



Debunking Irish income tax myths

**An analysis of the taxation of income in
Ireland**

September 2014

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Key findings on taxation of income in Ireland

1. Ireland is not a low income tax country: Despite regular claims to the contrary, Ireland is not by any measure a low income tax country. Since 2010 Ireland has experienced a sharp jump in taxation of personal incomes as a percentage of national income, rising from 8.7% to 11.6%, well above the EU average of 9.5%. This rise has seen Ireland become the 5th highest tax jurisdiction for personal incomes in the EU. Our tax rate on personal incomes is now the equivalent of over €3 bn in personal income taxation above the EU average, in proportionate terms.

2. Over half of all taxpayers would benefit from a cut in the marginal rate: Recent analyses which have suggested that only 17% of income taxpayers pay tax at the marginal rate and that the average tax rate is only 14.1% are both factually incorrect and technically flawed. Our analysis of the 2012 Revenue data shows that about half of Irish taxpayers pay tax at the marginal rate; while in the region of 54% of taxpayers are within the equivalent of two hours a week in overtime of entering the marginal rate.

3. The Irish tax system is highly progressive and redistributive in a European context: The Irish system of taxation and benefits is designed to be highly progressive and redistributive. According to the OECD our income tax system is the most progressive in the developed world. An earner at 167% (€54,442) of the average wage has an effective tax burden 19.3 percentage points higher than one at 67% (€21,842) of the average wage. Ireland's tax and transfers system reduces the Gini coefficient of measured inequality by 35%, compared to an EU average reduction of 15.7%, making it the most redistributive in Europe. The progressivity of the Irish tax system is based largely on a narrow income tax base (almost 38% of tax cases are functionally exempt from income tax) along with low levels of tax for those on lower incomes and Northern European style tax levels for those on medium to high incomes. This has important effects for post-tax income inequality and also work incentives.

4. Middle and high earners pay the vast majority of all taxes collected and have contributed most during the crisis: Inclusive of income tax and the USC, a single person will not reach an effective tax rate of 5% until over €20,000 in income. At the top end of the scale, the average effective tax rate for a single-income earner (based on Revenue data) including income tax, USC and employee PRSI is 43% with a sharp shift upward in effective tax rates at the entry point to the marginal rate of tax. The top 1% of all income tax cases in Ireland earn 9.1% of income and pay 30.4% of the taxation, the top 5% pay almost 55% of all taxation from 22.7% of the income. In effect this means that those persons or households with over €100,000 in income account for over half of all income tax paid, underlining the extreme redistributive effects of the Irish tax system.

5. Low earners pay less tax than the OECD average but at the average wage and above Irish tax rates are relatively high: Ireland is a low income tax country at lower than average earnings (€32,600 and under). For earners above this level, however, Ireland is a high tax country compared to the rest of the developed world. At earnings of 120% of the average wage or just above €39,000, Ireland surpasses the OECD average effective income tax rate. Our analysis shows that, in particular, those people earning from around €39,000 upwards pay a disproportionate share of tax and are taxed higher than their OECD counterparts. By 250% of average wage (€81,500) Ireland has the sixth highest average income tax rate in the OECD at 34.6%, five percentage points higher than the OECD average.

6. There are a number of unique features to the Irish tax system which provide a clear disincentive to work: There are a number of unique features in the Irish taxation system which provide a disincentive to work for Irish people and skilled employees from abroad. The largest of these is the high marginal tax rate we have at modest wages. For example, a skilled graduate moving from gross pay of €20,000 to gross pay of €60,000 over the first ten years of their career will see an increase of annual net pay of just €22,888 in Ireland; the same person in the UK would see an equivalent increase of €30,287 a difference of €7,399. Skilled graduates would be better off by over €5,000 annually working in the UK if given a choice between working in Ireland or in the UK over the years in their career in which earnings growth is highest. The latest emigration statistics showing three-quarters of all emigrants since 2009 were either employed or recent graduates (with only 20% unemployed) suggest that this effect on earnings and career progression may be more important than employment in decisions to emigrate among skilled employees.

Ibec recommendations for reform

1. Lower the marginal rate of tax and increase the entry point: The marginal tax rate decreases the incentive to work at the margin. In addition it kicks in at a level which is amongst the lowest in the OECD (barring some flat tax regimes). This means that Irish workers at modest wages are paying more tax than their OECD counterparts and it is costing companies more and more to reward employee performance. The marginal rate of tax should be reduced below the 50% threshold over time, beginning in the upcoming budget. Additionally, the entry point to the higher rate of tax should be raised over time so that workers are not paying the top rate on modest wages.

2. Smooth out kinks in the PRSI system: Ibec has previously drawn attention to the fact that the abolishment of the PRSI allowance of €127 per week has amplified an existing kink in the tax system, where an increase in gross pay at certain levels actually results in lower net or take-home income. Someone on €18,300 per annum now receives €17,340 in take-home pay following all taxes and levies. The same individual earning €18,400, however, will see their net pay drop to €16,677 as they cross the hard eligibility threshold for the 4% rate of employees PRSI which applies to all income. This means that a person earning €18,300 will have to earn an extra €1,065 (€19,365) before they receive an extra euro of take-home pay. This anomaly has a disproportionate impact on people at these income levels and also impacts on employers by effectively entirely disincentivising the take-up of overtime work at these income levels.

3. Equalise USC for self-employed: The USC surcharge for the self-employed is an anachronism when government is trying to encourage entrepreneurship elsewhere in the tax system and should be allowed expire at the end of 2014. The marginal rate of 55% for entrepreneurs' disincentives people from entering self-employment, starting up their own business or expanding relatively small operations. With multiple schemes operating to try to encourage self-employment this USC surcharge is likely to have both significant deadweight loss on its own but additionally adds to deadweight loss from other schemes.

4. Set out a long-term vision for taxation in Ireland: As part of a 'post-BEPs¹' strategy the Government should set out a long term vision for Irish taxation. Our income tax system has become burdensome when compared internationally with effects both domestically and in our ability to attract and retain skilled workers and investment. This vision on taxation should allow for clear and substantial discussion on changes over the long-term in how the tax system in Ireland operates with a focus on reducing the burden of taxation on work.

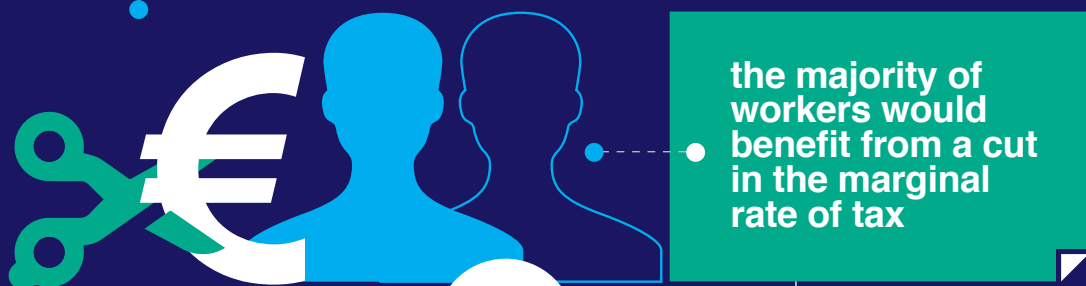
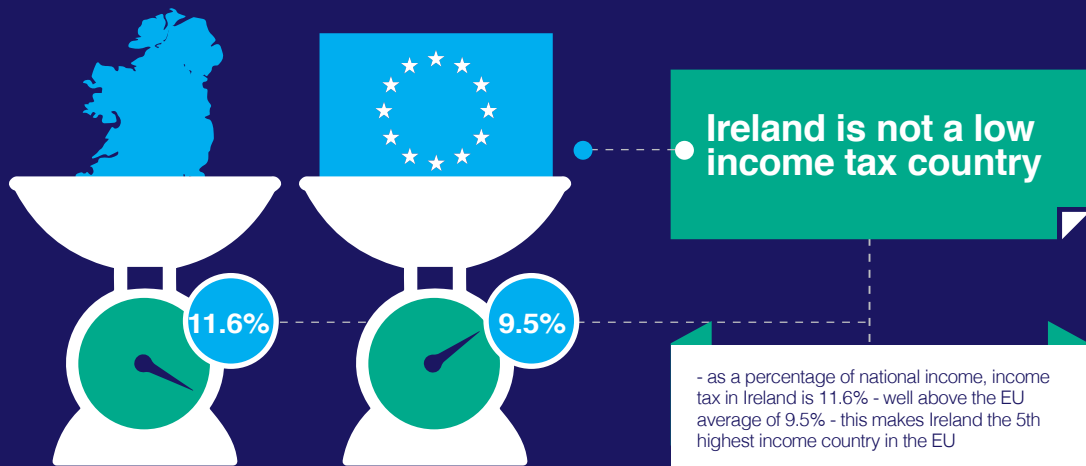
5. Shift the burden of taxation away from labour: Income taxes grew from 28.7% of the overall tax take in 2007 to 42.6% in 2014; this is disproportionate in the European context. Taxation of earned income disincentives work and creates barriers to a better functioning labour market and economy – our radically progressive tax system has now reached a tipping point in this regard. Recent work by the Department of Finance (O'Connor, 2013) and the OECD (2010) have shown that there are significant positives from the point of view of economic growth and employment by moving the burden of taxation away from earned income and onto less productive or unproductive areas such as immovable property or user charges. This switch would have the added benefit of retaining the progressivity of the overall tax system. It would also be simple and efficient with minimal impact on economic transactions, spread the tax base more evenly whilst also being less volatile than previous taxes on property transactions. Additionally, it would encourage investment in areas of the economy with a higher value-add.

¹ Base Erosion Profit Shifting initiative by the OECD to review the taxation of multinational corporations.

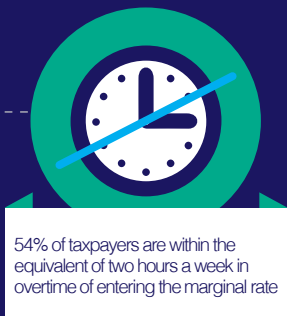


Debunking Irish Income Tax Myths

An analysis of the taxation of income in Ireland

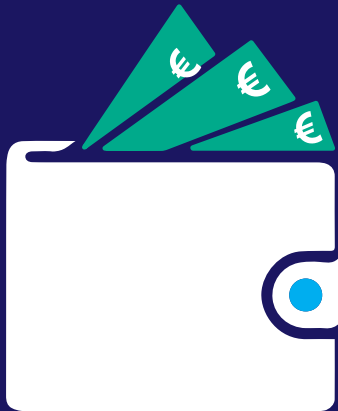


Our analysis shows





Ireland's income tax system is the most progressive in the OECD



Middle and high earners pay the vast majority of all taxes collected and have contributed most during the crisis



The top 1% of all income tax cases in Ireland earn 9.1% of income and pay 30.4% of the taxation

The top 5% pay almost 55% of all taxation from 22.7% of the income



Low earners pay less tax than the OECD average but at the average wage and above Irish people pay tax rates which are relatively high:

Our analysis shows



People earning from around €39,000 upwards pay a disproportionate share of tax and are taxed higher than their OECD counterparts.



By 250% of average wage (€81,500) Ireland has the sixth highest average income tax rate in the OECD at 34.6%, five percentage points higher than the OECD average.

