# Income Tax Simplification

## Future Issues for Consideration

The complex road to simplicity

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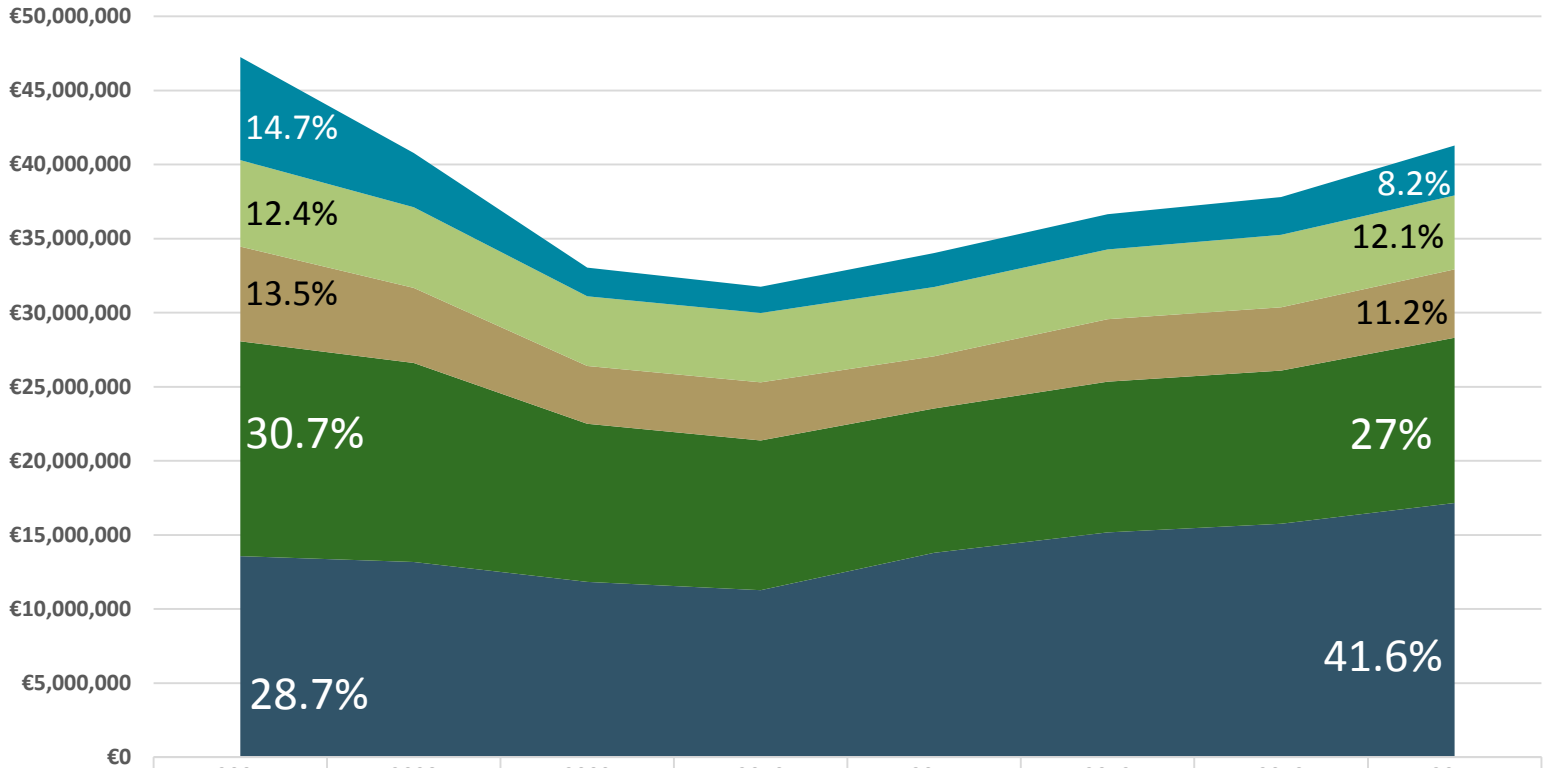
# Overview

- This presentation discusses four possible paths to income tax simplification
- Presented as four distinct options for discussion purposes - hybrid approach more likely in reality
- Investigation of potential issues to inform future policy debate – this presentation does not purport to be the views of the Department of Finance.

