



Fairness in Changing Income Taxes

Eight options compared



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Introduction

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation 33 years ago. It stated:

“...in our recommendations the spirit of equity is the 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)¹

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 are considered.

Despite low overall levels of taxation, and low effective income taxation rates, reductions in income taxation levels continue to be highlighted as a potential policy reform.² *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. 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 forthcoming Budgets 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 highlighted throughout our 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.

The document includes two examinations:

- An assessment of the fairness of eight possible income taxation options, each with a full-year cost of between €184m to €288m; equivalent to approximately 1% and 1.5% of the income taxation yield.
- An assessment of the fairness of plans to abolish the Universal Social Charge (USC) for most earners.

¹ Commission on Taxation (1982) *Commission on Taxation First Report*, Dublin, Stationery Office.

² We detail current levels, and recent trends, in overall taxation levels and in effective income taxation levels in our annual *Socio Economic Review*. The 2016 edition is available on our website and was launched during April 2016.

Fairness in Changing Income Tax – 8 options compared

Here we examine the fairness of various income tax reform options open to Government.³ Our analysis is based on the Pre-Budget 2017 Taxation Ready Reckoner published by the Revenue Commissioners.

Our approach has been to examine eight 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 €184m to €288m; equivalent to between 1% and 1.5% of the expected income taxation yield in 2016.

The reforms examined are for the 2016 income taxation system and are:

- a decrease in the top tax rate from 40% to 39% (full year cost €283m)
- a decrease in the standard rate of tax from 20% to 19.5% (full year cost €288m)
- 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 €227m)
- an increase in the standard rate band (20% tax band) of €1,500 (full year cost €279m)
- a 1% point decrease in the 1% USC rate (i.e. its abolition) – that applies to income below €12,012 (full year cost €247m)
- a 1.5% point decrease in the 3% USC rate – that applies to income between €12,012 and €18,668 (full year cost €235m)
- a 0.5% point decrease in the 5.5% USC rate – that applies to income between €18,668 and €70,044 (full year cost €184m)
- a 2.5% point decrease in the 8% USC rate (i.e. merging it with the 5.5% rate) – that applies to income above €70,044 (full year cost €265m)

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.

Abolishing the 1% USC rate (i.e. reducing it 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.

Halving the 3% USC rate benefits all those with incomes of more than €12,012. Earners above €18,688 (the entry point to the next USC rate) experience the full benefit of the reduction – gaining €99.84 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.

³ Earlier editions of this document were prepared pre and post Budget's 2015 and 2016.

Table 1: Comparing gains under eight 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 €283m)						
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 €288m)						
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 €227 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 €279 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% USC rate (full year cost €247m)						
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 1.5% point decrease in the 3% USC rate (full year cost €235m)						
Single earner	44.82	99.84	99.84	99.84	99.84	99.84
Couple 1 earner	44.82	99.84	99.84	99.84	99.84	99.84
Couple 2 earners	0.00	63.57	182.16	199.68	199.68	199.68
A 0.5% point decrease in the 5.5% USC rate (full year cost €184m)						
Single earner	0.00	31.66	156.66	256.88	256.88	256.88
Couple 1 earner	0.00	31.66	156.66	256.88	256.88	256.88
Couple 2 earners	0.00	0.00	69.16	188.32	313.32	382.29
A 2.5% point decrease in the 8% USC rate (full year cost €265m)						
Single earner	0.00	0.00	0.00	123.90	748.90	1373.90
Couple 1 earner	0.00	0.00	0.00	123.90	748.90	1373.90
Couple 2 earners	0.00	0.00	0.00	0.00	0.00	280.15

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 2016 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.

Compared to these three options, the other five 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 two top USC bands (5.5% and 8%) also produces notably unfair outcomes. Decreasing the 5.5% band benefits earners with income between €18,668 and €70,044 and for those within this band the benefit is greater the higher an individual's income. Similarly, it is only individuals with earnings in excess of €70,044 who gain from a reduction in the 8% rate with the gains greatest for those with the most 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 two 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 1-8) illustrate these changes. In terms of fairness, reducing the bottom two USC rates or increasing tax credits are the best options.

