Foundations for the Future



Report of the Commission on Taxation and Welfare

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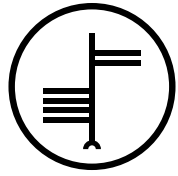
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Report of the Commission on Taxation and Welfare

Contents

Chairperson's Foreword *x*

Acknowledgements *xiii*

Membership of the Commission on Taxation and Welfare *xv*

Secretariat *xvi*

Terms of Reference *xvii*

Executive Summary *xix*

Outline of the Report *xxvii*

List of Recommendations *xxxi*

Part 1: Strategic Approach *1*

Chapter 1: The Commission *2*

1.1 Establishment *2*

1.2 Seeking input *3*

1.3 Secretariat *4*

1.4 Strategic approach *4*

Chapter 2: Context *7*

2.1 A changed Ireland *7*

2.2 Strategic foresight *12*

Chapter 3: Objectives and Principles *20*

3.1 Over-arching policy challenges *20*

3.2 Fiscal sustainability and stability *20*

3.3 Promoting enterprise, innovation and employment *24*

3.4 Inequality, poverty and income adequacy *29*

3.5 Climate *36*

3.6 Design principles for the taxation and welfare systems *38*

3.7 International obligations *47*

Part 2: Fiscal Sustainability and Taxation *51*

Chapter 4: Fiscal Sustainability *52*

4.1 Introduction *52*
4.2 Conclusion *67*
4.3 Recommendation *67*
Chapter 5: Balance of Taxation *68*
5.1 Introduction *68*
5.2 Optimal balance of taxation *69*
5.3 Trends of Irish tax receipts *73*
5.4 International context *78*
5.5 Strategic approach to tax reform *81*
5.6 Recommendations *90*
Chapter 6: Tax Equity and Base Broadening *91*
6.1 Introduction *91*
6.2 Equity in personal taxes *92*
6.3 Savings and investments *97*
6.4 Consumption taxes *106*
6.5 Recommendations *113*
Chapter 7: Taxes on Capital and Wealth *115*
7.1 Introduction *115*
7.2 Wealth in Ireland *116*
7.3 Distribution of wealth *118*
7.4 A Wealth Tax for Ireland? *125*
7.5 The Commission's approach *129*
7.6 Capital Gains Tax and Capital Acquisitions Tax reforms *131*
7.7 Recommendations *148*
Chapter 8: Taxes on Retirement Savings *149*
8.1 Introduction *149*
8.2 Brief overview of main tax expenditures and cost *154*
8.3 Automatic Enrolment pensions *156*
8.4 Strategic objectives *158*
8.5 Commission proposals *160*
8.6 Recommendations *170*
Part 3: Policy Goals *173*

Chapter 9: Promoting Enterprise *174*

9.1 Introduction *174*

9.2 Strategic approach *183*

9.3 Corporate tax strategy *185*

9.4 Supporting investment in SMEs *192*

9.5 Research and Development (R&D) *198*

9.6 Enabling SME access to tax reliefs *202*

9.7 Attracting talent with share-based remuneration *204*

9.8 Global mobility – attracting investment and talent *211*

9.9 Recommendations *221*

Chapter 10: Labour Markets and Social Protection Systems *224*

10.1 Introduction *224*

10.2 Social protection systems and labour market models *226*

10.3 Key policy considerations *232*

10.4 Strategic approach to building inclusive labour markets and integrated social protection systems *249*

10.5 Other approaches: universal basic income and refundable tax credits *257*

10.6 Recommendations *262*

Chapter 11: Promoting Employment *263*

11.1 Introduction *263*

11.2 Strategic approach *265*

11.3 Commission proposals *267*

11.4 COVID-19 lessons learned *280*

11.5 Recommendations *284*

Chapter 12: Inclusive and Integrated Social Protection *287*

12.1 Introduction *287*

12.2 Adequacy and benchmarking *288*

12.3 Working-age income supports *295*

12.4 Child income supports *300*

12.5 Towards greater social welfare individualisation *304*

12.6 Recommendations *307*

Chapter 13: Moving to a Low-carbon Economy *309*

13.1 Introduction *309*

13.2 Context *311*

13.3 Strategic approach *317*

13.4 Commission proposals *320*

13.5 Recommendations *335*

Chapter 14: Land and Property *337*

14.1 Introduction *337*

14.2 Commission objectives *338*

14.3 Site Value Tax (SVT) *343*

14.4 Local Property Tax *358*

14.5 The role of tax and welfare systems in achieving housing policy objectives *367*

14.6 Recommendations *373*

Chapter 15: Promoting Good Public Health *375*

15.1 Introduction *375*

15.2 Public health in Ireland *376*

15.3 Role of taxation in public health *380*

15.4 Taxation of alcohol *381*

15.5 Taxation of tobacco *382*

15.6 Obesity *384*

15.7 VAT treatment of healthy and unhealthy food *393*

15.8 International public health taxes *395*

15.9 Tax relief on private health insurance *395*

15.10 Recommendations *397*

Part 4: Better Systems *399*

Chapter 16: Tax Expenditure Review Process *400*

16.1 Introduction *400*

16.2 Background to tax expenditures *400*

16.3 National and international context *404*

16.4 Existing approach to tax expenditure review *406*

16.5 Tax expenditure data *411*

16.6 Strengthening tax expenditure evaluation *415*
16.7 Strategic changes to the tax review process *419*
16.8 Recommendations *423*
Chapter 17: Modernisation of Tax Administration *425*
17.1 Introduction *425*
17.2 Context *426*
17.3 Benefits and opportunities of modernisation *431*
17.4 Key pillars of modernisation *434*
17.5 Improved Revenue and DSP interactions *440*
17.6 Recommendations *445*
Chapter 18: Strategic Reform *447*
18.1 Introduction *447*
18.2 Anticipatory governance *447*
18.3 The budgetary process *448*
18.4 Scenario modelling *450*
18.5 Policy levers *451*
18.6 Medium-term reform roadmaps *451*
18.7 Performance reporting *452*
18.8 Data collection and research *453*
18.9 Distributional analysis and impact assessment *455*
18.10 Skills *456*
18.11 Recommendations *458*
List of Tables *462*
List of Figures *464*
Glossary of Terms *466*
Annex 1: Impact Assessment *479*
Annex 2: Letter from Rena Maycock *487*
Annex 3: Letter from Dr. Tom McDonnell *490*
Annex 4: Members of the Commission on Taxation and Welfare *493*
Index *496*

Chairperson's Foreword

I am delighted to present the Report of the Commission on Taxation and Welfare – *Foundations for the Future*. The Commission was given a wide-ranging terms of reference by Government and was, in essence, charged with examining the suitability and sustainability of the taxation and welfare systems in Ireland.

This was an important task. Our taxation and welfare systems are fundamental to our well-being, our standards of living, and our prosperity. They are among the most powerful levers the State can use to deliver economic and social policy and to secure our future. They represent the obligations that we owe to each other and the protections we provide for each other.

The job of the Commission was to stand back, examine these two critical systems as a cohesive whole, and consider how they could best be refined to ensure their sustainability over the long term and to support the State in meeting our needs into the future. In doing so, the Commission was mindful of the scale of the challenges the taxation and welfare systems are facing. Chief among these is the pressure on long term fiscal sustainability, in particular from Ireland's ageing demographic profile but also from other acute demands, including those related to the carbon transition. The Commission 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. Given the magnitude and urgency of the fiscal sustainability challenge, the Commission therefore agreed to adopt the net-revenue raising approach which has framed its proposals.

Our taxation and welfare systems have performed well in many areas and have proven to be resilient, including throughout the COVID-19 pandemic when the taxation system pivoted to pay out critical welfare supports. However, a number of substantial reforms are needed to support these systems to adapt to a rapidly changing environment and to meet the fiscal sustainability imperative that framed the Commission's work.

In the area of taxation, the Commission has made proposals to broaden the base across most tax heads in order to secure the sustainability of revenues and to increase the overall yield from the least distortionary taxes. These proposals would increase revenue in an efficient, sustainable, and progressive manner that ensures a supportive environment for enterprise, innovation, and investment in Ireland. In essence, the balance of taxation must shift away from taxes on labour and towards taxes on capital, wealth, and consumption. A strengthening of the PRSI base, to enhance the Social Insurance Fund, is also required. These reforms should ensure the resilience of the tax base into the future and thereby reduce its vulnerability to future shocks.

In the area of welfare, the Commission has made proposals to significantly improve the effectiveness of the welfare system through the progressive introduction of reforms focused on supporting employment, addressing child poverty, and avoiding distorting cliff-edge effects. Mindful that the adequacy of social welfare rates is central to poverty reduction, it has also proposed regular benchmarking for working age payments.

The Commission's Report presents a balanced package of interconnected reform proposals. Given the breadth of the Commission's mandate, the Report has not commented on every tax or welfare measure but adopts a principles-based approach, designed to identify the structural reforms necessary to ensure the resilience and effectiveness of our taxation and welfare systems. While the Commission anticipates that the implementation of its recommendations will require further detailed planning and will reflect prevailing circumstances, it regards the reforms as forming a package that it believes should be introduced in a measured and deliberate manner to secure the sustainability of our taxation and welfare systems.

Throughout its work, the Commission was conscious of the present inflationary environment and of cost-of-living pressures. We recognise that some of our recommendations may, in the short-term, be challenging. Our terms of reference, however, charged us to take a medium- to long-term view. We have therefore sought to look through the current difficulties to assess the longer-term needs of the State and the economy and to place the taxation and welfare systems on a sustainable basis to meet future needs.

I would like to pay tribute to the Members of the Commission. From our first meeting in June 2021 their commitment to act in the public interest was unwavering as was their professionalism, dedication, and collegiality. We were fortunate to be supported in our work by an outstanding Secretariat, ably led by Dr Colm O'Reardon, which allowed us to deliver on our wide-ranging and challenging mandate on schedule. My warmest thanks to everyone.



Professor Niamh Moloney
Chair
Commission on Taxation and Welfare

Acknowledgements

The Commission is very grateful for the mandate provided by the Ministers for Finance and Social Protection. It is also grateful to the Secretaries General of both Departments and the Chairman of the Revenue Commissioners who supported the Secretariat through the provision of staff and access to expertise.

The members of the Commission, along with the Secretariat, wish to acknowledge the assistance received from officials in the Central Statistics Office; Departments of the Environment, Climate and Communications; Finance; Health; Housing; Social Protection, and the Revenue Commissioners. The Commission, together with the Secretariat, particularly acknowledges:

- The Department of Defence for providing meeting facilities at the National Emergency Coordination Centre.
- John Barron, Revenue Commissioners
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- Dr. Micheál Collins, University College Dublin
- Ivan Cooper, Director of Public Policy, The Wheel
- Dr. Donal de Buitléir
- Tony Donohue, Chair of the Expert Group on Future Skills Needs
- Dr. Karina Doorley, Economic and Social Research Institute
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- Tim Duggan, Department of Social Protection
- Niall Egan, Department of Social Protection
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- Sinéad Gibney, Chief Commissioner, Irish Human Rights and Equality Commission

- Anne Gunnell, Irish Tax Institute
- Dr. Claire Keane, Economic and Social Research Institute
- Colm Kelly, PricewaterhouseCoopers
- Dr. Gavin Kelly, Chair of the Resolution Foundation
- Ruth Kennedy, Revenue Commissioners
- Dr. Stephen Kinsella, University of Limerick
- Dr. Martina Lawless, Economic and Social Research Institute
- Barry Lowry, Government Chief Information Officer
- Ita Mangan, Former Chair of the Advisory Group on Taxation and Welfare
- John McCarthy, Chief Economist, Department of Finance
- Dr. Anne-Marie McGauran, National Economic and Social Council
- David Moloney, Secretary General, Department of Public Expenditure and Reform
- Denis Moynihan, Former Principal Officer, Department of Social Protection
- Bríd O'Brien, Irish National Organisation of the Unemployed
- David O'Sullivan, Department of Finance
- Gerry Reilly, Central Statistics Office
- Conor Skehan, Strategic Planner and Facilitator
- Gerry Smyth, Former Assistant Secretary, Revenue Commissioners
- Piret Tõnurist, OECD Observatory of Public Sector Innovation

The Commission is also very grateful to the 229 individuals and organisations who made a submission to the public consultation and to all those who participated in our stakeholder events in March 2022.

Membership of the Commission on Taxation and Welfare

- Professor Niamh Moloney (Chair)
- Marie Bradley
- Philip Brennan
- Sandra Clarke
- Rowena Dwyer
- Philip Kermode
- Rena Maycock[1]
- John-Mark McCafferty
- Dr. Tom McDonnell[2]
- Dr. Aoife Ní Lochlainn
- Fergal O'Brien
- Dr. Barra Roantree
- Anne Vaughan

*Dr. William Hynes resigned from the Commission in March 2022 owing to work commitments.

See Annex 4 for Commission member biographies.

1 Please note Rena Maycock does not endorse recommendation 11.4. Please see Annex 2 for further information.

2 Please note Dr. Tom McDonnell does not endorse the content of Chapter 9 and its related recommendations. Please see Annex 3 for further information.

Secretariat

- Dr. Colm O'Reardon (Secretary)
- Gary Hynds
- Sinéad Ryan
- Aideen Foley
- Áine Griffin
- Anne Marie Doherty
- Deirdre Ní Alluráin
- Hugh Cronin
- Lynda O'Keeffe
- Colin O'Connor
- Lara Mullen
- Liam Cunnane
- Oisín Tarrant
- Paul Dockery
- Mairéad Ross (to March 2022)
- Joe Balfe (to August 2021)
- Emma Murphy (to May 2021)

Terms of Reference

As set out in the Programme for Government, the Commission of Taxation and Welfare is being established to independently consider how best the taxation and welfare systems can support economic activity and promote increased employment and prosperity, while ensuring that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term.

The Commission's work will have regard to the principles of taxation and welfare policy outlined within the Programme for Government, including the Government's commitment to a pro-enterprise policy framework and to providing a stable and sustainable regulatory and tax environment. It will also take account of relevant issues such as the impact of the COVID-19 Emergency, ageing demographics, digital disruption and automation and the long-term strategic commitments of Government regarding health, housing, and climate.

Towards this end the Commission is asked to:

- review how best the taxation and welfare systems can support economic activity and income redistribution, whilst promoting increased employment and prosperity in a resilient, inclusive and sustainable way and ensuring that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term.
- examine what changes, if any, should be made to the social insurance system, including structure and benefits coverage, while ensuring sustainability. This will include consideration of the NESC report No 151 (November 2020) on the future of the Irish social welfare system and output from the Pensions Commission regarding sustainability and eligibility issues in respect of State Pension arrangements. It will also include examination of how welfare policy can work in tandem with the taxation system to support economic activity, and while continuing to support those most vulnerable in our society in a fair and equitable way, having regard in particular to experience gained during the COVID-19 Emergency.

- examine how the taxation system can be used to help Ireland move to a low-carbon economy as part of the process of meeting its climate change commitments as set out in the Climate Action and Low Carbon Development (Amendment) Bill 2021. This will include ensuring the sustainability of environmental tax revenue resulting from decarbonisation of the economy.
- consider the appropriate role for the taxation and welfare system, to include an examination of the merits of a Site Value Tax, in achieving housing policy objectives. This consideration should include reviewing the sustainability of such a role. It should also have regard to the experience of previous interventions in the housing and construction market and the current significant State supports for housing provision.
- consider how Ireland can maintain a clear, sustainable, and stable taxation policy as regards Ireland's attractiveness to Foreign Direct Investment in a changing global taxation environment, including retention of the 12.5% corporation tax rate.
- review how best the taxation environment for SMEs and entrepreneurs can ensure that Ireland remains an attractive place to sustain and grow an existing business or to start and scale up a new business.
- review the adaptability of the taxation and welfare systems to the rise of digital disruption and automation and other technological changes.
- examine the process for reviewing taxation measures and expenditures in order to ensure it is aligned with best practice and where appropriate make recommendations as to how it can be improved.
- examine how effectively good public health is promoted in Ireland, and present relevant reforms to advance and incentivise this goal.
- consider taxation practices in other similar sized open economies in the OECD to see what lessons Ireland can learn from such countries. This will include consideration of how the tax administration system should be modernised, building on real time payroll reporting which underpinned the existing modernisation of the PAYE system, and ensuring that the tax administration system meets best international standards. This will also include consideration of the potential for improvements in simplicity and administrative efficiency from integrating the taxation and welfare systems, as well as options for reform on the balance between the taxation of earned income, consumption, and wealth.
- submit its report to the Minister for Finance by no later than 1 July 2022.

Executive Summary

INTRODUCTION

Taxation and welfare policies are among the most potent instruments available to the State to influence the living standards of the country and its people. They have a major bearing on numerous aspects of economic and social policy. They are part, but not the totality, of a wider social contract – the set of rights and mutual obligations that come with living in Ireland. For this reason, debates over taxation and spending lie at the heart of our democratic tradition.

The Commission on Taxation and Welfare (the Commission) was established by the Minister for Finance on 6 April 2021, and following appointment of members, commenced its work in June 2021. The Commission's terms of reference asked for an overall appraisal of the suitability of the taxation and welfare systems to Ireland's present and future needs, and the consideration of a number of specific policy matters. The members of the Commission are drawn from a variety of backgrounds and bring a range of expertise to the Commission's work from relevant areas, including taxation, social policy, economics, public administration, business, enterprise, law and broader civil society. The Commission's role is to stand back from day-to-day concerns and to provide advice to the Government, and to the public, on how the taxation and welfare systems should be reformed to respond to the country's needs.

The Commission's task is explicitly strategic in nature. Given its wide-ranging mandate, and the Government's request for the Commission to report to the Minister for Finance by 1 July 2022, the work of the Commission has not been to conduct a comprehensive line-by-line review of every aspect of both the taxation and social welfare systems, but to look at both systems and their interaction in a holistic fashion with a long-term perspective. This has required judgement about which issues are most salient and relevant to the Commission's remit, and the application of a clear set of framing principles.

The issue of fiscal sustainability, as set out in Chapter 4 of this report, is of such magnitude and urgency that the Commission has

adopted a net revenue-raising approach. Given Ireland's demographic profile, level of public debt, and a number of other fiscal risks, it is inevitable that the total amount of taxation required to fund public services will increase in the years ahead. While the level of spending on public services is a matter for the democratic system to determine, to simply meet existing expectations for public service provision, the reality is that the State will require additional tax revenues. Accordingly, the Commission's recommendations are intended to either directly increase revenues or to reform the structures of the taxation system and social insurance system so that additional revenues can be raised over time at the lowest possible cost, and in line with the principles set out by the Commission - see Chapter 3 (Objectives and Principles).

The issue of social cohesion, and relatedly of intergenerational equity, has been a recurring theme in the Commission's deliberations. Over the past thirty years, Ireland has become a richer and somewhat more equal society. This social progress, however, cannot be taken for granted, and will depend on the ongoing provision of adequate social welfare payments, high levels of labour force participation and a progressive and fair system of taxation, and on Ireland remaining a competitive location for investment and employment creation. It also fundamentally, depends on the Irish systems of taxation and welfare including and supporting everyone. Ensuring the sustainability of the social insurance system through reforms to the Pay Related Social Insurance (PRSI) system is a vital component of this approach.

In addition to facing the demographic and other fiscal risks outlined earlier, Ireland is also faced with the defining challenge of carbon reduction which it must address in a manner that secures social cohesion. The Commission believes that the taxation and welfare systems have an important role to play in achieving a carbon-neutral economy, and that this should be carefully achieved via a 'just transition'. This will require ongoing implementation of the Carbon Tax and progressive reductions in fossil fuel subsidies, in order to better align taxes on fossil fuels with their carbon content. Over time, as fossil fuel usage falls, so too will income from related taxes. Therefore, it is necessary to begin planning to replace these revenues in a fair and sustainable way.

Throughout its work, the Commission has been conscious of the need to ensure a supportive environment for enterprise, innovation and investment in Ireland. The Irish economy has been transformed over the past three decades, but this success cannot be taken for granted.

While it is important to continue to attract Foreign Direct Investment, it is also important to promote investment and growth in indigenous enterprise, including innovative entrepreneurship. In this regard, a particular focus is required on the availability of finance for early-stage companies, on support for research and development, and on ensuring that enterprise can attract talent. Likewise, maintaining a high level of employment is critical, socially and economically, and this is reflected in a number of the Commission's recommendations.

The Commission's report is intended to form a balanced package of reform proposals to address these challenges. While taxation and welfare policies will inevitably be implemented over a series of annual budgets, it is important to see the report in a holistic way. As the Commission's framing recommendations on the balance of taxation make clear, there is a requirement for reform and change across several taxheads, and the Commission's recommendations in this regard are intended to sit alongside each other and to work together to secure the sustainability of the taxation system as a whole. Equally, in the area of welfare policy, the recommendations made are part of a balanced overall approach which is firmly linked to the proposals on taxation.

The Commission is mindful that its report is being published during a period of rapid inflation which is having a serious impact on household living standards. This report, however, is about the medium and longer-term needs of the Irish economy, and the Commission has sought to look through the present difficulties and to take a longer-term perspective. Given this approach, it is not expected, or realistic, that the Commission's recommendations, while interconnected, should be implemented all at once. Rather the Commission's recommendations are made in the expectation that detailed planning and distributional impact analysis (with the benefit of improved tools) will be required as necessary changes are phased in over time. Careful consideration has to be given to how the necessary and principles-based reforms we recommend can be implemented, and to how interactions between recommendations might, in certain circumstances, affect particular sets of households and businesses. By the same token, the yield from, or cost of, different recommendations will depend on when they are introduced and the circumstances at that time. Accordingly, the Commission has sought to avoid being overly prescriptive, while setting out clear principles and directions of travel. This does not mean that action to address fiscal sustainability can be postponed. Rather, action should be taken in

a measured and deliberate way to reduce risk and minimise the costs to society of higher taxes.

The principles adopted by the Commission build on long-standing and well-understood concepts in the fields of taxation and welfare and on the work of previous Commissions on Taxation and the Commission on Social Welfare, while also reflecting contemporary concerns, and are as follows:

Sustainability

In the 21st century, it is necessary to identify sustainability as a distinct and defining principle of taxation and welfare design. The concept of sustainability has economic, social and environmental dimensions. While economic theory has always identified a case for the taxation of 'externalities' on efficiency grounds, the scale of the climate challenge is so profound and so systemic that sustainability has to be seen as a design principle both for taxation and for welfare. Moreover, fiscal sustainability is also an important consideration.

Reciprocity

The systems of taxation and welfare have evolved over a long period of time, and are at the core of the social contract – what we owe each other. We pay taxes and social welfare contributions into a common pool in the expectation that, when needed, we can rely on adequate social welfare supports, and that we benefit from living in a society which attempts to achieve the lowest possible level of poverty. We also expect that everyone of working age who can work should do so according to their capacity and in line with an evolving concept of participation in society. As part of this set of mutual obligations, it is important that everyone participates, to the extent possible, in supporting our welfare system through taxation and PRSI.

Adequacy

An objective common to both the taxation and welfare systems is to redistribute market incomes to achieve greater equality and prevent poverty. This is part of a broader objective to ensure that people are protected against sudden loss of income, that everyone can participate in society, and to engender social cohesion. To achieve these goals, there is a fundamental requirement that income supports must be adequate with respect to prevailing living standards, a premise given particular emphasis by the 1986 Commission on Social Welfare. As we

show elsewhere in this report, there is a clear relationship between the adequacy of income support and poverty trends over recent decades. The issue of adequacy, however, is a nuanced one and is broader than the setting and benchmarking of social welfare rates. It needs to be set in a frame which includes having a system of taxation and welfare that is supportive of people participating in the labour market, being able to improve their income without encountering cliff-edges and traps, and being able to improve their earning potential by acquiring skills and experience.

Equity

Taxes and social insurance contributions should be levied in line with the concept of equity. Those in like circumstances should contribute equally, embedding the concept of horizontal equity. Vertical equity, on the other hand, requires that, at a systems level, those who can contribute more should do so. Taxation should not be confiscatory but, at the same time, exempting large groups, sectors or activities entirely from tax also creates difficulties.

Efficiency

An efficient, or neutral, tax system is one which treats similar activities in similar ways, and thereby minimises distortions that are economically and socially costly. Equally, an efficient social protection system, should be efficacious, easy to navigate and should treat individuals in similar circumstances the same way. Well-designed taxation and welfare systems will avoid 'traps' that create strong disincentives to enter the labour market or to increase hours worked. Efficient administration and simplicity of design are generally conducive to more efficient systems.

By using these five principles to frame its work, and by applying them to the terms of reference while being cognisant of the challenges and opportunities set out in Chapter 2 (Context), the Commission has determined the following key messages which are elaborated on further throughout the report.

KEY MESSAGES

- Ireland faces major fiscal sustainability challenges. Over time, the overall level of taxation as a share of national income will have to increase.
- While the existing taxation and welfare systems have performed well in many areas, to meet the fiscal sustainability challenges, and the

country's broader needs, a number of substantial reforms are required.

- It is necessary to broaden the tax base so as to limit the need for increases in tax rates and to secure the sustainability of the taxation system against future challenges. This will entail widening the base within taxheads and increasing the yield from taxes which are least distortionary, promote environmental goals and enhance the overall progressivity of the system. The balance of taxation needs to shift away from taxes on labour and towards taxes on capital, wealth and consumption. A strengthening of the PRSI system is also required. Over-reliance on Corporation Tax receipts to narrow the tax base or increase public spending needs to be curtailed.
- While personal taxes are highly progressive, the exclusion of large numbers of individuals from the personal tax system is becoming increasingly problematic from a fiscal sustainability and reciprocity perspective, which increases vulnerabilities. The priority for reform in this area is in respect of PRSI. A number of reforms should be made to PRSI to broaden the base and enhance the income of the social insurance fund.
- To promote equity and sustainability, preferential Income Tax or Universal Social Charge (USC) treatment based on factors such as age or personal characteristics should be phased out. As far as possible, and with limited exceptions, Income Tax and PRSI charges should be based on income only, and different types of income should be treated equally.
- The share of taxation from property and wealth is low and should increase. While the Commission is not recommending a net wealth tax; the yield from Capital Gains Tax (CGT) and Capital Acquisitions Tax (CAT), as well as from taxes on land and property, should be substantially increased. Distortions within the system, such as the treatment of death for CGT purposes, should be removed.
- A Site Value Tax (SVT) applicable to all land that is not subject to the Local Property Tax (LPT) should be introduced, replacing the existing system of Commercial Rates. There should be differential treatment in the application of SVT to agricultural land.
- LPT is a well-functioning tax, the yield from which should be increased materially. The Commission recommends that tax incentives should not be used in order to stimulate the supply of housing.
- The tax system has an important role to play in promoting carbon reduction. The schedule of Carbon Tax increases to 2030 should be

implemented, and fossil fuels should ultimately be taxed in proportion to their carbon content, which will require the phasing out of implicit subsidies. As the yield from taxes on fossil fuels declines, it will be necessary to replace these revenues with new taxes, including road usage charges. In the short-term, the Commission supports the introduction of congestion charging.

- Value Added Tax (VAT) should be reformed to increase its yield by merging the existing special reduced rates and increasing them incrementally over time. Temporary VAT reductions should not be used as a counter-cyclical measure. VAT administration should be modernised.
- There is scope to make significant improvements to the welfare system through the progressive introduction of reforms focused on supporting employment, addressing child poverty and removing cliff-edge effects. The Commission does not support the introduction of Universal Basic Income.
- The adequacy of social welfare rates is central to poverty reduction. Regular benchmarking exercises for working-age payments should be undertaken, which would set multi-annual targets for progress in rates.
- Working-age payments should be reformed to move towards a working-age assistance payment available to all households. The existing system of child income support should be enhanced with a second level of child income support, in addition to Child Benefit, for low-income households. These reforms could usefully be progressed in tandem.
- There should be a single employer rate of PRSI, and a gradual increase in the Class S rate for the self-employed. Other reforms are necessary to broaden the base of the PRSI system.
- Given changes in social norms and family structures, individualisation should be progressed in both the Income Tax and welfare systems (although this term means different things in each system).
- Ireland's existing corporate tax strategy has many of the building blocks fundamental to promoting enterprise. It is important to continue to maintain this environment for enterprise, innovation and investment. Tax-based policies to support productivity and employment growth in Small and Medium Enterprises (SMEs) are appropriate, but should be targeted towards and made more accessible to early-stage, high-risk and research and development-intensive businesses.

- While it is appropriate to incentivise savings for retirement, reforms are required to ensure that tax-relieved savings are taxed appropriately at the point of drawdown. An explicit policy is required to specify the level of retirement income up to which tax subsidies are appropriate. A more flexible approach to encourage greater retirement savings at younger ages should be adopted, subject to an appropriate lifetime limit.
- It is appropriate to use Excise Duties to discourage consumption of alcohol and tobacco and to support public health. The link between the public health rationale and design of these taxes should be strengthened. The Government should reserve the right to impose taxes on the consumption of ultra-processed foods, in order to support its policy of reformulation.
- Tax expenditures should only be introduced where there is a clear market failure and direct expenditure options have been examined. Better data and more resources for evaluation, including peer review, are also required.
- Building on progress to date, further investment in digital transformation of tax administration is recommended; including increasing integration of tax processes into a taxpayer's day-to-day activities.
- A strategic approach is required to address long-term fiscal challenges. The annual budget cycle should be enhanced to provide for greater debate on these issues, and the necessary fiscal instruments and administrative systems should be put in place to deal with them in advance.

Outline of the Report

PART 1

Part 1 of the report, entitled *Strategic Approach*, sets out the approach which the Commission has taken to its work, and the context in which its work is situated.[3]

Chapter 1 explains how the Commission's approach has involved careful selection of the issues on which to concentrate, standing back from day-to-day controversies to take a long-term perspective. **Chapter 2** sets out how, in order to assess the suitability of the taxation and welfare systems for the future, the Commission has looked at changes in the Irish economy over the past thirty years. The scale of change in the Irish economy and in Irish society more broadly during that period is remarkable, with the taxation and welfare systems playing an important role in that change. This chapter also outlines some of the major 'megatrends' that are likely to influence policy in decades to come, including technological change, demography, and climate change. **Chapter 3** then outlines the core policy objectives which the taxation and welfare systems must address i.e. fiscal sustainability, income adequacy and equality, promoting enterprise, innovation and employment, and climate action. It also outlines the principles which the Commission have adopted in guiding its work, which are Sustainability, Reciprocity, Adequacy, Equity and Efficiency.

PART 2

Part 2 of the report, entitled *Fiscal Sustainability and Taxation*, sets out in more detail the scale of the fiscal challenge, and the Commission's recommendations for how this should be approached.

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3 It is important to note, that the Commission's Report is designed to form a balanced package of interconnected reform proposals, based on a set of core principles. At the same time, given the breath of the terms of reference, it is expected that some readers will have greater interest in particular issues. Accordingly, the text contains extensive cross-referencing and some element of repetition to facilitate individual chapters being read on a stand-alone basis.

Chapter 4 sets out some of the major fiscal risks that face Irish society, including an ageing population, high levels of public debt, and growing reliance on Corporation Tax receipts. It explains why the Commission has adopted a net revenue-raising approach, identifying areas where revenue can be increased and reforms to the taxation and welfare systems necessary to achieve a higher tax yield while, minimising economic, social and environmental costs.

Chapter 5 discusses how the balance of taxation has evolved in recent years, compares the make-up of tax receipts in Ireland to other European countries, and makes recommendations in relation to how this balance should evolve over time. At the core of the Commission's approach is the broadening of the tax base. Government should focus on maintaining the progressivity of existing personal taxes without further erosion of the Income Tax or USC base. Base-broadening reforms should focus on PRSI and on addressing horizontal equity concerns. Consideration should be given to broadening the base of consumption taxes, placing emphasis on limiting the use of zero and reduced VAT rates and on the introduction of a number of environmental-related taxes, and reforms to existing taxes, to replace revenue streams and support the transition to a low-carbon economy.

Chapter 6 looks at a number of issues that arise in respect of horizontal equity. The Commission recommends that age should be removed as a factor for determining the charge to Income Tax and USC. Rates of USC should be determined by income level and not by any other eligibility criteria. Deposit interest income should be taxed at an individual's marginal rate of Income Tax and USC, and a system should be developed to facilitate the collection of these charges at source in real time. The Commission recommends widening the VAT base by limiting the use of reduced rates and the zero rate of VAT. The Commission does not support the use of temporary VAT reductions as a short-term stimulus measure.

Chapter 7 sets out the Commission's approach to the taxation of capital and wealth. While not recommending the introduction of a net wealth tax, the Commission recommends a number of major reforms to increase the yield from, and enhance the efficiency of, existing capital taxes. These include applying CGT at death, curtailing extensive reliefs that currently apply to CGT and CAT, and the introduction of a minimum capital charge on inheritances and gifts.

Chapter 8 addresses a number of concerns and related

recommendations in respect of pensions-related tax expenditures. The Commission endorses the continuation of the existing 'Exempt, Exempt, Taxable' (EET) model, but recommends that this model be applied more effectively. A clear policy is required as to what level of retirement income it is appropriate for the tax system to support, and a more flexible approach should be taken to facilitate building up the level of savings over a working life.

PART 3

Part 3 of the report, entitled *Policy Goals*, addresses a number of particular policy issues which were included in the Commission's terms of reference.

Chapter 9 sets out the Commission's recommendations to promote enterprise. The Commission welcomes progress at international level to address aggressive and/or harmful corporate tax practices, and also endorses the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy.[4] The Commission is of the view that many of the building blocks for promoting enterprise already exist in Ireland's current broad-based corporate tax strategy. However, in order to enhance productivity growth and innovation, there is a role for targeted tax incentives that support enterprise, provided that they are clearly targeted at early-stage start-ups, research and development and attracting skills.

Chapter 10 discusses the Commission's overall strategic approach to the evolution of social protection policy, which is subsequently developed in Chapter 11 (Promoting Employment) and Chapter 12 (Inclusive and Integrated Social Protection). A core part of this approach, set out in chapter 10, is a set of recommendations to broaden the base of PRSI to support the sustainability of the system.

Chapter 11 sets out recommendations on supporting employment growth, including avoiding over-reliance on labour-taxes, addressing 'traps' in the taxation and social welfare systems, and ongoing expansion in the role of the Public Employment Service.

Chapter 12 addresses the issue of the adequacy of social welfare payments, and makes a number of recommendations for reform, including changes to in-work benefits, a second tier of child income support, and further 'individualisation' of social welfare payments.

Chapter 13 sets out the Commission's conclusions and

4 Developed by the OECD/G20 Inclusive Framework on BEPS.

recommendations on the role of taxation in encouraging carbon emissions reduction, through the implementation of the scheduled increases in Carbon Tax and reduction in fossil fuel subsidies. It also addresses the importance of developing new taxes to replace the revenues from taxes on fossil fuels, including road usage charges.

Chapter 14 discusses the taxation of land and property, as it relates to the provision of housing and in respect of its appropriate contribution to the overall balance of taxation. The Commission is proposing the introduction of a SVT on all land not subject to the LPT.

Chapter 15 discusses the Commission's conclusions in respect of its terms of reference that touch on public health.

PART 4

Part 4 of the report is entitled *Better Systems* and addresses recommendations to develop the system of tax administration as well as reforms to policy development and evaluation.

Chapter 16 discusses the Commission's views on the system for evaluating tax expenditures, and makes recommendations in respect of methodology, additional resourcing and peer review.

Chapter 17 deals with the ongoing modernisation of the system of tax administration, and makes a number of recommendations to support further digital transformations in tax administration.

