



*Social Justice Ireland*

# Fairness in changing income tax – an examination of three options

Occasional Papers



## Favouring changes to tax credits rather than tax rates and tax bands

*Social Justice Ireland* believes that any future income tax changes should be focused on changes to tax credits rather than tax bands and tax rates. This is more desirable in the context of achieving fairness in the taxation system. In this study we set out the analysis that has brought us to this conclusion.

We compare three options (i.e. increasing the standard rate income tax band, reducing the top income tax rate and increasing tax credits) and we analyse the impacts each of these would have on the income distribution.

Table 1 presents a comparison of reforms to tax rates, tax credits and tax bands. In all cases the policy examined would carry a full year cost of approximately €205 million.<sup>1</sup> The reforms examined are for changes to the 2014 income taxation system and are:

- a decrease in the top tax rate from 41% to 40% (full year cost €205 million)
- an increase in the personal tax credit of €108 with commensurate increases in couple, widowed parents and lone parents credit (full year cost €205 million)
- an increase in the standard rate band (20% tax band) of €1,350 (full year cost €202.5 million)

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**The fairest outcome is achieved by increasing tax credits.**

Although all of the income taxation options cost the same, they each carry different effects on the income distribution. The fairest outcome is achieved by increasing tax credits. It provides the same value to all taxpayers across the income distribution provided they are earning sufficient to pay more than €108 in income taxes. Therefore, the increased income received by a single earner on €25,000 and on €125,000 is the same – an extra €108.

However, a decrease in the top tax rate only benefits those paying tax at that rate. Therefore, the single earner on €25,000 gains nothing from this change while those on €50,000 gain €172 per annum and those on €100,000 gain €672 per annum.

The higher the income, the greater the gain. This is the least fair outcome of the three examined.

Changing the entry point to the top tax rate (i.e. increasing the standard rate band) also provides gains which are skewed towards higher incomes.

A single earner on €25,000 gains nothing from this reform and it is only individuals with incomes of €32,800 plus, and couples with 2 earners with gross income above €65,600, who gain.

<sup>1</sup> The cost estimates are based on the most recent income tax ready reckoner available from the Department of Finance (Budget 2012). The cost estimates are unlikely to be significantly different currently.

