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Pre-Budget 2019: Income Tax, USC and PRSI issues and options

Summary of Tax Strategy Group papers

Introduction

The Tax Strategy Group (TSG) is comprised of a number of senior officials and political advisors from across a range of civil service departments and offices. Though not a decision making body, the TSG discusses, on the basis of pre-prepared papers, tax related issues and options to be considered in the budgetary process. These papers are later published. In order to aid Members of the Oireachtas to engage on the issues in Budget 2019 the PBO has prepared a series of summaries of the TSG papers highlighting some of the main issues and policy options.

The Government's stated goal with regard to taxing income is to gradually reduce the burden on middle income earners and explore the merger of USC and PRSI. Taxes levied on wages are an essential part of Irish Exchequer funding. The taxes levied directly on wages in Ireland are Income Tax, the Universal Social Charge (USC) and social security contributions in the form of Pay Related Social Insurance (PRSI). These taxes are an essential part of funding social welfare benefits and broader State expenditure. There are two TSG papers on these issues the TSG paper prepared by the Department of Finance on *Income Tax & Universal Social Charge* and the paper on *Pay Related Social Insurance* prepared by the Department of Employment Affairs and Social Protection.

In 2017, Income Tax and USC raised a total of €20 billion (39.4% of total Exchequer tax revenue and 37% of Gross Current Expenditure). They are projected to yield €21.4 billion in 2018 (39.6% of the total).[1] The great majority of the yield, 81.1% in 2017 comes directly from employee wages.[2] PRSI is also a significant contributor to Government revenue. In 2017, PRSI yielded €9.8 billion, of this the employer contribution was €7.1 billion, the employee contribution was €2.1 billion and the self-employed contributed €522 million.

To promote social solidarity these taxes are generally structured to be progressive in nature. Progressive taxes are those where the wealthy or higher paid pay a larger proportion of their income as tax than those who are poorer or lower paid. This supports the state redistributing income.

Key Messages

The Irish income tax system (including USC) is progressive with higher earners paying a large share of income tax. For the average worker the tax wedge (the net amount the worker receives compared to what they cost their employer) in Ireland is lower than most OECD countries and well below average.

Income tax, the Universal Social Charge and Pay Related Social Insurance collectively raised almost €30 billion in 2017 and are expected to raise more in 2018.

Any changes to these taxes tend to raise or cost relatively large amounts as they are broad based taxes.

The merger of USC and PRSI if progressed will be complicated and will be a significant reform of the system. There are a range of issues to be considered including, amongst others, the revenue to be raised, the tax base, distributional and equality issues, and the effect on marginal tax rates. However, a merger is an opportunity to tackle anomalies in the current systems.

[1] Tax Strategy Group 18/02 Income Tax and USC

[2] Revenue Statistics, Revenue Net Receipts by Taxhead

Taxes on wages in Ireland

There are three main elements to Ireland's system of taxes on wages. These are income tax (often referred to as Pay As You Earn or PAYE), the Universal Social Charge (USC) and Pay Related Social Insurance (PRSI). Each of these taxes is levied directly on salaries earned by employees and the self-employed. To protect those on lower incomes from contributing a disproportionate amount of their earnings, these are levied in a range of bands and with a number of credits. Each of these elements though separate, are collected through a common administrative system. This section will outline how these sections operate independently and their combined impact. There are other taxes on income depending on its source, such as Capital Gains Tax, Deposit Interest Retention Tax, Dividend Withholding Tax, etc. These are not dealt with in this Note.

Income Tax (PAYE)

Income tax in Ireland is designed to be a progressive system. A progressive tax system aims to ensure that those on higher incomes pay a greater proportion of their income in tax than those on lower incomes. This is achieved in the income tax system by applying different rates on different 'slices' of a person's income. The standard rate of 20% is applied up to the "standard rate cut off point". On income earned above this, the higher rate of 40% is applied. The point at which a person begins paying the higher rate of tax is determined by their personal circumstances.

Table 1: Standard Rate Cut Off Points

	Standard Rate Cut Off Point
Single Person	€34,550
Married couple/civil partners, one income	€43,550
Married couple/civil partners, two incomes	Up to €69,100[3]
One parent family	€38,550

Source: Revenue.ie

[3] The standard rate cut-off point for a married couple or civil partners is €43,550. If both are working, this amount is increased by the lower of €25,550 or the amount of the income of the spouse or civil partner with the smaller income. Effectively, this means that the partner with the higher income has a Standard Rate Cut Off Point of €43,550, while the partner with the lower income begins to pay the higher rate at €25,550.

