Deloitte.

Consultation on Ireland's Personal Tax System

April 2023

Public Consultation Response

Deloitte Ireland LLP
Deloitte & Touche House
29 Earlsfort Terrace
Dublin 2
D02AY28
Ireland
Tel: +353 (1) 417 2200
Fax: +353 (1) 417 2300
Chartered Accountants

www.deloitte.com/ie

11 April 2023

Consultation on Ireland’s Personal Tax System,
Personal Tax Policy Review,
Tax Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2,
D02 R583.

VIA EMAIL: personaltaxreview@finance.gov.ie

Dear Sirs/Mesdames:

We are pleased to submit comments on behalf of Deloitte in response to your Consultation document of 8 March 2023. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives, and are available to discuss anything in this document, as needed. In the meantime, if you have any queries, please do not hesitate to contact us at 01-417-2200.

Yours sincerely,

Lorraine Griffin
Partner
Head of Tax and Legal

Daryl Hanberry
Partner
Tax and Legal

Consultation Questions and Deloitte recommendations

General comments

Given the OECD Pillars One and Two agreements and the EU Anti-Tax Avoidance Directive (ATAD), corporation tax policy is moving towards a time when there may be a reduced yield from corporation tax. Ireland has been a major beneficiary of globalisation, one of the drivers of which has been our corporate tax regime and the focus on providing taxpayers with clarity and certainty. While there are many reasons other than tax for Ireland's success, we cannot ignore the reality that the 15% minimum tax may to some degree level the playing field with other competitor countries. Accordingly, other areas of the tax system and economy must be adequately served to ensure that Ireland is a competitive location in which to invest and grow businesses.

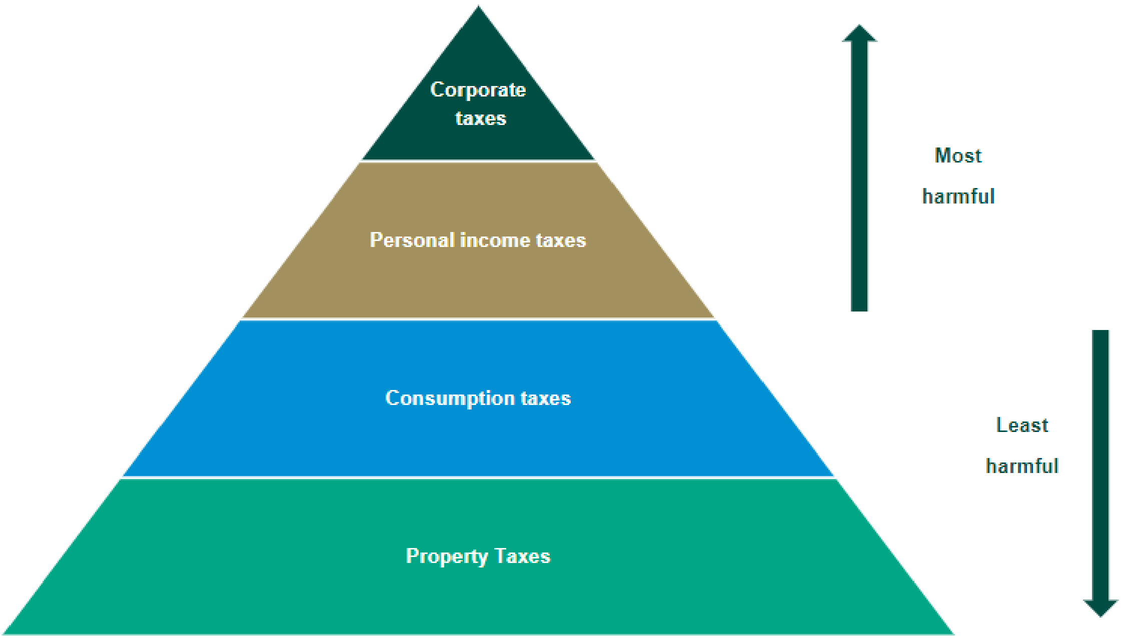
In view of the above, making the personal tax regime more attractive needs to be a key policy imperative for retaining and attracting FDI and key talent. An attractive personal tax regime is also vitally important for the SME and indigenous business community which relies on access to talent in order to grow and scale business. Unless remedial action is taken in the short term, as with corporation tax, the income tax yield may reduce over the medium to long term (thereby failing to meet one of the consultation's terms of reference, as noted in question 1).

While our response outlines in greater detail our views with respect to the questions raised, we would draw the reader's attention to our core views with respect to the Irish personal tax system:

- Strong equity considerations underpin the Irish taxation system, with personal taxes in particular being recognised as one of the most progressive systems of any OECD member.
- A tax policy that is competitive and effective is vital to Ireland's position in retaining and attracting talent in the world which is highly digitalised and mobile.
- We strongly support this progressive system of taxation which ensures that the those on higher incomes contribute more in terms of tax revenues proportionate to those on lower incomes.
- While progressivity in the personal tax system presents many positive aspects, it can result in a relatively narrow tax base. Accordingly, our view is that personal taxes should be all encompassing whereby everyone contributes, according to their means, but with built in safeguards to ensure redistribution of income to those on lower incomes.
- The redistribution of income via the personal taxation system should also be fair and equitable and not regressive.
- In the absence of any reform, our current personal tax regime may act as a disincentive for businesses and workers who are considering doing business in Ireland, and may also present barriers to retaining existing business, entrepreneurs, and workers in Ireland.
- Broadening of the tax base, where considered as a form of tax reform, should not be carried out at the expense of workers and economic growth in businesses.
- We would support reform across a number of areas but in particular would recommend a specific focus on moving the entry point to the higher rate of tax away from the average wage range, and a reduction in the overall higher rate of income tax.
- Complexity costs business. At a minimum, employer PRSI should not be increased, and we would recommend further thinking be carried out to identify whether simplification measures can be applied to the existing PRSI system in Ireland, while merging USC and income tax.
- Further consideration should be given to the indexation of rate bands and credits.