Conclusion

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

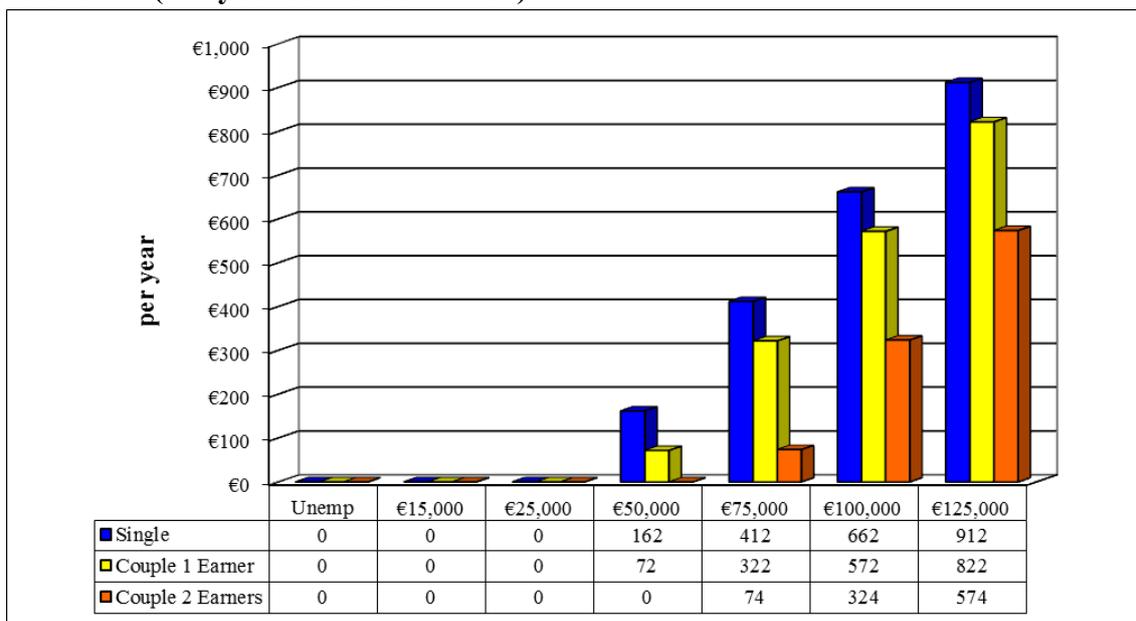
- increasing the personal tax credit;
- reducing the 1% USC rate by 1 percentage point; and
- reducing the 3% USC rate by 1.5 percentage points.

Five 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;
- reducing the 7% USC rate; and
- reducing the 8% USC rate.

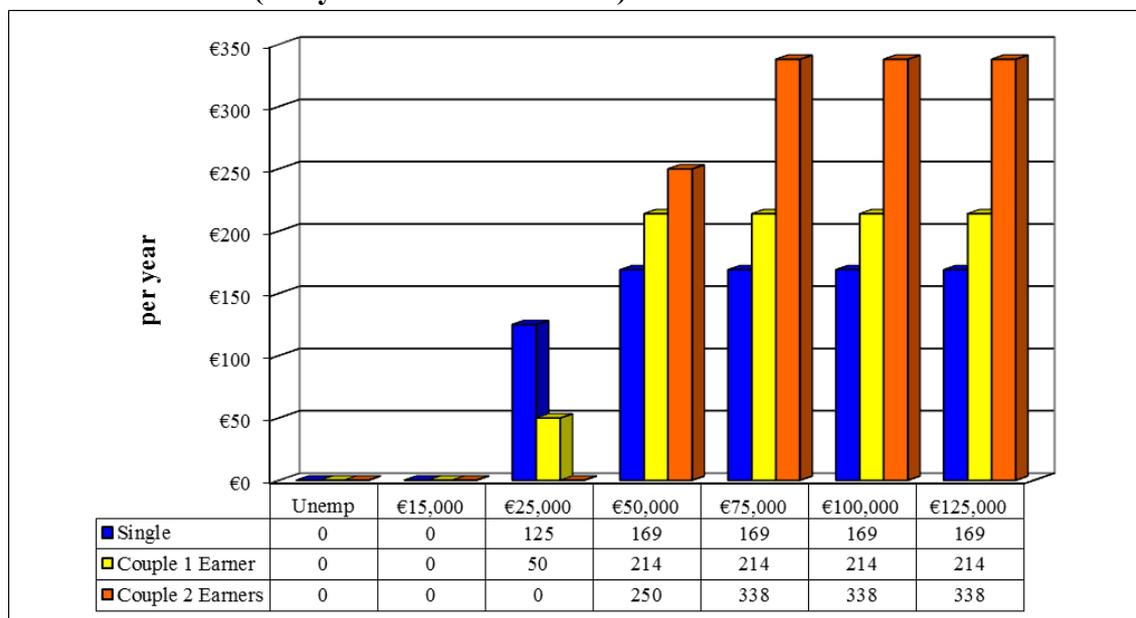
Each of the three fair options would provide beneficiaries with an improvement in their annual income of around €100-120. Each of the five unfair options would skew benefits towards those with higher incomes.

