INCOME TAX

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I. Introduction - Fiscal and Economic Context

1. The overall economic and fiscal context has been set out in paper Economic Framework for the Budget (TSG12/03).

II. Programme for Government 2011

2. The programme for Government states that:

   "As part of our fiscal strategy, the new Government will:
   - Maintain the current rates of income tax together with bands and credits. We will not increase the top marginal rates of taxes on income"

3. To meet the Government's deficit target of 7.5% in 2013, policy adjustments of at least €3.5 billion will be needed. Similar adjustment will be needed in 2014 if a deficit of less than 3% is to be achieved by 2015. The current Memorandum of Understanding under the EU/IMF Programme indicates that Revenue measures will raise at least €1.25 billion of the adjustment needed for 2013. xxxx

Table 1: Estimated burden of USC for 2012 (post Budget) base year 2010

Gross Earnings	Number of Income Earners	% Income Earners	% of USC Paid
> €200,000	21,100	1%	14%
> €100,000	104,300	6%	31%
> €75,000	209,100	13%	43%
> €50,000	470,600	29%	65%
> €35,000	813,700	50%	82%
> €16,016	1,457,700	89%	99%
> €10,036	1,629,700	100%	100%

*numbers are rounded to the nearest hundred and percentages are rounded to the nearest percentage point.

- 2012 number of income earners paying maximum 4% USC rate 172,000
- 2012 number of income earners paying maximum 7% USC rate 1,432,600
- 2012 number of income earners paying maximum 10% USC rate 25,100

Table 2: Estimated burden of Income Tax for 2012 (post Budget) base year 2010

Gross Earnings	% Income Earners 2012	% Tax Paid 2012
> €200,001	1 %	20%
> €100,001	5%	43%
> €75,001	10%	59%
> €50,001	22%	80%
< €50,000	78%	20%

* percentages are rounded to the nearest percentage point.

Table 3: Estimated Cumulative Burden of Income Tax and USC for 2012

Gross Earnings	% Income Earners 2012	% Tax & USC Paid 2012
> €200,000	1%	19%
> €100,000	5%	40%
> €80,000	8%	51%
> €50,000	22%	76%
< €50,000	78%	24%

NOTE: The figures are estimates from the Revenue tax-forecasting model using actual data for the year 2010 adjusted as necessary to take account of the most recent data available for income and employment trends for the year in question. It is, therefore, provisional and likely to be revised.

Table 4: Distribution of Income earners 2010 – 2012

	2010	2011	2012
Total	2,203,600	2,162,600	2,156,800
Higher Rate	286,500 (13%)	367,600 (17%)	366,700 (17%)
Standard Rate	925,500 (42%)	951,600 (44%)	949,000 (44%)
Exempt	991,600 (45%)	843,400 (39%)	841,100 (39%)

Marginal Tax Rates 2012

7. The marginal tax rate is described as the tax rate that applies to the last euro of the tax base. Marginal tax rates are important because they influence individual decisions to work more or indeed to work at all. Having a low and competitive top marginal tax rate is viewed as one of the major drivers in promoting labour force participation.

8. The measures introduced in Budgets from 2009 to 2011 have resulted in significant increases in the effective marginal rates.

9. The top marginal tax rate for employees, including USC and PRSI, is now 52%. This has increased from 43.5% in 2008. The top marginal tax rate for self-assessed is now 55%. This has increased from 46.5% in 2008. Not only have the top marginal rates increased significantly but marginal rates on lower income levels have also increased. In addition, the top marginal rates take effect at significantly lower income levels. For example, the top marginal tax rate for employees in 2008 was 43.5% and took effect at an income level of €100,101 and above. In 2012 the top marginal tax rates for employees is 52% and takes effect at an income level of €32,800 and above.

10. The marginal tax rates for income earners on the average industrial wage and twice the average industrial wage increased from 26% in 2008 to 31% in 2012 and from 43% in 2008 to 52% in 2012 respectively.

Table 5: Marginal Rates for PAYE employees

Income Earners 2008	November 2008	Income Earners 2012	2012
Minimum Wage €17,542	0%	Minimum Wage €17,542	27%
Average Wage €34,431	26%	Average Wage €31,485	31%
2* Average Wage €68,862	43%	2* Average Wage €62,970	52%
€76,000	43%	€76,000	52%
€100,101	43.5%	€100,101	52%

Table 6: Marginal Rates for Self-employed income earners

Income Earners 2008	November 2008	Income Earners 2012	2012
Minimum Wage €17,542	23%	Minimum Wage €17,542	31%
Average Earnings €34,431	25%	Average Wage €31,485	31%
2* Average Earnings €68,862	46%	2* Average Wage €62,970	52%
€76,000	46%	€76,000	52%
€100,101	46.5%	€100,101	55%

IV. Policy Considerations for 2013

11. A number of policy considerations need to be taken into account in terms of any proposed income tax changes in the context of Budget 2013 and forthcoming Budgets including:
    - the overall fiscal position given that income tax raises 40% of tax revenue
    - the Government Programme commitment to maintain income tax rates, bands and credits,
    - the implications for jobs and growth and
    - the efficiency of the income tax system.