- Tax policy must adapt to new ways of working such as hybrid and remote working.

Before considering the five questions presented, and to set the context for our answers, it is worth mentioning the OECD's hierarchy of taxation regarding how particular types of taxes impact economic growth:



As an overarching comment, while reforms to the personal tax system to enhance its competitiveness are a key focus, any reforms leading to the broadening of the income tax base should be very carefully evaluated from economic and equity perspectives to mitigate any negative effects. A reduction in inward investment could also impact the amount of income taxes collected. To the extent that a move away from an overly harmful personal income tax regime could be adequately compensated for by a corresponding shift to less distortionary taxes (to the extent that such a shift does not negatively affect economic growth), consideration should be given to same.

Question 1:

Do you have any suggestions on how the personal tax system could be reformed or enhanced, while broadly maintaining the yield and ensuring it continues to provide a sustainable and stable source of revenue to the exchequer to fund public services?

Summary of key proposals

There are aspects of the current taxation system which present barriers to achieving sustainable business growth, namely the high personal tax rate when income tax, USC and PRSI are combined, and the imposition of a tax on employment (employer PRSI) on employers who provide jobs. Our two key proposals on the reform and enhancement of the personal tax system are:

1) An increase to the SCROP (e.g., from €40,000 to €50,000);
2) A reduction in the higher rate of income tax.

The above recommendations should, in our view, be designed in such a way so as to ensure that the combined top rate (currently 52%- 55%) for a worker based in Ireland (whether employed or self-employed) should not cross 50%. An additional solution for achieving this reduced personal tax burden would look to introduce an intermediate rate of tax, which we have discussed in more detail in the body of our response.

As an overarching comment, recent Budgets have referred to the introduction of a Personal Tax Roadmap, similar to the strategy adopted on corporation tax. Public consultations should address specific areas of the tax system in a targeted way to identify the areas most in need of change and specific actions to be taken. In summary, we should seek to make Ireland the number one location for enhancing employment and economic activity and for reducing and eliminating poverty and deprivation. To achieve these aims, the strategic approach taken with our corporation tax strategy needs to be replicated.

Introduction

As a general comment, recent Budgets have mentioned the introduction of a Personal Taxes roadmap, similar to the approach taken with corporation tax. In our view this should be a priority.

Ireland as a competitive jurisdiction

A tax policy that is competitive and effective is vital to Ireland's position in retaining and attracting talent in the world which is highly digitalised and mobile. For indigenous companies looking to expand operations and footprint, personal taxes are a key factor as such taxes contribute to the costs of running a business. While some costs are apparent (i.e., employer PRSI), high personal taxes also require companies to offer attractive remuneration packages including higher base salaries to workers. For SMEs, access to talent will likely play a large part in whether ambitious growth targets are achieved, with 35% of founders indicating plans to employ new staff in 2023 according to the Enterprise Nation Quarterly Small Business Barometer[1]. In addition, the personal taxes which key executives and key employees will be liable to pay will also play an important role in deciding whether to locate a business or mobile projects in a particular country. Key talent required in order to ensure a successful business venture may have a preference to locate in a country with a more competitive personal tax regime. Alternatively, even where the personal tax burden is borne in whole/part by the business in question, a high tax personal tax and employer PRSI regime can act as a disincentive to locate in a country like Ireland given other locations may be more cost competitive.

In the absence of any reform, our current personal tax regime may act as a disincentive for businesses and workers who are considering doing business in Ireland as, for example, our combined top personal tax rates of 52% - 55% remain among the highest in the EU (Top 10[2]). For a single person[3], income of up to €40,000 is taxable

[1] Enterprise Nation Ireland, Small Business Barometer, Q4 2022, with summary available at Rise in small business optimism as Irish entrepreneurs predict growth in 2023 | Enterprise Nation
[2] Ireland remains in the top 10 – see OECD.Stat, Top marginal rates: https://stats.oecd.org/index.aspx?DataSetCode=TABLE_I7#.
[3] Including a widowed person or surviving civil partner without qualifying children, per Tax rates, bands and reliefs (revenue.ie)

at the standard rate of 20% of income tax, while the balance over the €40,000 threshold (referred to as the Standard Rate Cut-Off Point or "SRCOP") is taxable at the higher rate of 40% (referred to in the remainder of this submission as the higher rate of income tax).