1. Introduction

Over the past number of years the topic of taxation, of who pays, has been to the forefront in the public discourse. In its policy campaign 'An Ireland that works' Ibec recognised that although it was necessary to broaden the tax base and increase some taxes over the past seven years, tax hikes have gone too far and are restraining the nascent recovery in the domestic economy. This is particularly true when it comes to the increasing burden of taxation on earned incomes.

This document begins by setting out to establish the basic facts about taxation of income in Ireland. The following sections describe the Irish taxation system in broad terms using stylised models and international data. We examine income and taxation distributions in Ireland using actual tax collection data from Revenue and their development over time. We also examine the claim that Ireland is a low tax country using OECD data to compare our tax system with those of other developed countries.

Our research shows that the Irish income tax system is one where the burden is borne disproportionately by middle and higher income earners. Higher earners pay significantly more than their share of income with the top 5% of all tax cases paying over half of all tax. As a result Ireland has a highly progressive, highly redistributive tax system; one which is uniquely so in a European context. The results of international comparisons show that claims that Ireland is a low tax country are only true for lower income earners with Irish middle and high income earners paying average or above average taxes.

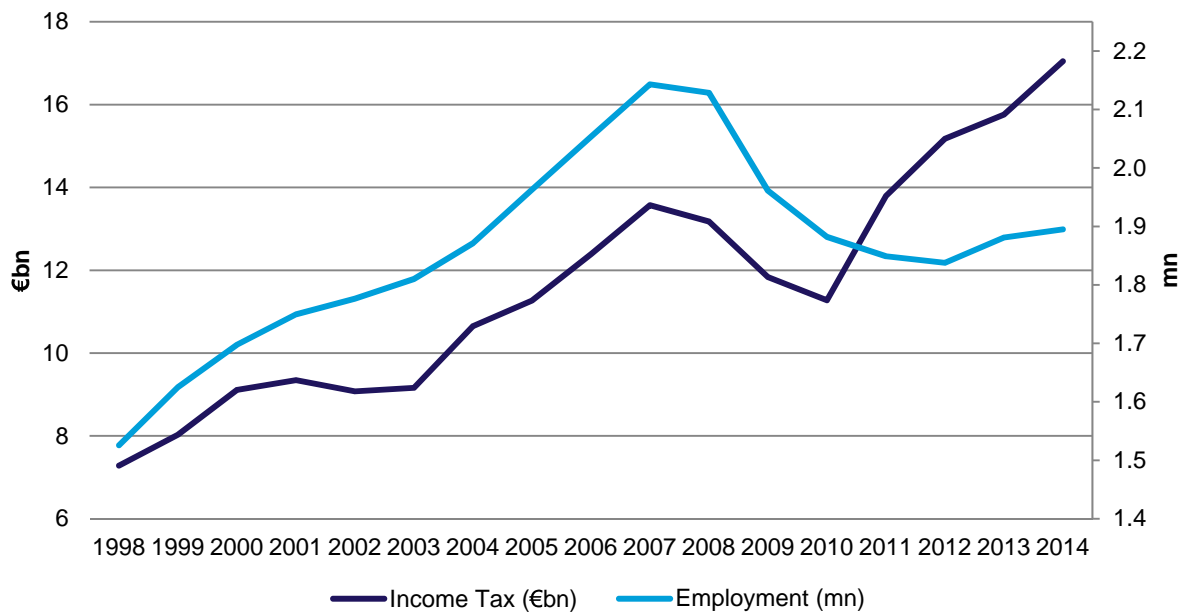
Finally, we provide a discussion on how the Irish tax system could be improved for workers, business and the economy and provide specific policy recommendations in that light. Our suggestions of increasing the entry point to the marginal tax rate and lowering the marginal tax rate would put money back in the pockets of in the region of 650,000 tax-paying individuals and households; half of the tax-paying individuals and households in the country; additionally another 50,000 individuals and families would be able to take on more overtime without hitting the higher rate of taxation.

2. Changes in taxation during the crisis

In the years between 2007 and 2011 employment in Ireland fell from a high of 2.14 million people to a level of 1.84 million. Despite the sharp upturn in employment since the second half of 2013 there are still 268,000 less people in employment than there were at the height of the boom, a drop of 12.3%.

Despite this, receipts from income tax, excluding the USC, are up over 25.5% over the same period, meaning income tax receipts are up €3.5 billion on where they were at the height of the boom. This has meant that an increasing burden of income taxation has been shifted onto fewer taxpayers.

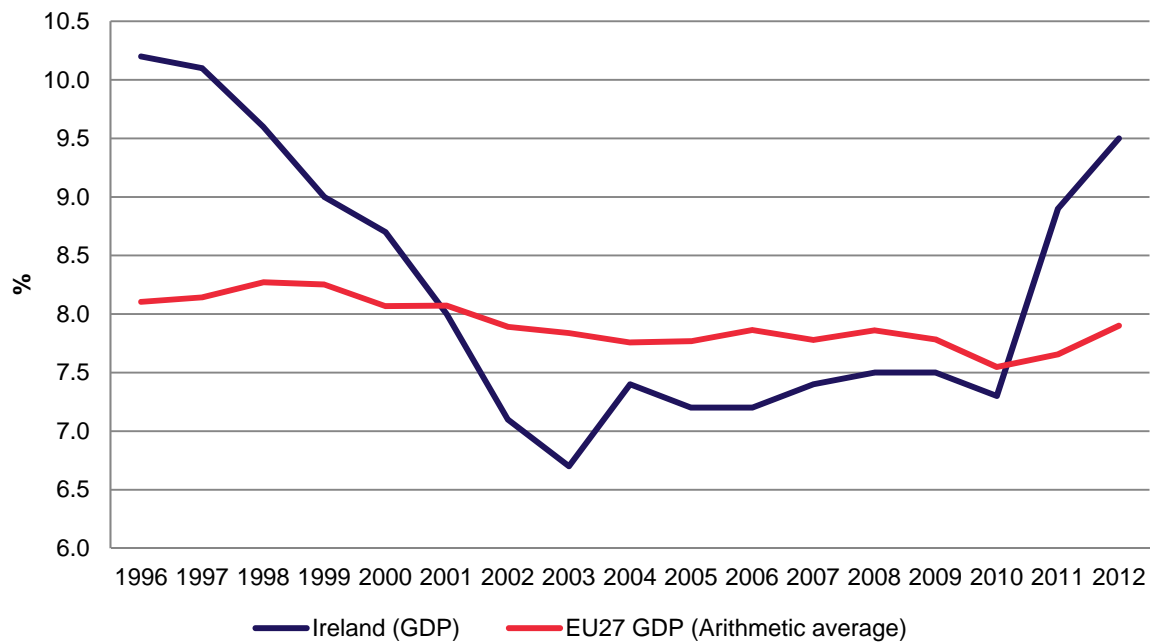
Figure 1: Income taxation and employment



Source: Department of Finance databank

Despite the introduction of the property tax, various levies and increases in consumption taxes in the past six years, income tax has actually grown as a share of overall taxation with the majority of extra tax collected over the period coming from income. Income taxes grew from 28.7% of the overall tax take in 2007 to 42.6% in 2014. Some of this shift reflected the need to broaden the income tax base, and falling income from other sources, but it also reflected the rising effective tax burden on work.

Figure 2: Taxation of personal and household incomes, % of GDP

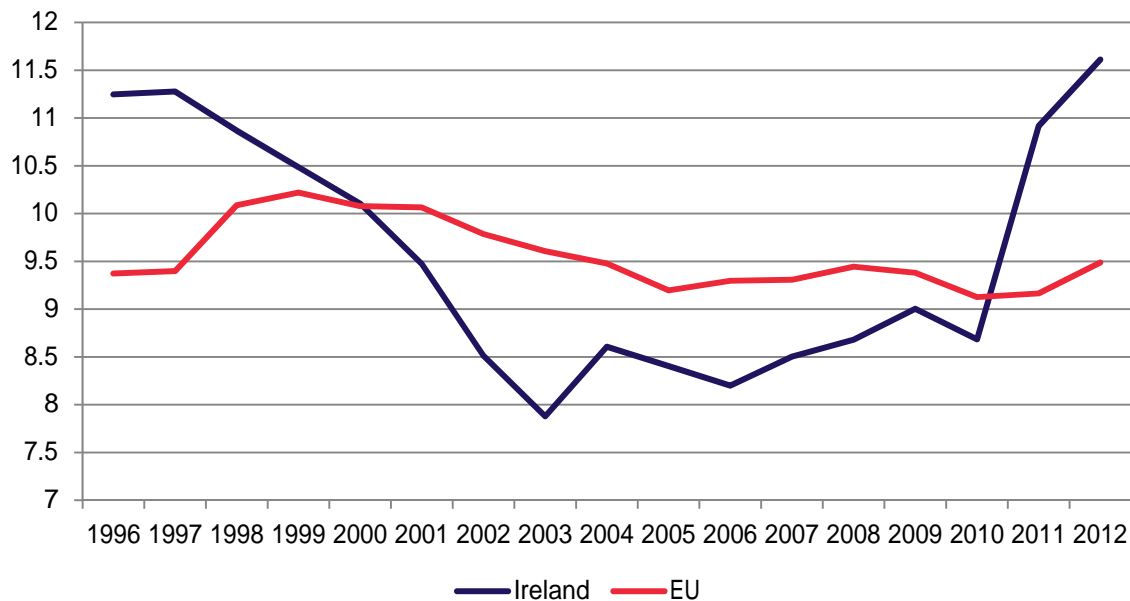


Source: Eurostat

Taxes on personal income show Ireland as an average to high income tax country over the years between 1996 to 2012. Despite falling below the EU average from 2001 to 2010, Ireland's taxation of personal income as a % of GDP is now, at 9.5%, significantly higher than the EU27 average of 7.9%.

Due to the well noted effect of multinationals on Irelands GDP figures, alongside the fact that taxes on income are not levied on net factor flows (the difference between GDP and GNP), looking at tax as a proportion of GNP may be a more appropriate comparator

Figure 3: Taxation of personal and household incomes, % of GNP



Source: Eurostat

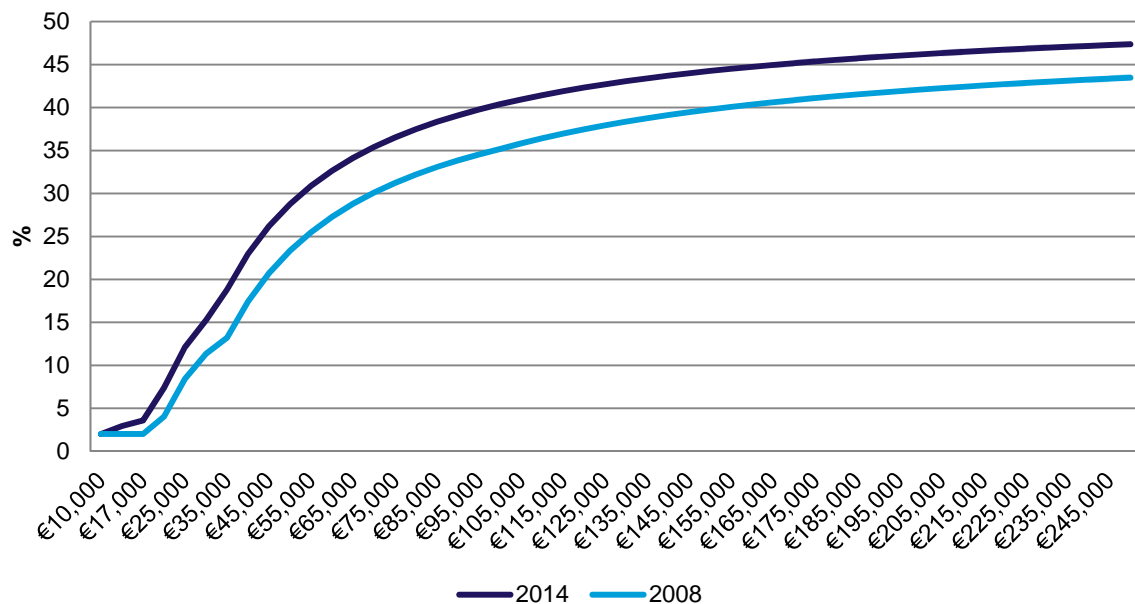
On a GNP basis, Ireland has experienced a sharp jump since 2010. Taxation of personal incomes as a percentage of GNP has risen from 8.7% to 11.6% well above the EU average of 9.5%. This rise has seen Ireland become the 5th largest taxer of personal incomes as a proportion of national income in the EU. Our tax rate on

personal incomes is now 2.1 percentage points greater as a proportion of national income than the EU average the equivalent of over €3 bn in personal income taxation in Ireland last year in proportionate terms.

