Irish Fiscal Advisory Council

Potential impact of Commission on Taxation and Welfare proposals

Analytical Note No. 17

Eddie Casey

November 2022

Abstract

This note looks at the recent Commission on Taxation and Welfare's recommendations. While the Commission focused on the overall strategy, we draw our own interpretation of the proposed reforms to assess the potential impact on taxation. In terms of what can be quantified, property-related taxes play a large role, with other measures spread relatively evenly across capital taxes, VAT, environmental taxes, and a string of tax reforms related to incomes. Large uncertainties remain, however, and major data gaps limit our ability to quantify potential impacts. Our broad-brush estimates suggest an increase in total revenues of around 5.3% of GNI* if measures were implemented as we assume.

Reforms along the lines of what is proposed by the Commission offer one way to help address some of the sizeable challenges Ireland is facing: ageing, climate change, and the over-reliance on unpredictable corporation tax receipts. If implemented, it would see Ireland moving from a relatively low tax country to one more similar to current EU norms.

Suggested reference:

Casey, E. (2022). "Potential impact of Commission on Taxation and Welfare proposals". Irish Fiscal Advisory Council, Analytical Note Series No. 17. Dublin. Available at: www.FiscalCouncil.ie

© Irish Fiscal Advisory Council 2022

This report can be downloaded at www.FiscalCouncil.ie

The author is the Chief Economist at the Irish Fiscal Advisory Council. Email: admin@fiscalcouncil.ie.
The opinions expressed and arguments employed in this paper do not necessarily reflect the official views of the Fiscal Council. We would like to acknowledge the feedback and kind assistance received from members of both the Council and the Secretariat of the Fiscal Council.

1. Background

The Commission on Taxation and Welfare published its report this September, setting out 116 recommendations. The Government established the Commission in 2021 to independently assess how best the taxation and welfare system could support economic activity and income redistribution, while generating sufficient resources to meet the costs of public services and supports in the medium and longer term.

Broadly speaking, the Commission's report sets out a strategy to raise the level of government revenue. This recognises the expected rise in age-related expenditure and the vulnerabilities associated with corporation tax receipts. In clear terms, the Commission notes that it "is convinced that the overall level of revenues raised from taxation and Pay Related Social Insurance (PRSI), as a share of national income, will have to increase materially over the coming years".

The Commission's proposals involve broadening the tax base across most areas, as a possibly more efficient approach to simply raising tax rates. This approach is intended to make raising taxes more efficient and fairer. The goal is to make revenues sustainable, with a focus on taxes that tend to distort behaviour less than others. The recommendations would see larger PRSI receipts and an effort to shift the balance of taxation away from labour and towards capital, wealth, and consumer spending.

At the same time, the Commission makes proposals to significantly improve the effectiveness of the welfare system. This is through reforms that support employment, address child poverty, and avoid "cliff-edge" effects — badly designed thresholds that can cause or perpetuate poverty. It also proposes regular benchmarking for working age payments. These proposals could increase the generosity of the social welfare system and require additional resources if current payments were not to be scaled back in some other way.

An important point to make is that the Commission's Report aims to provide a strategic view of future tax and welfare policy, rather than specific changes. The goal is more to establish a foundation from which to build rather than to provide a specific indication of the revenue that could be raised from the measures it identifies nor any fiscal costs. Indeed, its work was not framed around any specific shortfall in funding that needed to be filled. Instead, it was guided by a broad intention to generate additional revenue and reform the tax system in such a way as to limit economic, social and environmental costs.

Against that context, this Analytical Note attempts to provide a broad-brush assessment of the potential size of the Commission's suggested reforms in terms of their impact on overall taxation.