12. If fiscal considerations are the over riding consideration, then there are potential options for raising the required revenue, as outlined for illustrative purposes in the Ready Reckoner in Appendix 1 to this paper including a 1% increase in the Standard Income Tax Rate (estimated at €460m in a full year), or a 1% increase in the Higher Income Tax Rate (estimated at €195m in a full year), or a 1% increase in each of the three rates of Universal Social Charge (estimated at €745m in a full year and the revenue that would accrue from a number of changes to bands and credits. In addition, for illustrative purposes nine proposals demonstrating the savings that could be achieved from reductions of 2.5%, 5.0% and 7.0% in credits, bands and a combination of both credits and bands are set out below.

Table 7: Summary of Income Tax Proposals

Proposals 1-9	First Year Yield	Full Year Yield
2.5% reduction in the main income tax credits	€98 million	€131 million
2.5% reduction in the standard rate bands	€98 million	€131 million
2.5% reduction in the main income tax credits and standard rate bands	€195 million	€262 million
5% reduction in the main income tax credits	€197 million	€263 million
5% reduction in the standard rate bands.	€199 million	€268 million
5% reduction in the main income tax credits and bands	€395 million	€530 million
7% reduction in the main income tax credits	€285 million	€380 million
7% reduction in the standard rate bands	€291 million	€391 million
7% reduction in the main income tax credits and bands	€574 million	€770 million

13. Clearly, however, raising taxes on labour is not conducive to job creation, improving competiveness or economic growth, all of which are Government priorities and the basis for the Government programme commitment to maintain income tax rates, bands and credits.

V. International Comparisons

Tax Wedge

14. The Tax Wedge is defined as the sum of personal income tax plus employee and employer social security contributions together with any payroll taxes less cash transfers, expressed as a percentage of labour costs. It is the difference between what an employer has to pay in terms of gross wages plus taxes to hire an employee and the net revenue received by that employee after deduction of all taxes on their wages.

15. A competitive tax wedge is considered vital in encouraging employment growth across all income categories and to incentivise people to remain in or return to the labour market.

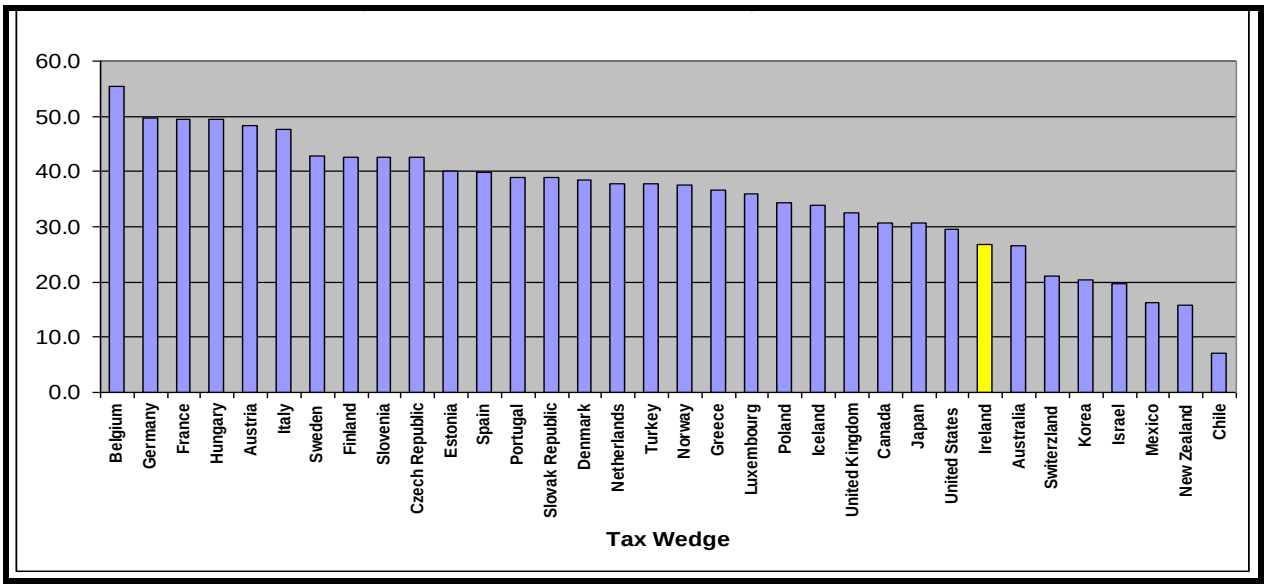
16. According to the latest OECD Taxing Wages report 2010-2011, based on wage and tax levels for 2011, Ireland had the eighth lowest tax wedge (26.8%) of the 34 members in the OECD for a single worker on average earnings (€32,841). This demonstrates a drop of 2 places on our best position of sixth lowest tax wedge in the OECD in 2007 but maintains our position as lowest tax wedge of the 21 EU members of the OECD.