At a more disaggregated level, we can use some stylised examples to examine how the changes to income tax affected tax rates and take-home pay for individuals in the period between 2008 and 2014. This will allow us to examine how policy changes over the period affected a hypothetical single earner in a clear, consistent and timely way whilst including all taxation of income such as the USC, PRSI and income tax.

There are some well-noted drawbacks to using stylised tax models (such as are used here or by the OECD) when looking at tax changes. Chief among these is that they are not representative of the whole of society only those tax cases to whom the hypothetical tax case applies. In this case a single income earner is representative of 60% of the tax cases in the country which gives us a broad overview of the effect of changes. Additionally, it is difficult to adjust for hypothetical tax credits which can be claimed in these examples (such as for pensions and health insurance) and as such we present effective tax rates before allowances in this section. We address this in more detail in Section 3 of this publication where we supplement this analysis by looking at actual tax return data from Revenue which allows us to look at the data for different types of taxpayer after any additional tax credits have been claimed. As such the data in this section should be viewed as the maximum effective tax rate i.e. tax before credits excluding the PAYE and single person credit.

Figure 4: Maximum effective tax rates for single income earners

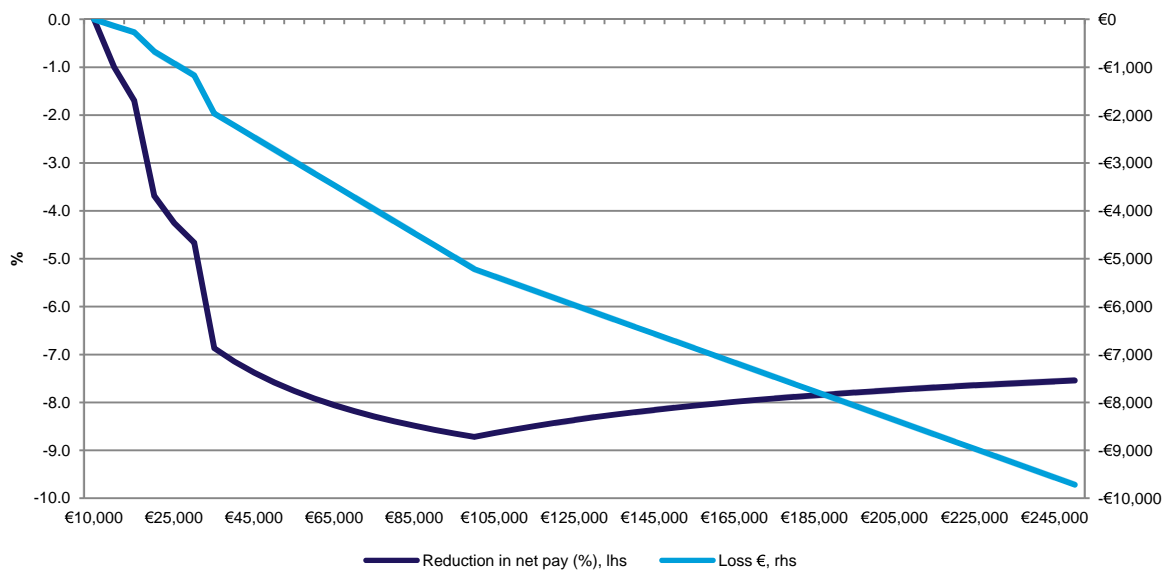


Note: Inclusive of income tax, employees PRSI, the USC and other levies.

Source: Ibec calculations based on single person aged below 65.

Changes to taxation of income since 2008 have led to increases in effective tax rates for all classes of income earners. The effective tax rates on income in 2014 range from 2% for someone earning €10,000 up to 47.4% for someone earning €250,000. For brevity, we include earners up to €250,000 (99.8% of single income earners) but these tax rates continue to rise as we go up the earning spectrum, with a single income earner, hitting an effective tax rate of 50% at €535,000. The change in effective tax rates over the period 2008 - 14 was highest amongst those earning between €35,000 and €100,000 with the largest increases from €35,000 to €60,000 due to falls in the entry point to the marginal rate of tax affecting this earnings group disproportionately. The maximum effective tax rate for a single person earning €35,000 rose from 13.2% in 2008 to 18.8% in 2014.

Figure 5: Decrease in net pay due to tax changes, 2008 – 2014



Note: Inclusive of income tax, employees PRSI, the USC and other levies.
Source: Ibec calculations based on single person aged below 65

Analysis of the loss of take-home pay for a single income earner in the years between 2008 and 2014 shows that in real terms higher earners paid the most. An earner on €100,000 would have lost €5,216 in their annual net pay compared to a loss of less than a euro for a person earning €10,000. The increase in loss of take-home pay is fairly steady across the earnings distribution apart from some noticeable kinks around entry point to new taxes but in broad terms those who have more have lost more from tax changes both in proportionate and nominal terms. One issue which is evident from the data, however, is that in proportionate terms those upper middle income earners between €65,000 and €100,000 per annum have been hardest hit.

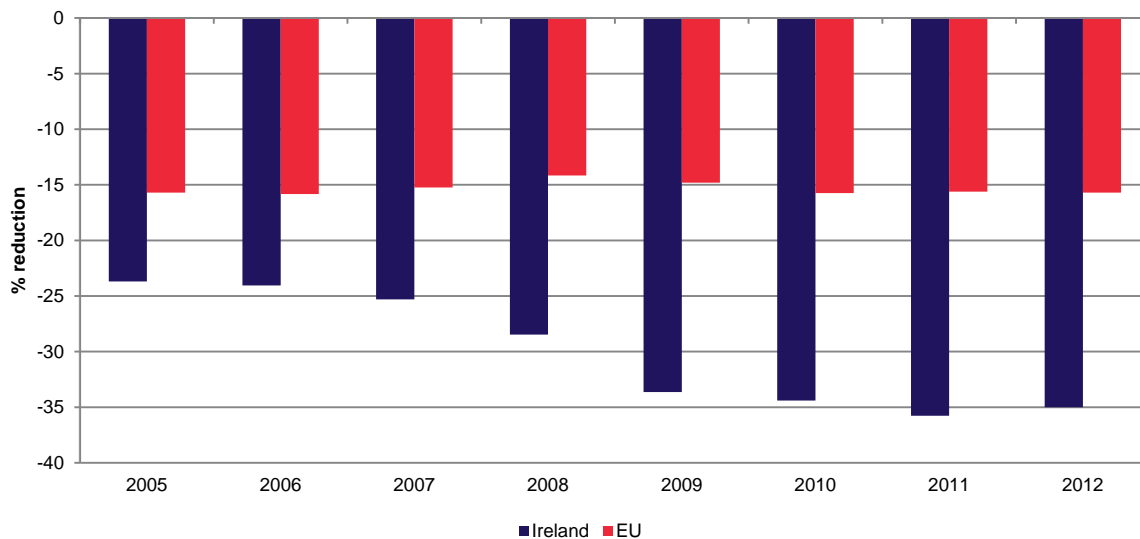
3. Income tax in Ireland: Who pays?

3.1 Progressive by design

The Irish system of taxation and benefits is designed to be highly progressive and redistributive. Indeed, according to the OECD our income tax system is the most progressive in the developed world. The OECD method of judging the progressivity of the tax system is to compare the tax due by a single person on 167% of average income with that payable on 67% of average income. Under this measure Ireland has the most progressive tax system in the OECD with the high earner having an effective tax burden 19.3% greater.

The progressivity of the Irish tax system is based largely on the low level of income tax for those on lower incomes added to Northern European style tax levels for those on medium to high incomes (see Section 4); with important effects for post-tax income inequality but also work incentives. This is added to by the fact that, although it has been broadened in recent years, we continue to have a very narrow tax base with large sections of income earners (38%) functionally exempt from income taxation. This is unique in Europe and has led to our tax and transfers system being the most redistribute in Europe and the most successful at reducing inequality.

Figure 6: % reduction in inequality due to tax and transfers system



Source: Eurostat, SILC

Ireland has the highest level of earnings inequality in Europe before social transfers. This is primarily due to high levels of household joblessness and low work intensity which have been shown by NESF and the ESRI to be much higher than our European counterparts, including those with much higher unemployment. Inequality in Ireland, however, is about the eurozone average after the tax and transfer system redistributes income. Ireland's tax and transfer system reduces the Gini coefficient of measured inequality by 35%, compared to an EU average reduction of 15.7%, making it the most redistributive in Europe.

The effect of this system on inequality can be seen particularly during the crisis years. Despite rising earnings inequality due to large increases in unemployment actual inequality post tax and transfers actually fell. The Gini coefficient of earnings inequality rose by 11% over the period 2008 to 2012; on the other hand actual inequality of disposable income fell marginally over the same period. This means that our tax and welfare system has actually become more progressive in effect since the beginning of the crisis.

3.2 The distribution of income and taxes

To pay for the highly redistributive nature of our tax and transfer system the burden of income taxation is heavily distributed toward the top end of the earning spectrum. The top 1% of all income tax cases in Ireland are responsible for 9.1% of the income and pay 30.4% of the taxation, the top 5% pay almost 55% of all taxation from 22.7% of the income. In effect this means that those persons or households with over €100,000 in income account for over half of all tax paid, underlining the extreme redistributive effects of the Irish tax system.

Table 1: Total distribution of income and tax

	Income	Cases	Tax %	Income %
Top 1%	€200,000+	18,741	30.4	9.1
Top 5%	€100,000+	99,129	54.6	22.7
Top 10%	€75,000+	199,802	58.1	33.9

Source: Revenue Statistical report 2012, Ibec calculations

Due to the fact that households and individuals pay tax at different effective rates it may be more informative to study the two groups separately. Among single earners the top 1% of earners earn 7.2% of all incomes but pay 17.5% of income tax with the top 5% - roughly those earning over €100,000 paying over 40% of income tax from 18.9% of the income. For married - two earner families, the top 1% is those with incomes over €200,000 with this group earning 8% of all incomes but paying almost 16% of the taxation. Those earning €100,000 or more jointly (two earners on €50,000 for example) constitute the top 5%. These couples earn 18.6% of all income in their group and pay a third of all taxes.