Chart 1: How much better off would people be if the top tax rate was decreased from 40% to 39% (full year cost €283 million)



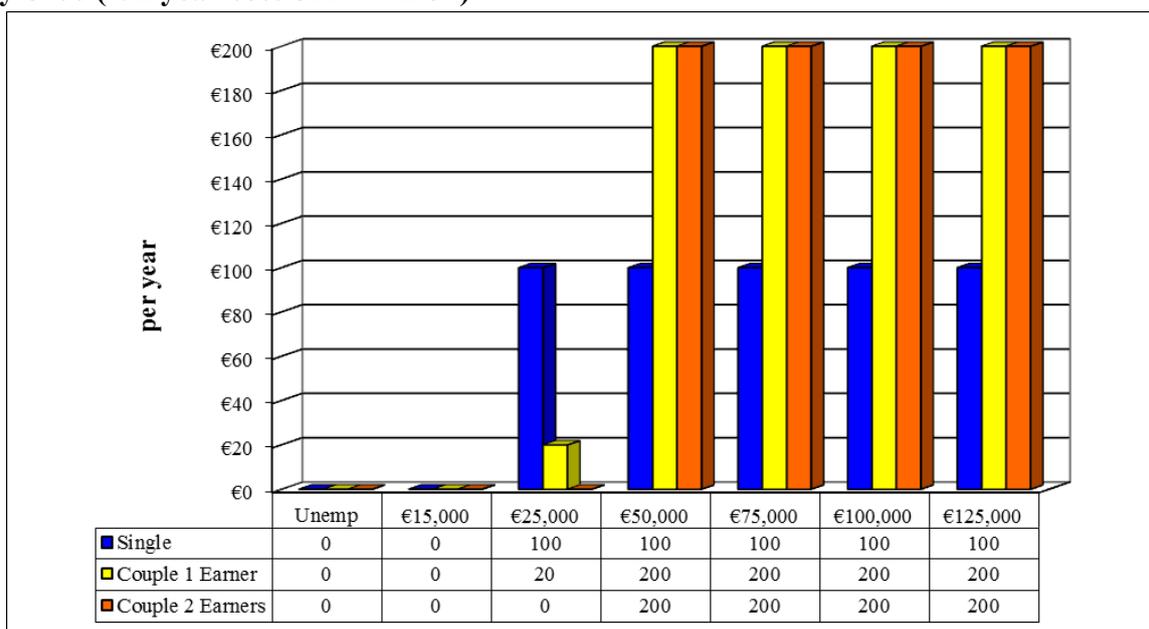
Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system.

Chart 2: How much better off would people be if the standard tax rate was decreased from 20% to 19.5% (full year cost €288 million)