Despite a slight increase in the in the SRCOP in the last Budget, we still have a low entry point for the higher rate of income tax to apply. For example, a single person who earns an average salary of €46,800 gross (CSO, Earnings and Labour Costs, 2022) will take home circa €36,405 (77% of the gross salary), while someone in a senior role who earns €100,000 will take home circa €62,755 (63%). The difference between gross and net salary in the example above occurs as a result of the higher tax rate being applied to the salary in excess of €40,000. As such, by remaining in the EU's Top 10, the personal tax burden in Ireland will continue to be higher than many of our competitors. There are numerous forces which will drive a successful entrepreneurial landscape in Ireland, such as a skilled workforce, financial and technological resources, and infrastructure, etc. Critical to all of these forces is our tax system. Personal tax is only one of the factors which workers and businesses are considering (with other factors being housing, transport, infrastructure, education, health care, cost of living etc), however, it is definitely one of the key factors.

Main options for the reform of the existing personal tax system

Going forward personal taxes will continue to be critical in not only attracting and retaining talent but also enabling companies (both FDI and indigenous) to meet their growth targets.

Therefore, we would recommend considering two main short-term options for the reform of the existing personal tax system:

1) An increase to the SCROP (e.g., from €40,000 to €50,000); and

2) A reduction in the higher rate of Income tax.

Increasing SCROP

Ireland's personal tax rates are currently uncompetitive in comparison to other countries both inside and outside the EU, which is hampering SMEs and the indigenous business community as well as multinationals in their efforts to attract and retain talent. With the advancements in remote working, high personal taxes could result in people based in Ireland moving to other locations with a resulting loss of both income and corporate taxes. Therefore, this aspect of the current personal tax system may be harmful to growth and prosperity of the State. The proposal to increase the SCROP is regularly and well addressed and evaluated by the Tax Strategy Group in advance of the Budgets.[4] When one considers that the average salary in 2022 was €46,800 (CSO, Earnings and Labour Costs, 2022[5]) and is likely to exceed €48,000 in Q4 of 2023[6] due to inflationary pressures and rising wages, such reform would be welcome by the existing workers in receipt of an average salary in the State, as well as potential expatriate workers. Our recommendation would mean that workers on the average salary in the State would not become automatically taxed at the higher rate of income tax of 40%; an increase to the SCROP would keep a larger portion of such workers' salaries on the standard rate of income tax of 20% and thus provide greater take home pay for these individuals.

Lowering the higher rate of income tax

Based on the latest statistics, our top combined personal tax rates of 52% - 55% (higher rate of tax of 40%, plus top USC rate and PRSI rate) remain among the highest in the EU (Top 10). Ireland's high personal tax rate is a disincentive to businesses locating in Ireland and employees taking on additional work. It is also a disincentive to foreign based talent (including Ireland's diaspora) relocating to Ireland. Furthermore, in light of the potential

[4] For example, see the latest TSG paper 22-02 Income Tax, p. 34., available here: https://www.gov.ie/en/collection/d5b41-budget-2023-tax-strategy-group-papers/.

[5] Earnings and Labour Costs - CSO - Central Statistics Office

[6] CSO, Earnings and Labour Costs Q3 2022 (Final) Q4 2022 (Preliminary Estimates), available here https://www.cso.ie/en/releasesandpublications/ep/p-elcq/earningsandlabourcostsq32022finalq42022preliminaryestimates/#:~:text=Earnings%20and%20Hours-,Average%20weekly%20earnings%20were%20%E2%82%AC900.26%20in%20Q4%202022%2C%20an,and%20Labour%20Costs%20quarterly%20release. The calculation of the predicted salary was based on the average increase of gross salary in the last 5 years, based on the information provided by the CSO (i.e., the difference between gross salaries in Q4 in 2022 – 18 were (in order 2022 – 18) €36, 16,60 and 29, with the average being €28 per week or €1,456 per year, gross).

opportunities/risks arising out of OECD Pillar Two/Brexit, we need to ensure that the personal tax system is not a barrier to attracting and retaining talent in Ireland. This will be critical in terms of driving economic activity, future investment and reinvestment, and supporting SMEs and entrepreneurs to grow and scale their businesses in and from Ireland. The top combined rate of 52% - 55% should be reduced, which would include a reduction in the higher tax rate of 40%.

The above recommendations should, in our view, be designed in such a way so as to ensure that the overall to combined tax rate for a worker based in Ireland (whether employed or self-employed) should not cross 50%.

The following real-life situations should be kept in mind:

- Officially, a private sector employee's top tax rate is 52% (income tax 40% + USC 8% + PRSI 4%). However, due to how difficult it is for an employment related expense to meet the "necessarily" test in section 114 TCA 1997, the effective rate can often be higher. For example, most professional subscriptions are no longer allowable notwithstanding the fact that they may represent a vital link to professional bodies and industry connections that are necessary for professional and business growth.

- A self-employed person can be liable for an additional 3% USC which brings the nominal marginal rate to 55% in this instance. However, due to some expenses being either disallowed (e.g., business entertainment) or only being allowed over time (capital expenditure), the effective rate can often be higher.

With a rate of tax that is approaching or exceeding 60% applying to additional income, it is a disincentive to taking on additional work, given how little of the additional earnings will be realised in take-home income for the individuals concerned.

In addition, changes should be made to ensure that all genuine employment and business-related expenses are deductible when they are incurred. These changes should be made in a single Finance Act. We would be of the view that existing anti avoidance provisions in Irish law are sufficiently effective to ensure that such expenses are not overinflated for the purposes of calculating an individual's personal tax liability in any given year.

