Social Justice Ireland

Fairness in Changing Income Tax: 8 options compared

Occasional Papers

Introduction

Possible changes to income taxation levels have been highlighted as a potential policy reform in Budget 2016. *Social Justice Ireland* believes that the best reform to the income taxation system would be to make tax credits refundable. Such a reform would mean that the full value of tax credits goes to everybody who has an earned income.[1] The main beneficiaries would be low-paid employees (full-time and part-time). This option would improve the net income of workers whose incomes are lowest.

Broader reforms to income taxes are not a central priority for *Social Justice Ireland* either in the forthcoming Budget or in any future plans for taxation policy reform. We believe that any available money should be used to improve Ireland's social services and infrastructure, reduce poverty and social exclusion and increase the number of jobs – policy priorities constantly highlighted by *Social Justice Ireland* in its various publications.

However, as discussion and policy considerations often focus on income taxation reductions we have undertaken this study to examine, from the perspective of fairness, various reform choices. As a minimum, the analysis highlights the distributive impact taxation policy choices can have and the potential policy has to pursue both fair and unfair outcomes.

This document includes two examinations:

- An assessment of the fairness of seven possible income taxation options, each with a full-year cost of between €182m to €272m; equivalent to between 1% and 1.5% of the income taxation yield.
- An assessment of the fairness of a package of income taxation changes costing €725m in full-year terms and including changes to both tax bands and USC rates.

Fairness is essential

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation more than 34 years ago.

The need for fairness is just as obvious today and *Social Justice Ireland* believes that this should be a central objective of Government decision-making as it makes choices on how to allocate available resources in the income tax system in Budget 2016.

Fairness and the Taxation System

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation 34 years ago. It stated:

> "…in our recommendations the spirit of equity is the

[1] We have outlined our proposal on this issue in our pre-Budget Submission, *Budget Choices*, which is available on our website – www.socialjustice.ie – see page 10.

> first and most important consideration. Departures from equity must be clearly justified by reference to the needs of economic development or to avoid imposing unreasonable compliance costs on individuals or high administrative costs on the Revenue Commissioners." (1982:29)[2]

The need for fairness is just as obvious today and *Social Justice Ireland* believes that this should be a central objective of policy making as various plans for changes to the system of income taxes are discussed in advance of Budget 2016.

Fairness in Changing Income Tax – 7 options compared

Here we examine the fairness of various income tax reform options open to Government.[3] Our costings are based on the Pre-Budget 2016 Taxation Ready Reckoner published by the Revenue Commissioners during August 2015.

Our approach has been to examine seven possible income taxation options. Each of these options and their full-year costs are outlined below. The full-year cost of the options range from €182m to €272m; equivalent to between 1% and 1.5% of the expected income taxation yield in 2015.

The reforms examined are for the 2015 income taxation system and are:

- a decrease in the top tax rate from 40% to 39% (full year cost €246m)
- a decrease in the standard rate of tax from 20% to 19.5% (full year cost €272m)
- an increase in the personal tax credit of €100 with commensurate increases in couple, widowed parents and the single person child carer credit (full year cost €220m)
- an increase in the standard rate band (20% tax band) of €1,500 (full year cost €257m)
- a 1% point decrease in the 1.5% USC rate – that applied to income below €12,012 (full year cost €243m)
- a 2% point decrease in the 3.5% USC rate (so that it merges with the 1.5% rate) – that applied to income between €12,012 and €17,576 (full year cost €264m)
- a 0.5% point decrease in the 7% USC rate – that applied to income above €17,576 (full year cost €182m)

Table 1 presents the results of this comparison. Although all of the income taxation options have similar costs (1%-1.5% of the income taxation yield), they each carry different effects on the income distribution.

[2] Commission on Taxation (1982) *Commission on Taxation First Report*, Dublin, Stationery Office.
[3] Earlier editions of this document were prepared pre and post Budget 2015 and are available on our website.