Tax credits are used to lower the burden on taxpayers. These are subtracted directly from a taxpayers calculated liabilities. A comprehensive list of tax credits can be found on the Revenue Commissioner's website.

Tax reliefs lower the amount of a taxpayer's income that is considered for tax purposes. In general, the effective benefit of a tax relief depends on whether the taxpayer is paying tax at the standard or higher rate. Individuals/couples earning over the Standard Rate Cut Off Points (Table 1) can benefit significantly more from tax reliefs than those earning under the cut off point. This is because tax reliefs applied on earnings under the cut off point result in a saving of 20% of the value of the tax allowance. Tax reliefs applied on earnings above the cut off point result in saving of 40% of the value of the tax allowance. However, many tax reliefs are limited to the standard rate i.e. higher rate taxpayers can only gain relief at the standard rate. Many income tax reliefs are considered tax expenditures and the PBO has published a separate Briefing Paper on tax expenditures.

USC

The Universal Social Charge (USC) was introduced in 2011 as a replacement for the Income Levy and the Health Levy. It is designed to be a progressive charge that applies a higher rate at higher levels of income. While USC is not levied on incomes below €13,000, once this threshold has been reached it is applied to the entire income. As there are very few exemptions such as tax credits, taxpayers generally have USC levied on a greater proportion of their income.

Table 2: USC Bands once income is above €13,000

USC Bands	Applicable rate on earnings in band
0 - €12,012	0.5%
€12,012.01 - €19,372	2%
€19,372.01 - €70,044	4.75%
€70,044.01+	8%
€100,000+ (non-PAYE income)	3% supplement (i.e. 11%)

Source: Revenue.ie

Non-PAYE income of over €100,000 has an additional surcharge of 3% applied to it. This gives a top rate of USC of 11% for self-employed taxpayers or those with significant income from other sources.

PRSI

The third aspect of payroll taxes in Ireland is Pay Related Social Insurance (PRSI). While there are a number of PRSI 'classes', the great majority of employees will be considered to be 'Class A.' PRSI is imposed through two channels. One part is paid by a charge taken from an employee's wages, while the other is paid by the employer for every employee. PRSI due is calculated based on weekly earnings.

Employee PRSI: On weekly incomes of less than €352, the employee does not pay PRSI. Weekly incomes of greater than this amount are charged PRSI at a rate of 4% on the entire income. To avoid a "cliff effect" at the threshold and high marginal tax rates, a tapered PRSI credit is applied on incomes up to €424 per week.

Employer PRSI: Employers are required to make a contribution towards PRSI on behalf of employees. Up to earnings of €376 per week this is charged at 7.8% of the employee's salary. Above this it employers must pay 10.05% of their employee's salary.[4]

Self-Employed PRSI: Self-employed people with an annual income of over €5,000 pay PRSI at a rate of 4% on all their reckonable income with a minimum charge of €500.

Analysis of Yield

Table 3 shows the revenue from income taxes and PRSI from 2011 to 2017. In total income taxes, which include USC, brought just under €20 billion in revenue in 2017, with PRSI bringing in €9.8 billion, for a total of €29.75 billion. This is €8.5 billion or 40% more than 2011 reflecting the strong economic growth over the period. USC has not increased in line with economic growth mainly due to the current and previous Government's strategy of gradually reducing USC rates and expanding its income bands – these changes are estimated to have cost €1.5 billion over the period 2016-2018.[5]

[4] In addition, employers pay a National Training Fund levy of 0.8% on the PRSI base income.

[5] TSG (2018) *Income Tax & Universal Social Charge* p.16.

Table 3: Revenue from Income Taxes and PRSI 2011 to 2017 (€ million)

	2011	2012	2013	2014	2015	2016	2017
PAYE Income Tax	8,496	9,058	9,508	10,778	10,950	11,985	13,071
Self-Assessed Income Tax	811	883	1,039	1,332	1,434	1,915	1,844
Income Tax	**9,307**	**9,941**	**10,547**	**12,110**	**12,384**	**13,900**	**14,915**
PAYE USC				3,171	3,640	3,287	3,131
Self-Assessed USC				476	534	681	593
Universal Social Charge	3,114	3,790	3,930				
Universal Social Charge (Total)	**3,114**	**3,790**	**3,930**	**3,647**	**4,174**	**3,968**	**3,724**
Other income taxes	1,391	1,420	1,275	1,375	1,785	1,304	1,333
Total income taxes	**13,812**	**15,151**	**15,752**	**17,132**	**18,343**	**19,172**	**19,972**
Employer PRSI	5,461	4,996	5,331	5,749	6,165	6,606	7,137
Employee PRSI	1,617	1,480	1,580	1,704	1,826	1,957	2,114
Self-Employed PRSI	348	310	397	406	460	607	522
Total PRSI	**7,426**	**6,786**	**7,308**	**7,860**	**8,452**	**9,171**	**9,773**
Total income taxes and PRSI	**21,238**	**21,937**	**23,060**	**24,992**	**26,795**	**28,343**	**29,745**

Source: PBO based on Revenue Commissioner's Total Net Receipts by Taxhead and Department of Employment and Social Protection (2018) Annual SWS Statistical Information Report 2017.