As an alternative to the above approach, consideration could be given to adopting a flat rate of income tax/USC/PRSI at a rate below 50% with a refundable tax credit to provide equal treatment of workers (whether employed or self-employed). Current personal tax credit and employee personal tax credits are both €1,775 giving a total of €3,550. The lower rate income tax band is €40,000 which at 20% is worth €8,000. These items combine to give €11,550 or €222 per week, which is more than the current single person social welfare unemployment payment (which would be replaced by a refundable tax credit available to all individuals, whether in employment/self-employed/unemployed). We acknowledge that this represents a departure from the current system of progressivity provided for through set rate bands dependent on individual taxpayer circumstances, and appropriate modelling would need to be carried out to identify the fiscal impact of such a measure. We also recognise that work would need to be undertaken to ensure that the replacing of existing tax credits with a single universal credit should not negatively impact taxpayers.

The intermediate rate of tax

The policy rationale for introducing an intermediate rate of tax at 30% is to increase the entry point before taxpayers are subject to the higher rate of income tax (currently 40%), which would result in an increase in net pay for those taxpayers. Considering that the average salary in 2022 was €46,800 (CSO, Earnings and Labour Costs, 2022[7]), the introduction of an intermediate rate of income tax between the current standard rate of income tax of 20% and the top rate of income tax of 40% would benefit middle/average and high income earners (i.e. those that have some part of their earned income between those income bands) as they would see a direct increase in their net income due to the intermediate rate of tax. While we are of the view that focus needs to be given to middle income workers and the tax burdens faced by them, we would note that the same result could arguably be achieved by effectively addressing our previous recommendations 1 and 2 (moving the entry point to the standard rate cut off and reducing the top rate of Income tax), without the need for introducing a new

[7] Earnings and Labour Costs - CSO - Central Statistics Office

rate of tax. While we support a reduction in the tax burden for workers, such objectives should not result in greater complexity in the personal tax system.

Other recommended enhancements

In addition to the main options for reform presented above, other enhancement measures could be considered, as follows:

- **Merge income tax with the USC:** With three personal taxes in play (Income tax, USC and PRSI), together with their different rates and reliefs, this creates a level of uncertainty and complexity in the tax system which is not conducive to employment or economic growth. Of the 624 appeals heard by the Tax Appeals Commission in the period from 2016-2022 inclusive (and published in the TAC website), 322 contain some element of personal taxes (whether income tax, PAYE, PRSI or USC), demonstrating the uncertain nature of this area in practice for taxpayers. Merging income tax with the USC would provide a measure of clarity and would streamline the tax system considerably.
- **PRSI rates and classes:** Any increases in either employee or employer PRSI will add to the cost for employers of employing people in Ireland. If an employer has a hiring budget, the cost of employer PRSI means that less employees may be hired. Accordingly, we are not of the view that employer PRSI should increase in future Budgets and future opportunities to reduce the cost of employments to employers should be considered. With 12 different rates and 11 different classes, further divided into sub-classes, the Pay Related Social Insurance (PRSI) is overly complex and difficult for people to understand. Significant simplification is required if PRSI is to be effective going forward.
- **Income tax treatment of R&D employees:** Attracting talent is key to attracting R&D and innovation activities and to help foster a knowledge-based economy. Steps need to be taken to reduce the personal tax burden on employees engaged in appropriate R&D activities, to ensure that Ireland can retain and attract key R&D talent. While there are existing measures included in the R&D tax credit regime aimed at reducing the personal tax burden of certain key R&D employees, these measures are seldom used. We would recommend that alternatives are considered including applying the standard 20% rate to an appropriate amount of remuneration reasonably attributable to qualifying R&D activities of R&D employees or offering R&D employees a personal tax credit commensurate with time spent on such activities.
- **Indexation:** We would recommend that existing reliefs, bands, thresholds, and credits are indexed annually based on movements in the consumer price index.
- **Reform and enhancement of key reliefs**
  - *SARP:* A tax policy that is competitive and effective in attracting top mobile talent to Ireland is vital to Ireland's position in retaining and attracting Foreign Direct Investment. In our view, the current relief is insufficient and too restrictive. Therefore, while the extension of the relief is welcome, further enhancements to SARP are required to make it easier to access including:
    - Making it available to new hires,
    - Removing the 90-day administrative reporting rules and instead incorporating any information requests within the self-assessment income tax return,
    - Removing the cap on qualifying school fees,
    - Providing for its extension to 10 years,
    - A review of how the relief is applied by Revenue,
    - Application of the relief for PRSI and USC purposes as well as income tax.

  Ireland's SARP regime needs to be reconsidered from an international competitiveness perspective, which we would be pleased to discuss further with the Department of Finance, including assessing the competitiveness of the current earnings ceiling. A competitive and attractive SARP regime can ultimately result in increased investment into Ireland, increased jobs creation, and while the SARP relief itself may reduce a specific individual's personal tax burden, overall Ireland should achieve increased tax receipts through the additional corporate tax and personal taxes generated from the business and jobs that have been secured.