Table 1: Comparing gains under seven possible income tax reforms (€ per annum)

Gross Income	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Decrease in the top tax rate from 40% to 39% (full year cost €246m)						
Single earner	0	0	162	412	662	912
Couple 1 earner	0	0	72	322	572	822
Couple 2 earners	0	0	0	74	324	574
Decrease in the standard tax rate from 20% to 19.5% (full year cost €272m)						
Single earner	0	125	169	169	169	169
Couple 1 earner	0	50	214	214	214	214
Couple 2 earners	0	0	250	338	338	338
Increase in the personal tax credit of €100 (full year cost €220 million)						
Single earner	0	100	100	100	100	100
Couple 1 earner	0	20	200	200	200	200
Couple 2 earners	0	0	200	200	200	200
Increase in the standard rate band of €1,500 (full year cost €257 million)						
Single earner	0	0	300	300	300	300
Couple 1 earner	0	0	300	300	300	300
Couple 2 earners	0	0	0	600	600	600
A 1% point decrease in the 1.5% USC rate (full year cost €243m)						
Single earner	120.12	120.12	120.12	120.12	120.12	120.12
Couple 1 earner	120.12	120.12	120.12	120.12	120.12	120.12
Couple 2 earners	0.00	120.12	240.24	240.24	240.24	240.24
A 2% point decrease in the 3.5% USC rate (full year cost €264m)						
Single earner	59.76	111.28	111.28	111.28	111.28	111.28
Couple 1 earner	59.76	111.28	111.28	111.28	111.28	111.28
Couple 2 earners	0.00	84.76	221.04	222.56	222.56	222.56
A 0.5% point decrease in the 7% USC rate (full year cost €182m)						
Single earner	0.00	37.12	162.12	262.33	262.33	262.33
Couple 1 earner	0.00	37.12	162.12	262.33	262.33	262.33
Couple 2 earners	0.00	0.00	74.62	199.24	324.24	393.20

Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. The increase in the personal tax credit assumes a commensurate increase in the couple, widowed parents and the single person child carer credit. USC calculations assume earners pay the standard rate of USC.

Decreasing the 1.5% USC rate by one percentage point provides the same gain to all individuals with earnings in excess of €12,012. Therefore, the increased income received by a single earner on €25,000 and on €125,000 is the same – an extra €120.12.

Decreasing the 3.5% USC rate by two percentage points benefits all those with incomes of more than €12,012. Earners above €17,576 (the entry point to the next USC rate) experience the full benefit of the reduction – gaining €111.28 per annum. The gain is the same for all earners above this level.

Increasing the personal tax credit also provides a fair distributive outcome across the income distribution. The gain is the same for all taxpayers earning sufficient to pay more than €100 in income taxes. However, below €16,500 for single earners / €24,900 for couples with one earner / €33,000 for couples with two earners, there are no gains as up to these points tax credits absorb all income tax liabilities.

Compared to these three options, the other four income tax reforms skew the benefits towards those on higher incomes.

A decrease in the top tax rate only benefits those paying tax at that rate. Therefore, the single earner on €25,000 gains nothing from this change while those on €50,000 gain €162 per annum and those on €100,000 gain €662 per annum. The higher the income, the greater the gain. This is the least fair outcome of those examined.

Reducing the 7% USC rate by half a percentage point (to 6.5%) also produces a notably unfair outcome. Earners with income €17,576 and €70,044 (the top point of this USC band) gain 0.5% of any income in that range meaning the benefit is greater the higher an individual's income.

Changing the entry point to the top tax rate (i.e. increasing the standard rate band) also provides gains which are skewed towards higher incomes. A single earner on €25,000 gains nothing from this reform and it is only individuals with incomes of €33,800 plus, and couples with 2 earners with a gross income above €67,600, who gain.

Finally, decreasing the standard rate of income tax also skews any gains towards higher income earners. A single individual on €15,000 gains nothing while those on €25,000 get some benefit (+€125). The maximum value of the gain is only available to single individuals with incomes of €33,800 plus, couples one-earners with an income of €42,800 plus and couples 2 earners with a gross income above €67,600.