Table 8: Ireland's Tax Wedge position for a single person on the average wage

	2004	2005	2006	2007	2008	2009	2010	2011
Tax Wedge	24.1	23.5	23.0	22.2	22.3	24.7	25.8	26.8
OECD ranking	6th	6th	6th	6th	7th	7th	7th	8th
EU ranking	1st	1st	1st	1st	1st	1st	1st	1st

17. It is expected that our tax wedge for low income earners (*up to an income of €18,304)* would have reduced significantly as a result of the reduction of the lower Employer Social Security Contribution Rate, from 8.5% to 4.25% introduced in the Jobs Initiative. As stated above, a competitive tax wedge remains vital in encouraging employment growth across all income categories and to incentivise people to remain in or return to the labour market.

Chart 1: Tax Wedge OECD Members 2011 – Single Individual on AIW



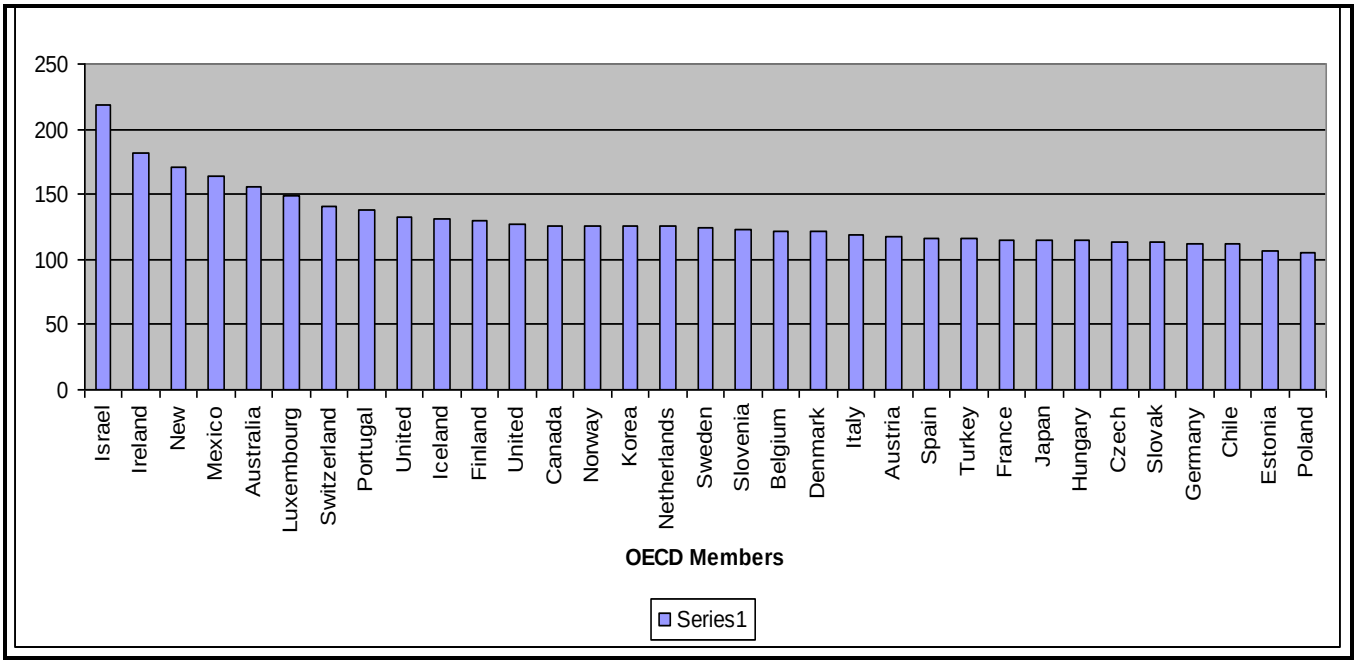
Progressive Taxation

18. A progressive taxation system means that those on higher incomes should pay proportionately more of their income in tax than those on lower incomes.

19. The European Commission method of comparing progressivity of taxation is by taking the OECD tax wedge on 167% of average income as a percentage of the tax wedge on 67% of average income. On a rating system where less than 100 is regressive and above 100 is progressive, most EU countries had a progressivity rate of between 120 and 140. Ireland, in comparison, had a progressivity rate of 182.

20. After Budget 2011 changes, Ireland's progressivity rate has decreased slightly from 220 to 182 in 2011. This is still far more progressive than any other EU member of the OECD.

Chart 2: Progressivity of Taxation – OECD Members 2011



Income Tax Ready Reckoner*

Indicative costs/yields to the Exchequer of various proposals Pre-Budget 2013 (base 2010)

Income Tax	First Year	Full Year
	€m	€m
Standard Rate		
1% point increase/decrease	340	460
Higher Rate		
1% point increase/decrease	130	195
PAYE Tax Credit		
€100 increase/decrease	100	130
Personal Tax Credit[1]		
€100 increase/decrease	135	185
Standard Rate Band		
€100 increase/decrease	12	15
Universal Social Charge	**First Year**	**Full Year**
	€m	€m
1% point increase/decrease in 2% rate	140	190
1% point increase/decrease in 4% rate	75	105
1% point increase/decrease in 7% rate[2]	310	450
Total	525	745
Age Exemption Limits	**First Year**	**Full Year**
	€m	€m
Increase/decrease limits by €500 (single/widowed) and €1000 (married)	9	13

* NOTE: These are provisional figures and may be revised

[1] Includes commensurate increases/decreases in married persons' credit, widowed persons' personal credit and lone persons' credit.