  - *KEEP:* The aim of the KEEP is to help smaller firms who cannot compete with larger firms in cash remuneration terms to attract and retain talent in a challenging labour market. However, KEEP in its current design has not been successful in providing SMEs with an easy to implement and cost-effective way to offer shares to employees. The current KEEP legislation has presented a number of difficulties in operating the scheme effectively which has put SMEs on the back foot in terms of competing in the labour market. In particular, we would recommend the extension of KEEP allowing for its application to all companies. Similarly, we would recommend the removal of income tax treatment applied to shares, with CGT treatment instead applying on the disposal; this enhancement would align the Irish treatment with similar schemes in other EU Member States (i.e., Poland).
  - *FED:* The Foreign Earnings Deduction (FED) plays an important role in encouraging and incentivising Irish businesses to export to emerging markets. However, there are many areas of the relief which require amendment to improve its attractiveness and usefulness for Irish companies. In particular, we would recommend a move to a territorial system of taxation whereby the deduction is based on all earnings referable to workdays outside Ireland would be of great assistance to exporters.
  - *Travel & Subsistence Relief for inbound temporary assignees to the State*: In order to enhance Ireland's competitiveness in attracting key talent to Ireland and to the reduce the costs of international assignments to Ireland, we would recommend that the accommodation costs for the first 24 months of an international assignment to Ireland are tax free, as opposed to the current period of 12 month. Our closest competitor for talent, the UK, allows for such a longer period of relief at a temporary work location.
- Enhancements to the APSS rules by increasing the €12,700 threshold (which has been in place since 1995[8]) to €25,000 and allowing relief for USC and PRSI purposes.
- Consider fixed period tax reliefs to assist certain sectors. With the shortage of construction workers and the requirement for more housing, consideration should be given to a 50% tax exemption for earnings and profits from construction employments and businesses (similar to the treatment that used to apply to manufacturing dividends). The suggestion is that these exemptions would expire after five years.
- **Enhancements in hybrid and remote working incentives:** With hybrid working an option for many, consideration needs to be given to measures to ensure that remote workers are not enticed overseas, resulting in not only in a drop in personal/employment taxes, but also a potential drop in corporate tax revenues. One practical measure to be considered is the Taxsaver Commuter Ticket Scheme. The Scheme is designed to encourage workers to use public transport and to reduce traffic congestion. It reduces the cost for workers using public transport, but it is not limited to State-owned public transport. According to Taxsaver, employees can save between 28.5% and 52% of travel costs as a result of tax, PRSI and USC savings by using a TaxSaver ticket. The scheme needs to be adapted for workers who only commute to work for 1-3 days per week. At present, such workers only have an option of purchasing monthly or annual tickets, when they are only travelling to the office occasionally. We would support and recommend a re-evaluation on this point and the introduction of a flexi tax saver ticket for hybrid workers.
- **Place of work in a hybrid world:** Identification of an employee's normal place of work is central to the tax treatment of travel and subsistence payments made to employees. While the historical position adopted by Revenue is that an employee's home is not a normal place of work, such rules should now be reconsidered in light of the growing portion of the labour market who work remotely or on a hybrid basis. The employee's normal place of work should be based on the facts of where the employee carries out the majority of their duties of employment, irrespective of whether that is their home or their employer's office or, indeed, some other workspace.
- **Maximisation of the effect of the small benefit exemption–** Removal of the restriction on the Small Benefit Exemption where only the first two awards awarded to an employee by an employer in a tax year are allowed under the exemption regardless of the value of those awards. This will allow employers to make multiple awards in the tax year to an employee up to the maximum exemption of €1,000 per annum.

[8] According to the CSO, CPI has almost doubled since June 1995 when that year's Finance Act was signed into law.

Broadening the tax base

In the past 20 years, income tax receipts remained resilient. Failure to be an attractive place for substantial business (both FDI and indigenous) could result in the erosion of our tax base and the loss of employment and income tax receipts. Any reforms leading to the broadening of the income tax base should be very carefully evaluated from economic and equity perspectives to mitigate any negative effects. A reduction in inward investment could also impact the amount of income taxes collected.

We would refer to our previous comments with respect to the OECD hierarchy of taxation and would note that to the extent that a move away from an overly harmful personal income tax regime could be adequately compensated for by a corresponding shift to less distortionary taxes (to the extent that such a shift does not negatively affect economic growth), consideration should be given to same. It is recognised that, with the standard VAT rate at 23% and the current inflationary environment, a shift from tax on income towards tax on other items, such as consumption, to allow further reductions could be difficult at present (given the desire to maintain the yield).

Question 2:

Does the personal tax system sufficiently support a competitive economy to incentivise and encourage work?

Summary of key messages

- At a minimum, the employer PRSI rate should not be increased and the requirement for employer contributions under pension auto-enrolment should be carefully monitored going forward to ensure affordability for employers.
- Cliff-edges in the taxation and welfare systems should be removed.
- The absence of any meaningful tax measures to incentivise and encourage people to take up employment (i.e., employees) and remain in the employment (including a progression from an average earner to the higher earner) may indicate a scope for review and an introduction of such measures, taking into the account any possible cliff-edges.
- Avoiding cliff-edges in the way that both tax and welfare function and co-exist in some cases is important, so that people have an incentive to take up and retain employment.
- While we already have limited measures in place to encourage people to work in Agriculture, Forestry & Fishing sector, the statistics clearly indicate that it is not enough and further incentives may be required, including tax incentives to promote careers in this sector.

