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SYMPOSIUM ON TAXATION
SOME IMPLICATIONS OF TAX REFORM

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Commission on Taxation

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"We have travelled so far down the vicious path of decadent tax systems - the path of charging more and more on less and less - that it requires a great effort of imagination to turn back and realise that one cannot have it both ways. Taxes approaching 100 per cent confiscation can exist on paper. But one cannot apply the same notions to a genuine system and expect that it would work."

- Lord Kaldor

Introduction

The present Irish tax system is conceded on all sides to be totally unsatisfactory. It is unfair and complicated. It wastes resources on a grand scale. Reform is long overdue. In this paper I examine the changes in the burden of taxation in recent years and discuss how the proposals for tax reform proposed by the Commission on Taxation can begin to be implemented.

The Level of Taxation

Table 1 shows changes in the level of taxation in Ireland since 1975 in relation to gross domestic product. It also shows taxes on income and profits (including social insurance contributions) as a percentage of gross domestic product and the share of these taxes in total taxes.

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Table 1: Changes in the level of taxation in Ireland since 1975, and Income and Profits as percentages of G.D.P.

Year	GNP per head at 1975 prices	Total taxation as percentage of gross domestic product	Taxes on income and profits as percentage of gross domestic product	Taxes on income and profits as percentage of total taxation
	£	%	%	%
1975	1,177	32.1	14 1	43 9
1976	1,187	35.6	15.4	43.3
1977	1,229	34.6	15.6	45.1
1978	1,292	33.1	15.6	47 1
1979	1,315	33 1	16.5	49 8
1980	1,316	36.5	18.6	51 0
1981	1,318	38.4	19 4	50 5
1982	1,286	40.1	20.3	50 6
1983 (est)	1,286	41.3	21.4	51.8

Source: OECD Tax Revenue Statistics of Member Countries and department of Finance.

The data in the Table suggest that:

(i) The level of taxation in Ireland has risen rapidly since 1975. It is now almost 30 per cent higher as a share of gross domestic product. In fact the level of taxation in Ireland is the 8th highest of the 23 OECD countries while our level of income is the 20th highest.

(ii) Taxes on income and profits have risen more rapidly than other taxes. Their share of gross domestic product had risen by a half and they have accounted for 80 per cent of the total increase in taxes.

(iii) As a consequence taxes on incomes and profits now account for over half of total taxation in Ireland.

(iv) Gross National Product per head, after taxation, has declined by over 5 per cent since 1975.

The OECD has published data in relation to the amount of tax and social insurance contributions paid by the average industrial worker in 22 countries for 1981. This shows that the percentage of disposable income retained by such a worker in Ireland was about average. In terms of the burden, we ranked 11th of 22 countries for a single person, and 10th for a married person with two children. Table 2 gives the position in relation to those countries included in the study of income tax schedules referred to below.

Table 2: Disposable income as a percentage of gross income of average production worker in certain OECD countries 1981

Country	*Gross income in Irish pounds*	*Single Person*	*Married Person with 2 children*
	£	*%*	*%*
Austria	*6,837*	*75.0*	*91.1*
Canada	*10,302*	*77.4*	*88.0*
Denmark	*11,026*	*57.3*	*66.1*
Ireland	*6,890*	*70.5*	*81.9*
Netherlands	*9,149*	*64.1*	*74.0*
Norway	*10,121*	*64.5*	*80.3*
Sweden	*9,546*	*63.5*	*73.6*
United Kingdom	*8,643*	*68.2*	*79.0*
United States	*10,194*	*69.8*	*79.0*
Average		*67.8*	*79.2*
Ireland's Ranking		*7th*	*7th*

Source: The 1981 Tax/Benefit position of a Typical Worker in OECD member countries, OECD Paris 1982.

This suggests that the burden of direct tax on people on average industrial earnings was not excessive, even though it begs the question whether or not we get the same value for money for our taxes in Ireland as is provided in other countries.

Sur-taxes are fairly unimportant sources of revenue in most countries They apply at relatively high income levels and to small numbers of taxpayers. The OECD has published data relating to the distribution of taxpayers. These are shown in Table 3

Table 3: The Distribution of Taxpayers

Country	*Percentage of taxpayers with marginal rate above 35%*	*Percentage of taxpayers with marginal rate of 60% or higher*
	%	%
Austria (1976)	10.2	0.0*
Canada (1978)	1.4	NIL
Denmark (1978)	4.2	NIL
Ireland (1978-79)	14.9	5.0
Ireland (1983-84)**	40.0	9.0
Netherlands (1975)	16.8	1.7
Norway (1975)	7.4	NIL
Sweden (1981)	12 4	NIL
United Kingdom (1977-78)	5.2	1.3
United States (1977)	11.9	0.3

Source: Income Tax Schedules Distribution of Taxpayers and Revenues OECD, 1981, Table 7 and Revenue Commissioners.

* The share of taxpayers is less than 0.05 per cent but there are taxpayers charged at rates of 60 per cent and higher.

** Estimate

Ireland now has double the percentage of taxpayers with a marginal rate of 60 per cent, or higher, than are liable to rates higher than 30 per cent in the United Kingdom.

Table 4 shows the tax yield from selected brackets in the income tax schedule.