[2] Includes 1% increase/decrease for those paying 10% rate and for those whose top rate is 4%, although estimates relating to these groups are tentative.

Historic Reform and Developments

I. Historic Reform and Developments 2009 to 2011

Budget 2009, Supplementary Budget 2009 and Budget 2010

1. In Budget 2009 an income levy was introduced. The income levy applied at 1% on income up to €100,100, at 2% on income above €100,100 but below €250,120 and 3% on income in excess of this amount. In Budget 2009 the standard rate cut off point was increased by €1,000 to €36,400 for single and to €45,400 for married one earners so as to ameliorate the effect of the income levy on middle income earners.

2. In Supplementary Budget April 2009, the income levy rates were doubled and thresholds reduced. The Health Levy was doubled from 2% to 4% and 2.5% to 5% and the higher threshold reduced from €100,100 to €75,036. The PRSI ceiling was also increased from €52,000 to €75,036.

3. Budget 2010 focused on expenditure reduction measures; consequently there were no changes to income tax credits, bands, rates or PRSI charges.

4. No significant changes were made to the income tax system in these Budgets. All revenue raising was instead done through the Income and Health Levies.

5. Income Tax yield continued to fall as a result of increasing unemployment and lowering of wages. (As a result of changes in Budget 2011 – see below- the yield for 2011 and 2012 is estimated to increase to €13.8bn and €15.3 respectively).

Table 1: Income Tax Yield

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
€bn	9.1	9.2	10.7	11.3	12.4	13.6	13.2	11.8	11.3	13.8
% Tax	31.0	28.5	29.9	28.7	27.2	28.7	32.3	35.8	35.5	40.5

Budget 2011

6. Budget 2011 introduced a number of measures to widen the tax base and raise revenue to reduce the budget deficit. In general, all tax credits and standard rate bands were reduced by approximately 10% with the exception being the age tax credits and exemptions limits which were decreased by 25%. For example, the personal and PAYE tax credits were reduced from €1,830 to €1,650. In addition, the single standard rate band was reduced by approximately 10% from €36,400 to €32,800 and the relationship between the single standard rate band and the additional rate bands was maintained. Therefore, the married one-earner rate band is still €9,000 greater (€41,800) than the single standard rate band.

7. In addition, the PRSI ceiling was abolished and the self-employed PRSI rate was increased from 3% to 4%.

8. As result of the income tax adjustments, credits and bands have returned to 2006/07 levels. Furthermore, the entry point to taxation has been reduced significantly for all income earners but the tax base has been broadened as a result. See table below:

Table 2: Entry Point to Tax 2011

	2008	2010	2011
Single Individual	€18,300	€18,300	€16,500
Married One-earner (no children)	€27,450	€27,450	€24,750
Married One –earner (with children)	€31,950	€31,950	€28,800

9. These changes to the income tax system meant that an estimated 107,200 more individuals paid income tax in 2011 than 2010 and the number of individuals liable to the higher rate of tax has increased by 91,000. This is illustrated in the table below:

Table 3: Distribution of Income Earners 2010 – 2011 vs. 2008

	2008	2010	2011
Total	**2,459,200**	2,203,600	2,162,600
Higher Rate	397,300 (16%)	286,500 (13%)	367,600 (17%)
Standard Rate	1,031,700 (42%)	925,500 (42%)	951,600 (44%)
Exempt	1,030,200 (42%)	991,600 (45%)	843,400 (39%)

NOTE: Figures are rounded. Estimates, using actual data for the year 2010 and adjusted as necessary to take account of the most recent data available for income and employment trends for the year in question, are used for 2011 onwards. It should be noted that a married couple electing or has been deemed to have elected for joint assessment is counted as one tax unit.

