CORI JUSTICE COMMISSION

Bloomfield Avenue,
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Presentation by CORI Justice Commission at meeting with Joint Oireachtas Committee on Finance and the Public Service Concerning the Review of Tax Reliefs and High Earners

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Introduction

For some time CORI Justice Commission has highlighted the inequity which certain tax incentive schemes and tax exemptions schemes produce in the tax system.[1] We believe that reforming these tax breaks is long overdue and is a necessary part of building a fairer taxation system.[2] Below, we outline the background to our views on this issue before setting out a series of proposals to reform the system.

Core Policy Objective

CORI Justice Commission believes the core policy objective on taxation policy should be: to collect sufficient taxes to ensure full participation in society for all, through a fair tax system in which those who have more, pay more, while those who have less, pay less

Background

The Irish tax system incorporates a sizeable number of tax expenditures, primarily in the form of tax reliefs. In November 2004 the Revenue Commissioners estimated that the annual cost of tax relief's was €8.4 billion, a value that is equal to 22 per cent of the total taxation collected each year in Ireland.[3] They also indicated that they were unable to provide complete information on 44 individual tax relief schemes. Of these, the Revenue has no figures for the number of claimants and the size of the

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[1] See CORI Justice Commission 2002:8, 2003:49; 2004a:58-60; 2004b:4; and 2004c:7.

[2] A detailed outline of our views on building a fairer tax system can be found in Healy and Reynolds (2004:151-188)

[3] The Revenue Commissioners Statistical Report (2004:8) indicates that the total taxation collected in 2003 equalled €37.7b.

claims made under 33 schemes. In the case of a further 11 schemes there is no information available on the number of taxpayers availing of the schemes (2004:63-66).

Table 1 presents information on some of the major tax expenditures, the overall cost of providing them per annum and the average cost per recipient. The cost of these schemes is calculated in the amount of tax revenue foregone (i.e. not collected).

Table 1: The annual cost of income tax allowances and relief's.

	No's availing	**Cost in €m's**	**Av. Cost €'s**
Capital allowances	269,300	1,921	7,133
Exemption of Pension Fund Income	n/a	1,268	n/a
SSIA scheme	1,113,880	540	485
Employers Pension Contributions	n/a	673	n/a
Employees Pension Contributions	670,500	526	784
Resort Relief	n/a	106	n/a
Mortgage Interest Relief	622,500	221	355
Self Employment Pension Contributions	109,600	170	1,551
Medical Insurance Relief	533,800	191	358
Employee Expenses	855,800	73	85
Business Expansion Scheme (BES)	2,015	20	9,925
Investments in Films	1,470	15	10,204
Artists Relief	1,300	37	28,461

Source: Calculated from NESC, 2003:341-342, Revenue Commissioners (2004:63-66) and Department of Finance (2004b:10).
Notes: The most recent data on each scheme is used. The figures provided are mainly for the tax year's 2000/01 and in some cases 2004. All numbers availing are for the 2001 tax year.

As Rapple (2004:79) has pointed out the distribution of these tax expenditures is primarily in the direction of the better off elements of Irish society. To take one example, the National Economic and Social Council (NESC) recently examined which households in the income distribution gained as a result of tax relief on employee's occupational pensions during 1998 (2003:301). Their findings are presented in table 2 and show that the bottom 20 per cent of households received zero per cent while the top twenty per cent of households receive 56.8 per cent of the relief. Overall the distribution of the tax relief is heavily skewed towards the top forty per cent of households who receive almost 89 per cent of the value of this scheme.

Table 2: The distribution of employees' occupational pension tax relief across households in the income distribution, 1998.

Income Decile	% of total tax relief
Bottom	0.0
2nd	0.0
3rd	0.3
4th	1.6
5th	2.7
6th	6.4
7th	13.8
8th	18.3
9th	20.8
Top	36.0
Total	100.0

Source: NESC, 2003:301.

One worthwhile policy approach that can address the inequity highlighted in table 2 is to introduce a cap on the maximum amount of money that any individual can have in their pension fund. An annual contribution limit plus an additional overall pension fund limit of approximately €1.5 million would provide more than adequate provision for any individual in their retirement. Introducing this policy would follow similar schemes adopted elsewhere, such as in the UK.

The suggestion that it is the better-off who principally gain from the provision of tax exemption schemes is underscored by reports published by the Revenue Commissioners entitled *Effective Tax Rates for High Earning Individuals* (2002 and 2005). These reports provide details of the Revenue's assessment of the top 400 earners in Ireland and the rates of effective taxation they faced[4]. Table 3 presents their findings and shows that many of Ireland's highest earning individuals successfully use tax planning, schemes and loopholes to reduce their tax liability. These studies found that property tax reliefs, such as those provided for hotels and car parks, were the most effective in reducing the tax rates of the highest earners. Comparing the figures from 1999/00 and 2001 shows that over time the number of top earners benefiting from very low tax levels has reduced slightly from 18.25 per cent to 14.50 per cent.