# Why Could Simplification be Needed?

- Simplicity and transparency, for individuals and employers
- HM Treasury – Office of Tax Simplification
- Current system: 3 distinct charges on 3 separate bases
  - Income tax
  - Universal Social Charge (USC)
  - Pay-Related Social Insurance (PRSI)
- Income tax, including USC, is now the largest source of tax revenue to the Exchequer
- It is also the tax over which Ireland retains the most control
- Policy lever to achieve socio-economic objectives

# Tax Yields 2007 - 2014




| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| Other Taxes | 6,951,851 | 3,661,505 | 1,935,428 | 1,773,687 | 2,291,379 | 2,376,854 | 2,550,531 | 3,366,016 |
| Excise Duty | 5,837,878 | 5,443,338 | 4,702,552 | 4,677,969 | 4,677,600 | 4,707,018 | 4,891,105 | 4,991,147 |
| Corporation Tax | 6,390,625 | 5,065,894 | 3,900,306 | 3,923,637 | 3,520,193 | 4,215,671 | 4,270,332 | 4,614,462 |
| VAT | 14,496,588 | 13,429,602 | 10,669,652 | 10,101,284 | 9,740,525 | 10,170,770 | 10,336,000 | 11,152,929 |
| Income Tax | 13,572,410 | 13,176,857 | 11,835,235 | 11,276,092 | 13,797,532 | 15,175,819 | 15,757,908 | 17,157,467 |



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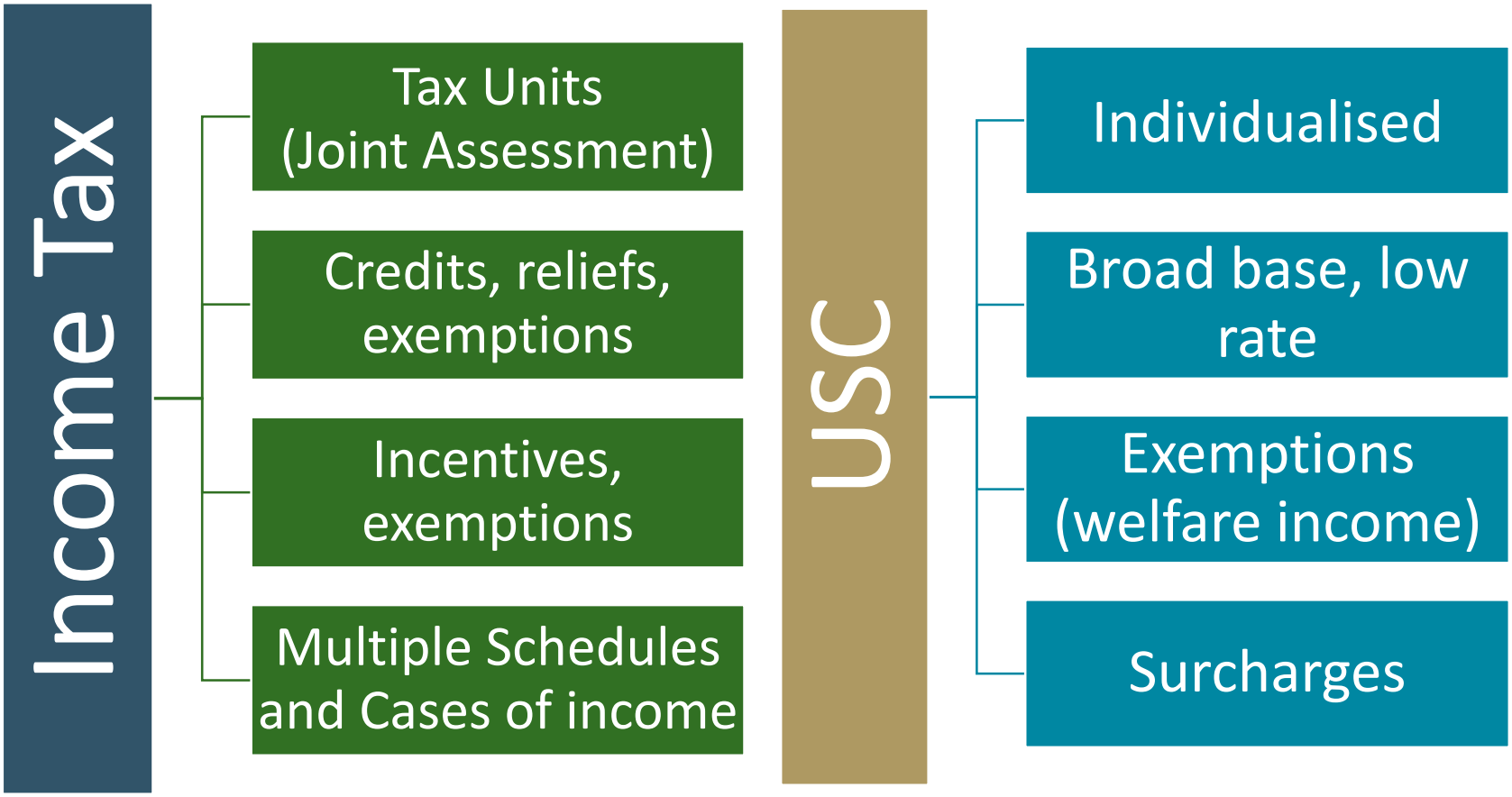
# Complications of a Dual System



