where exit tax is deducted by a fund the deduction represents a final liability to Irish tax for unit holders who are individuals. Any gains, income or payments in connection with investment undertakings are not liable to the USC.⁹

The rate of exit tax for companies is generally 25%. If a company has not made an appropriate declaration then the exit tax rate is increased to 41%. In the case of Irish resident corporates who have suffered exit tax on payments, including redemptions, the amount received by the corporate is treated as a net annual payment, grossed up accordingly and taxed, with credit given for the tax withheld by the fund.

⁸ Where an individual has unearned income above €5,000, Class K PRSI applies at 4% on all unearned income.

⁹ Relating to payments described in Chapter 1A, Part 27 TCA 1997

Certain unit holders are exempt from the exit tax, subject to a declaration procedure. These include non-resident unit holders (as their liability to tax on gains from the fund will be determined in their home jurisdiction), pension schemes, life assurance companies, credit unions and charities.

The Irish tax treatment of an investment in a fund depends on a number of factors, including whether the fund is an Irish fund or an offshore fund. In the case of offshore (i.e. non-Irish domiciled) funds, the treatment further depends on whether the funds are domiciled in an EU, EEA or OECD member state or otherwise. Due to the wide variety of investment structures available globally, there is an extensive amount of rules and legislation concerning funds. Revenue have published detailed guidance explaining the tax treatment of various investment structures, available at the [link here](#) (see “further guidance” tab for access to Revenue’s Tax and Duty Manuals).

2.1.3 Life Assurance Exit Tax (LAET)

Domestic life assurance companies are authorised and regulated by the Central Bank of Ireland. The companies and their policyholders are taxed depending on when the life assurance business was written. If the business was written on or after 1 January 2001 it is referred to as ‘new basis business’ and it is taxed under a gross roll-up regime. The life company is generally exempt from tax on the profits it earns on behalf of its policyholders and instead, those profits roll up within the life policy until a “chargeable event” occurs e.g. until such time as a policyholder realises his or her investment. Life assurance exit tax (LAET) is generally deducted by the life company when the chargeable event occurs. A chargeable event is also deemed to arise every eight years in order to prevent the indefinite deferral of a chargeable event and exit tax. Any tax paid on a deemed disposal is allowed as a credit against any final tax liability on the ultimate disposal of the investment.

Gains arising to individuals from a life assurance policy are liable to LAET at a rate of 41%. Products subject to LAET include all life savings plans, life investment bonds (capital protected, trackers) and life protection plans. If a policy has a return that is greater than the amount invested, that difference/gain is subject to LAET which the life assurance company is obliged to deduct and pay to Revenue. The 41% rate has applied since 2014, having steadily increased from a 23% rate in 2008. The exit tax rate is 60% in the case of a personal portfolio life assurance policy. This is defined in broad terms as a policy which allows the policyholder to select, or to influence the selection of, assets which determine the policy benefits. Any gains, income or payments in connection with life policies are not liable to the USC.¹⁰

¹⁰ Relating to payments described in Chapter 5, Part 26 TCA 1997

In general a final rate of 25% applies to income and gains from investment in life assurance policies by companies (increased to 41% if the company does not hold the appropriate declaration).

2.2 Policy rationale for differences in the rates

The issue of the different tax treatment of financial products subject to DIRT and LAET has come to the fore since the rate of DIRT was reduced in 2017. Both DIRT and LAET were increased to 41% at the same time and the reduction of DIRT prompted requests for similar reductions in LAET.

The Department of Finance reviewed this issue in 2018,¹¹ concluding that the differential was justified based on the many differences in the products liable to each tax in terms of the level and application of fees to clients, the level of risk and return and potential losses. It was argued that the products liable to DIRT and LAET were not totally comparable and the tax rates should not necessarily move in tandem. The insurance sector did not support the conclusions of this review. This sector notes life assurance premiums also incur a 1% stamp duty charge and argues the 41% rate of LAET should be reduced in line with the DIRT and CGT 33% rates.

A further review of the issue as part of the Tax Strategy Group (TSG) papers for Budget 2021 also agreed with the Department's previous conclusion, noting that there were a number of non-tax reasons as to why investors may prefer to invest in financial products subject to DIRT rather than life assurance products subject to LAET.¹²

The debate on this issue has developed since, with the most recent TSG paper on capital and savings¹³ including the following commentary:

"While the debate over the last number of years has surrounded differentials between DIRT and LAET and subsequently CGT, the focus has since broadened into a debate surrounding the lack of neutrality in the current system particularly in relation to Exchange Traded Funds (ETFs).¹⁴ This raises the question as to whether or not a more fundamental review of the neutrality of the tax system for individual savings and investors is needed. For example, are the current differential rates linked to savings and investment distorting behaviour and direct

¹¹ Department of Finance, [The taxation of DIRT and LAET](#), December 2018

¹² Tax Strategy Group, [Capital and Savings Taxes 20/10](#), September 2020

¹³ Tax Strategy Group, [Capital and Savings Taxes 21/13](#), September 2021

¹⁴ An Exchange Traded Fund (ETF) is a general investment industry term that refers to a wide range of investments, which can take many different legal and regulatory forms even where they are established within the same jurisdiction. ETFs are funds traded on a regulated stock exchange. A typical ETF can be compared to a tracker fund in that it will seek to replicate a particular index.

There is no separate tax regime in Ireland specifically for ETFs. They generally come within the regimes for collective investment funds, which are taxed depending on whether they are domestic or offshore funds.

funds into less productive forms of assets or contribute to inflation in certain sectors e.g. housing. Clearly this is not a discussion that can happen in isolation and any review of savings taxes needs to be considered in the context of the wider tax system, giving due consideration to the effective tax rate of investments including not just investor level taxes but also investment level and fund level taxes.”

2.3 Investment via intermediary structures

Members of this Commission have previously referred to the differing tax treatment for investment via “traditional” company structures and more tax efficient structures or funds that can avail of gross roll-up regimes. It was acknowledged that tax neutral vehicles can incentivise investment in Ireland that may not otherwise happen, or be viable from a cost perspective (e.g. in the property market). However, a concern was raised by members over their use by non-residents and whether a fair share of taxation was being paid, as well as whether the differing treatment for funds and “traditional” companies was still relevant.

2.3.1 General treatment of investment and savings by companies

Companies are treated as separate legal entities and are subject to corporation tax on their profits (i.e. their income and gains). Corporates are subject to corporation tax at 12.5% on trading income, 33% on chargeable gains and 25% on other forms of income (including investment income). Dividends received by Irish resident companies from other Irish resident companies are exempt from corporation tax (referred to as Franked Investment Income).

