



*Social Justice Ireland*

# Fairness in Changing Income Tax: 6 options compared

Occasional Papers



## Introduction

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation more than 33 years ago. It stated:

“...in our recommendations the spirit of equity is the first and most important consideration. Departures from equity must be clearly justified by reference to the needs of economic development or to avoid imposing unreasonable compliance costs on individuals or high administrative costs on the Revenue Commissioners.” (1982:29)<sup>1</sup>

The need for fairness is just as obvious today and *Social Justice Ireland* believes that this should be a central objective of Government decision-making as it makes choices on how to allocate available resources in the income tax system in Budget 2015.

## Fairness in Changing Income Tax – 6 options compared

Changes to income taxation levels have been highlighted as a potential policy reform in October’s Budget 2015. *Social Justice Ireland* believes that Government decisions should be based on the principal of fairness. We present this analysis as a contribution to pre-Budget considerations of the fairness of possible income taxation policy reforms.

*Social Justice Ireland* believes that the best reform to the income taxation system would be to make tax credits refundable. Such a reform would mean that the full value of tax credits goes to everybody who has an earned income - we outlined our proposal on this issue in our recent pre-Budget *Policy Briefing on Budget Choices* (available on our website [www.socialjustice.ie](http://www.socialjustice.ie)).

Here we update a document we published earlier this year examining the fairness of various income tax reform options being considered by Government.<sup>2</sup>

## Fairness is essential

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation more than 33 years ago.

The need for fairness is just as obvious today and *Social Justice Ireland* believes that this should be a central objective of Government decision-making as it makes choices on how to allocate available resources in the income tax system in Budget 2015.

<sup>1</sup> Commission on Taxation (1982) *Commission on Taxation First Report*. Dublin: Stationery Office.

<sup>2</sup> The earlier document was entitled ‘Fairness in Changing Income Tax – an examination of three options’ and is available on our website.

The update includes:

- A rebasing of the cost estimates using the latest Department of Finance Tax Strategy Group Income Tax Ready Reckoner (TSG 13/08).
- The inclusion of reforms to the three rates of Universal Social Charge (USC) – as costings for these reforms are now available.

The six options and their full-year costs are outlined below. The full-year cost of the options range from €190m to €225m.<sup>3</sup> Because we wish to ensure that the options analysed here cost the Exchequer similar amounts we have omitted our preferred option i.e. making tax credits refundable, as the costs would be significantly less<sup>4</sup>.

The reforms examined are for the 2014 income taxation system and are:

- a decrease in the top tax rate from 41% to 40% (full year cost €195m)
- an increase in the personal tax credit of €105 with commensurate increases in couple, widowed parents and the single person child carer credit (full year cost €194.25m)
- an increase in the standard rate band (20% tax band) of €1,300 (full year cost €195m)
- a 1% point decrease in the 2% USC rate – that applied to income below €10,036 (full year cost €190m)
- a 2% point decrease in the 4% USC rate – that applied to income between €10,036 and €16,016 (full year cost €210m)
- a 0.5% point decrease in the 7% USC rate – that applied to income above €16,016 (full year cost €225m)

Table 1 presents the results of this comparison.

Although all of the income taxation options have similar costs, they each carry different effects on the income distribution. The fairest outcomes are achieved by reducing the bottom two USC rates or increasing tax credits.

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<sup>3</sup> The cost estimates are based on the most recent income tax ready reckoner available from the Department of Finance (TSG 13/08 page 12 for Budget 2013 and published in mid-2014). The cost estimates are unlikely to be significantly different currently.

<sup>4</sup> Social Justice Ireland (2010) *Building a Fairer Taxation System: The Working Poor and the Cost of Refundable Tax Credits*. Dublin: Social Justice Ireland.