Finally, **Chapter 18** makes some comments and recommendations on the importance of improving debate on medium and long-term fiscal sustainability and the importance of adopting a strategic approach to achieve such sustainability.

List of Recommendations

Chapter 4: Fiscal Sustainability

4.1 The Commission recommends that given the medium- to long-term threats to fiscal sustainability, the overall level of revenues raised from tax and Pay Related Social Insurance as a share of national income must increase materially to meet these challenges. These increased yields should be obtained in a manner that minimises economic, social and environmental costs.

Chapter 5: Balance of Taxation

5.1 The Commission recommends that Government continue to focus on broadening the base of taxation across all categories of taxation.

5.2 The Commission recommends that Government should focus on maintaining the progressivity of the existing personal taxes system without further erosion of the Income Tax or Universal Social Charge base. Future base-broadening reforms should focus on Pay Related Social Insurance and on addressing horizontal equity concerns.

5.3 The Commission recommends that long-term over-dependence on Corporation Tax receipts poses significant sustainability risks and should be avoided. The Commission supports proposals to target the use of excess receipts in this area towards the Rainy-Day Fund or to reduce debt rather than fund tax reductions or permanent increases in expenditure.

5.4 The Commission recommends incrementally broadening the base of consumption taxes placing emphasis on limiting the use of zero and reduced rates of Value Added Tax. A number of environmental-related taxes and reforms to existing taxes should be introduced to replace revenue streams and support the transition to a low-carbon economy.

5.5 The Commission recommends that overall yield from wealth and capital taxes, including property, land, capital acquisitions and capital gains taxes should increase materially as a proportion of overall tax revenues.

Chapter 6: Tax Equity and Base Broadening

6.1 The Commission recommends that age should be removed as a factor for determining the charge to Income Tax and Universal Social Charge. The necessary changes to each charge should be introduced over time to minimise negative impacts.

6.2 The Commission recommends that rates of Universal Social Charge should be determined by income level and not by reference to any other eligibility criteria.

6.3 The Commission recommends that the remittance basis of taxation should be subject to a lifetime limit of three years.

6.4 The Commission recommends that the High Income Earner Restriction should be retained. To ensure that its original policy objective is not eroded, tax reliefs should only be excluded from its remit in exceptional cases.

6.5 The Commission recommends that deposit interest income should be taxed at an individual's marginal rate of Income Tax and Universal Social Charge. A system should be developed to facilitate the collection of these charges at source in real time by financial institutions.

6.6	The Commission recommends that a working group should be established to review and propose changes to the taxation of funds, life assurance policies and other investment products with the goals of simplification and harmonisation where possible. The working group should be established with a net revenue-raising or neutral mandate.
6.7	Having regard to the role of institutional investment in the Irish property market, the Commission recommends that Government undertake a review of the Real Estate Investment Trust framework, the Irish Real Estate Fund regime and the use of section 110 vehicles in this area. Consideration should also be given to a wider review of the section 110 regime generally. This review should be supported by the Department of Finance, the Revenue Commissioners and the Central Bank of Ireland.
6.8	The Commission recommends widening the Value Added Tax (VAT) base and limiting the use of zero and reduced rates of VAT. The VAT treatment of goods and services to which those rates currently apply should be reviewed to assess if it continues to be appropriate.
6.9	The Commission recommends that the rate of Value Added Tax on those goods and services currently attracting a second reduced rate (currently 9 per cent) should be increased over time to the reduced rate (currently 13.5 per cent).
6.10	Due to the relatively large share of goods and services attracting zero and reduced rates of Value Added Tax in Ireland, the Commission also recommends that the reduced rate of 13.5 per cent should be increased progressively over time.
6.11	The Commission does not support the use of temporary Value Added Tax reductions as a short-term stimulus measure.

6.12 The Commission recommends the introduction of an accommodation tax. The intention to introduce this tax should be signalled early and a process of engagement with relevant stakeholders should be undertaken prior to implementation of the tax.

Chapter 7: Taxes on Capital and Wealth

7.1 The Commission recommends, on horizontal equity grounds, that the transfer of assets on a death is treated as a disposal for Capital Gains Tax purposes. The Capital Gains Tax treatment of assets transferred during a lifetime in terms of tax payable, exemptions and reliefs available should also apply to assets transferred on a death.

7.2 The Commission recommends that the Capital Gains Tax Principal Private Residence Relief should be restricted over time.

7.3 The Commission recommends the introduction of a lifetime limit on all disposals of businesses and farms to children that qualify for Retirement Relief.

7.4 The Commission recommends substantially reducing the Capital Acquisitions Tax Group A threshold, bringing the Group A threshold closer to the Group B and Group C thresholds. Furthermore, the Commission recommends that the reporting requirements relating to the utilisation of group thresholds be strengthened.

7.5 The Commission recommends that the Group B relationship thresholds for Capital Acquisitions Tax should apply to a foster child in the same manner that would have been applicable if the child in question was, in law, a child of his or her foster parents.

7.6	The Commission recommends that the level of Agricultural and Business Relief available for Capital Acquisitions Tax be reduced and that the qualifying conditions for both reliefs be amended to incentivise, and ensure active participation in the farm or business by the recipient.
7.7	The Commission recommends that a modest charge should be applied to gifts and inheritances generally.

Chapter 8: Taxes on Retirement Savings

8.1	The Commission recommends more comprehensive implementation of the 'Exempt, Exempt, Taxed' model of pension provision including recommending a meaningful reduction in the overall level of tax-free lump sum available from its current level (worth over four times average earnings). Marginal tax rates should apply on all lump sums over the tax-free threshold.
8.2	The Commission recommends that there should be a single tax-free lump sum lifetime limit to include both pension lump sums and any ex-gratia termination payments received.
8.3	The Commission recommends that Approved Retirement Fund (ARF) assets should be treated for inheritance tax purposes in the same way as other assets where inherited by anyone other than the individual's spouse. Both Income Tax and Capital Acquisitions Tax should apply. This supports the 'Exempt, Exempt, Taxed' model and maintains equitable treatment within the system.
8.4	The Commission recommends the removal of age-related contribution rates to be replaced with a single annual contribution rate. The Commission also recommends the removal of the annual earnings cap on contributions subject to appropriate lifetime limits remaining in place.

8.5 The Commission recommends the periodic benchmarking of the Standard Fund Threshold to an appropriate and fair level of estimated retirement income.

8.6 The Commission recommends an urgent review of the availability of appropriate and adequate data on the cost and distribution of pension tax expenditures. The absence of good data significantly inhibits the regular and rigorous evaluation of these costly expenditures.

8.7 The Commission recommends that anomalies in the tax treatment of different retirement arrangements should be eliminated, as far as possible.

Chapter 9: Promoting Enterprise

9.1 The Commission endorses Ireland's current corporate tax strategy, including Ireland's ongoing participation in international efforts to tackle aggressive and/or harmful corporate tax practices. The Commission also endorses the adoption of the Two-Pillar Solution to Address the Tax Challenges arising from the Digitalisation of the Economy, as well as the development of multilateral solutions to combat base erosion and profit shifting.

9.2 The Commission recommends the continued use of feedback statements and roadmaps which should be better applied to indigenous entities and Small and Medium Enterprises.

9.3 The Commission recommends that consolidation of the Taxes Consolidation Act 1997 (TCA) should be carried out periodically as a matter of principle. Consideration should be given to how greater simplification of existing tax codes can be achieved as part of this exercise.

9.4 The Commission endorses the use of appropriately targeted taxation measures to support Small and Medium Enterprises in raising equity investment, and thereby supporting such firms to establish, grow and sustain employment. The Commission supports the continued use and development of investment-based schemes, such as the Employment Investment Incentive (EII). The Commission recommends that EII should be extended and enhanced to support early-stage, high-risk and research and development-intensive businesses in attracting stable financial investment.

9.5 The Commission recommends that Entrepreneur Relief be extended to angel investors, subject to appropriate limits and conditionality.

9.6 The Commission recognises the important role played by the tax system in supporting and encouraging a strong innovation, research and development culture across the economy. The Commission also recognises the importance of the Research and Development (R&D) tax credit in this area and therefore recommends that enhanced relief measures be introduced which are targeted at small and micro-sized enterprises. Furthermore, more guidance and supports should be introduced to facilitate greater uptake by Small and Medium Enterprises more generally. The Commission recommends that consideration be given to a limited acceleration of the refundable element of the R&D tax credit from three years to one in order to support early-stage and research and development-intensive businesses.

9.7 The Commission recommends that specialist resources and capabilities be allocated to the Revenue Commissioners, and the Department of Enterprise, Trade and Employment and its agencies to develop an advance assurance mechanism in order to enable wider access to tax incentives such as the Research and Development tax credit and Employment Investment Incentive.

9.8	The Commission recognises the importance of share-based remuneration to support SMEs and indigenous enterprises in attracting and retaining talent and sees a role for the tax system in this area. The Commission does not believe that the Key Employee Engagement Programme (KEEP) is achieving its objectives in its current form and recommends that KEEP should be reformed to broaden its use.
9.9	The Commission recommends that the exemption from employer Pay Related Social Insurance (PRSI) on share-based remuneration should be limited through the introduction of an appropriate annual cap or, alternatively, by restricting the exemption to micro, small and medium-sized enterprises.
9.10	The Commission recommends that the taxation of employee share options should be moved from self-assessment to the Pay As You Earn (PAYE) system.
9.11	The Commission recommends that the Special Assignee Relief Programme (SARP) should be subject to further restriction and that its continuation should be subject to regular review as part of the tax expenditure review process.
9.12	The Commission recommends that the qualifying criteria of the Foreign Earnings Deduction (FED) be reviewed to ensure the measure is utilised by claimants in a manner consistent with its original policy objective.
9.13	The Commission recommends that the taxation of internationally mobile employees who receive share remuneration (including Restricted Stock Units) should be aligned with the general treatment applicable to unapproved share options.
9.14	The Commission recommends that the qualifying conditions of trans-border relief be reviewed in the context of modern work practices.

Chapter 10: Labour Markets and Social Protection Systems

10.1	The Commission recommends maintaining a low entry threshold for access to social insurance.
10.2	The Commission believes that a lower nominal rate of employee Pay Related Social Insurance (PRSI) should apply to earnings below the employee PRSI contribution threshold, currently €352 per week.
10.3	The Commission recommends that, with a view to broadening the Pay Related Social Insurance (PRSI) base, PRSI should be extended to all sources of employment income including, as a general rule, share-based remuneration.
10.4	The Commission recommends that those over State pension age pay Pay Related Social Insurance on all income other than social welfare payments.
10.5	The Commission recommends removing the Pay Related Social Insurance exemption on supplementary pension income (occupational and personal pensions, and public sector pensions).
10.6	The Commission recommends that, in the interests of solidarity, the rate of charge for Pay Related Social Insurance (PRSI) on unearned income should remain aligned to the higher rate of PRSI applicable to employees on their income from employment generally.
10.7	The Commission recommends that cliff-edges in the taxation and welfare systems should be removed.
10.8	The Commission does not support the development of a Universal Basic Income in Ireland.

Chapter 11: Promoting Employment

11.1 The Commission recommends that secondary benefits for people of working age should be designed on a cross-departmental basis to ensure coherence, with negative work incentives minimised and benefits targeted appropriately and effectively. To ensure appropriate integration and tapering of secondary benefits with the existing framework of income supports, an assessment of the impacts of any new benefit should be conducted before new schemes are introduced. Other departments should consult with, and take advice from the Department of Social Protection in respect of any means-tested payments. All agencies making decisions on eligibility should have access to the same high-quality information.

11.2 The Commission notes that a number of recommendations in this report will affect the cost of employment and is cognisant of other policy developments (including, for example, changes in respect of statutory sick pay, auto-enrolment, etc.) that will also affect employers' costs over the medium term. There is a need to coordinate and manage the phased introduction of such reforms. The Commission therefore recommends the establishment of appropriate coordination mechanisms to monitor the cumulative effect of policy-related labour cost changes on enterprise and the self-employed.

11.3 The Commission believes that only one rate of employer Pay Related Social Insurance (PRSI) equal to the higher rate (currently 11.05 per cent) should apply on all weekly incomes, and that the lower rate of employer PRSI, which currently applies on incomes up to €410 per week, should be gradually phased out.

11.4 To minimise the distinctions between legal forms and to treat similar activity in similar ways the Commission endorses the principle that the rate of Pay Related Social Insurance (PRSI) on self-employment (Class S) should be aligned over time with the employer's rate of Class A PRSI attaching to employment (currently 11.05 per cent).

11.5	The Commission recognises that the Universal Social Charge surcharge on non-Pay As You Earn (PAYE) income above €100,000 does not comply with the principle of horizontal equity and recommends that the tax treatment for all income earners should be aligned.
11.6	The Commission recommends a phased move towards individualisation of the Standard Rate Cut off Point as a step towards addressing disparities in the Income Tax system, facilitating increased employment, and decreasing the gap in the employment rate between men and women.
11.7	The Commission recommends that the Public Employment Service (PES) should provide advice based on the employment trajectories of people with similar characteristics, with analysis of the outcomes of PES programmes informing the particular programmes at specific points in the economic cycle.
11.8	The Commission believes the range of Active Labour Market Programme offerings should be led by rigorous evidence and evaluation of their net impact on the jobseeker's long-term employment prospects.
11.9	The Commission recommends expanding employment services to recipients of other income support payments. The Public Employment Service must be adequately resourced to deliver these services.
11.10	The Commission recommends that a model of employment services, similar to that currently in place for lone parents, be extended to qualified adults.

Chapter 12: Inclusive and Integrated Social Protection

12.1 The Commission recommends that Government undertakes a regular benchmarking exercise in respect of all working-age income supports (including supports for people who are unemployed, people with disabilities and people parenting alone), following which multi-annual targets should be set for social welfare rates which provide for regular incremental progress. Annual increases in social welfare rates should be based on a transparent and evidence-led process.

12.2 The Commission recommends that working-age payments should be reformed to move towards an income related working-age assistance payment available to all households. The payment should be designed so as to avoid subsidising low-paid employment.

12.3 The Commission notes the intention of the Government to introduce a greater element of pay-related benefits within the Social Insurance system. The Commission recommends that the design of such benefits should take account of incentives to work and the sustainability of the Social Insurance Fund. If introduced, any such benefit should be short in duration, subject to a cap, and progressively extended to include maternity, paternity, parents' and illness benefit.

12.4 The Commission does not recommend that Child Benefit should be subject to tax.

12.5 The Commission recommends that the existing system of child income supports should be reformed to facilitate the introduction of an income related second tier of child income support in addition to Child Benefit that combines existing supports and that would be provided to all low-income households, whether in receipt of a social welfare payment or not.

12.6 The Commission recommends that the individualisation of payments made to qualified adults be progressed. This should be guided by the set of principles outlined by the Commission.

Chapter 13: Moving to a Low-carbon Economy

13.1 The Commission recommends that the phased increase in the Carbon Tax to €100 per tonne of carbon dioxide emitted by 2030, as set out in the Schedule 2 to Finance Act 1999 (Mineral Oil Tax) as amended, is implemented. Increases in Carbon Tax after this date should be clearly signalled and linked to the societal cost of carbon.

13.2 The Commission recommends the equalisation of the rate of Excise Duty on auto-diesel and petrol in the short to medium term.

13.3 The Commission supports the principle that embedded tax fossil fuel subsidies should be reduced on a phased basis over time, with the aim of ensuring that the taxation of fuel reflects the amount of carbon emitted. Those most environmentally harmful tax fossil fuel subsidies should be prioritised for removal along with those for which viable alternatives exist. Government should publish a roadmap by 2023 setting out ambitious targets for the elimination of subsidies by 2030.

13.4 The Commission notes the changes at EU level in respect of the future taxation of electricity, including the anticipated mandatory application of a minimum rate of Excise Duty to electricity for household use. The Commission also recognises the need for the Exchequer to generate additional revenue from tax on electricity in the medium to long term (post-2030) to replace revenues from fossil fuels. The Commission recommends that any such increases should be carefully timed, clearly signalled in advance and should not act as a disincentive to the use of renewable electricity sources in carbon-intensive activities.

13.5 The Commission recommends that Motor Tax and Vehicle Registration Tax on commercial and non-commercial motor vehicles be redesigned in the medium to long term, in a manner that is consistent with environmental objectives and ensures that tax revenues from motor vehicles are maintained.

13.6 The Commission recommends the introduction, in the medium term, of distance, location and time-based road usage charges. Planning for such charges should include early identification of the appropriate technology to be used in calculating and applying them.

13.7 The Commission recommends the introduction of congestion charges in key urban areas, based on a number of key metrics linked to environmental and individual impact. These charges should be reviewed following the introduction of road usage charges.

13.8 The Commission recommends the introduction of an additional duty on non-residential car parking, both public and private, and not limited to employer-provided car parking, in the same key urban areas identified as suitable for congestion charges.

13.9 The Commission accepts the rationale for the use of targeted taxation expenditures to support the achievement of Government policy goals with respect to decarbonisation, and to address the gap between the upfront costs of investment and the timeframe for return on same. Such measures should have a clearly identified policy objective, be targeted in nature, and be in place for a limited period to help influence the behavioural change required.

Chapter 14: Land and Property

14.1 The Commission recommends the introduction of a Site Value Tax (SVT) on all land currently not subject to Local Property Tax. This includes all commercial (developed and undeveloped), mixed-use, agricultural, undeveloped zoned residential lands, and State-owned lands as well as all land on which derelict and uninhabitable premises sit. SVT should replace the existing system of Commercial Rates over time.

14.2	The Commission recommends that there should be differential treatment in the application of Site Value Tax to agricultural land.
14.3	The Commission recommends that the current structure and broad features of Local Property Tax should remain. This includes a market value basis for applying the charge, keeping exemptions to a minimum and the continued use of regular revaluations.
14.4	Revenues deriving from Local Property Tax (LPT) should increase to form a substantially larger share of total revenues through the adjustment of the basic rates of taxation and potentially through an adjustment of valuation bands. The ability of local authorities to decrease the basic rate of LPT should be removed.
14.5	The Commission recommends that, in the case of multiple property owners, a Local Property Tax surcharge should apply to properties not occupied as the principal private residence of the property owner or a registered tenant.
14.6	A Local Property Tax surcharge should be introduced for vacant properties.
14.7	The Commission recommends that tax incentives should not be used in order to stimulate the supply of housing.
14.8	The Commission supports the reform of the differential rent schemes towards a national system based on ability to pay. Any proposed changes to social housing supports should fully consider the potential impact on incentives to work.
14.9	The Commission recommends that the tax system should be neutral in its treatment of different tenure types.
14.10	The Commission recommends that the Help to Buy scheme be allowed to expire as planned at the end of 2022.

Chapter 15: Promoting Good Public Health

15.1 The Commission supports the use of taxation in promoting public health in Ireland. In particular, it supports the levying of Excise Duties/taxes at high rates related to the social cost arising from the consumption of alcohol, tobacco and sugar-sweetened drinks. The Government should seek to strengthen the link between the public health rationale and design of these taxes over time.

15.2 The Commission recommends that Government develop fiscal measures which could be introduced to encourage a reduction in the consumption of ultra-processed foods, to support reformulation measures to reduce the harm of such foods and promote healthier eating. In developing such proposals, Government should be conscious of the distributional effect of proposed changes and the influence of fiscal and other policies on consumer purchasing and their impact on overweight and obesity.

15.3 In the context of the implementation of Sláintecare, tax relief for private health insurance should be phased out over time.

Chapter 16: Tax Expenditure Review Process

16.1 The Commission recommends that the Department of Finance should ensure that adequate evaluation data on tax expenditures is collected, and where necessary propose legislative amendments in order to allow collection. This will address existing data gaps and allow more comprehensive understanding of the taxes forgone, the objectives achieved and at what cost.

16.2 The Commission recommends that the Department of Finance and the Revenue Commissioners should regularly examine the most appropriate way to cost tax expenditures on a case-by-case basis and consider alternative costing methodologies where data becomes available.

16.3 The Commission supports the continued inclusion of sunset clauses for the review of all new tax expenditures, Government should also consider the retrospective inclusion of sunset clauses in respect of existing tax expenditures. This would provide a statutory basis for the regular review of all tax expenditures.

16.4 The Commission recommends the expansion of dedicated economic evaluation capacity within the Department of Finance to work specifically on tax expenditures with the aims of providing more and better information on tax expenditures and introducing a greater degree of rigour and consistency in the quality of the evaluation process. This evaluation work should also be peer-reviewed by an appropriate outside body.

16.5 The Commission calls for strengthening the ex-ante evaluation of tax expenditures ahead of their introduction to ensure better policy outcomes. This should include clear articulation of what the objective of the tax relief is, what market failure it is designed to address (if any), the distributional impacts of the planned tax relief and why it is being addressed via tax relief rather than direct expenditure. Annual tax expenditure reports should also include forecasts for coming years in line with guidelines on forecasts for direct expenditure. Ex-post reviews should be similarly rigorous.

16.6 The Commission recommends that the Department of Finance, with support from the Revenue Commissioners should publish and maintain a single agreed definition of the benchmark tax system and compile a master list of all tax expenditures. This would ensure that tax measures are systematically included either in the benchmark or the tax expenditure list.

16.7 The Commission recommends that the Department of Finance should devise a strategic plan to regularly and rigorously evaluate all tax expenditures in line with relevant guidelines.

Chapter 17: Modernisation of Tax Administration

17.1 The Commission believes that digital transformations are fundamental to the successful modernisation of tax administration processes. The Commission recommends that such transformations should be a central tenet of a structured programme of tax administration reform that should be commenced as soon as possible.

17.2 The Commission recommends that, in so far as possible, compliance obligations should be built into natural taxpayer systems and that due consideration should be given by the Revenue Commissioners, in conjunction with other Government Departments as required, as to how such systems should be leveraged in order to improve real-time reporting.

17.3 The Commission endorses the use of whole-of-government solutions to improve service delivery.

17.4 The Commission recommends that the necessary steps are taken to ensure that modernisation of tax administration is fully supported by legislation.

17.5 The Commission recommends that the necessary investments are made by the State to further develop the appropriate technical architecture required to properly support modernised tax administration and data collection. This should also include developing appropriate frameworks for stakeholder engagement as part of a co-design approach to such modernisation.

17.6 The Commission recommends that the Revenue Commissioners and the Department of Social Protection be given supports, as necessary, to develop the skills base required to digitally transform tax and welfare administration.

17.7	The Commission believes that data protection and data security must be a key consideration in any modernisation process, and that the public must have a clear understanding as to how their data is being used.
17.8	The Commission recommends that the necessary supports and alternatives are retained, or developed where necessary, to address digital exclusion.
17.9	The Commission recommends that existing linkages between the Revenue Commissioners and the Department of Social Protection (DSP) be further enhanced to explore a solution that provides for application of PAYE to taxable payments made by DSP as they are being paid. In exploring such a solution, careful consideration is required to avoid undue hardship for recipients of such payments, taking account of the importance of cash payments in poverty alleviation.
17.10	The Commission recommends that further linkages be developed between the Revenue Commissioners and the Department of Social Protection (DSP) to facilitate the more effective means testing of DSP payments.

Chapter 18: Strategic Reform

18.1	The Commission recommends that the annual budgetary cycle be augmented in order to enhance debate about and public knowledge of long-term issues of fiscal sustainability.
18.2	The Commission recommends that Government departments should build on existing long-term fiscal analysis capabilities to develop a system of scenario modelling and associated stress testing. The system should be used to examine different future public finance scenarios and how well the State could react to them. It should also analyse whether there are adequate policy tools and administrative systems in place to address potential outcomes.

18.3 The Commission recommends greater use of medium-term roadmaps to provide certainty as to the direction of travel of policy in respect of specific elements of the taxation and welfare system.

18.4 The Commission recommends that Public Service Performance Reports, and where appropriate other public accounts, should include information on the total amount of resources allocated to each Department and what has been achieved with these resources, including information on tax expenditures.

18.5 The Commission recommends that greater access should be provided to suitably anonymised administrative data to support public interest research.

18.6 The Commission recommends ongoing support for research in the areas of the distribution of income and wealth and the effects of taxation and welfare policy, as well as the development of improved tools for ex-ante evaluation and impact assessment of proposed policy changes.

18.7 The Commission recommends that the public service continues to invest in the people and skills needed to improve policy analysis and policy development in the realm of taxation and welfare across a range of disciplines.

Part 1:
Strategic Approach

Chapter 1: The Commission

1.1 ESTABLISHMENT

The Commission on Taxation and Welfare (the Commission) was established by the Minister for Finance on 6 April 2021, pursuant to a decision of the Government and a commitment in the Programme for Government. The members of the Commission were appointed on 3 June 2021. The membership is comprised of individuals drawn from a range of backgrounds bringing a variety of expertise and experience to the work of the Commission from relevant areas, including taxation, social policy, economics, public administration, business, enterprise, law and broader civil society. This is the fourth time in the history of the State that a Commission on Taxation has been established, and there have been several different bodies established in the past to examine the social welfare system. It is, however, the first Commission tasked with examining both together.

The issues to be considered as part of the Commission's terms of reference are generally wide-ranging but, in some cases, are quite specific. They include an overall appraisal of the suitability of the taxation and welfare systems to Ireland's present and future needs, and a number of specific matters such as the appropriate role for the tax system in supporting Government policy on Housing and Public Health.

Throughout its work, the members of the Commission have been mindful and appreciative of the importance of the task that they have been asked to undertake. For a small open economy such as Ireland's, taxation and welfare policies are among the most potent instruments available to the State to influence the living standards of the country and its people. They have a major bearing on numerous aspects of economic and social policy. At a broader level, however, the tax and welfare systems together constitute some of the most significant and regular interactions between people and the State. They are part of a wider social contract – the set of rights and mutual obligations that come with living in Ireland. While taxes and social insurance contributions are legal obligations, they are also underpinned by the

general principle of reciprocity. People expect to contribute to the State over their lifetime based on their circumstances and, in return, they expect that the State will provide public services and support them via the welfare system in difficult times. The taxation and social welfare systems are, therefore, part of 'what we owe each other'.

For this reason, debates over taxation and spending lie at the heart of our democratic tradition, and have shaped the evolution of our democratic institutions over centuries. The Commission's work does not in any way supersede the normal work of the democratic system. The Commission's role is that of an expert advisor, on a once-off basis, to Ministers and the Government, but also to the Oireachtas and to the public, who are part of democratic debate about these issues. The Commission has considered the topics set out in the terms of reference and offers advice and recommendations on them. It is for others to consider how best to translate this advice into concrete policy and legislative action. Given the nature of the Commission's mandate, this report is intended to be of value for several years to come.

1.2 SEEKING INPUT

From inception, consultation and engagement featured as a fundamental part of the process to deliver this report, and a range of events, platforms and strategies were used to engender dialogue and encourage feedback. The process adopted by the Commission comprised two key elements: public consultation and stakeholder engagement, and sought to allow all relevant stakeholders, including private individuals, industry, academia, consumers, civil society organisations, practitioners, policymakers, experts and interest groups an opportunity to participate in the process of shaping the recommendations of the Commission.

The public consultation opened on 20 October 2021 and closed almost three months later on 17 January 2022. It was hosted on a web-based platform, Citizen Space, which provided a rich interactive experience for participants and complies with the web content accessibility guidelines. The platform allowed for in-depth, objective analysis of submissions. Mindful of the potential for digital disenfranchisement, the public consultation was advertised across a mix of owned, earned and paid media, including social media, transit and print advertising. A total of 229 submissions were received as part of the public consultation.

The second pillar of the process was stakeholder engagement, which in turn consisted of two events: an Open Public Meeting and

a Stakeholder Forum. 83 delegates attended the Open Public Meeting, some representing groups or bodies, and 362 attended the Forum, while the latter event also had a series of break-out sessions each of which was linked to the terms of reference for the Commission. There was very strong engagement at both events with, for example, more than 50 questions being raised by the audience at the Open Public Meeting.

The Commission's Secretariat also consulted widely, including through bi-laterals with a range of stakeholders, individual Government Departments and via a cross-departmental information session held as part of the launch of the consultation.

1.3 SECRETARIAT

Throughout its work, the Commission has been supported by a Secretariat drawn from the Department of Finance, the Revenue Commissioners, and the Department of Social Protection, who were seconded for the duration of the Commission's work and who worked in mixed inter-disciplinary teams. The Commission is grateful to the three organisations for this support, which made it possible to address the demanding terms of reference in a short period of time.

1.4 STRATEGIC APPROACH

The Commission's task is explicitly strategic in nature. The role of the Commission is to broadly examine the systems of taxation and welfare as a whole, and to look in some detail at specific issues explicitly mentioned in the terms of reference, taking a 'medium and longer-term' perspective, i.e. over the next ten to fifteen years and beyond. Given this mandate, and the request for the Commission to report by 1 July 2022, it will be seen that the work of the Commission was not to conduct a comprehensive line-by-line review of every aspect of both the taxation and social welfare systems. Rather, the Commission's role was to take a systemic view, to consider how well those systems currently achieve their objectives and how well they are likely to achieve them in the future. To be strategic is to make choices. The Commission reflected carefully on which aspects of taxation and welfare to enquire into most closely, standing back from some of the day-to-day debates in order to take a longer-term view and whole-of-system perspective. This required judgement about which issues are most salient and relevant to the Commission's remit and hence to concentrate on, and which, however important in other senses, to leave to others.

Looking into the future is intrinsically difficult. It requires reflection

on the recent past, to try to understand what have been the drivers of our recent experience, to consider how long those drivers might be expected to persist and to determine what other forces are likely to influence our future. Accordingly, this report contains reflections on the past three decades of economic growth and development in Ireland, as well as material gleaned from strategic foresight, which identifies the major global forces that are likely to shape our world in the future - see Chapter 2 (Context). Such an exercise involves weighing many uncertainties, since change is constant.

Against the backdrop of this rapid change, a fundamental part of the Commission's work has been to consider, in a strategic manner, what it is that the taxation and welfare systems should do. What role should the taxation and welfare systems play in promoting economic and social development in Ireland, and how can they sustainably continue to do so in the future? Here again, choices are necessary. The taxation and welfare systems cannot be directed at too many objectives, nor can every demand made of Government in this area be accommodated. Of its nature, policy-making in respect of taxation and welfare has to be selective and difficult trade-offs are often required. Trying to load too much onto the levers of taxation and welfare would cause them to fail in their core purposes. It is also important to look at both systems holistically. It is not possible to properly assess each element or proposed amendment in isolation from the system as a whole. It should also be remembered that, powerful though they are, taxation and welfare policies are only part of the wider policy context and that government has other levers at its disposal to address policy concerns.

In the face of such uncertainty and change, a central component of the Commission's work, and its discussions, has been consideration of the key organising principles that should underpin the design of tax and welfare policy in the future. Given the pace of change, especially in technology, it is not possible to make precise predictions about how the future will unfold. However, the key principles for the design of taxation and welfare policy in a small open economy have evolved over a long period of time and will remain salient. The question for policymakers now and in the future is how to apply these principles as conditions evolve. The Commission has consciously taken this principles-based approach in its deliberations and in arriving at its recommendations. In some areas these recommendations are specific, but in others they take the form of principled guidance about how to approach the

problems that can be expected to arise in the years to come. In this report, as a whole, the Commission is satisfied that it has adopted a suitably strategic approach, while also addressing the specific concerns included in the terms of reference.

By the same token, the Commission's recommendations have to be seen in a medium-term and long-term perspective. The Commission began its work during the COVID-19 pandemic and continued through the illegal Russian invasion of Ukraine. As well as tragic loss of life and human suffering, these events have given rise to the highest rate of inflation seen in decades in Ireland, and growing public concern about the cost of living. Whatever the immediate context, however, and while conscious of public concerns, the Commission has to look beyond these immediate issues and consider long-run trends. There are always short-term challenges that Government has to address. These may require short-term targeted solutions but this does not invalidate the need for a longer term and strategic policy orientation. The Commission has been tasked with considering medium and long-term responses to what are long-term challenges, and opportunities facing the Irish economy. Government responses to these challenges will evolve over the medium term and longer term. For the avoidance of doubt, it is important to emphasise that the Commission is not suggesting that all of its recommendations should be implemented at once. Indeed, some of our proposals will require a number of years of careful planning if they are to be brought into effect. Rather the Commission's recommendations should feed into improved processes of public policy development and be implemented in a balanced manner over time. What is important is that there is a realistic debate and that processes are put in place to address the issues set out in this report. The longer it takes to address the cost of ageing and other fiscal risks, the more drastic and costly future measures will be, unfairly transferring the burden of adjustment to future generations.

Chapter 2: Context

2.1 A CHANGED IRELAND

The Commission's terms of reference ask it to consider how the taxation and welfare systems can best serve Ireland's needs in the medium and longer term, i.e. the next ten to fifteen years and beyond. While this requires consideration of the major trends that are likely to affect the country in the decades ahead, it also requires an assessment of the recent historical context. To look forward, we must first look back. We need to understand how Ireland has been changing, and the role of the taxation and welfare systems in that change, before considering whether that change is likely to continue.

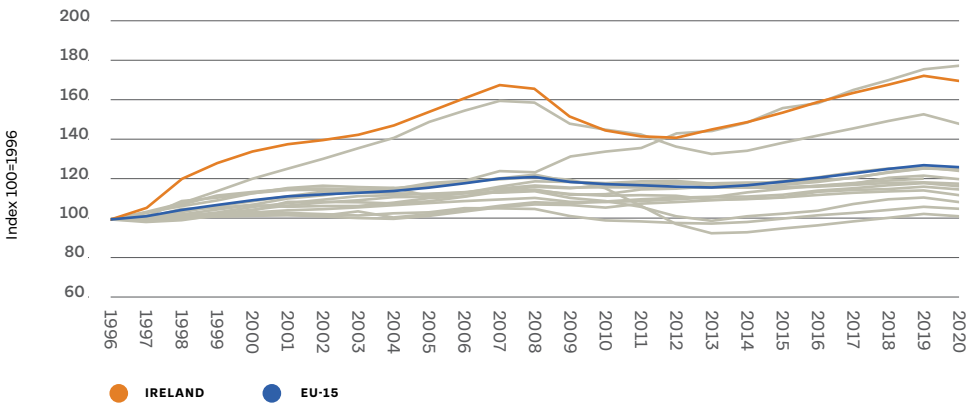
The choice of starting point for this retrospective analysis is ultimately an arbitrary one. Reflecting on the history of post-war Europe, however, 1989 was clearly a watershed year, when the Cold War came to an end, ushering in a period of accelerated globalisation of the world economy. Looking back over the period since then, Ireland, economically, is a country transformed. In the three decades from 1989, when the post-war global order came to an end, to 2019 on the eve of the UK exit from the EU (Brexit) and the global COVID-19 pandemic, the pace of growth and structural change in the Irish economy has been remarkable. In the late 1980s, Ireland as a country was one of the poorest of the rich. Measured in terms of income per capita, Ireland ranked towards the bottom of the European rankings. The benefits of European Economic Community (EEC) membership had not prevented the 1980s resembling another lost decade, similar in many ways to the 1950s. High levels of unemployment and outward migration, a long-running fiscal crisis and an over-large national debt were marked characteristics of Ireland's economic performance. Thirty-three years later, despite the turbulence of the financial crisis, Brexit, the pandemic and the illegal Russian invasion of Ukraine, income per capita has more than doubled. So too has the level of employment. Over that period, Ireland has added more than one million jobs.

Much of this change was clearly driven by overseas investment.