# Possible Simplification Options for the Future

1. Simplify income tax system through removal of many tax credits, reliefs and deductions
2. Revisit individualisation, with a view to completing or reversing it
3. Gradual transfer of revenue-raising from income tax to USC
4. ‘Growing Out’ of USC

# 1. Simplify Income Tax System

- The income tax system is significantly complicated by the variety of tax credits, reliefs, exemptions and deductions available
- Revenue estimate the cost of personal & PAYE tax credits alone to be c.€7.8bn per year
- Other tax expenditures include:
  - Investment incentives, including business, agricultural
  - Exemptions for artists, childcare, renting rooms
  - Property reliefs and capital allowances
  - Relief for health expenses, education fees
- Estimated cost of all personal credits/reliefs/deductions €13.5bn*

*2013 figures for credits / reliefs / deductions used by individuals and which can be costed by Revenue

# Pros and Cons of Income Tax Expenditures

- Many income tax expenditures aim to achieve a social good:
  - Support families with caring responsibilities
  - Recognise additional costs faced by specific groups such as the elderly, single-parents, blind persons
  - Incentivise investment in businesses and business assets
- Potential to bring those currently outside charge back into the tax net, and thus widen the income tax base
- Is the achievement of social good a function of the tax system?

but…

- Is the tax system the more effective policy lever?

# 2. Complete or Reverse Individualisation

- Individualisation commenced in Budget 2000 – prior to that credits and tax bands were fully transferrable
- Objectives
  - To ease the tax burden on single persons (65% of workforce)
  - To take workers on industrial wage out of higher tax rate
  - To reduce overall numbers paying tax at the higher rate
  - To improve labour market participation – second earner would no longer face higher rate taxation on first euro of earnings
- Unpopular with single-income families
- Progressed but never completed – hybrid system remains

# Completed / Reversed Individualisation

| Current Rate Bands | |
|---|---|
| Single | €33,800 |
| Married one-earner | €42,800 |
| Married two-earners (max) | €67,600 |

| Completed Individualisation Rate Bands | | |
|---|---|---|
| Single | €42,800 | Cost*: €687 million |
| Married one-earner | €42,800 | |
| Married two-earners (max) | €85,600 | |

| Reversed Individualisation Rate Bands | | |
|---|---|---|
| Single | €33,800 | Cost*: €643 million |
| Married one-earner | €67,600 | |
| Married two-earners (max) | €67,600 | |

*Costed in 2014 on a post-Budget 2013 basis

# 3. Move from Income Tax to USC

- Income tax for 2015 will be c.€14.2 billion, and USC yield will be €4 billion – together accounting for c.42% of the total tax yield
- Projected income tax and USC yield for 2016 is c.€18.995bn
- What USC rates would be required in order to achieve this yield, preserving the current USC structure?
  - Preserve existing USC exemptions, eg Social Welfare income
  - Exemption threshold?
  - Progressive series of rates and bands
- Radical change – increase in USC revenue from €4bn to €19bn

# Hypothetical USC-Only Structure to Yield €19bn

| Income Band | USC Rate | Comment |
|---|---|---|
| €0 - €12,012 | 2% | Current entry band |
| €12,013 - €18,668 | 11% | Full-time minimum wage worker |
| €18,669 - €36,400 | 17% | Average wage |
| €36,401 - €65,000 | 46% | |
| €65,001+ | 49% | |

Assumptions:

- No tax credits or deductions
- Existing USC exemptions preserved (social welfare income)
- No other reliefs or exemptions
- Yield: c.€18.8bn. Estimate for 2016 from the Revenue tax forecasting model using the latest actual data for the year 2013, adjusted as necessary for income, self-employment and employment trends in the interim

# USC-Only Option – Considerations

- USC is fully individualised, whereas income tax allows partial transferability under joint assessment
- Under a revenue-neutral move to USC, single-income families could therefore lose out
- Depending on the structure adopted, low-income single individuals could also lose out
- Single earners with income over €20,000 would benefit
- Married two-earner couples would experience up to double the gain, depending on income levels
- Groups benefitting at present from additional tax credits or deductions – such as the elderly, single parents, home carers, those with medical expenses or paying pensions – would lose out