If an individual extracts profits from a company, for example, via a director’s fee or shareholder dividend then that individual is separately taxed on receipt of that income.

Up until 2021 non-resident companies (which do not have a branch or agency in Ireland) are subject to income tax at a 20% rate on Irish sourced rental income. Finance Bill 2021 provides that non-resident companies will now be liable to corporation tax on such income instead, thereby increasing the rate of taxation from 20% to 25% and equalising the treatment of resident and non-resident corporate landlords. This change will apply for accounting periods on or after 1 January 2022 and also ensures that such companies are within the scope of new anti-tax avoidance directive interest-limitation rules being introduced.

Close companies, which are Irish resident companies controlled by the directors or by five or fewer participators, may also be liable to a 20% surcharge on undistributed investment and rental profits. The close company surcharge is intended to prevent companies from accumulating investment and

rental profits and to encourage bona fide distributions of profits to the shareholders, which will then be liable to income tax at the individuals' marginal rate. Close company rules do not apply to non-resident companies.

2.3.2 Savings and investment via other structures

In order to incentivise collective investment, certain vehicles are treated under the gross roll-up taxation regime. In effect this means there is little to no tax on the income and gains arising to the fund or entity. Instead, tax occurs primarily at the investor level. Withholding taxes or exit taxes will apply to distributions or payments to the investors, as well as on certain deemed chargeable events.

As described in section 2.1 above, domestic life assurance companies and investment undertakings are taxed under gross roll-up regimes, as are Real Estate Investment Trusts (REITs), investment structures classified as Irish Real Estate Funds (IREFs), and several other structures.

The rationale for these tax neutral models is to attract investment and to facilitate collective investment by smaller investors. Before the gross roll-up regime was introduced, funds were taxed annually in Ireland. This was out of line with the standard international practice and changes were brought in to improve Ireland's international competitiveness. Most OECD countries have a tax system that provides for neutrality between direct investments and investments through a collective investment vehicle or fund. The structures provide after-tax returns to investors similar to direct investment. This is achieved by eliminating the double layer of taxation at corporate and shareholder level which would otherwise apply if the investment activity were to be undertaken via a normal intermediary company. This model aims to attract international capital to Irish markets and reduce reliance on traditional bank financing as a source of funding investment.

This is particularly relevant to the property development sector given the reduction in available bank debt for this sector. Institutional investors are important providers of apartments given the viability cost issues with their development.

The REIT regime is purposefully designed to incentivise investment in the Irish property market. Extensive conditions must be met in order to qualify as a REIT (of which there are only three in the Irish market) and the framework is designed to encourage long-term engagement in the rental market rather than short-term gains. While profits are not taxed within the REIT plc, a key requirement is that the REIT must distribute 85% of its rental profits annually by way of a dividend, for taxation in the hands of the investors. Distributions from a REIT are subject to dividend withholding tax (DWT) at 25% which is available as a credit against final tax liabilities. Non-resident investors who suffer DWT and

who are resident in countries with which Ireland has a double tax agreement (DTA) may be able to reclaim some of the DWT if the relevant DTA permits. Tax treaty rates on dividends vary from treaty to treaty, but the most common rate applicable to small shareholdings is 15% - meaning that Ireland would retain taxing rights of 15% on dividends paid from Ireland.

The IREF regime was introduced to protect the Irish tax base as far as profits from Irish property were concerned. Fund vehicles that come within the IREF tax regime are obliged to deduct a 20% IREF withholding tax on payments to non-residents. This was introduced over a concern that non-resident investors were avoiding a charge to Irish tax on profits arising from Irish real estate. In most cases the withholding tax will be in full and final settlement of any resultant tax liability. Irish resident investors are not subject to this withholding tax as they will already be subject to the normal 41% exit tax on fund profits. The gross amount of IREF withholding tax paid in 2017 was €8.3 million, rising to €28.2 million in 2018 and €65.7 million in 2019.¹⁵

In some circumstances the withholding tax can be reduced by a DTA. The total value of reclaims processed by Revenue from 2019 up to the period ended 30 April 2021 was €3.3 million, the bulk of which relates to withholding tax deducted in 2019. If a unit holder holds more than 10% of the assets of the IREF, any payment from the IREF is regarded as from immovable property and the withholding tax is not reduced.

A number of technical amendments were made to the taxation of REITs and IREFs under Finance Act 2019 to ensure appropriate levels of tax are paid by investors in Irish property.

2.4 Options for reform

This section presents some options for modification to the taxation of savings and investment and highlights some of the opportunities and difficulties with reforming this area.

Equalise the taxation of different forms of investment and savings by individuals

Horizontal equity could be achieved through a number of different tax rate changes. While the impact of tax changes on behaviour can never be definitively quantified by policymakers in advance, Revenue do provide estimates of the Exchequer impact in certain cases.

i) Lower the exit tax rate on life assurance policies and investment undertakings

Various lobby groups, sectors and commentators have called for equalisation in the taxation of savings and investment in the form of deposit interest and life assurance policies. Unsurprisingly the request

¹⁵ [Parliamentary question 29147/21](#), 1 June 2021

has been to reduce the rate of LAET closer or equal to the rate of DIRT, rather than a suggestion of increasing the preferential rate deposit holders currently have. The full year cost of reducing the standard rate of LAET from 41% to 33% is estimated at €24 million. A reduction in the rate to 40%, 38% or 35% is estimated to cost €3m, €9m or €18m respectively.¹⁶ An estimate of the Exchequer cost of a change to the exit tax on investment undertakings is not available. A change in the exit tax rates would not impact the treatment of non-residents, who are already generally exempt and instead subject to the tax regime of their home jurisdictions.

ii) Increase the rate of DIRT

The previous policy rationale for increasing the rate of DIRT was to raise revenue and to encourage consumer spending to boost economic activity. The interest rate available from lenders to private households is very low and unlikely to change in the immediate future. Even though deposits overall have increased (and continue to increase during the Covid-19 pandemic) this low-interest environment inhibits any significant yield from DIRT. It is estimated an increase in the standard rate of DIRT by 2% would yield an additional €2 million to the Exchequer, with a 4% or 6% increase generating €5 million and €7 million respectively. An increase in the rate of DIRT would therefore not be an impactful revenue raising measure but it could act as a way to harmonise the treatment of different savers and investors. Given the low interest rates available, arguably an increase in DIRT would not adversely affect an individual's after-tax return as much at this point in time.