Table 4: Tax yield from selected brackets of the Tax Schedule

Country	*Cumulative percentage of tax up to and including the 35 per cent bracket*	*Percentage of tax from the last bracket*	*From other higher rate brackets*
	%	%	%
Austria (1976)	83.6	0.0	16.4
Canada (1978)	93.0	2.0	5 0
Denmark (1978)	87.6	12.4	NIL
Ireland (1978-79)	73.4	15.1	11.5
Netherlands (1975)	64.8	3.1	32.1
Norway (1975)	78 5	1.8	19.7
Sweden (1981)	69 0	4.4	26.6
United Kingdom (1977-78)	88.1	2.1	9.8
United States (1977)	74.4	1.8	23 8

Source. Income Tax Schedules Distribution of Taxpayers and Revenues OECD 1981, Table 6

In recent years, Ireland has got very much out of line with other countries in charging very large numbers of taxpayers to relatively high rates of tax This is shown in Table 5 which sets out the number of taxpayers liable at the higher rates since 1973-74.

Table 5: Number of taxpayers liable at higher rates of tax since 1973-74

Year	*Taxpayers liable at the higher rates*	*Percentage of total taxpayers*
	000	*%*
1973-74	*8,000*	*1.1*
1974-75	*19,000*	*2.6*
1975-76	*37,000*	*4.9*
1976-77	*60,000*	*8.0*
1977-78	*80,000*	*10.6*
1978-79	*118,000*	*15.0*
1979-80	*217,000*	*26.9*
1980-81	*107,000*	*12.1*
1981-82	*132,000*	*14.8*
1982-83	*292,000*	*32.3*
1983-84	*363,000*	*40.1*

Source: Revenue Commissioners

In my view it is not surprising that dissatisfaction with our system of taxation, and particularly our system of direct taxation, should have increased against this background. If taxation is low, inadequacies in the system can be ignored.

However, when taxation is high, it intrudes much more in day to day living and perceptions of its fairness and its overall effect on economic life become much more important Taxation at the level now imposed in Ireland is likely to be unacceptable unless we do something now to adapt it to modern conditions

There seems to be a consensus between Government and Opposition that the burden of taxation is too high

> "The growth in the burden of taxation in recent years, both on the average income-earner and on the economy, has had adverse affects on the enterprise of the individual and on the competiveness of the economy The Plan, therefore, envisages reducing the total burden of taxation as a proportion of GNP and transferring the incidence from PAYE to other forms of taxation "[1]

> "There is understandable concern at the present burden of taxation, a concern increased by a widespread feeling that this burden is unfairly distributed "[2]

> "I readily acknowledge that our tax rates are now rather on the high side and that we should aim to achieve reductions as soon as we reasonably can "[3]

This suggests that once the problems in relation to the public finances are resolved, the aim will be to reduce the burden of taxation in the long-term

Commission on Taxation

The Commission on Taxation was established in March, 1980 as a result of "widespread public unrest and dissatisfaction" with the tax system The Commission's terms of reference were wide, requiring it to recommend a system which was *equitable,* with, *due attention being paid to the need to encourage development of the national economy and to maintain an adequate revenue yield.*

The First Report of the Commission, published in July 1982, proposed a general system of direct taxation covering income tax, corporation tax, capital gains tax and the taxation of capital and capital transfers A general system of indirect taxation and issues in relation to incentives will be among the items dealt with in further reports Once these proposals are made, it is very desirable if, after a reasonable period of discussion, long-term tax policy could be settled This is because uncertainty about future tax policy breeds lack of confidence and inhibits investment It is, however, important that if the Commission's proposals are rejected, alternative proposals to reform what if agreed on all sides to be an unacceptable system are put on the table The debate should focus on the relative attractions of realistic alternatives rather than dismissal of one set of proposals

The Commission's main proposals were that

(i) income tax should be charged at a single rate on all income including wages, salaries, profits, realised capital gains, lump sum receipts, gifts, inheritances and other windfalls.

(ii) the extraordinary range of exemptions and deductions from income should be abandoned Only standard personal allowances given in the form of tax credits should remain

(iii) the essential redistributive function of the tax and public expenditure systems should be achieved through direct payments at the bottom of the scale, through the choice of a level of personal credit and tax rate in the middle income range and the introduction of a progressive direct tax on expenditure at the top of the scale.

(iv) social insurance contributions should be replaced by a social security tax levied on all income

(v) the tax system should be adjusted systematically to deal with the distortions arising from inflation This requires the indexation of progressive tax structures and capital/income adjustments to take account of changes in the real value of liabilities and income-producing assets

Revenue Effects of Commission's Proposals

The Appendix to this paper contains estimates of the effect of adopting the proposals in the Commission's First Report in 1983-84. The effects of this are summarised in Table 6.

Table 6: Effect of single rate of tax of 35 per cent under proposals in First Report

Level of tax credits		*Shortfall over current revenue*
Single person	*Married couple*	
£	*£*	*£m*
635	*1,270*	*474*
385	*770*	*49*

Tax credits of £385 and £770 are required to replace the existing personal allowances. Tax credits of £625 and £1270 are required to replace the existing exemption limits (which the Commission recommended should be abolished). The appropriate level of credits is a political decision. However, even taking the higher figures the loss of revenue is substantially less than the yield from the existing employers' social insurance contribution. The Commission considered, (subject to the reservations of two members), that any shortfall in the Social Insurance Fund over and above revenue raised from a 5 per cent social security tax should be raised from indirect taxation. On current estimates this would be £410 million. The existing employers' contribution yields £617 million. The Commission takes the view that this is mainly passed on to consumers in the form of higher prices. Therefore, if the basis of employers' social insurance contributions is changed from payroll to profits, the Commission believes that indirect taxation could be raised by £400 million without any net increase in prices.