**Table 1: Comparing gains under six possible income tax reforms (€ per annum)**

Gross Income	€15,000	€25,000	€50,000	€75,000	€100,000	€125,000
<b>Decrease in the top tax rate from 41% to 40% (full year cost €195 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 €105 (full year cost €194.25 million)</b>						
Single earner	0	105	105	105	105	105
Couple 1 earner	0	50	210	210	210	210
Couple 2 earners	0	0	210	210	210	210
<b>Increase in the standard rate band of €1,300 (full year cost €195 million)</b>						
Single earner	0	0	273	273	273	273
Couple 1 earner	0	0	273	273	273	273
Couple 2 earners	0	0	0	546	546	546
<b>A 1% point decrease in the 2% USC rate (full year cost €190m)</b>						
Single earner	100.36	100.36	100.36	100.36	100.36	100.36
Couple 1 earner	100.36	100.36	100.36	100.36	100.36	100.36
Couple 2 earners	0	100.36	200.72	200.72	200.72	200.72
<b>A 2% point decrease in the 4% USC rate (full year cost €210m)</b>						
Single earner	99.28	119.60	119.60	119.60	119.60	119.60
Couple 1 earner	99.28	119.60	119.60	119.60	119.60	119.60
Couple 2 earners	0	124.28	239.20	239.20	239.20	239.20
<b>A 0.5% point decrease in the 7% USC rate (full year cost €225m)</b>						
Single earner	0	44.92	169.92	294.92	419.92	544.92
Couple 1 earner	0	44.92	169.92	294.92	419.92	544.92
Couple 2 earners	0	1.17	89.84	214.84	339.84	464.84

**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 the single person child carer credit. USC calculations assume earners pay the standard rate of USC.

Decreasing the 2% USC rate by one percentage point provides the same gain to all individuals with earnings in excess of €10,036. Therefore, the increased income received by a single earner on €25,000 and on €125,000 is the same – an extra €100.36.

Decreasing the 4% USC rate by two percentage points benefits all those with incomes of more than €10,036. Earners above €16,016 (the entry point to the next USC rate) experience the full benefit of the reduction – gaining €119.60 per annum. The gain is the same for all earners above this level.

Increasing the personal tax credit also provides a fair distributive outcome across the income distribution. The gain is the same for all taxpayers earning sufficient to pay more than €105 in income taxes. However, below €16,500 for single earners / €24,750 for couples with one earner / €33,000 for couples with two earners, there are no gains as up to these points tax credits absorb all income tax liabilities.

Compared to these three options, the other three income tax reforms skew the benefits towards those on higher incomes.

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 those examined.

Reducing the 7% USC rate by half a percentage point (to 6.5%) also produces a notably unfair outcome. Earners above €16,016 gain 0.5% of their income as a tax cut meaning the benefit is greater the higher an individual's income.

Finally, 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.

The following diagrams illustrate these changes. In terms of fairness, reducing the bottom two USC rates or increasing tax credits are the best options.

## Similar costs

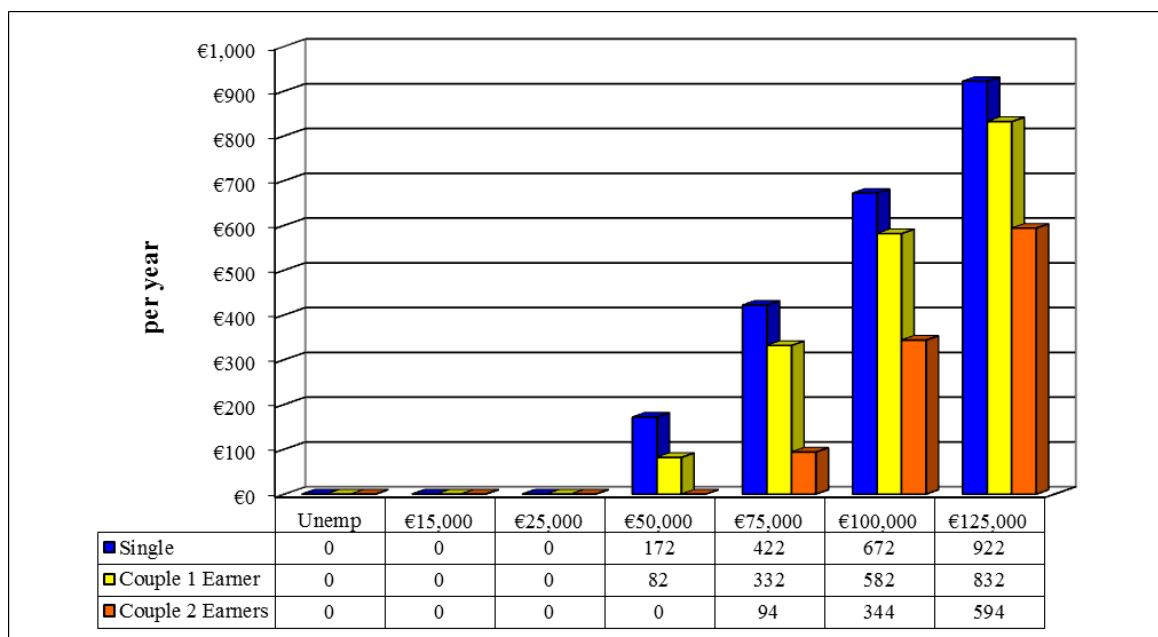
## Different outcomes

Although all of the income taxation options considered here have similar costs, they each carry different effects on the income distribution.