The diagrams below (Charts 1-7) illustrate these changes. In terms of fairness, reducing the bottom two USC rates or increasing tax credits are the best options.

Similar costs

Different outcomes

Although all of the income taxation options considered here have similar costs, they each carry different effects on the income distribution.

The fairest outcomes are achieved by reducing the bottom two USC rates or increasing tax credits.

If Government wishes to reduce income tax it should choose one of these three options.

Summary

Overall, three of the changes would produce a fair outcome:

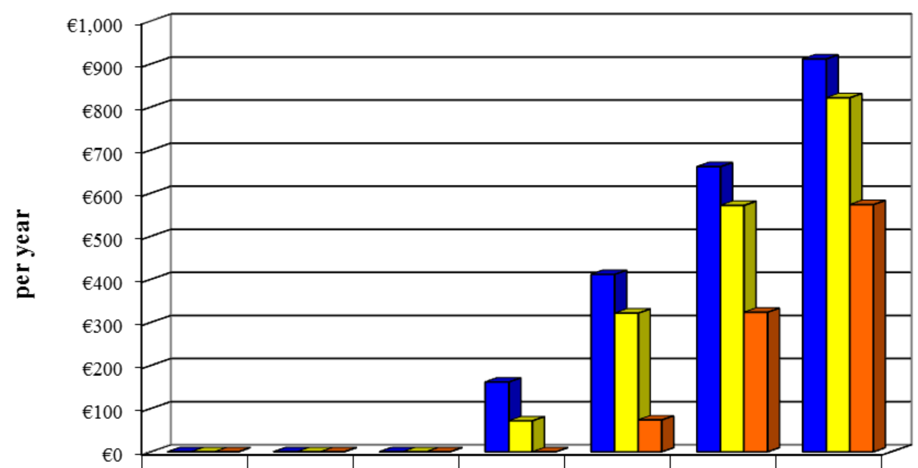
- increasing the personal tax credit;
- reducing the 1.5% USC rate by 1 percentage point; and
- reducing the 3.5% USC rate by 2 percentage points.

Four of the changes would produce an unfair outcome:

- reducing the top tax rate to 39%;
- reducing the standard tax rate to 19%;
- increasing the standard rate band; and
- reducing the 7% USC rate.

Each of the three fair options would provide beneficiaries with an improvement in their annual income of around €100-120. Each of the four unfair options would skew benefits towards those with higher incomes.

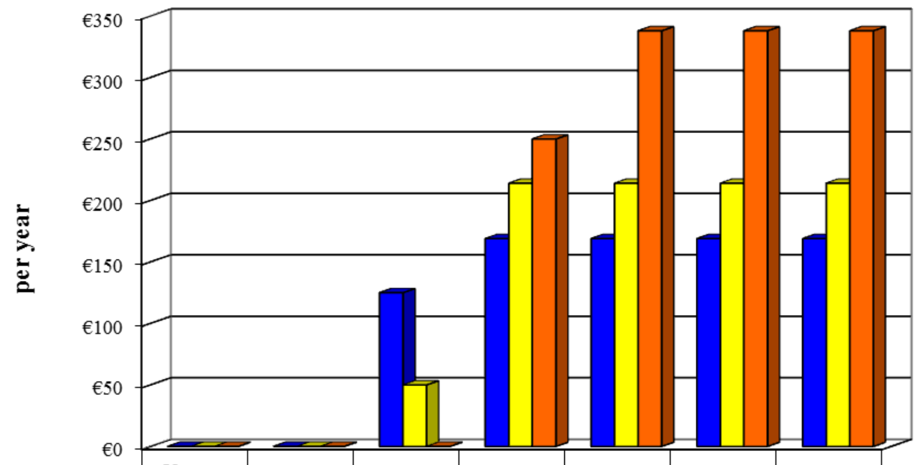
Chart 1: How much better off would people be if the top tax rate was decreased from 40% to 39% (full year cost €246 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	0	0	162	412	662	912
Couple 1 Earner	0	0	0	72	322	572	822
Couple 2 Earners	0	0	0	0	74	324	574

Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system.