There are a substantial number of tax changes proposed in the Commission's report. However, the Report itself, for the most part, does not provide estimates of what these measures may yield, nor the specific rates or adjustments that might be followed. Our attempt to provide these estimates is purely a technical piece of analysis to try to contextualise their proposals. It relies heavily on our own interpretation of what the Commission recommends. To do this, we make a best guess around what the proposed taxes would apply to, what the rates might be, and so on. The Council, more broadly, does not take a view on the Tax and Welfare Commission's recommendations.

The Commission makes a number of recommendations on areas where much-needed information is lacking. This includes information on taxes foregone, notably in the area of pensions, and on areas where various capital gains taxes may apply, such as on people's principal private residences and on other assets when they die. The Government should prioritise addressing these and other data gaps to better inform its decision making.

To assess their wider economic impact, the Government should publish an assessment of the fiscal implications of the main policy options set out by the Commission. The Government should develop tools such as "ready reckoners" that would allow alternative paths to be costed and act as a guide to future policy.

Whether or not these proposals are ultimately implemented, addressing the data gaps that exist and updating them regularly would be an essential step. This would at least help prepare for the fiscal challenges that the State is going to face.

The State faces many fiscal pressures in the coming years and decades. Revenues from areas related to climate, such as taxes on vehicles and fuels, are likely to fall. At the same time, pressures related to the ageing population, including pensions and health costs are likely to rise. Vulnerabilities associated with Ireland's reliance on unreliable and excess corporation tax receipts could also pose problems if these were to suddenly reverse having expanded sharply in recent years.

Dealing with these challenges while maintaining existing policies and implementing other reforms will be difficult. The Commission's net revenue-raising proposals offer one potential strategy to address these challenges. The Council does not take a view on whether or not this is the right approach. Hopefully this analysis contributes to understanding what such an approach might entail and the broader discussion about how Ireland's public finances might respond to these challenges.

2. Assessing the potential impacts

To assess the potential impact of the Commission's proposals, we use two approaches:

1) a "bottom-up" approach that works through the recommendations one by one, drawing our own interpretation of what these might imply in a quantitative sense; and

2) a "top-down" approach that leaves aside the Commission's specific recommendations, instead focusing on the broad thrust of its guidance. We combine this with an assessment of how Ireland compares to other countries to ascertain the possible scale of what might be involved.

2.1 A bottom-up approach

First, we use a bottom-up approach. This involves going through the Commission's recommendations one by one and seeking out available costings wherever possible, based on our own interpretation of their recommendations.

In many cases, there are no ready-made costings available for the measures proposed by the Commission. The Commission also tends to give general guidance rather than suggested rates or other specifics. This allows for flexibility in terms of how the tax system is eventually calibrated, although it gives little insight as to the scale of what is being proposed.

The Commission's Report presents a package of interconnected reform proposals, so ideally the proposed measures should be viewed alongside other elements of the package. For example, increasing the base that a specific tax covers will then affect the amount that would be raised should the tax rate also be increased.

There is some evidence from various other sources of potential yields associated with the proposed measures, such as the "Ready Reckoner" produced by the Revenue Commissioners.[1] These can be used to provide a general assessment of most measures.

Figure 1 attempts to gather potential yields from tax changes recommended where these are available and can be estimated to provide a broad-brush assessment of potential impacts. Changes to the tax system