By 2019, nine of the top ten US tech companies had a presence in Ireland, and the country can point to strong overseas investment in pharmaceuticals, medical devices and information technology, which not alone built on, but greatly exceeded, the foundations that had been in place thirty years before. Strong investment programmes have substantially improved the country's infrastructure, although more development is still required, and third-level education participation has greatly expanded such that the number of adults with a third-level qualification increased from 13.6 per cent in 1991 to 42 per cent in 2016. This growth performance was accompanied by major structural changes in both the economy and society.

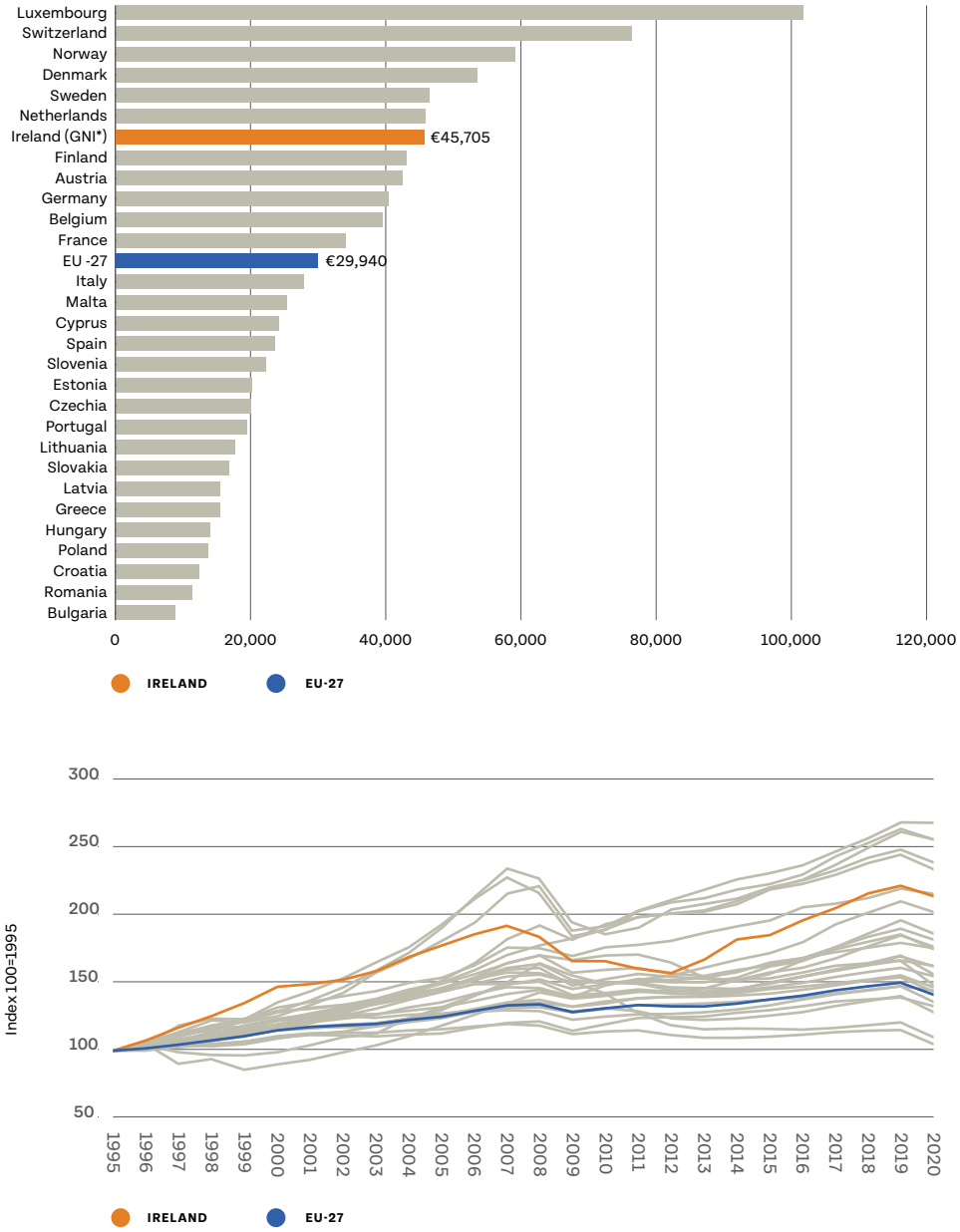
The composition of employment has also shifted, with an expansion of high-value service orientated employment and a correspondingly lower level of reliance on manufacturing, including some element of shifting of low-paid manufacturing employment to other countries. Between 1989 and 2019, the population of Ireland has increased by 40 per cent. Whereas the 1986 Census showed that only 6 per cent of the population was born outside Ireland, by 2016 this figure had increased to 17 per cent. There have also been major changes in social attitudes and choices, including towards marriage and household formation, and female labour force participation has increased from 45 per cent in 1990 to 67 per cent in 2019. These changes have profound implications for the way both society and the economy functions, and indeed for the role of the taxation and welfare systems.

Figure 1: Employment growth in EU-15 countries, 1996-2020



Source: Secretariat calculations using Eurostat data
Note: EU-15 used as EU-27 country data only available for later years.

Figure 2: i) GDP per capita, 2020 and ii) real GDP and GNI* growth, 1995-2020*



Source: Secretariat calculations using Eurostat; CSO
GNI is used for Ireland due to distortions in GDP. See the Glossary for more details on GNI*.

While there are many positives to note in this period of economic growth and change, for those who have lived through the period, the averaged and annualised economic growth rates tell only a small part of the tale. It took some years before the benefits of economic growth in the 1990s fed through to full employment, and this was dramatically (albeit only partially) reversed during the financial crisis. The experience of the financial crisis and the requirement to rapidly correct a fiscal deficit, which emerged because of over-reliance on construction and related revenues, was a painful one. By 2019, full employment had effectively been restored, only for hundreds of thousands of people to suddenly find themselves reliant on the Pandemic Unemployment Payment (PUP) during the pandemic.

The level of Government debt has fluctuated considerably over the past thirty years, but is once again at an elevated level compared to other comparable economies. In common with other countries, strong economic growth, rising demand, and low real interest rates have contributed to rising house prices. As a result of higher population, changing household formation patterns, and the disruption to housing supply resulting from the property bubble and its aftermath, there has been a housing 'crisis' in one form or other for twenty years. The housing issue has become a major social and economic dislocation.

Moreover, there can be no doubt that this level of growth, including population growth, has also had an impact on our environment in many ways, for example, in respect of Greenhouse Gas (GHG) emissions. While carbon dioxide emissions have fallen from around 70 million tonnes of carbon dioxide equivalent in the mid-2000s to just under 58 million tonnes of carbon dioxide equivalent in 2020 (latest year for which data are available), the link between economic activity and GHG emissions remains. Most recently, Ireland's GHG emissions fell by 6 per cent due to the periods of lockdown during the pandemic, but this effect is expected to be temporary (the decline in 2020 was just 3.6 per cent), and is below Ireland's annual target of 7 per cent emissions reduction.

What explains this transformation? Undoubtedly there have been multiple factors involved, and there is plenty of room for debate about the relative importance of each. The strategy of attracting Foreign Direct Investment (FDI) has clearly been central and is a defining characteristic of the Irish experience. The success in enhancing the quantity and value-added in FDI is itself a function of many factors, including a stable and predictable Corporation Tax regime, long-run

investment in education, access to a growing European Union (EU) single market, strong institutions and stable industrial relations. The broad essentials of the model have been in place for a long time and have been consistently applied and ably promoted. This period of rapid change coincided with an intensification of globalisation and an expanding volume of world trade. From an Irish perspective, the establishment of the EU and Single Market in 1993 was particularly important, which was followed by the foundation of the World Trade Organisation (replacing the General Agreement on Tariffs and Trade) in 1995. This has also been a period of rapid technological advances that are a major driver of economic growth. During this period Ireland also enjoyed a favourable demographic profile, including expanding female labour force participation.

Ireland also benefited from a significant inward flow of migration following the enlargement of the EU in 2004, which supported rapid employment growth. To what extent the social changes that took place in Ireland during this time were the result of, or a driver of, economic transformation is hard to assess, but there can be little doubt that Irish society has transformed and is transforming.

The taxation and welfare systems have played an important role in this experience of rapid growth and transformation, contributing to it and changing as a result of it. Undoubtedly, Ireland's tax regime contributed to the attraction of FDI to Ireland, not just because of the rate of Corporation Tax, but also because of a long-lasting commitment to providing a stable, clear, rules-based business tax environment. The taxation and welfare systems have evolved, with a growing emphasis on active employment supports, and the system as a whole has facilitated strong employment growth. Of course, as in any other country, taxation and welfare are only part of the overall institutional and policy framework, which drive the creation and distribution of value in the Irish economy and the resulting impact on our environment. Ireland's education and training system, our scientific and research community, labour market regulation, the minimum wage, and a range of other policies, agencies and structures influence what is produced, who is employed, what people receive in terms of income and wealth, and how the environment is affected. The contribution of the taxation and welfare systems, however, is central, both in their own terms and in how they interact with these other policy regimes.

One element of the Irish experience, which the Commission

believes does not receive enough attention, is the importance of social cohesion and the role of taxation and welfare therein. Social solidarity is important in and of itself, but it is also an important factor in promoting sustainable economic growth. In recent decades, the taxation and social welfare systems have developed to the point where both combined have a more substantial impact on the distribution of income in Ireland than is true of many other countries. Looked at over a long period of time, core rates of social welfare payments have increased ahead of inflation. As just one example, the contributory old age pension has increased from €74.30 (£58.50) in 1989 to €253.30 in 2022, as the number of recipients has increased from 75,000 to 431,000. As a result, poverty among people aged over 65 has markedly reduced. The taxation and welfare systems, in other words, have underpinned the Irish model by distributing the fruits of growth across society, contributing to both its utility and a broad level of social support for the Irish model. In its deliberations, the Commission has been mindful of the need to sustain social solidarity despite multiple challenges, and of the reality that there is more work to do.

Despite many vicissitudes, the last thirty years have been a period of rising incomes, high levels of job creation and falling inequality, accompanied by rapid social change. At the same time, the Commission is also conscious that expectations of the State are changing. There are growing demands for the State to intervene in areas such as the housing market or environmental protection, including meeting climate goals. This is not uncommon across developed economies, and may have been accelerated by an unprecedented level of State intervention during the pandemic. These demands will undoubtedly put pressure on the taxation and welfare systems, both to provide revenues to meet new expectations and to act as policy levers to meet new goals, while core objectives, such as the reduction of poverty, remain.

2.2 STRATEGIC FORESIGHT

The concept of strategic foresight, and the related concept of 'anticipatory governance', represents a strategic approach to the process by which Governments assess emerging challenges and risks and make future-facing plans to take account of changes and long-term megatrends. In many ways, the work of the Commission is a type of point-in-time strategic foresight exercise.

What is Strategic Foresight?

Strategic foresight is the ability of an organisation to constantly perceive, make sense of, and act upon different ideas of the future emerging in the present. Strategic foresight involves identifying signals of change, making them instructive, and considering strategic implications. The purpose is to challenge assumptions about what the future might look like, and provoke reflection on new ways to achieve success. Strategic foresight is not a method, tool, or decision support system. It is distinct from forecasting, risk assessment, and strategic planning.

Source: OECD, Observatory of Public Sector Innovation, Towards a Strategic Foresight System for Ireland, 2021.

Both the OECD and the EU Commission are developing competencies in the area of strategic foresight. Governments worldwide are also using strategic foresight to get early warnings of oncoming disruptions, to reframe and enhance the effectiveness of their strategies, and to generate shared language and visions of success. Times of rapid change, uncertainty, novelty and ambiguity highlight the limitations of traditional forecast-based planning. Foresight helps policymakers to challenge and overcome current assumptions about the future and prepare for a broader set of possibilities. Ireland is also in the process of developing a strategic foresight system in collaboration with the OECD.[5]

A central component of strategic foresight methodologies is the identification of 'megatrends' or long-run developments that are likely to have an enduring impact across multiple sectors. The EU's 2021 Strategic Foresight Report sets out four key trends that will, in the coming years, affect the EU's choices and ability to act.[6] Many of these have resonance for the forward-looking work of the Commission. The four trends identified are broadly defined as follows:

1. Climate change and other environmental challenges
2. Technological change
3. Social contract and changing values
4. Demographic changes

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5 The Department of Public Expenditure and Reform is developing Strategic Foresight Capacity in the Irish administration, assisted by the OECD, and funded by an EU Commission grant under the Technical Support Instrument.

6 European Commission (2021) Strategic Foresight Report, Brussels.

While all of these will likely impact upon Ireland in the future, some are more noteworthy than others with regard to the Commission's terms of reference, and a number are called out for specific examination as part of our work. We examine each in turn below.

2.2.1 Climate change, public health and other environmental challenges

Broadly, this megatrend considers the emerging pressure on water and food security continuing to grow across the world, and notes that parts of Europe are already experiencing water stress, which is expected to get worse over the coming decades. In turn, this will likely lead to drought-based food insecurity, as food production is unlikely to move northwards to areas with less water scarcity due to vulnerability to cold shocks caused by a weakened Gulf Stream. A particularly alarming situation regarding biodiversity loss and change in the nitrogen cycle is anticipated. These pressures stem from, and are exacerbated by, pollution, land use, resource extraction, invasive species and loss of pollinators. Such environmental challenges are expected to have economic consequences that are often overlooked.

In Ireland, as across the world, resources are expected to be increasingly scarce, including water, land, and mineral resources needed for technological transformation and energy. For example, although Ireland is perceived to be a wet country, it has the largest trend for increasing summer meteorological drought in Europe and it is estimated that approximately 1.76 million Irish people are living in areas of water stress – where the demand for water is not being met.[7] Ireland scores well internationally as a food-secure nation, but the recent shocks of the United Kingdom (UK) exit from the EU, the pandemic disruptions to supply chains, and the war in Ukraine paint a less certain future.[8]

Project Ireland 2040[9] anticipates that many more people will choose to live in cities, towns and villages by 2040 than currently do so. Without the Project Ireland 2040 investment to change current development trends, Ireland would see a continuation of sprawling growth around, but mainly outside, our cities and towns. This would mean a greater distance between where people live and where people work, leading to infrastructure stress, environmental damage and

7 The Water Forum (2020), Communication on Irelands' Water Resources.

8 The Economist (2021), Global Food Security Index.

9 Department of Public Expenditure and Reform, Project Ireland 2040.

other fiscal and societal costs. Increased distance to travel leads to more car-centric development, which in turn leads to poorer air quality and increased climate emissions. The technological megatrend discussed below suggests that there may be implications for where people work, with more remote working and blended working now likely, offering opportunities to reduce these costs. Social disadvantage and inequality perpetuated by geographic location and duplication of new investment in services and infrastructure in rapidly growing areas are also anticipated.[10] Project Ireland 2040 is targeting a population growth range of between 20 per cent and 60 per cent for Ireland's towns and cities in the next 20 years. This ties into the megatrend related to demographic changes.

Ireland is also already in the throes of an obesity epidemic, along with many other developed nations. The World Health Organisation states that obesity has nearly tripled since 1975 and it is estimated to affect over half a billion people worldwide.[11] This is putting a greater strain on a health and social care system in Ireland that will increasingly struggle to cope with an ageing demographic, without significant reform. The taxation system is one of a number of policy tools that can be used to support better public health by (amongst other things) tackling obesity.

2.2.2 Technological change

There is a range of specific technological innovations that are expected to impact increasingly on our day-to-day lives, including greater use of artificial intelligence, quantum technologies, biodegradable electronics, flexible and printed electronics and 2D material-based technologies such as graphene.

Beyond specific technologies, hyper-connectivity and automation will lead to transformation. The number of connected devices globally is expected to increase from 30.4 billion in 2020 to 200 billion by 2030.[12] This increased connectivity of objects, places and people will result in new products, services, business models, and life and work patterns. Concurrently, this brings increased risk of network outages and cyber-attacks, and may also increase the threat of intellectual property and data loss and theft.

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10 Government of Ireland (2018) Project Ireland 2040: National Planning Framework.

11 World Health Organisation (2021) Factsheet on obesity and overweight.

12 The Water Forum (2020), Communication on Irelands' Water Resources.

Increasing use of automation and artificial intelligence is likely to lead to significant disruption for workers, a development that has been hastened as a consequence of the pandemic. Technological adoption by companies will transform tasks and, by 2025, it is expected that the time spent on current tasks at work by humans and machines will be equal.[13] This rebalancing of tasks will have an impact upon company locations, value chains and the size of their workforce. The flip side of automation is that it may free up valuable human capital[14] to concentrate on more productive tasks,[15] leading to new jobs, in areas where humans can add value and where automation does not offer benefits. Technological change will also offer opportunities to reimagine taxation and welfare systems administration, allowing for the basis of charges and payments to be rethought, the use of more streamlined processes, and the development of real-time ways to pay.

Hyper connectivity will lead to some job losses as a result of automation. However, research to date has shown that such shifts will also give rise to significant opportunities.[16] New jobs will appear, which will require new skills, underlining the importance of reskilling, upskilling and lifelong learning.

Loss of jobs will also result in impacts upon the fiscal position of the State. Digitalisation may result in wider structural changes to the Irish economy. The shift to online retail, streaming digital content and increased digital media consumption during the pandemic are examples of this phenomenon, which could lead to downsizing of the traditional bricks and mortar retail sector. This would have consequential implications for employment and tax revenue. Another potential driver of fiscal change is reduced Stamp Duty receipts due to lower levels of commercial property development.

Many of these mega trends have begun to play out in Ireland in recent years, including increasing environmental concerns and planning difficulties around development of new data centres due to demand

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13 World Economic Forum (2020) Future of Jobs Report 2020, Geneva.

14 Human capital is the skills, knowledge and experience of workers.

15 McGuinness, S., P. Redmond and K. Pouliakas (2021). How does technological change really impact jobs and workers?, ESRI Research Bulletin 2021 16, Dublin: ESRI.

16 In 2018 it was estimated that around 14 percent of adult workers were found to face a very high risk of automation, Determinants of automation risks in the labour market, a skills-needs approach, by Pouliakas K. (2018), IZA Institute of Labour Economics.

pressures on the national electrical grid, the 2021 cyber-attack on the Health Service Executive and housing shortages. The pandemic has also accelerated the adoption of remote working, which has proven very successful for sectors of the economy that could work from home but also gives rise to challenges to employment law and tax obligations for workers and employers. The Government have called for all employers and employees to make remote and home working a much bigger part of working life after COVID-19 and have published Ireland's first National Remote Work Strategy in response to this changing landscape.[17]

2.2.3 Shifts in the global world order and demography

The world's population is projected to reach 8.5 billion in 2030 and 9.7 billion in 2050. Population growth will be uneven, however, and is expected to stagnate in many advanced economies. The EU's population is expected to fall to just over 420 million (from 447 million in 2021), a 4.3 per cent share of global population. Asia and Africa are expected to continue to grow their populations for much longer. Projections suggest that by 2050, India, China, Nigeria, the USA and Pakistan will be the most populated countries. Demographic growth will influence geopolitical ambitions, but may also create sustainability or migration challenges. By 2050, the working-age population is expected to diminish by about 16 per cent in Europe and 17 per cent in China, while it will grow in North America and India. The projected median age of the EU population will rise from 43.9 in 2020 to 48.2 years by 2050. Sharp rises in total-age dependency ratios are projected for many EU areas. If this trend continues, by 2050 there may be 135 dependant non-workers for every 100 workers in the EU27.

This will cause changes in demand for public services, and will lead to increased urbanisation and exacerbation of regional imbalances. Rising old-age dependency ratios will put the financing of adequate pensions, health and long-term care under high pressure.[18]

Changes in the demographic distribution will be accompanied by changes in the economic vigour of different regions. China is expected to be the largest economy by the end of this decade, with India possibly surpassing the EU within 20 years.[19] The energy transition is expected to

17 Department of Enterprise, Trade and Employment (2021) Tánaiste calls on employers to make remote working a much bigger part of life after COVID-19, Dublin.

18 OECD (2019), Fiscal challenges and inclusive growth in ageing societies.

19 European Commission (2021) Strategic Foresight Report, Brussels.

contribute further to the redistribution of power, with States with a large capacity to generate and export renewable energy gaining influence.

The illegal Russian invasion of Ukraine in February 2022 could be considered an example of this megatrend. This conflict has many roots, including energy politics, geo-political realities and concepts of identity with roots in the old Soviet Union. The fallout from this conflict is still unfolding but it looks likely to have long-term implications for food and energy supplies, financial systems (in the form of sanctions) and consequent impacts upon inflation and cost of living globally. All of these aspects of change will have unanticipated downstream effects. It may also contribute to a pattern of de-globalisation, with countries less willing to facilitate economic integration, the most striking example of which for Ireland is Brexit. This reinforces the importance of Ireland's place in the EU. It also highlights a continuing need for Ireland to contribute to the development of the EU and to make its voice heard there.

2.2.4 Social contract and changing values

The social contract is an implicit agreement among the members of a society to cooperate for social benefits, for example, by sacrificing some personal freedom for state protection or by paying taxes and, in turn, receiving public goods and services. The social contract has been in transition for many years, driven by changing values and attitudes in society, new economic realities (increasing scarcity of social and affordable housing, uncertain retirement incomes, rising income inequality globally) as well as new environmental concerns (climate change, biodiversity loss, scarcity of key resources including clean water and minerals). It is clear that the cost of Government supports in the areas of housing, healthcare and climate will increase in the years to come. These will come at the cost of higher taxes, reductions in spending elsewhere or a combination of both. Increased government interventions may bring benefits.[20] The State, for example, is particularly well placed to coordinate the simultaneous shift to a low- and zero-carbon solution. Nevertheless, it is also the case that a rising share of taxation in national income comes with a falling share of private consumption by households.

Evidence of attitudinal shifts have been observed in Ireland in recent years, including marriage equality, the repeal of the eighth

20 Sandbu, M. (2022) The new Social Contract and your money, Financial Times.

amendment and increased cultural and ethnic diversity in society. Expectations of public sector service delivery have changed too in recent years, with an increased demand for provision of childcare (linked to increased female participation in the labour force) and delivery of social and affordable housing, along with pandemic income support linked to previous earnings all being examples of this. The Public Sector is also expected to take a leadership role in climate transition; improving education and increasing up- and re-skilling. International experience suggests that these trends are likely to continue and indeed accelerate.

In Ireland, a household's position in the wealth distribution is strongly influenced by home ownership or tenure status and recent decades have seen a rapid reduction in home ownership levels here. The proportion of people born in each decade since the 1960s who own the home they live in, by a certain age, is decreasing. This trend is amplified by later entry into the workforce because of further education. The increasing concentration of wealth towards older cohorts leads to intergenerational equity issues

2.2.5 What does this all mean?

The Commission has embraced the concepts behind strategic foresight and fully supports the ongoing work by the Department of An Taoiseach and the Department of Public Expenditure and Reform in strengthening policy making capacity in this area and embedding a culture of strategic foresight across the Public Service.

In framing its work, the Commission has considered some of the key megatrends that can be expected to have a significant impact on how the economy may evolve over the next 10 to 15 years and how the taxation and welfare systems may be positioned in order to respond. It is clear that the context within which taxation and welfare policy is developed will continue to evolve rapidly in the years ahead. It will be more important than ever, therefore, to be clear about the strategic objectives of taxation and welfare policy and to apply sound principles in policy design.

The work of the Commission is a form of strategic foresight and it should not be a standalone exercise. Continual re-evaluation of trends, developing challenges and opportunities should form part of the future work of Government, the results of which exercises can inform further future changes in the taxation and welfare systems.

Chapter 3:
Objectives and Principles

3.1 OVER-ARCHING POLICY CHALLENGES

In order to develop future policy in the areas of taxation and welfare, it is important to have a strong strategic view of what we, as a country, want the taxation and welfare systems to achieve. Some of these goals are obvious, such as raising revenue to finance the State, but equally there are multiple competing demands for the taxation and welfare systems to respond to innumerable issues, which cannot all be accommodated, even if they were all appropriate. Accordingly, the Commission has identified four over-arching policy objectives, which should be central to the development of taxation and welfare policy in the years ahead. These are:

1. Fiscal sustainability and stability
2. Promoting enterprise, innovation and employment
3. Inequality, poverty and income adequacy
4. Climate.

In this section, we examine each in turn, looking at the challenges ahead.

3.2 FISCAL SUSTAINABILITY AND STABILITY

> *"Fiscal sustainability is the ability of a government to maintain public finances at a credible and serviceable position over the long term. Ensuring long-term fiscal sustainability requires that governments engage in continual strategic forecasting of future revenues and liabilities, environmental factors and socio-economic trends in order to adapt financial planning accordingly."*
>
> OECD, Government at a Glance, 2013

The first function of the taxation system is to fund public services, at a level determined by the democratic system. While much of this report will be devoted to consideration of ways in which different policy goals can be achieved via taxation policy, it remains the case that the

primary objective of taxation is raising sufficient revenue to fund public services. As set out in Chapter 4 (Fiscal Sustainability), Ireland currently faces a number of significant fiscal challenges and risks, which together make it clear that the amount of these revenue requirements will inevitably rise in the years ahead. There are a number of fiscal issues of major concern, not the least of which is Ireland's demographic structure, which means that significant additional resources will be required to fund age-related public services in the future. The Department of Finance has estimated that by 2030 age-related expenditure is expected to cost an additional 3.3 per cent of GNI* per year when compared to 2019 costs, the equivalent of an extra €7 billion a year in today's terms.

There is also considerable uncertainty about future yield from Corporation Tax. Throughout the period of the Commission's work, the international tax framework in respect of Corporation Tax has been the subject of ongoing international negotiations through the OECD/G20 Inclusive Framework on BEPS.[21] In October 2021, almost 140 jurisdictions agreed a two-pillar solution to address tax challenges arising from the digitalisation of the economy through the Inclusive Framework. While significant progress has been made in these negotiations, there remains considerable uncertainty about how the final agreement will operate and how it is likely to affect the Irish Exchequer. To what extent the final agreement will influence the amount of investment in Ireland, or the Corporation Tax liabilities of firms located here, is hard to assess. The Department of Finance has tentatively estimated that the agreement could reduce Corporation Tax revenues by up to €2 billion annually – a figure that will undoubtedly be revisited. To the extent that investment decisions are affected, there will be consequences too for the growth in other taxheads such as Income Tax.

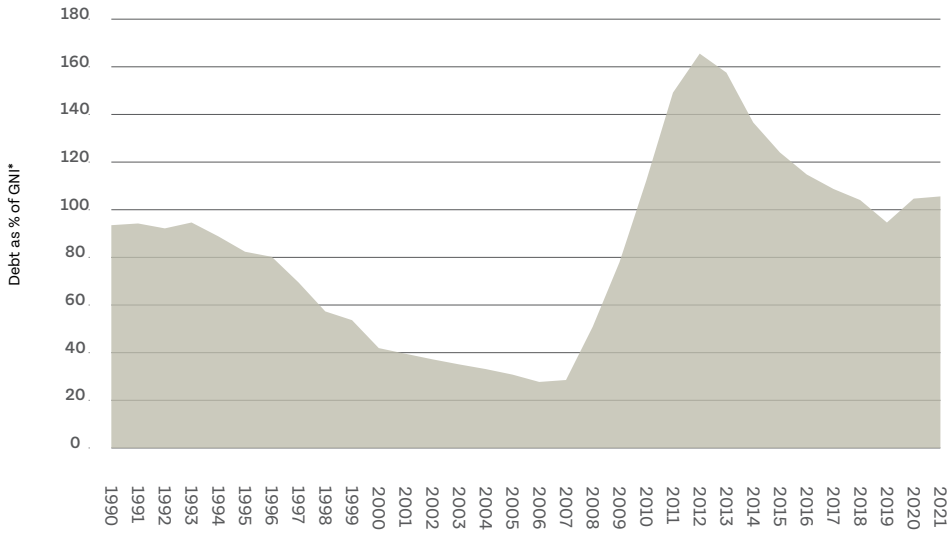
These realities cannot be avoided through long-run deficit financing. Ireland has experienced a number of economic crises in recent memory and the economy is still recovering from the COVID-19 pandemic. Having a strong fiscal position on the eve of the pandemic allowed the State to provide unprecedented levels and forms of support to firms and households during the pandemic, significantly lessening the impact on the economy. This was appropriate. The provision of emergency supports in a crisis, however, is not the same as addressing long-term revenue needs. Ultimately, public services must be provided

21 Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, OECD, October 2021.

from sustainable government revenues.

As shown in Figure 3, public sector debt levels in Ireland have oscillated quite considerably over the past thirty years. Most recently, the reduction of debt levels in the run-in to the UK exit from the EU (Brexit) created room for the public-sector balance sheet to respond to the pandemic in an unprecedented manner. Through a combination of events, however, public sector debt is now high in Ireland compared to other developed economies, which could potentially limit room for policy action in the years to come. In order to respond adequately to any future crisis that may arise, the State will have to rebuild its fiscal position. Given the volatility and vulnerability of the Irish economy, as demonstrated over the past thirty years, and the present high level of debt, an adequate level of revenues will be required in order to rebuild fiscal buffers. Moreover, to manage fiscal risks, revenues need to be drawn from an array of different sources.

Figure 3: General Government Debt as percentage of GNI, 1990-2021*



Source: IFAC; Department of Finance; CSO

Fiscal sustainability is not just a question of the amount of revenues raised. The diversity and stability of individual revenue flows is also

important. In the years preceding the financial crisis, the Irish exchequer became overly dependent on once-off taxes related to the property boom, which subsequently evaporated, worsening the fiscal situation. It is important to avoid a repeat of this experience. Over-reliance on any particular source of revenue, such as happened during the property bubble, must be avoided. One of the consequences of Ireland's successful model of attracting inward investment has been a growing level of revenues received from Corporation Tax, which now accounts for approximately 19 per cent of total tax revenue.[22] The issue of concern here is not that these revenues might somehow evaporate entirely, but that they come from a small number of firms, with 53 per cent coming from the top 10 taxpaying units. In global terms, these firms are also concentrated in a small number of sectors. Hence, there is a risk that these receipts could become more volatile in the future. There are serious risks entailed in financing public expenditures on the basis of revenues that could prove unstable, and of expectations building up that expenditure can continue to grow on the back of further increases in these receipts. It is only prudent, therefore, to be cautious about over reliance on these Corporation Tax receipts, which might be vulnerable in the event of shifts in the international tax landscape, corporate strategy or a future downturn, either in the global economy or in the relevant sectors.

In essence, a diverse array of sustainable revenue streams and available policy levers are needed to limit the impact on the public finances and to provide policy options when recessions do occur.

Accordingly, in order to provide the level of public services which Irish society desires, as determined by the democratic system, additional revenues will be required. This does not absolve the State of its obligation to ensure value-for-money in public services, nor does it preclude future Governments from altering the level of public services provided, if they deem that appropriate. The size of the State is a matter for the democratic system to determine. Nonetheless, looked at from this point in time and based on the existing level of public service provision, realistically, it seems inevitable that the amount of revenue raised will need to increase to fund public services.

The Commission, therefore, has adopted a net revenue-raising

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22 Throughout the remainder of this Report, total tax revenues refer to the broad measure of the sum of Exchequer, Pay Related Social Insurance, Local Property Tax, and Commercial Rates revenues. In 2021, total revenues amounted to €82 billion.

approach to its work. This has two important dimensions. Firstly, the Commission has made recommendations on the basis that the total tax yield will have to increase as a share of national income, and has identified areas where this can be achieved.

Secondly, recognising that a higher tax yield will be necessary over time, the Commission is recommending structural reforms that will be required if this rising yield is to be obtained at the lowest possible economic, social and environmental cost. The Commission cannot, and does not pretend to, identify every detail of every change that will be required in the years ahead. What it has done is examine how raising additional revenues can be consistent with the principles of taxation and welfare set out in this report, and it has made recommendations on how this can be achieved. Looking at the taxation and welfare systems through this lens, a number of important and timely reforms are required to ensure that the raising of additional revenues does not generate unnecessary problems, or repeat past mistakes.

3.3 PROMOTING ENTERPRISE, INNOVATION AND EMPLOYMENT

> *"It is difficult to avoid the conclusion that Irish economic performance has been the least impressive in Western Europe, perhaps in all Europe, in the twentieth century. It must count as one of the more striking records in modern European economic history."*
>
> J.J. Lee, Ireland 1912-85, 1989, P521

3.3.1 Economic growth

Since 1989, when Lee's dreary assessment provoked extensive national soul-searching, Ireland has experienced an extraordinary economic transformation. The level of income per capita is twice what it was thirty years ago, and the number of people at work has also doubled. At the same time, the experience of the past three decades, not least the experience of loss of national creditworthiness, clearly demonstrate the level of exposure of the economy to significant shocks. In promoting further growth in output and employment, policy should be based on a realistic appraisal of both opportunities and risks.

There is considerable room for debate about how the Irish experience is to be interpreted. Ó Gráda and O'Rourke (2021), looking at Ireland's economic performance over a century of independence, paint a somewhat negative picture. In effect, the rapid growth of the past thirty years, when seen in a very long-run context, is little more

than a long overdue catching up. According to the economic theory of 'convergence', poorer economies will, somewhat automatically, tend to grow more quickly than richer ones. For much of the century after independence, however, this convergence failed to occur, until finally there was a rapid catch-up in the 1990s. Thus, they summarise Ireland's long-run performance as follows:

> *"In a convergence perspective Ireland performed as well as it should have done in the interwar period (but no country performed well in the 1920s and 1930s); it underperformed between 1950 and 1973, a period elsewhere remembered as the European 'Golden Age'; it stopped underperforming after 1973, but experienced no overall convergence between then and 1990; and it made up for lost time in the 1990s, over-performing and converging in spectacular fashion."*

Overall, by 2001, Ireland's growth performance placed it almost exactly where it would have been expected to be, given its level of development in the 1920s, but only after decades of delay. Having caught up to European norms by the turn of the century, convergence theory would have predicted that Ireland would settle into a slower and more normal level of long-term growth. Instead, the property bubble followed leading to another period of boom and bust. Thus, according to this view, the growth of the last three decades can be understood as an initial period of long-delayed catch-up followed by another period of underperformance. Of particular note is that Ó Gráda and O'Rourke assign little weight to tax policy in explaining the growth of the 1990s.

Writing in 2002, Barry (2002) contested this convergence view of the Celtic Tiger era, arguing that the Irish experience at that time should be seen as a regional boom. This approach placed far greater emphasis on the role of Corporation Tax in explaining the rapid growth of the 1990s. It was also more optimistic since it held out the prospect of being able to sustain higher levels of growth for longer than the convergence school predicted, while also highlighting the dangers of any exogenous shock to Ireland's capacity to attract Foreign Direct Investment (FDI), such as harmonisation of corporate tax rates.

The work of Iversen and Soskice (2019) casts the Irish experience in a somewhat different light. Looking at development of advanced capitalists democracies over a long period of time, they note that:

> *"A remarkable fact is that the group of advanced democracies has only been slightly expanded since their rise in the nineteenth and early twentieth centuries.... For more than a century, entry into the advanced group has only occurred in the instances of Singapore, South Korea, Taiwan, Israel, Ireland and Hong Kong."*
>
> Iversen & Soskice, P26

Ireland, on this analysis, is the only European country to have escaped the middle-income trap and to have made the transition from what was a heavily agricultural economy at independence to one which now includes some of the highest value-added sectors in the global economy. The way that population structure and the decline in agricultural employment weighed on the Irish labour market up to the 1980s underlines the economic challenge that Ireland faced. Looked at in this light, there is nothing inevitable about Ireland's convergence towards the living standards of core European economies. Rather, Ireland has achieved a remarkable feat in turning itself into an advanced knowledge-based economy. In particular, Iversen & Soskice argue that a durable relationship develops between knowledge-based firms and their workforce, and that such firms are less mobile than is often suggested. The Irish transition, in other words, is neither wholly dependent on tax policy, nor is it likely to be dramatically reversed. This approach also suggests that there is scope for taxation and welfare to play an important role in the distribution of incomes.