**Table 1: Comparing gains under three possible income tax reforms: tax rates, tax credits and tax bands (€)**

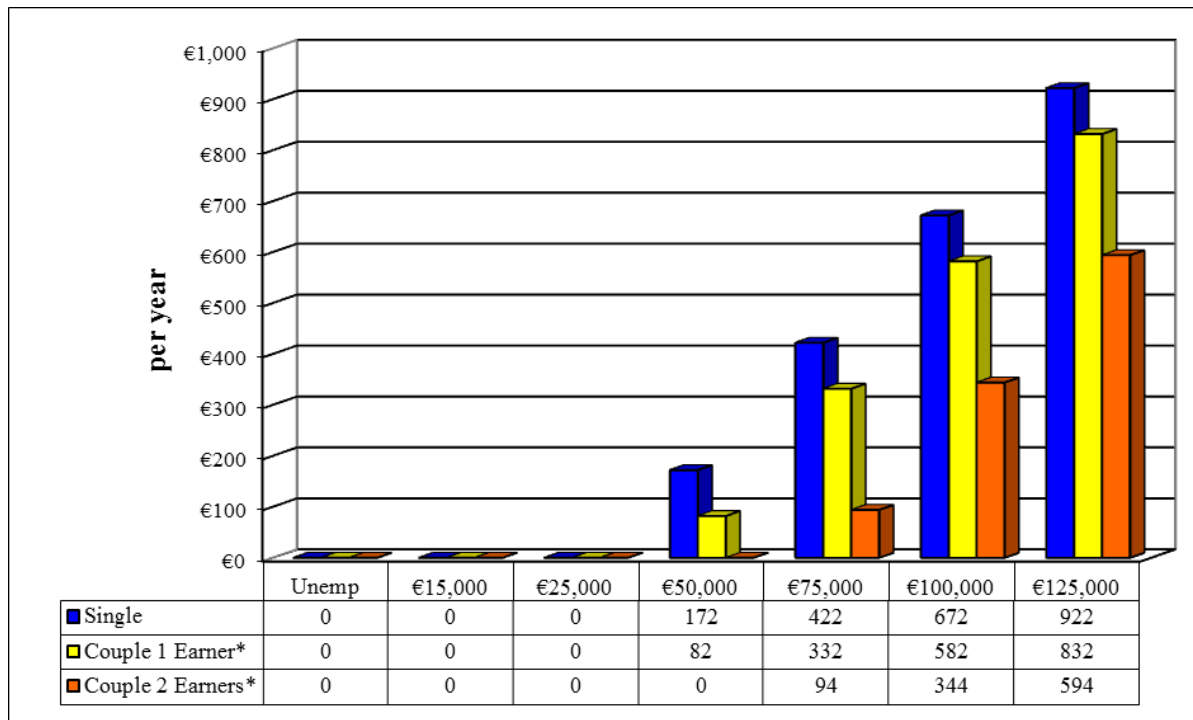
<b>Gross Income</b>	<b>€15,000</b>	<b>€25,000</b>	<b>€50,000</b>	<b>€75,000</b>	<b>€100,000</b>	<b>€125,000</b>
<b>Decrease in the top tax rate from 41% to 40% (full year cost €205 million)</b>						
Single earner	0	0	172	422	672	922
Couple 1 earner	0	0	82	332	582	832
Couple 2 earners	0	0	0	94	344	594
<b>Increase in the personal tax credit of €108 (full year cost €205 million)</b>						
Single earner	0	108	108	108	108	108
Couple 1 earner	0	50	216	216	216	216
Couple 2 earners	0	0	216	216	216	216
<b>Increase in the standard rate band of €1,350 (full year cost €202.5 million)</b>						
Single earner	0	0	283.50	283.50	283.50	283.50
Couple 1 earner	0	0	283.50	283.50	283.50	283.50
Couple 2 earners	0	0	0	567.00	567.00	567.00

**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system. The increase in the personal tax credit assumes a commensurate increase in the couple, widowed parents and lone parent's credit.

The following diagrams illustrate these changes.

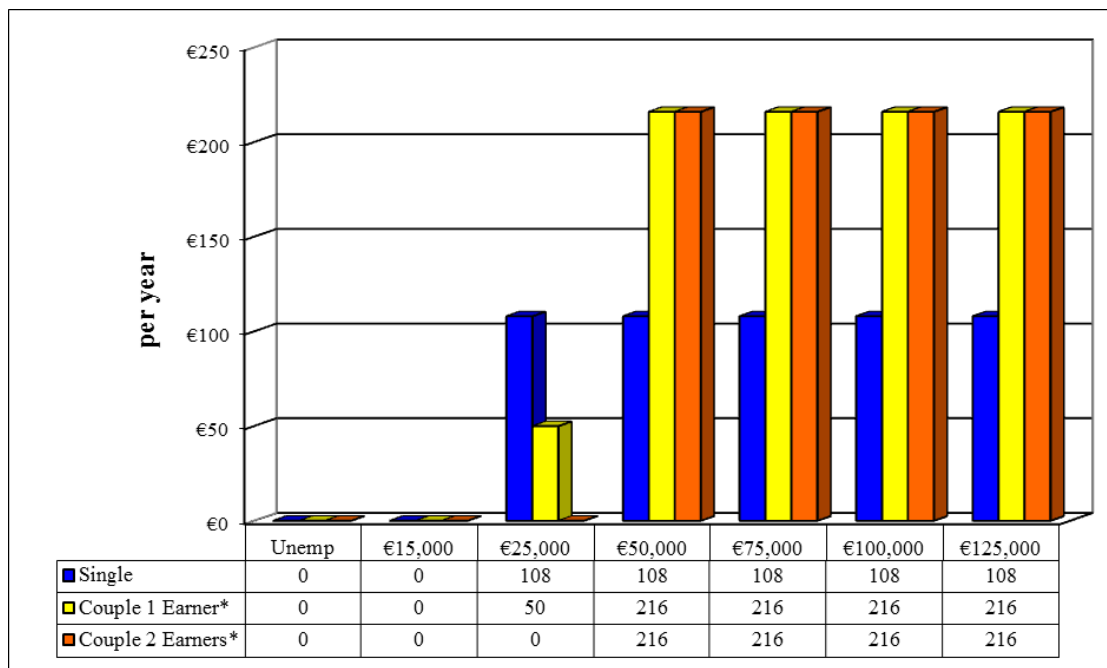
In terms of fairness, changing tax credits is the best option. Government should always take this option when it has money available to reduce income taxes.