Another reform of DIRT could be to harmonise the taxation of Irish, EU and non-EU accounts, which currently are taxed at either 33% or 40% depending on circumstances.

iii) Align the taxation of all individual investment income

Another way of harmonising the treatment of investment income would be to align the rates of DIRT and exit taxes with the standard or higher rates of income tax. DIRT and exit taxes are generally fixed irrespective of the overall income level, marital status or age of the individual (other than the DIRT exemption for over 65s whose income is below the income tax exemption threshold).

Deposit interest income and gains from life assurance policies and funds also benefit from no USC liability, compared with those whose investment return is in the form of dividends or rental profit.

Exit taxes and DIRT are withheld at source by third parties (e.g. the life assurance company or financial institution). This tax is withheld at a fixed rate, which is administratively simple. Any move to taxation based on an individual's income level or age would require consideration of how this would be collected. For example, it could necessitate a real-time system similar to Revenue's tax credit and band

¹⁶ Revenue, [Ready Reckoner Post Budget 2022](#), November 2021

notification to employers for payroll, which would require IT development, data sharing, etc. Alternatively, you could keep the practice of a fixed rate deduction at source but require an up-front declaration to the withholding agent, or a year-end tax return filing from the individual, if this rate is not representative of the final liability.

Reform of the taxation of non-residents

Commission members highlighted that they wished to further consider the contribution of non-residents to the Irish Exchequer. This is linked to the wider policy objective of government in ensuring Ireland remains an attractive location for international investment.

A key consideration is an EU principle that requires residents and non-residents in similar circumstances to be treated similarly for tax purposes. A non-resident could not therefore be treated less favourably than a resident taxpayer under similar circumstances. Furthermore, any increase in taxation with the intention of increasing the level of Irish tax contributed by non-residents may be negated by a double tax agreement (DTA). DTAs are negotiated between jurisdictions to provide relief to taxpayers from double taxation under domestic rules. They could potentially exempt the source of income from taxation in Ireland or restrict the level of taxation, thereby rendering any domestic tax increases ineffective in some cases. Irish withholding taxes would however represent a final liability in Ireland if the DTA does not have a relieving provision, or if the taxpayer is resident in a non-DTA country.

The question of what additional revenue could be raised from increasing exit tax rates or withholding taxes on payments to non-residents has arisen previously. Due to the interaction with tax treaties, the taxation of distributions which varies from treaty to treaty, and because information is not available in relation to potential future distributions to investors, an accurate estimate of any potential revenue from an increase in the withholding tax rates cannot be made.¹⁷

There are a wide range of rules in relation to the tax treatment of non-residents depending on the income source or particular area of taxation.

Does the Commission feel that this is an area where changes or reforms could be considered? If so are there any specific areas you would like to see examined in future papers?

¹⁷ [Parliamentary question 18768/20](#), 28 July 2020

Equalise the tax treatment of investment through intermediaries

The often favourable treatment of large scale investors is frequently criticised, but any change in their taxation would need to be approached with caution. Ireland introduced the gross roll-up regime to align the treatment of funds with other OECD countries, where such tax neutral models are common practice. Removal of this treatment could impact Ireland's international competitiveness and ability to attract capital investment, so any policy change in this area would need careful consideration. In particular, institutional investment is a key source of funding for the property development sector so the original policy rationale for tax neutral investment (at the fund level not investor level) arguably remains relevant. If institutional investors are no longer incentivised to invest in the Irish property market, consideration needs to be given to what alternative source of financing will be available in their absence.

Does the Commission feel that this is an area where changes or reforms could be considered? If so are there any specific areas you would like to see examined in future papers?

3. Income and capital gains

A common metaphor used to illustrate the difference between income and a capital gain is a tree that bears fruit. The tree is the capital property and selling the tree could create a capital gain. The profit from the fruit produced is business income. However, if someone was in the business of selling trees then the profit on selling the tree would also be considered business income. Making a determination between income and capital gains can sometimes be difficult and subject to interpretation. The tax treatment can also influence whether a taxpayer wishes for a particular profit to be treated as income or a capital gain.

Haig and Simons argue that capital gains and income are equivalent because they equally affect the ability of individuals to consume without affecting net worth. A comprehensive definition of income, known as the Haig-Simons definition, includes typical forms of earned income from labour, returns to capital such as dividends and interest income and rental income from property.¹⁸ It also includes

¹⁸ Haig, Robert M. ["The Concept of Income—Economic and Legal Aspects"](#), 1921 and; Simons H. [Personal Income Taxation: the Definition of Income as a Problem of Fiscal Policy](#), 1938

moneys from gifts and inheritances received as well as the net increase in the value of the owner's assets (i.e. capital gains). In other words, annual income is equal to the change in a person or entity's potential consumption or command over resources in a year, without consideration for the stock of wealth they already own. An increase in moneys from net real capital gains (excluding inflation and net of losses) and/or gifts or inheritances increase consumption potential, just as incomes from salaries, rents and dividends do.

Box 1: Capital gains and income terminology

The Haig-Simon definition treats capital gains and income as equivalent. This is from an economic perspective based on their interactions with consumption and net wealth.

From an Irish tax perspective, the terms "income" and "capital gains" (referred to as *chargeable gains* in legislation) have distinct meanings. The Taxes Consolidation Act 1997 is comprised of the Income Tax Acts, the Capital Gains Tax Acts and the Corporation Tax Acts, which together set out the rules of taxation in Ireland.¹⁹ Each of those Acts use specifically defined terms, for example, *taxable income* and *total income* for the purposes of charging income tax. CGT is charged on *chargeable gains* computed in accordance with the CGT Acts and corporation tax is charged on a company's *profit*, which means *income and chargeable gains* for the purposes of interpreting the Corporation Tax Acts.

The characterisation of income and capital gains may vary depending on the jurisdiction. For example, some countries may treat capital gains as a form of business income in the case of corporates but apply a different tax regime for capital gains of individuals.

Therefore, while this paper references capital gains as a form of income in a general sense, it should be noted that there are technical differences between the terms in the context of tax legislation.

This section will examine the current tax treatment of capital gains vis-a-vis other forms of income from capital. It will give insight into some of the criticisms of differential rates across forms of income, some of the options for reform along with some of the complications in reforming the current system.