International Comparisons

Internationally, Ireland has a relatively low tax wedge i.e. the difference between the cost to an employer of hiring a worker and the amount the worker receives in wages. While Ireland's income tax share is close to the average for the OECD, Ireland's overall tax wedge is lower (Table 4). This is driven by lower social security contributions than the OECD average.

Table 4: Tax Wedges in OECD Countries: Single individual without children at the income level of the average worker (%)

Country	Total tax wedge	Income tax	Social security contributions	
			Employee	Employer
Belgium	53.7	20.7	10.9	22.2
Germany	49.7	16.0	17.4	16.3
Italy	47.7	16.5	7.2	24.0
Austria	47.4	11.2	14.0	22.2
Finland	42.9	17.1	7.6	18.2
Portugal	41.4	13.3	8.9	19.2
Spain	39.3	11.3	4.9	23.0
Estonia	39.0	12.5	1.2	25.3
Netherlands	37.5	15.5	11.8	10.1
Denmark	36.3	35.8	0.0	0.8
United States	31.7	16.9	7.1	7.7
United Kingdom	30.9	12.6	8.5	9.8
Australia	28.6	23.0	0.0	5.6
Ireland	**27.2**	**13.9**	**3.6**	**9.7**
Korea	22.6	5.5	7.6	9.4
Mexico	20.4	8.8	1.2	10.4
New Zealand	18.1	18.1	0.0	0.0
OECD Average	**35.9**	**13.5**	**8.2**	**14.2**

Source: OECD Taxing Wages 2018

Budget 2019 – Cost of potential tax changes

Table 5 examines the cost of or yield from selected policy changes to Income tax, USC and PRSI. Most of these are changes to tax rates or changes to bands/credits. This is not an exhaustive list of potential changes to rates, credits, exemption limits etc., the Revenue Commissioner's Ready Reckoner – Pre Budget 2019 contains costings of additional rates, credits, exemption limits and options.

The main issue that Table 5 illustrates is that small incremental changes to rates, credits, exemption limits etc., have significant fiscal impacts. For example decreasing the 20% Income Tax rate by one percentage point would cost €660 million in a full year, which would be 82.5% of the €800 million the Government has indicated to be the net Budget 2019 package. Due to the broad base of USC and PRSI small percentage point changes to their rates cost/yield significant amount of revenue.

Indexing the income tax system (i.e. increasing tax bands, limits and credits in line with income growth) is costed at approximately €188 million per percentage point increase in earnings. Given earnings are expected to increase by 2.8%[6] full indexation would cost approximately €526 million.

[6] Government of Ireland (2018) Stability Programme Update 2018.