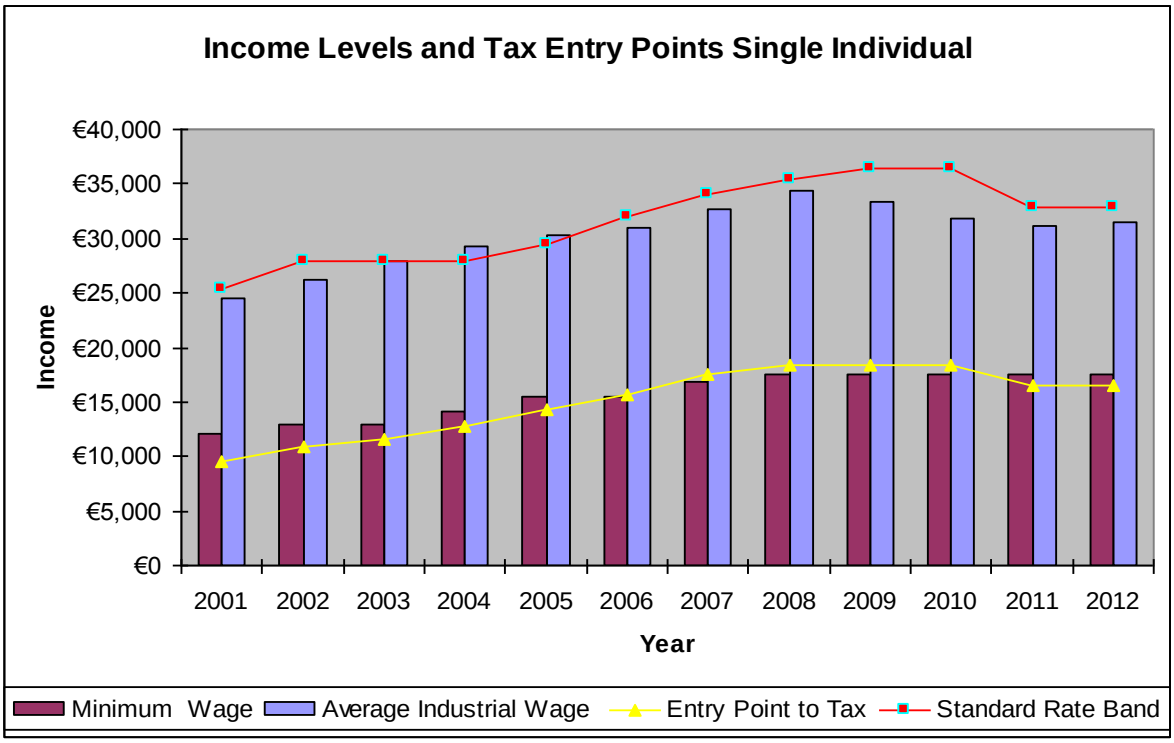
10. The income tax adjustments in Budget 2011 have redistributed the burden of income tax where the top 1% of income earners (i.e. over €200,000) are paying 20% of all income tax in 2012:

Table 4: Estimated burden of income tax for 2012 vs. 2008

Gross Earnings	% Income Earners 2008	% Tax Paid 2008	% Income Earners 2012	% Tax Paid 2012
> €200,001	1%	25%	1%	20%
> €100,001	6%	50%	5%	43%
> €75,001	11%	65%	10%	59%
> €50,001	23%	84%	22%	80%
< €50,000	77%	16%	78%	20%

*****percentages are rounded to the nearest percentage point.

Chart 1: Income levels and Tax Entry Point 2001 – 2012 for a Single Individual



Universal Social Charge (USC)

11. In 2011, the USC was introduced to replace the Income levy and Health Levy. The USC was designed to apply across income levels in a smoother progression. The measure was intended to widen the tax base, remove poverty traps and raise revenue to reduce the budget deficit. It is a more sustainable charge than those it replaced. The USC was designed to be revenue neutral in 2011, the year of its introduction, but was expected to deliver an additional yield of the order of €0.4 billion in a full year. It is estimated that approximately 514,000 more income earners pay the USC compared to the Income Levy.

Reforms and Developments Pre Economic Crisis, 2000 to 2008

12. The income tax burden was reduced significantly in the years 2000 to 2008. Tax rates were reduced and the standard rate band widened. The move from allowances to a more equitable tax credits system was completed in 2001 and in almost every year up to 2008 tax credits were increased.

13. The standard tax rate was reduced from 22% in 2000 to 20% by 2001 while the higher rate was reduced from 44% in 2000 to 41% by 2007. The standard rate band was increased by 64% from €21,590 in 2000 to €35,400 in 2008. Since its conversion to a credit in 2001, the PAYE tax credit had increased by 260% from €508 to €1,830 by 2008. The personal tax credit has increased by 31% in the same period. The other tax credits relating to specific circumstances of individuals were also increased significantly in this period.

14. By 2008 the national minimum wage at €17,542 was below the entry point to income tax and PRSI at €18,300 and €18,304 respectively. The average industrial wage for 2008 €34,431 was below the liability to tax at the higher rate.

Minimum Wage

15. The minimum wage was introduced in 2000 at a rate of €5.59 per hour. At that time, the minimum wage was subject to an effective tax rate of 36%. By 2008, the value of the minimum wage had increased six times by almost 55% to €8.65 per hour which is equivalent to a little over €17,542 on an annualised basis.

16. In line with income tax policy, the tax burden on the minimum wage was reduced progressively from 2000 by increasing the value of the personal and PAYE credits. By 2006, the minimum wage was entirely outside of the income tax net. From 2000 to 2008, the entry point to income tax increased from €7,238 to €18,300.