Table 3: The Distribution of Effective Tax Rates of the Top 400 Earners, 1999/00 and 2001

Effective Tax Rate	1999/00 % of Total	2001 % of Total
Less than 15%	18.25	14.50
15%-29%	11.00	14.25
30%-44%	57.75	71.25
45% +	13.00	0.00
Total	100.00	100.00

Source: Revenue Commissioners (2002 and 2005).

More recent figures from the Revenue Commissioners indicate that in 2001 41 people earning over €500,000 used various tax relief schemes to reduce their income tax liability to zero. These included 11 individuals who earned more than €1 million in 2001. A further 242 individuals earning more than €100,000 also paid no tax. Put simply, is this fair? Are these individuals paying their way in Irish society or are they exploiting loopholes in the tax system? CORI Justice Commission believes

[4] The effective taxation rate is calculated as the percentage of an individual's total pre-tax income that they pay in taxation.

there is something profoundly unfair with a tax system where some millionaires pay no tax while employees on the minimum wage must pay tax.

CORI Justice Commission believes that many of these reliefs serve minimal purpose. We have argued for some time that these reliefs should be reviewed via an assessment of the economic and social benefits that they provide. Only where these benefits surpass the costs should the reliefs be retained. Furthermore we believe that in the future any proposed reliefs should be subject to detailed assessment before they are introduced. It should also be a requirement that the Revenue Commissioners collect data on the size and distribution of these reliefs. Such information is critical to any assessments of the role they play.

Proposals for reform

While it is clear that there are a number of tax expenditures that are worthy of being retained, others clearly require reform. Given the above findings, CORI Justice Commission believes that the following reform proposals should be announced and introduced by the Minister for Finance in Budget 2006:

- New procedures should be adopted in the Department of Finance when proposing the introduction of any new tax expenditure. Principally, these should involve a detailed internal evaluation of the costs and benefits of each new scheme. The lifetime costs of most of these schemes will run into many millions of euro and expenditure on this scale deserves detailed evaluation. In that context we note the recent announcement by the Department of Finance in its new *Guidelines for the Appraisal and Management of Capital Expenditure Proposals in the Public Sector* that "programmes with an annual value in excess of €50 million and of 5 years or more duration to be subject to prior and mid-term evaluation at the beginning and mid point of each 5 year cycle or as may be agreed with the Department of Finance" (February 2005:9). If such detailed analysis is merited for the expenditure of sums in excess of €50 million then a similar procedure is appropriate for tax expenditure programmes whose lifetime values tend to significantly exceed this figure.

- Each new or renewed tax expenditure should also be poverty proofed to establish the impact that its introduction will have on the income distribution, the level of median income and poverty rates.
- New procedures should be adopted in the Revenue Commissioners such that they are able to collect and provide accurate data on the scale and distribution of all tax expenditures.
- Many of the existing tax expenditures, in particular those giving relief to construction costs, offer levels of relief that seem to have been chosen arbitrarily. For example, in the case of Section 23 relief we are unclear as to how the various relief levels offered were established and justified by the Department of Finance. Furthermore, it remains unclear to us why the same development could not have been achieved as a result of offering a considerably lower level of relief, one that was provided at a lesser cost to the exchequer. In future the percentage level at which reliefs are offered must be clearly justified.
- Discretionary tax expenditures are an inappropriate means of achieving policy objectives. In general these expenditures are neither efficient nor fair. Accordingly we believe that government should move to ensure that relief on all discretionary tax expenditures where available should be at the standard rate only.
- The inequity in the distribution of pension contribution reliefs is of concern. One obvious approach to address this is to introduce a cap on the maximum amount of money that any individual can have in their pension fund. An annual contribution limit plus an additional overall pension fund limit of approximately €1.5 million would provide more that adequate provision for any individual in their retirement. Introducing this policy would follow similar schemes adopted elsewhere, such as in the UK.

- The average benefit from artists' relief equals €28,461 (see table 1 above). In reality the distribution of this relief is such that a number of individuals are gaining large tax-free incomes while others are benefiting at a much smaller level. We believe that a cap on this relief should be set at €20,000 per annum with artists paying tax on all income above this figure.
- In Budget 2006 the Minister for Finance should introduce a new law limiting the number of tax reliefs any one individual may avail of in each tax year. A limit of 5 would seem appropriate.
- In Budget 2006 the Minister for Finance should introduce a new law limiting the value of tax reliefs any one individual may avail of in each tax year. An index linked limit of €250,000 per annum would seem more than generous.

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