Table 5: Cost/Yield of selected policy changes to Income Tax, USC and PRSI

Options	First Year Cost/Yield €m	Full Year Cost/Yield €m
Income Tax		
Cost of 1 percentage point (pp) decrease in 20% rate Cost of 1pp decrease in 40% rate	-567 -287	-660 -348
Yield from 1pp increase in 20% rate Yield from 1pp increase in 40% rate	571 286	664 347
Yield from introduction of 3rd rate of 41% - Earnings over 80,000 Yield from introduction of 3rd rate of 43% - Earnings over 80,000	114 341	144 433
Selected Tax Credits		
Increase main personal tax credits by €100 per person Increase Single Persons Credit from €1,650 to €1,750 Married or in a Civil Partnership Credit from €3,300 to €3,500 Widowed Person or surviving Civil Partner (without qualifying child) Credit from €2,190 to €2,290 Single Person Child Carer Tax Credit from €1,650 to €1,750	-217	-254
Increase PAYE Credit by €50 - From €1,650 to €1,700	-89	-103
Increase Earned Income Credit by €500 - From €1,150 to €1,650	-28	-46
Increase Home Carer's Credit by €50 - From €1,200 to €1,250	-3.5	-4
Increase Incapacitated Child Credit by €100 - From €3,300 to €3,400	-1.9	-2.2
Increase Age Credit by €50 for single/widow/surviving Civil Partner (from €245 to €295) and Age Credit by €100 for married/civil partners (from €490 to €590)	-14	-16
Standard Rate Bands*		
(single, married one-earners and two earners) Increase standard rate cut off point by €500 Increase standard rate cut off point by €1,000 Increase standard rate cut off point by €1,500	 -93 -183 -271	 -108 -213 -316
Indexation		
Indexation at 1% - PAYE Credit, Exemption limits, Personal Tax Credits with rate bands Indexation at 1% - Earned Income Credit Indexation at 1% - USC rate bands and exemption limits	-143 -0.7 -18	-166 -1.2 -21
Universal Social Charge		
Decrease main USC rates by 1pp (0.5pp for the 0.5% rate) • Decrease 0.5% rate to 0.0% • Decrease 2% rate to 1%** • Decrease 4.75% rate to 3.75% • Decrease 8% rate to 7%*** • Total of above changes	 -117 -157 -349 -135 **-758**	 -136 -183 -408 -171 **-898**
Increase main USC rates by 1pp • Increase 0.5% rate to 1.5% • Increase 2% rate to 3%** • Increase 4.75% rate to 5.75% • Increase 8% rate to 9%*** • Total of above changes	 233 157 349 135 **874**	 272 183 408 171 **1,034**
Pay Related Social Insurance		
Increase main PRSI rates by 0.5 percentage point • Employer PRSI 7.8% to 8.3% • Employer PRSI 10.05% to 10.55% • Employee (Class A) PRSI 4% to 4.5% • Self-employed PRSI (Class S) 4% to 4.5% • Total of above		 21 356 358 57 **792**

Source: Revenue Ready Reckoner – Pre Budget 2019 with the exception of PRSI which is based on Tax Strategy Group – Pay Related Social Insurance July 2018. *Assumes the maximum allowable transferability of €9,000 across the board. These costs do not take into account the Earned Income Credit. **Includes the reduced rate USC for Medical Card holders. ***Includes those paying the 3% surcharge on non-PAYE income exceeding €100,000 in a year.

Merger of PRSI and USC

The Programme for Government committed to "ask the Oireachtas to continue to phase out the USC as part of a wider medium-term income tax reform plan". In Budget 2018, the Minister for Finance and Public Expenditure and Reform announced that a working group would be set up to plan the process of amalgamating USC and PRSI over the medium term. This group was set up in February 2018 with the remit to examine options which address:

- "the need to preserve the tax base having regard to the need for certainty, equity, and ease of compliance and administration
- current and future funding challenges facing the Social Insurance Fund
- issues likely to arise from a phased implementation over a number of years of the new instrument
- simplification of the personal tax and social insurance systems."

The group was set a deadline of 30 June 2018 to complete its work and it is likely that its work will be published with Budget 2019.

Issues to be considered include:

Revenue to be raised – USC raised approximately €3.7 billion in revenue in 2017 with PRSI raising over €10 billion. Post-amalgamation the revenue raised would need to replace the amount that USC and PRSI currently raise, accounting for other policy decisions on total revenue to be raised from these taxes.

Bases – the tax base (i.e. sources of income) of USC is wider than that of PRSI as it covers more forms of income and individuals. For example, those aged 66 and over are not liable to PRSI but they are liable to USC, and reduced rates of USC apply for over 70s and medical card holders. In addition, PRSI operates on a week-on-week basis whereas the USC is a cumulative annual tax. One of the key considerations of the working group is to preserve the tax base.

Rates – PRSI for most individuals is 4% on income over a certain level. As shown above USC rates are progressive increasing with income. In addition, consideration would need to be given to certain public servants (those who entered service before April 1995) who pay reduced rates of PRSI as they receive few social insurance benefits (e.g. they are not eligible for the State Contributory Pension). In addition, how the self-employed, who do not have the equivalent of employer's PRSI, are treated must be considered.

Thresholds – both USC and PRSI have thresholds below which individuals do not pay the tax. This can affect the incentive to work additional hours especially for part-time employees as once they pass the threshold their full income is taxed. This means that the marginal tax rate for the additional income can be extremely high. For USC the threshold is €13,000 per annum (after which income up to €12,012 is taxed at 0.5%, and the balance is taxed at 2% up to €19,372). For PRSI it is €352.01 per week (though there is a tapered PRSI credit for income up to €424 to ensure that the marginal tax rate is lower). The threshold income for the new tax will have to be considered as will any credit system to taper the marginal effect.

Phasing in period – it is likely that any change will have to be phased in over a period of years in order to have a smooth transition that does not jeopardise tax yield.