Table 5: Minimum Wage and Entry Point to Tax 2000 – 2008

Year	Minimum Wage	Entry Point to Taxation (single person)	Effective Tax Rate
Apr 2000	€11,337 (€5.59/hr)	€7,238	8%
Jul 2001	€12,107 (€5.97/hr)	€9,523	5%
Oct 2002	€12,878 (€6.35/hr)	€10,900	3.1%
Jan 2003		€11,600	2%
Feb 2004	€14,196 (€7.00/hr)	€12,800	2%
May 2005	€15,514 (€7.65/hr)	€14,250	3.9%
Jan 2006		€15,600	0%
Jan 2007	€16,832 (€8.30/hr)	€17,600	0%
Jul 2007	€17,542 (€8.65/hr)	€17,600	0%
Jan 2008		€18,300	0%

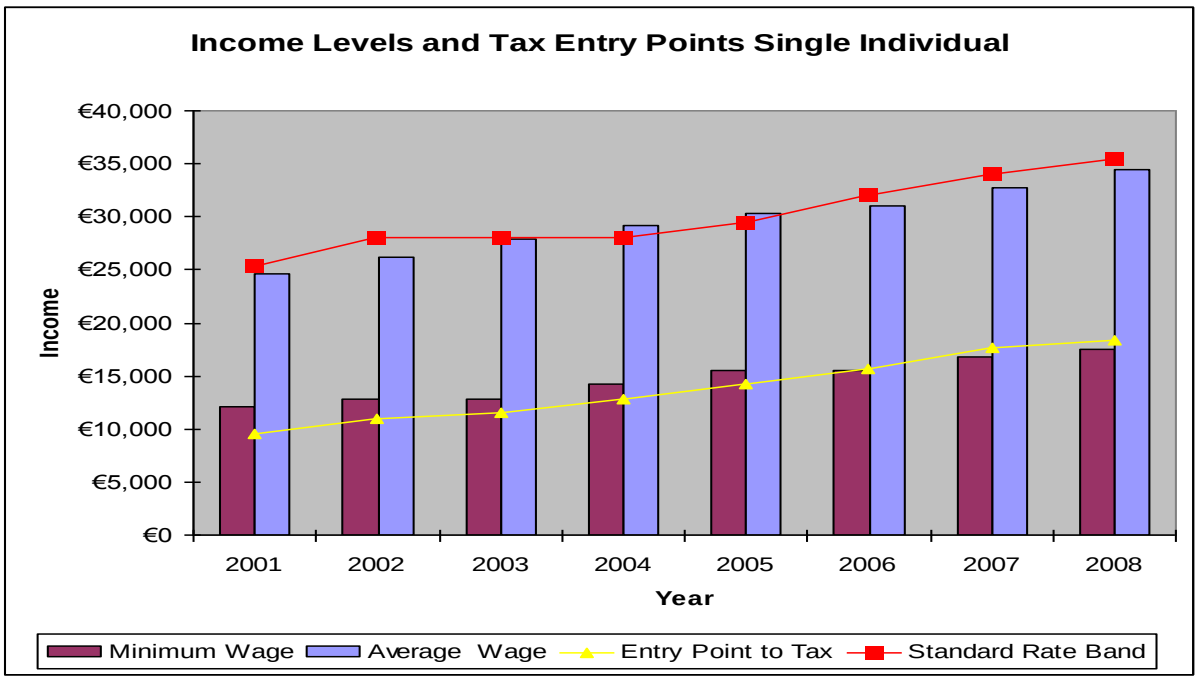
Average Industrial Wage (AIW)

17. The AIW increased from €24,557 in 2001, to €34,431 in 2008. The standard rate band for a single individual increased from €25,395 in 2001 to €35,400 in 2008. Through the increases in the standard rate band, the AIW was removed from the liability to tax at the higher rate, by 2006. The impact of these changes on the tax system is shown in Chart 1 in terms of entry points to the tax system for a single person.

Table 6: Credits, Bands and Average Industrial Wage 2001 – 2008

Year	Standard Rate Band (Single)	Credits (Personal and PAYE)	Average Industrial Wage
2001	€25,395	€1,905	€24,557
2002	€28,000	€2,180	€26,150
2003	€28,000	€2,320	€27,935
2004	€28,000	€2,560	€29,240
2005	€29,400	€2,850	€30,288
2006	€32,000	€3,120	€31,010
2007	€34,000	€3,520	€32,730
2008	€35,400	€3,660	€34,431

Chart 2: Income levels and Tax Entry Point 2001 – 2008 for a Single Individual



Distribution of income earners

18. The table below illustrates that between 2001 and 2008 the proportion of income earners exempt from income tax had increased from 29% to 42%. Furthermore, the minimum wage was outside the tax net, the average industrial wage was outside the liability to the higher rate of tax and over 80% of income earners were paying tax at no more than the standard rate.

Table 7: Distribution of income earners 2001 – 2008

	2001	2002	2003	2004	2005	2006	2007	2008
Total	1,790,000	1,885,000	1,927,200	2,013,700	2,175,000	2,370,700	2,489,100	2,459,200
Higher Rate	30%	19%	20%	23%	21%	18%	16%	16%
Standard Rate	41%	47%	46%	43%	43%	43%	42%	42%
Exempt	29%	34%	34%	34%	36%	39%	42%	42%

NOTE: Figures are rounded. Estimates, using actual data for the year 2008 and adjusted as necessary to take account of the most recent data available for income and employment trends for the year in question, are used for 2009 onwards. It should be noted that a married couple who has elected or has been deemed to have elected for joint assessment is counted as one tax unit.