The large proportion of the tax paid by relatively small groups of high earners is a function of a tax system designed and functioning as the most progressive in Europe. This allied to the fact that 38% of tax cases are functionally exempt from income tax means that the total burden of taxation falls on 60% of income earners; in the case of married couples in particular this contains individuals on fairly modest earnings.

Table 2: Distribution of income and tax by family type

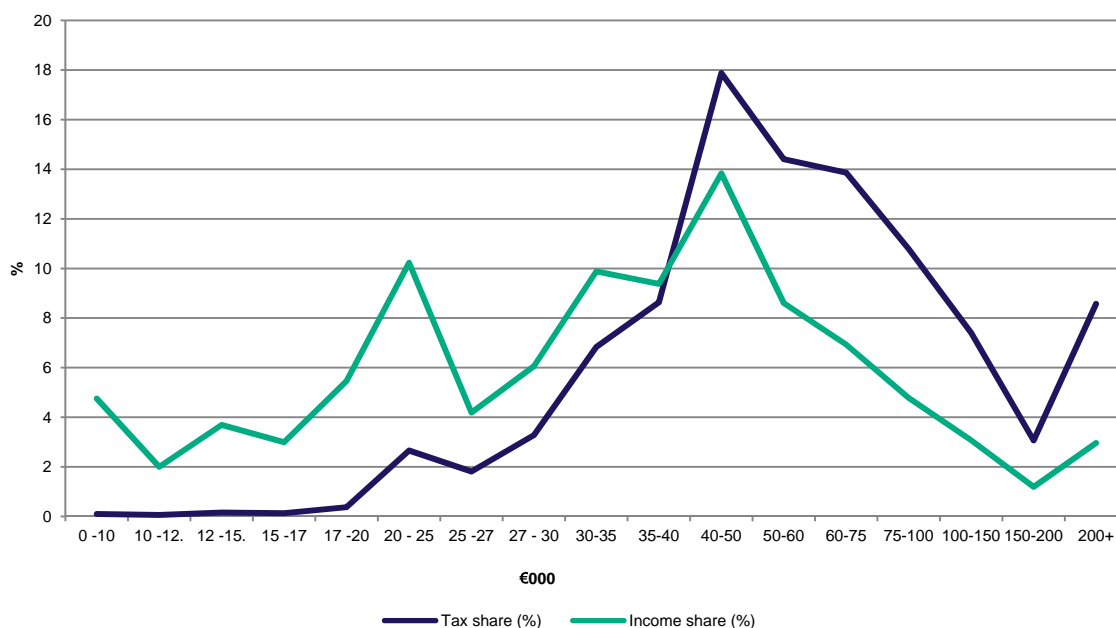
	Single		Married - two earner		Married - one earner	
	Income%	Tax %	Income %	Tax %	Income %	Tax %
Top 1%	7.2	17.5	8.0	15.8	11.0	23.6
Top 5%	18.9	40.9	18.6	33.7	26.5	52.5

Source: Revenue Statistical report 2012, Ibec calculations

Note: Numbers for single earners in top 5% actually reflective of top 5.7% due to data restrictions.

In a perfectly proportionate tax system individuals would pay according to their income a direct proportional share of taxation. Under a progressive taxation system, however, there are clear transfers of wealth from higher to lower earners. In Ireland a single income of more than €40,000 is the cut-off point in paying more taxation than their share of income, as such those with earnings under €40,000 are the effective beneficiaries of the Irish tax system. People earning between €40,000 and €50,000 earn 13.8% of total income and pay almost 18% of total taxation a difference of 4 percentage points. The difference between share of income and share of taxation is largest among those earning between €60,000 and €75,000 who pay 13.9% of tax from only 6.9% of total income, a difference of 7 percentage points. On the other hand those earning between €20,000 and €25,000 pay 2.7% in tax from a 10.2% share in income a difference higher on average by 4 percentage points than earners on less than €20,000.

Figure 7: Income and tax share (%) by income bracket of single earners



Source: Revenue Commissioners statistical report, 2012

From this analysis it is clear that Ireland has a highly redistributive tax and transfers system. Within the tax system itself those on single incomes of €40,000 or more pay more into the system than their share with those earning under €40,000 the effective beneficiaries in proportional terms.

3.3 Marginal and effective tax rates

Table 3 shows the distribution of earners by income tax band. Some recent discussion has suggested that only 17% of taxpayers pay the marginal rate of tax. This would rightly surprise many and is the result of misinterpretation of Revenue data. The problems with these analyses are twofold; firstly they conflate ‘tax cases’ with ‘taxpayers’; this is inaccurate and grossly misleading. Secondly, for no apparent reason a number of recent studies have mis-classified over 200,000 tax cases that pay at the marginal rate as paying at the 20% rate which renders their analysis and conclusions inaccurate.

A tax case is any individual with a taxable income; for example earnings from employment, self-employment, rent or leasing and other items such as occupational pensions. A taxpayer on the other hand is any person who effectively pays tax to the state i.e. any person whose tax liability is greater than their exemptions from tax. Table 3 shows that 17% of tax cases with a taxable income pay income tax at the marginal rate, however, our analysis shows that of taxpayers, those persons who actually pay income tax, half pay at the marginal rate.

It is clear from the table that a large proportion of income tax cases reported in the data are actually exempt from income tax. This arises because tax relief is now given by way of a reduction of tax chargeable and not as a deduction from income as was the position before 1999. For a large proportion of people (40%) this means that although they have a taxable income (and thus are a ‘tax case’) their reduction in tax chargeable is greater than their tax liability and they do not therefore pay income tax. As a result over 825,707 (40%) tax cases included in the data are not liable for tax at all². This is an increase of 5.2 percentage points from 34.9% in 2005 representing the narrowing of the income tax base in the last decade, although it is down on 2009 (44%) due to reductions in tax exemptions during the intervening period.

The figures suggest that 29% of taxpayers pay at the marginal rate with 68% paying at the lower rate of tax. This again is an underestimate due to a second problem with the data used. Previous analyses on the number of taxpayers at the marginal rate have relied on Table IDS17 from Revenue’s statistical report 2012. What previous

² For example a person with an annual income from an occupational pension of €17,900 constitutes a tax case as they have a taxable income but they do not pay tax as the tax exemption for a single pension is €18,000, thus they are not a taxpayer.

reports have failed to address is the fact that a proportion of the tax cases at the 20% income tax rate in Table IDS17 (and Table 3) include taxpayers whose nominal liability at 41% is fully covered by their tax credits³.

For example, for single income earners this would mean all taxpayers earning up to €40,000 would be included at the 20% rate in this Revenue data despite paying tax at the higher rate on their earned income. This group would, however, benefit from a reduction in the marginal tax rate or change in bands by a reduction in their pre-tax relief tax liability. From Revenue earner bands and standard rate cut off points, it is clear that 556,794 tax cases are in an income band with a minimum in excess of the relevant cut-off point for their household type. These households have a liability at the marginal rate of tax but have been disregarded in previous studies leading to largely inaccurate conclusions. We can say for sure there are over 200,000 tax cases in this group.

There are indeed more individuals who pay at the higher rate, who are classified otherwise, but due to the income bands on Revenue data it is difficult to estimate how many. For example a proportion of the single people in the earning band between €30,000 and €35,000 will pay at the marginal rate but it is only possible to give a range of estimates as to the size of this group. The maximum number in this category is 102,344 cases with the minimum being 0, however unlikely.

Given where the cut off points are placed within the bands on Revenue data a conservative estimate would be that 50% or 51,172 of these cases are above the standard rate cut off point and thus pay tax at the marginal rate. As such a conservative estimate of the number of tax cases at the marginal rate would be in the region of 607,000 or 49.6% of all taxpayers. A further 50,000 are within the same earning band as the higher rate of tax meaning the equivalent of two hours overtime a week at average hourly pay would put them into the top rate of tax. As such 54% of taxpayers would benefit either directly or in being able to take on a small amount of overtime from changes to the rate or bands of the marginal rate.

These figures are based on 2012 data but the share of people paying tax at the marginal rate will not have changed hugely since. In terms of total numbers, however, our estimates seem to be quite robust. Recent Revenue figures supplied in parliamentary question 34951/14 show Revenue estimate the cost of a 1% reduction in the top rate of tax in 2015 would be €164 million and benefit 700,000 individuals and households a full 300,000 more than suggested in some recent commentary.

Table 3: Distribution of tax cases by income tax band

Including exemptions							
	No. of cases	% of earners	Income €bn	% of income	Tax €bn	% of tax	
Exempt	825,707	40.3	8.67	12.2	0	0	
Marginal relief	32,830	1.6	1.5	2.1	0.13	1.2	
20%	836,149	40.8	29.37	41.2	2.77	25.6	
40%	354,931	17.3	31.70	44.5	7.92	73.1	
Excluding exemptions							
Marginal relief	32,830	2.7	1.5	2.4	0.13	1.2	
20%	836,149	68.3	29.37	23.8	2.77	12.9	
40%	354,931	29.0	31.7	14.5	7.92	19.7	

Source: Revenue Statistical report 2012, Ibec calculations

Recent studies have reported an average effective tax rate in Ireland of 14.1% based on Revenue figures as being indicative of a low tax economy. This, however, is based again on tax cases rather than taxpayers and does not take into account the dispersion of effective income tax rates around the mean. Ireland has a large dispersion around the mean in terms of tax data which needs to be interpreted in its proper context.

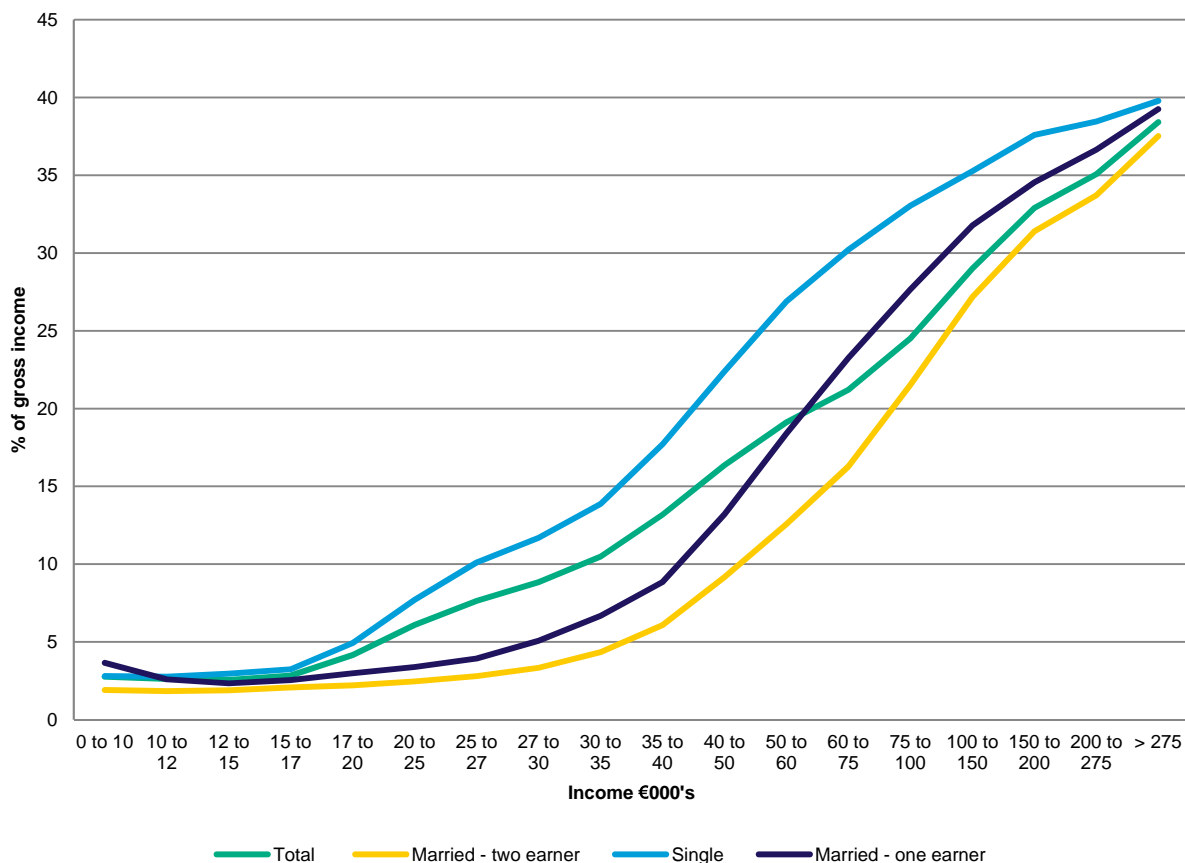
Firstly, tax cases are full year and as such income statistics will not be adjusted for time worked. The data include a large number of seasonal or temporary workers who may have worked for short periods during the year (e.g. students, summer workers and including persons who only joined the workforce late in the year or left early in the year). The data also include other incomes such as people/couples in receipt of occupational or personal pensions. These effects must be borne in mind when interpreting the figures as they skew the figures of cases among lower income earners upwards and thus average tax paid downwards.