However, even if one accepts that there are short-term public finance constraints which make the full implementation of the report difficult or impossible, the question arises as to how much could be done to accommodate those constraints The Commission recognised that the new system could not be introduced overnight and set out its views on how its proposals could be phased Insufficient attention has been paid to the implications of these transitional proposals The Commission argued and, in my view, conclusively showed that the existing tax system is very unfair, hopelessly inefficient and much too complicated Substantial progress towards improving it can be made without question of loss of revenue

Transition

In this section of the paper, I set out the phased reforms which are feasible despite existing contstraints The Commission suggested that its proposals could be implemented in three phases which could overlap to some degree·

Phase one involved those items on which work could begin immediately[1] Phase two covered items which caused greater difficulty.

Phase three, dealt with the steps involved in the final integration of the system of direct taxation

The Commission proposed that tax reform in phase one should fall under nine headings

- (i) Extension of the income tax base.
- (ii) Charge to tax of lump sum receipts and other windfalls.
- (iii) Reform of income tax structure.
- (iv) Reduction in income tax rates
- (v) Reform of capital gains tax.
- (vi) Reform of corporation tax.
- (vii) Reform of capital acquisitions tax.
- (viii) The adjustment of taxes for inflation
- (ix) Reform of social insurance contributions.

The data on which to base estimates of changes in tax policy of the type proposed by the Commission are variable. In some instances the data are inadequate and make reliable estimates difficult. This is not to detract from the substantial improvements that have taken place in the amount of information published by the Revenue Commissioners for which they must be congratulated. Estimates of the amount of income exempt under some headings have to be tentative since the information on which to base reliable estimates is not collected. However, the figures provide an indication of the orders of magnitude involved.

Before considering these reforms in detail, I set out in Table 7 estimates of the tax base and the yield of various taxes in 1983-84

Table 7: Estimates of Tax Base and Net Produce of Tax in 1983-84

Tax Heading	Tax Base	Net Produce of Tax
	£m	£m
Income tax	5,060	1,921
Corporation tax	667	261
Capital gains tax	12	6
Capital acquisitions tax	40	13
Social insurance contributions and levies		
- Employees		457
- Employers		596
- Self-employed		21

Extension of the Income Tax Base

In phase one the income tax could be increased by over 28 per cent. The items in question are shown in Table 8

Table 8: Extensions of the Income Tax Base

	£m
Short-term social welfare benefits and exemption limits	802
Fringe benefits	170
Social Welfare Allowance	210
Interest paid in full	167
Life assurance premiums	33
Medical insurance premiums	27
Covenanted subscriptions	7
Age allowance	3
Artists' relief	2
Treat widowed persons with no dependants as single	11
Permanent Health insurance premiums	1 5
Foreign pensions	0 5
	1434

Lump-sum Receipts and other Windfalls

Lump-sum receipts and other windfalls confer the same command over economic resources as other income and should in principle be charged to tax in the same way. In the absence of proper averaging provisions, it would be unfair to subject such receipts to the full scale of progressive rates since they typically accrue in an uneven pattern. Accordingly, the Commission proposed that such receipts be charged at a rate of 30 per cent during phase one of the transiton. The amounts of income involved are shown in Table 9.

Table 9: Term Yield from Lump-Sums and Windfalls

	£m
Retirement lump-sums	90
Statutory redundancy payments	23
Prize Bond and Sweepstake winnings of Irish Residents	6
Compensation payments for loss of office.	25
	144
Total yield of tax	£43 million

Reform of Income Tax Structure

The Commission recommended substantial reform of the personal income tax structure during phase one These measures have in general no revenue implications since they can be put into operation on a revenue - neutral basis. These reforms are:

(i) the adoption of the family as the unit of personal taxation.
(ii) the replacement of income tax allowances by tax credits.
(iii) the replacement of income tax and social welfare child allowances with a universal child benefit and
(iv) the abolition of many income tax secondary allowances such as dependent relative allowance, blind persons allowance, incapacitated child allowance and their replacement, where necessary by direct payments.
(v) the integration of the reduced and standard rates thereby starting on the road towards a low single rate band at the bottom of the scale.

In the first instance increasing the reduced rate of tax of 25 per cent to 35 per cent would allow an increase in personal allowances of £250 for single persons and £500 for married persons. Other combinations of increasing personal allowances and reducing the standard rate of tax would also be feasible at no net cost. These changes would not generally increase marginal tax rates because, due to the operation of the exemption limits at the bottom of the scale, many taxpayers at that level are now subject to very high marginal tax rates. This is best illustrated by the example in Table 10.

Table 10: Effective rate structure facing a married person on PAYE in 1983/84

Range of income	*Marginal rate of tax°*
£	
0 - 4,800	*NIL*
4,800 - 5,524	*60*
5,524 - 5,786	*25*
5,786 - 11,786	*35*

° *excluding social insurance contributions and levies.*

The existence of the reduced rate band has very little relevance for low income taxpayers. In addition, the operation of exemption limits means that married persons in a significant range of income face marginal tax rates of 68.5 per cent (including PRSI contributions and levies). Again we have the worst of both worlds, no benefits from a more complicated tax structure and higher costs arising from having to administer two additional PAYE tables.