These contrasting theoretical perspectives are important in assessing policy stances for the future. The convergence narrative highlights the importance of avoiding policy errors, including in fiscal policy, which play a role in explaining Ireland's delayed convergence to European living standards. The 'regional boom' narrative places a greater emphasis on maintaining competitiveness, especially as regards attracting FDI. The Iversen & Soskice approach to understanding advanced capitalist democracies, on the other hand, highlights the long-run policies that have led to the build-up of multinational investment in Ireland, particularly investment in education and skills. It suggests that what is important to understand is the extent to which the systems of taxation and welfare are part of, and interact with, a set of policies and institutions that underpin and sustain long-term growth.

3.3.2 Performance of the labour market

A particular feature of the Irish model is the performance of the

labour market.

Using the same starting point, the number of people in employment increased steadily from its 1989 value of 1.11 million, rising to 2.25 million by 2007. This was partly due to the increased number of people living in Ireland, as the population grew from 3.5 million to almost 5 million in 2019. Even still, of those living here, the proportion in the labour force grew from its 1989 levels. For those aged 20 to 64, the employment rate rose from 57 per cent in the early 1990s to 75.1 per cent in 2007.

The dramatic increase was, in part, driven by women joining the workforce, increasing from 375,400 in 1989 to over 1 million 30 years later. This is reflected in both the female employment rate, which languished below 40 per cent in the early 1990s before rising to 62.9 per cent in 2007, and steady increases in the female labour force participation rate (from one in three women of working age in the late 1980s, to two in three at present).

The notion that labour market policy success equates to making the best use of the skills and talent in the country is brought into sharp relief by progress in education. In this regard, attainment metrics show continued improvement, with the share of the population aged 25 to 64 with tertiary education rising from 14.8 per cent in 1989 to 49.9 per cent in 2020. The proportion of women completing third level overtook the share of men during that period. More people becoming better educated is, of course, reflective of global trends away from industry or agriculture and towards services, but Ireland performs well in any comparative assessment.

An increasing number of workers with third-level qualifications tallies with the requirements of large multinationals operating in Ireland, as well as the jobs in the financial, legal and regulatory service providers that accompany them. This is partly supplied by the Irish population but also by the capacity to move freely within the Single Market. This factor also bookends this period of Ireland's history and highlights the attractiveness of employment in Ireland compared to our starting point – where once Irish young people sought employment elsewhere (37,000 of those aged 15 to 24 left in 1989, which has dropped to 17,600 in 2019), some 21,400 people of the same age arrived in 2019, an idea that was attractive to only 7,700 in 1989.

Within this period of employment growth, there were setbacks and notable shifts in composition. For those under 25 years, the focus on education means they delay labour market entry – a shift over the

past decade that seems structural rather than cyclical. The increased employment of older people in this period is also noteworthy, and is reflected both in the absolute increase as the labour force grew and when scaled by the population in the age group. Age-specific employment rates increased from 12.5 per cent in 1989 to 18.2 per cent in 2020 for those aged 65 to 74 years. This reflects both greater capacity for employment at more advanced years due to better health and longer life expectancy (an additional 6.7 years for women and 8.6 years for men since 1986).

To summarise the performance of the labour market over the past 30 years, there have been large increases in jobs over the 1990s and 2000s as female labour force participation and migration, respectively, matched the job creation efforts of national and multinational firms. In the 2010s, recovery from recession was again led by employment, with full-time jobs recovering rapidly.

3.3.3 Future policy

What of prospects for the future? Based on the experience of the past three decades, there are numerous grounds for optimism. Many of the factors that have driven growth over this period remain in place. Ireland is well positioned in certain sectors that appear to have strong growth prospects such as chemicals and chemical products, computer and information services, and financial services, as well as other tech-based services. Provided the core elements of the Irish model remain in place, there are grounds to believe that income and employment growth will continue to perform well. There are, however, a number of risks.

These include the, as-yet, unknown impact of changes in the Corporation Tax regime on investment and growth. Moreover, there can be little doubt that Brexit will continue to weigh on Irish growth, when compared to the pre-2019 position, including for Small and Medium Enterprises (SMEs) who have long seen the United Kingdom (UK) as a natural first extension of the home market. As discussed in section 2.2 on strategic foresight, there are further risks related to geopolitical tensions and de-globalisation. One tragic manifestation of this has been the illegal Russian invasion of Ukraine, which, as well as its humanitarian consequences, has also thrown up further economic uncertainties. It is also possible that Brexit is only one example of trends towards de-globalisation, which could weigh on growth in global trade volume and investment flows in the medium to long-term.

There are also less positive aspects of the Irish growth performance

that require attention. OECD research has commented on the ongoing weakness of the indigenous SME sector, where, notwithstanding recent Government policy initiatives, a long-run issue of low productivity growth remains. Although there are good examples of innovative entrepreneurship in this sector, there is a long-standing issue as to how to improve productivity performance outside of the multi-national sector.

Growth in both output and employment over the past three decades has also been facilitated by favourable demographics, which cannot be expected to continue. As outlined in Chapter 4 (Fiscal Sustainability), there is a risk that greater fiscal pressures will lead to higher taxes on labour which, if taken too far, could undermine the capacity of the economy to generate jobs at the pace that has been achieved in more recent years.

While it is not possible to predict the future, certain fundamental tenets regarding taxation and welfare policy in a small open economy in a monetary union remain true, and should inform policy formation in the future. These include an evidence-based[23] tax regime that is attractive to foreign-direct investment, a supportive environment for investment in enterprise, an overall concern for the competiveness of the economy generally, and a taxation and welfare code that promotes, rather than inhibits, employment creation.

3.4 INEQUALITY, POVERTY AND INCOME ADEQUACY

> *"The test of our progress is not whether we add more to the abundance of those who have much - it is whether we provide enough for those who have little."*
>
> Franklin D. Roosevelt (1937)

The ideas of equity and progressivity have long been central to thinking about tax design and, with the emergence of the modern welfare state over the course of the twentieth century, welfare systems have been developed to protect living standards among those who, for one reason or another, require support. More recently, increasing attention has been paid across the globe to the distribution of income and wealth and the level of inequality in advanced economies. Significant advances have been made in measuring the distribution of incomes, in understanding

23 Including remaining cognisant of horizontal equity, the potential for deadweight, and the potential for creating perverse incentives.

what drives income inequality, and in considering its implications. There has been a discernible, but not uniform, shift towards higher levels of income inequality in many advanced economies, and a far greater level of attention has been paid to this issue by policymakers internationally. There is a greater consensus that high levels of income inequality have negative effects on economic growth and a better understanding of how high income inequality constrains intergenerational mobility, as well as a greater consensus on a number of other concerns such as health and well-being and political stability. As discussed elsewhere in this report, social cohesion is an important bedrock of economic growth.

The standard approach to measuring and assessing the distribution of income is to consider the amount of disposable income at household level. Disposable income is generally defined as market incomes less taxes paid plus benefits received, and the standard methodology involves calculating the total income of the household adjusted to take account of the number of people in the household (using an equivalence scale). Therefore, the taxation and welfare systems are the primary means of translating the distribution of market incomes into the distribution of disposable incomes. This is a major part of the function of the taxation and welfare systems, while taxation also finances the provision of public services which tend to equalise the distribution of well-being and life chances. In recent years, there has also been a growing interest in the idea of pre-distribution or the potential for policy to influence the distribution of market incomes. In other words, the level of inequality in society will depend, not just on the amount of income re-distributed through taxation and welfare, but also on the employment rate, how well paid employment is, the prospects of progression to higher-paid employment and the availability, cost and quality of public services. Taxation and welfare policy need to have regard to these issues, since the design of the systems can influence, amongst other things, the incentive to take up or remain in employment.

Ireland's experience in respect of income inequality is unusual. Thirty years ago, compared to its peers, Ireland was clearly among the countries with higher levels of income inequality. Since then, income inequality has, in fact, fallen somewhat in Ireland, while it has tended to rise in many other countries. Perhaps the most striking feature of the Irish experience in this area is that while the distribution of market incomes has been and remains highly unequal compared to other advanced economies, the distribution of disposable incomes is closer to

European norms. Of the 23 OECD countries in Table 1, Ireland is ranked second in market income inequality and 15th when ranked by disposable income inequality. Thus, the taxation and welfare systems have played a critical role in distributing and re-distributing the fruits of rapid economic growth over the past thirty years, during a period when that growth has been rapid. This has left Ireland mid-table internationally in terms of income distribution. This is an important achievement, but not one that can be taken for granted, given the unusual distribution of earnings in Ireland and growing fiscal pressures.

Table 1: Gini coefficient for market and disposable income distribution, 2018

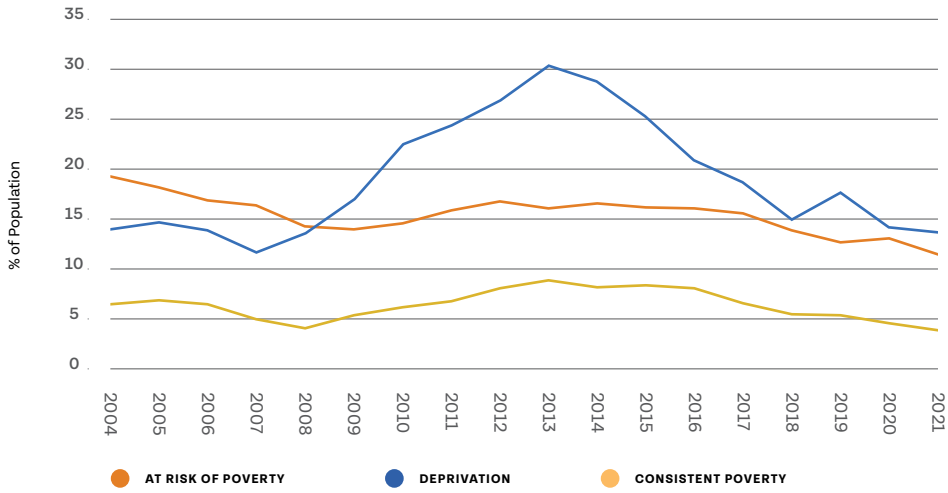
COUNTRY	2018 MARKET INCOME	2018 DISPOSABLE INCOME
Australia	0.454	0.325
Austria	0.494	0.280
Belgium	0.490	0.258
Canada	0.427	0.303
Denmark	0.443	0.263
Finland	0.509	0.269
France	0.529	0.301
Germany	0.494	0.289
Iceland	0.369	0.250
Ireland	0.520	0.292
Israel	0.444	0.348
Italy	0.511	0.330
Japan	0.501	0.334
Korea	0.402	0.345
Luxembourg	0.490	0.318
Netherlands	0.445	0.295
New Zealand	0.462	0.262
Norway	0.429	0.330
Spain	0.506	0.275
Sweden	0.428	0.299
Switzerland	0.395	0.311
United Kingdom	0.513	0.390
United States	0.506	0.393

Source: OECD Income Distribution Database (Total Population; Measure Gini coefficient; 2012 income definition); selection: 23 of the richest EU or OECD countries (those with GDP per capita over $29,000, using purchasing power parity conversion, in 2012.
Note: Iceland's values are from 2017 and New Zealand's are from 2014.

During this period, poverty rates have also fallen. As shown in Chapter 10 (Labour Markets and Social Protection Systems), poverty rates are lower on aggregate than they were at the turn of the century,

reflecting the performance of the labour market and the high level of redistribution achieved through the taxation and welfare systems, especially social transfers. Rates of poverty, however, vary considerably across household types – see Figure 4. There have been major reductions in poverty among the elderly, but the experience for other groups, including children and people with disabilities, is far less laudable. Despite the strong performance of the labour market over the past three decades, there is a clear linkage between the reduction in income inequality and poverty that is achieved by the taxation and welfare systems at any given time and the adequacy of welfare payments. This inescapable reality and the resurgence of inflation following the pandemic and the illegal Russian invasion of Ukraine point to the need for a coherent and systemic policy on income adequacy.

Figure 4: Headline poverty measures in Ireland, % of population, 2004-2021



Source: CSO Survey on Income and Living Conditions

The Roadmap for Social Inclusion 2020 to 2025 sets out Ireland's national target for poverty reduction. This national target for poverty reduction is to reduce consistent poverty to 2 per cent or less by the end of 2025 and to make Ireland one of the most socially-inclusive countries in the European Union (EU). The consistent poverty rate (i.e. those who are experiencing both income poverty and material

deprivation) in 2021 was 4 per cent. Other targets contained in the Roadmap include increasing the employment rate for people with disabilities, increasing social housing supply, reducing child poverty and reducing income inequality.

While our understanding of income distribution, including poverty, has improved, this is nonetheless only one dimension of what constitutes equality in our society. In the words of the Nobel laureate Amartya Sen:

> *"A common characteristic of virtually all the approaches to the ethics of social arrangements that have stood the test of time is to want equality of something."*

The question is 'equality of what? Disposable income is clearly a vital proxy measure of access to resources, and the capacity to consume, as well as the capacity to participate in society and to realise human potential, but income measured at a point in time does not give a complete picture of the opportunities that a person will enjoy over their lifetime. A person can have low income at a particular moment in time, but have access to significant wealth in the long-term. Similarly, two families of the same size could have the same income, but be in quite different positions as regards housing, which has become an increasingly significant factor in determining standards of living. If we think of equality in terms of access to resources and opportunities over a life cycle, our frame of reference for policy development expands beyond current disposable income.

As is the case with most countries, the distribution of wealth in Ireland is less equal than the distribution of income. What we know about income is far more detailed, comprehensive and reliable than what we know about wealth. This has become more apparent in recent decades - a period of low interest rates and rising asset prices – and the question of how the taxation and welfare systems have responded to this reality is hampered by infrequent data on the distribution of wealth. Nevertheless, we know the distribution of wealth is, at least to some extent, correlated with the distribution of income. Since 1987, an increasing share of total net wealth is being held by the top ten per cent of households when households are ranked by income - see Chapter 7 (Taxes on Capital and Wealth).

More recent statistics on wealth in Ireland indicate the factors that determine a household's position on the wealth distribution – this includes the fact of having received an inheritance and, specifically,

having received an inheritance of a business or farm. One other notable trend over time is the interaction between age, housing and wealth as reflected in the sharp decline in home ownership rates among recent generations. Analysis of the proportion of people born in each decade since the 1960s who own the home they live in shows a changing trend. Over 60 per cent of those born in the 1960s lived in a home they or their partner owned by the age of 30, whereas the comparable figure for those born in the 1970s was 39 per cent and, for those born in the early 1980s, 32 per cent.

While the taxation and welfare systems are undoubtedly having a major impact in lessening the extent of market income inequality, the highly unequal distribution of market income and the level of low pay remain a concern. If market income inequality were to increase further, it may be difficult for the taxation and welfare systems to prevent inequality in disposable income from rising. The taxation system is already highly progressive and, in the context of greater fiscal pressures, there are limits to how far redistribution can go without impacting on competitiveness or the labour market. It is important, therefore, to have regard to the full range of policies that affect the distribution of market incomes, and not assume that the taxation of incomes and social transfers will be able to generate an ever more equal distribution of disposable incomes. To the extent that market income inequality is an outcome of differences in pay levels between different sectors (many of which represent sectors where FDI plays a prominent role), there is a strong policy rationale for encouraging productivity growth more broadly. Distribution of market income is also a function of the concentration of wealth and, therefore is a strong rationale for a greater focus in the tax code on the taxation of wealth. The rationale for this approach derives not just from the concentration of wealth but also the notion that the future capacity of the taxation and welfare systems to redistribute will be restricted if the return to capital outstrips rates of economic growth in the long term.

By the same token, while the primary function of the welfare system remains that of providing a safety net for those in need in times of particular vulnerability, and while this insurance is of value to everyone, as was clearly demonstrated during the pandemic, the social protection system cannot be analysed simply in terms of income replacement. Access to income is important, but so too is having the opportunity to participate in society including through meaningful and appropriately

paid work, with benefits for the individual, their dependants and wider community. In common with previous bodies that have examined the taxation and welfare systems, the Commission believes that the tax and social welfare systems should not be used to subsidise low pay and that encouraging and supporting active participation and progression in the world of work, including through employment services, is a vital part of how the taxation and welfare systems should be designed.

During the course of its work, the Commission has also heard significant concerns expressed about the issue of intergenerational equity. For many decades, there has been an expectation that the benefits of economic growth would be widely shared, so that each succeeding generation can expect its living standards and the opportunities it enjoys to be at least as good as, if not better, than those enjoyed by the generation that went before. In recent years, this assumption has been challenged in quite a fundamental way by increases in housing costs, higher costs of care and changing access to occupational pensions. These create challenges for individuals and also increase demand for State income and housing support in old age. While there is no doubting that Irish society as a whole is much better off than it was three decades ago, these issues have created a sense of unfairness that should not be ignored. Over the past three decades, Ireland has managed to achieve both rapid economic growth and lower income inequality. Its status as an advanced economy means that it has the capacity to make choices about the distribution of income and opportunities. This does not mean, however, that trade-offs will not arise in particular aspects of the design of taxation and welfare, or that taxation and welfare design can be treated as a 'pure distribution problem', where a fixed cake is divided up with no consequences for economic activity. Rather the taxation and welfare systems have to be seen as part of the wider set of policies that promote sustainable growth and employment and which distribute the fruits of growth with a strong awareness of where difficult balances have to be struck.

3.5 CLIMATE

> *"We all need to imagine this world we must hurry towards. It will be a much healthier world, without the air and water pollution of fossil fuel, and it will be a more equal world because everyone will have access to clean energy. To get there, we will have had to show the solidarity called for in the 2030 Agenda, so it will be a world of deeper human relationships at all levels. It will also be a world of a circular economy, consuming less and valuing more. Rising to the challenge of addressing the threat of climate change can be truly transformative, and achieve the commitment in the 2030 Agenda to leave no one behind."*
>
> Mary Robinson, July 2019

There can be little doubt that lowering greenhouse gas emissions and managing the transition to net-zero will be the defining policy challenge during the timeframe set out in the Commission's terms of reference. While as shown in Chapter 13 (Moving to a Low-carbon Economy) there has been some progress towards decarbonisation over recent decades, it is clear that there is a long road to travel before economic growth becomes fully decoupled from higher carbon emissions. The task ahead is great and a sense of urgency is required. The achievement of Ireland's climate goals will require a wide range of policy actions across a wide range of sectors, but there is a critical role for the taxation and welfare systems to play, in a number of respects.

In part, this can be viewed through the lens of the classic public finance argument about taxing externalities, which is discussed later in this report. The complexity of the problem, however, is far greater and its implications far wider. Clearly there is a role for the taxation system in the pricing of carbon. Given the economy-wide nature of the problem, taxation is a natural policy instrument to deploy in order to achieve an economy-wide reduction in emissions. However, in light of the scale of the challenge and the transformation that is required, the issues involved are more fundamental. As the economy moves to what will be a new paradigm, a whole series of legacy issues will come under scrutiny, including implicit tax-based subsidies for fossil fuels, which were baked into the taxation system over many decades. The rationale for numerous policy measures will need to be re-appraised and numerous sectoral policy approaches will have to be re-thought.

As the economy de-carbonises, several of our tax bases will be eroded, and the question arises as to how these revenues will be replaced. To an extent, that is not currently known, it will be necessary to develop new revenue-streams that both fund the exchequer and support our climate objectives. The gap, however, will have to be filled. In some areas this will lead to first principles debates about the basis for and appropriate level of different types of taxes. It will also require a willingness to pay new taxes. These issues will be complicated by uncertainty around timing. How long will the transition to a carbon-neutral economy take? When will revenues from fossil fuels start to fall away, and how can the transition to new forms of taxation be managed fairly? To what extent does the availability of alternatives matter when imposing taxes, and what technologies are likely to come on stream in the future? Undoubtedly, there will be costs involved, both in achieving decarbonisation and in paying for climate adaptation. Climate change is a global megatrend, the implications of which will play out over the decades ahead in an intrinsically unpredictable manner.

The question of 'just transition' will also loom large in these debates. A just transition recognises the fact that the impact of moving to a carbon-neutral and a climate-resilient society will necessarily not be the same for everyone. Certain individuals and sectors of the economy will be more affected than others. In particular, some households may not have the means to avail of alternative options and, for certain businesses, alternative options may not yet exist to allow them do business in a greener way. Indeed, some existing businesses and jobs may become unsustainable into the future due to the reforms needed. Consequently, there is a need to manage the transition and change in behaviour in a balanced way.

It is undoubtable that a just transition will help create the necessary buy-in and social cohesion to accept and implement the measures necessary to reduce emissions – without it, the transformation required to protect both the planet and the people inhabiting it cannot be successful or sustainable. However, the challenge of the just transition cannot be underestimated and it is becoming increasingly urgent. The actions taken in the short and medium term will be critical.

Opportunities also exist for Ireland to be a leader and innovator in terms of climate and the environment and these should be seized. With appropriate education, training and reskilling, we can ensure that individuals and businesses have the tools to adapt, thrive and innovate

and successfully contribute to achieving a carbon-neutral economy. Additionally, the EU will continue to significantly shape the direction and policy in respect of emissions reduction and it is also important that Ireland continues to contribute positively in this policy context.

3.6 DESIGN PRINCIPLES FOR THE TAXATION AND WELFARE SYSTEMS

While the taxation and welfare systems must respond to emerging challenges in the decades ahead, it is important to re-state some of the core principles which underpin well-functioning taxation and welfare systems, and which apply irrespective of time and place. In the course of its work and in framing its recommendations, the Commission has drawn on long-standing and well-understood concepts in the fields of taxation and welfare, and on concepts set out in the reports of previous Commissions on Taxation as well as the Commission on Social Welfare, while also reflecting contemporary concerns.

The principles which apply to both taxation and welfare have long-established roots. In 1776, Adam Smith enunciated his canons of taxation as follows:

> *"1. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state...*
>
> *2. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person...*
>
> *3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it...*
>
> *4. Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state..."*
>
> The Wealth of Nations, Book V, Chapter 2

A century later in 1903, Charles Francis Bastable, Professor of Political Economy in Trinity College, Dublin endorsed these principles, on the basis that:

"Though fully in harmony with the spirit of the 18th century, they have not been found inapplicable to modern conditions, and in spite of much hostile criticism bid fair to hold their ground in the future."

Another century further on, one of the most prominent works on tax design of recent years, the Mirrlees review, effectively did the same. However, Mirrlees also argued that:

"these recommendations may command near-universal support but they are not comprehensive, and they do not help with the really difficult questions which arise when one objective is traded off against another."

The Mirrlees review summarised its approach in the following four objectives, as follows:

"For a given distributional outcome, what matters are:

- *The negative effects of the tax system on welfare and economic efficiency – they should be minimised;*
- *Administration and compliance costs – all things equal, a system that costs less to operate is preferable;*
- *Fairness other than in the distributional sense – for example, fairness of procedure, avoidance of discrimination, and fairness with respect to legitimate expectations;*
- *Transparency – a tax system that people understand is preferable to one that taxes by 'stealth'."*

Systems of social protection also have deep historical roots, and are built around important principles. As described in Chapter 10 (Labour Markets and Social Protection Systems), there is a significant diversity in how European countries organise their welfare systems, but common themes recur, and these are also reflected in the Irish system. While protecting against a range of specific risks, social protection systems have an over-arching purpose to prevent poverty. The Irish system incorporates an important contributory element, such that people pay into the system at particular times and receive benefits in particular circumstances. Historically, there has also been an expectation that, as well as making financial contributions, people who can work should do so. This insurance element is an important feature of the system,

although it is described as 'social insurance' since the system is not risk rated like private insurance and there is an explicit re-distributional rationale in how the system is constructed. This concept of reciprocity is a critical part of the system, and extends beyond Pay Related Social Insurance payments, to a more general sense that we all benefit collectively from the set of mutual obligations that are inherent in the social contract. This idea was expressed in the 1942 Beveridge report:

> *"...social security must be achieved by co-operation between the State and the individual. The State should offer security for service and contribution."*
>
> Social Insurance and Allied Services, P6

Referring to previously existing schemes of social insurance, Beveridge also made the point that the level of provision of social insurance payments should be assessed against the findings of 'impartial scientific authorities' and that 'abolition of want requires, first, improvement of State Insurance', or

> *"To prevent interruption or destruction of earning power from leading to want, it is necessary to improve the present schemes of social insurance in three directions: by extension of scope to cover persons now excluded, by extension of purposes to cover risks now excluded, and by raising rates of benefit."*
>
> Social Insurance and Allied Services, P7

Beveridge was also clear, however, about the important role of child benefit in reducing 'want' i.e. poverty.

A similar emphasis on the importance of adequacy in social welfare payments was central to the 1986 report of the Commission on Social Welfare, which stated that:

> *"The most important principle is that of adequacy and, as will emerge below, the furtherance of this objective may need to be 'traded off' against other objectives. For instance, a system which is adequate in relation to the variety of needs which exist may not be the most simple system."*

Building on this literature, and on the work of previous Commissions and bodies that have examined taxation and welfare in Ireland, and bearing in mind its remit to consider both taxation and welfare, the present Commission has identified five principles for policy

design, as follows:

1. Sustainability
2. Reciprocity
3. Adequacy
4. Equity
5. Efficiency

To some degree each of these is multi-dimensional. So, for example, the concept of efficiency incorporates that of simplicity, which was a compelling idea for the 1982 to 1986 Commission on Taxation. Similarly, the idea of equity incorporates both horizontal and vertical equity. The idea of sustainability is clearly linked to climate, but also to fiscal sustainability. Each of the principles is discussed in more detail below.

3.6.1 Sustainability

In the 21st century, it is necessary to identify sustainability as a distinct and defining principle of taxation and welfare design. Sustainability has many dimensions, including economic and social as well as environmental. While economic theory has always identified a case for the taxation of 'externalities' on efficiency grounds, the concept of sustainability in a modern context brings in a wider canvass than is incorporated within traditional welfare economics. It expands our frame of reference beyond the immediate concerns of the nation-state, to encompass our obligations to future generations and to the wider world.

While much of the impact of the taxation and welfare systems is on outcomes - redistributing to equalise outcomes to some extent, or incentivising particular outcomes in the short term - we must also consider how the taxation and welfare systems of today, and the behaviour they incentivise, shape the range of opportunities available to future generations. Sustainability also incorporates a sense that the current generation does not have the right to constrain future generations' capacity to enjoy a standard of living that is at least comparable to that of the current generation. This sense of long-term responsibility also informs the Commission's understanding of sustainability.

Moreover, as outlined earlier, given Ireland's particular circumstances and experience, the sustainability of revenue flows

and of the public finances generally is an important consideration. It is important to build taxation and welfare systems that work to smooth ups-and-downs in economic life, rather than exacerbating them. It is also important to build an economic and social model that supports social cohesion if it is to be sustainable in the long-run.

3.6.2 Reciprocity

In common with other advanced economies, the taxation and welfare systems in Ireland have expanded in scale and scope over more than a century, such that they play a fundamental role in Irish life. They are a major part, but not the totality of, the social contract – the set of rights and mutual obligations that come with living in Ireland. Or, put another way, they are part of 'what we owe each other'.[24]

Taxes are paid into a common pool, which provide a variety of services and benefits. Some of these are classic 'public goods', such as policing and security, where one person's benefit from the good is not reduced by the fact that others also access them. Others, like education, are provided as universal services, while others, like many welfare benefits, depend on a person's particular circumstances. Thus, what we pay in taxes and social insurance contributions and what we receive in services and benefits is not strictly related at a given point in time. This is justified by the common bond or sense of social solidarity that comes with living in Ireland – the sense that there is a 'we' and that we need to look after each other. But it is also because the modern state creates a greater good. Even if we cannot always measure the direct benefits that come to us from the common pool, we know that we benefit from living in a more secure, equal, more educated, healthier society with a cleaner environment and are capable of projecting our values on the global stage. As taxpayers, we are not just paying for what we may ourselves receive, we are also contributing to a greater good of which we are part.[25]

For the social insurance system, the prevention and reduction of poverty is a core element of that greater good. At individual and societal level, for reciprocity to be meaningful, social welfare benefits have to be provided at a level which is adequate to prevent poverty. In contributing

24 See e.g. Shafik (2021) for a recent discussion.

25 This is not inconsistent with there being a wide divergence of views as to the size and appropriate role of the State - how much tax should be raised, how much should be spent, and on what.

to the system through taxes or social welfare payments, there is an expectation that either in old age or in the face of other contingencies, the level of support will be adequate to support people's needs.

At the same time, this idea of reciprocity, is not exclusively financial. There are other non-financial mutual obligations that apply. The welfare system, for example, has long been prefaced on the idea that those who can work, other than the retired, should do so.

3.6.3 Adequacy

An objective common to both the taxation and welfare systems is to redistribute market incomes to achieve greater equality and prevent poverty. This is part of a broader objective to ensure that people are protected against sudden loss of income, that everyone can participate in society, and to engender social cohesion.

To achieve this goal, there is a fundamental requirement that income supports must be adequate with respect to prevailing living standards, a premise given particular emphasis by the 1986 Commission on Social Welfare. As we show elsewhere in this report, there is a clear relationship between the adequacy of payment rates and poverty trends over recent decades.

The issue of adequacy, however, is a nuanced one and is broader than the setting and benchmarking of social welfare rates. It needs to be set in a frame which includes having a system of taxation and welfare that is supportive of people participating in the labour market, being able to improve their income without encountering cliff-edges and 'traps', and being able to improve their earning potential by acquiring skills and experience.

Building on the work of the Commission on Social Welfare, the 2001 Social Welfare Benchmarking and Indexation Group outlined three aspects to be considered as follows:

> *"The debate on adequacy centres on three very basic questions: adequate for what?, for whom?, and for how long?"*

In terms of the first issue, 'adequate for what', Ireland's official poverty target is set in terms of levels of 'consistent poverty'. This metric combines two concepts of poverty i.e. one which conceives of poverty in terms of relative income, and one concept relating poverty to deprivation. An individual is in consistent poverty if their disposable income is under 60 per cent of the median and they are experiencing enforced

deprivation in respect of two or more of eleven types of deprivation. This reflects the reality that poverty is a complex concept which is hard to capture in a single dimension. This approach builds on work such as that of the sociologist Peter Townsend, whose work focused on the understanding of the concept of poverty in advanced economies. Townsend argued that poverty was a relative concept, and that:

> *"Individuals, families and groups in the population can be said to be in poverty when they lack the resources to obtain the types of diet, participate in activities and have the living conditions and amenities that are customary [...] in the societies to which they belong."*

For social welfare rates to be adequate, therefore, they have to be sufficient to prevent people falling into poverty over time in a way which excludes them from the normal activities of life.

The question 'adequate for whom?' raises the issue of different people in different situations having different needs. This includes the situation of families with children and other caring responsibilities.

The question 'adequate for how long?' argues for differences in treatment for people who can be expected to be on social welfare payments for long periods because their prospects of obtaining employment are limited.

Our understanding of adequacy has evolved over time, from a basic alleviation of destitution, and should continue to do so. Providing adequate protection for all is a fundamental part of the social contract and is a core element of what the sociologist, TH Marshall calls citizenship:

> *"I propose to divide citizenship into three parts. [...] I shall call these three parts, or elements, civil, political and social. By the social element I mean the whole range from the right to a modicum of economic welfare and security to the right to share to the full in the social heritage and to live the life of a civilised being according to the standards prevailing in the society."*

In adopting the principle of adequacy, the Commission is building on the approach of the 1986 Commission on Social Welfare, by interpreting adequacy as it applies in this decade, with reference to prevailing household and family structures, and patterns of employment that have changed considerably since 1986. It does not imply simply setting a single rate of payment which is adequate for everyone - rather,

there is room for evidence-based analysis of different people's needs. This does not detract from the importance of designing the tax and welfare systems in a way which maximises labour market participation.

3.6.4 Equity

In taxation policy, it is common to think of equity as having two dimensions – 'horizontal' and 'vertical'. The concept of horizontal equity is the idea that people in similar circumstances should be taxed similarly. This is particularly relevant where two people earn the same amount of money in the same period, but may be required to pay different amounts of tax because of the source of that income.

The Commission of Taxation 1982 to 1986 explicitly addressed this issue by embracing the Haig-Simons definition of income (used by public finance economists). Under the Haig-Simons approach, income broadly connotes the exercise of control over scarce resources and is equal to total consumption during a year plus any increases in capital (after taking account of inflation) in the same period. A comprehensive definition of income on these lines would include capital gains, gifts and inheritances, lottery winnings and all other receipts. The implications of this approach are that income from different sources, such as rents, interest or earnings should, as far as possible, be taxed the same way, contributing to a more neutral taxation system where decisions regarding how to generate monies are made on their economic merit and not on the basis of the tax implications of that choice. While there may be practical limitations to how precisely this principle can be applied, it remains essential to the design of the taxation system in terms of not just efficiency, but also, crucially, in terms of fairness. That two people who have the same income should be taxed similarly is a basic principle of tax design.

Given the changes that have occurred in Irish society in recent decades, there is a need to evaluate how well this principle is being applied. The structure of family life in Ireland has changed significantly due to factors such as the introduction of divorce provisions as well as evolving personal choices around cohabitation. The role of women in society has changed significantly, particularly in respect of participation in the workforce. It is important to ensure that the taxation and welfare systems do not discriminate against personal choices regarding family. It also necessary to acknowledge that different family and personal circumstances may give rise to different needs and/or responsibilities – such as with regard to childcare or elder care, which are an important

contribution to society. As such, different supports may be required to address such needs, while also supporting one's ability to engage in productive activity or facilitating a return to such activity in the future.

While horizontal equity refers to the equal treatment of people who have similar levels of income, the principle of vertical equity is an explicit commitment to progressivity in the taxation system. The 2009 Commission on Taxation defined vertical equity as a concept that suggests that the tax burden should be distributed fairly across persons with different abilities to pay. Persons with higher income should pay more in taxes than persons with lower income. A progressive tax takes a higher percentage of income as income rises, so that high earners pay a higher proportion of their incomes than low earners.

Progressivity is an explicit feature of the design of Income Tax, but the principle of vertical equity also applies to the taxation system as whole. It cannot be expected that each and every element of the system will be progressive, and some elements of our existing system are regressive in nature, that is for some measures those on lower incomes pay a higher percentage share of their income than those who are better off. In designing reforms, it is important to have regard to the progressivity of the system overall.

3.6.5 Efficiency

In keeping with a long-standing approach in public finance theory, the dominant principle of the Mirrlees review is the concept of neutrality:

> *"A neutral tax system is one that treats similar activities in similar ways.... So, a neutral tax system minimizes distortions over people's choices and behaviour. In general, it therefore minimises welfare loss. In a non-neutral system, people have an incentive to devote socially wasteful effort to reducing their tax payments by changing the form or substance of their activities."*

Importantly, the Mirrlees review makes it clear that this definition of neutrality is not inconsistent with, say, imposing higher taxes on 'environmental bads'. The understanding of efficiency has always accommodated the idea that, where an activity of one individual imposes 'externalities' on others, imposing taxes on that activity promotes efficiencies. On the other hand, Mirrlees argues that the taxation systems in most modern economies are 'full of non-neutralities' and distortions which 'create complexity, encourage avoidance, and add costs for both taxpayers and governments'.