In our view, the personal tax system should be enhanced to provide further support for a competitive economy and to incentivise and encourage work.

Two related items are

(i) the taxation of employment by charging employer PRSI (currently 11.05%) on payroll costs and
(ii) the likely requirement for employer contributions under pension auto-enrolment.

If an employer has a hiring budget, costs such as (i) and (ii) mean that less employees may be hired.

Therefore, at a minimum, the employer PRSI rate should not be increased and the requirement for employer contributions under pension auto-enrolment should be carefully monitored going forward to ensure affordability for employers.

In addition, we would make the following comments with respect to the labour force and how the personal tax system could be enhanced in support of same:

- **Agriculture, Forestry & Fishing sector:** While the largest employment increases were in Administrative & Support Service activities and the Transportation & Storage sector, more focus is required on incentivising and encouraging people to work in the Agriculture, Forestry & Fishing sector. In 2022 the Agriculture, Forestry & Fishing sector showed the largest decrease, down 5.7% or 6,100 compared with Q4 2021. This is disappointing, considering that the agri-food sector is Ireland's oldest and largest indigenous exporting sector. In 2020, the sector accounted for over 6% of GNI and 9% of exports in value terms. The sector accounts for 38% of total indigenous exports and over 60% of indigenous manufactured exports. In Ireland, agri-food is an integral part of the economy and society, and especially so for our rural and coastal communities.[9] While we already have limited measures in place to encourage people to work in these areas (e.g., Fisher Tax Credit, Flat Rate Allowances), the statistics clearly indicate that it is not enough and further incentives maybe required, including tax incentives to promote careers in Agriculture, Forestry & Fishing sector.
- **Cliff-Edge effects:** When it comes to a discussion on cliff-edge effects, a combined and a simultaneous review of the tax and welfare systems is required. Cliff-edges can result in individuals being left financially worse off as a result of taking up employment, increasing their hours of work or getting a pay rise. They can occur, for example, when earnings surpass the liability threshold for PRSI (at €352 per week) and USC (at €13,000 per year)[10], as well as when working more than three days a week on low levels of pay (leaving individuals ineligible for a partial Jobseekers Allowance payment). Cliff-edges in the taxation and welfare systems should be removed. The Departments overseeing both systems should recognise that arbitrary thresholds and boundaries which result in cliff-edges in both systems may create disincentives for individuals to move from the welfare system into the tax system and to remain in the tax system. The transition from one system to another should be gradual, and in cases where the provisions of both systems apply to a worker (e.g., Back to Work, Family Income Supplement), two systems should work in tandem.
- The welfare system already includes a number of measures aiming to avoid cliff-edges (e.g., the retention of the medical card, a gradual reduction of welfare payments on return to work, particularly for long-term unemployed and a possibility to receive welfare payments when working part-time), which is welcome. From tax perspective, however, the existing measures are not as extensive, and broadly limited to refunds of tax and focused mainly on promoting entrepreneurship, rather than employment.
- Irish tax legislation provides a number of supports and initiatives to assist start-up business and small and medium enterprises. Initiatives include tax incentives - tax reliefs, deductions and exemptions as well as supports and other initiatives[11]. While we recognise that entrepreneurs are vital to the success of the Irish economy and we support existing measures, the absence of any meaningful tax measures to incentivise and encourage people to take up employment (i.e., employees) and remain in the employment (including a progression from an average earner to the higher earner) may indicate a scope for review and an introduction of such measures, taking into the account any possible cliff-edges. Avoiding cliff-edges such that both tax and welfare function and co-exist in some cases is important, so that people have an incentive to take up and retain employment, and they do not artificially curtail the hours that they work, decline promotions due to tax concerns or use other measures in response to existing rules under both systems.

Some of the measures were already discussed in Question 1, while other tax measures may also be considered, such as those targeting:

i. unemployed people returning to the workforce, particularly long term-unemployed (e.g., Returning to Work tax Credit similar to the PAYE Credit; tax reliefs for unemployed who return to and take up employment similar to those available to individuals who start up the business etc.);

[9] Department of Agriculture, Agri-Food and Economy, available here: https://www.gov.ie/en/publication/e2273-agri-food-and-the-economy/.
[10] Revenue Commissioners, https://www.revenue.ie/en/jobs-and-pensions/usc/index.aspx.
[11] For example, the Seed Capital Scheme, Employment and Investment Incentive Scheme, Relief from Corporation Tax for start-up companies. A range of other supports for small and medium businesses are also in place such as exemptions from the requirement to register for VAT and the use of the cash basis for VAT.

ii. one-parent families[12] (by, for example, including further increases in related tax credits and the SRCOP) and
iii. those over 65.[13]

Question 3:
Do you have views on the progressivity of the personal tax system?

Summary of key points

- Ireland has the most progressive system of personal taxes of any OECD member.
- Reviews and reforms must continue as the social and economic progress will depend on them. Periodic reviews of the personal tax system and its progressive characteristic will help Ireland to remain a competitive location for investment and employment creation.

How are we performing in Ireland?