Social Insurance Fund – PRSI revenue is used to finance Social Insurance Fund benefits effectively on a pay-as-you-go basis and pay for the benefits that accrue to eligible recipients. The benefits accrue through paying PRSI both though individual and employer contributions. How the SIF will operate after the amalgamation needs to be considered as do the benefits that accrue to beneficences including the self-employed and certain public servants whose SIF benefits are lower than employee's benefits.[7]

[7] While in general the self-employed pay the same individual rate (4%) in PRSI as employees there are no employer contributions thus their contributions in total are much lower than employees.

Auto-enrolment into soft-mandatory pension system – The Government has recently announced a consultation process on a soft-mandatory pension system for those not currently covered by employer pension schemes. The proposal[8] would mean that 6% of an employee's income would eventually be put into pension savings. Even if this is not compulsory it could be seen as an additional tax on income.

Marginal rate of tax – Currently the marginal rate of tax for employees is 48.75% on income between €34,550 and €70,044. PRSI makes up 4 percentage points and USC 4.75 percentage points of this figure. Above €70,044 the marginal rate increases to 52% and to 55% for those with self-employed income above €100,000 due to increased rates of USC. The TSG paper shows that Ireland has higher marginal tax rates at lower incomes than most European countries. When merging USC and PRSI the marginal tax rate at different levels of income should be accounted for, as well as the different treatment of incomes from different sources.

Bi-lateral social security agreements – Ireland has a number of bi-lateral social security agreements in place which allow the transfer of benefits between jurisdictions. How these will operate if USC and PRSI are merged will need to be considered.

Distribution and equality issues – When merging these taxes, the issue of equity both horizontal (i.e. those with similar incomes should pay a similar amount of tax) and vertical (i.e. those with higher incomes should pay more tax) need to be addressed. The opportunity could be used to correct existing anomalies in this regard (for example pension income from private sources is liable to USC while State pension income is not). The exclusion of social welfare payments from the definition of income for USC and PRSI purposes can also cause equity issues. Correcting these issues however could be controversial as the groups affected which benefit from such anomalies tend to be relatively small and identifiable whereas taxpayers overall benefit from the removal of anomalies (e.g. the same amount of tax can be raised but with lower rates).

[8] Department of Employment Affairs and Social Protection (2018) A Strawman Public Consultation Process for an Automatic Enrolment Retirement Savings System for Ireland.

Other Issues raised in TSG papers

The TSG paper on Income Tax & Universal Social Charge raises a number of issues including:

- The top 1% of income earners (>€200,000) pay 28% of total Income Tax and USC, with the top 26% of income earners (>€50,000) paying 85% of Income Tax and USC.
- Tapered withdrawal of tax credits for high income earners - this would mean that above a certain income threshold tax credits would gradually reduce and over a certain income be withdrawn altogether. This would mean higher earners paying a higher share of their income in tax as well as being responsible for more tax revenue overall.
- Updates of reviews of certain income tax expenditures including the help-to-buy scheme, the agri-taxation review and some tax breaks for entrepreneurs. These are due to be published with Budget 2019. The PBO has published a Briefing Paper on tax expenditures.
- Equality and gender proofing of the Budget. The TSG paper mentions that impact of the Budget as a whole should be assessed rather than individual measures and discusses how Ireland's tax and welfare system has consistently reduced inequality and substantially redistributes incomes especially in comparison with other countries.
- The TSG paper also includes an Appendix which discusses the distributional effect of a small number of tax measures. This section uses the Economic and Social Research Institute's (ESRI) SWITCH (tax and welfare) model to examine these measures on socio-economic status (i.e. income) and family status of Irish households. The PBO has funded the ESRI to expand the SWITCH model to include a gender analysis and in future the distributional affects can be analysed by gender as well. The ESRI will publish a paper on the gender impact of recent Budgets in late October 2018.

The TSG paper on Pay Related Social Insurance also raises a number of issues including:

- The *Actuarial Review of the Social Insurance Fund* which identified a shortfall from 2020 onwards in the Social Insurance Fund (see PBO Note 8 of 2018: A Overview of the Social Insurance Fund).
- Social insurance benefits for the self-employed which discussed:
  - extending certain benefits and the issues arising from such an extension including cost and increasing contributions; and
  - the issue of false self employment and the report on the issue. The TSG paper sets out the Department's response to the report which includes a media campaign to highlight the issue of false self-employment.
- Increasing the entry threshold for social insurance cover which is currently is €38 per week and entitles those with just four hours of work per week at the minimum wage to the full set of social insurance benefits with very little contributions. The TSG paper suggested increasing the threshold to €115 per week (increasing the self-employed threshold to match).

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