# 4. ‘Growing Out’ of USC

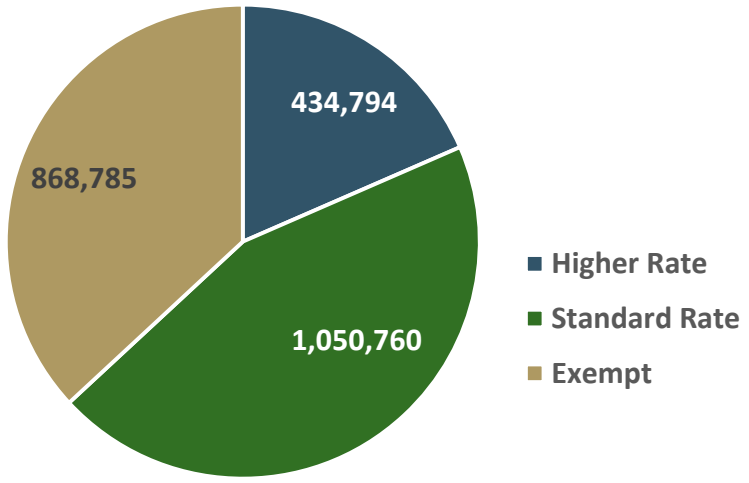
- Introduced in 2011, on incomes of over €4,004
- Seen in the minds of many as ‘the recession tax’, though it replaced the pre-existing Income Levy and Health Levy
- Budget 2016 income tax package focussed primarily on USC reductions
- Potential to ‘grow out’ of USC over time by focusing available fiscal space on USC cuts

# Considerations

- Potential to reduce marginal tax rate – highlighted as key issue for economic growth and international competitiveness
- USC is progressive (although not as progressive as income tax)
- USC specifically introduced to broaden the tax base - income tax base is narrower
- 'Growing out' of USC would benefit all those currently paying USC, on that broader base

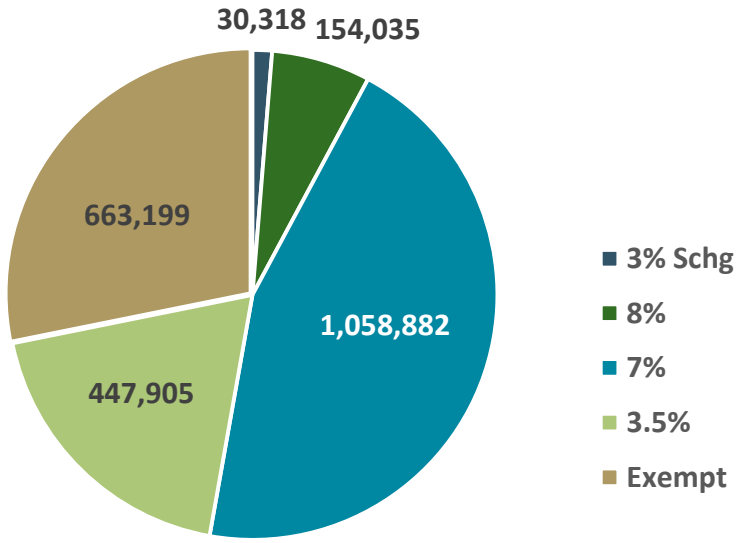
# Width of the Tax Bases

## Income Tax 2015
## Distribution of Income Earners




| Total | Higher Rate | Standard Rate | Exempt |
|---|---|---|---|
| 2,354,339 | 434,794 | 1,050,760 | 868,785 |
| | 18% | 45% | 37% |

## Universal Social Charge 2015
## Distribution of Income Earners




| Total | 3% Schg | 8% | 7% | 3.5% | Exempt |
|---|---|---|---|---|---|
| 2,354,339 | 30,318 | 154,035 | 1,058,882 | 447,905 | 663,199 |
| | 1% | 7% | 45% | 19% | 28% |

# Other Policy Options

- Introduce a flat rate of tax
  - Pro: Simple, easy to understand and administer
  - Con: Regressive, increased burden on low-earners
- Transfer revenue-raising from USC to PRSI
  - Pro: Removes one tax on income
  - Cons: PRSI revenue accrues to the Social Insurance Fund

    The PRSI base is narrower than both the Income Tax and the USC bases

# Points for Discussion

- Should the tax system concentrate solely on revenue raising, or does it have a socio-economic role to play?
- In designing a fair tax system, how do we decide and evaluate what is 'fair'?
- Are 'regressive' tax cuts inevitable with a progressive system?
- If so, is this 'fair'?
- How to maintain a broad tax base while ensuring Budgets are not regressive

# Thank you

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