3.1 Capital Gains Tax

Capital gains tax (CGT) was introduced in 1975 following the Government publication of a White Paper in 1974 on capital taxation, which outlined a comprehensive new system of taxes on capital gains, wealth and capital acquisitions. Up until then capital gains were generally untaxed and the high

¹⁹ Different Acts apply to other tax heads e.g. stamp duty and Capital Acquisitions Tax.

marginal tax rates on income at the time led to several cases of taxpayers trying to transform their taxable income or profits into non-taxable capital gains. The primary intention of CGT was to bring previously untaxed forms of profit into the tax net and to strengthen tax equity across forms of income, albeit at a considerably lower rate than earned income.²⁰

CGT applies to the nominal appreciation in value between the price that was originally paid for an asset and the price at which it was disposed of.²¹ Transfers to connected persons or transactions otherwise than by way of a bargain made at arm's length (for example gifts) are deemed to pass at market value. There are a number of exemptions including an annual personal exemption of €1,270 of net gains, transfers between spouses/civil partners and an exemption on the sale of the Principal Private Residence (PPR) in so far as it has been a PPR for the entire duration of ownership and was not partly used for business purposes.

CGT is taxed at the individual or company level, unlike for income tax purposes where married couples and civil partners are jointly assessed. However, losses can be transferred between spouses and civil partners.

Capital gains are included in a company's profits for corporation tax purposes, but subject to the same CGT rate as individuals. Companies only pay CGT on development land gains and they cannot avail of the annual exemption.

3.1.1 CGT Rate

Capital Gains Tax was introduced in 1975 at a rate of 26 per cent.²² Today, the tax applies at a rate of 33 per cent to the gain made on the disposal of assets such as quoted and unquoted shares, residential and commercial property and land. Specifically, the 33 per cent rate applies to net gains i.e. the total amount of chargeable gains in a year minus allowable current year losses and unused losses carried forward from previous years. Since 2008, the CGT rate has been increased on four occasions from 20 per cent to 22 per cent in 2008, to 25 per cent in 2009, to 30 per cent in 2011 and finally to 33 per cent in December 2012 where it has remained since.

An international comparison of headline capital gains taxes is presented below. Ireland's rate of CGT is often called out for being one of the highest in Europe, however, it should be noted that these are

²⁰ OECD – [Taxation of Capital Gains of Individuals](#), 2006

²¹ CGT is assessed and charged in respect of chargeable gains computed in accordance with the Capital Gains Tax Acts and accruing to a person on the disposal of assets.

²² An alternative basis was available to individuals for small gains (£5,000), giving them an option of having the gain treated as income for income tax purposes instead. This treatment was subsequently removed.

headline rates only, and direct comparison across countries based on these figures alone is not advised. Country-specific reliefs and exemptions provide nuance to some of the effective tax rates in these countries. Similarly, some countries provide differing CGT rates for individuals and companies while some countries charge differing rates depending on holding periods.²³

Table 3: International Capital Gains Tax rates - 2021

Country	CGT Rate % for individuals
Austria	27.5%
Belgium	In general exempted (except in some specific cases)
Denmark	Subject to normal PIT rate (27% up to 56,500 DKK and 42% above this)
Finland	30% and 34% on income exceeding €30,000 annually
France	30%, plus exceptional income tax for high earners at 4%
Germany	25%, plus solidarity surcharge
Ireland	33%
Italy	26%
Latvia	20%
Lithuania	20%
Luxembourg	Subject to the normal PIT rate (0% - 45.78%)
Netherlands	30%
Norway	22%
Slovakia	19%
Slovenia	27.5%
Spain	Residents – 26% Non-residents – 19%
Sweden	30%
UK	< £12,300 in net gains – exempt; The rate of CGT is determined by the type of asset disposed of and whether the individual pays income tax at the basic rate or higher rate. Basic rate band up to £37,500 – 10%; higher rate – 20%. UK residential property and carried interest -28% (higher rate) and 18% (basic rate).

Source: [Department of Finance; PwC Worldwide Tax Summaries](#)

Note: PIT – Personal Income Tax

²³ Ireland historically charged different rates of CGT depending on the holding period. A single rate was reintroduced in 1994 at 40%, with the distinction between short-term and long-term gains abandoned for most purposes.

3.2 CGT and income tax differential

Subject to some of the exceptions outlined in Section 2, individuals are generally subject to tax at their marginal rate of income tax, USC and PRSI on most sources of income e.g. trading profits, dividends, rents, etc. Since (according to the Haig-Simons definition) capital gains are a form of income, taxing them differently to other forms of capital income and indeed all forms of income deviates from the principle of horizontal equity.

From a vertical equity perspective, income in the form of capital gains increases proportionately with income, and differential treatment has consequences from this point of view. Similarly, from a neutrality perspective, taxation at different rates creates tax-induced choices in favour of one form of activity over another. In theory, in the absence of differential rates, actors would choose the more efficient form of economic activity instead. In Ireland, the 33 per cent CGT rate is lower than the 40 per cent higher rate of income tax. All else being equal, this discourages saving via other forms in favour of capital gains for high earners, as the income tax and USC rates on income increase with income, whereas the rate on CGT-liable sources remains fixed. The opposite is the case for low-income earners, who pay lower effective tax rates on income than on capital gains, although it should be noted that capital gains accrue disproportionately to higher earners.

The opposite is also the case for companies, whose trading income and passive/investment income is taxed at lower rates of corporation tax. There is a large differential between the 12.5 per cent and 25 per cent rates of corporation tax on trading and passive income compared with the 33 per cent rate on chargeable gains. A company may therefore attempt to structure its affairs so that sources of profit are categorised as passive or trading income as opposed to capital gains. The profits liable to corporation tax usually come mainly from trading income e.g. €195.3 billion taxable trading profits reported on all CT1 returns in 2019 compared with €812 million of capital gains (from 1,288 companies).²⁴

On this basis it could be argued that the CGT and income tax rates should be aligned. How this could be achieved or implemented is not straight forward, however. Increasing the CGT rate further may impact investment and Ireland's perceived international competitiveness, whereas reducing the income tax rates towards the CGT rate would have a substantial impact on Exchequer receipts. For example, a 1% decrease in the higher rate of income tax is estimated to cost the Exchequer €404 million per year.²⁵ While increasing the CGT rate towards the higher income tax rate may improve

²⁴ Revenue, [Corporation Tax – 2020 Payments and 2019 Returns](#), April 2021

²⁵ Revenue [Ready Reckoner Post Budget 2022](#)

horizontal equity for the treatment of income and capital gains for individuals, it would further drive the gap between CGT and other tax rates available to corporates.

Furthermore, capital gains exhibit characteristics that make their associated tax treatment different to that of other forms of income, regardless of tax rates. The following sections will explore some of these characteristics.