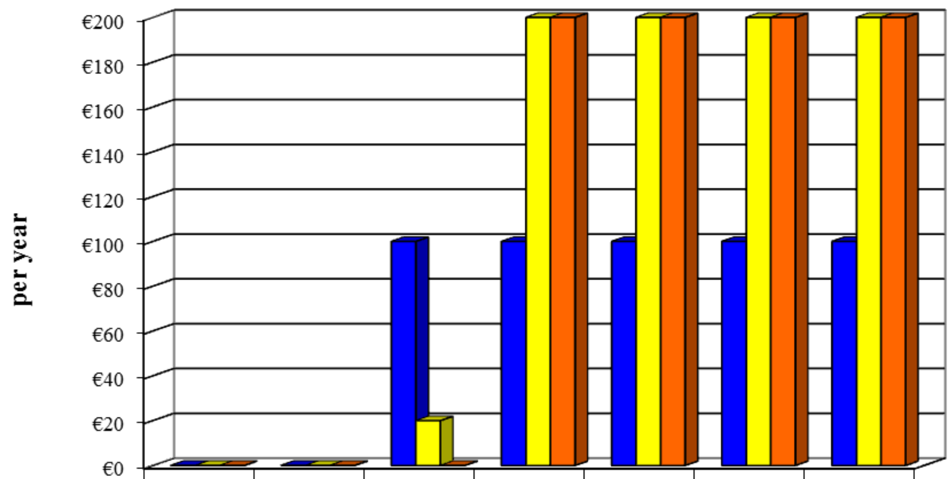
Chart 2: How much better off would people be if the standard tax rate was decreased from 20% to 19% (full year cost €272 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	0	125	169	169	169	169
Couple 1 Earner	0	0	50	214	214	214	214
Couple 2 Earners	0	0	0	250	338	338	338

Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system.

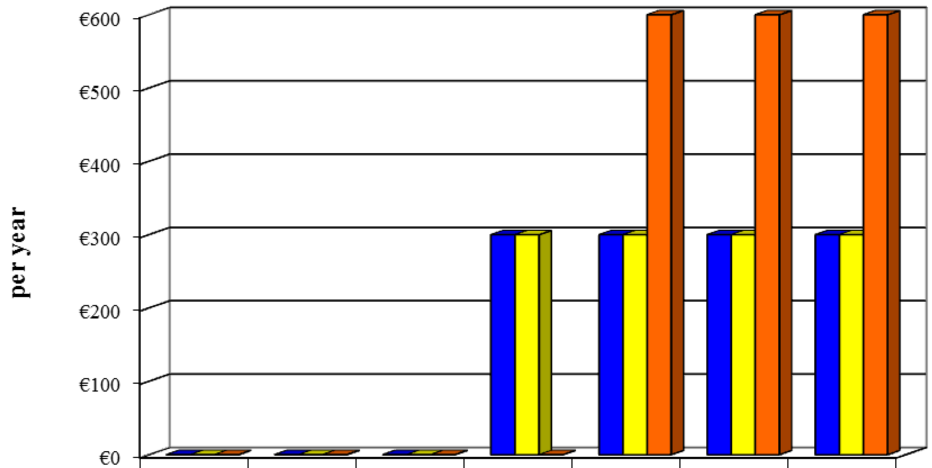
Chart 3: How much better off would people be if the personal tax credit was increased by €100 (full year cost €220 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	0	100	100	100	100	100
Couple 1 Earner	0	0	20	200	200	200	200
Couple 2 Earners	0	0	0	200	200	200	200

Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. The increase in the personal tax credit assumes a commensurate increase in the couple, widowed parents and the single person child carer credit.