In 2021, according to the OECD Ireland had the most progressive system of taxes of any OECD member. Ireland ranked 32 of 34 among OECD members for income inequality before taxes. However, compared to other OECD countries, Ireland remained moderately unequal after taxes, ranking 15 of 34.[14] The latest OECD data (2022) showed that for those on 67% of the average wage, the tax wedge in Ireland was one of the lowest in the OECD, standing at about 25%.[15] In contrast, for higher earners, the tax wedge in Ireland was 42.4% which is above the OECD average. Such advanced progressivity of the Irish personal tax system was also highlighted and recognised by ESRI (2020)[16], IMF (2022)[17] and TSG (2022).[18]

Perceived advantages and disadvantages of the progressive personal tax system

Advantages

- Since the top earners are taxed more and on larger sums of money, a progressive personal tax system increases the amount of tax revenue collected by the Exchequer.
- A progressive tax system reduces and, in some cases, eliminates the tax burden on taxpayers who can least afford to pay.
- The tax burden under the progressive tax system is proportionate to income.

[12] In accordance with the latest ESRI report, over the period 2004-2019, lone parents and their children and working-age adults with disabilities and their children experienced the highest rates of at risk-of-poverty, deprivation and consistent poverty. See ESRI, *Decreasing poverty requires a mix of policy measures such as increasing female labour force participation and spending more on benefits targeting children* (June, 2022), available here: https://www.esri.ie/news/decreasing-poverty-requires-a-mix-of-policy-measures-such-as-increasing-female-labour-force. And also, ESRI, *POVERTY, INCOME INEQUALITY AND LIVING STANDARDS IN IRELAND: SECOND ANNUAL REPORT* (October, 2022), available here: https://www.esri.ie/system/files/publications/JR1.pdf.

[13] CSO, Survey on Income and Living Conditions (SILC) 2022 (22 February, 2023) indicated that that older people living alone are at highest risk of poverty of all households, available here: https://www.cso.ie/en/releasesandpublications/ep/p-silc/surveyonincomeandlivingconditionssilc2022/poverty/. The 'at risk of poverty rate' for all older people aged 65+ has almost doubled since 2020 (9.8% to 19%). This represents the highest increase of any age group.

[14] OECD, Government at a Glance 2021 Country Fact Sheet – Ireland, available here: https://www.oecd.org/gov/gov-at-a-glance-2021-ireland.pdf.

[15] OECD (2022), Taxing Wages 2022, available at: https://www.oecd.org/tax/taxing-wages-20725124.htm. Examples are based on a single individual without children at the average level of income.

[16] ESRI, https://www.esri.ie/sites/default/files/media/file-uploads/2020-01/Slides_1.pdf and https://www.esri.ie/news/irish-tax-system-does-most-in-europe-to-reduce-inequality. ESRI mentions the report in the presentation, I need to locate this report, but the message is clear and in line with TSG, OECD, and IMF views.

[17] IMF, IMF Country Report No. 22/214 (2022) – Ireland, available here: file:///C:/Users/tatkelly/Downloads/1IRLEA2022002.pdf.

[18] DoF, Economic Context for Taxation Policy, Tax Strategy Group –22/01,July, 2022, available here: 1290b2b7-ac4a-4127-ac46-a21b8e22549c.pdf (www.gov.ie), p. 11.

- A progressive personal tax system also tends to collect more taxes than flat taxes or regressive taxes, as the highest percentage of taxes is collected from those with the highest incomes. [19]

Disadvantages

- Critics of progressive personal taxes may consider them to be a disincentive to success (i.e., disincentive for getting a job that pays a higher wage).
- While the progressivity of the personal tax system is positive from an equity perspective, it can result in a narrow income tax base (see our response to Question 1 regarding the broadening of the tax base).

Discussion and our views

While the progressivity of the personal tax system can appear positive from an equity perspective, it can result in a relatively narrow tax base. In 2018 (the latest year for which data is available) c.25% of top earners paid over 80% of all Income tax. The latter numbers demonstrate an overreliance on a small proportion of high earners (similar to concerns raised in the context of the corporation tax receipts). Overall, high personal tax rates coupled with such allocation of tax collected from a small group of top earners could act as a disincentive to inward investment by multinationals and indigenous growth by Irish businesses. Similarly, we must be cognisant of the increasing costs for smaller businesses and the rising cost of living pressures experienced by those on low and middle incomes, and an equitable tax system would in our view require those on higher salaries to pay a greater proportion of the tax take. In our view, a well-designed personal tax system would require contributions from all taxpayers, with built in safeguards such as tax credits, rate bands and welfare receipts to ensure that those on lower incomes are guaranteed a good quality of life.

We also cannot ignore global trends such as digitalisation and globalisation, which allow entities and people to become increasingly mobile, and which could erode the personal tax base in the longer term. [20] With these matters in mind, and to ensure that the overall tax yield is maintained and continues to provide a sustainable and stable source of revenue to the Exchequer to fund public services,[21] our view is that a sustainable taxation system should remain progressive but with a focus on widening the tax base as a whole, with a view to shifting towards less distortionary taxes as per our response to Question 1. In light of such concerns, serious consideration should be given in future Budgets to enhance and amend the existing personal tax regime to achieve a top combined rate of tax which is not in excess of 50% (through our two key recommendations contained in our response to Question 1) and to move away from high taxes on labour which disincentivise growth.