Thus, while it may be appropriate to pursue certain policy objectives through the tax code, such measures invariably come with a cost. This includes the cost of what is achieved by the measure, the deadweight cost of lost revenues forgone for activity that would have happened anyway, and the impact on the system as a whole in terms of higher complexity.

Crucially, the Mirrlees review points to the importance of thinking about tax as a system. The way that the system as a whole operates, and how individual elements fit together is what matters, not whether each component is, for example, progressive. This point also applies when thinking about the taxation and welfare systems, taken together, as do the points about administrative costs, process fairness and transparency. Just as tax liabilities should be clear and predictable, welfare entitlements should equally be understandable and accessible, and the behavioural impacts of the welfare system clearly understood.

In addition to the principles of good policy design, there are a number of practical issues of which policymakers must be cognisant when designing policy in the areas of taxation and welfare. People increasingly expect seamless integration of technology with their day-to-day activities, as more and more goods and services are a few short clicks away. The digital environment has created an opportunity to reimagine the administration of tax in a manner that can design out non-compliance and reduce the administrative burden for both taxpayers and the Revenue Commissioners (Revenue) thereby reducing errors, speeding up services and driving down costs. Ultimately, an optimised administration supports the ongoing operation of the taxation and welfare systems, as well as the delivery of our recommendations, in a manner consistent with the principles of design underpinning our work.

3.7 INTERNATIONAL OBLIGATIONS

Tax and welfare policy must also be designed in a manner that is compliant with relevant EU law as well as other international obligations and commitments.

As an EU member, Ireland cannot enact laws that are contrary to European law and is bound by the four freedoms underpinning the European Single Market, which restrict the creation or retention of obstacles to the free movement of goods, services, capital or people within the EU. Furthermore, European State Aid rules restrict Ireland's ability to give public assistance using taxpayer-funded resources due

to its potential to distort intra-EU competition and trade. Ireland's need to ensure compliance with these State Aid rules can constitute an important, resource-intensive step in the policy process. There are also extensive EU rules on indirect taxes.

Ireland must also be cognisant of non-binding tax recommendations made by, as well as its commitments to, the EU, OECD and International Monetary Fund (IMF).

There are also common rules in the EU to protect social security rights within Europe. EU social security coordination and free movement are inextricably linked. The recognition of social insurance contributions paid in other countries is an important aspect of these arrangements. The EU rules do not replace national social security systems and all countries are free to decide who is insured under national legislation, which benefits are granted and under what conditions. The UK has left the EU and is now considered a third country in an EU context meaning that the EU rules on social security coordination no longer generally apply to the UK as of 1 January 2021. Notwithstanding this, there are two agreements under which the rights of some persons continue to be protected:

1. The withdrawal agreement in respect of social security coordination.
2. The trade and cooperation agreement protocol on social security.

In advance of the withdrawal of the UK from the EU, Ireland concluded a convention on social security with the UK that maintains the status quo between Ireland and the UK under the Common Travel Area (CTA) arrangements.[26] This convention replicates EU social security coordination provisions, so that benefits that the UK previously coordinated in an EU context will continue to be coordinated in respect of Ireland, without reduction.

26 Convention on Social Security between the Government of Ireland and the Government of the United Kingdom of Great Britain and Northern Ireland (2019) Dublin.

Part 2:
Fiscal Sustainability and Taxation

Chapter 4:
Fiscal Sustainability

4.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"review how best the taxation and welfare system can support economic activity and income redistribution, whilst promoting increased employment and prosperity in a resilient, inclusive and sustainable way and ensuring that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term".*

While the taxation system performs a number of key functions such as the redistribution of resources and influencing behavioural changes, its primary role is to ensure that resources are available to fund capital and current expenditure at a level that is ultimately determined by the democratic system. As such, tax revenues should not become decoupled from expenditure in the long run to ensure that services and public investment demands can continue to be satisfied through economic cycles and that public finances are sufficiently agile to meet future challenges. Consequently, as a Commission, we are tasked with making recommendations that ensure the State is provided with sustainable and sufficient resources to meet the costs of public services in the medium to long run. This chapter gives insight into some of the challenges and risks that may cause divergence of long-term revenues from expenditure.

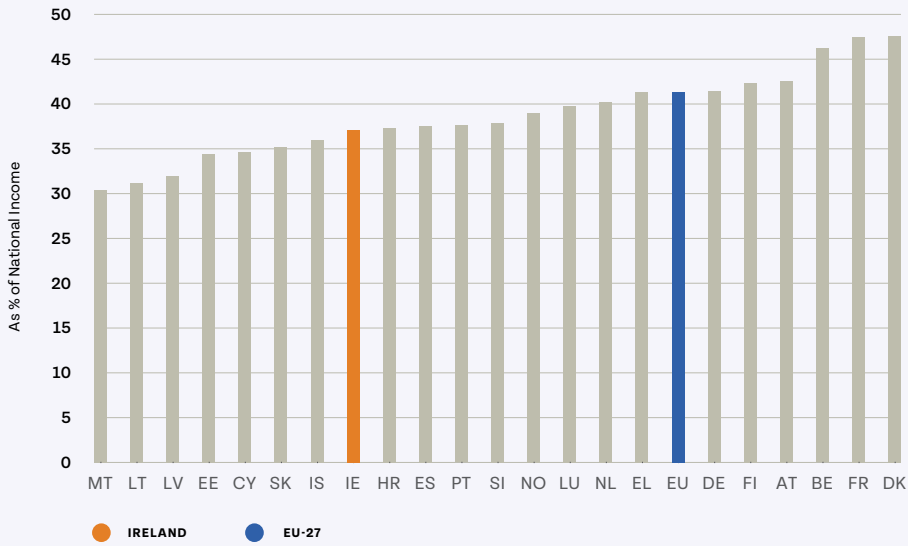
As Ireland emerges from the COVID-19 pandemic, and notwithstanding the risks posed by elevated inflation rates and the war in Ukraine, the public finances are expected to improve considerably in the short term, returning to a balanced budget by 2023. However, beyond the next five years, the public finances face significant pressures relating primarily to structural demographic changes, but also to risks that are more uncertain in both their timing and scale. In addressing climate change, the public finances will come under pressure from both an expenditure and tax revenue perspective, while the digital transition, which has been accelerated by the pandemic, is also likely to bring fiscal challenges. Likewise, it is widely acknowledged that the

level of revenues currently collected from corporate profits may be unsustainable.[27] Now the third largest of all taxheads, Corporation Tax has experienced rapid and sustained growth in recent years and the majority of receipts are concentrated in a very small number of firms. Similarly, sustainability issues are arising from ongoing discussions on the taxation of corporate entities generally at a global level.

Box 1: Revenues in an international context

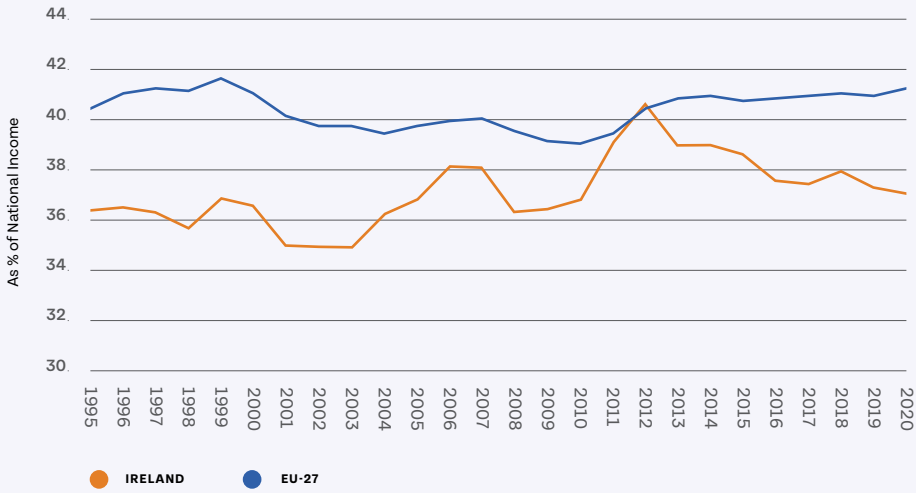
In a European context, Ireland collects a below-average share of total tax and social security contribution revenues (Figure 5A). In 2020, Ireland's revenue-to-income ratio was 37 per cent of GNI*, which is below the EU-27 average of 41 per cent of GDP.

*Figure 5: Revenues as a share of national income**
i) Figure 5A: Ireland (IE) and selection of EU-27 countries, 2020



27 Irish Fiscal Advisory Council (2022) Fiscal Assessment Report: Rising prices and an uneven recovery; Department of Finance (2022) Draft Stability Programme Update 2022; European Commission (2020) Country Report Ireland 2020, Brussels; McQuinn, K., C. O'Toole, W. Disch, E. Shiel and E. Kenny (2022). Quarterly Economic Commentary, Spring 2022, ESRI Forecasting Series QEC2022SPR, Dublin: ESRI.

ii) Figure 5B: IE and EU-27, 1995-2020



Source: Eurostat; CSO

Note: Revenues include tax and social security (PRSI) contributions. GNI is used for Ireland due to distortions in GDP. See the Glossary for more details on GNI*. One per cent of GNI* in 2020 was equivalent to €2.1 billion.*

Tax and social security contribution revenues as a share of GNI* have been reducing in recent years. In this period, revenues as a percentage of income have remained below the EU-27 average, with the exception of 2012. Across the past 25 years, the EU-27 revenue-to-income ratio is 40.5 per cent of GDP on average (Figure 5B).

This data shows that Ireland has consistently collected proportionately less tax revenue than its EU counterparts have on average. Such cross-country statistics on tax and social security contributions as a percentage of national income are useful to give a broad brush-stroke comparison; however, they do not give insight into the country-specific structures of each tax and social security system, or indeed the level of services that these revenues provide.

This chapter gives insight into some of the threats to fiscal sustainability, highlighting the scale of potential challenges where such estimates exist and how these considerations have influenced the work of the Commission. The challenges facing the public finances are ever-evolving. While the Commission does not attempt to place precise estimates on the amount of tax revenues needed to address these issues, this chapter intends to give some sense of the scale of the fiscal

headwinds that are seen to exist from the time of writing and, ultimately, to inform an overarching principle of the Commission's Report. Thus, given the likely scale of the fiscal risks facing the State, and in order to meet the demands of public services in the medium to long run, the Commission is clear that the net level of revenues raised from tax and Pay Related Social Insurance (PRSI) should increase materially as a share of national income in the medium to long term in order to address the future challenges and risks outlined previously. Furthermore, the Commission recognises that these higher yields should be obtained in a manner that minimises economic, social and environmental costs.

Recommendation

4.1 The Commission recommends that given the medium-to long-term threats to fiscal sustainability, the overall level of revenues raised from tax and Pay Related Social Insurance as a share of national income must increase materially to meet these challenges. These increased yields should be obtained in a manner that minimises economic, social and environmental costs.

4.1.1 Context and short run fiscal outlook

The following section provides an overview of the fiscal and economic position over the past number of years, as well as giving insight into some of the fiscal projections for the near and medium term.

Prior to the pandemic, Ireland's debt ratio had fallen significantly from a historical high of 166 per cent in 2012 to 95 per cent of GNI* in 2019.[28] While the decade following the 2008 Global Financial Crisis was marked by increased taxation combined with reductions in public expenditure, this led to a significantly reduced debt burden; and provided a base from which to borrow significantly during the pandemic. This placed Ireland in a position to run large budget deficits that were necessary to support those who were affected by restrictions and to increase expenditure in a time of unique global crisis. The Irish economy remained remarkably buoyant throughout the pandemic resulting in relatively stable tax revenues, owing in large part to continued strong performance of the multinational sector in particular. Pandemic related

28 Irish Fiscal Advisory Council (2020) Long Term Sustainability Report, Dublin.

expenditure in 2020 and 2021 amounted to €17 billion and €13 billion, respectively, with a further €7 billion assigned in 2022.[29] By end-2022, public debt is projected to be approximately €30 billion higher than it was at end-2019, standing at €234 billion. Due to a robust economic recovery, the debt ratio is projected to be just above the end-2019 figure, standing at 96.5 per cent of GNI* by end-2022.

The pandemic period also saw unprecedented changes to fiscal institutions. The regular fiscal requirements set out in the European Fiscal Rules were temporarily suspended in early 2020 following significant and necessary levels of expenditure on pandemic supports across Member State economies and have been further suspended in light of the ongoing war in Ukraine.[30] It is anticipated that the fiscal requirement will be restored in 2024. In the 2021 Summer Economic Statement, the Government introduced a five-year expenditure ceiling to keep expenditure commitments in line with potential growth of the economy. This set a ceiling on annual permanent expenditure increases of 5 per cent per year.[31] This is consistent with the medium-term commitments in the National Development Plan[32] (NDP) 2021, which sets out much of the public infrastructural investment committed to over the next ten years relating to climate, housing and health. The NDP commits to a total of €165 billion in expenditure between 2021 and 2030, bringing public investment to 5 per cent of GNI* by 2030. However, the Irish Fiscal Advisory Council (IFAC) has warned that these projections do not fully reflect the estimated cost of existing government priorities, including the Climate Action Plan 2021 and the implementation of Sláintecare.

Official forecasts from the Stability Programme Update 2022 provide the most up-to-date fiscal outlook for the short to medium term at the time of writing, incorporating forecasted general government

29 Department of Finance (2022) Stability Programme Update 2022.

30 The European fiscal rules, formally the Stability and Growth Pact, require that Member States keep public debt below (or at least reduce it toward) 60 per cent of GDP and deficits below 3 per cent of GDP.

31 It should be noted that in the 2022 Summer Economic Statement, the Government updated this strategy for 2023, allowing for core spending to increase by 6.5 per cent. This is in light of a large increase in inflation in the interim that has outpaced the assumed rate of inflation of around 2 per cent for 2023, 2024 and 2025 that was contained in the 2021 Summer Economic Statement.

32 Department of Public Expenditure and Reform (2021) National Development Plan 2021-2030.

balances over the next five years (projections beyond this are not currently available), as well as the debt outlook, presented in Table 2.

Table 2: Government balance and debt from Stability Programme Update 2022, 2021-2025

	2021	2022	2023	2024	2025
General Government Balance (€ millions)	-8,110	-1,880	1,230	6,460	7,625
General Government Balance (per cent of GNI*)	-3.6	-0.8	0.5	2.4	2.7
Gross debt (€ billions)	235.9	233.8	230.8	231.4	227
Gross debt (per cent of GNI*)	105.6	96.5	89.9	85.4	79.4

Source: Department of Finance

While official growth forecasts for 2022 have been revised downwards from 5.2 per cent to 3.7 per cent due to the economic fallout from the ongoing war in Ukraine and associated heightened inflation, the fiscal position has improved since Budget 2022 forecasts.[33] The General Government Balance is projected to return to a surplus of 0.5 per cent of GNI* (€1.2 billion) in 2023 and the public debt ratio is forecast to continue to fall to levels not seen in the last decade, reaching 79.4 per cent of GNI* by 2025. While the public finances have recovered considerably following the easing of the pandemic restrictions, failure to continue to reduce the debt burden would bring risks. The following section gives insight into some of the likely structural challenges facing the public finances in the coming decades.

Box 2: Debt in Ireland and in an international context[34]

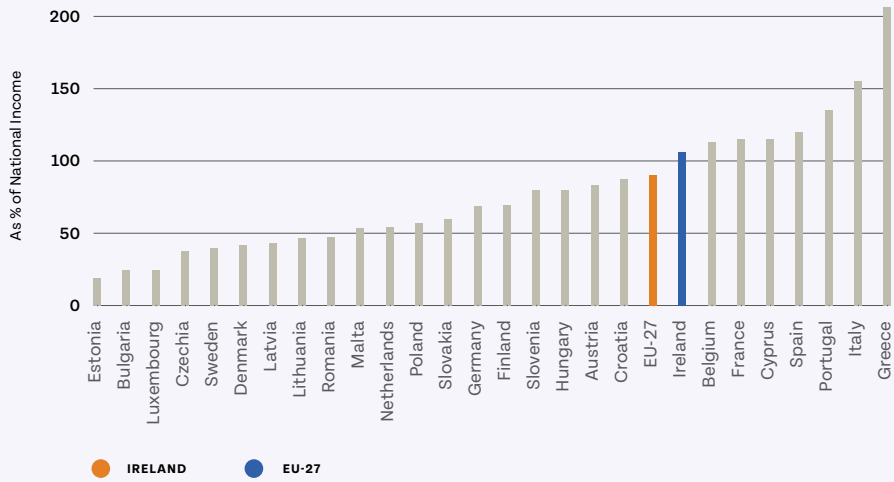
There are many metrics by which a country's ability to manage debt in a sustainable way can be assessed and it is important not to rely on any one measure.

Gross public debt as a percentage of national income is the most commonly-used measure of debt sustainability, often referred to as the debt ratio. In 2020, in a European context, Ireland had a relatively high debt ratio at 105 per cent of national income (GNI*), above the EU-27 average of 90.7 per cent of GDP.

33 Department of Finance (2021) Budget 2022 Economic and Fiscal Outlook.

34 The various estimates of debt sustainability referenced are from Department of Finance's Annual Report on Public Debt in Ireland Report 2021.

Figure 6: Gross debt as a share of national income in EU-27, 2020



Source: Eurostat
Note: GNI is used for Ireland due to distortions in GDP. See the Glossary for more details on GNI**

However, the debt ratio is often considered an inappropriate measure of debt sustainability due to its comparison of a stock metric (debt) with a flow metric (income). A more suitable measurement is one that compares inflows with outflows, representing the draw on public resources due to debt servicing. In 2020, interest costs in Ireland absorbed 4.6 per cent of government revenue (i.e. roughly one in 20 euro was used to pay interest on the national debt). A decade ago, one in eight euro was dedicated to paying interest costs. This metric of debt sustainability has improved in recent years and Ireland is now in line with EU norms, although interest rates remain at extremely low levels.

Finally, the debt burden can be assessed by estimating the public debt per head of population. In 2021, Ireland has a gross debt per capita of €47,000, one of the highest among developed economies; this compares with the Netherlands (a country with a similar income per capita) with debt per capita of approximately €28,000 in 2021.

The degree of variation across these metrics points to the need to assess debt sustainability along a number of metrics.

4.1.2 The medium to long run

Many uncertainties remain regarding the recovery from the pandemic and the evolving conflict in Ukraine, and the associated economic and fiscal costs that may emerge. The Commission has been tasked with looking beyond the short term to assess whether there is likely to be sufficient resources to meet the costs of public services in the medium and long term. Challenges exist from both an expenditure and revenue point of view. Chief among these is the relatively quantifiable phenomenon of an ageing population, which will place significant pressures on healthcare, pensions and long-term care expenditures, but will also lead to moderating growth in revenues due to a slowing in labour force growth - see Chapter 10 (Labour Markets and Social Protection Systems).

Other less quantifiable but no less serious risks also exist. Policies aimed at decreasing the consumption of fossil fuels will lead to diminishing revenue streams associated with these sources - see Chapter 13 (Moving to a Low-carbon Economy). Similarly, significant commitments in the Climate Action Plan 2021 will add to expenditure demands. Continued digitalisation of the economy may lead to structural challenges, relating primarily to the labour market, which may also pose challenges to the public finances. Finally, continued growth in highly concentrated Corporation Tax receipts in particular cannot be relied upon as a sustainable means of funding public expenditure.

The following section assesses each of these challenges in turn, providing estimates where possible of the potential scale of each in a fiscal context.

4.1.2.1 Demographic changes

Ireland currently has a very young demographic profile compared to its EU counterparts. In 2020, the median age in Ireland was 38.1 while the EU equivalent was 43.9.[35] However, the composition of Ireland's population is set to converge on the EU average over the coming decades. While the old-age dependency ratio, or the number of persons aged 65 and over as a proportion of 20 to 64 year olds, stood at 24.2 per cent in 2019, this is projected to increase to 30.3 per cent in 2030, reaching 46.5 per cent by mid-century. In other words, while there are currently four people of working age for every person aged 65 and over, by 2050 this will likely be closer to two.[36]

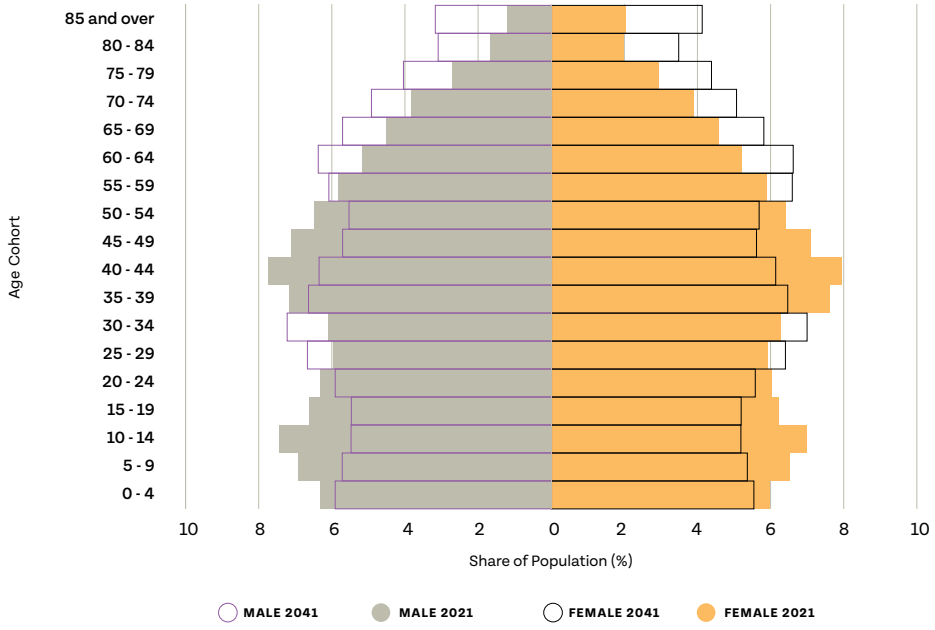
Two of the key contributing factors to Ireland's increasingly ageing population are the recent phenomena of low fertility rates (relative to historical levels) and an increasing life expectancy among the population. Not only is each woman of childbearing age having fewer children on average, those born into the larger families of the past are also living longer and, therefore, living an increasing proportion of their lives in retirement. Ireland's fertility rate is projected to average 1.8 between 2019 and 2070, a significant reduction from an average rate of 3.3 recorded over the 1960 to 1990 period. Conversely, life expectancy at birth has increased in recent decades. In 1961, life expectancy at birth was 68.1 for males and 71.9 for females. Males and females born in 2019 can expect to live to 80.8 years and 84.7 years, respectively.[37] These two key factors are projected to drive an increase in over-65 year olds as a share of the population, with significant increases in the over-85 cohort in particular. The shift in population structure is also influenced by major changes in migration flow, with the large-scale outward migration that took place during the 1950s and 1960s replaced with a modest inflow. The consequence of these changes is that age cohorts of working age will decline as a share of the population, as represented in Figure 7.

35 Eurostat (2021) Are you younger or older than the median age in your region?

36 Department of Finance (2021) Population Ageing and the Public Finances in Ireland.

37 Central Statistics Office (2020) MIP12 – Life expectancy at birth (years).

Figure 7: Age cohort projections, Ireland, 2021 and 2041



Source: Eurostat

While improvements in life expectancy are undoubtedly a positive phenomenon, they pose challenges from a fiscal perspective. In 2021, the number of working-age adults for every retiree is comparatively high, resulting in sufficient tax and PRSI revenues from the former supporting the relatively high expenditure needs of the latter. However, over the coming decades, this is likely to change with declining Income Tax and PRSI revenues, in relative terms, from the working-age cohort available to support each person over 65 years. Inevitably, there will be increased pension, health and long-term care expenditure and, while pension costs can be reduced by increasing the State pension age (as proposed by the Commission on Pensions), increases in the number of persons in the top age cohorts in particular will lead to unavoidable costs as these age cohorts use particular services disproportionately, such as health services. While representing only 13 per cent of the population in 2016, those over the age of 65 represented 39 per cent of day-case procedures across both public and private hospitals. Within

older-person services,[38] those aged over 85 represented approximately half of those receiving care. This cohort is set to grow by 44 per cent over the coming decade, compared to just 10 per cent growth among the general population.[39]

The Department of Finance and the IFAC have published estimates of the projected increased costs of age-related expenditure (see Table 3). In its central scenario, the Department of Finance estimates that, when compared to 2019 levels, annual age-related expenditure will increase by €7 billion by 2030 in today's terms (or by 3.4 per cent of GNI*).[40] In proportional terms, annual age-related expenditure is projected to increase as a percentage of national income from 21.4 per cent of GNI* in 2019 to 24.7 per cent in 2030, to 29.5 per cent in 2050 and 31.5 per cent of GNI* by 2070. Pension expenditure will represent the largest component of this increase;[41] however, long-term care expenditure is expected to increase by nearly two thirds by 2040.

Table 3: Age-related expenditure, as a percentage of GNI(%), 2019-2070*

	2019	2030	2040	2050	2070
Pension	7.4	9.6	11.2	12.1	12.3
Health care	6.6	7.2	7.8	8.3	8.9
Long-term care	2.0	2.7	3.2	3.9	5.1
Education	5.3	5.3	5.0	5.2	5.1
Total age-related	21.4	24.7	27.2	29.5	31.5

Source: 2021 Ageing Report, European Commission and Department of Finance

In 2020, IFAC's Long Term Sustainability Report's central scenario assumed that the State Pension Age was to increase in line with previous legislation; however, the projected expenditure impacts are

38 Defined as 'long- and short-stay residential care beds in public and private nursing homes and home care/home help.'

39 Department of Health (2018) Health Service Capacity Review 2018.

40 Department of Finance (2021) Population Ageing and the Public Finances in Ireland. The Department of Finance's central scenario assumes that the State Pension age (SPA) remains at 66 over the time horizon. There is currently no commitment to increase the SPA. The Social Welfare Act 2020 repealed the previous commitment to increase the SPA to 67 in 2021 and to 68 in 2028.

41 Department of Finance submission to the Commission on Pensions: Public sector pensions currently (2019) make up one in every five euro of pension expenditure, by 2070, this will have reduced to less than one in every ten.

still significant. IFAC estimates that annual age-related expenditure would have increased by 3 per cent of GNI* annually by 2030 and by 5 per cent of GNI* by 2040 in this scenario.[42] Both of these estimates demonstrate that the costs from an ageing population will grow considerably and, importantly, at a faster pace than national income and corresponding tax revenues, which tend to move one-for-one with national income in the long run.

Both IFAC and the Department of Finance estimate that, if left unfunded, demographic changes would lead to significant increases in the debt burden, accelerating after 2030. In a hypothetical situation of solely age-related costs affecting the debt burden, the debt ratio would be approximately 20 percentage points of GNI* higher by 2050 than in 2019, and 85 percentage points of GNI* higher by 2070, if left unfunded.[43] It is important to reiterate that this abstracts from other factors that would likely add to or reduce the debt burden, some of which are discussed in the following sections.

4.1.2.2 Climate action

Climate action presents risks to the public finances from both a revenue and expenditure perspective. Climate change is likely to present challenges to economic growth through many channels, and the successful adoption of cleaner energy sources required to decarbonise the economy will necessarily lead to diminished revenue streams from fossil fuels. From a public expenditure perspective, climate action will require large-scale investment in mitigation measures like retrofitting homes and upgrading the public transport stock.

Regarding expenditure, the NDP proposes historically high levels of public capital investment in housing (for example, in the case of Housing for All commitments), transport and climate action. The NDP provides for a commitment to increase Ireland's capital investment to 5 per cent of GNI* by 2030 or a total of €165 billion over the period 2021 to 2030, a significant increase from approximately 3 per cent of GNI* today.[44] Moreover, according to IFAC, not all climate adaptation measures are fully costed in the NDP.[45]

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42 In 2020 terms, 3 per cent of GNI* is equivalent to €6.3 billion. IFAC and the Department of Finance's estimates are not directly comparable due to differing methodologies used; however, they both show similar magnitudes in scale.

43 Department of Finance (2021) Population Ageing and the Public Finances in Ireland.

44 IFAC (2021) Ireland's next ramp-up in public investment.

45 IFAC (2021) Fiscal Assessment Report.

Success in the area of climate action will necessarily lead to behavioural change away from use of fossil fuels toward more sustainable sources of energy. In the five years prior to the pandemic, revenues strongly associated with carbon emissions averaged just over €4.2 billion annually (or 7 per cent of total tax revenues).[46] It is highly likely that the vast bulk of these revenues are at increased risk over the next decade, with Ireland seeking to achieve a 51 per cent reduction in greenhouse gas emissions between 2021 and 2030 and to achieving net-zero emissions no later than 2050.

4.1.2.3 Concentration of tax revenues

The overreliance of Exchequer spending on Corporation Tax receipts presents a risk to the sustainability of the public finances. The tax head has grown significantly as a proportion of total revenues, is becoming more concentrated in fewer taxpayers and is under increased risk in the context of both the ongoing deliberations on the international tax architecture within the OECD/G20 Inclusive Framework on BEPS and at EU level, and emerging concerns around a potential reversal of globalisation trends generally.

Over the past decade, Corporation Tax receipts have increased nearly fivefold. In 2021, Corporation Tax receipts amounted to €15.3 billion (an increase of 30 per cent on 2020) representing the highest tax take on record for the seventh year in a row. Since 2014, it has been the third-largest tax head, and in 2021, tax revenues from Corporation Tax were just €117 million lower than the second-largest tax head Value Added Tax (VAT). In proportional terms, Corporation Tax represents nearly one in every five euro collected in total tax revenues in 2021 (19 per cent). The composition of receipts presents issues from a sustainability perspective. In 2021, 53 per cent of Corporation Tax receipts came from the top 10 Corporation Tax paying companies or, in other words, 10 per cent of total tax revenues came from just 10 companies. Furthermore, the vast bulk of receipts in Ireland comes from foreign-owned multinational companies, with 80 per cent of receipts being paid by such companies. These same companies directly support revenue streams deriving from employments (PRSI, Universal Social Charge (USC) and Income Tax) and VAT amounting to €15.3

46 Department of Finance (2020) Climate Action and Tax Strategy Group -20/06; Revenue (2021) Excise receipts by commodity. This figure is the sum of Excise Duties on heavy and light oils, VRT, motor tax and carbon tax revenues.

billion in 2020.[47]

These factors provide a backdrop to the domestic position as it currently stands. The evolving international Corporation Tax landscape heightens potential sustainability concerns surrounding Corporation Tax receipts. The Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the Two-Pillar Solution)[48] is a historic multilateral agreement developed by the OECD/G20 Inclusive Framework on BEPS. Pillar One provides for a reallocation of a proportion of profits of the largest, and most profitable multinational groups to market jurisdictions. Pillar Two will ensure that large multinational groups will pay a minimum effective rate of taxation on their profits; being 15 per cent in each jurisdiction in which the group operates. These rules have not yet been implemented and important technical details relating to this solution are yet to be agreed internationally. Furthermore, it remains to be seen how the US Global Intangible Low-Taxed Income (GILTI) regime will interact with these rules, which is of particular interest to Ireland given the large US Multinational Enterprise (MNE) presence here. The Department of Finance estimate that, Corporation Tax revenues could reduce by up to €2 billion as a result of the agreement. However, this is a highly tentative estimate and there is significant uncertainty around the timing and ultimate destination of these measures at the time of writing of this report.

Income Tax, the single most significant tax as a share of total tax revenues, is also a relatively concentrated tax head. While not presenting the same level of risk as Corporation Tax, Income Tax is nonetheless dominated by a relatively small share of taxpayers. In 2018, the top 25 per cent of gross income earners (tax units) paid over 80 per cent of all Income Tax revenues in that year, a trend consistent with earlier years.[49]

The presence of large concentration risks in tax revenues points to the need to ensure a broad tax base more generally, reducing the over-reliance on two relatively concentrated sources of tax.

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47 Revenue (2022) Corporation Tax 2021 Payments and 2020 Returns.

48 Further detail in respect of the Two-Pillar solution is available on the BEPS hub on the OECD website. The hub is updated on an ongoing basis.

49 Revenue Commissioners - Income Distribution Statistics. Figures are based on taxpayer units. Jointly assessed couples are counted as one taxpayer unit and their incomes are aggregated.

4.1.2.4 Other risks

A number of other significant risks to fiscal sustainability include expenditure commitments related to Sláintecare, the digitalisation of the economy, housing and capital investment.

The implementation of Sláintecare, the intention of which is to provide publicly-funded universal access to healthcare, will present increased estimated costs to the State that have not been updated since the original 2017 estimate. IFAC has warned that the 2017 costings of expenditure of €2.8 billion per annum to 2027 are in need of updating to reflect wage and price pressures in the sector in the intervening period. IFAC estimates that annual expenditure on Sláintecare implementation is likely to be upwards of €3.5 billion by 2027.[50]

Digitalisation presents structural challenges to the Irish economy, which are likely to have been accelerated by the pandemic restrictions. The ability of employees to work productively in a remote setting presents new opportunities for MNEs to scale back investment in a physical presence in Ireland. Similarly, the intensification of online retail means that there may be a reduction in the physical presence of smaller enterprises. These shifts in business activity may result in particular challenges for the labour market and associated Income Tax revenues, as well as resulting in reduced Commercial Rates and Stamp Duty revenues from commercial premises. Similarly, many sectors are at risk from automation and this is likely to lead to increased demands on retraining and reskilling expenditure over the coming decades.[51]

Expenditure commitments on capital infrastructure and housing can also be expected to increase over the medium to longer term. IFAC and others have queried whether existing capital commitments are adequate to meet future challenges, particularly in the area of housing.[52] Similarly, there have been other expenditure commitments that have emerged in recent times, either as a response to the pandemic, recent inflationary pressures or other Government commitments such as redress schemes etc., elements of which also have the potential to result in permanent increases in expenditure, which will need to be sustainably funded into the future.

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50 IFAC (2021) The Path for Ireland's health budget.

51 National Economic and Social Council (2020) Addressing Employment Vulnerability as Part of a Jurisdiction in Ireland, No. 149.

52 IFAC (2021) Pre-Budget 2022 Statement.

4.2 CONCLUSION

This chapter has highlighted some of the fiscal headwinds that Ireland is likely to face over the next decade and beyond. The public finances have improved despite the costs of meeting the pandemic challenges and notwithstanding the ongoing war in Ukraine. However, there are longer-term structural challenges facing the public finances that will likely lead to a decoupling of levels of expenditure from revenues over the coming decades if not addressed with an increase in sustainable sources of revenues. Setting public debt on a downward trajectory in the short run will reduce the longer-term significant costs of doing otherwise. Ireland is a small, open economy, which, by its nature, is highly exposed to global crises. Protecting the public finances against the likely structural risks that are approaching will improve the State's capacity to support households and firms in the event of the less expected downturns, as was demonstrated during the pandemic, while maintaining ongoing expenditure for essential public services and infrastructure. While the Commission does not attempt to place precise estimates on the amount of revenues needed to address these challenges, it is against the backdrop of the structural challenges facing the public finances in the coming decades that the Commission is adopting a core net-revenue-raising approach. The net level of revenues raised from tax and PRSI should increase materially in the medium to long term in order to address the future challenges and risks outlined previously. Given the need for the tax and PRSI systems to generate a higher yield over time, the Commission is also recommending a number of structural reforms in order to ensure that higher yields can be obtained in a manner that minimises economic, social and environmental costs.

4.3 RECOMMENDATION

Chapter 4: Fiscal Sustainability

4.1 The Commission recommends that given the medium- to long-term threats to fiscal sustainability, the overall level of revenues raised from tax and Pay Related Social Insurance as a share of national income must increase materially to meet these challenges. These increased yields should be obtained in a manner that minimises economic, social and environmental costs.