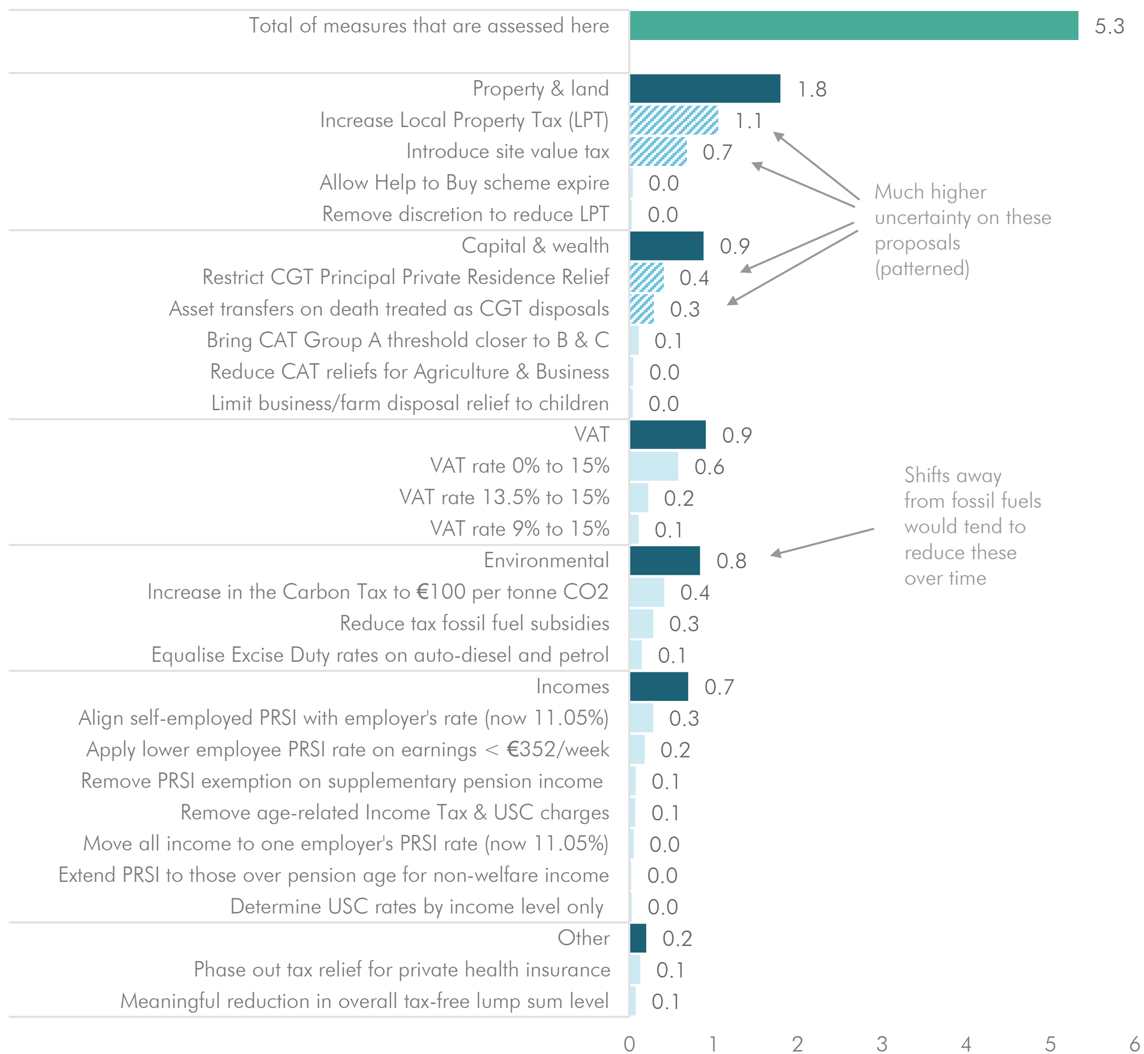
[1] The Ready Reckoner shows projected Exchequer costs and yields of proposed changes to rates, bands and so on, for a range of taxes.

on this scale would likely be implemented over many years and so, for the most part, this represents an estimate of the potential long-run impact.[2]

In the case of each reform, we make a number of judgement calls about what might be implied by the Commission's recommendations. In the interests of transparency, we have published detail on these assumptions as an accompaniment to the note. Given the lack of specifics around key elements of each recommendation, the potential impact should be seen as our interpretation of the reforms — one of multiple possible interpretations.