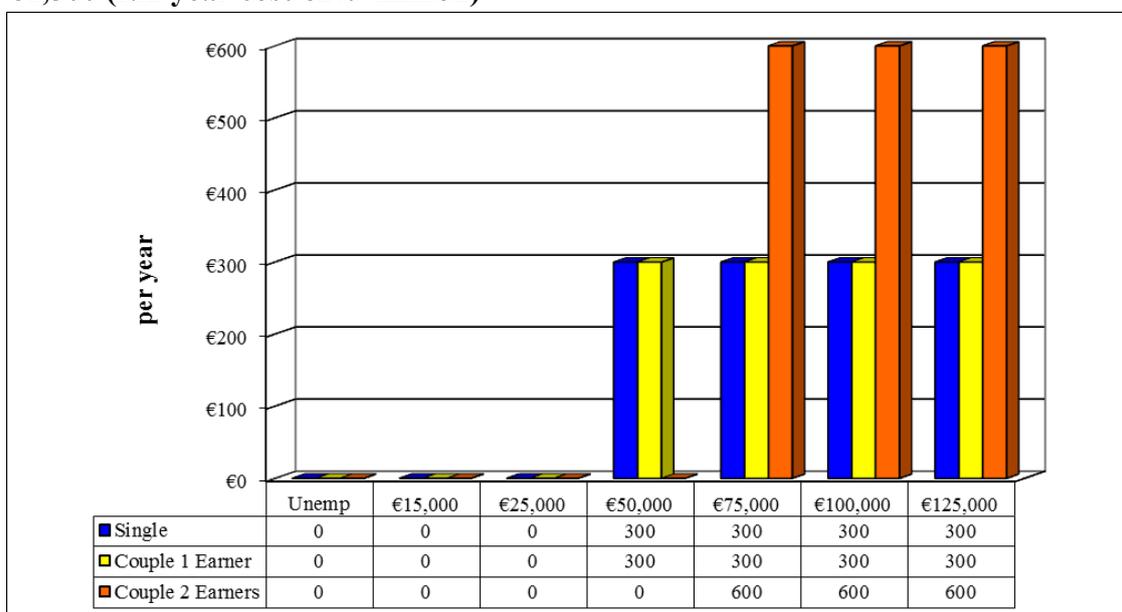
Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system.

Chart 3: How much better off would people be if the personal tax credit was increased by €100 (full year cost €227 million)



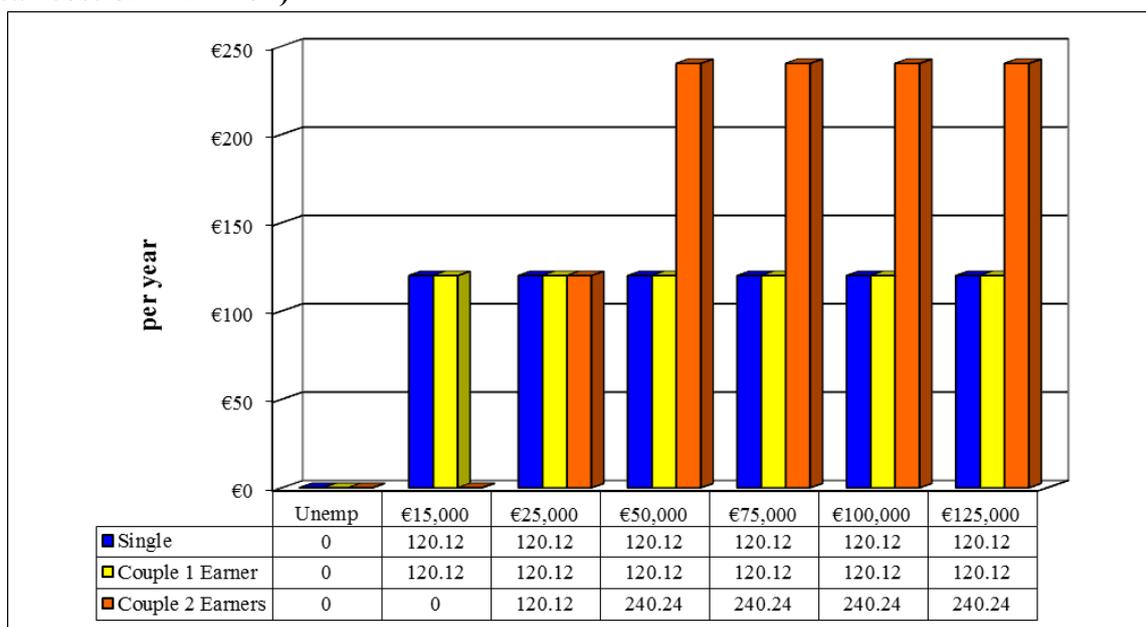
Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system. The increase in 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 €279 million)