Chapter 5:
Balance of Taxation

5.1 INTRODUCTION

The terms of reference asked the Commission to consider:

> *"options for reform on the balance between the taxation of earned income, consumption, and wealth."*

In addressing this mandate, the Commission recognises that there is a need to generate a higher tax yield over time but that those additional revenues must be raised in a manner that minimises economic, environmental and social costs and is reflective of the principles outlined in Chapter 3 (Objectives and Principles). Consequently, the Commission has considered the existing taxation system from those perspectives, both in the context of how taxation levels have evolved over the recent past, and in the light of the need to respond to emerging challenges and existing fiscal risks, as outlined in the previous chapter.

In this chapter, the Commission examines the current balance of taxation across earned income, consumption and wealth, and forms recommendations around how future tax policy might strike an appropriate balance across each area, while taking account of future revenue needs and the range of policy objectives that the Commission is trying to achieve. As part of this analysis, and having given due regard to how the different taxes operate, we consider the economic literature on the effects of individual taxes on economic growth and taxpayer behaviour as well as their wider societal impact.

In forming its conclusions, the Commission has been focussed on its driving concern to identify ways to improve the overall design of the taxation system in a manner that will help improve the sustainability of the public finances over the medium term, while supporting economic growth and job creation, with a view to ensuring greater equity across the taxation system as a whole.

5.2 OPTIMAL BALANCE OF TAXATION

5.2.1 Definitions

The terms of reference asked the Commission to consider *"options for reform on the balance between the taxation of earned income, consumption, and wealth"*. The Commission has interpreted these terms as meaning the following:

- *Taxes on earned income:*
  This relates to all taxes and levies such as Income Tax, Universal Social Charge (USC) and Pay Related Social Insurance (PRSI) on labour (both employed and self-employed) and business trading income, including Corporation Tax.
- *Taxes on consumption:*
  This covers taxes on spending such as Value Added Tax (VAT), Excise Duties, including Carbon Tax and Vehicle Registration Tax (VRT), as well as Commercial Rates.[53]
- *Taxes on wealth:*
  This covers taxes on income derived from ownership of a capital asset (e.g. shares, property, deposit accounts, etc.), together with taxes on the gains from disposal, acquisition, holding or occupation of such assets. This includes Income Tax, Deposit Interest Retention Tax (DIRT), USC, PRSI and Corporation Tax on investment, savings and passive income,[54] as well as capital taxes such as Stamp Duty, Capital Acquisitions Tax (CAT), Capital Gains Tax (CGT), Corporation Tax on chargeable gains, and Local Property Tax (LPT).

5.2.2 Earned income, consumption and wealth

In reviewing options for reform of the balance between the taxation of earned income, consumption and wealth there are clearly many competing priorities to be weighed when assessing revenue-raising options under each category.

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53 Commercial Rates are categorised as consumption taxes for the purposes of this Report as they are a payment to local authorities for the services provided in the area. This is generally calculated as a proportion of estimated rent paid by the tenant (while not as directly linked to consumption as VAT, for example). They are not a tax on earned income as they are not generally linked to income received; nor are they a tax on wealth, as rent paid by a tenant does not approximate the wealth of the tenant.

54 Passive income is income that is earned without much active involvement e.g. from dividends, royalties, rental income from immovable property, etc.

Taxes on labour typically form the core of many taxation systems. They represent the single largest source of revenue and support the redistribution of resources within the State. They have, however, the potential to discourage the supply of labour. Higher taxes on individuals with lower incomes potentially discourages participation in the labour market (especially given the potential effects from the interaction between the taxation and social welfare systems, which is explored in detail in Chapter 11 (Promoting Employment)) and may impact on the number of hours people are willing to work. Increasing taxes on labour can also fuel demands for wage increases and may also influence business investment and growth, thus increasing the vulnerability of Income Tax revenues to a negative shock.

Consumption taxes also influence decisions and change economic outcomes, but they are less likely to influence individual choices to work or invest. Taxing tobacco, alcohol and sugar can have positive effects, including better health outcomes. Where such taxes are set at an overly high rate, however, they have the potential to push economic activity into the shadow economy by creating incentives to evade taxation. Similarly, environmental taxes are often used as a tool to influence behaviour from an environmental perspective, while also being a source of tax revenue. However, the sustainability of environmental tax revenue is a challenge when a policy of decarbonising the economy is simultaneously pursued. From the equity perspective – which is a key consideration for the Commission - taxes on consumption tend to be more regressive than other taxes, taking up a larger proportion of the overall income of lower-income households.

Wealth is typically highly concentrated in the upper income deciles and income flows from wealth generally further increase the level of inequality - see Chapter 7 (Taxes on Capital and Wealth). The taxation of wealth, therefore, can increase the overall progressivity of a taxation system, while also being economically efficient. For example, taxes on inheritance and gifts, tend to approximate to a 'windfall' tax, which is economically efficient because it does not distort behaviour (unless there is scope for avoidance). However, distortions can arise. For example, in the case of CGT, some research indicates the tax can impact the level of risk-taking, although there is not wide agreement as to the extent. The tax treatment of capital gains can also impact the level of savings and investment. Furthermore, the level of tax on gains relative to income can influence decisions by businesses on whether to reinvest

or distribute profits. It can also affect a firm's financial structure and gearing based on the relative cost of debt finance to equity. On the other hand, differences between rates of tax on capital gains and on income can open up opportunity or incentives for tax planning.

Stamp Duty receipts, another form of taxation on wealth, are dependent on transaction levels and values. As such they are particularly subject to market fluctuations. In contrast, recurrent taxes on real-estate property have attracted increasing attention from policymakers in many countries as existing yield from such taxes tends to be relatively low; thus, they are a potential source of increased revenue. Moreover, such taxes are viewed as a viable option to generate revenue, as they are considered less detrimental to economic growth given the physical immobility of the tax base. Immobility also makes them a highly sustainable source of revenue.

5.2.3 Literature

There is a wide range of economic literature that examines the effects of individual taxes on economic growth and taxpayer behaviour. While taxes play a key role in redistributing resources and funding public expenditure, they can also be an impediment to growth. There is a range of international evidence to suggest that some taxes are more harmful than others in terms of their economic impact and that tax revenues from more mobile activities can be most responsive to changes in taxation.

Following the financial crisis of the late 2000s, the OECD recommended a hierarchy of taxation for countries facing the challenge of restoring public finances while still supporting growth.[55] This analysis suggests corporate taxes are the most harmful type of tax for economic growth, followed by personal income taxes and then consumption taxes, while recurrent taxes on immovable property appear to be the least harmful form of tax.

While this hierarchy represents a useful starting point, there are limits to the usefulness of cross-country studies of this kind.[56] For example, country-specific factors are also highly relevant; there may be differences in short-run versus long-run impact of individual tax changes; and the OECD analysis only considers the impact of these

55 OECD (2010) Tax Policy Reform and Economic Growth.

56 See Bairdi et al (2017), Tax Policy and Economic Growth: Does It Really Matter? for a critique of the OECD paper.

taxes on economic growth. Thus, the Commission needs to balance economic considerations with considerations relevant to equity and progressivity as outlined in Chapter 3 (Objectives and Principles). It recognises, accordingly, that many trade-offs can exist when considering reforms to tax policy. Nonetheless, the OECD study provides a useful set of headings under which to consider the balance of taxation.

As regards the position in Ireland, the Economic and Social Research Institute (ESRI) has examined effective tax rates over the period between 1995 and 2017, and finds that consumption taxes account for a higher share of total taxes in Ireland, when compared to the European Union (EU) average, while the opposite is the case for labour taxes. The ESRI notes that this mix of effective tax rates may have been associated with Ireland's strong economic performance over the period concerned.[57]

The 2009 Commission on Taxation also examined this issue and concluded that the appropriate hierarchy to apply when considering revenue raising in Ireland should be firstly, property taxes, followed by spending/consumption taxes (especially environmental taxes), and then taxes on income. It recommended this approach should be taken in tandem with a broadening of the base for each tax head. Similarly, a number of Irish studies, including O'Connor (2016),[58] provided further evidence supportive of such a position, identifying possible shifts from the taxation of labour (or more mobile factors of production) towards more immobile factors such as property taxes, and in a manner that enhances growth and employment. These studies are also consistent with the findings of other economic literature that taxes levied on the factors of production (labour and capital) may be more distortionary than taxes on consumption and wealth.[59]

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57 Kostarakos I. and Varthalitis P. (2020) Effective Tax Rates in Ireland, Dublin, ESRI.

58 O'Connor, B., Hynes T., Haugh D. and Lenain P. (2016). 'Searching for the Inclusive Growth Tax Grail: The Distributional Impact of Growth Enhancing Tax Reform in Ireland', The Economic and Social Review, 47 (1, Spring), 155-184.

59 See for example: Gemmell, N., Kneller, R., & Sanz, I. (2014). The growth effects of tax rates in the OECD, The Canadian Journal of Economics / Revue Canadienne d'Economique, 47(4), 1217–1255.
Kostarakos I. and Varthalitis P. (2020) Effective Tax Rates in Ireland, Dublin, ESRI.

5.3 TRENDS OF IRISH TAX RECEIPTS

5.3.1 Earned income, consumption and wealth

Using the definitions of earned income, consumption and wealth as set out in section 5.2.1, and as far as available data allows, the total receipts from 2021 show a strong reliance by the State on taxes on earned income (66 per cent of total receipts), followed by taxes on consumption (28 per cent) and lastly taxes on wealth (6 per cent).

Table 4 provides a breakdown of net tax revenues across the various categories as outlined. The table presents total tax receipts for 2021 of €82 billion, which includes all Exchequer tax receipts along with non-Exchequer revenues including PRSI contributions of €12.6 billion, Local Property Tax revenue of €551 million and Commercial Rates income collected of €1,089 million.

Table 4: Breakdown of total tax receipts (€82 billion), 2021

TAXES ON EARNED INCOME	€M	TAXES ON CONSUMPTION	€M	TAXES ON WEALTH	€M
Income Tax* *PAYE: 18,737* *Self-assessed: 1,858*	20,595	VAT	15,390	Capital Gains Tax	1,645
Corporation Tax†	15,323	Excise	5,823	Stamp Duty *Other:** 395* *Shares: 372* *Property: 728*	1,495
Employer PRSI<	8,704	Commercial Rates ††	1,089	Capital Acquisitions Tax	582
USC* *PAYE: 3,742* *Self-assessed: 625*	4,367	Customs	520	Dividend Withholding Tax	582
Employee PRSI	3,171	Plastic Bag Levy	4	Local Property Tax	551
Professional Services Withholding Tax	902			Life Assurance Exit Tax	129
Self-Employed PRSI*	720			Investment Undertaking Tax	91
				Deposit Interest Retention Tax	20
				Other Income Taxes	64
Total	**53,791**		**22,826**		**5,159**

Source: Revenue Commissioners, Department of Finance and Department of Social Protection

Notes: For ease of presentation PRSI is referred to as a tax.

* *Data is not separately available for Income Tax, USC and PRSI on trading/self-employed income, non-trading/investment income and certain company directors. Investment Undertaking Tax, however, is readily separable and*

is classified under taxes on wealth.

† *Data is not available for tax collected under each of the 12.5 per cent (trading income), 25 per cent (passive income) and 33 per cent (capital gains) rates of Corporation Tax, however Revenue have stated that the bulk of Corporation Tax paid is attributed to trading income in all years. Therefore, Corporation Tax receipts from 2020 have been included in the taxes on earned income category above.*

< *Employer PRSI includes the National Training Fund of €798 million in 2021. Estimates for PRSI are provisional and may be subject to revision.*

** *Other Stamp Duty includes the non-life levy and life assurance levy, levy on certain financial institutions and duties from insurance policies, cheques, credit cards, etc.*

†† *Commercial Rates income was taken from Appendix 7 of Local Authority annual financial statements and represents rates collected. It does not include COVID-19 waivers and credits.*

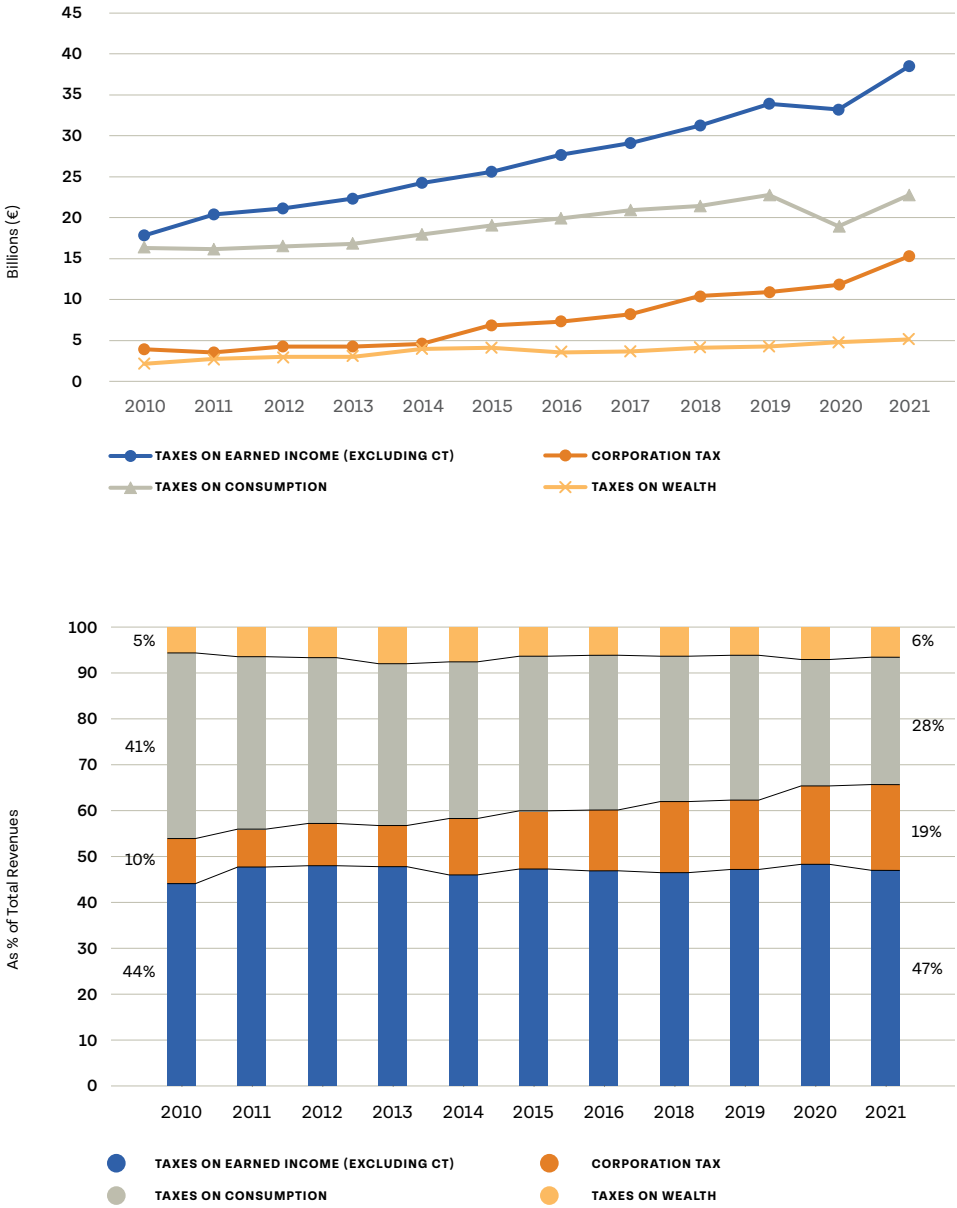
Due to limits in the way data is collected, it is not possible to separately present the Corporation Tax receipts from each of trading income, passive income and chargeable gains. The Revenue Commissioners (Revenue) have stated that the majority of Corporation Tax paid was attributed to trading income in all years and, as such, has been included in earned income for presentational purposes.[60] Data is also not available on the breakdown of Income Tax, USC and PRSI receipts from self-employed income compared with investment/non-trading income.

5.3.2 Trends in Irish tax receipts

Figure 8 demonstrates the trend of Irish tax receipts over the last decade. It is clear that the size and composition of tax revenues have significantly changed over that period, with a notable increase and reliance on taxes collected from earned income (Income Tax from employments and Corporation Tax in particular).

60 Revenue Commissioners (2020) Corporation Tax – 2020 Payments and 2019 Returns

Figure 8: Irish tax receipts from earned income, consumption and wealth, 2010-2021



Source: Revenue Commissioners, the Department of Finance, Department of Social Protection and Department of Housing, Local Government and Heritage

As regards personal taxation, following the financial crisis in the late 2000s, a number of reforms were introduced that were designed to broaden the personal tax base in order to move away from highly cyclical or transitory sources of revenue. Much of this reform was conducted through the personal taxation system by way of reform of reliefs, reductions in tax credits and bands and through the introduction of USC. Since 2015, however, Government policy has been to reduce Income Tax, primarily through reductions targeted at low- to middle-income earners. Personal tax receipts collected under the Pay as You Earn (PAYE) system now consistently represent the single largest source of tax to the State, which is reflective of the high volume of employments registered in the country, having grown by 14 per cent from 2015 to 2021 (from 2.5 million PAYE taxpayers in 2015 to 2.9 million in 2021).[61]

Corporation Tax receipts have increased significantly in recent years and represented 19 per cent of total revenues in 2021. This constituted the ninth consecutive year of annual growth from a low point of €3.5 billion in 2011. The growth is attributed to a number of reasons, including improved trading conditions (in particular improved profitability among the Information, Communications and Technology (ICT) and Pharmaceutical sectors), the exhaustion of historical losses from the recession, positive currency fluctuations and increases in the numbers of companies of all sizes paying tax and across most economic sectors.[62]

As regards consumption taxes, VAT is the second-largest contributor to tax receipts and the primary tax on consumption, followed by Excise Duties. VAT receipts increased by an average of 7 per cent per year from 2013 to 2019, largely driven by increased consumption.

Excise duties contributed €5.8 billion to the Exchequer in 2020, representing approximately 7 per cent of revenues. Excise Duties on alcohol and tobacco products accounted for a large proportion (€1.2 billion from both alcohol and tobacco) of such revenue in 2020. Excise Duty on heavy oils, which include auto diesel, marked gas oil, kerosene and fuel oil, provided the largest yield at almost €1.4 billion in 2020. The Excise Duty yield also includes a number of taxes and duties on motor vehicles, diesel, and petrol, some based on carbon dioxide emissions.

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61 Revenue Commissioners (2022) Annual Report 2021; Revenue Commissioners (2017) Annual Report 2016.

62 Coffey S. (2017) Review of Ireland's Corporation Tax Code.

In the absence of change in taxation in this area, however, the intended and likely increase in the purchase of electric vehicles over the long term will reduce revenues from motor and fuel taxation, and narrow the current tax base; these risks are considered further in Chapter 13 (Moving to a Low-carbon Economy).

Commercial Rates, a further form of consumption tax, are a levy collected by local authorities based on the rental valuation of business premises. In the decade prior to 2020, Commercial Rates averaged €1.3 billion in revenues for local authorities, steadily increasing from €1.3 billion in 2010 to €1.4 billion in 2019. In 2021, Commercial Rates revenues collected amounted to €1.1 billion; this was lower than typical annual collections due to the waivers applied to various sectors as a result of the COVID-19 pandemic.

In total, consumption taxes generally have fallen as a percentage of total revenue since 2010, from 41 per cent of total revenue in 2010 to 28 per cent by 2021.

Taxes on wealth have consistently represented between 5 to 7 per cent of total tax revenues over the past decade. While receipts from CGT have more than doubled since 2011, representing the largest source of tax on wealth in 2021, receipts remain well below their pre-recession peak (€1.6 billion collected in 2021, compared with €3.1 billion in 2007). Stamp Duty receipts from shares and property make up the majority of Stamp Duty receipts (total €1 billion in 2021). As a transactional tax, Stamp Duty receipts can fluctuate considerably from year to year; an exceptional €580 million increase was recorded in 2020 (from a total €1.5 billion in 2019). High Stamp Duty and CGT receipts were an important driver of tax revenues in the 2000s. However, ultimately reliance on revenues from these mainly transactional taxes proved to be unsustainable.[63]

CAT receipts, a further element of taxes on wealth, are largely drawn from inheritance tax (€481 million out of €582 million CAT receipts in 2021), followed by gift tax (€95 million), with the balance coming from discretionary trust tax and probate tax.[64] LPT receipts (€551 million in 2021) are stable year to year, with some small variations arising as an effect of local authority decisions. Recent reforms to LPT are expected to generate a modest increase in LPT receipts in 2022

63 Department of Finance (2021) Annual Taxation Report 2021.

64 Revenue Commissioners (2022) Breakdown of CAT receipts.

(to €560 million).[65] Revenue analysis generally indicates an overall trend that the share of taxpayers engaging in capital tax transactions increases as incomes increase.[66]

As regards wealth taxes on savings, receipts from DIRT on deposit interest income have collapsed in recent years, reflecting the low interest rates available on deposits with financial institutions. However, a relatively high level of tax is collected from life assurance policies (€129 million Life Assurance Exit Tax (LAET), as compared with the €20 million collected from DIRT in 2021).

Overall, total tax receipts[67] hit a record high of €82 billion in 2021, well in excess of pre-pandemic receipts, a figure that peaked at €72 billion in 2019. The Commission takes note that 91 per cent of these receipts are now drawn from just four key areas: personal taxes (Income Tax, USC and PRSI) (46 per cent); Corporation Tax (19 per cent); VAT (19 per cent); and Excise Duty (7 per cent). It further notes that such concentration of tax receipts raises significant fiscal sustainability risks in the longer term, which are considered in further detail in section 5.5.

5.4 INTERNATIONAL CONTEXT

Figure 9 gives a breakdown of the 2020 balance of taxation across EU countries categorised by the tax bases: capital (excluding corporate income), corporate income, labour and consumption.[68] Ireland collects a lower share of total taxes from capital and labour (which includes both Income Tax and social security contributions) than the EU-27 average, with capital taxation diverging steadily from the EU average since 2015. Labour taxation as a percentage of total taxation has remained consistently lower than the EU average (around nine percentage points lower). By contrast, Ireland derives a higher-than-average share from taxation of consumption and corporate income, with only Cyprus collecting a higher share of tax from corporate income.

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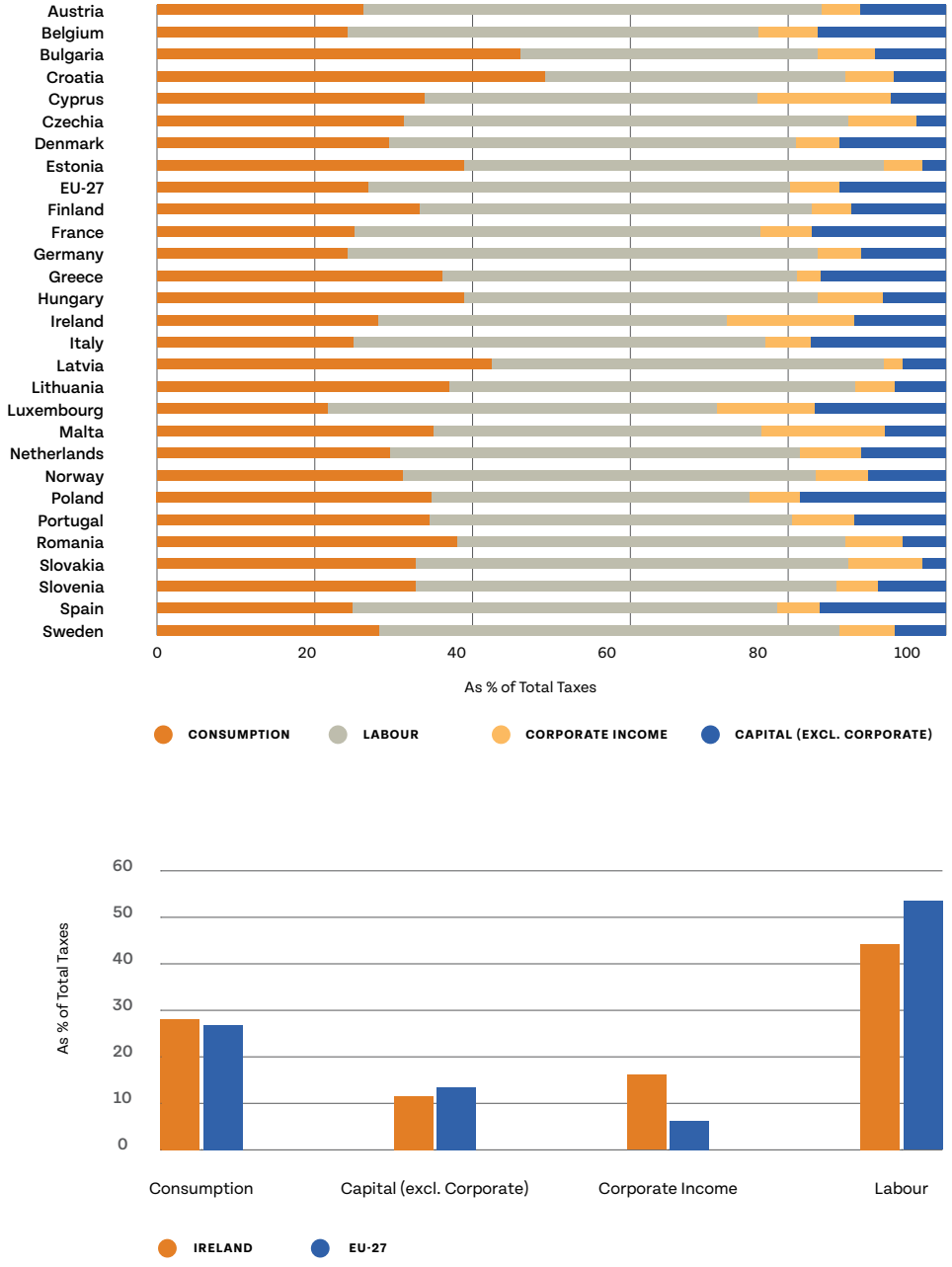
65 Department of Finance (2021) Minister Donohoe announces changes to Local Property Tax.

66 Revenue Commissioners (2018) Profile and distribution of capital taxes.

67 As defined by the Commission on Taxation and Welfare (see section 5.2).

68 The European Commission's breakdown by earned income, consumption and wealth is not published across countries.

Figure 9: Balance of tax in a European context, 2020



Source: European Commission (2022) Taxation and Customs Union, Data on Taxation.

Such analysis gives a comparative perspective of the sources of revenues across labour, consumption and capital. However, it is useful to get a sense of the average effective tax rates paid by each cohort, as the comparisons above do not account for the fact that certain tax bases may be relatively large in certain countries - for example, Ireland's corporate tax base (corporate profits) is relatively large and, as such, it accounts for a large share of total revenue.

A top-down, economy-wide average effective tax rate, known as an 'implicit tax rate', gives some insight into the average burden of taxation across different tax bases; it is equivalent to the tax yield from a given cohort divided by the total base of that cohort. For example, the implicit tax rate for consumption is equal to total receipts from consumption of goods and services divided by total private and public consumption in the economy.

Table 5: Implicit tax rates in European countries, 2020

	CONSUMPTION	LABOUR	CAPITAL
Min	14.1% – Spain	28.1% – Croatia	6.2% – Luxembourg
Ireland	**18.2%**	**32.0%**	**14.4%**
European Median	19% – Poland	36.6% – Norway	26.5% – Slovenia
Max	24.7% – Denmark	44.7% – Italy	60.0% – France

Source: European Commission (2022) Taxation and Customs Union, Data on Taxation
Note: For information on how ITRs are calculated see Annex B to the European Commission 'Taxation trends' report

As shown in Table 5, in 2020, the implicit tax rates in Ireland on labour and capital were below that of the median country in the EU-27. The implicit tax rate on consumption was close to the EU-27 median. The implicit tax rate is particularly low for capital - it is nearly half that of Slovenia's (the EU-27 median). However, it should be noted that the implicit tax rate for capital in this analysis also includes corporate income taxes and thus reflects Ireland's low Corporation Tax rate (see section 9.3). The ESRI also produces estimates of effective tax rates for Ireland. This data is consistent with the European Commission analysis and shows that effective rates on capital taxes are significantly below EU averages even after separating out taxes on corporate income.[69] Implicit rates are useful for high-level comparisons of average effective tax rates.

69 Kostarakos, Ilias and Varthalitis, Petros, ESRI (2020), Effective Tax rates in Ireland.

They do not, however, accurately reflect the variance in effective tax rates faced by individuals. For example, many workers pay a higher effective rate than 32 per cent in Ireland, while others face an effective tax rate of zero.

5.5 STRATEGIC APPROACH TO TAX REFORM

The Commission's strategic approach to tax policy on the issue of the balance of taxation builds on the principles adopted by the Commission, and given fiscal sustainability risks, assumes that the overall level of revenues raised from tax and PRSI must increase materially over the medium term. This approach means that the Commission has sought to identify specific areas where revenues can be increased, but has also recommended structural reforms, such that additional revenues can be raised in conformity with the Commission's principles as outlined in Chapter 3 (Objectives and Principles), and at the lowest economic, social and environmental cost. At the core of the Commission's approach is its guiding objective of broadening the tax base, within and across taxheads while also being conscious of the principle of equity. Alongside this, our aim is to promote fiscal sustainability in the medium term, and to lessen the need for increases in rates of tax so as to minimise distortions. By broadening the tax base consistent with the principle of horizontal equity (i.e. treating all forms of income equally in as far as possible), a fairer and economically more efficient taxation system can be achieved.

Recommendation

5.1 The Commission recommends that Government continue to focus on broadening the base of taxation across all categories of taxation.

5.5.1 Taxes on earned income

Personal taxes (including Income Tax, USC and PRSI) represented approximately 47 per cent of total revenues in 2021. Individuals generally

begin paying Income Tax on gross taxable incomes above €17,000 (single workers) and progress to the higher 40 per cent rate relatively swiftly at €36,800 of income. USC was introduced in 2011 to widen the personal tax base and now accounts for approximately €4 billion of revenues. USC applies on a broader base and has multiple progressive rates with few reliefs and no credits, and now represents a fundamental part of the personal taxation system. These features result in a highly progressive personal taxation system whereby the more an individual earns, a higher proportion of tax is paid. In 2021, employee, self-employed and employer PRSI contributed a combined €12.6 billion to total revenues and, while the Social Insurance Fund was in deficit throughout most of the pandemic, it has returned to surplus in Q1 2022.[70]

In considering the overall burden of personal taxes, the Commission has also reflected on the competitiveness of the taxation system. The OECD Taxing Wages Report is the international standard for comparing the competitiveness of Income Tax systems consistently in a multi-country comparison.[71] While it is the case that Ireland currently has a competitive tax wedge[72] at average incomes across the main household types, this competitive level is particularly attributable to comparatively low levels of social security contributions. When only Income Tax is taken into account, Ireland ranks less competitively for average single workers, with the sixth-highest wedge of 18.8 per cent. It is for this reason, and in support of further enhancing the element of reciprocity within the social protection system as set out in Chapter 11 (Promoting Employment) and Chapter 12 (Inclusive and Integrated Social Protection), that the Commission is of the view that reform of the PRSI system is the appropriate way to broaden the personal tax base.

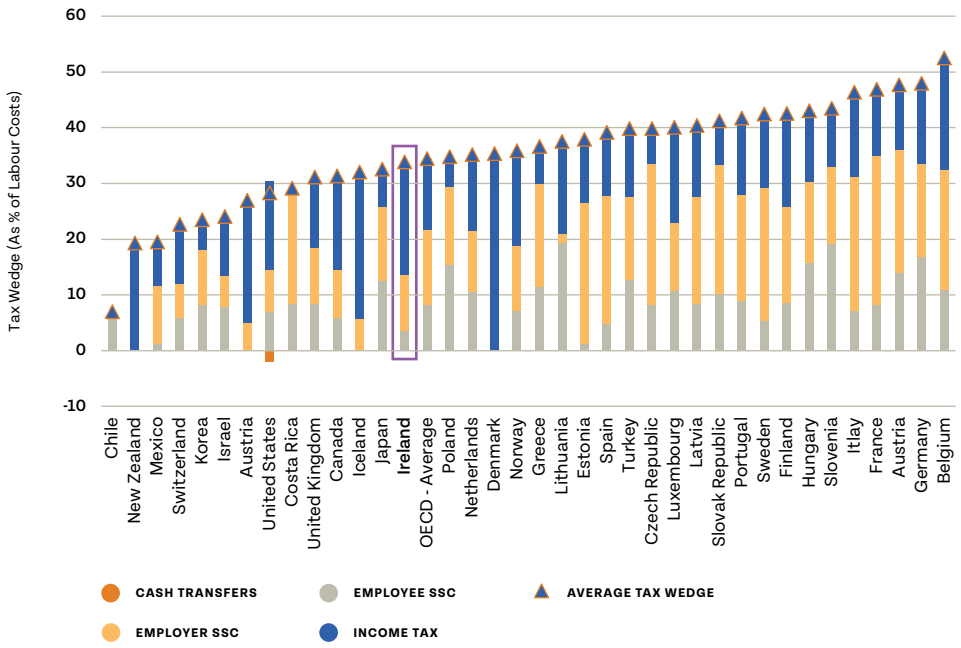
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70 The Social Insurance Fund is made up of a current account and an investment account managed by the Minister for Social Protection and the Minister for Finance, respectively. The current account consists of monies collected from people in employment. This money is then used to fund social insurance payments. The investment account is a savings account that is managed by the Minister for Finance. Data on the SIF is available from Department of Social Protection (2022) Quarterly Statistical Report.

71 OECD Taxing Wages Report.

72 The tax wedge is the difference between what an employer pays in gross wages plus taxes to hire an employee and the net income received by that employee after deduction of all taxes on wages.

Figure 10: Average tax wedge of single worker on average wage with no children in OECD, 2021



Source: OECD - Taxing Wages – Ireland, 2022

While the progressivity of the Income Tax system is positive from an equity perspective, it results in a narrow Income Tax base. In 2018 (the latest year for which data is available)[73] nearly 35 per cent of income earners paid no Income Tax due to the application of credits or other relief. This represented approximately 887,000 out of 2.5 million taxpayer units.[74] At the top end, approximately 25 per cent of earners paid over 80 per cent of all Income Tax. Similarly, 29 per cent of income earners were exempt from USC in 2018, with just over a million taxpayer units paying a 4.75 per cent top rate of USC and approximately 10 per cent of taxpayer units paying a top rate of 8 per cent or 11 per cent.[75]

73 Revenue Commissioners (2020) Income earners by Income Tax rate.

74 The figures are based on taxpayer units. A married couple or civil partners that are jointly assessed are counted as one taxpayer unit and their incomes are aggregated in the statistics.

75 Revenue Commissioners (2020) Income earners by USC rates.

It is clear, therefore, that the burden of personal Income Tax mostly falls on higher-paid taxpayer units. While the progressivity of the Income Tax system is positive from an equity perspective, the reliance on a small proportion of higher income earners is a source of vulnerability from the perspective of fiscal sustainability. Concerns are also growing that digitalisation may allow this group to become increasingly mobile, which could erode the personal tax base in the longer term.[76]

The Commission notes these vulnerabilities and recognises that a sustainable taxation system should be one that spreads the burden of taxation across as wide a tax base as possible. However, there is a balance to be struck when considering at which point individuals should begin to contribute to Income Tax revenues and where marginal tax rates should begin. The existing progressive approach to personal taxation in Ireland offsets high levels of market income inequality - as noted in Chapter 11 (Promoting Employment), and reflects the responsiveness of different cohorts to tax rates. Both high and low earners are particularly responsive to changes to marginal tax rates,[77] which is reflected in the design of the Income Tax system (through the use of tax credits etc.), but such responsiveness also acts as a constraint on how much the Income Tax base can be broadened and on how much can be raised at the marginal rate. There are limits to how much further progressivity may be possible and the retention of a policy approach that keeps such a high proportion of the workforce outside of the Income Tax base may not be sustainable in the long term.