Figure 1: Potential impact of tax measures where estimates are available

% GNI* estimated full-year yield



Sources: Fiscal Council workings; Commission on Taxation and Welfare (2022); Revenue; Kakoulidou and Roantree (2021); Eurostat; OECD; Pensions Commission (2021); and CSO.
Notes: Costings are taken from a variety of sources and estimated where needed. For more detail on how estimates are derived see the full detail in the data pack: Explore the data in more detail.

[2] The potential long-run impact of the environmental taxes may be much lower of course.

The total tax changes we measure here would raise revenues by almost €15 billion, equivalent to 5.3% of GNI* (Figure 1).[3]

In some sense, this is likely to be an optimistic estimate for the measures we are able to assess because it does not allow for behavioural responses. For example, the environmental taxes are intended to change behaviour and reduce the use of fossil fuels. While that would help reduce carbon emissions and deliver a desirable outcome, it would ultimately reduce the yield ultimately generated by these taxes. It is also possible that increased tax burdens on capital, for example, could lead to greater levels of tax avoidance that would reduce the potential yield generated.

However, we also leave out several measures identified by the Commission. There are a number of proposed measures we cannot estimate and, as such, these are not included in the analysis. This would lead us to underestimate the total yield from the Commission's proposals. However, we generally only exclude measures that we expect to be relatively small in terms of their potential yield. For example, we exclude proposals to replace age-related pension contributions rates with a single rate, to remove the annual earnings cap on contributions, and to tax deposit interest income at an individual's marginal tax rate. Some of these measures could be introduced in a revenue-neutral way or the tax base for these measures and likely rates would tend to suggest smaller yields.

In terms of what can be quantified, the tax measures appear to have a big emphasis on property and land. The other measures contribute broadly similar amounts: VAT, capital and wealth, environmental taxes, and a string of tax reforms related to incomes.

- In relation to recurring taxes on property and land, we estimate an additional 1.8% of GNI* being potentially raised. This is based on our interpretation of the Commission's proposals. For household properties, we assume the Commission's proposal to "significantly increase the overall yield from these sources of wealth" entails an increase that would see Ireland move towards the upper end of international norms. Property taxes in many countries are generally perceived to be low (Norregaard, 2013). This approach would lead to an additional 1.1% of GNI* raised on people's homes. For the Site Value Tax, we follow a similar approach. Ireland currently raises about 0.7% of GNI* from commercial rates, which the Commission proposes be superseded by the Site Value Tax, albeit with

[3] Most estimates of tax yields that are available assume no behavioural effects — the way people would adjust their behaviour in response to higher taxes. These effects would tend to reduce yields and so our estimates could be seen as optimistic. For example, carbon tax receipts should fall as people move away from carbon-intensive activities. We make other optimistic assumptions in terms of the potential yield that would be raised: for example, the estimate for how much would be raised by adjusting the tax-free lump sum assumes that it would be removed in full. More detail on the assumptions we use are available online in the "Data Pack" accompanying this Fiscal Assessment Report.

"significantly more" of an overall yield. How much more is unclear. The Site Value Tax it envisages is very broad: applying to all land currently not subject to Local Property Tax. Ireland already has a high yield relative to EU norms for taxes raised on non-household properties. The EU median is 0.4% of GDP and the upper end of the range for EU countries is about 0.7% — in line with Ireland's current yield.[4] We interpret the Commission's recommendation that "significantly more" of an overall yield be raised to imply increasing Ireland's yield by about 0.7% of GNI* to a total of 1.4% of GNI*. This would broadly align it with the upper end of property tax yields (excluding households) for the OECD and with the yield raised in the UK.