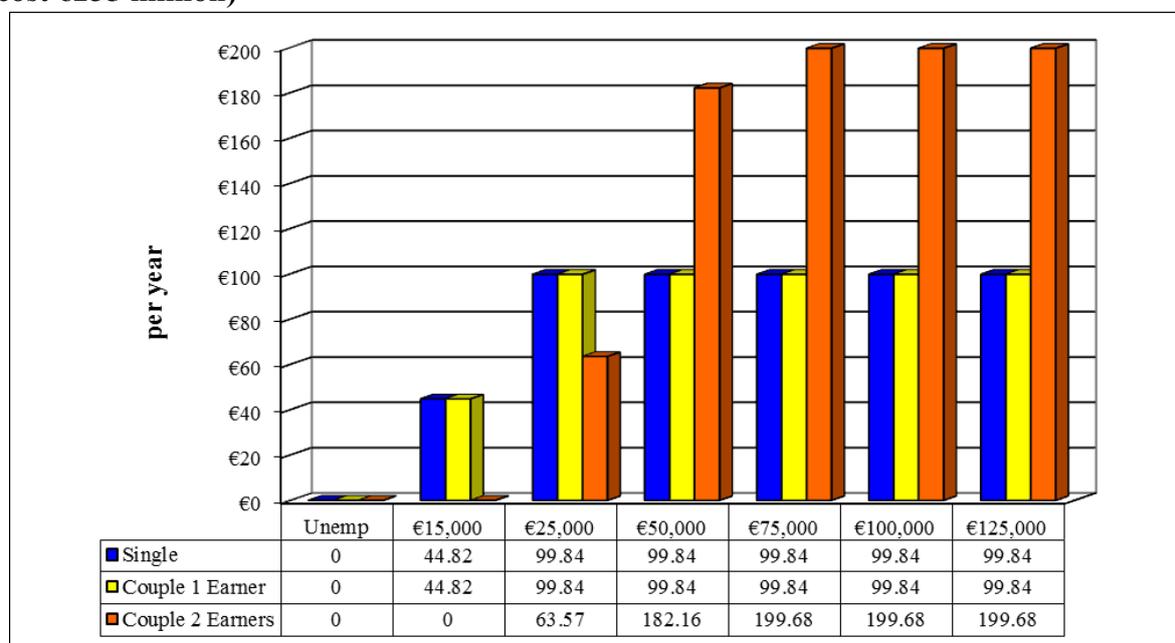
Notes: All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system.

Chart 5: How much better off would people be if the 1% USC rate was abolished (full year cost €247 million)



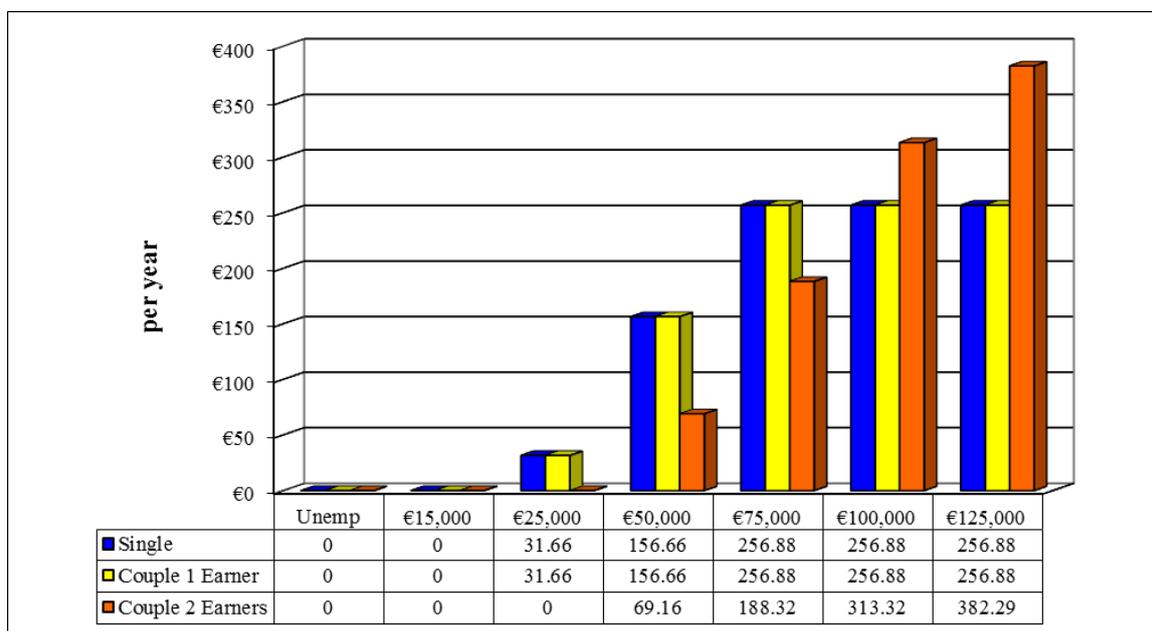
Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system. USC calculations assume earners pay the standard rate of USC.