Accordingly, our recommendations in this report, have identified a number of areas where the taxation system affords different treatment dependent on the age or other characteristics of the individual rather than the level of income earned. These measures deviate from the principle of horizontal equity, under which each individual with the same income should have the same tax liability, and they offer potential avenues for base broadening.

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76 De la Feria, R. and Maffini, G. (2021) The Impact of Digitalisation on Personal Income Taxes, British Tax Review 2, 154-168.

77 Department of Finance, Elasticity of Taxable Income, 2018.

Recommendation

5.2 The Commission recommends that Government should focus on maintaining the progressivity of the existing personal taxes system without further erosion of the Income Tax or Universal Social Charge base. Future base-broadening reforms should focus on Pay Related Social Insurance and on addressing horizontal equity concerns.

5.5.2 Corporation Tax

Corporation Tax receipts have increased rapidly over the last 10 years reaching €15.3 billion in 2021 and now represent approximately 20 per cent of all tax receipts. This figure is €11.4 billion higher than 2010 receipts (an increase of 288 per cent); a point at which Corporation Tax receipts accounted for approximately 10 per cent of total tax receipts. Corporation Tax receipts are also highly concentrated, with Corporation Tax returns for 2020 showing that foreign-owned multinationals accounted for 82 per cent of the total Corporation Tax liability and 53 per cent of employment taxes, while employing around 33 per cent of corporate employees. The ten largest Corporation Tax payers in 2020 accounted for €8.2 billion (53 per cent) of net Corporation Tax receipts in 2021.

While such outperformance in Corporation Tax receipts has bolstered Government revenues, the volatility in these receipts, coupled with the high degree of concentration among a small number of multinationals who contribute such a large portion of those receipts, present a clear risk to the sustainability of the public finances generally.

Significant change has occurred in the international tax environment over the past ten years and the outcome of ongoing reforms remains uncertain. Notwithstanding the current strength in Corporation Tax receipts, the risk of future volatility remains as Ireland's corporate tax strategy is increasingly being driven by international factors and is no longer moving in line with underlying economic activity in Ireland. While it is difficult to estimate the impact of currently proposed future changes on Corporation Tax revenues into the future, the Department of Finance's working estimate is that the proposed Base Erosion and Profit Shifting (BEPS) related changes could result in a reduction of up

to €2 billion annually.[78] However, this is a highly tentative estimate and there remains significant uncertainty around the timing and ultimate destination of the BEPS-related proposals at the time of writing.

The Commission notes the assessment of the Irish Fiscal Advisory Council (IFAC) that Government should take measures to reduce its reliance on Corporation Tax and that excess receipts should be identified and used to reduce debt or directed towards the Rainy-Day Fund rather than used to fund ongoing expenditure. The Commission shares IFAC's concerns around the sustainability of Corporation Tax receipts, and supports such an approach in order to limit potential over-reliance on such receipts, and enhance our ability to respond to future economic shocks through that approach.

Recommendation

5.3 The Commission recommends that long term over-dependence on Corporation Tax receipts poses significant sustainability risks and should be avoided. The Commission supports proposals to target the use of excess receipts in this area towards the Rainy-Day Fund or to reduce debt rather than fund tax reductions or permanent increases in expenditure.

5.5.3 Consumption taxes

Consumption taxes affect individual behaviours and change economic outcomes. While shifts towards consumption taxes are generally preferable to taxes on earned income from an economic growth perspective, such changes need to be closely examined to maintain equity.

In general terms, increases in VAT and other consumption taxes can be regressive due to the relatively higher proportion of disposable income that low-income households tend to spend relative to their income. While Ireland has the joint fourth-highest standard rate of VAT in the EU, at 23 per cent, Ireland is the only EU country that applies a zero rate of VAT on a very extensive range of activities, including most food, water, books and children's clothes. Furthermore, Ireland also continues to apply reduced rates to an extensive range of economic activity relative to other EU Member States. As a result Ireland has

78 Department of Finance (2021) Tax Strategy Group: Corporation Tax 21/05.

a relatively low VAT-to-revenue ratio i.e. the ratio between actual VAT collected and the revenue that would otherwise be raised if VAT were applied at the standard rate, when compared to other OECD countries.[79] The Commission is concerned that these zero and reduced rates significantly erode the VAT base. In order to avoid increasing what is already a high standard VAT rate it is important to broaden the VAT tax base and the Commission makes a number of recommendations in Chapter 6 (Tax Equity and Base Broadening) designed to address these concerns in a manner that limits the regressive nature of such changes.

Similarly, the Commission supports the taxation of carbon at a high level to discourage its consumption. This is not simply a matter of increasing the Carbon Tax. A number of pre-existing provisions in the tax code effectively act as fossil fuel subsidies, and these need to be addressed in conjunction with the Carbon Tax, such that the overall tax treatment, and the final pricing of any product, reflects the amount of carbon emissions that it produces. The Commission recognises the regressive nature of such charges and supports the use of associated revenues to help with the 'just transition' as well as the use of temporary measures to mitigate the impact of the increased Carbon Tax on those who are most vulnerable and least able to change their behaviour. The Commission also recognises the expected loss of significant revenue streams through decarbonisation, including from Excise Duties and emission based revenues such as Motor Tax and VRT. It will be necessary to find alternative sources of tax revenue in the medium term and the Commission has set out a number of recommendations in this regard in Chapter 13 (Moving to a Low-carbon Economy).

Recommendation

5.4 The Commission recommends incrementally broadening the base of consumption taxes placing emphasis on limiting the use of zero and reduced rates of Value Added Tax. A number of environmental-related taxes and reforms to existing taxes should be introduced to replace revenue streams and support the transition to a low-carbon economy.

79 Parliamentary Budget Office (2019) Value Added Tax: Overview and Issues.

5.5.4 Wealth

As outlined in section 5.2.1, the Commission has defined taxes on wealth to include taxes on income derived from ownership of a capital asset (e.g. property, shares, deposit accounts, etc.), together with taxes on the gains from disposal, acquisition, holding or occupation of such assets.

Taxes on wealth and capital currently comprise a low proportion of Irish tax receipts, being 5 to 7 per cent of total tax revenues over the past decade. As outlined in detail in Chapter 7 (Taxes on Capital and Wealth), wealth is typically highly concentrated in upper wealth and income deciles and income flows from wealth can generally increase levels of income inequality. Thus, the taxation of wealth tends to increase the overall progressivity of the system. Consequently, the Commission has identified a number of areas where it may be possible to increase taxes on capital as a proportion of total revenues in a manner that can both address the long-term sustainability of tax revenues and enhance equity across the broader taxation system.

As indicated in Chapter 14 (Land and Property), annual taxes on immovable property such as buildings and land can be seen as being among the least damaging from an economic perspective and the Commission supports the continued focus on growing this area of the capital tax base. Notwithstanding the introduction of LPT in 2013, overall revenues from recurrent taxes on immovable property remain low as a share of total revenues, with the majority of the tax raised falling directly on businesses in the form of Commercial Rates. As set out in detail in Chapter 14 (Land and Property), the Commission recommends an approach to the taxation of land that acts to stabilise prices, encourages the efficient use of land and property and collects a stable and relatively non-cyclical revenue stream to fund future public services. Therefore, the Commission has recommended that Government significantly increase its revenue from such sources over the medium term through increases in the LPT and the introduction of a broad-based land tax.

Wealth in Ireland is less equally distributed than income but is correlated with income (people in the top 40 per cent of the income distribution hold nearly two-thirds of all net wealth). Age, household composition and tenure status are also strong determinants of share of

net wealth in Ireland.[80] The increasing concentration of wealth towards older cohorts and among those with housing and pension assets presents long-term intergenerational equity issues. The Commission recognises that the principle of equity requires that taxpayers should contribute in proportion to their ability to pay and that individuals derive benefits from capital assets, which the flows of income from such assets do not fully reflect; these include security of tenure, increased capacity for leisure, collateral for accessing finance, etc. The Commission, therefore, sees an opportunity to reform the capital tax base to increase the overall contribution from these sources.

The Commission has examined the feasibility of a recurrent wealth tax and does not support its introduction without first attempting to substantially amend Ireland's existing taxes on capital and wealth - see Chapter 7 (Taxes on Capital and Wealth).

Consequently, the Commission has focused its recommendations on reforms to the existing aspects of the taxation system that have an influence on wealth, namely, taxes on asset transactions such as CAT and CGT. The Commission has identified a number of areas where additional revenues may be found in a manner that should have a limited effect on economic growth and should also enhance vertical equity, addressing the increasing concentration of wealth in society and its transmission across generations. These changes are discussed in detail in Chapter 7 (Taxes on Capital and Wealth) of the report.

Recommendation

5.5 The Commission recommends that overall yield from wealth and capital taxes, including property, land, capital acquisitions and capital gains taxes should increase materially as a proportion of overall tax revenues.

80 For more information see CSO (2022) Household Finance and Consumption Survey 2020.

5.6 RECOMMENDATIONS

Chapter 5: Balance of Taxation

5.1 The Commission recommends that Government continue to focus on broadening the base of taxation across all categories of taxation.

5.2 The Commission recommends that Government should focus on maintaining the progressivity of the existing personal taxes system without further erosion of the Income Tax or Universal Social Charge base. Future base-broadening reforms should focus on Pay Related Social Insurance and on addressing horizontal equity concerns.

5.3 The Commission recommends that long-term over-dependence on Corporation Tax receipts poses significant sustainability risks and should be avoided. The Commission supports proposals to target the use of excess receipts in this area towards the Rainy-Day Fund or to reduce debt rather than fund tax reductions or permanent increases in expenditure.

5.4 The Commission recommends incrementally broadening the base of consumption taxes placing emphasis on limiting the use of zero and reduced rates of Value Added Tax. A number of environmental-related taxes and reforms to existing taxes should be introduced to replace revenue streams and support the transition to a low-carbon economy.

5.5 The Commission recommends that overall yield from wealth and capital taxes, including property, land, capital acquisitions and capital gains taxes should increase materially as a proportion of overall tax revenues.

Chapter 6:
Tax Equity and Base Broadening

6.1 INTRODUCTION

As outlined in Chapter 3 (Objectives and Principles) the concepts of equity and progressivity have long been central tenets of tax design, and one of the core principles which guided the work of this Commission is that of equity – both horizontal and vertical. Horizontal equity concerns the idea that those with similar income should pay the same proportion of that income in taxes, and vertical equity dictates that the tax burden should be distributed fairly across those with different abilities to pay. The Commission is also mindful of the concept of intergenerational equity – economic growth should be widely shared, so that each succeeding generation can expect its living standards and the opportunities it enjoys to be at least as good as, if not better than, those enjoyed by the generation that went before. Exceptions to such equitable treatment should have a clear and evidence-based rationale.

In considering equity, the Commission has also been cognisant of the concept of incidence – who ultimately bears the burden of a tax or charge. In many cases, the individual or business who bears some, or all, of the burden is not the same as who directly pays the tax or charge to the State (often referred to as statutory incidence). As such the effects of the tax or charge can be felt across a broader or different range of stakeholders than anticipated. This concept is particularly acute in the area of consumption taxes, and is therefore a key consideration when formulating policy so that the full effects of that policy can be determined.

While the principle of equity has guided the Commission in reaching its recommendations throughout this report, we believe there are a number of issues of equity across a range of taxes and charges that warrant specific consideration, some of which we address in this chapter. Others, relating to taxes on capital and wealth, pensions, and Pay Related Social Insurance (PRSI) are addressed in Chapter 7 (Taxes on Capital and Wealth), Chapter 8 (Taxes on Retirement Savings) and Chapter 10 (Labour Markets and Social Protection Systems), respectively.

The Commission believes that if these issues are addressed, not only will there be more fairness across the taxation system, but also that opportunities to generate additional revenue in a manner that conforms to the Commission's principles will be created.

6.2 EQUITY IN PERSONAL TAXES

As noted in Chapter 5 (Balance of Taxation), the Income Tax and Universal Social Charge (USC) systems are highly progressive and, as a result of reforms introduced following the financial crisis in the late 2000s, Income Tax and USC apply to a relatively broad base. However, the Commission believes that a number of additional changes could be made that, would not only broaden the bases further, but also create more equity in the taxation system.

6.2.1 Personal circumstances

While differing Income Tax and USC treatment of individuals may well be justifiable for a particular policy objective, better design in any taxation system involves avoiding unnecessary and arbitrary thresholds or limits. One of the clear examples of such an arbitrary approach is the different treatment of income based on age. Such different treatment means that individuals who earn the same income from the same sources and are otherwise identical are subject to different Income Tax charges. For instance, those aged 65 years or over with total income of less than or equal to certain exemption limits (currently €18,000 for a single person and €36,000 for jointly assessed couples) do not have to pay Income Tax on that income. If the household has dependent children, these exemption limits are also increased for each child. Additionally, those age 65 and over are entitled to a specific age tax credit, and may be exempt from Deposit Interest Retention Tax (DIRT).[81]

A similarly inequitable discontinuity applies in the case of the USC. People aged 70 or over, with aggregate annual income of €60,000 or less, are subject to a reduced top rate of USC, which allows all income in excess of €12,012 to be taxed at 2 per cent, rather than the full USC rate structure applying.

Furthermore, those in receipt of a full medical card, with aggregate income of €60,000 or less, currently pay a maximum USC rate of 2 per cent regardless of their income or other circumstances.

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81 Note, in the case of jointly assessed couples, even if only one spouse/civil partner is over 65, the age exemptions and credits are available to both.

The determination of an individual's tax treatment based on age narrows the base and breaches the concept of horizontal equity, whereby those with similar income should pay the same proportion of that income in taxes. It also breaches the concept of intergenerational equity. These base-broadening and equity considerations, together with the demographic shifts that have taken place and those on the horizon, have influenced the Commission in reaching the view that age is no longer an appropriate factor in determining an individual's personal tax liability.

Similar to age, and drawing on the simple proposition that the system of taxes and charges is most efficient if we treat similar activities in similar ways, the Commission believes that medical card status or other similar eligibility criteria should not be used as a determinant of the applicable rate of tax.

Related to this point, and as addressed more fully in Chapter 10 (Labour Markets and Social Protection Systems), on the basis of horizontal equity, the Commission is of the view that the legal form through which people engage in economic activity should not of itself determine the level of USC paid by individuals on similar income, be that income derived from that economic activity or not.

The Commission is conscious that a move towards equity with regard to the factors noted previously might have a significant impact on particular households, especially when taken with the Income Tax individualisation recommendation in Chapter 11 (Promoting Employment). However, the role of the Commission is to identify appropriate design reforms in the taxation system rather than cataloguing the ways in which changes will affect the status quo. As with all the recommendations of the Commission, the details of implementation are an important policy matter and should be subject to careful impact assessment in advance of implementation.

Recommendation

6.1 The Commission recommends that age should be removed as a factor for determining the charge to Income Tax and Universal Social Charge. The necessary changes to each charge should be introduced over time to minimise negative impacts.

6.2 The Commission recommends that rates of Universal Social Charge should be determined by income level and not by reference to any other eligibility criteria.

6.2.2 Remittance basis

Another feature which is used to determine the charge to tax in Ireland is that of domicile. Individuals resident in Ireland for tax purposes are typically subject to Irish tax on their worldwide income and chargeable gains. However, individuals who are resident, but not domiciled in the State, are subject to a different tax treatment known as the remittance basis. Where the remittance basis applies, foreign income[82] and foreign gains are subject to Irish tax (being Income Tax, USC and Capital Gains Tax (CGT)) only to the extent they are remitted to the State.

What is Domicile?

Domicile is a complex common law concept rather than a tax-specific term, which loosely relates to a person's concept of their home or where their 'roots' are. Domicile is distinct from legal nationality and from tax residence.

Domicile is relevant for establishing the law governing an individual's status (in cases such as divorce), their property (such as for estate purposes) and, in certain cases, their tax affairs in common-law jurisdictions.

No individual can be without a domicile and it is not possible to have more than one domicile at the same time.

There is no requirement for an individual to have ever been in the country understood to be their domicile for any set period, or even at all. In the case of Re O'Keefe, Poingdestre v. Sherman, a woman born in India with British citizenship was held to have an Irish domicile as her father was born in Ireland, despite having only spent three weeks of her life in Ireland.

82 Being income from foreign securities and possessions that is chargeable to tax under Schedule D, Case III. Individuals who are not resident or domiciled in Ireland, but who are ordinarily resident, are also subject to the remittance basis on certain sources of income.

The Commission recognises that non-domiciled individuals resident in Ireland can generally be divided into two categories:

- Individuals who come to reside in Ireland on a temporary or more short-term basis, often to take up an employment in the State for a fixed period.
- Long-term residents who claim a non-domicile status.

In the case of the latter, such individuals may have either been born in Ireland and live here permanently, having acquired their non-domicile status from a parent, or they may have been born elsewhere and have simply chosen to reside here on a long-term basis. Such residents have a significant connection and link to the State, but can avail of a different tax regime from other Irish tax residents who are Irish-domiciled.

The 2009 Commission on Taxation examined the issue of the remittance basis and referred to the measure as "an anachronism that is not compatible, on equity grounds, with a modern tax system," a position with which this Commission finds itself broadly in agreement.

The remittance basis facilitates and encourages the holding of certain income and assets by non-domiciled individuals outside of Ireland, potentially discouraging inward investment. Furthermore, the concept of remittances may be outdated as the point of remittance is becoming increasingly uncertain with new forms of wealth such as cryptocurrency.

However, the remittance basis may play a role in attracting internationally mobile and/or highly skilled individuals to live, invest and work in Ireland. Such individuals may not otherwise choose or agree to be located here in the absence of this measure, a consideration which, as outlined in Chapter 9 (Promoting Enterprise), the Commission accepts is important in the context of increasing global mobility and the need to promote enterprise.

Accordingly, while calling for extensive restriction of the remittance basis, the Commission believes that the measure should be retained for individuals living or working in Ireland on a short term or more transient basis and who have no real ties to the State. This could be achieved by aligning the maximum period for claiming the remittance basis to three years of residence, similar to the time period that establishes ordinary

residence status.[83] Linking the remittance basis in this way would mean an individual would cease to claim the remittance basis as they begin to develop ties to the State. For anti-avoidance purposes this three-year limit should be applied on a non-consecutive basis.

Recommendation

6.3 The Commission recommends that the remittance basis of taxation should be subject to a lifetime limit of three years.

6.2.3 High income earner restriction

In addition to considering the broad design of the Income Tax system, the Commission noted specific measures currently in place to ensure equitable contributions are made by all taxpayers. In particular, it considered the High Income Earner Restriction (HIER). The measure is in place to ensure that high income earners who avail of certain tax reliefs and exemptions to substantially reduce their liabilities, pay an effective rate of Income Tax of approximately 30 per cent (in scenarios where the full restriction applies).[84]

While the Commission notes that the objective of ensuring this effective rate is being achieved, it also notes that the list of reliefs that are excluded from the HIER calculation has increased in recent years in order to maximise the use of the reliefs themselves, and that some new reliefs that were introduced are not taken into account for the HIER.

The Commission recognises that there may be sound policy objectives for limiting the application of the HIER in some circumstances, such as promoting enterprise. However, the Commission believes that the effectiveness of the restriction should not be eroded over time to such an extent that it is no longer effective in ensuring that equitable contributions are made by all taxpayers.

83 An individual becomes ordinarily resident in Ireland for a tax year once they have been resident in the State for three consecutive tax years. An individual ceases to be ordinarily resident once they have been non-resident in the State for three consecutive tax years.

84 PRSI and USC may also apply.

Recommendation

6.4 The Commission recommends that the High Income Earner Restriction should be retained. To ensure that its original policy objective is not eroded, tax reliefs should only be excluded from its remit in exceptional cases.

6.3 SAVINGS AND INVESTMENTS

As noted in Chapter 5 (Balance of Taxation) the Commission supports increasing the share of taxation derived from land, capital and wealth. Savings and investments represent a large share of financial wealth in Ireland.[85]

The Commission has examined the taxation of the different forms of saving and investment income and has concluded that there should be greater parity of tax treatment on horizontal equity grounds. As a general principle, the Commission believes that a taxpayer's level of income should determine the marginal rate of tax payable, rather than the type of savings or investment product used.

The Commission was also taken by commentary and feedback to the Commission with regard to concerns over the role of institutional investment in Irish property through use of various collective investment structures (see section 6.3.3).

6.3.1 Deposit interest income

Deposit interest income is currently liable to Deposit Interest Retention Tax (DIRT) at a rate of 33 per cent,[86] having steadily declined in recent years from the 41 per cent rate that applied from 2014 to 2016. DIRT is deducted from the interest paid on all deposit accounts held by Irish-resident individuals. This includes deposit accounts with banks, credit unions and building societies. DIRT is a final liability tax in that it satisfies an individual's full liability to Income Tax in respect of the deposit interest. There is no additional USC charge, although PRSI may apply under Class K (currently 4 per cent).[87]

85 CSO (2013, 2018 and 2020), Household Finance and Consumption Survey.

86 A higher 40 per cent rate applies to interest from EU and non-EU Member State accounts in certain circumstances.

87 Where deposit interest is at least €100 per week (or €5,200 per annum).

Under the current system, financial institutions act as collection agents for the State, withholding DIRT at a fixed rate and remitting this on a quarterly basis to the Revenue Commissioners (Revenue). DIRT is not withheld on exempt accounts, provided the relevant declaration of exemption is in place. Exempt accounts include those held by charities, companies liable to Corporation Tax, non-resident individuals and individuals aged 65 or over whose income is below the annual exemption limit (the latter of which the Commission propose should be removed as a basis for exemption for taxes on income, see section 6.2.1).

While, as noted previously, savings represent a large share of financial wealth in Ireland, the recent few years of increased savings in a low interest rate environment[88] suggests that it is unlikely that a change in the tax rate on deposit interest would materially change the revenue to the State, or lead to significant behavioural change for savers in the short term. Although it may be limited for use as a revenue-raising measure in the current low interest rate economy, changes to the taxation of deposit interest should still be made for future-proofing purposes.

On horizontal equity grounds, the Commission recommends that deposit interest should be treated the same as other forms of income for tax purposes. Such a change would mean charging deposit interest at an individual's marginal rate of tax (being the amount of additional tax paid for every additional euro earned as income) together with USC and PRSI, as opposed to a flat 33 per cent rate of DIRT plus PRSI. The marginal rate of Income Tax, USC and PRSI will vary between individuals and from year to year depending on an individual's total income and their personal circumstances. This means that for Income Tax purposes, deposit interest income will be charged at the 20 per cent or 40 per cent rate. Similarly, for USC purposes, deposit interest income will either be exempt or charged at a rate of 0.5 per cent, 2 per cent, 4.5 per cent or 8 per cent. PRSI may also apply (under normal rules for Class K). This will require significant administrative changes to facilitate collection of the right amount of tax.

Rather than requiring self-assessment of deposit interest income, the Commission recommends this change from DIRT to marginal rate taxation should happen over the medium term in conjunction with a real-time deduction-at-source regime.

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88 Central Bank of Ireland (2021) Money and Banking Statistics.

The mechanism for the application of the tax at source could be modelled on the real-time reporting system currently in place for PAYE - see Chapter 17 (Modernisation of Tax Administration), allowing the application of the tax in real time as part of day-to-day banking activities.

Significant time and resources would be needed to engage with relevant stakeholders and to build and design the technological infrastructure necessary to support this approach.

Recommendation

6.5 The Commission recommends that deposit interest income should be taxed at an individual's marginal rate of Income Tax and Universal Social Charge. A system should be developed to facilitate the collection of these charges at source in real time by financial institutions.

6.3.2 Taxation of investments

The investment market has expanded exponentially over recent years with a wide array of investment and savings products and platforms now available to investors. These investments are also more accessible to a much broader cohort of taxpayers, both retail investors and professional investors, with varying levels of access to professional advice.

The tax landscape for investment and savings products has evolved over time, particularly in relation to the funds and life assurance industries, in order to promote Ireland as a competitive location for investment while also deterring non-compliance or tax avoidance. The wider regulatory framework and international developments have also influenced the shape of the taxation system.

Many structures, such as domestic life assurance companies and investment undertakings, are taxed under gross roll-up regimes. In line with most OECD countries, the Irish taxation system provides for neutrality between direct investment and investment via a collective investment vehicle or fund, by eliminating the double layer of taxation at corporate/entity level and unit holder level which would otherwise apply. This model aims to attract international capital to Irish markets, reduce reliance on traditional bank financing as a source of funding and facilitate collective investment by smaller investors. This treatment

means there is little to no tax on the income and gains arising to the fund or entity. Instead, tax occurs primarily at the investor level. Withholding taxes or exit taxes may apply to distributions or payments to the investors, as well as on certain deemed chargeable events.

Individual financial products are being developed continually. As such, there is no comprehensive list of all products and their tax treatment. The tax rate, method of collection and extent to which an Irish tax charge can arise can vary considerably depending on a number of factors. This includes the type of investment product, who the investor is (as well as their tax residence or domicile status), the percentage holding or level of influence of the investor, the source jurisdiction and in some cases depending on whether there has been compliance with certain administrative or filing obligations.

Calls have been made for the tax regime for investments to be simplified in order to increase certainty, reduce the risk of error and support tax compliance. Furthermore, while public debate has historically focused on tax rate differentials across products, this has broadened to a discussion on the neutrality of the taxation system with respect to the form of savings or investment chosen. Differences in tax treatment can potentially lead to distortionary behaviour, with investors choosing between equivalent investments based on the tax treatment rather than on the investment outcome.

The Commission advocates for greater horizontal equity in the tax treatment of different forms of investment and savings to reduce such distortions. The Commission's terms of reference do not request an examination of savings and investment products, nor does the short timeframe of the Commission lend itself to a thorough review of such an expansive and often complex topic. However, it is an area the Commission strongly believes could benefit from reduced complexity and greater harmonisation of tax treatment.

To that end, the Commission recommends the establishment of a working group to examine and make recommendations for modernising the taxation and administration of investments. This working group should include officials from Revenue and the Department of Finance and should consult with relevant experts and stakeholders in the industry.

The main goals or guiding principles forming the basis of the working group should be:

- How to simplify the tax treatment of investment products generally, to give greater certainty to taxpayers, reduce the administrative burden, reduce the risk of error and support tax compliance.
- Identification of opportunities for greater promotion of horizontal equity and neutrality in the taxation system when it comes to investment decisions.

These guiding principles would be subject to identification of circumstances where changes would not be appropriate, for example, in order to deter tax avoidance or distortionary behaviour.

The Commission recommends the matters to be considered by the working group should include:

- Identification of the various types of investment products available and the mix of investors who use them.
- A comprehensive review of the Irish tax treatment of investors in these products, including the difference in treatment depending on the tax residence or domicile position of the investor and the location and type of investment product used.
- Identification and assessment of the anti-avoidance rules in place and the types of behaviour or misuses they are trying to prevent.
- Consideration of the rationale for the different treatment of different products (including the type of tax, rate and method of collection applicable).
- Analysis of whether differential treatment for products is justified.
- Identification of options for harmonising and/or reducing complexity in the tax treatment of different investments, where such a change is appropriate. This would include consideration of the arguments for and against reform.
- Identification of any anti-avoidance rules necessary to facilitate the proposed changes.

This exercise should be a comprehensive review of the tax regime for investments with the ultimate goal of presenting options for reform. Those options should have regard to maintaining Ireland's international competitiveness and ability to attract capital investment.

The recommendations should also have regard to fiscal sustainability and be net revenue-raising, or at least revenue neutral, in terms of their impact on the Exchequer.

This is a large undertaking and it is essential that appropriate time and resources are allocated to the working group to achieve this outcome.

Recommendation

6.6 The Commission recommends that a working group should be established to review and propose changes to the taxation of funds, life assurance policies and other investment products with the goals of simplification and harmonisation where possible. The working group should be established with a net revenue-raising or neutral mandate.

6.3.3 Institutional investment in Irish property

Investment in the Irish property market can take several forms, either through direct ownership of land and buildings or indirectly via company structures and funds. In particular, institutional investment in Irish property through use of various collective investment structures grew considerably following the financial crisis.

Public commentary and feedback to the Commission's public consultation have highlighted concerns over the increasing impact of institutional investment in the Irish property market. In particular, the tax status of Irish Real Estate Funds (IREFs), Real Estate Investment Trust (REITs) and section 110 companies has attracted attention.

6.3.3.1 Irish Real Estate Funds (IREFs)

IREFs are investment vehicles where at least 25 per cent of the value of the undertaking is made up of Irish real estate assets. There were 204 IREFs established in Ireland as of 2020.[89] The IREF tax regime was introduced in Finance Act 2016 to address concerns over the use of collective investment vehicles by certain non-resident investors to minimise their exposure to Irish tax on Irish property transactions. Irish regulated funds designated as IREFs must withhold tax at 20 per

89 Based on the number of IREF returns filed with the Revenue Commissioners (2022) Corporation Tax – 2021 Payments and 2020 Returns.

cent from certain property distributions to non-resident investors, with the aim of ensuring profits arising to an Irish fund from Irish property remains within the charge to Irish tax. Withholding tax is not deducted from payments to exempt investors, such as Irish regulated funds, section 110 companies, life assurance companies, charities, pension funds and EU/EEA-based equivalents. A number of anti-avoidance rules were brought forward in Finance Act 2019 with the goal of ensuring the IREF withholding tax was not being avoided, including both a debt cap and an income-to-interest ratio.

6.3.3.2 Real Estate Investment Trust (REITs)

REITs are publicly listed companies whose income is derived from the rental of commercial and residential property. REIT structures are common internationally and the Irish REITs tax regime was introduced in 2013 to facilitate the recovery of the property market in the wake of the financial and property crashes. There is currently only one REIT operating in the Irish property market, reduced from four originally. As with funds, taxation occurs in the hands of the shareholder rather than within the REIT. The framework is designed to encourage stable long-term engagement in the rental market, rather than short-term gains. A key requirement of the REITs tax regime is that the REIT must distribute 85 per cent of its rental profits annually by way of a dividend, for taxation in the hands of the investors. This measure is designed to prevent an indefinite tax-free roll-up of property rental profits within the REIT. Distributions from a REIT are subject to Dividend Withholding Tax (DWT) at 25 per cent, which is available as a credit against tax liabilities. An Irish-resident "excluded person", such as a pension scheme or charity investing in the REIT, may receive distributions gross.

As with IREFs, Finance Act 2019 further amended the taxation of REITs by extending the obligation to deduct DWT to include distributions out of the proceeds of capital disposals. A provision providing a relief from CGT on ceasing to be a REIT was limited to apply only after a minimum term of 15 years of REIT status. Other amendments were made to prevent the use of inflated costs to reduce distributable profits.

6.3.3.3 Section 110 companies

A section 110 company is an Irish-resident special purpose vehicle (SPV) that holds and/or manages "qualifying assets". There were 1,722 SPVs who filed a tax return with Revenue as a section 110 company in 2021. Introduced in the early 1990s, section 110 is designed to act as a tax-neutral regime to improve Ireland's offering as a location for securitisation transactions in the financial sector. Securitisation allows banks to raise capital and to share risk and, by providing a repackaging and resale market for corporate debt, it lowers the cost of debt financing. Section 110 companies cannot directly hold property assets such as land and buildings. However, these companies can hold loans and other financial assets that derive their value from Irish land and buildings, such as mortgages on Irish houses.

Finance Act 2016 introduced changes in order to address concerns that the section 110 regime was being used by international investors to reduce their Irish tax liabilities in respect of investments in Irish property-backed assets. The changes restricted the use of section 110s to minimise Irish tax liabilities on certain distressed debt transactions that are secured over, or derive their value from, an interest in Irish land, to ensure that profits made on Irish property transactions are taxable at the 25 per cent rate of Corporation Tax.

6.3.3.4 Proposal for review

As noted in the previous section, the taxation of institutional investors is an area that has attracted increased attention and was raised by stakeholders responding to the Commission's public consultation, particularly in the context of housing policy and affordability. While we recognise the increasing role and impact of institutional investors in the Irish property market, given the breadth and depth of our terms of reference and our short timeframe, we have been unable to examine this topic in as much detail as is warranted. While the issues concerning supply and affordability are matters that are currently under consideration by the Commission on Housing,[90] the Commission believes that it is timely that the tax structures relating to institutional investment in the property sector, the bespoke tax regimes applicable to them and the effects of various legislative amendments made to those regimes are reviewed collectively to assess if they are achieving

90 The Housing Commission (2022) Terms of Reference.

their intended policy objectives.

A review of institutional investors in the Irish property market needs to be considered in the context of Ireland's overall position as a competitive location for international investment. The Commission's view is that the ability to attract inward capital investment to fund the supply of housing needs to be carefully balanced with enabling an appropriate share of tax being paid on returns from Irish assets. There are trade-offs involved in pursuing these objectives through tax policy. The tax regime should eliminate the scope for aggressive tax planning, while also ensuring the structures are accessible and attractive enough to warrant their use for investment. Other relevant factors include maintaining competitiveness relative to the offerings of other jurisdictions and complying with international rules governing taxation of non-residents. For example, the terms of a double taxation agreement may restrict the amount of tax Ireland can impose on a person resident in another jurisdiction. Therefore, changes to domestic tax rules may not impact all investors equally.

To that end, the Commission recommends that the government undertake a review of the REIT, IREF and section 110 tax regimes with regard to institutional investment in the Irish property market. This should include an assessment of whether the structures are achieving their intended policy objectives (recognising that trade-offs exist in this space), their impact on the supply and affordability of housing, as well as whether they are meeting the needs and expectations of the users of such structures.

Given that section 110 rules apply to a wide range of assets beyond debt over Irish land and property, we also recommend a wider review of the section 110 regime generally.

This review should be supported and assisted by the Department of Finance, Revenue and the Central Bank of Ireland.

Recommendation

6.7 Having regard to the role of institutional investment in the Irish property market, the Commission recommends that Government undertake a review of the Real Estate Investment Trust framework, the Irish Real Estate Fund regime and the use of section 110 vehicles in this area. Consideration should also be given to a wider review of the section 110 regime generally. This review should be supported by the Department of Finance, the Revenue Commissioners and the Central Bank of Ireland.

6.4 CONSUMPTION TAXES

6.4.1 Value Added Tax (VAT)

As outlined in Chapter 5 (Balance of Taxation) consumption taxes are an important part of the taxation system representing 28 per cent of total revenue in 2021, of which Value Added Tax (VAT) represents the largest portion - 19 per cent of total revenues.

In preparing our recommendations in relation to VAT, the Commission has taken a high-level approach to considering the overall policy landscape and reflected on the alignment between current VAT policy and other Government policies. We also considered the terms of reference as set down for us by Government and the other recommendations being made by us across the full spectrum of the taxation and welfare systems, including the areas of fiscal sustainability, taxation expenditures, public health and the environment.