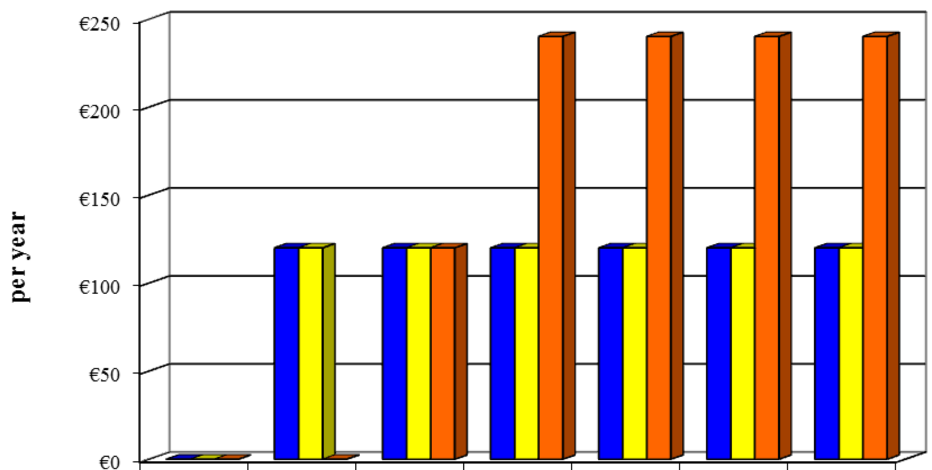
Chart 4: How much better off would people be if the standard rate band was increased by €1,500 (full year cost €257 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	0	0	300	300	300	300
Couple 1 Earner	0	0	0	300	300	300	300
Couple 2 Earners	0	0	0	0	600	600	600

Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system.

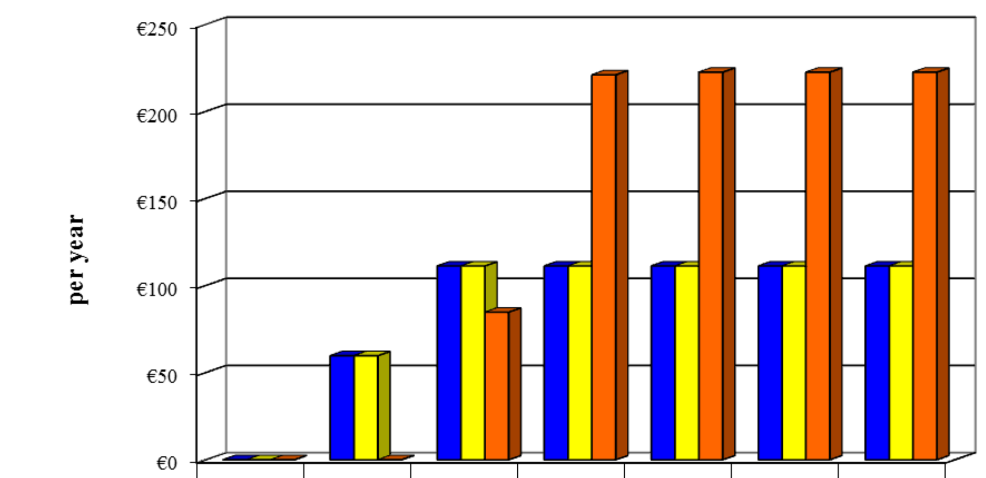
Chart 5: How much better off would people be if the 1.5% USC rate was reduced by one percentage point (full year cost €243 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	120.12	120.12	120.12	120.12	120.12	120.12
Couple 1 Earner	0	120.12	120.12	120.12	120.12	120.12	120.12
Couple 2 Earners	0	0	120.12	240.24	240.24	240.24	240.24

Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. USC calculations assume earners pay the standard rate of USC.