- For proposals related to capital and wealth, we estimate an additional 0.9% of GNI* being generated. The yield could potentially be larger, and the Commission notes how these changes could improve the efficiency of the tax system. But quantifying the potential impact is difficult due to major data gaps — a problem highlighted by the Commission.[5] We base our estimates on an assessment of the potential tax base involved. For capital gains tax on principal private residences, we assess what we feel are reasonable estimates of home ownership, the housing stock, new builds, obsolescence, life expectancy, population increases, age of tenure commencement, annual house price increases, death rates, and an assumed 33% tax rate — in line with the existing rate. For other assets, in the absence of information on other asset types, we assume a yield equivalent to about half that for principal private residences, recognising that the assets in question would be difficult to capture and evaluate. These estimates are subject to a very large uncertainty range. The yield could be higher if, for example, more assets are captured or if annual gains differ substantially to historical norms. However, it could be smaller if exemptions, thresholds and credits offset the gains that are liable for tax substantially.[6]

- For VAT, we envisage the proposals potentially implying changes that would yield a combined increase in revenues of 0.9% of GNI*. We assume that the Commission's proposals to widen the base and limit

[4] By the "upper end", we mean the 95th percentile. We use this for the reference to the upper end of the OECD range as well.

[5] The Commission notes that the Irish tax system currently provides that the disposal of a property, which was occupied by the taxpayer, or by a dependent relative of the taxpayer, as their sole or main residence, does not give rise to a chargeable gain. It notes that the complete exclusion of principal private residences from capital gains tax in Ireland is an "anomaly" — one that it proposes should be restricted over time. The Commission also highlights the very limited data on the cost of principal private residence relief as a tax expenditure. The total consideration reported in 2019 and 2020 was €906 million and €837 million, respectively. However, the actual value of taxes forgone is unknown, as is the number of claimants and number of properties it applies to.

[6] Indeed, the Commission recommends that existing rules, reliefs and exemptions that apply on lifetime disposals should also apply to transfers on death. In addition, it recommends that any liability due should be credited against any capital acquisitions tax liability arising on inheritance.

zero or reduced rates means increases in the lower and zero VAT rates to 15%.[7] This could be seen as producing a high estimate, given that the Commission appears open to retaining the zero rate, for example, on some goods or services.

- Environmental tax changes could raise a further 0.8% of GNI*. This includes the planned carbon tax increases — though this could be transient as behaviours adapt — and the removal of certain tax exemptions on fossil fuels, such as for commercial flights.

- Changes to taxes on income could potentially raise 0.7% of GNI* based on our interpretation of the Commission's proposals. These changes are spread across many areas. Two of the biggest measures here would be to align self-employed rates with employers' rates and to apply a lower PRSI rate to low incomes currently exempt from PRSI.

[7] The Commission recommends limiting the use of zero and reduced VAT rates and that the second reduced rate (currently 9%) be raised to the first reduced rate (currently 13.5%), with the latter also being increased progressively over time. However, the Commission does not specify a new rate. Hence, we assume a 15% rate — below the 23% standard rate.

2.2 A top-down approach

A different approach to assessing the impact of the measures is a top-down assessment: this leaves aside the Commission's specific recommendations and instead focusses on the broad proposal to raise capital taxes, property taxes, consumption taxes, and PRSI.

A top-down estimate of potential revenue gains can be made assuming the aim were to raise the tax take in these tax areas from their current share of national income in Ireland to higher international norms. This can seen as akin to implementing the Commission's recommendations via benchmarking Ireland's tax system in an international context. While there may be no compelling reason to align exactly to the international median, this can provide a useful benchmark. Some EU countries have high taxes that their governments are looking to cut, while pressures to raise taxes are high in many countries due to ageing and high debt levels. Such an approach could underplay areas where the Commission calls for measures that, given current rates, would potentially imply Ireland moving above existing EU norms. An example of this would be in the areas of property, wealth and capital taxes.