³ A single person earning €40,000 would pay €2,952 in tax at the marginal 41% rate but as their standard tax credits (PAYE and single person) amount to €3,300 are not included in the data above as paying at the top rate

Secondly, as we have outlined, the number of income earners in the data with a taxable income is higher than the numbers who are effectively liable to tax. The effect of this on the average effective tax rate is particularly seen in that the effective tax rate is 0% for over 40% of tax cases skewing average tax rates downward. Another

Using Revenue data, Figure 8 displays the effective tax rates (inclusive of income tax and USC) of different household groups by income category. Inclusive of income tax and the USC, an earner will not reach an effective tax rate of 5% until over €20,000 in income. At the top end of the scale the average effective tax rate for a single-income earner including income tax, USC and employee PRSI would be in the region of 43% with a sharp shift upward in effective tax rates once an earner reaches the entry point to the marginal rate of tax.

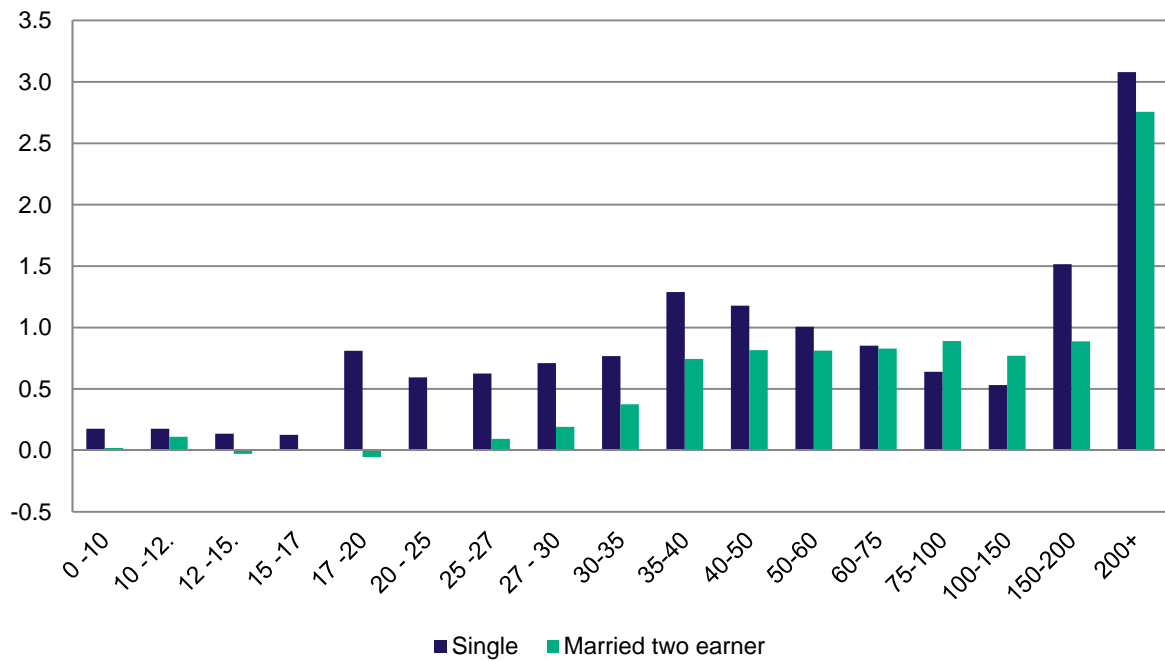
Figure 8: Actual effective tax rates of income tax and USC



Source: Ibec calculations from Revenue commissioner’s statistical reports

The clear dispersion of the income tax burden is best illustrated by the fact that a single person does not meet the average effective tax rate for all income earners until they are earning between €60,000 and €75,000; a level almost three times the average level of earnings (€25,504 – which is again skewed downward by temporary or seasonal workers). This shows the dispersion of the tax burden is weighed strongly toward the upper end of the earning spectrum.

Figure 9: Change in average effective tax rate by income groups 2008- 2011



Source: Ibec calculations from Revenue commissioner's statistical reports

In terms of the change since 2008 single income households have seen the largest increase in effective tax rates with single earners of over €200,000 seeing their average effective income tax rate increase by 3.1 pp. Single income earners between €35,000 and €60,000 have seen their average effective tax rates rise by between 1 - 1.5pp (€906) annually over the same period, while those earning less than €17,000 have seen their average effective tax rates rise by just over 0.1pp on average or €13 annually.

4. Is Ireland a low tax country?

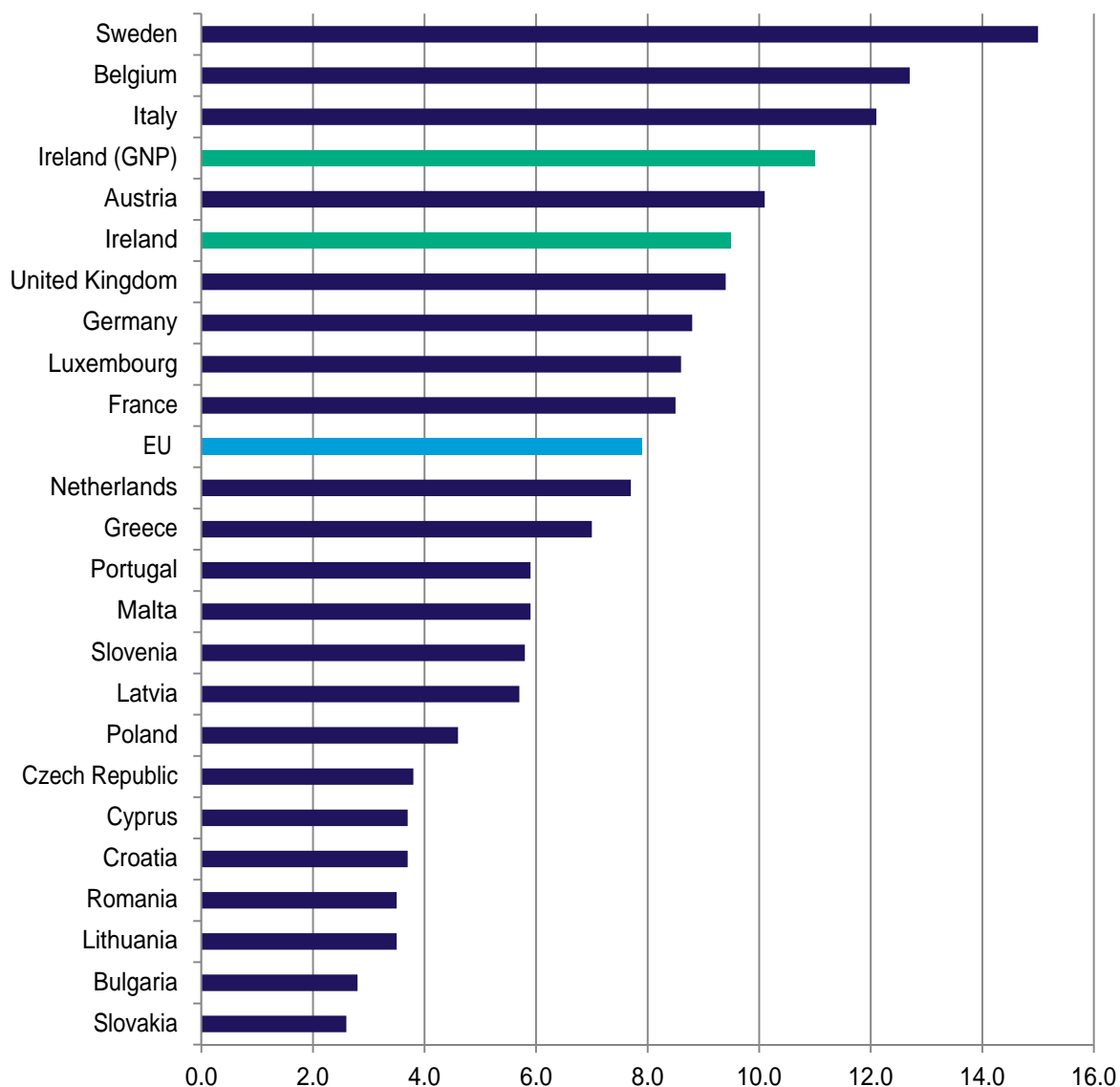
It has been claimed that Ireland is a low income tax country compared to our neighbours. In Section 2 we showed that Ireland as a proportion of both GDP and GNP levies more income taxation than most European countries and well above the EU average. The analysis in the following section shows that the aggregate is only part of the story. For average or below average earners Ireland is indeed a low income tax country. For those earning from just under €40,000 per annum (120% above the average wage), however, Ireland has levels of income tax which are well above the OECD average.

At first glance, Eurostat's tax figures seem to support the idea of Ireland as a low tax country. Ireland's revenue from personal income tax and social contributions amounted to €23 billion in 2012. That is an equivalent of 17.3% of GNP; five percentage points below the EU average (22.42%).

This comparison, however, is distorted by the fact that social contributions (PRSI) in Ireland are much lower than in other comparable countries. Cross-country comparisons of social contributions are complicated and not very enlightening given that the social contributions entitle individuals to different levels of provision in different jurisdictions. For example, many benefits, including pensions and healthcare, derived from social insurance in some countries are provided by the private sector in others. The best example of this is the UK where social contributions at 7.8% of GNP are higher than in Ireland 5.3%. Social contributions in the UK, however, fund the NHS system; as a result less than 10% of adults in the UK have private health insurance. In Ireland social contributions are marginally lower but 45% of the adult population have private medical insurance meaning the cost is eventually borne by companies and households elsewhere in the system and the cost to an employee is effectively the same. These kinds of anomalies exist throughout the social insurance system in Europe and mean that international comparisons involving social insurance are next to meaningless.