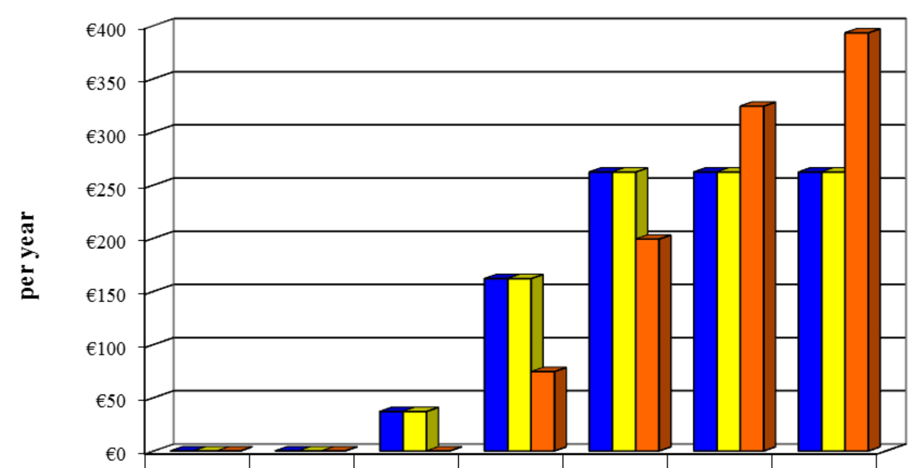
Chart 6: How much better off would people be if the 3.5% USC rate was reduced by two percentage points (full year cost €264 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	59.76	111.28	111.28	111.28	111.28	111.28
Couple 1 Earner	0	59.76	111.28	111.28	111.28	111.28	111.28
Couple 2 Earners	0	0	84.76	221.04	222.56	222.56	222.56

Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. USC calculations assume earners pay the standard rate of USC.

Chart 7: How much better off would people be if the 7% USC rate was reduced by half a percentage point (full year cost €182 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0	0	37.12	162.12	262.33	262.33	262.33
Couple 1 Earner	0	0	37.12	162.12	262.33	262.33	262.33
Couple 2 Earners	0	0	0	74.62	199.24	324.24	393.2

Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. USC calculations assume earners pay the standard rate of USC.

Fairness in Changing Income Tax – considering a package of changes

Although it is informative to examine the individual effects of changes to rates and bands (as above), in general Budgets announce a suite of simultaneous changes to income taxation measures. Often such changes can be multiple and complex, as was the case in Budget 2015 where existing rates, bands and thresholds changed while new rates and thresholds were introduced.

Here we examine the fairness of a sample package of income taxation changes. The composition of the package considered includes changes to both tax bands and USC rates and has a full year cost (in lost revenue) of €725m. Our costings are based on the Pre-Budget 2016 Taxation Ready Reckoner published by the Revenue Commissioners during August 2015.

The package of measures we examine includes:

- an increase in the standard rate band (20% tax band) of €1,000 (full year cost €173.4m) – after this change a single person begins to pay at the 40% income tax rate when their income exceeds €34,800, for couples with one income the threshold becomes €43,800 and for couples with two incomes it becomes €69,600
- a 0.5% point decrease in the 1.5% USC rate – that applied to income below €12,012 (full year cost €121.5m)
- a 0.5% point decrease in the 3.5% USC rate– that applied to income between €12,012 and €17,576 (full year cost €66m)
- a 1% point decrease in the 7% USC rate – that applied to income above €17,576 (full year cost €364m)
- Total full-year cost of this income taxation package = €724.9m