3.2.1 Distribution of CGT

While from an economist's perspective capital gains could be considered a form of income, CGT could in many respects also be considered a tax on the transfer of wealth. Capital gains generally relate to disposals of shares, property and land, which are common forms of wealth. Saving in the form of capital gains is disproportionately utilised by the better off. Latest data from Revenue shows that 74 per cent of CGT receipts are paid by the top 10 per cent of income tax payers. The bottom half of income tax payers accounted for only 8.8 per cent of the value of CGT receipts, or 19 per cent of total CGT cases in the year 2016.²⁶ Similarly, in the UK, 90 per cent of all taxable gains go to individuals with total remuneration (income plus capital gains) above £100,000 annually. Those who have profits in the forms of both capital gains and earned income see their effective tax rate fall as their capital gains rise, compared to those with only earned income.²⁷ It is for these reasons that the UK applies different rates of CGT to higher and standard rate taxpayers (see section 3.2.3 below). The structure of the differential rates in the Irish system would suggest a similar effect here. Thus, changes to the CGT rate along with the current preferential treatment already given to saving/investment via capital gains will need to be considered in this context.

3.2.2 Realisation basis of CGT and lock-in effects

Savings and investment through capital gains is often preferential, as tax payments are not due annually on unrealised multi-year gains (i.e. CGT is paid on a realisation basis when assets are disposed of rather than on an accruals basis). Mirrlees argues that the ability to delay and defer tax payments until realisation can be seen as an interest-free loan from the government to the taxpayer and assets held for long periods see associated effective tax rates fall.²⁸

²⁶ Revenue Commissioners – [Profile and Distribution of Capital Taxes](#), 2018

²⁷ Advani A. and Summers A. – [How much tax do the rich really pay?](#), 2020

²⁸ Mirrlees, [Chapter 13 The taxation of household savings](#), 2011

From an efficiency perspective, 'lock-in' effects can be created by capital gains taxes as they apply on a realisation basis (as opposed to on an accrual basis like most other forms of income). If an asset is rising in value, in theory there is an incentive to hold onto it, where in the absence of the tax the asset may have been disposed of earlier. Minimum holding period requirements of tax reliefs such as Entrepreneurial Relief (three years), as well as the CGT exemption for the holding of property and land acquired between 2011 and 2014 (four to seven years) may further exacerbate lock-in effects. The tax system may also encourage the transfer of assets on a death (where no CGT liability arises) over transfers within the lifetime of the asset owner, which can prolong the disposal of an asset beyond a point in time that may have been chosen in the absence of this treatment.²⁹ In practice, however, there are a number of economic and other non-tax considerations as to the timing of a disposal. The lock-in effect is mitigated in the case of smaller gains, due to the availability of the annual exemption of €1,270.

Box 2: Example of CGT and CAT at death:

Mr A bought an asset for €10,000 in 2005. In 2021, he gifted the asset to his neighbour Mrs B when the asset was worth €15,000.

Mr A has realised a gain of €5,000 and he must pay a CGT liability of €1,231 $((5,000 - 1,270) \times 33\%)$.

Mrs B also has a CAT liability on receipt of the gift. Assuming she has fully utilised her CAT Group C threshold on other benefits received by her, CAT will be charged at 33% on the value of the benefit received minus the €3,000 small gift exemption i.e. €3,960 $((15,000 - 3,000) \times 33\%)$. She can reduce her CAT liability by CGT paid by Mr A on the gift using the CGT/CAT same event credit. She must therefore pay CAT of €2,729. If Mrs B sells the asset in the future her base cost for CGT purposes will be €15,000.

If instead Mr A died in 2021 and transferred the asset to Mrs B via an inheritance, no CGT will arise on the disposal and the €5,000 gain remains outside the scope of CGT. Mrs B must pay CAT of €4,950 $(15,000 \times 33\%)$ on her inheritance as no small gift exemption or same event CGT credit applies. Mrs B's base cost for CGT purposes on a future disposal will be €15,000.

The total tax (CGT plus CAT) paid on the transfer is €3,960 when it is by way of gift and €4,950 by way of inheritance. Depending on the asset stamp duty may also apply.

²⁹ However, Capital Acquisitions Tax (CAT), if applicable, is paid by the recipient on the market value of assets inherited at death.

Similarly, a form of lock-in may be created for corporates where tax deferral via capital gains occurs, which lowers the effective shareholder tax rate on capital gains. A comparatively lower effective rate through capital gains may encourage retention of profits within the corporate entity, as opposed to distributing them via dividends.³⁰ Several anti-avoidance provisions exist to counter arrangements by shareholders to take profits out of a company without attracting an income tax liability. For example, where a company acquires its own shares any amount paid in excess of the original issue price is normally treated as a distribution (akin to a dividend). CGT treatment is permitted, however, in certain circumstances.

3.2.3 Aligning the treatment of capital gains and income

Taxing capital gains on a similar basis to other incomes is not easily implementable. Capital gains are currently taxed on realisation as opposed to on accrual, like other forms of capital income such as interest and rental income. Both the 2009 and 1980s Commissions on Taxation considered that this characteristic meant that taxing capital gains using a progressive tax system creates issues for horizontal equity.³¹ Taxing realised capital gains accumulated over numerous years at the marginal rate according to income tax, USC and PRSI thresholds (which apply on annual and weekly bases) would result in dissimilar effective tax rates across capital gains and other incomes that are subject to tax on accrual (see Box 3). A multi-year realisation, where income is ‘bunched’, could be taxed equitably on a similar basis to annual incomes from other sources if a proportional income tax system existed, however, this would be at the expense of the high degree of vertical equity in the income tax system as it currently stands.

Box 3: If capital gains were taxed at progressive income tax rates

Ben purchased an asset 5 years ago for €50,000 and sold it today for €200,000. This led to a chargeable gain of €150,000. If the current income tax system applied to the gain, a 20% tax would apply on the first €36,800 and 40% on the remainder, resulting in a tax liability of €52,640.

Ann is a single PAYE income tax payer who earns €30,000 annually across five years (i.e. a €150,000 increase in income). She would pay tax at the 20% rate each year, resulting in an accumulated liability of €30,000 over 5 years.

All else equal, Ben pays a higher effective rate than Ann on the same increase in income.

Note: Both examples ignore impacts of credits, allowances, USC and PRSI for the purposes of simplification.

³⁰ OECD – [Taxation of Capital Gains of Individuals](#), 2006

³¹ Commission on Taxation - [First Report](#), 1982 and; [Commission on Taxation Report 2009](#)

While Ireland's CGT system is in many ways based on the UK's, the UK operates a multiple rate system. The UK's CGT and income tax rates used to be aligned. Today, different rates of CGT apply, although they are still linked to the individual's overall level of income and whether they pay income tax at the basic (20 per cent) or higher (40 per cent)/additional (45 per cent) rate. For example, if the individual is a higher rate income tax payer, they will pay CGT in the UK at 28 per cent on residential property gains³² and 20 per cent on all other gains. A basic rate income tax payer's liability to CGT is 10 per cent if their net taxable income and gains is below the basic income tax band (or 18 per cent if residential property).³³ The UK model, therefore, represents a method of linking CGT to the income level of the individual, albeit still at a considerably lower rate than that paid on other forms of income.