Reduction of Income Tax Rates

The Commission's analysis of the defects of the Irish income tax system suggested that the base was too narrow and the rates of tax were too high It was concerned that its proposals to extend the tax base be accompanied by measures to reduce tax rates. Given the substantial extension of the tax base to which I have already referred, there is scope for a substantial reduction in income tax rates on a revenue neutral basis Obviously, opinions will differ on how these should be distributed.

The options are.

(i) to increase tax thresholds substantially
(ii) to make an across the board reduction in income tax rates.
(iii) to concentrate the reductions in the rates at the higher end of the rate structure

The astonishing growth in the number of taxpayers liable at the higher rates, which is shown in Table 5, is due largely to the failure to adjust the thresholds for higher rate tax in line with inflation. High tax rates at relatively low income levels have serious economic implications. They have inflationary consequences as people seek ever larger increases in money incomes in an attempt to maintain their spending power in real terms. They contribute to tax avoidance, e.g through the extension of fringe benefits which are inadequately charged to tax Tax evasion is given a great boost The Commission was very conscious of these undesirable effects and argued that its proposals must result in the vast majority of taxpayers being liable at a single relatively low rate of tax This view was endorsed in strong terms by the trade union representatives on the Commission 6 The Commission's view is that priority should be given to reducing the number of taxpayers liable at the higher rates of tax.

Reform of Capital Gains Tax

The present capital gains tax like most taxes in Ireland, is characterised by high rates levied on a base that is too narrow. The Commission's proposals would involve a net addition to the capital gains tax base of 40 per cent in phase one These are shown in Table 11.

Table 11: Changes to Capital Gains Tax in Phase One

Additions to Base		
Principal Private Residence		5.0
Disposal of a business or farm		Nil
Relief for assets required by compulsory purchase order		Nil
Disposals on death		2.5
Small gains		2.5
Roll-over relief		Nil
		10.0
Deductions from Base		
Indexed losses	4.0	
Capital gains by companies now subject to double taxation	1.25	5.25
Net addition to base		4.75

As regards the rate of capital gains tax in the transitional period, the Commission recommended that such gains be charged at a single rate so as to achieve neutrality in the treatment of income and realised capital gains to the greatest extent possible. As far as companies are concerned, this is very easy to achieve, the rate of tax on capital gains should be the normal rate of corporation tax. With individuals the position is more complicated Gains realised in a period of less than a year should be treated as ordinary income. Gains realised over longer periods should be charged at a rate between the existing minimum and maximum rates of income tax. A rate of 36 per cent would maintain the existing yield from capital gains tax.

Reform of Corporation Tax

There is a widespread misconception that the tax burden on manufacturing industry in Ireland is exceptionally favourable by international standards. Following the introduction of advance corporation tax in the Finance Act, 1983 and the termination of export sales relief for new ventures, this is not so Despite the fact that the nominal rate of corporation tax on manufacturing profits in the United Kingdom is 52 per cent and a rate of 10 per cent applies in Ireland, tax in the United Kingdom is not very much higher than here.

Only 50,000 out of a total of 140,000 manufacturing companies in the United Kingdom pay any corporation tax on undistributed profits. It has been estimated that the cost in the United Kingdom of reducing the rate of corporation tax for manufacturing industry to 10 per cent would over the five years to 1980 have averaged £750 million per year. This is equivalent to about 20 per cent of the total yield from corporation tax in the United Kingdom excluding that arising from North Sea Oil and Gas. This suggests that the effective rate of corporation tax in the United Kingdom is about 12 per cent.

A number of reforms of corporation tax are possible in phase one without any loss of

revenue. These are.

(i) abolishing the special rate of tax applying to small companies,
(ii) charging close companies to tax on a partnership basis
(iii) abolishing the surcharge on the undistributed income of certain close companies.
(iv) charging capital gains made by companies to the normal rate of corporation tax

Reform of Capital Acquisitions Tax

The existing capital acquisitions tax is characterised by very high nominal rates of charge on a base which is eroded through the granting of exemptions and reliefs and relatively high thresholds. For example, the rates run up to 60 per cent while the threshold for immediate relatives is £150,000. The effective rates of tax on an inheritance of £200,000 are:

Class I	(Spouse or child)	6.25
Class II	(Lineal ancestors or desendents other than in Class 1)	23.70
Class III	(Brother, sister, nephew or niece)	34.45
Class IV	(Others)	48.08

The distribution of the yield from gift and inheritance taxes in the year ended 31 December 1980 is shown in Table 12.

Table 12: Distribution of yield from capital acquisitions tax 1980

	% of net receipt	*% of assessments*
Class I	*22.7*	*2.8*
Class II	*3.2*	*3.6*
Class III	*48.9*	*63.2*
Class IV	*25.2*	*30.4*

Source: Annual Report of the Revenue Commissioners 1980, Tables 59 to 62.

A number of reforms are possible on a revenue - neutral basis. The first step is to make the family the unit of taxation, thereby exempting inter-spousal transfers and removing an impediment to the reduction in tax thresholds. The cost of this concession could be recovered by a combination of:

(i) reducing tax thresholds.
(ii) introducing a charge on discretionary trusts.
(iii) reducing valuation concessions for productive assets.
(iv) introducing lifetime cumulation of gifts and inheritances.
(v) abolishing the preferential rate of tax on gifts.

There is also a need to reduce some of the higher marginal rates of tax on inheritances. Rates of up to 60 per cent are only supportable if the tax base is so

narrow that such rates are ineffective.