**Chart 1: How much better off would people be if the top tax rate was decreased from 41% to 40% (full year cost €205 million)**



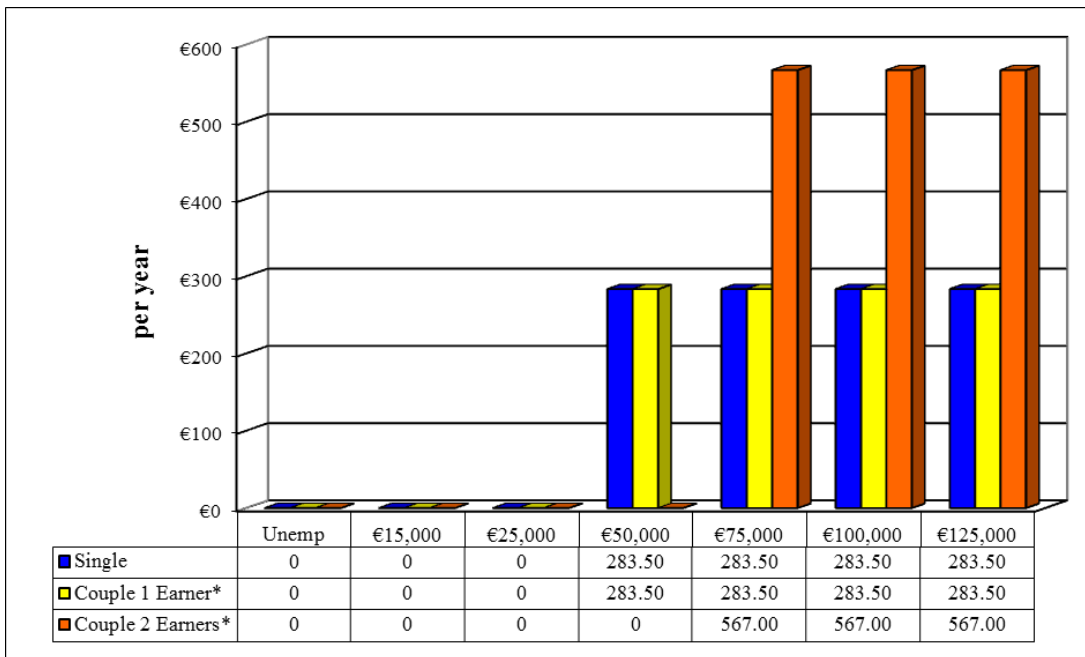
**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system.

**Chart 2: How much better off would people be if the personal tax credit was increased by €108 (full year cost €205 million)**



**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system. The increase in the personal tax credit assumes a commensurate increase in the couple, widowed parents and lone parent's credit.

**Chart 3: How much better off would people be if the standard rate band was increased by €1,350 (full year cost €202.5 million)**



**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system.

**Social Justice Ireland** is an independent think-tank and justice advocacy organisation of individuals and groups throughout Ireland who are committed to working to build a just society where human rights are respected, human dignity is protected, human development is facilitated and the environment is respected and protected.

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