[20] e la Feria, R. and Maffini, G. (2021) The Impact of Digitalisation on Personal Income Taxes, British Tax Review 2, 154-168.

[21] While there is always a scope to increase tax on higher earners, aiming at providing a comprehensive system of quality public services in Ireland may also require more earners to pay more tax and social insurance too.

Question 4:

Do you think the personal tax system operates as an effective means of income redistribution?

Summary of key messages

- The application of high rates of tax on income (at relatively modest levels when compared to other countries) acts as an effective redistribution mechanism.
- The redistribution of income via the personal taxation system should also be fair and equitable and not regressive.

Personal taxes form the core of the Irish tax system. It supports the redistribution of resources within the State and influence behavioural changes (see our response to Q1). Redistribution of income includes the transfer of income from some individuals to others through a social mechanism such as taxation, welfare and public services. An objective common to both the taxation and welfare systems is to redistribute market incomes to achieve greater equality and prevent poverty.

The redistribution of income can only occur after a successful collection of taxes. However, at times of fiscal pressure, despite our personal taxation system already being recognised as highly progressive, there could be limits to how far redistribution can go without impacting our competitiveness and the labour market. It is important, therefore, to have regard to the full range of policies that affect the distribution of incomes, rather than limiting the focus on the taxation system alone as an effective means of income redistribution. To be more impactful, redistribution of income via personal tax system should be accompanied by corresponding measures by the welfare system, educational and other systems.[22]

The application of high rates of tax to income (at relatively modest levels when compared to other countries) does act as an effective redistribution mechanism.

The redistribution of income via the personal taxation system should also be fair and equitable and not regressive. As noted in previous responses, data in respect of taxpayers indicates an overreliance on a small proportion of high earners. Such a regime could be perceived as "high" and "unfair" by this group of taxpayers. Accordingly, if there is a perception that such redistribution favours only some people or that contributors receive very little or nothing in return for their contributions (i.e., access to public services, housing, infrastructure etc.), a negative reaction may occur from such contributors (as we discussed in our reply to Question 3 on the progressivity of taxation), including leaving Ireland.

Question 5:

What are the key areas in the personal tax system for future policy consideration?

Summary of key areas

While a number of key enhancements have been noted at question 1 above, we have summarised the key areas for future consideration below:

- Continuous focus on tax rates, bands and credits (with a view to ensuring that the top combined rate of tax does not cross 50% across income tax/USC and PRSI. Levers such as an intermediate rate of tax, higher standard rate cut off point and a reduction to the higher rate of personal tax may be considered (as outlined in our response to Question 1).
- Merging income tax with USC to provide greater clarity to workers and employers.

[22] Despite a strong and progressive income growth over the past three decades in Ireland, there are still groups of individuals and households who experienced the highest rates of at risk-of-poverty, deprivation and consistent poverty. These groups are lone parents and their children and working-age adults with disabilities and their children and older people (65+) living alone. See ESRI, POVERTY, INCOME INEQUALITY AND LIVING STANDARDS IN IRELAND: SECOND ANNUAL REPORT (October, 2022), available here: https://www.esri.ie/system/files/publications/JR1.pdf. Also, CSO, Survey on Income and Living Conditions (SILC) 2022, available here: https://www.cso.ie/en/releasesandpublications/ep/p-silc/surveyonincomeandlivingconditionssilc2022/poverty/.

- No increase in employer PRSI and consider opportunity to reduce the cost of employments for employers over time.
- Amend rules to allow for deductions in respect of genuine employment and business-related expenses.
- Enhance SARP relief to make it easier to access, to remove certain administrative conditions, making it available for new hires, extending the relief to 10 years and allowing relief for USC and PRSI purposes.
- Ireland's SARP regime needs to be reconsidered from an international competitiveness perspective, which we would be pleased to discuss further with the Department of Finance, including assessing the competitiveness of the current earnings ceiling.
- Enhancements to FED by moving to a territorial system of taxation.
- Enhancement to certain travel and subsistence expenses relief for temporary inbound assignees.
- Expansion of KEEP to all companies, and enhancement of the relief in terms of the treatment of shares with CGT treatment applying on disposal.
- Enhance the APSS rules by increasing the threshold from €12,700 to €25,000 and allowing relief for USC and PRSI purposes.
- Removal of the first two awards restriction on the Small Benefit Exemption.
- Enhancement of the R&D tax credit regime to provide greater personal tax benefit to employees involved in appropriate R&D activities.
- Maintain tax relief for medical expenses.
- Reduce overreliance on personal taxes by considering a gradual broadening of the tax base in the medium to longer term, with a focus on less distortionary taxes.
- Consider fixed period tax breaks to assist certain sectors (i.e., construction workers and those in under supported industries such as agri-food and fishery).

Finally, one aspect of the personal tax system that does give rise to a lot of complexity in practice is the funds regime. It is difficult to say with certainty whether an investment is within or outside the regime. Also, it can be a barrier to mobility. For example, the eight-year anniversary deemed disposal rule can act as a barrier to an expatriate with an investment portfolio relocating to Ireland. Serious consideration should be given to removing this part of the Taxes Consolidation Act with the same treatment to apply as applies to other share investments (dividend treatment, CGT etc). This would not have any material impact on yield.