Chart 6: How much better off would people be if the 3% USC rate was halved (full year cost €235 million)



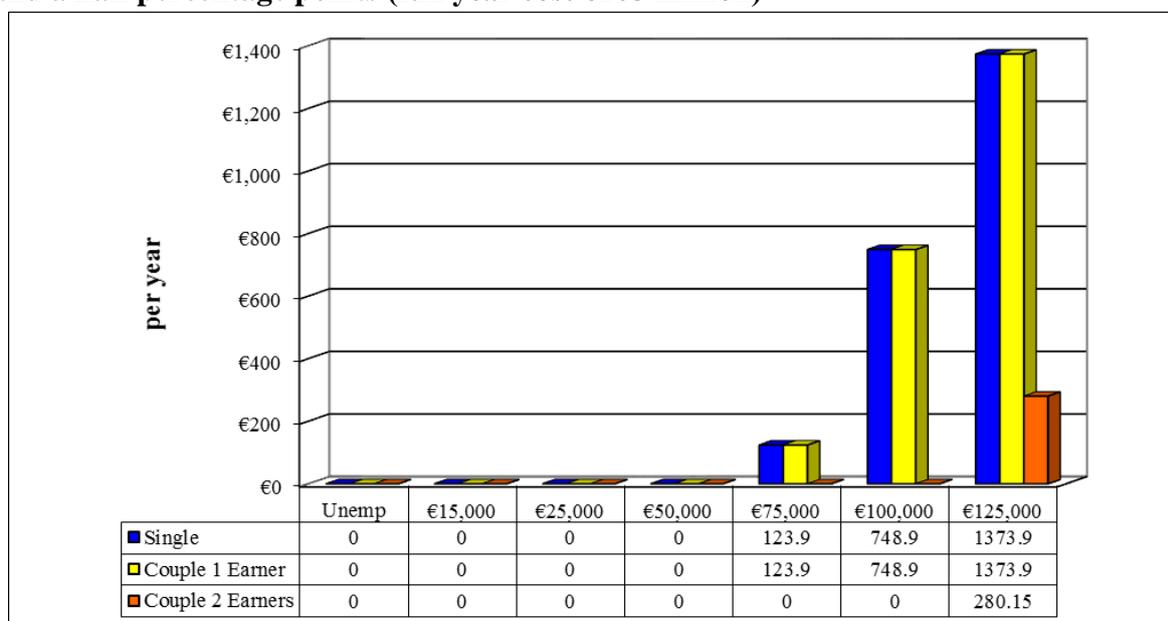
Notes: For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system. USC calculations assume earners pay the standard rate of USC.

Chart 7: How much better off would people be if the 5.5% USC rate was reduced by half a percentage point (full year cost €184 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 2016 income taxation system. USC calculations assume earners pay the standard rate of USC.

Chart 8: How much better off would people be if the 8% USC rate was reduced by two and a half percentage points (full year cost €265 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 2016 income taxation system. USC calculations assume earners pay the standard rate of USC.

Abolishing the USC for Most Earners

Many recent discussions on the reform of income taxes have focused on changes to the USC. While proposals have varied, they have generally argued for the elimination of the first three rates of the USC (1%, 3% and 5.5%) over a series of Budgets.

