Opening Statement – Select Committee on Budgetary Oversight

'Meeting to discuss Chapters 6, 7, 8 and 14 of the Commission on Taxation and Welfare Report'

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Introduction

Let me start by thanking the Chair and the members and staff of the Committee for the invitation to appear before you today.

The NERI is very grateful for this opportunity to present our views on the Report of the Commission on Taxation and Welfare (Commission).

As a member of that Commission I would personally like to pay tribute to the professionalism, creativity and diligence of the Commission's Chair and Secretariat, and acknowledge the dedication and conscientiousness of the other members.

Context of the Report

Before I turn to the four chapters being examined I must first note the fiscal context of the report.

The Commission is of the view that Ireland faces major fiscal challenges and risks over the medium-term, and that these threats are of such scale that the overall level of government revenue will have to increase materially as a share of national income. This is the first and most important recommendation of the report.

The issue is therefore not so much whether taxes and social contributions will have to increase, but *which* revenue sources we should focus on increasing the yield from, given our five high-level policy goals of (A) Sustainability, (B) Reciprocity, (C) Adequacy, (D) Equity and (E) Efficiency.

Chapter 6 and Chapter 8 – Horizontal equity

The first part of Chapter 6 focuses on horizontal equity. This is the principle that those with similar income should pay the same proportion of that income in taxes. This means that a taxpayer's age, legal status or where they are domiciled, their source of income, or other factors unrelated to their total income should be irrelevant for determining their tax liability. This is broadly the position of the Commission and it is a principle that NERI fully supports.

The second part of Chapter 6 focuses primarily on reforms to VAT. NERI agrees with the Commission that the use of zero and reduced rates should be limited, that VAT reductions should not be used as a short-term stimulus, and that the 9% and 13.5% rates should be merged and increased progressively over time.

The timing of these changes should only begin to take place once annual inflation rates are brought back close to ECB target levels. While consumption taxes are often regressive in themselves, the revenues generated can be used to support our adequacy, equity and sustainability goals via enhanced resources for free universal basic services and for income transfers.

In addition, NERI supports the Chapter 8 recommendations regarding the overall level and tax treatment of the lump-sum, the benchmarking of the Standard Fund Threshold, and, as noted already, the ending of concessionary tax treatment based on age.

Chapter 7 – Taxes on Capital and wealth

Chapter 7 notes the scale of wealth and wealth inequality in Ireland, the very low tax yield from wealth compared to income and consumption, and the need to increase the yield generally from capital taxes. The Commission's recommended approach is that there be a substantial re-working of existing taxes on capital and wealth in order to deliver a much higher tax yield. On the other hand, it notes that attempts to introduce a new tax on net wealth should be put into temporary abeyance until the outcome of these attempts to amend existing taxes on capital and wealth was known.

The report notes the major deficiencies in the way Capital Gains Tax (CGT) and Capital Acquisitions Tax (CAT) are currently structured, and the deleterious impact on the amount of tax collected on intergenerational asset transfers. The current highly regressive system of tax breaks effectively imbeds inequality of opportunity across generations and does so without any economic justification or rationale. In particular, CAT is a tax on windfall gains and is likely to have much less of a negative economic impact than taxes on income and consumption.

NERI therefore strongly support the recommendation that transfers of assets on death be treated as a disposal for CGT purposes, that the CAT Group A threshold should be substantially reduced, and also that the level of Agricultural and Business Relief from CAT be reduced and reformed. Enterprise policy should focus instead on supports for new businesses and innovation.

In addition, we agree that the CGT Principal Private Residence Relief has no economic justification, benefits better-off households and should be materially restricted over time. Finally, we support the recommendation that a modest capital charge be applied to gifts and inheritances generally.

Chapter 14 – Land and property

I will turn finally to Chapter 14. The main residence, other property, and land, cumulatively make up three quarters of household wealth.

There are a wide range of economic and social arguments for materially increasing taxes on property and land (see appendix). We know that the tax structure influences growth, and the economics literature generally finds that recurrent taxes on immovable property are the least distorting to economic activity and therefore least damaging (i.e. most beneficial) to long-run growth prospects.

The taxation of land is the optimal form of tax from an efficiency perspective as it has no effect on supply and does not discourage development of the property. On the other hand, property taxes are preferable from a vertical equity perspective. Ireland has an extremely modest tax on property and no site value tax on land.

The NERI agrees with the view of the commission that the composition of taxation should materially shift towards the taxation of land and property. This is for equity, efficiency, and sustainability reasons, all of which I am happy to elaborate upon.

Our view is that the local property tax should be significantly increased, should be made progressive, and should contain surcharges for vacancy and for non-principal private residences. This should be accompanied by the gradual introduction of a site value tax with a yield significantly in excess of the current yield from commercial rates.

At the same time, we must be cognisant of asset rich and income poor situations. The best way to resolve this problem is through a generous deferment system. The deferred amount along with interest would only be payable on the sale or transfer of the property. This resolves the hardship issue and simultaneously protects government revenue over the long-term.

Finally, we agree with the Commission that tax incentives – for example Section 23 type reliefs and the Help to Buy scheme – should not be used in order to stimulate the supply or demand for housing. Past interventions in this area have been calamitous resulting in distorted incentives and significant deadweight. Government should desist from using the tax system as a means to fuel the property market.

I am happy to take any questions.

Appendix

There are strong theoretical arguments in favour of recurrent taxes on immovable property (see McDonnell, 2019):

a. They are shown empirically to have a minimal negative impact on GDP; in other words, they are growth-friendly taxes;

b. They are very difficult to avoid or evade;

c. Unlike transaction-based property taxes, they are reasonably stable throughout the economic cycle and therefore provide a reliable tax base;

d. They do not by and large penalise productive activity;

e. Taxes on immovable assets are particularly appropriate in the context of increasing globalisation where the factors of production (labour and financial capital) are increasingly mobile;

f. They do not create a barrier to labour mobility unlike transaction-based property taxes which potentially add an additional cost to moving for economic reasons;

g. They can encourage investors to redirect capital to more productive sectors of the economy;

h. They can be progressive *if* correctly designed and

i. In the case of local property taxes they enable the State to recoup some of the costs of public infrastructure provision through the increased (and unearned) value that will accrue to local housing