Adjustment of Taxes for Inflation

The Commission gave considerable attention to the distorting effects of inflation on taxation Inflation changes the overall level of taxation as a proportion of national income It raises the share of particular taxes as a proportion of total tax revenue and reduces others It changes the distribution of taxation among individuals in an arbitrary fashion, it favours those who can arrange to pay their tax later and it distorts the tax base For these reasons the Commission concluded that "it is essential that measures are taken very soon to adjust the tax system for the effects of inflation "[7]

Some might argue that because the rate of inflation is falling inflation adjustments are less urgent It is now (August 1983) 10 per cent compared with an average of 16 per cent per year since 1974 However, the introduction of inflation adjustments is easier and causes less disruption when inflation is low It may be argued that we should grasp the opportunity offered by a period of relatively low inflation to put our tax system on a basis that can cope with the reality that stable prices are the exception rather than the rule

Indexation of the personal tax system is costless All this requires is that decisions to change the tax burden are taken explicitly rather than by stealth. The erosion of the value of tax bands since 1978-79 is shown in Table 13.

Table 13: Comparison of value of tax bands in 1983-84 with the indexed position for 1978-79

	Single Persons Taxable Income		Married Persons Taxable Income	
Top of	1983-84	1978-79 (Indexed)*	1983-84	1978-79 (Indexed)*
	£	£	£	£
25% Band	1,000	3,125	2,000	3,125
35% Band	4,000	9,374	8,000	9,374
45% Band	6,000	12,499	12,000	12,499
60% Band	10,000	no ceiling	20,000	no ceiling

* Assumes average rate of inflation in 1983-84 is 10 per cent.

Table 13 shows that marginal rates have increased substantially at constant real income levels. This is particularly marked in the case of single people However, it is also clear that the substantial benefits which accrued to married couples with higher incomes on the introduction of income splitting in 1980-81 have been more than recovered. Table 13 in fact understates the real increase in taxation because of the decline in the value of deductions for life assurance relief and mortgage interest due to the erosion of the value of the ceilings on these reliefs During this period the value of tax thresholds has substantially increased in real terms following the introduction of exemption limits in 1980-81 This is shown in Table 14

Table 14: Comparison of value of personal allowances and effective exemption limits in 1983-84 with the indexed position for 1978-79

	Single Persons		Married Persons	
	1983-84	1978-79 (Indexed)	1983-84	1978-79 (Indexed)
Personal Allowance	1,450	1,802	2,900	3,604
Effective Exemption Limits	2,400	1,802	4,800	3,604

The increase in the real value of thresholds, combined with a decline in the real value of personal allowances, has led to an increase in the problem of the poverty trap

Substantial progress can also be made in moving the tax system closer to neutrality with respect to inflation. The following measures would increase revenue at existing rates of tax·

1 Introduce current basis of assessment for Schedule D taxpayers.
2. Withdraw the deduction for interest paid in full
3 Treat all new Government securities as chargeable assets for capital gains purposes

The revenue raised from these measures could be used to:

1. Extend the cost of sales adjustment to all business sectors on a permanent basis.
2. Increase the exemption limit for bank and other deposit interest substantially.

Reform of Social Insurance Contributions

The Commission proposed substantial reform of social insurance contributions. It recommended that ultimately these be replaced by a social security tax levied at a uniform rate on all income including realised capital gains and taxable gifts and inheritances Any shortfall required to finance benefits should be raised from indirect taxation It is clear that employers' social insurance contribution add directly to the cost of living since they are allowed by the Prices Commission in determining applications for price increases. A reduction in contributions can therefor be translated into lower prices. This leaves the way open for some increases in indirect taxation.

The major concerns regarding loss of revenue arise here. A 5 per cent social security tax would raise £574 million Existing social insurance contributions and levies yield £1074 million of which £90 million is paid by the State as an employer. This leaves a shortfall of £410 million to be raised from indirect taxation.

Significant reform of the employees' social insurance contribution is possible in the short-term:

1. Health contributions, special levy and youth employment levy could be fully integrated with income tax. This would significantly improve the

efficiency of collection of these imposts from the non-PAYE sector

2 The ceiling on contribution could be removed and the rate reduced on a revenue - neutral basis

3 The ordinary rate of contribution could be extended to categories and incomes which enjoy preferential rates at present This would enable the rate of contribution to be further reduced The question arises as to the effect this would have on benefit entitlements While these could be extended if desired it does not inevitably follow that they must because (i) existing entitlement relates, not to the amount of contributions paid, but to the number of contribution weeks (ii) many people who have absolutely no entitlement to benefit bear the burden of the existing contributions

Reform of the employers' social insurance contribution may have to proceed more slowly However a number of changes can be made at an early date (i) Take a decision not to increase the contribution in real terms (ii) Remove the income ceiling and reduce the rate of contribution on a revenue - neutral basis This is likely to favour labour intensive firms

Further progress is more difficult unless the reality of the employers social insurance is grasped A simple-minded approach suggests that because employers send the cheque to the Revenue Commissioners (as they do in the case of PAYE) they must bear the burden of the tax Such an assumption may be convenient for policy analysis, but it does not reflect the reality which is much more complex The employers' contribution could also be shifted to employees in the form of lower wages or higher unemployment This is more likely in the unsheltered sector, particularly in the weaker industries To the extent that this is so, the removal of contributions will lead to increased tax revenue arising from higher employment and reduced expenditure on unemployment benefits