Marginal Tax Rates

19. The marginal tax rates were reduced for all income earners over this period (2000 -2008). For example the marginal tax rates for income earners on the minimum wage and the average industrial wage decreased from 22% to 0% and from 28.5% to 26% respectively, even though the income levels had increased significantly for both categories of income earners over this period by 55% and 49% respectively. In addition, the highest marginal tax rate for employees in Ireland in 2008 was 43.5% compared to 46% in 2000.

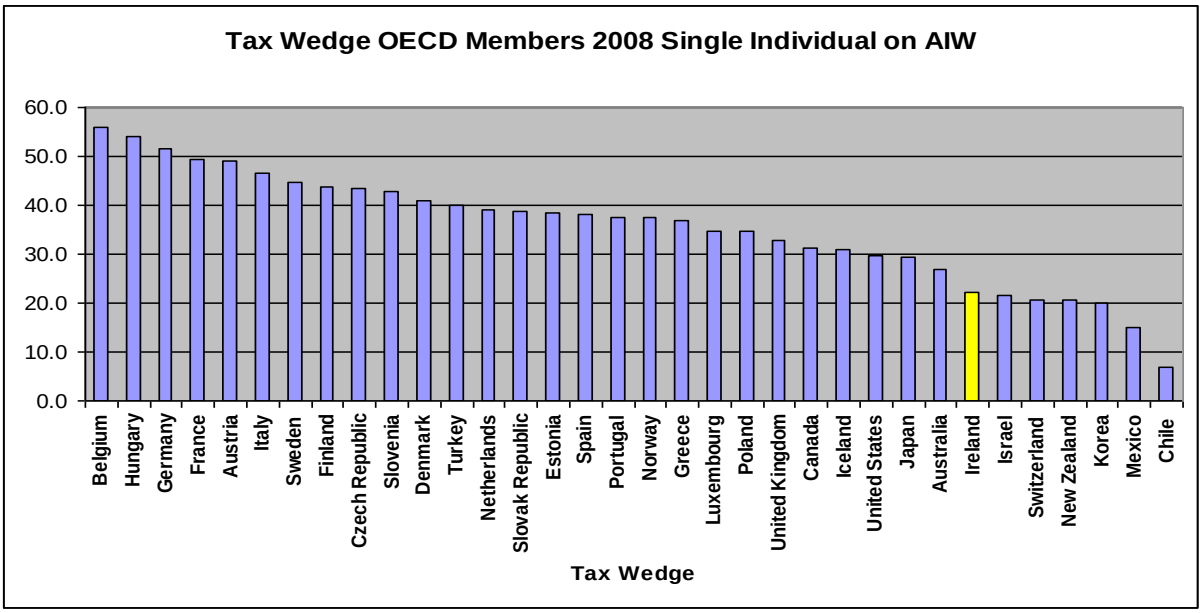
Table 8: Marginal Rates for PAYE employees

Income Earners 2000	2000	Income Earners 2008	2008
Minimum Wage €11,337	22%	Minimum Wage €17,542	0%
Average Wage €22,745	28.5%	Average Wage €34,431	26%
2* Average Wage €45,490	46%	2* Average Wage €68,862	43%
€76,000	46%	€76,000	43%
€100,101	46%	€100,101	43.5%
€176,000	46%	€176,000	43.5%

International Comparisons

20. In international terms, the OECD Taxing Wages report 2010-2011, indicated that Ireland had the seventh lowest tax wedge in the OECD in 2008 for a single worker on average income (22.3%). This was the lowest tax wedge of the 21 EU members of the OECD.