The fairest outcomes are achieved by reducing the bottom two USC rates or increasing tax credits.

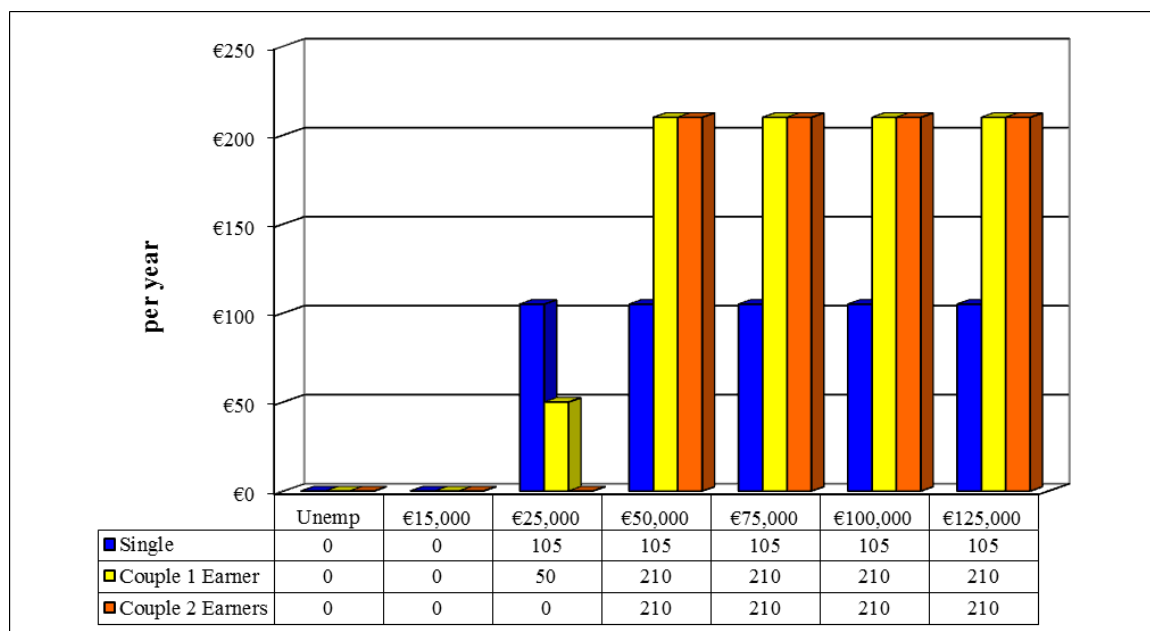
If Government wishes to reduce income tax it should choose one of these three options.

**Chart 1: How much better off would people be if the top tax rate was decreased from 41% to 40% (full year cost €195 million)**



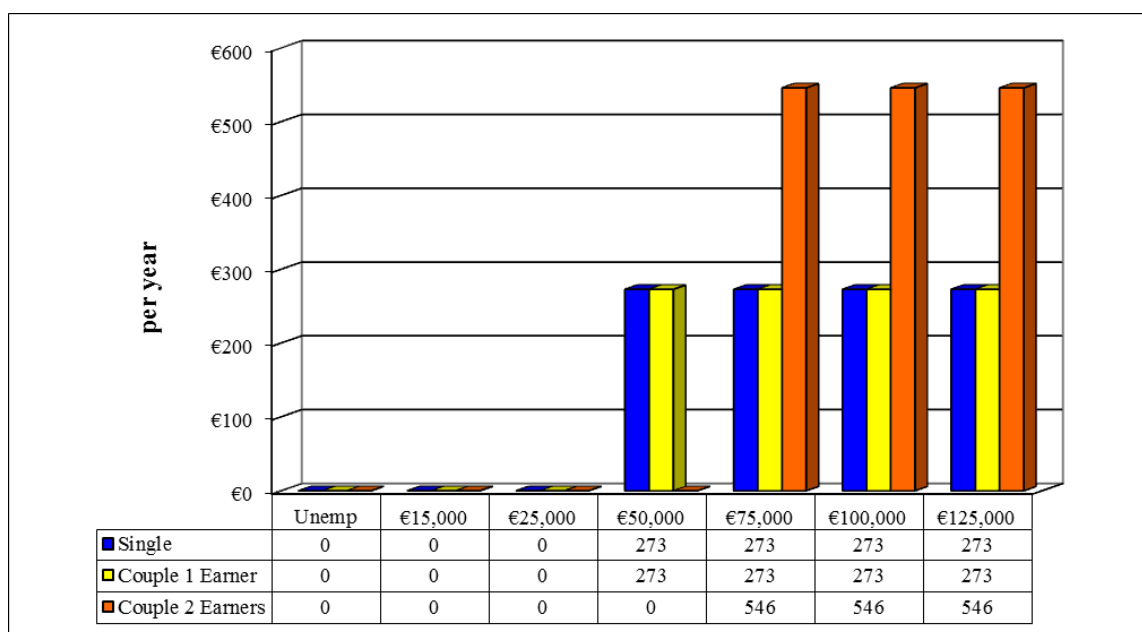
**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system.