If the contribution is not shifted to employees the effect is to increase the price of labour, thereby giving a boost to labour substitution In the sheltered sector, it is likely that contributions will be passed on to the consumer in higher prices In these circumstances, as far as the domestic consumer is concerned, the incidence of employers' social insurance contributions is likely to be the same as a sales tax, albeit one with a bias against those products where labour forms a relatively high proportion of domestic value-added As a result, it also favours goods in which the value-added in Ireland is relatively low e g imports

If any of these more realistic possibilities about the incidence of employers' social insurance contributions are examined, they will be clearly seen to have bad economics and income distribution effects Firstly, they are likely to increase unemployment. Secondly, by taxing exports and exempting imports they adversely affect the balance of payments Thirdly, since they tax only goods produced in Ireland, they are likely to be regressive This is because people with higher incomes are likely to spend a much higher percentage of their income on imports than those with low incomes

The Commission considered that these adverse effects would be eliminated if the employers' social insurance contribution were replaced by more neutral indirect taxes: value-added tax is the main candidate, but excise duties could carry some of the burden. This should not lead to any general increase in prices even though there would be changes in the prices of individual goods and services

(i) prices of imports would rise to home produced goods
(ii) prices of labour-intensive goods and services would fall

Improved Efficiency

In making calculations about the revenue effects of implementing the Commission's proposals, I have taken no account of any increase in revenue which would arise from adopting a tax system that encourages economic growth in place of one which inhibits it. It would be naive to assume that the present tax system has no cost in lost growth, just because we are unable to measure this. To take one example, thre is great concern about the fact that the efficiency of investment in Ireland is very low by international standards. Much of this may be related to tax which distorts investment decisions to an extraordinary degree. By changing to a system which encourages productive rather than just taxefficient investment, we could reasonably expect an increase in the efficiency of investment.

Progressivity

Some criticisms have been made of the Commission's proposals and in particular the proposal for a single rate of tax - on the grounds that they are regressive The difficulty with retaining a progressive income tax structure is that it makes it impossible to adopt a proper income tax base Special treatment is essential for company income and for capital gains under a progressive income tax system This can only be avoided by adopting a system of lifetime averaging of income This is generally conceded to be impracticable. Once capital gains and company income are subject to separate taxation, effective progression simply breaks down and the opportunities for tax avoidance are multiplied There is a clear choice between having a progressive income tax on a restricted base or a single rate on a much wider base. In the Commission's view, the wider base is to be preferred, because it is much fairer, offers a far greater prospect of having a tax system which substantially contributes to economic progress and allows an enormous degree of simplification A single rate of income tax does not require any sacrifice in effective progression It is of course true that the rate structure proposed by the Commission if taken on its own is less progressive than the existing rate structure, at least for the vast bulk of people on middle incomes. The structure would be more progressive at the very bottom of the scale, since those on low incomes would not pay social security tax in cases where they are now liable for social insurance contributions. However, other changes proposed by the Commission would substantially increase progressivity These include.

(i) the abolition of reliefs and deductions which mainly benefit those on higher incomes,
(ii) the change from tax allowances to tax credits,
(iii) the extension of the income tax base,
(iv) the abolition of the ceiling for social security tax, and
(v) the abolition of the employers' social insurance contribution

It is not possible to say whether the Commission's proposals favour any particular income group In general, people who have been able to take full advantage of existing tax reliefs tend to lose while those who have not tend to gain. It may be that

some will consider that the system proposed by the Commission is not progressive enough, others will argue that it is too progressive. That is the essence of political debate and it is right that there should be argument and discussion about it. However, there are other options. Public expenditure has potentially a far greater effect on the overall progressivity of the tax/expenditure system than taxation, and it is the overall position that is important The scope for greater selectivity in public expenditure is clear [8] and has received inadequate attention from policy-makers Properly designed schemes can impose significant progressivity to the tax/ expenditure system

Conclusion

In this paper I have been concerned to show that there is significant scope for tax reform in the short-term within the constraints imposed by the present state of public finances Since the tax base can be significantly extended these constraints may be exaggerated. Significant and radical tax reform is a feasible proposition. A comprehensive tax base with lower rates would make a great contribution to the efficiency of the economy. However, the argument is much more basic and has been well put by other writers.

> "Administrators . should be vitally concerned as to whether levies like the income tax are generally felt to be clearly inequitable. This feeling, we venture, is more likely to arise where persons are seen to pay very different taxes for no good reason, or to pay similarly when difference is clearly appropriate, than where the general level of rates or degree of progression is high for all alike. Thus, the avoidance of obvious and flagrant inequity is imperative "[9]

"The ideal of the comprehensive tax base is an assignment of taxes so obviously fair and appropriate that all conflict over payment for the services of government would be eliminated. Allow farmers to pay different taxes than plumbers, homeowners to pay ddifferent taxes than tenants, easterners to pay different taxes than westerners, and we are in danger of losing the consensus on which democratic government depends "[10]

Footnotes

1. The Way Forward pl. 1061, October 1982, pp.23-24
2. Budget Speech, 9 February, 1983
3. Address of Minister for Finance, Mr. Alan Dukes T.D. to the Institute of Taxation on 4 March 1983.
4. Budget Speech 27 February, 1980
5. Chapter 38 of the Report.
6. Observations and Reservations by Mr. Daniel Murphy and Mr. Donal Nevin, paragraph 31, First Report p. 474-475
7. Commission on Taxation, First Report, p 262

8. For example, see "The Financing of Third-Level Education" A.C. Barlow E S.R I Paper No. 106

9 "Personal Income Taxation" Henry C. Simmons. University of Chicago Press 1938 pp 108-109

10 "The Economic Prerequisite to Democracy". Dan Usher. Basil Blackwell Oxford 1981. p. 110.