A much more meaningful picture evolves if we compare direct income taxation differences between jurisdictions. In Ireland the share of income tax in 2012 of GDP was 9.5% and 11.6% of GNP. Looking at the core income tax in an international context demonstrates that Ireland cannot be regarded as a low income tax country. Ireland has the 5th highest income tax ratio relative to GDP in the EU. Only Sweden, Belgium, Italy and Austria have higher ratios of income tax.

Figure 10: Tax on income as a % of GDP

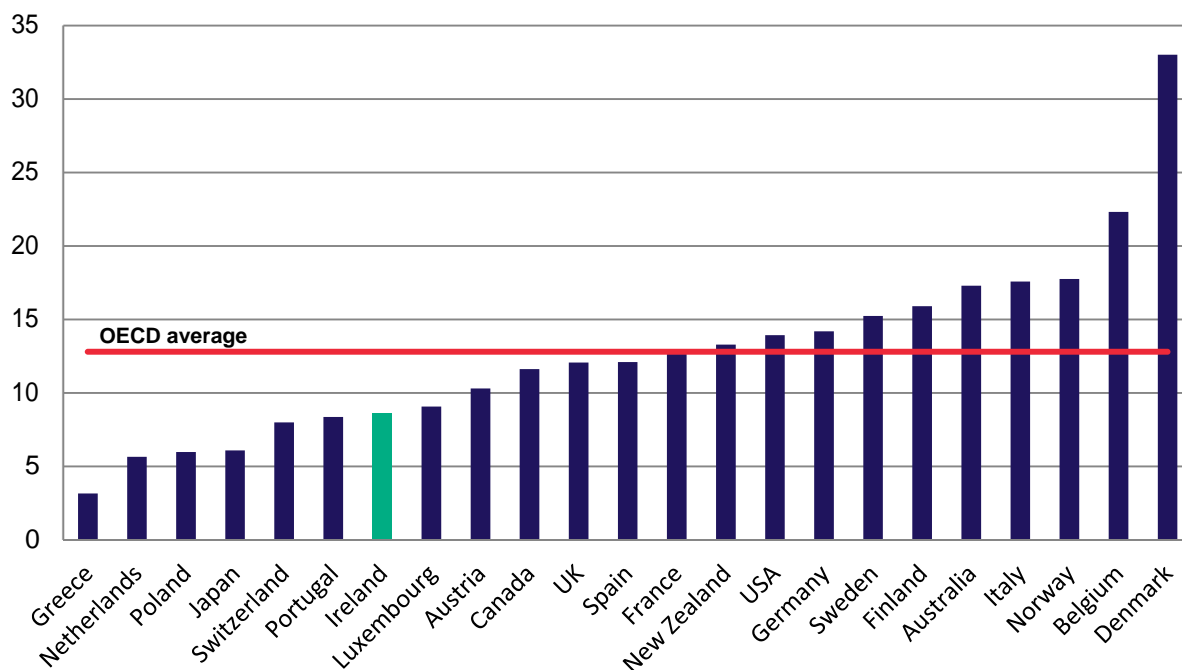


Source: Eurostat

We have shown above and in Section 2 that Ireland is indeed a high income tax country relative to the size of the economy. What we have also shown in Section 3 is that middle and higher earners in Ireland pay the majority of the income tax burden. Here we demonstrate that Irish middle and high income earners are taxed well above the OECD average despite regular use of misleading statistics referencing the average wage for single earners (€32,800) to claim otherwise.

The 'OECD Taxing Wages' data for 2013 allow us to compare Ireland's income tax excluding social security contributions with that of other OECD countries for different wage levels. Figure 11 shows the core income tax in percent of total income for different OECD countries at 67% of average wages for a single earner without children. At 67% of average wage the average income tax rate of the 23 OECD countries is 12.8%; Ireland's tax rate is 8.6% and it ranks the seventh lowest after countries such as Greece, Poland and the Netherlands. The highest income tax rate at 67% of the average wage is in Denmark with 33%.

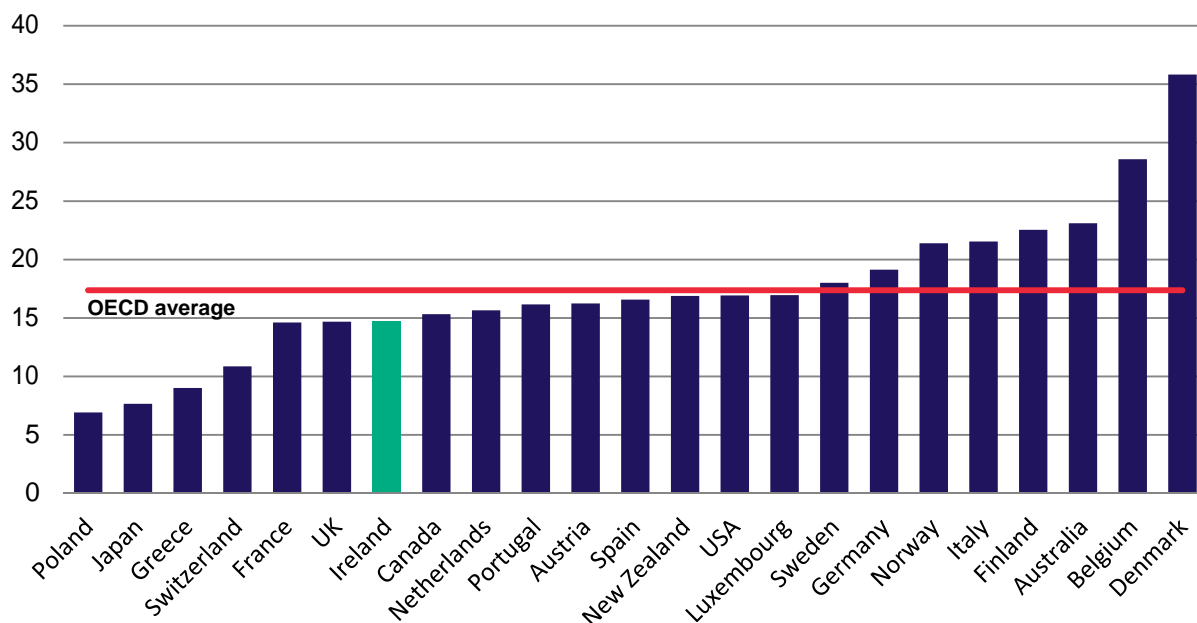
Figure 11: Effective income tax rate at 67% of the average wage



Source: OECD taxing wages

For a single person with 100% of average wage the average income tax rate in the OECD is 17.4%. Ireland's effective tax rate by comparison amounts to 14.7% and it remains the country with the 7th lowest income tax rate. Portugal and the Netherlands levy higher taxes, the UK and France are amongst the six countries with the lowest income tax rate at 100% of average wage.

Figure 12: Effective income tax rate at the average wage



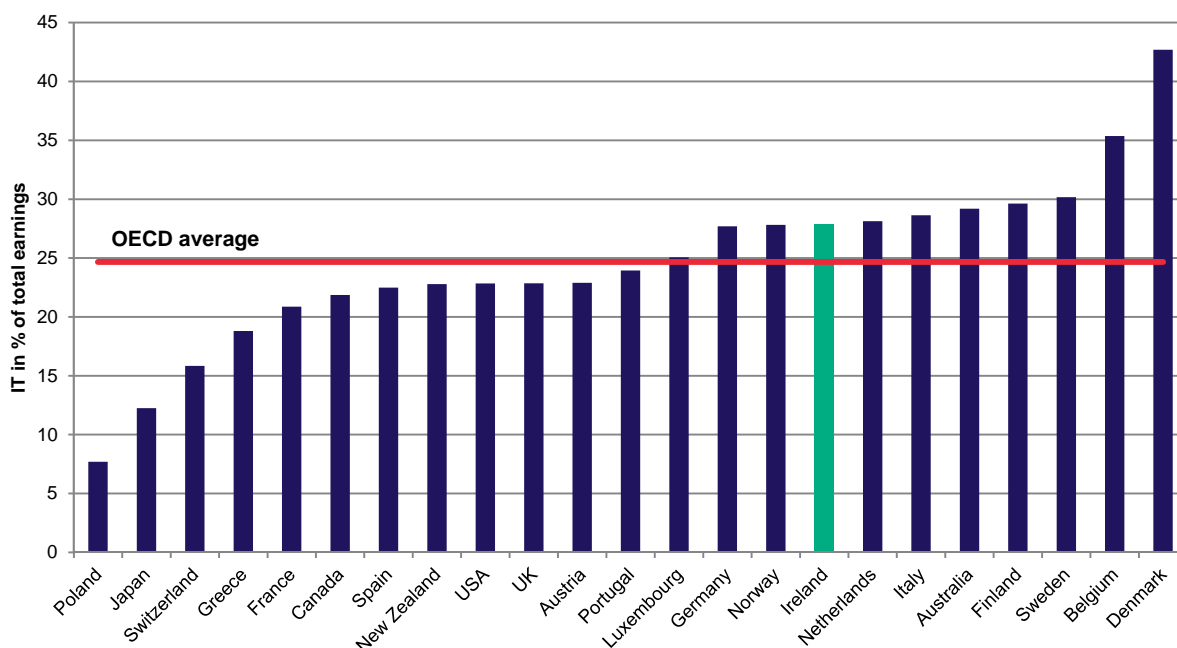
Source: OECD taxing wages

At incomes above the average wage Ireland changes from a low tax to a high tax country. At earnings of 120% of the average wage or just above €39,000 Ireland surpasses the OECD average effective income tax rate. The effective income tax rate for a person earning 167% of average wage, which for a single Irish earner without

children in 2013 was equivalent to €54,076, is 27.9%. This rate is higher than the OECD average of 24.7%. At this level Ireland is the country with the 8th highest income tax rate, higher than the rates for instance in Germany and the UK.

At 250% of average wage (€81,500) the average income tax rate for the 23 OECD countries climbs to 29.6% while Ireland's rises to 34.6%, five percentage points higher than the OECD average. It is the country with the 6th highest tax rate. These figures, much like those in previous sections, show that Irish workers' pay low to below average tax rates on earnings on low to average wages but pay income tax rates which are disproportionately high on wages above the average. Our analysis shows that in particular those people earning from around €39,000 upwards pay a disproportionate share of tax and are taxed higher than their OECD counterparts.