Here we examine the fairness of such a reform. Our analysis is based on the Pre-Budget 2017 Taxation Ready Reckoner published by the Revenue Commissioners. It does not include any accompanying policy measures which might attempt to claw back some of the gains from earners with very high incomes.⁴

The reform examined is based on the 2016 income taxation system and includes:

- the elimination of the current 1% USC rate – that applies to income below €12,012 (full year cost €247m);
- the elimination of the current 3% USC rate – that applies to income between €12,012 and €18,668 (full year cost €471m);
- the elimination of the current 5.5% USC rate – that applies to income between €18,668 and €70,044 (full year cost €2,024m); and
- no change in the 8% USC rate – that applies to income above €70,044.⁵

The total cost of these changes would be €2,742m in a full tax year; equivalent to 13.7% of the expected income taxation yield in 2016.

Table 2 presents the results of this analysis in € per annum terms and Table 3 shows these results as a proportion of gross income.

Charts 9 and 10 illustrate the results.

What the results show is a dramatically unfair impact from the USC reform. As Table 2 and Chart 9 show, the gains are heavily skewed towards those on the highest incomes. Single earners above €70,044 gain €3,145 per annum, more than 4.5 times the gains for a worker on €25,000. Couples with two incomes totalling €125,000 gain over €4,000 per annum, almost three times the amount that goes to a similar middle-income couple on €50,000.

Looked at as a proportion of gross income (Table 3 and Chart 10), the regressive nature of the tax change is further visible. As income increases so too does the proportional gain, peaking at a value of 4.2% of gross income for single earners at €75,000 and peaking for couples with two incomes at an annual income of €100,000.

⁴ Proposals have included the tapering out of tax credits for high earners and/or new levies on those with individual incomes in excess of €100,000. Such measures would reduce the gains received by those with the very highest incomes.

⁵ The 8% rate raises €848m a year giving a total USC yield of €3,590m.

Table 2: Comparing gains from the abolition of the 1%, 3% and 5.5% USC rates (€ per annum)

Gross Income	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single earner	209.76	668.06	2,043.06	3,145.48	3,145.48	3,145.48
Couple 1 earner	209.76	668.06	2,043.06	3,145.48	3,145.48	3,145.48
Couple 2 earners	0.00	247.26	1,365.32	2,711.12	2,711.12	4,086.12

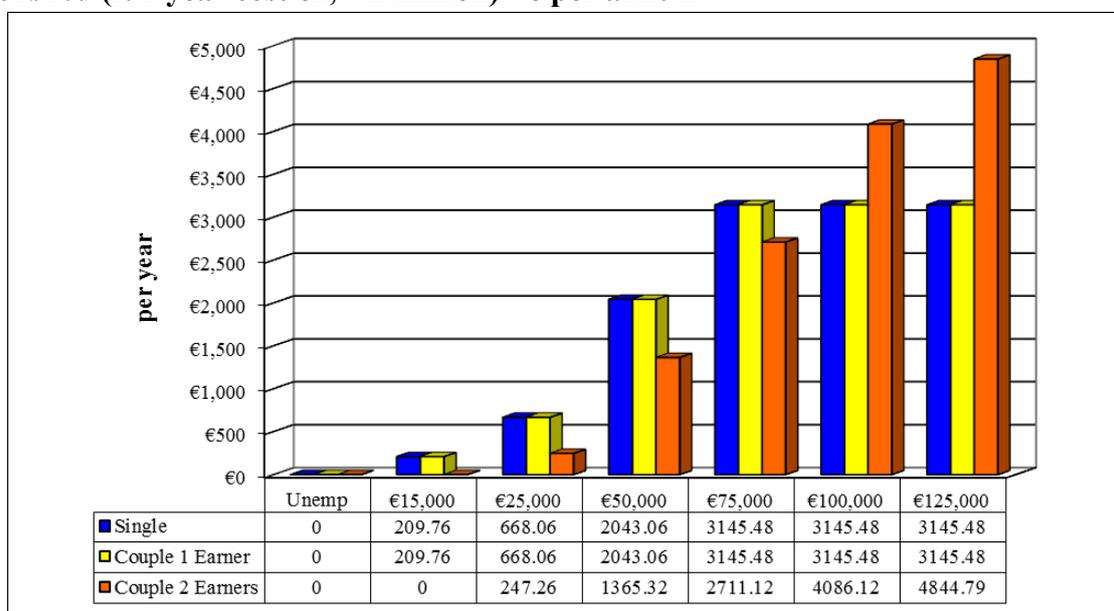
Notes: USC calculations assume earners pay the standard rate of USC. All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Revenue Commissioners taxation ready reckoner and are applied to the structure of the 2016 income taxation system.