**Chart 2: How much better off would people be if the personal tax credit was increased by €105 (full year cost €194.25 million)**



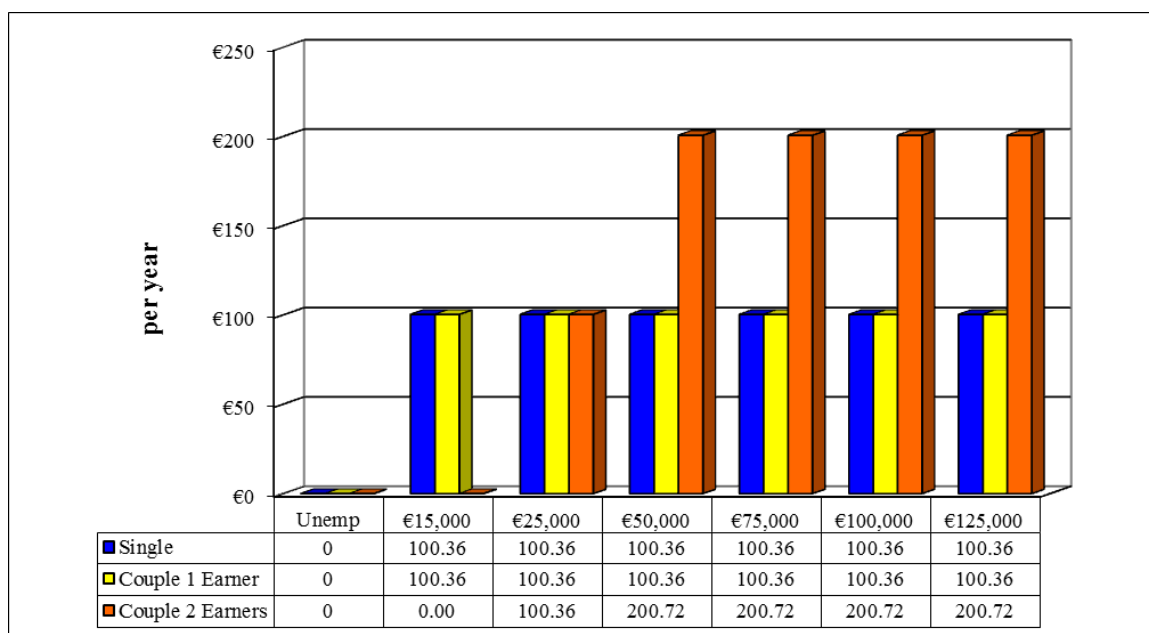
**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system. The increase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

**Chart 3: How much better off would people be if the standard rate band was increased by €1,300 (full year cost €195 million)**