Another theoretical solution might be to tax capital gains on an accrual basis, as opposed to when they are realised. However, taxation on an accrual basis (i.e. annually) may create practical issues. Imposing year-to-year valuations of assets that have not been yet disposed of creates additional administration, extra costs for the taxpayer and uncertainty as to what valuation should be used. One potential workaround might be to charge accrual-based CGT annually based on estimated gains. If, on disposal, realised gains turned out to be less than estimated accrued gains a tax refund could apply, and vice-versa. However, the taxpayer whose wealth is tied up in unrealised capital gains may face cash-flow issues when paying accrual taxes and difficulties may arise in estimating capital gains from year-to-year. It also raises questions as to what loss relief should be allowed and whether the annual exemption should be available.³⁴ Furthermore, it creates additional reporting and administrative requirements.

In sum, reforming the tax system to achieve perfect neutrality between forms of income would require significant shifts away from how capital gains are currently taxed.

3.3 Wholesale reform of CGT

There is a perceived trade-off between increasing the tax rates for CGT on the one hand, in order to promote horizontal equity, and discouraging saving and investment on the other. For example, if all tax rates were equalised to the current income tax rates, this would necessarily achieve the former at

³² Disposals of the principal private residence are generally exempt.

³³ HMRC guidance on how CGT is calculated in the UK is available at www.gov.uk/capital-gains-tax

³⁴ For example, a gain of €20,000 on disposal of an asset held for five years normally would give rise to a tax charge on a gain of €18,730 if sold in year five (the gain is reduced by the €1,270 annual exemption). If the gain was instead taxed annually in tranches of €4,000 then the total gain subject to tax after five years would be reduced to €13,650 (i.e. $(4,000 - 1,270) \times 5$).

the expense of the latter. A recent publication by the Institute for Fiscal Studies (IFS) in the UK suggests that this trade-off exists only in the instance where tax rates alone are used to achieve the goal of neutrality.³⁵ It is argued that the twin goals of horizontal equity and neutrality around investment and savings decisions can be achieved by equalising all tax rates with the current income tax rates coupled with tweaking the tax base to which these rates apply.³⁶

The following sections look at various ways that rates on CGT can be aligned with income tax rates, while potentially reducing incentive-harming effects of a rate increase. This package-based approach follows the IFS approach; however, the Office of Tax Simplification as well as our own previous Commissions on Taxation have also recommended some of these policies. Some of these recommendations could be applied to equalise all rates of capital income and labour income (such is the scope of the IFS paper), however, the following sections will look at alignment of CGT and income tax rates alone.

3.3.1 Exemption of normal returns

The authors of the IFS publication recommend that the UK tax base should be reformed as to only tax above-normal (excess) returns on savings and investment. According to optimal tax theory, this is the most efficient way of taxing capital income. It is argued that this reform could negate the potential negative incentive impacts of a CGT equalisation at the marginal rate of income tax.

The normal rate of return is the minimum rate of return an investor would be willing to accept to make an investment. If the expected return of an investment in a given project is below the normal level of return (for example due to tax), the investor will choose not to invest in this project, accepting a risk-free rate of return instead.³⁷ Similarly, for a saver, a normal return is the minimum return an individual is willing to accept to forgo consumption today for consumption in the future (i.e. saving). When tax is charged on the normal rate of return, this artificially discourages saving in favour of consumption today. Under this proposal, returns in excess of the normal rate of return would be taxed at the marginal rate of income tax (i.e. at the same rate as labour income). Taxing an excess return does not discourage investment or saving as the post-tax return is still profitable and would likely go ahead anyway (in the case of investment) and does not affect decisions to save (as the rate of return is

³⁵ Adam A. and Miller M. – [Taxing work and investment across legal forms](#), 2021

³⁶ While the focus of this paper looks at reforms to CGT, the IFS paper does consider reforms of other areas as part of its proposals e.g. in relation to national insurance and the UK's different tax rate on dividend income.

³⁷ The normal rate of return is often equated to a risk-free return. US Treasury bonds offer such a rate, for example.

compensation enough not to discourage saving). Such a system exists in Norway as part of its ‘shareholder model’ whereby investors are granted a tax-sheltered return above which CGT applies. However, normal return tax-free deductions are available only at the personal level and not at the corporate level.³⁸

The authors claim that the current system makes otherwise ‘just worthwhile’ investments unviable by taxing normal returns. Similarly, incentives that offer reduced rates are under-taxing investments and saving that would have occurred anyway e.g. those that generate excess returns. Offering reduced rates to investments that would have otherwise occurred in the absence of the incentive leads to deadweight. Taken together, the authors argue that these reforms would allow for the twin goals of increasing rates on capital gains with little concern over potential incentive-weakening side effects.

From a theoretical perspective, this reform is sensible, however, in practice, there are other consequences that must be taken into account. Firstly, implementation of this proposal would lead to wholesale changes in how the taxation system interacts with tax bases across all forms of capital income. Secondly, it would likely be perceived as unequal to exempt a portion of capital income for both individuals and corporations from taxation based on the rate of return that they receive, with no regard for ability to pay. Disproportionately large gains could be entirely exempt from tax, if as a proportion of the asset’s value they were below the normal rate of return. Insight into the distributional impacts of such a reform would be useful. Importantly, if capital income were exempt from taxation based on a certain rate of return this would necessarily create disparity between the taxation of labour and capital income, where there is no equivalent allowance for labour income. Finally, the CGT regime in the UK operates under a progressive rate system already and moving to the twin proposal outlined above would be a disruptive change from the status quo in Ireland.

While this option presents a wholesale change to the base, there are other changes that could be made to the base to accompany the equalisation of rates if it were desired.

3.3.2 Offset of losses

Another proposal for reform to the base that could be made alongside CGT increases is to allow losses to be offset more flexibly. Currently, there are restrictions on losses whereby CGT losses cannot be transferred across incomes and vice versa. From an economic standpoint, the cushioning of losses should apply at the same level that gains are taxed. This implies that relief for losses could be offset against other forms of income tax liabilities. It also implies that the present value of losses should be

³⁸ OECD, [Taxation of Capital Gains of Individuals](#), 2006

maintained when carried forward for use against future year gains. This suggests CGT losses carried forward should attract an interest rate to maintain their present value (and the opposite would be the case for losses carried back, if these were allowed). Increasing CGT rates could, in theory, have less distortionary effects if it were coupled with this reform to the base.