Figure 13: Effective income tax rate at 167% of the average wage

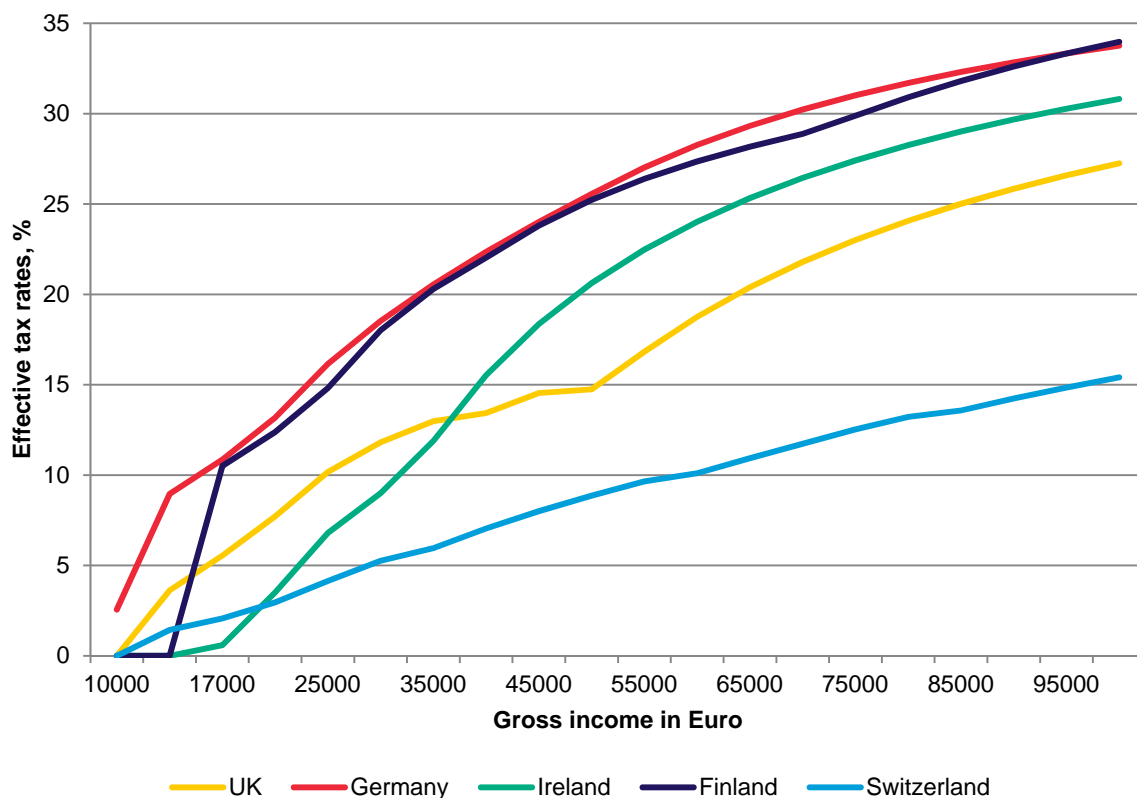


Source: OECD taxing wages

As average wages vary throughout OECD countries another way of analysing tax systems is by comparing how much tax a person has to pay for the same amount of gross income in each country. This is particularly important for international competition for mobile skills in companies which operate tax equalisation models based on net take home pay.

The comparison in Figure 14 of income tax rates at different wage levels clearly demonstrates that the statement that Ireland's income tax burden on labour income is amongst the lowest of all OECD countries is not correct. From our own stylised models of tax systems in different comparator countries we can see again that Irish income taxes are only competitive at the lower end of labour income. On the other hand Ireland again becomes relatively high tax once a worker reaches fairly moderate wages. For example, if the gross income of a single earner increases from €30,000 to €50,000 then the effective income tax rates he has to pay in the UK rises from 7.7% (€2,310) to 14.7% (€7,350). In Ireland the effective income tax rates would increase from 3.5% (€1,050) to 20.6% (€10,300).

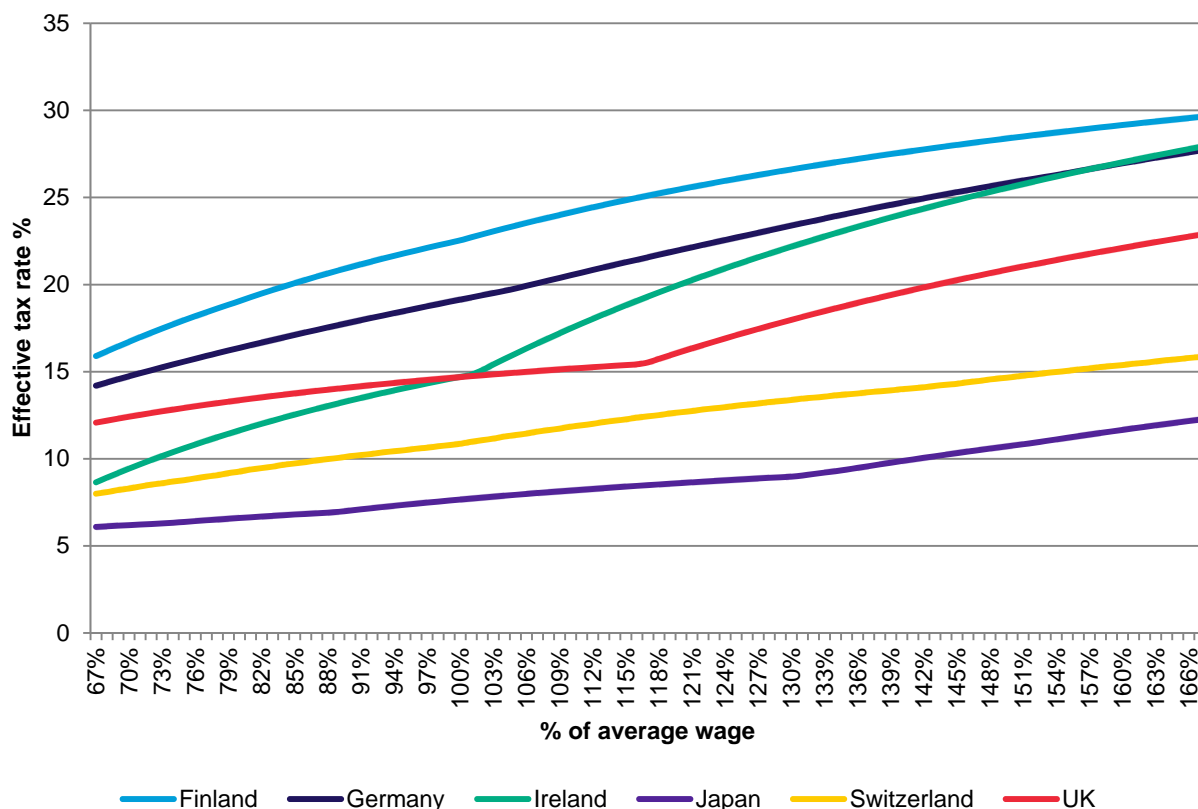
Figure 14: Effective income tax rates by gross income



Source: OECD taxing wages

Figure 15 illustrates how progressive Ireland’s income tax system is compared with a selection of other countries. For wages above 100% of average wage Ireland’s tax burden climbs steeply and outpaces the tax rates of other states. This puts Ireland at a competitive disadvantage in its pursuit to attract a skilled labour force from abroad. For people who choose to work abroad other countries such as the UK, which levies a lower tax burden on labour income, might become a more appealing place to live and work. Moreover, our high tax rates on earned income might also deter Irish people, who left the country during the recession to take up jobs abroad, from returning home.

Figure 15: Effective income tax rates by % of national average wage

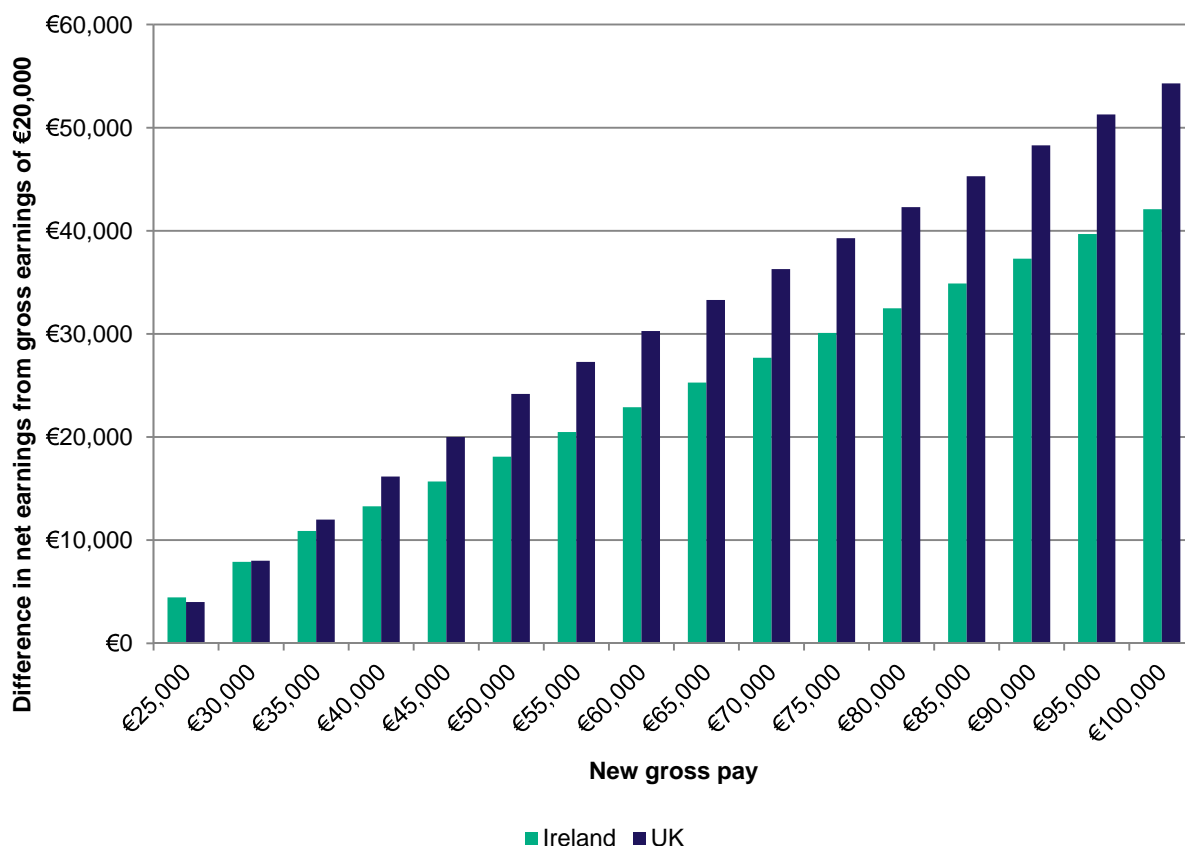


Source: OECD taxing wages

This large increase in the middle of the income distribution is likely to be particularly burdensome for younger workers who earn below average wages but would typically see 70% of their career wage growth over the first ten years of their career. Earnings and career decisions for this group will already have been affected drastically by the recession (Oreopoulos et al, 2006). Added to this, entering into the marginal tax rate at what is just above typical graduate earnings provides additional distortionary effects on career and life decisions particularly around emigration. This is given some credence by recent official statistics which have shown that half of all emigrants since 2009 were employed in the period before they left with another quarter being recent graduates.

The marginal attractiveness of the UK for example as a place to develop a career radically improves at modest earnings due to the low entry point to the marginal rate of taxation. This is partly the product of the radical progressivity of the Irish income tax system among OECD countries. The difference between the tax rates at 67% (€21,842) and 167% (€54,442) of average wage is 19.3 percentage points in Ireland compared with 13.5 in Germany and 10.8 in the UK respectively. This provides a clear problem for Irish companies competing for or retaining talented graduates or young workers when compared to the alternative of working in other European countries.

Figure 16: Net impact of pay progression, Ireland v The UK



Source: Ibec calculations

The clearest illustration of this issue is a comparison with the UK. Figure 16 compares the increases in net earnings a single worker in Ireland will receive moving up the pay scale with a person in the UK. In Ireland a person moving from gross pay of €20,000 to gross pay of €60,000 will see an increase in net pay of just €22,888. The same person in the UK would see an equivalent increase of €30,287 a difference of €7,399. Given a choice between working in Ireland or in the UK over the years in their career in which earnings growth is highest skilled graduates would be better by tens of thousands (in the region of an annual average of €4,000 to €5,000 per annum if pay rises are spread throughout the first decade evenly) working in the UK over the course of the decade. Recent emigration statistics (see Section 5) suggest that this effect on earnings and career progression may be more important than employment growth in decisions to emigrate among third level graduates (50% of all emigrants since 2009).