Table 3: Comparing gains from the abolition of the 1%, 3% and 5.5% USC rates (% of annual gross income)

Gross Income	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
Single earner	1.4%	2.7%	4.1%	4.2%	3.1%	2.5%
Couple 1 earner	1.4%	2.7%	4.1%	4.2%	3.1%	2.5%
Couple 2 earners	0.0%	1.0%	2.7%	3.6%	4.1%	3.9%

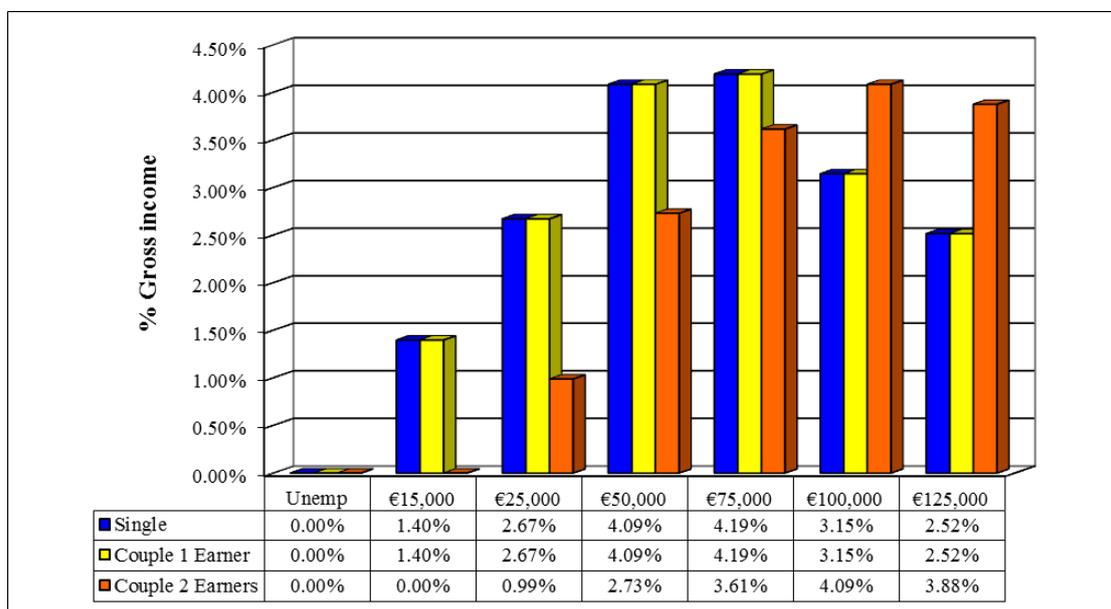
Notes: See Table 2.

Chart 9: How much better off would people be if the 1%, 3% and 5.5% USC rates were abolished (full year cost €2,742 million) - € per annum



Notes: USC calculations assume earners pay the standard rate of USC. 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 2016 income taxation system. The results do not include the effect of any accompanying measures to claw back some of the gains from high earners.

Chart 10: How much better off would people be if the 1%, 3% and 5.5% USC rates were abolished (full year cost €2,742 million) - % gross income



Notes: USC calculations assume earners pay the standard rate of USC. 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 2016 income taxation system. The results do not include the effect of any accompanying measures to claw back some of the gains from high earners.

Conclusion

Overall, reforming the income taxation system through the elimination of the first three rates of the USC is an expensive and unfair policy path. Although we have assumed here that there is no change to the 8% USC rate, the gains are heavily skewed towards those on the highest incomes.

From the perspective of fairness, the question arises as to whether such a large amount of annual taxation revenue could be used in a much fairer and better way?

Social Justice Ireland is an independent think-tank and justice advocacy organisation of that advances the lives of people and communities through providing independent social analysis and effective policy development to create a sustainable future for every member of society and for societies as a whole.



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