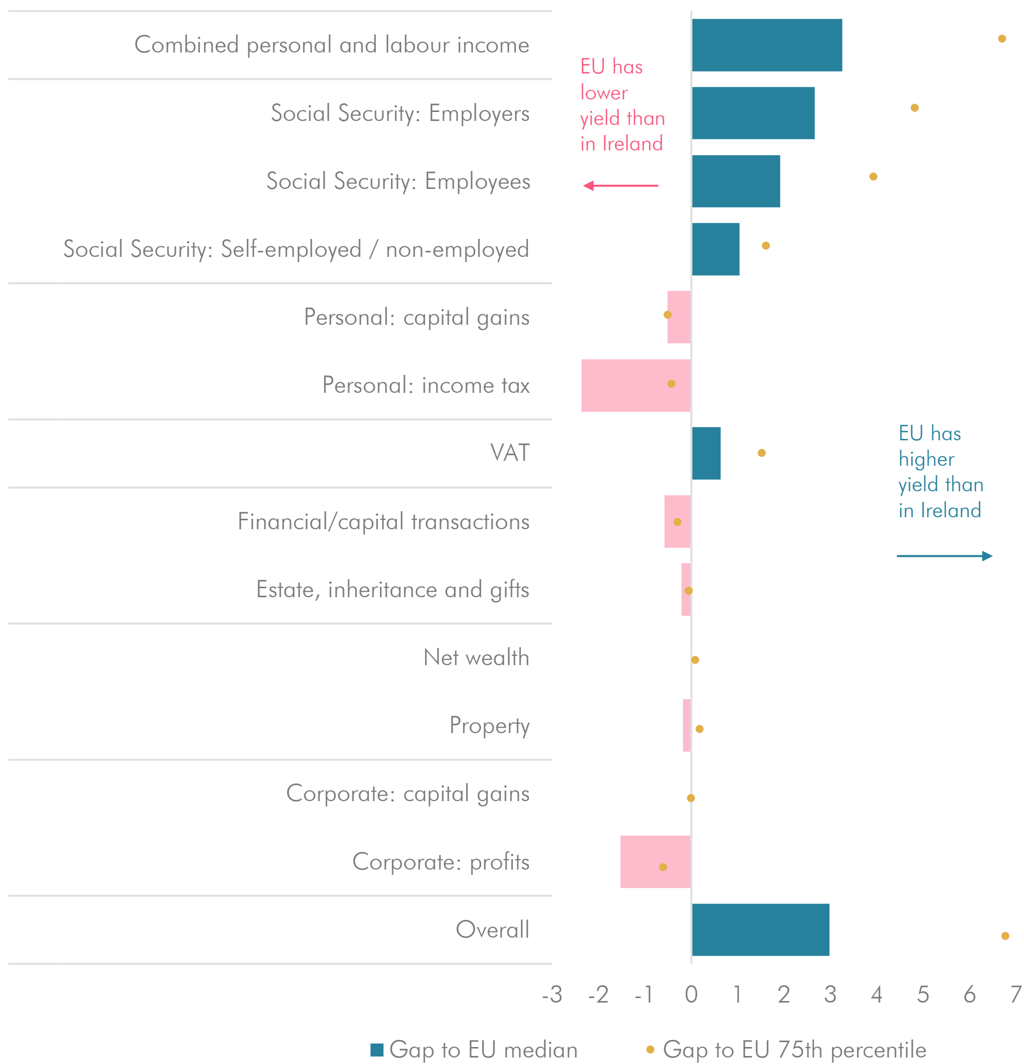
The main gap between Ireland and other EU countries in terms of taxes raised is for taxes on personal and labour income (combining personal income tax, USC and PRSI). These are substantially lower than the EU median. This reflects Ireland's relatively low employer and employee social security contributions, which more than offset relatively high personal income tax receipts.

In the areas of capital taxes, property taxes, consumption taxes, Ireland is broadly in line with the EU norms. However, these are areas where many economists and international organisations view the tax burden in most countries as being too low. Many have therefore argued to raise taxes in these areas as part of a strategy to shift the tax burden away from labour to better support growth (Abdel-Kader and de Mooij, 2020).