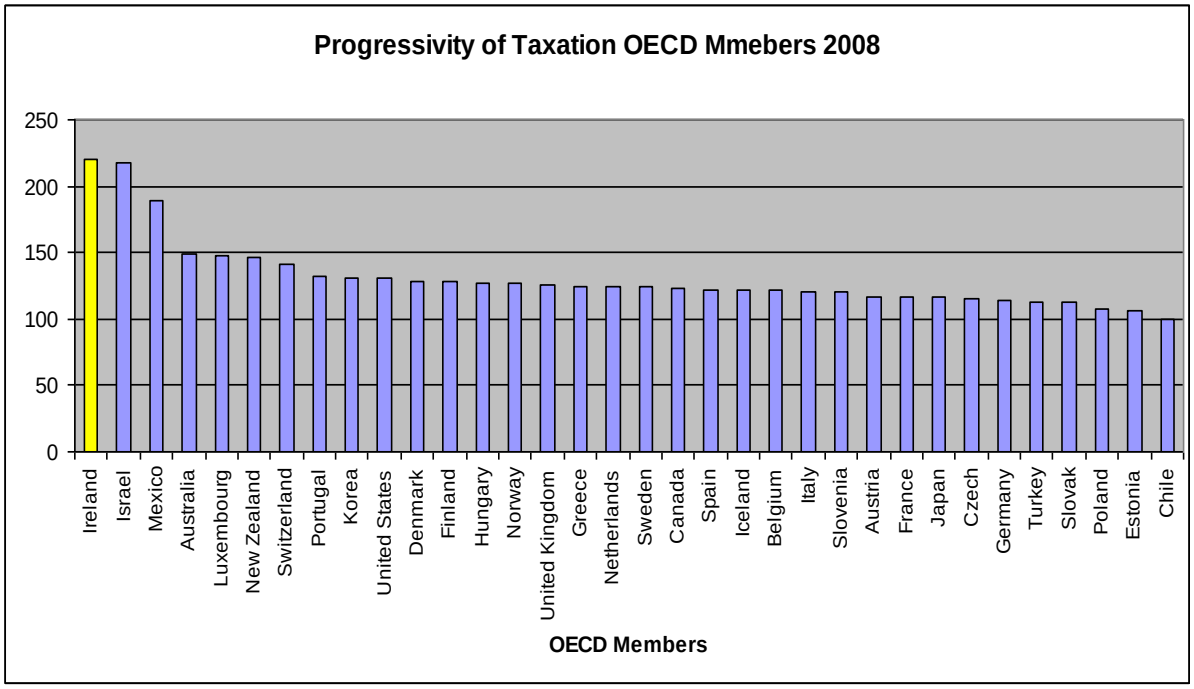
Chart 3: Tax Wedge OECD Comparison



Progressive Taxation

21. As mentioned above most EU countries had a progressivity rate of between 120 and 140. In 2008 Ireland had the most progressive taxation system in the entire OECD.

Chart 4: Progressivity OCED Comparison



Individualisation

Partial Individualisation

1. Prior to 2000, the tax bands were fully transferable between spouses. In Budget 2000, the Minister announced that he intended to commence a three year policy of individualisation of the standard rate tax bands. This would involve narrowing the gap between the single and married one-earner band by keeping the married one-earner band static and increasing the single person band. At the end of the process, the single band would be the same as the married one-earner band and each spouse in a married couple would have the same non-transferable standard rate band.

2. When announced in Budget 2000, the stated purpose of individualisation was essentially, to ease the burden on single persons (65% of the work force), to take workers on the average industrial wage out of the higher rate of tax and more generally to facilitate a reduction in the numbers paying tax at the higher rate. This was not in the Programme for Government but was considered the quickest way to achieve another Programme commitment that "*80% of taxpayers do not pay tax at the higher rate on any part of their income*".

3. The immediate impact of the measure in the tax year 2000/01 was to take all those on the average industrial wage out of the top rate of tax. It also meant that a second earner entering the workforce no longer faced taxation at the top rate from the first euro of earnings, a measure that would help improve labour market participation.

4. The move provoked outrage from many married one-earners who saw it as an assault on the family (which are provided certain protections under the Constitution) and an effort to drive married women into the workforce. In response, and shortly after the Budget, a home carer allowance benefiting stay-at-home spouses was introduced.

5. Individualisation was progressed to some extent in later years but never completed. The result is that we now have a hybrid system, with the band partially transferable between spouses, €9,000 being the gap between the single and married one-earner bands; the second earner in a married two-earner couple has their own non-transferable standard rate band of €23,800.

6. The married two-earner band is doubled the value of the single band and it has to be at least that. The basis for the current tax treatment of married couples derives from the Supreme Court decision in Murphy v the Attorney General (1980) which held that it was contrary to the Constitution for a married couple to pay more tax than two single people living together and having the same income.

Current Band Structure

7. The current band structure is as follows:

Single	€32,800
Married one -earners	€41,800
Married two-earners	€65,600 (with maximum transferability between spouses of €41,800).

To Complete Individualisation

8. Completing the process would result in the following structure:

Single	€41,800
Married one-earners	€41,800
Married two-earners	€83,600 (i.e. €41,800 for each spouse with no transferability between spouses).

9. This would be very costly to achieve, given that it would involve significantly increasing the single band and the married two-earner bands. Married one-earners would lose in relative terms. The cost of completing individualization is estimated to be approximately €715 million in a full year (on a post Budget 2012 basis).

To Reverse Individualisation

10. Reversing individualisation would give the following structure:

Single	€32,800
Married one-earner	€65,600
Married two-earner	€65,600 (with full transferability between spouses).

11. Like wise, reversing individualisation would be very costly to achieve as it would involve a significant increase in the married one-earner band. The cost is estimated to be €665 million in a full year (on a post Budget 2012 basis).

12. It has to be said however that the current hybrid system is complex and, because of transferability issues, does not easily lend itself to the introduction of additional rates, either at the bottom of the income scale or the top.

13. The issue of tax individualisation was considered by the Commission on Taxation who recommended that no change be made to the current system. It concluded that the current system represents a balance between, on the one hand, acknowledging the choices families make in caring for children and, on the other, taking account of the need to encourage labour participation.