5. Conclusions

Our research has a number of clear findings from which we derive policy conclusions. Our analysis shows that the tax system has become more reliant on taxation of income during the crises as income tax replaced other forms of tax. As a result, when it comes to personal taxation Ireland is now a high tax country when compared internationally; particularly for individuals with incomes above the entry point to the marginal rate of tax.

The design of our progressive taxation system, and in particular the narrow income tax base and low cut in point to the marginal rate of tax, means that people earning above the average wage have paid and continue to pay the vast majority of tax (82.5%) and pay rates which are high in European terms despite claims to the contrary. This increasing burden of labour taxation has a number of consequences for the Irish economy.

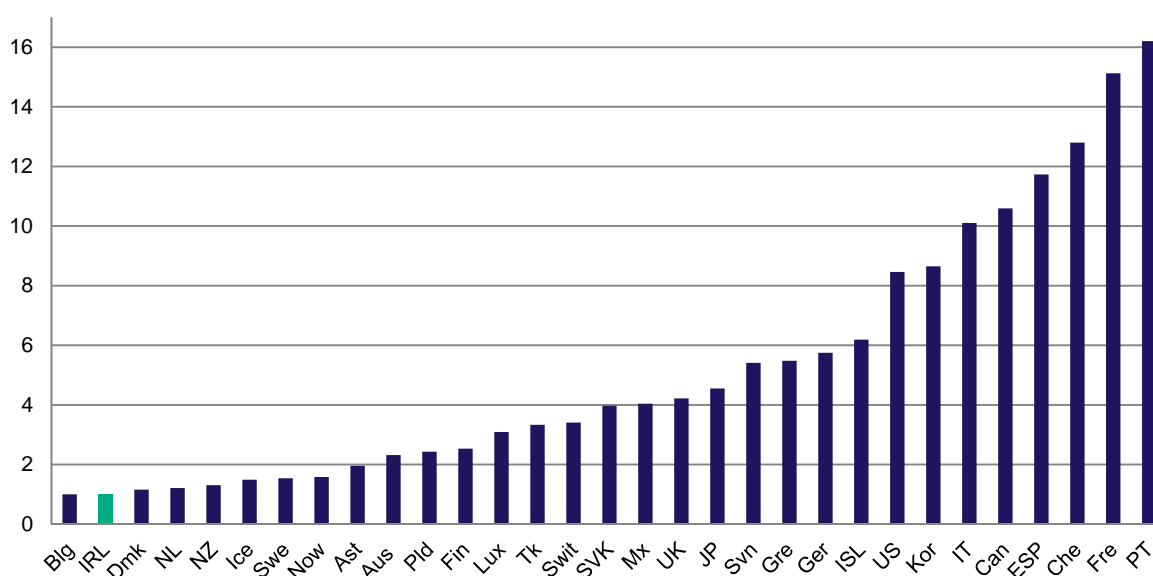
5.1 Income tax in Ireland and the incentive to work

Effective tax rates have received a lot of attention in the Irish debate due to their importance in understanding the distributional effects of income tax. This aggregate analysis, however, misses the main economic effect of income taxation that being its effect on people's labour market decisions at the margin. There is a clear and unavoidable trade-off in taxation between redistribution and efficiency recognised as far back as Adam Smith. It is also well established (Meghir & Phillips, 2009), that the main avenue through which income taxation affects economic growth is the effect of marginal tax rates on incentives to take on extra work (the intensive margin), to work at all (extensive margin) and accumulate additional human capital.

Although average effective tax rates are useful in understanding distributions of the tax burden, the effects of taxes on individual's decisions to work are determined by the overall marginal tax rates and the entry point to the marginal tax rate. A high marginal tax rate or one which cuts in at a low level will reduce the marginal benefit from working additional hours or receiving an increase in pay; additionally it will reduce the marginal benefit from additional education or training. Prescott (2004), for example, finds that increases in marginal tax rates in Europe compared to the US explain the majority of the divergence in labor supply between the United States and European countries over the past thirty years which has had a large effect on economic growth.

Ireland has a marginal tax rate which is amongst the highest in the OECD but what is more damaging to the economy is the fact that the marginal rate cuts in at the average wage; this is the lowest cut in point in the developed world barring Hungary (which operates a 17% flat tax regime) and Belgium. As a result, the incentive to work reduces dramatically at average wages. This is an issue for business and also for society at large.

Figure 17: Cut in point for the marginal tax rate as a multiple of the average wage



Source: OECD tax wages

In the short-term high marginal tax rates at low income will reduce the incentive to work and thus labour supply. Estimates of labour supply elasticity to changes in tax are fraught with methodological issues particularly for top earners but the economic literature generally agree that the work outcomes of women, low earners and particularly lone parents are affected disproportionately in their labour market decisions (men on the other hand tend to be less affected). The Mirrless Review (2011) of taxation in the UK drew attention to these points in great detail with specific recommendations on reducing the negative incentive effects of taxation.

5.2 Personal income tax and mobile skills

Tax on work is now completely out of line with our international competitors; despite regular claims that Ireland is a low tax economy detailed analysis shows that this is only true for lower income earners. Our analysis shows that for middle and higher income earners Ireland is a medium or high tax country. At average earnings Ireland now has the highest marginal income tax rate in the OECD. In addition, individuals enter the top marginal tax band at just below the average wage – the lowest entry point in the OECD bar certain countries which operate a flat tax and Belgium.

In addition the OECD's taxing wages database shows that the tax wedge (the difference between total labour costs minus net pay) from income taxation is, at 13.3%, above the OECD (10.1%) average at the average wage for a single person in Ireland and at 28.2% is almost twice the OECD average (16.6%) at double the average wage (€70,000). The total tax wedge on labour (income tax, employer and employees PRSI plus other levies) in Ireland, is relatively low (7th lowest in the OECD) at average earnings due to lower social security costs⁴, however, this rises to the OECD average at 167% of the average wage (€56,000). Ireland's effective income tax rates are above the OECD average from 120% of the average wage (€39,120) and above, showing Ireland is now a high income tax country for those on fairly modest wages.

Many companies report finding it difficult to retain talent with the high personal tax burden increasingly cited as a reason for staff to move overseas. Multinational companies which are seeking to attract workers for a project or placement typically operate tax equalisation models. This has the effect of delivering an agreed net salary to the employee and an adjustment in the gross salary to reflect this. The overall impact of Irish income tax increases in recent years has therefore been to increase the total labour cost for multinational businesses locating positions in Ireland. This means that Ireland is becoming a less attractive location for investment and many direct and ancillary jobs are being lost to competitor jurisdictions with lower personal income tax burdens. This is costing jobs and damaging Exchequer returns.

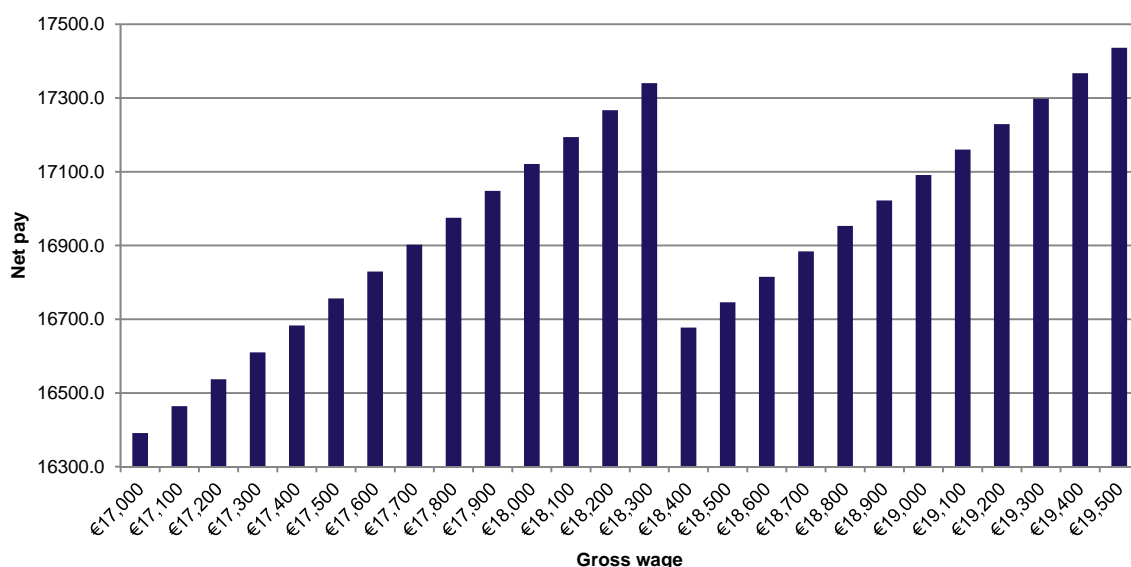
The tax system does not only impact the attraction of skilled people but their retention as well. Ireland has also seen something of a brain drain in recent years. Recent CSO figures challenged the dominant narrative that emigration was predominantly related to unemployment. Indeed less than one in five (20%) of people who have emigrated since 2009 were unemployed before they left. Almost half were employed and another quarter were students. In order to retain or regain these skilled individuals it is imperative we deliver a system of tax which is attractive to these individuals.

⁴ In addition comparisons including of social security taxes are less than ideal given the different coverage in other European countries particularly in areas like healthcare and pensions where private sector provision is much less common than in Ireland.

5.3 Anomalies in the tax system

There are three notable anomalies in the Irish income tax system which negatively affects the incentive to work or take on overtime or expand a business. The first is due to the entry point to the USC with the second at the entry point to the 4% rate of employee PRSI. Ibec has previously drawn attention⁵ to the fact that the abolishment of the PRSI allowance of €127 per week has amplified an existing kink in the tax system, where an increase in gross pay at certain levels actually results in lower net or take-home income. Someone on €18,300 per annum now receives €17,340 in take-home pay following all taxes and levies. The same individual earning €18,400, however, will see their net pay drop to €16,677 as they cross the hard eligibility threshold for the 4% rate of employees PRSI which applies to all income. This means that a person earning €18,300 will have to earn an extra €1,065 (€19,365) before they receive an extra euro of take-home pay. This anomaly has a disproportionate impact on people at these income levels and has also had an impact on employers by effectively entirely disincentivising the take-up of overtime work at these income levels. The absolute entry point to the USC at €10,036 also means that a person earning an extra €100 at the cut-off point will actually see their take-home fall by over €200.

Figure 18: Employee PRSI anomaly – Net take home pay at gross wage



Source: Ibec calculations

A recent NESC report has raised the possibility that hard cut offs in eligibility for social welfare payments (in terms of income, work status and hours worked) and hard entry points to new taxes such as these may provide barriers to further workforce engagement among the disproportionate number of households with low work intensity in Ireland. International evidence would suggest that these issues added to the marginal rate and its entry point may reduce incentives to work at very low earnings with particular effects on young workers and women.

Finally, the 3% USC surcharge for the self-employed is an anachronism at a time when government is trying to encourage entrepreneurship elsewhere in the tax system. The surcharge incentivises people to avoid self-employment or the expansion of relatively small operations by increasing the marginal rate of tax to 55% for entrepreneurs in direct opposition to stated government policy elsewhere. With multiple schemes operating to try to encourage self-employment, this USC surcharge is likely to have both significant deadweight loss on its own but additionally adds to deadweight loss from other schemes.

⁵ Ibec budget submission 2013

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