Appendix

REVENUE EFFECTS OF COMMISSION ON TAXATION PROPOSALS

This appendix contains details of the revenue effects of the proposals contained in the first report of the Commission on Taxation assuming these were implemented in 1983/84. Proposals made by the Commission which have already been implemented are excluded.

The net revenue of the Commission's proposals assuming a single rate of tax of 35 per cent is summarised in Table 1

Table 1: Revenue Effect of Commission's Proposals 1983/84

	Net Produce of Tax 1983/84	Net Produce at 35% on base proposed by Commission	Change
	£m	£m	£m
Income tax	1,921 1	2,653 8	+732 7
Corporation tax	261	317 1	+56 1
Capital gains tax	6	5 9	- 0 1
Capital acquisitions tax	13	31 5	+18 5
	2,201 1	3,008 3	+807 2
Direct expenditure tax*	NIL	175	+175 0
Discretionary trusts	NIL	3 0	+3 0
Social insurance contributions and levies	1,074**	NIL	- 1034 0
Total	3,275 1	3,186 3	- 48 8

* About 3 per cent of total tax revenue

**Of this £617 million is paid by employers including £90 million paid by the State as an employer The cost of replacing secondary allowances under the tax code with Social Welfare payments where appropriate would not exceed £50 million The net change on social payments is therefore £1,034 million

INCOME TAX BASE 1983-84

Taxable Income		5119 7
Additions to Base	£m	
Married persons allowance	1,119	
Single persons allowance	677	
Widowed Persons (no children)	45	
Widowed person (with children)	26	
Single parents	32	
Child allowance	86	
Social Welfare Allowance	210	
Deduction for Schedule E taxpayers	535	
Exempt income of taxpayers subjec to marginal relief	112	
Income to persons exempted under exemption limits	802	
Short term social welfare benefits		
Income of persons currently outside the tax net	317	
Interest paid in full	167	
Medical insurance premiums	27	
Life assurance	33	
Retirement pension lump sum	90	
Schedule D current basis (3)	250	
Rates deduction	38	
Age allowance	3	
Dependent relative allowance	5.5	
Blind person's allowance	0 2	
Allowance for employed person to care for incapacitated individual	3 5	
Health expenses relief	3	
Premiums under permanent health benefit schemes	1 5	
Artist's relief	2	
Covenanted subscriptions	7	
Statutory redundancy payments	23	
Compensation payments for loss of office	25	
Profits of Sweepstakes under Public Hospitals Act, 1933	0 4	
Prize Bond and Sweepstake winnings by residents	6	
Fringe benefits	170	
Employers social insurance contributions as deduction	132	4,948.1
Total		10.067.8

Additions to base as result of 1983 Budget		30	
Deductions from base			
Bank Deposit interest	166		
Building Society interest	4		
		170	140

Adjusted income tax base		9,927 8
Total tax at 35%		3,474 7

Cost of Tax Credits

Married persons (£770 x 591,000)	455 1	
Other persons (£385 x 759,000)	292 2	
Credit for Rates Paid (Schedule D)	38	
Credit for distributions (Schedule F)	26	
Head of Household Credit (£385 x 25,000)	9 6	820 9

CORPORATION TAX BASE 1983-84

Amount chargeable to corporation tax		667 0
Add		
1983 Budget anti-evasion measures	4 4	
Rates deduction	67	
P R S I deduction	277 1	
ESR profits switched to 10 per cent rate	62	410 4
Adjusted base		1,077 4
Net Produce at 35%		377 1
Deduct	£m	
Rates credit	67	
Continuance of 10 per cent rate	28	
	95	
Add ACT	35	
Net deduction	60	60 0
		317 1

CAPITAL GAINS TAX BASE 1983-84*

Chargeable gains		12
Additions to Base		
Roll-over relief	*Nil*	
Disposal of business or farm	*Nil*	
Death a disposal	*2,5*	
Principal private residence	5 0	
Small Gains	2 5	
CPO Relief	Nil	10 00
Deductions from Base		
Tax credit on company distributions	1 25	
Indexation losses	4 0	5 25

Net addition	4 75
New Base	16 75

* The base for capital gains tax has fallen substantially in the current year with the decline in real terms in the value of assets Any recovery in asset prices could be expected to lead to a significant increase in these figures

CAPITAL ACQUISITIONS TAX 1983

		£m
Estimates of taxable value of gifts and inheritances		87
Add		
Aboltion of agricultural valuation	12	
Deduct		
Exemption of inter-spousal transfers	9	3
Adjusted Base		90

1. Tables 65 and 66 of the Annual Report of the Revenue Commissioners for 1980 show the following amount of taxable gifts and inheritances.

	£m	Increase %
1977	15 2	
1978	30.1	98 0
1979	38 2	26 9
1980	50.7	32 7

Assuming a rate of growth of 20 per cent per annum since 1980 gives a figure of £87 million for 1983

2 No figures are available on the amount of capital in discretionary trusts. I have included an estimate of £3 million as the likely yield from the annual charge on such capital recommended by the Commission.