Raising the total share of income taxes plus social security contributions to the EU median would raise revenues by around 3.3% of GNI*. This "single" measure would yield about three-fifths of the total potential revenue of all the Commission recommendations estimated in the bottom-up approach (Section 2.1). Other areas would tend to suggest relatively little scope to increase yields without going beyond what is typical of other EU countries. Moving to the median for VAT would raise 0.6% of GNI*, while moving to the higher end of what other EU countries raise — the 75th percentile — would raise 1.5% of GNI*. Given the emphasis by the Commission on broadening the tax base, additional revenues would come from raising capital, property, consumption environmental taxes above current EU norms.

Figure 2: A top-down assessment of potential revenue gains

Gap between revenues raised as % GNI* in Ireland and as % GDP in other EU countries, 2019 data



Sources: OECD; and Fiscal Council workings.
Notes: The Figure shows the gap between what Ireland raised in 2019 in terms of various tax areas as a share of GNI* (with corporate profits adjusted for the Council's estimate of excess corporation tax receipts in this year) and as a % GDP for both the EU and OECD averages excluding Ireland.

3. Implications

Ireland faces major choices about the size of the State, and the role of different tax and spending instruments within that. The Commission's work is an important contribution in this respect.

The State faces many fiscal pressures in the coming years and decades. Revenues from areas related to climate, such as taxes on vehicles and fuels, are likely to fall. At the same time, pressures related to the ageing population, including pensions and health costs are likely to rise. Vulnerabilities associated with Ireland's reliance on unreliable and excess corporation tax receipts could also pose problems if these were to suddenly reverse having expanded sharply in recent years.

The potential impacts are large. The estimated increase in taxation needed to meet future pensions costs if the pension age remains at its current level would be 2 to 3% of GNI*. Excess corporation tax receipts are estimated by the Department of Finance at around 3½ % of GNI*.[8] The Council estimates that the scale of potential revenues exposed to climate change policies is of the order of 2.8% of GNI*.

Dealing with these challenges while maintaining existing policies and implementing other reforms will be difficult.

The Commission's net revenue-raising proposals offer one potential strategy to address these challenges. The Council does not take a view on whether or not this is the right approach. Hopefully this analysis contributes to understanding what such an approach might entail and to the broader discussion about how Ireland's public finances might respond to these challenges.

A broader debate needs to take place. It is not the Council's role to say how the balance of these choices should ultimately look. One choice could be to target a broadly revenue-raising approach. Another could be to reassess existing spending commitments. In this respect, The Government should develop the annual spending reviews into a more comprehensive spending review process with clearer direction on what adjustments could be made to various areas of spending. This would include assessing whether or not certain public services are still relevant, with a view to generating savings.

[8] The PRSI impacts are based on the Pensions Commission's Packages 1 and 3 and the estimated revenue yields for PRSI rate changes as set out in Kakoulidou and Roantree (2021). The estimated windfall corporation tax receipts are provided in *Budget 2023* and amount to an estimated €10 billion for 2023.