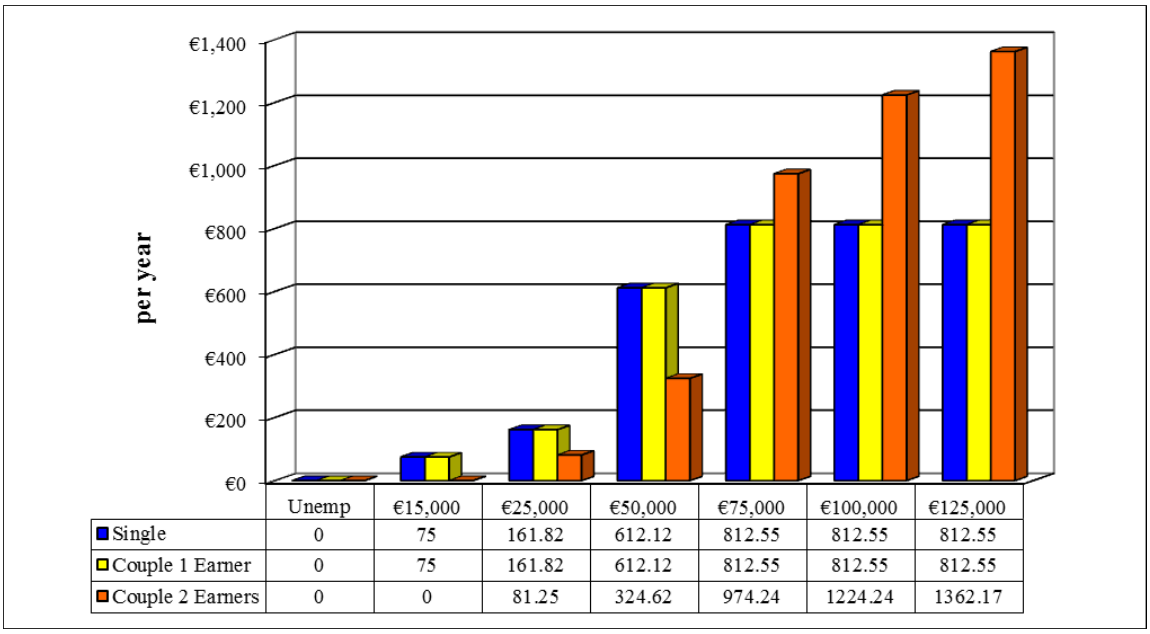
Table 2 and Chart 8 present the results of this comparison. Taken together, the analysis shows that the gains from such an income tax package are heavily skewed towards those on higher incomes. A single earner or one earner couple with an income of €25,000 gains €161.82 per annum while a similar individual with a taxable income of €50,000 gains more than 3½ times as much. The gains are capped beyond the entry point to the 8% USC rate at €812.55 – more than five times the gain received by earners on €25,000 per annum.

Similarly, it is dual income couples on the highest incomes that gain the most; with a high income couple on €125,000 gaining more than four times the amount received by a similar couple on €50,000.

Table 2:	**Distribution of gains from a sample income taxation package with a full year cost of €725m (€ per annum)**					
Gross Income	**€15,000**	**€25,000**	**€50,000**	**€75,000**	**€100,000**	**€125,000**
Single earner	75.00	161.82	612.12	812.55	812.55	812.55
Couple 1 earner	75.00	161.82	612.12	812.55	812.55	812.55
Couple 2 earners	0.00	81.25	324.62	974.24	1,224.24	1,362.17

Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. USC calculations assume earners pay the standard rate of USC.