However, losses accumulated over numerous years that could be offset against taxes from income that is taxed on an accrual basis such as labour income, would bring with it similar issues to what are highlighted in Section 3.2 above for taxing capital gains on an annual basis. Issues of equity could arise where large losses offset against income taxed at the higher rate could reduce the tax paid by higher income earners significantly, with the result that income could be sheltered from tax for a number of years to follow. Generous loss provisions were allowed under, for example, Section 23 type reliefs, which led to considerable losses being carried forward and offset against incomes over long periods. Ultimately, the Exchequer impacts of such provisions proved costly, leading to their abolition.

A question arises as to whether losses for income tax purposes (e.g. trading or rental losses) could equally be used to offset chargeable gains. If not, further distortions in the tax code are created. Differences in how losses are computed for different sources of income and capital gains also adds to the complexity.

If the income tax and CGT rates were not fully aligned it would mean that a CGT loss arising on the disposal of an asset could be used to shelter income taxed at a higher rate, whereas if that asset disposal gave rise to a gain it would be taxed at a lower rate.

3.3.3 Indexation Relief

Another reform to the base that could negate some of the negative incentive effects of higher CGT rates is the taxation of real capital gains, as opposed to nominal gains (that include appreciation of assets that are linked purely to rising prices elsewhere in the economy). Indexation relief for CGT was introduced in 1978 at a period of high inflation. The 1982 Commission on Taxation endorsed the measure as it meant that only real gains were taxed, with nominal gains deflated by a price index before the taxable gain is arrived at. Currently indexation applies to assets acquired and costs incurred prior to 2003, with the relief abolished for costs incurred post 2002. The Minister for Finance at the time removed indexation relief, together with rollover relief and other measures in order to broaden the base, stating that such reliefs only made sense when the CGT rates were 40 per cent and 60 per cent.³⁹ While it noted that many other countries no longer feature indexation relief in their tax regime

³⁹ Minister for Finance, [Budget 2003 Financial Statement](#), December 2002

for capital gains, the 2009 Commission on Taxation recommended its re-introduction on the basis that it would prevent gains from being taxed at an effective rate higher than the statutory rate. It should be noted that income tax and USC thresholds are not currently linked to inflation, so reintroducing indexation relief for capital gains only would create inequity between the two regimes.

3.3.4 CGT at death

Some Commission members have expressed an interest in exploring in more detail changing the current CGT treatment at death. Assets transferred on a death are not liable to CGT, meaning any uplift in the asset value between the original date of acquisition by the deceased and the date of death is not taxed. Similarly, any reduction in value, or loss, is not relieved. The beneficiary is deemed to acquire the asset at the market value on the date of death, which will form part of their base cost for any subsequent disposal (as well as the valuation base for CAT purposes).

The current system arguably gives preferential treatment to income from savings held in the form of assets over income deriving from other sources. It may also act to further encourage the lock-in effects associated with CGT, as holding an asset until death is incentivised by the special treatment given to capital gains. Furthermore, if CGT rates were to be increased in line with other reforms to the base, the incentive to hold assets until death would likely be encouraged further. Were it desired, a practical way to reform CGT relief at death (without causing undue cash-flow issues for the inheritor) could be to rebase the inherited asset's base value to the year at which it was originally acquired by the deceased, for the purposes of CGT only. The CGT liability would only then occur on a subsequent disposal by the new owner. The practicality of this reform would need to be examined from an administrative perspective, together with its interaction with CAT and the same event credit.

3.3.5 Other considerations

These potential options ignore the bunching or lumpy nature of capital gains tax payments as they are taxed on realisation. A progressive income tax system applying to capital gains leads to differing tax liabilities depending on the length of ownership (see Section 3.2 above). However, many countries including the UK, charge a different CGT rate depending on income. One potential method for alleviating the effect of bunching could be to grant some form of averaging relief that effectively takes

the annual average gains from a realised multi-year gain and applies income tax on the average annual basis.⁴⁰ However, the practical implications of such a change would need to be examined further.⁴¹

Another policy that could be investigated is a reducing tax rate that corresponds to length of ownership. The 2009 Commission on Taxation recommended that a tapering relief be introduced in the absence of indexation relief. The Commission argued that this could account for some of the time-related disadvantages of taxing nominal gains. Assets held for longer periods would attract lower rates. Indeed prior to 1992, lower CGT rates applied to assets held for longer periods. However, offering lower tax rates associated with prolonged realisation acts to create further distortions and the holding period chosen for the rate to be reduced is arbitrary. Similarly, it increases the advantage that tax deferral already provides to those who save in the form of capital gains.⁴²

4. Conclusion

This paper explores options for increasing the degree of horizontal equity across different forms of income and across capital gains and income. Aligning tax rates across different sources of capital income is desirable from an equity perspective as unfairness can arise where two parties with similar incomes are taxed at different rates. It is also desirable from a neutrality perspective. In theory, the market allocates resources efficiently. Where tax considerations are factored in to choices, a distortion occurs between the optimal market equilibrium and the after-tax equilibrium. Aligning tax rates can, in theory, mitigate against somebody's decision to choose one form of economic activity over another.

However, there are various considerations to bear in mind when considering aligning rates. While differentials can cause distortions, so too can higher rates. Conversely, considerations should be given to the Exchequer impacts of cutting rates. Vertical equity concerns should also be borne in mind when deciding on implications of changing rates. In sum, multiple interactions between competing demands of the tax system must be considered where alignment of rates is concerned, all of which need to be considered in the context of achieving neutrality and horizontal equity.

The first half of this paper examines different forms of savings and investment income. Tax rates vary considerably e.g. from the 20 or 40 per cent rate of income tax (plus USC) on income from dividends and rents, compared with the 33 per cent rate of DIRT on deposit interest and the 41 per cent exit tax on those who save in the form of life assurance policies or using an investment fund. Options are

⁴⁰ A similar relief known as Top Slicing Relief exists in the UK. Examples of how this applies in the UK system can be seen [here](#).

⁴¹ Office of Tax Simplification – [Capital Gains Tax review – first report](#), 2020

⁴² OECD – [Taxation of Capital Gains of Individuals](#), 2006

presented as to how rates across these various sources of income could be aligned, as well as associated implications. These include:

- Increasing the rate of DIRT
- Decreasing the rates of exit tax for funds and life assurance premiums
- Aligning the rates of taxation on funds, deposit accounts and life assurance policies with the standard and higher rates of income tax (and possibly introducing a USC charge).