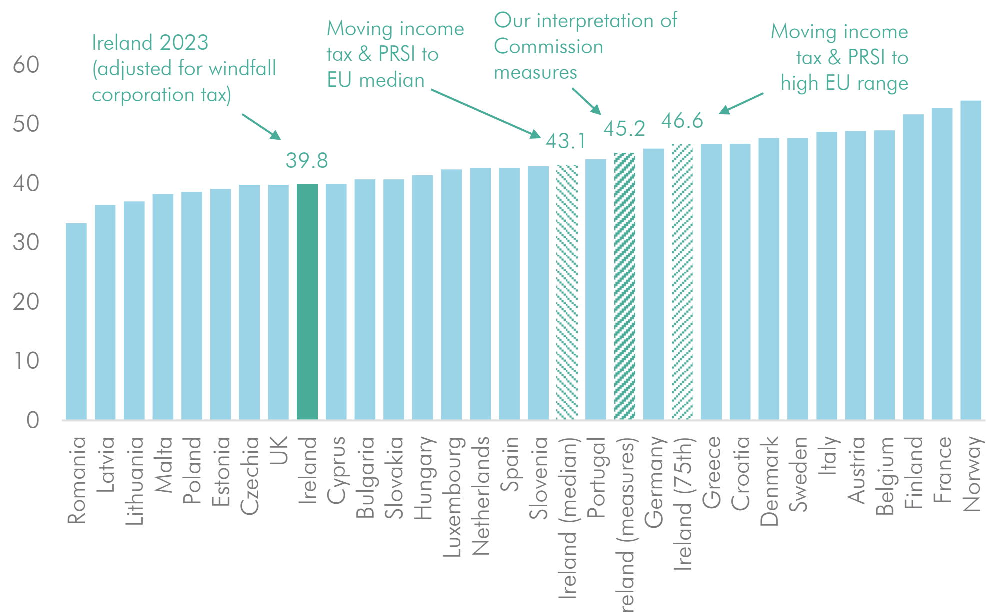
Assessing the potential revenue impact of the Commission's proposals, we estimate that — for those measures that we could quantify and provide an interpretation of — the impact could be to increase revenue as a share of GNI* by 5.3 percentage points.

We then use a top-down assessment drawing on international comparisons as a cross check. We find that if Ireland were to align with EU norms in terms of the net effect of raising both income tax and PRSI combined, it would increase revenues by about 3.3 percentage points of GNI*. It could potentially raise much more if it were to move to the higher end of what other EU countries raise in these and other areas —upwards of 8 percentage points of GNI*.

These changes offer one possible way to help address some of the sizeable challenges Ireland is facing. Changes on scale of what we assess here would mean that Ireland moves from being a relatively low tax country in the current European context, close to the UK at present, to one that is more similar to current EU norms (Figure 3). For instance, adding the estimated impact of the total measures that are assessed here would see Ireland's total revenues rise from about 40% of GNI* at present to 45% of GNI*. This would position it closer to where Portugal and Slovenia are today and between Spain and Germany.

Figure 3: Proposed tax changes would push Ireland closer to current EU norms

% GDP (% GNI* for Ireland), total government revenue 2023



Sources: AMECO; CSO; Department of Finance; and Fiscal Council workings.
Notes: The Department of Finance's estimated windfall corporation tax receipts for 2023 are removed from the 2023 estimate for Ireland. High EU range here refers to the 75th percentile for EU countries.

Taxes may rise over time in other countries as well as a result of long-term pressures, such as those related to ageing populations. However, this analysis puts some context on the scale of the measures being proposed.

References

Abdel-Kader, K. and R. A. de Mooij, (2020). Tax Policy and Inclusive Growth. IMF Working Paper No. 2020/271. Washington. Available at: https://www.imf.org/en/Publications/WP/Issues/2020/12/04/Tax-Policy-and-Inclusive-Growth-49902

Commission on Pensions (2021). Report of the Commission on Pensions. Available at: https://www.gov.ie/en/publication/6cb6d-report-of-the-commission-on-pensions/

Commission on Taxation and Welfare (2022). Foundations for the Future: Report of the Commission on Taxation and Welfare. Available at: https://www.gov.ie/en/publication/7fbeb-report-of-the-commission/

Department of Finance (2022). Budget 2023: Economic and Fiscal Outlook. Available at: https://www.gov.ie/en/publication/04fef-budget-publications/

Kakoulidou, T. and B. Roantree, (2021). Options for raising tax revenue in Ireland. ESRI Budget Perspectives 2022 Paper 1. Available at: https://www.esri.ie/system/files/publications/BP202201.pdf

Norregaard, J., (2013). Taxing Immovable Property Revenue Potential and Implementation Challenges. IMF Working Paper No. 2013/129. Washington. Available at: https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Taxing-Immovable-Property-Revenue-Potential-and-Implementation-Challenges-40594