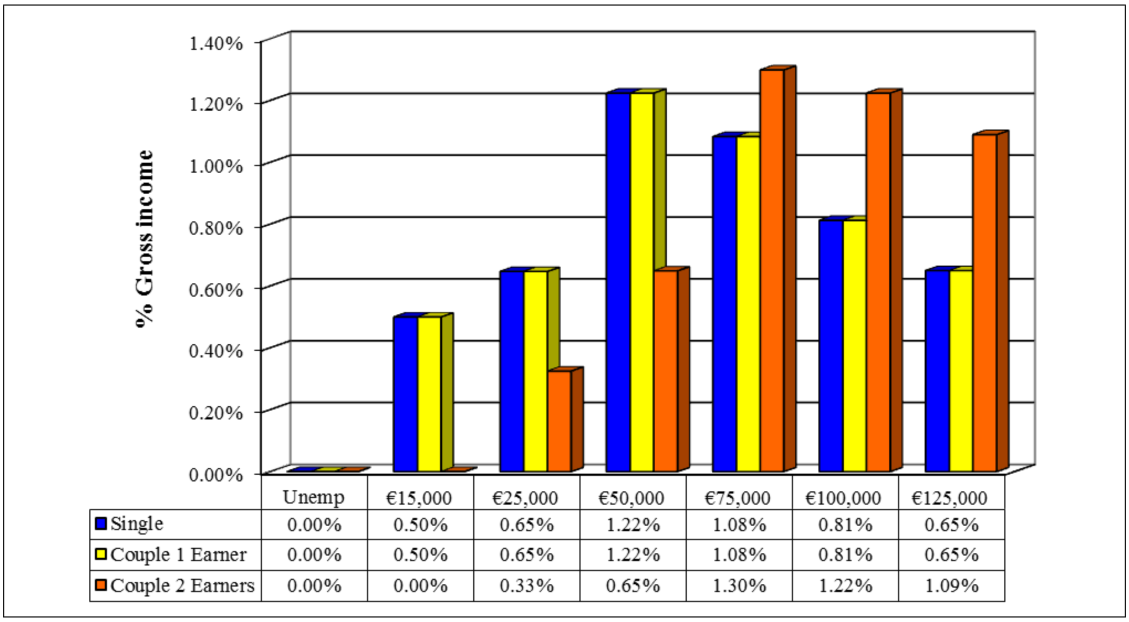
Chart 8: How much better off (€ per annum) would people be if this sample income taxation package was introduced in Budget 2016 (full year cost €725 million)



Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. USC calculations assume earners pay the standard rate of USC.

In cash terms such a set of choices are clearly regressive – benefitting those on the highest incomes much more than those on lower incomes. Judged as a percentage of gross income (the way progressivity or regressivity is generally measured) the picture is similar. For all household types, the gains increase as income increases with the maximum gains expressed as a percentage of gross income received by single earners/ couples with one income on €50,000 and two income couples on €75,000. Beyond these points the relative size of the income tax gain declines – and it remains well in excess of the gain experienced by lower earners until gross incomes reach levels at the top of the income distribution (€125,000 and above).

Chart 9: How much better off (% Gross Income) would people be if this sample income taxation package was introduced in Budget 2016 (full year cost €725 million)



	Unemp	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single	0.00%	0.50%	0.65%	1.22%	1.08%	0.81%	0.65%
Couple 1 Earner	0.00%	0.50%	0.65%	1.22%	1.08%	0.81%	0.65%
Couple 2 Earners	0.00%	0.00%	0.33%	0.65%	1.30%	1.22%	1.09%

Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2015 income taxation system. USC calculations assume earners pay the standard rate of USC.

Summary

There are multiple possible combinations of changes to income taxation measures which are open to Government if it decides to pursue an agenda of income taxation reductions in Budget 2016 – something we believe is not a priority. In examining this sample package we are not attempting to second guess the Governments plans, rather it is an attempt to examine the nature of a possible budget package and the likely impacts such choices would have on fairness.

As we have shown, income taxation measures which focus on changing tax bands and making reductions to upper USC rates will produce an unfair outcome which skews the benefits to those in society who are best off.

Policy makers should be aware of these outcomes as they frame their decisions. Taking decisions that produce such outcomes implies an agenda that would deepen inequality in our society. Such decisions would necessitate further policy measures focused on lower income households, including welfare dependent households, to counteract these regressive and unfair outcomes.

As we have shown earlier, if fairness is a priority, there are better policy options open to the Government.

Social Justice Ireland is an independent think-tank and justice advocacy organisation of individuals and groups throughout Ireland who are committed to working to build a just society where human rights are respected, human dignity is upheld, and development is facilitated and the environment is respected and protected.

Social Justice Ireland,
Arena House,
Arena Road,
Sandyford,
Dublin 18
Phone: 01 213 0724
Email: secretary@socialjustice.ie
Charity Number: CHY 19486
Registered Charity no: 20076481
www.socialjustice.ie