3. I have assumed no yield from the accessions tax put forward by the Commission as the most effective means of achieving redistribution of wealth.

NOTES ON TABLES

1 Employers contributions for 1983-84 are estimated to be £617 million. Of this amount £90 million is estimated to be paid by the State employer The balance of £527 million has been divided between corporate and non-corporate employers in the ratio 3 1 A further downward adjustment of 30 per cent has been made in the corporate element of £395 million to exclude export sales relieved companies

2 The Revenue Commissioners have estimated that the corporate tax base after the inflation adjustments proposed in recommendations 123 to 133 of the Commission's report would fall to £292 million The information on which to base such an estimate is sparse As a result, there is ample room for argument I believe the Revenue Commissioners estimate is too high for the following reasons

Stewart,(1) examined 6 companies in 1979 and found that the difference between inflation adjusted profits and profits as conventionally measured was about 28 per cent

The Revenue Commissioners take the view that Stewart's study is not particularly relevant since it specifically excludes financial and investment companies and "the greatest effects occur in the case of these very companies"

A United Kingdom estimate(2) of the cost of changing to CCA basis in the case of financial companies indicated that the profits of such companies would have been reduced by about 21 per cent on average in the years 1976 to 1980.

To complete profits on a Current Cost basis, four adjustments are made to the historical cost profit as follows.

(i) a cost of sales adjustment
(ii) a depreciation adjustment
(iii) a monetary working capital adjustment and
(iv)
(iv) a gearing adjustment

In its report the Commission recommended the introduction of the equivalent of the first three of these adjustments It did not recommend the equivalent of a gearing adjustment because it took the view that tax should be charged on profits before deduction of interest These are higher than CCA profits. In this regard, it is interesting to note the estimate in the U K. Green Paper "Corporation Tax" that if corporation tax had been charged on CCA profits on a revenue-neutral basis the rate would have been on average about 48 per cent compared with 52 per cent on a historical cost basis There would have been very large variations in the revenue-neutral rate from year to year.

3. The Revenue Commissioners have similarly estimated that any gain arising from introducing a current basis of assessment for Schedule D taxpayers would be offset by the loss of revenue arising from the implementation of recommendations 123 to 133. I have substituted an increase in the tax base of £250 million. This is based on an increase in agricultural income of £160 million in 1983 and 1982 and an increase of £185 million in non-agricultural non-wage income less an estimate for depreciation

SOCIAL SECURITY TAX BASE 1983/84

	£m
Income Tax Base	9,927 8
Corporation Tax Base	1,077 4
Capital Gains Tax Base	16.7
Capital Acquisitions Tax Base	90 0
Gross Income of Pension Funds	120.0
Export Sales Relieved Profits	248 0
	11,479 9
Add possible* extra benefits payable to self-employed and civil servants on the introduction of a social security tax	300
	11,779.9

* It does not necessarily follow that the introduction of a social security tax must inevitably lead to the extension of benefits There is no longer a close relationship between social insurance contributions and benefits. Many people who have absolutely no entitlement to benefits at present bear the burden of the existing social insurance contributions. Of course, if the benefits were to become payable, they would be included in the tax base. I have assumed that no additional benefits would become payable.

TAX CREDITS

The Commission did not recommend any particular rate of tax or tax credit. These must be determined together and are matters for political decision. The higher the credit - the higher the rate must be if the same revenue is to be raised. However, taking the existing level of personal allowances the position is as follows:

	Single Person £	Married Person £
Income	1,450	2,900
Present Liability [illegible]	123.25	246.50
Tax Liability at 35%	507 50	1015.00
Credit required	384.25	768.50

If it were desired to maintain the existing position for persons on exemption limits (which the Commission recommended should be abolished) the position would be as follows:

	Single Person £	Married Person £
Income	2,400	4,800
Present Liability (3)	204	408
Tax Liability at 35%	840	1680
Credit required	636	1272

In this instance the cost of the credits is increased by about £425 million.

There are a number of tax reliefs which the Commission did not deal with in the first report These are listed below with the estimated tax foregone in 1981/82

	Tax foregone £m
Export sales relief	106 0
Shannon relief	10 0
Reduced rate of tax on manufacturing profits	29 0(4)
Excess of accelerated depreciation over historical Cost depreciation for plant and machinery	74 0
Cost (5) of capital allowances in respect of	
· industrial buildings	6.5
- hotels	0.75
Income from stallions	not available
Income from woodlands	negligble
Allowances for certain purpose built rented accommodation	nil (6)
Relief for Profit Sharing Schemes	not available

FOOTNOTES

1. "Company Tax - Effective Tax Rates on Profits" J.C. Stewart Paper read to the Statistical and Social Inquiry Society of Ireland, 2nd April, 1981.
2. Corporation Tax Green Paper January, 1982 Cmnd 8456 Table 9A
3. The present liability is to social insurance contributions
4. This is the cost of the scheme based on assessments made in 1981/82. In terms of tax receipts, the cost is estimated at nil in 1981, £17 million in 1982 and £39 million in 1983.
5. It is not possible to isolate the accelerated element of depreciation for buildings.
6. The earliest year for which a cost will be incurred is 1983 The relief will cost £2 million in 1983. This is a partial cost in respect of dwelling units completed and let since 29 January, 1981. The full cost of the relief in respect of the total qualifying expenditure incurred up to the end of 1982 is about £18 million but this will be spread over a number of years.