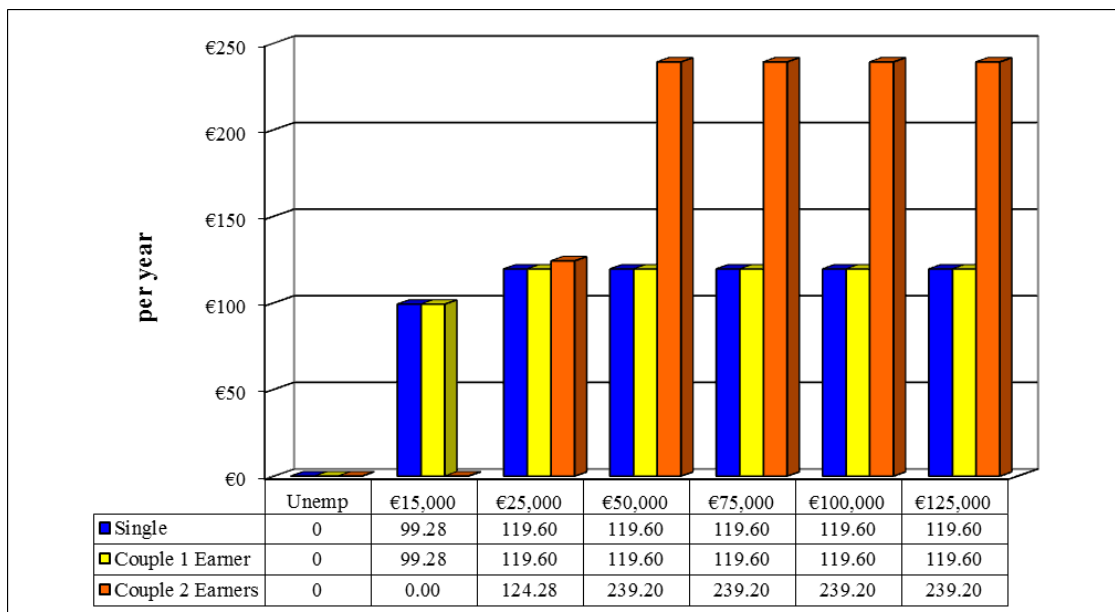
**Notes:** All workers are assumed to be PAYE workers. For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system.

**Chart 4: How much better off would people be if the 2% USC rate was reduced by one percentage point (full year cost €190 million)**



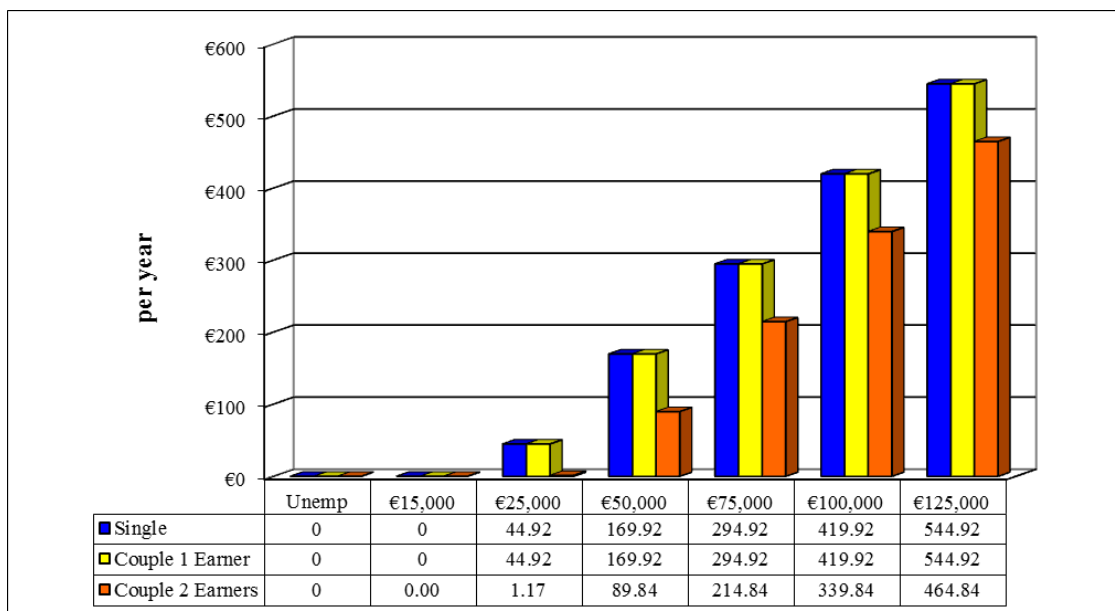
**Notes:** For couples with 2 earners the income is assumed to be split 65%/35%. Cost estimates are based on the latest available Department of Finance income taxation ready reckoner and are applied to the structure of the 2014 income taxation system. USC calculations assume earners pay the standard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

**Chart 5: How much better off would people be if the 4% USC rate was reduced by two percentage points (full year cost €210 million)**



**Notes:** 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. USC calculations assume earners pay the standard rate of USC.

**Chart 6: How much better off would people be if the 7% USC rate was reduced by half a percentage point (full year cost €225 million)**



**Notes:** 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. USC calculations assume earners pay the standard rate of USC.



**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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