This section of the paper also examines the treatment of traditional companies compared with structures taxed under the gross-roll up regime, and the treatment of non-residents.

Does the Commission view the current tax differentials to be justified and if not, how should the treatment be equalised?

The second half of the paper examines the differences that exist between the taxation of capital gains and other forms of capital income and income generally. Capital gains exhibit distinct characteristics that set it apart from other forms of income. Tax is paid on the realisation of capital gains, whereas rents, dividends and wages are taxed as they accrue. This difference presents challenges for the goal of vertical equity across forms of income. Options for changing the CGT regime are presented along with some analysis of the challenges that might come alongside these changes. These include:

- Aligning or reducing the gap between the tax rates on income and capital gains
- Linking the taxation of capital gains to the income level of the taxpayer
- Taxing capital gains as they accrue, rather than on a realisation basis
- Wholesale reform where the CGT rate would increase to the higher rate of income tax, in conjunction with other reforms to the base such as more generous loss relief, indexation of costs or only taxing excess returns.

In light of the varying degree of challenges associated with these options, does the Commission have a desire to implement changes and reforms to the CGT regime in order to align it with other taxes on income? If so, would the Commission recommend any changes to the base that would mitigate against some of the negative impacts of changes to the rates? Alternatively, is the Commission satisfied with the current design of the CGT regime?

Appendix 1 Cutting CGT rates and investment

There is little conclusive evidence on the impact cutting CGT rates has on investment. The following section will give a brief overview of some of the literature in this area.

Advocates of reducing CGT maintain that this fosters economic growth both by increasing the level of private saving and investment and by favouring investments with higher social payoffs, and that the additional growth in revenues would offset any initial revenue losses from cutting CGT. Opponents of this point of view would argue that cutting taxes on capital gains will have little to no effect on saving or investment, and will simply encourage investors to seek out ways of converting other forms of income into capital gains.⁴³

While there is evidence to suggest that disposal of capital gains may be responsive to tax rates (an effect that is greatest directly after the rate change), the same cannot be said for investment.⁴⁴ From Miller et al (p. 36):

*“Policy makers often support lower capital gains tax rates (relative to taxes on salaries or dividends) as a mechanism to encourage business owners to invest in their own enterprises. Here we show that there is no evidence that tax induced increases in retained profits lead to higher business investment. Instead, evidence suggests that owner-managers retain income for long periods in order to access lower tax rates, including preferential capital gains treatment.”*⁴⁵

As noted previously in the “Policy objectives for supporting SMEs and entrepreneurs” Secretariat paper,⁴⁶ a review of the CGT Entrepreneur Relief found that more of the entrepreneurs who availed of the reduced CGT rate used their funds for personal expenditure, savings or to pay off existing loans rather than for a reinvestment purpose.

This suggests that the tax *differentials* across forms of income is of considerable significance for the decision by owner-managers to invest in their business and that looking at the CGT rate in isolation fails to take account of the important effects of differential tax rates from an efficiency perspective. This is not necessarily to say however, that increasing rates of CGT would not have any effect on investment decisions and any decision to increase rates must also be looked at in a holistic manner.

⁴³ Journal of Economic Perspectives – [Cutting Capital Gains Taxes](#), 1991

⁴⁴ Kakoulidou T. and Roantree B. – [Options for Raising Tax Revenue in Ireland](#), 2021

⁴⁵ Miller et al. – [Intertemporal income shifting and the taxation of owner-managed businesses](#), 2019

⁴⁶ Copy available on Decision Time (meeting 8 folder)

Proponents of lower CGT often cite other issues with the base as being of significance. For example, nominal gains may be taxed without symmetric treatment for losses and gains. Indeed symmetric treatment⁴⁷ of gains and losses are of greater importance to risk-taking than the rates themselves according to theory developed by Joseph Stiglitz, although symmetric treatment can create difficulties where a tax applies on a realisation basis.⁴⁸ Indeed tax on realisation brings with it certain benefits to those experiencing capital gains such as tax deferral, another consideration that should accompany the debate on rates.

Economist Moore McDowell, gives insight into the impacts of the Irish CGT cut in 1998.⁴⁹ The Minister for Finance reduced the rate from 40 per cent to 20 per cent as part of Budget 1998 with a view to releasing “*pent up investment funds*” and creating “*an incentive for the acquisition of further capital assets. This will encourage investment and growth in the future.*”⁵⁰ One would expect the number of realisations and tax yield from CGT to increase considerably following this significant rate cut. However, little conclusive evidence is found of the rate cut leading to either of these effects. While assessments (i.e. realisations) increased following the tax rate increase, it is not clear what proportion of these are attributed to increased decisions to realise capital gains due the rate cut, or simply because asset prices were rising due to a booming economy, taking would-be realised gains above the exemption limit (i.e. increasing the number of chargeable gains in the economy). Furthermore, the rate reduction accompanied a move towards full self-assessment of CGT in the 1990s, which is generally accepted as having improved compliance. A reduction under Budget 1998 in the personal allowance from £1,000 (single) and £2,000 (married) to an individual allowance of £500 may also have impacted receipts due a larger amount of any gain becoming subject to CGT, all else equal.

MacDowell makes a tentative extrapolation based on various assumptions around average yields in previous years that the rate cut between 1996/1997 and 1998/1999 may have increased the tax yield by approximately 20 per cent at best, but that this was merely a short-run phenomenon. He caveats this estimate, noting that the sudden increased yield cannot be interpreted as a steady-state increase in annual yields, whereby a lower tax burden on capital gains leads to more investment, more growth and higher yields. He notes that “*the classic supply side argument about self-financing tax cuts cannot be supported by a simple reference to the change in the yield level after the rate cut at the end of*

⁴⁷ Perfect symmetry would allow losses to be deducted for tax purposes against any form of income. It would also entail the present value of losses to be maintained. For example, a loss of €100 incurred 20 years ago would not equate to a €100 gain made today. Similarly, a €100 loss incurred today would be less valuable than a €100 gain made 20 years ago.

⁴⁸ See page 72 of OECD – [Taxation of Capital Gains of Individuals](#), 2006

⁴⁹ Moore MacDowell - [Capital Gains Tax in Ireland](#) from International Evidence on the Effects of Having no Capital Gains Taxes, 2001

⁵⁰ Minister for Finance – [Budget 1998 Financial Statement](#), 1997

1997.” (page 162). Further analysis into the long run effects of this cut is needed before any conclusions are drawn.