It should be noted that widespread reform in the area of VAT is significantly restricted due to the EU's common system of VAT, which is enshrined in Directive 2006/112/EC.[91] This Directive sets out that Member States must apply a standard VAT rate of 15 per cent or more, and can apply up to two reduced VAT rates of 5 per cent or more. Such considerations have clearly impacted the Commission's approach to its work in this area. That being said, we believe there are opportunities for reform of the VAT system in Ireland, particularly with regard to the use

91 The European Council on 5 April 2022 formally adopted Council Directive (EU) 2022/542 introducing reforms to the VAT directive. The new rules will update and expand the existing positive list (Annex III to the VAT Directive).

of the reduced rates of VAT. There are also opportunities to be gained through modernisation of the administration of VAT.

6.4.1.1 Zero and reduced rates of VAT

Ireland is the only EU country that applies a zero rate of VAT on a wide-ranging array of goods and services. Furthermore, Ireland continues to apply two reduced rates (the reduced rate - currently 13.5 per cent, and the second reduced rate - currently 9 per cent) to an extensive range of economic activity, relative to other EU Member States. While, in an EU context, Ireland has a relatively high standard VAT rate (currently 23 per cent) and a high reduced VAT rate (currently 13.5 per cent), the Commission is concerned about the extent of the existing use of the zero and reduced rates and the impact of their usage on the overall VAT base. In 2020, Revenue estimated that increasing the reduced rates of VAT to the standard rate of 23 per cent could raise up to €2.4 billion per year.

The broad application of the zero and reduced rates represent a policy choice and, in the view of the Commission, their application should be considered as tax expenditures that warrant ongoing scrutiny and evaluation as set out in Chapter 16 (Tax Expenditure Review Process).

The Commission believes that it may be desirable to change the categorisation of some goods and services from the zero and reduced rate classes - in particular, where such treatment conflicts with other policy objectives such as the decarbonisation of the economy. For instance fertilisers currently fall within the zero rate category.

In terms of impact on disposable income of households, it would appear that increasing reduced rates of VAT to 23 per cent would result in larger losses as a share of disposable income for lower-income households than higher-income households. This is due to the fact that the reduced rates of VAT apply to home heating fuels and electricity, which make up a larger share of the spending of lower-income households. On the other hand, where the reduced rates apply to items such as hospitality and tourism-related services, the reverse is true with a larger share of spending being attributed to higher-income households.[92]

92 Kakoulidou, T. and Roantree B. (2021). Options for raising tax revenue in Ireland, Budget Perspectives 2022 01, Dublin: ESRI.

Nevertheless, simply increasing the reduced rates of VAT to 23 per cent will not deliver a progressive distributional pattern, and considerable offsetting measures might be required to compensate those in lower-income deciles who could be most impacted, depending on the good or service in question. Therefore, although the Commission considers that the retention of zero and reduced rates should be restricted in scope and retained only in limited circumstances, it is mindful of the delicate balance that needs to be struck and recognises the important role played by zero rates in alleviating food poverty and supporting access to other essential goods and services.

The EU Commission, the OECD and others have, on an ongoing basis, recommended broadening the VAT base and narrowing the scope of reduced rates to stabilise VAT revenues. Comparative international statistics indicate that significant improvement of the system is possible. This Commission has taken that evidence into account in examining the 9 per cent and 13.5 per cent rates.

Accordingly, while the Commission does not recommend increases in the zero or standard rates of VAT due to the distributional impact of such changes, it does see scope to increase the second reduced rate (currently 9 per cent) up to the 13.5 per cent reduced rate of VAT, and to increase the 13.5 per cent rate. These changes should be implemented progressively over time. In the short term, essential items, such as fuel and electricity, could potentially be maintained at a lower second reduced rate in order to limit the impact of these changes on lower income households. In the medium- to longer-term, as part of the move away from fossil fuels and, as alternatives are available, VAT subsidies on such items should be removed and VAT increased to the standard rate over time, a move which is also required at EU level as part of recent revisions to the VAT directive.

Recommendations

6.8 The Commission recommends widening the Value Added Tax (VAT) base and limiting the use of zero and reduced rates of VAT. The VAT treatment of goods and services to which those rates currently apply should be reviewed to assess if it continues to be appropriate.

6.9 The Commission recommends that the rate of Value Added Tax on those goods and services currently attracting a second reduced rate (currently 9 per cent) should be increased over time to the reduced rate (currently 13.5 per cent).

6.10 Due to the relatively large share of goods and services attracting zero and reduced rates of Value Added Tax in Ireland, the Commission also recommends that the reduced rate of 13.5 per cent should be increased progressively over time.

6.4.1.2 Temporary VAT reductions

On a number of occasions, Ireland has chosen to use its second reduced rate of VAT to facilitate applying broad-based VAT reductions to specific goods and services in order to provide stimulus to specific sectors of the economy. For example, in July 2011, a second reduced rate of VAT of 9 per cent on tourism-related goods and services was introduced as part of the Government's 2011 Jobs Initiative to support the tourism industry. The objective was to preserve and grow employment in the sector. Similar temporary reductions were again introduced or extended in 2020, 2021 and 2022 as part of the Government response to the COVID-19 pandemic.

A temporary cut in the applicable VAT rate has the advantage that it is a 'shovel-ready' measure, which is easy to implement quickly. It has been argued that it can provide a short-term boost to consumption by giving people more money to spend and by incentivising consumers to bring purchases forward to take advantage of temporarily lower prices. Alternatively, while many businesses may not pass on VAT reductions to consumers through lower prices, such measures can assist a struggling business' viability by improving profit margins.

In its 2018 paper "Review of the 9% VAT Rate Analysis of Economic and Sectoral Developments", the Irish Government Economic and Evaluation Service states "The ongoing and cumulative costs of the reduced rate are substantial, estimated at €490 million in 2017, and €2.6 billion in total since its introduction. The scale of these costs against the limited benefits point to significant deadweight." The IMF's Concluding Statement on the 2018 Article IV Mission to Ireland noted that "streamlining the value added tax structure by eliminating exemptions and preferential rates such as in the hospitality and services sectors, and

better targeting of tax expenditures could provide significant resources". The 2018 OECD Economic Survey of Ireland, also published in March 2018, recommended that preferential VAT rates be eliminated, while maintaining social inclusiveness, in order to improve Ireland's fiscal position in the face of a negative shock. The OECD noted that while reduced VAT rates on some household products may be an attempt to make VAT more progressive, lower rates for items such as purchases at restaurants, hotels and cinemas (i.e. discretionary categories of expenditure which comprise the majority of 9 per cent rate sectors) likely work in the opposite direction. There is also international evidence that such VAT reductions are ultimately more likely to benefit business owners than consumers.[93]

The Commission has reflected on this body of work in our consideration of temporary VAT measures and has concluded that temporary VAT reductions are costly, can lead to higher price levels (when not passed onto customers) and significant deadweight costs. The application of lower rates to discretionary expenditure is also potentially regressive and inequitable insofar as the benefits fall largely to households with higher levels of disposable incomes, to the extent that such reductions are passed on to customers at all.

Recommendation

6.11 The Commission does not support the use of temporary Value Added Tax reductions as a short-term stimulus measure.

6.4.1.3 VAT modernisation

As outlined in further detail in Chapter 17 (Modernisation of Tax Administration), the Commission believes that modernisation of tax administration can reap significant benefits for taxpayers, Revenue and the Exchequer as a whole. More closely aligning the reporting and compliance requirements with the normal operations and financial processes of the business would increase the accuracy of returns and reduce the risk of evasion. In addition, by integrating VAT reporting with the normal business process, more accurate, real-time data could be

93 Benzarti, Youssef & Carloni, Dorian. (2019) Who Really Benefits from Consumption Tax Cuts? Evidence from a Large VAT Reform in France. American Economic Journal: Economic Policy. 11. pp. 38-63.

obtained regarding the purchase and sale of goods and services within the various rate categories outlined previously, thus allowing for more informed policy decisions around appropriate categorisation in the future. In this context, the Commission notes the Revenue proposals, as set out in its submission to the Commission, to engage on a phased programme of VAT modernisation – a move which we support.

6.4.2 Accommodation tax

Accommodation or city taxes (also referred to as tourist or transient visitor taxes) are largely focused on tourism or accommodation providers, and are typically levied on short-term stays in paid accommodation. Across Europe, including in for instance Paris, Berlin and Vienna, such taxes are applied to hotel accommodation in addition to VAT.

Such taxes have been introduced across the globe in response to tourism consumption and the pressures it places on the provision of public goods and services. Consumers are generally responsible for paying such taxes, while the accommodation facility is responsible for collecting them.

Tourists and other visitors get a short-term benefit from public goods and services, such as water and sewerage systems, utilities, waste facilities, parks, security and public safety services, without having contributed to their funding. The rationale behind an accommodation tax is to ensure that those guests contribute to the ongoing costs of providing these goods and services. Depending on their design, accommodation taxes may also make the tourism industry more sustainable by providing a revenue stream that can improve environmental and economic sustainability as well as improving infrastructure.

An accommodation tax can be regarded as an adaptation of the general 'polluter-pays principle' to a 'user-pays principle' that calls upon the user of resources (i.e. the tourist) to bear the cost in a more sustainable way.

Accommodation taxes are typically charged per person, per night, with significant local/municipal discretion over the rates applied. Rates across the EU Member States that apply a tax range between an average of €0.40 and €2.50 per night and vary depending on the type of accommodation.

Recommendation

6.12 The Commission recommends the introduction of an accommodation tax. The intention to introduce this tax should be signalled early and a process of engagement with relevant stakeholders should be undertaken prior to implementation of the tax.

6.5 RECOMMENDATIONS

Chapter 6: Tax Equity and Base Broadening

6.1	The Commission recommends that age should be removed as a factor for determining the charge to Income Tax and Universal Social Charge. The necessary changes to each charge should be introduced over time to minimise negative impacts.
6.2	The Commission recommends that rates of Universal Social Charge should be determined by income level and not by reference to any other eligibility criteria.
6.3	The Commission recommends that the remittance basis of taxation should be subject to a lifetime limit of three years.
6.4	The Commission recommends that the High Income Earner Restriction should be retained. To ensure that its original policy objective is not eroded, tax reliefs should only be excluded from its remit in exceptional cases.
6.5	The Commission recommends that deposit interest income should be taxed at an individual's marginal rate of Income Tax and Universal Social Charge. A system should be developed to facilitate the collection of these charges at source in real time by financial institutions.
6.6	The Commission recommends that a working group should be established to review and propose changes to the taxation of funds, life assurance policies and other investment products with the goals of simplification and harmonisation where possible. The working group should be established with a net revenue-raising or neutral mandate.

6.7 Having regard to the role of institutional investment in the Irish property market, the Commission recommends that Government undertake a review of the Real Estate Investment Trust framework, the Irish Real Estate Fund regime and the use of section 110 vehicles in this area. Consideration should also be given to a wider review of the section 110 regime generally. This review should be supported by the Department of Finance, the Revenue Commissioners and the Central Bank of Ireland.

6.8 The Commission recommends widening the Value Added Tax (VAT) base and limiting the use of zero and reduced rates of VAT. The VAT treatment of goods and services to which those rates currently apply should be reviewed to assess if it continues to be appropriate.

6.9 The Commission recommends that the rate of Value Added Tax on those goods and services currently attracting a second reduced rate (currently 9 per cent) should be increased over time to the reduced rate (currently 13.5 per cent).

6.10 Due to the relatively large share of goods and services attracting zero and reduced rates of Value Added Tax in Ireland, the Commission also recommends that the reduced rate of 13.5 per cent should be increased progressively over time.

6.11 The Commission does not support the use of temporary Value Added Tax reductions as a short-term stimulus measure.

6.12 The Commission recommends the introduction of an accommodation tax. The intention to introduce this tax should be signalled early and a process of engagement with relevant stakeholders should be undertaken prior to implementation of the tax.

Chapter 7:
Taxes on Capital and Wealth

7.1 INTRODUCTION

As set out in Chapter 5 (Balance of Taxation), the Commission's approach to tax reform is focused on broadening the tax base, in line with the principles which the Commission has adopted. This includes the Commission's recommendation that the share of taxes from capital and wealth should be increased. To achieve that goal, and to improve the efficiency and equity of capital taxation in Ireland, the Commission is recommending a number of reforms in this area.

Meaning of Wealth, Income, Capital Gains and Acquisitions

Income and wealth are intrinsically related but distinct in many ways. Wealth is a stock of resources held by an individual or household measured at a point in time, while income is a flow of resources – being the flow of resources accruing to a person across a period such as a year. When an individual's inflows (income) are greater than their outflows (consumption) in a given period, the stock of wealth of that individual at the end of that period increases. Wealth is made up of assets, which can be held in the form of liquid assets such as cash and shares or illiquid assets such as land and buildings.

The ownership of wealth alone can increase the stock of wealth by an income flow - called the return of capital. Capital income can be derived from an asset where the owner leases the asset to another in exchange for a monetary return; for example, a landlord renting a property, or a bondholder allowing the use of their asset (cash) in return for interest. Likewise, an owner of shares can derive income from their shares following the distribution of company profits via dividends. An increase in the value of an asset such as a business asset, share or stock over time results in a capital gain, or an increase in the wealth of the owner. A capital acquisition accrues when wealth is transferred via a gift or inheritance. Accordingly, the base for Capital Gains Tax is the increase in the value of the asset and the base for Capital Acquisitions Tax is the market value of the asset.

While a pure wealth tax implies a tax levied on the stock of net wealth held by an individual/household, there are other means of taxing sources of wealth. This can be done by taxing gifts or inheritances or the value of estates on death. It can also be done by taxing flows derived from the passive ownership of an asset such as capital gains, interest or dividends.

Currently, the main taxes on wealth in Ireland are as follows:

- *Capital Gains Tax (CGT) – discussed in further detail in section 7.6.*
- *Capital Acquisitions Tax (CAT) – discussed in further detail in section 7.6.*
- *Stamp Duty – a tax on documents (instruments), including documents pertaining to the transfer of assets between persons.*
- *Local Property Tax (LPT) – a recurrent tax on the holding of residential property, discussed in further detail in Chapter 14 (Land and Property).*

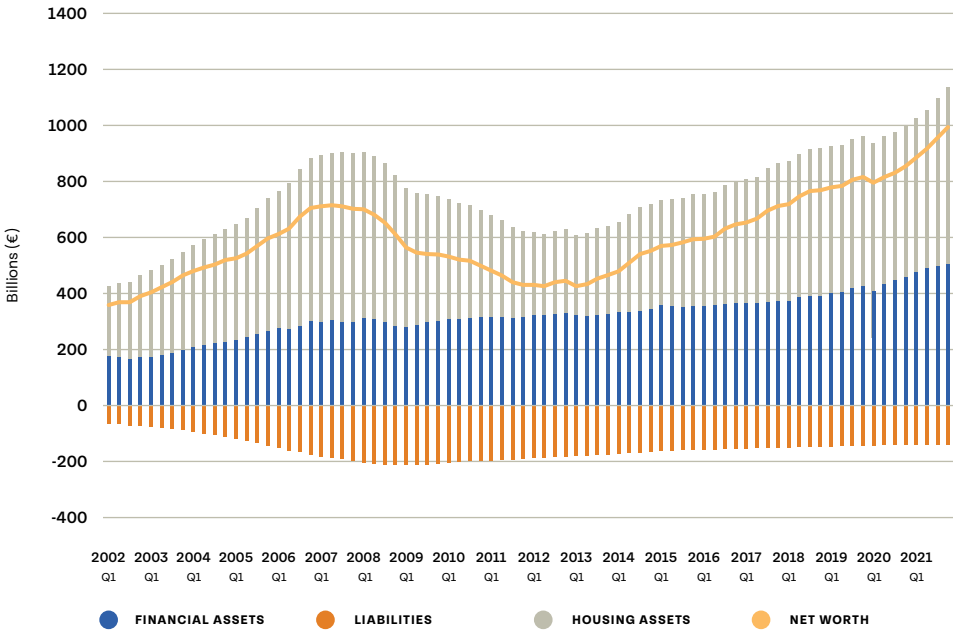
7.2 WEALTH IN IRELAND

7.2.1 Household wealth

What is known about income in Ireland is far more detailed, comprehensive and reliable than what is known about wealth. This is not unusual. Internationally, information on wealth is much sparser than information on income. This is perhaps understandable - information about flows are captured as they happen, whereas information about stocks is generally gathered at a point in time. Wealth is also concentrated among smaller numbers of households. The quality of data on wealth, however, is improving, and as part of our work, we were able to identify some core features of how wealth is composed and distributed in Ireland.

Figure 11 shows the aggregate value of net worth and its components for all households (housing and financial assets, and liabilities) from the Central Bank Quarterly Financial Accounts over the past 15 years. Another perspective on increases in household wealth over time is the Household Finance and Consumption Survey (HFCS) measure of average net wealth. This is an estimate of household wealth from a sample of households, extrapolated to the population.

Figure 11: Household assets, liabilities and net worth by quarter, 2002-2021



Source: Central Bank, Quarterly Financial Accounts

Both aggregate net wealth and median average net wealth have increased since 2013. In 2013, median household net wealth stood at €103,000. In 2020, this figure was €193,000. However, these high-level figures do not give a sense of the distribution of wealth across income levels, age, tenure or marital status.

Table 6 shows the composition of all household assets, with the importance of the household's main residence apparent through its increased share of gross wealth in the State since 2013. Other property and land accounts for the second highest proportion of gross wealth in 2020, followed by self-employed business wealth, which grew overall between 2013 and 2020.

Table 6: Value of total household assets as share of gross wealth (%) by type of asset, 2013, 2018 and 2020

ASSET	2013	2018	2020
Household Main Residence (HMR)	46.5	50.5	52.4
Other property/land	31.3	25.2	21.3
Self-employed business wealth	5.3	3.9	6.7
Vehicles and other valuables	4.3	4.5	4.2
All real assets	87.4	84.1	84.6
Savings	6.9	5.0	6.3
Bonds or Mutual Funds	1.2	1.9	1.9
Shares	1.2	1.6	1.3
Voluntary Pension	2.6	4.7	4.5
Other Financial Asset	0.6	2.6	1.4
All financial assets	12.6	15.9	15.4

Source: CSO, Household Finance and Consumption Survey (HFSC); Lydon R et al. – Changes in Irish Households' Finances from 2013 to 2018, 2021

Note: The Quarterly Financial Accounts (QFA) data in the first figure differs from the HFCS data in the table above for a number of reasons. QFA data is based on observed financial and housing assets held by households, whereas the HFCS is a survey based on a representative sample of the population. However, self-reporting bias can be a feature of surveys that make the recording of responses differ from objective valuations. This may lead to the under-reporting of certain assets' values (e.g. financial assets). Similarly, some real assets are not included in the QFA, resulting in differing relative shares across data sources. For more information see Cussen et. al (2018)

7.3 DISTRIBUTION OF WEALTH

In 2020, the top tenth of households, as measured by net wealth, had net wealth of at least €788,400, while the poorest tenth had net wealth below €600. Table 7 shows the distribution of net wealth, by the thresholds for each decile (each decile being 10 per cent of the population) and Table 8 shows how the concentration has evolved in recent times, using groupings such as the top one per cent and the bottom half of the distribution.

Table 7: Net wealth decile threshold limits, 2020

NET WEALTH DECILE	THRESHOLD
Lowest (1st)	< €600
2nd	< €10,900
3rd	< €58,900
4th	< €127,800
5th	< €193,100
6th	< €262,700
7th	< €359,600
8th	< €502,300
9th	< €788,400
Highest (10th)	> €788,400

Source: CSO.ie, Household Finance and Consumption Survey

As is the case with most countries, the distribution of wealth in Ireland is less equal than the distribution of income; the Gini coefficient for net wealth in 2020 was 0.65.[94]

Table 8: Share of total net wealth (%), 2013 and 2018

PERCENTILE OF HOUSEHOLD WEALTH	2013	2018
Top 1%	12.1	14.9
Top 5%	36.0	36.0
Top 10%	53.0	50.4
Top 30%	82.9	79.3
Bottom 70%	17.1	20.7
Bottom 50%	4.5	6.8

Source: Lydon R et al. – Changes in Irish Households' Finances from 2013 to 2018, drawing from CSO Household Finance and Consumption Survey

94 Income inequality, as measured by the Gini coefficient, was much lower at 28.5 (for disposable household income) and 0.44 (for gross household income) in 2020. See CSO SILC and HCFS.

Table 9: Share of total net wealth (%) by income quintile, 2013, 2018 and 2020

PERCENTILE OF HOUSEHOLD INCOME	2013	2018	2020
Less than 20 (or bottom fifth of income holders)	11.3	9.9	10.8
21-40	12.6	12.1	13.0
41-60	15.9	15.0	15.1
61-80	20.9	20.6	19.3
81-100 (top fifth)	39.3	42.5	42.0

Source: CSO.ie, Household Finance and Consumption Survey 2013-2020

Table 10 illustrates a more detailed examination of how income and wealth correspond (in 2018, the latest available data). It shows that the bottom fifth of the income distribution have lower levels of net wealth than the highest income quintile (8 per cent of people are in both the lowest wealth quintile and among the lowest earners, compared to just 0.6 per cent of the highest earners in the lowest wealth quintile). The highest fifth of income earners have higher levels of net wealth - 8.1 per cent of people are in the top wealth quintile and in the top income quintile, whereas just 1.7 per cent of people share membership of the highest wealth quintile and the lowest income quintile.

Table 10: Joint distribution of equivalised net wealth and gross income (% share of individuals), 2018

	WEALTH QUINTILE					
INCOME QUINTILE	1	2	3	4	5	TOTAL
1 (LOWEST)	8.0	4.6	3.0	2.9	1.7	20.0
2	6.5	4.3	3.5	3.4	2.2	20.0
3	3.3	4.6	5.0	3.7	3.4	20.0
4	1.6	3.9	5.3	4.6	4.6	20.0
5 (HIGHEST)	0.6	2.6	3.1	5.5	8.1	20.0
TOTAL	20.0	20.0	20.0	20.0	20.0	100.0

Source: CSO.ie, Household Finance and Consumption Survey 2013-2020
Note: if income and wealth were perfectly correlated, the diagonal cells would have exactly 20 per cent and all other cells would have zero. Random allocation along the joint distribution would result in a value of 4 per cent in each cell.

Despite the data constraints that limit our knowledge of wealth, the direction of travel on net wealth is towards increased concentration

among high-income households – the share of net wealth has increased for the highest income quintile between 2013 and 2018; for every other quintile, it has decreased.

As the total value of assets is higher among high-wealth individuals, it follows that capital gains realised, on these assets are also of a higher value. Administrative data from the Revenue Commissioners (Revenue) demonstrates the link between income levels and chargeable capital gains by transactions in 2015. The total number of transactions, as well as the value of gains, is particularly high in the highest income decile (Table 11).

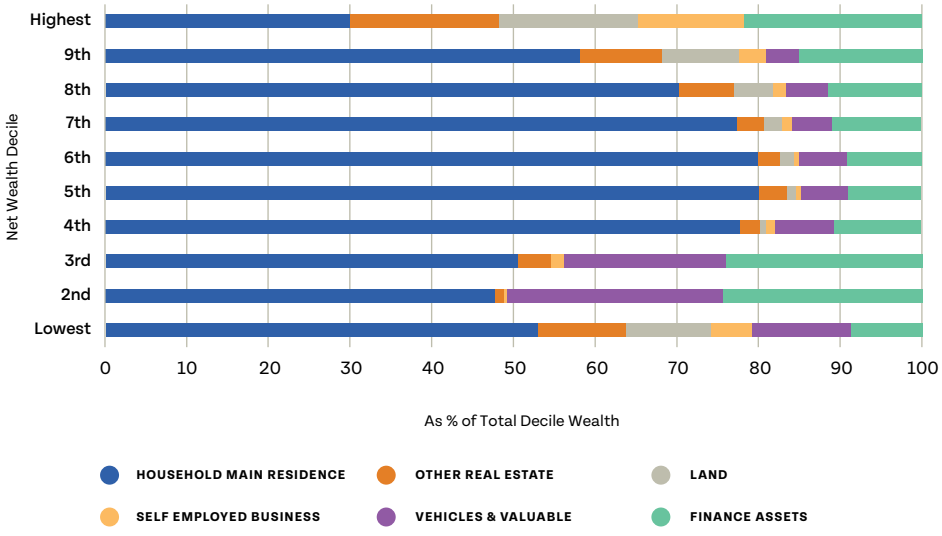
Table 11: Capital Gains Tax transactions distributions by income decile, 2015

INCOME DECILE	CGT TRANSACTIONS (NUMBER)	CGT LIABILITY (€M)
Lowest	888	13
2	729	5
3	1032	9
4	1,112	5
5	1,398	12
6	1,921	12
7	2,683	13
8	3,783	21
9	6,389	40
Highest	18,841	369

Source: Revenue Commissioners – Profile and Distribution of Capital Taxes, 2018
Note: this data captures chargeable gains only and as such underrepresents the level of gains.

Figure 12 shows the breakdown of assets by net wealth deciles. Self-employed business assets (13 per cent), land (17 per cent) and other real estate (18 per cent) make up a reliably larger share of wealth of the highest net wealth decile, while financial assets also account for a large share (19.5 per cent). The main residence makes up a relatively large share of deciles in the middle of the wealth distribution, while vehicles and valuables, as well as financial assets make up a considerable share of the bottom 30 per cent. Given that net wealth for the bottom 30 per cent is €58,900 or below, these shares reflect relatively small amounts in absolute terms.

Figure 12: Composition of household wealth by net wealth decile, 2020



Source: CSO.ie, Household Finance and Consumption Survey

7.3.1 Household characteristics of the distribution of wealth

Table 12 outlines various household characteristics associated with the distribution of wealth. Assessing the share of total net wealth by household type, households with two or more adults hold a greater share of wealth than one-adult households.

There is also a strong correlation between age and share of total net wealth. Households where the reference person (usually referred to as head of household) was aged 35 or under had a small share of total net wealth at just 3.4 per cent in 2020, a lower share than in 2013 and 2018. This gradually increases across higher age groups, peaking at 32.8 per cent of total net wealth held by households headed by persons aged 65 or older – a higher share for this group than in 2013 and 2018. Although not directly comparable methodologically, a 1987 survey on households shows this association holds over time, with mean wealth rising sharply with the age of the household head.[95]

95 Brian Nolan, The Geneva Papers on Risk and Insurance Vol. 24 No. 1, Survey Information on Household Assets: Some Irish Lessons (1999).

Those who live in owner-occupied homes hold 97.2 per cent of total net wealth, compared to just 2.8 per cent of people in rented or rent-free housing. Given that net wealth is being estimated in this table, those who have an outstanding debt on an owner-occupied house are represented as having lower net wealth. With the correlation between age and debt-free owner-occupied housing, older households have higher net wealth.

Table 12 appends the at-risk-of-poverty (income poverty) rates in 2021 to the share of net wealth to demonstrate the link between income and wealth for different household types, age groups and tenures. For example, lone-parent headed households, over one fifth of whom are at risk of poverty, own 1 per cent of net wealth; people living in rented or rent-free accommodation, own just 2.8 per cent of wealth and face an at-risk-of-poverty rate of 19.8 per cent.

Table 12: Characteristics of the distribution of wealth, 2013-2020 and At-Risk-of-Poverty Rate, 2021

HOUSEHOLD CHARACTERISTICS	SHARE OF TOTAL NET WEALTH, 2013 (%)	SHARE OF TOTAL NET WEALTH, 2018 (%)	SHARE OF TOTAL NET WEALTH, 2020 (%)	AT-RISK-OF-POVERTY RATE, 2021* (%)
HOUSEHOLD COMPOSITION:				
1 adult aged 65+	9.0	11.4	11.6	21.5
1 adult aged <65	6.6	8.5	7.7	28.8
2 adults, at least 1 aged 65+	18.5	17.2	17.6	8.9
2 adults, both aged <65	14.4	13.5	11.8	8.2
3 or more adults	23.4	15.7	22.4	6.1
1 adult with children aged < 18	0.8	1.0	1.0	22.8
2 adults with 1-3 children aged < 18	16.0	18.4	17.2	9.1
Other households with children aged < 18	11.3	14.3	10.7	13.7
AGE GROUP:**				
Under 35	3.5	3.8	3.4	11.3
35-44	13.3	15.2	12.8	8.7
45-54	25.1	23.5	23.3	12.8
55-64	25.7	28.3	27.7	15.2
65+	32.5	29.2	32.8	11.9
TENURE STATUS:				
Owner-occupied	95.7	95.8	97.2	9.2
Rented or rent free	4.3	4.2	2.8	19.8

Source: CSO.ie, Household Finance and Consumption Survey (HFCS) and CSO Survey on Income and Living Conditions (SILC) data

* *2021 SILC uses a 2020 income reference period and is most comparable with 2020 HFCS.*

** *Age group values refer to the age of the head of the household in the HFCS; the At-Risk-of-Poverty Rate is calculated for all members of a household in the SILC.*

One further aspect worth highlighting as regards household wealth distribution is the impact of receipt of an inheritance. This moves a household up the wealth distribution by 15.4 percentiles relative to

households at the same income level that did not receive an inheritance.[96] The asset types that households report receiving also varies substantially by current wealth, with 40 per cent of households in the top wealth decile having received a business or farm. In contrast, none of the lowest wealth decile have received a business or farm (even though 13 per cent of households in that decile received some gift or inheritance).

Inheriting a business moves the household up in the wealth distribution by almost 26 percentiles, relative to what would be expected on the basis of household income. This suggests taxes associated with inheritance could have a strong influence on the distribution of wealth.[97]

The importance of inheritance, along with the interaction between age and housing on net wealth values, and the associated question of debt levels, raises a concern about intergenerational equity in light of the sharp decline in home ownership rates among recent generations. Analysis of the proportion of people born in each decade since the 1960s who own the home they live in shows a changing trend. Over 60 per cent of those born in the 1960s lived in a home they or their partner owned by the age of 30, whereas the comparable figure for those born in the 1970s was 39 per cent and, for those born in the early 1980s, 32 per cent.[98]

7.4 A WEALTH TAX FOR IRELAND?

There is a long-standing international debate about wealth taxes. If the debate has grown in recent years, it is perhaps prompted less by a widespread implementation of wealth taxes and more by the problem to which they represent a solution. Ongoing debates about the concentration of wealth are being fuelled by fears about how technology will change the balance between the return to employment and the return to investment - see Chapter 2 (Context). At the same time, studies of large advanced countries show the average ratio of net household

96 Gifts and inheritances in Ireland (2017), Martina Lawless and Donal Lynch, Working Paper No. 579.

97 OECD (2021) Inheritance Taxation in OECD Countries, OECD Tax Policy Studies, No. 28, OECD Publishing, Paris.

98 Roantree, B., Maître, B., McTague, A. and Privalko I. (2021) Poverty, income inequality and living standards in Ireland Dublin, ESRI. Two aspects may influence this trend: later labour market entry and changes in patterns of family formation. However, as noted in the paper, rates of home ownership have tended to level off by age 45 for previous cohorts, with each successive generation less likely to live in owner-occupied housing than the last.

wealth to national income increasing substantially between 1970 and 2010. In Ireland, a period of low interest rates and rising asset prices has led to significantly higher net household wealth than ever before.

Wealth taxes relatedly feed into the debate on income inequality, with income inequality increasing in many OECD countries over the past three decades (although not in Ireland).

The current interest in wealth taxes also coincides with a decline in the number of OECD countries that impose a wealth tax. The number had fallen from 12 in 1990 to three by 2018.[99] Many countries repealed wealth taxes in the 1990s and 2000s, with some reinstating them temporarily in 2010 to 2011. France repealed its wealth tax in 2018 and replaced it with a tax on immovable property.

7.4.1 Rationale for a tax on wealth

Multiple arguments are advanced in favour of a wealth tax. They range from those associated with considerations of equity to those with a narrower, more functionally-oriented concern with the most economically- efficient way to raise revenue, while having minimal impact on labour supply or on investment in human capital.[100]

One of the primary arguments for a wealth tax is the principle of vertical equity, i.e. those with an ability to pay should do so. Vertical equity, in this context, is also informed by concerns about recent global trends, with a wealth tax proposed as a measure to counter the increase in wealth inequality. A wealth tax can counter the current economic trend whereby the return on capital is outstripping the rate of economic growth. It can also be argued that, as the holding of wealth confers advantages (such as security, choice and access to credit) above and beyond the consumption it supports, a wealth tax is appropriate so that the people who benefit from these advantages pay more tax than others with the same lifetime income and consumption. A wealth tax can, accordingly, be seen as promoting equality of opportunity, in a manner similar to the redistributive function of the taxation and welfare systems, which function is designed to ensure some degree of equality of outcome.[101]

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99 OECD (2018) The Role and Design of Net Wealth Taxes in the OECD, OECD Tax Policy Studies, No.26, OECD Publishing, Paris.

100 McDonnell, T.A. (2013) Wealth Tax: Options for its Implementation in the Republic of Ireland, NERI Working Paper Series, WP 2013/6.

101 Kuypers et al (2020) An Assessment of Wealth Taxes in a Joint Income-Wealth Perspective, Euromod Working Paper Series, WP 17/20.

A further argument for a new tax on wealth is the underperformance of the existing taxes on sources of wealth. As outlined in Chapter 5 (Balance of Taxation), capital taxes make only a minor contribution to the total tax take. Similarly, the low collection rate of the Domicile Levy suggests some underperformance. Introduced in 2010, it applies a levy to Irish-domiciled individuals whose worldwide income exceeds €1 million, whose Irish property is greater in value than €5 million and whose Income Tax liability is less than €200,000. In practice the revenue collected from this levy has been negligible; just €2.3 million on average over the past five years.

Once-off wealth taxes are known as capital levies.[102] One of the arguments in favour of once-off, rather than recurring, taxes is that they are a useful way to raise revenue in response to unique fiscal circumstances. The UK Wealth Tax Commission (established in April 2020) considered both once-off and recurring wealth taxes and recommended the former as a response to the expected budget deficit arising from the COVID-19 pandemic. At a more principled level, a once-off wealth tax does not elicit the same behavioural response as a recurring tax as regards avoidance or planning opportunities, nor does it affect future behaviours or decisions on investing and saving.

However, a once off tax does not provide a sustainable response to long-term funding challenges and has a higher administrative cost. A recurring tax on net wealth, in contrast, reduces reliance on other sources of revenue (e.g. labour, consumption) and may systematically reduce wealth inequality over time.

Finally, as outlined in Chapter 5 (Balance of Taxation) in terms of the optimal mix of taxation, taxes should, in theory, target windfall gains, such as gifts and inheritance, rather than, for example, earnings from employment. This is because taxing windfall gains does not distort future decisions or discourage employment or investment. Accordingly, the introduction a new tax on net wealth could certainly shift the balance of taxation away from taxes on labour while reducing the risk from a concentration of Corporation Tax revenues, as discussed in Chapter 5 (Balance of Taxation). However, the introduction of any tax gives rise to administrative challenges. While these are not insurmountable, any new tax requires substantial work at the design and implementation stages – this was also a factor in the Commission's conclusions.

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102 Eichengreen, B. (2011) The Capital Levy in Theory and Practice, Public Debt Management: Theory and History, pp. 191-220.

7.4.2 Challenges of a wealth tax

A recent examination of a wealth tax in Ireland notes that varying the threshold at which the tax applies is the key determinant of the scope of any such tax.[103] Further, the treatment of the principal private residence – the largest asset for almost all households – is the critical factor in determining the average tax payment and total revenues that could be derived from such a charge. The distributional impact of, and the revenue that a wealth tax would raise are, accordingly, largely a function of the threshold, rate and asset base. Different thresholds, asset bases and rates yield very different results. In designing a wealth tax, the precise specification of the tax base is the key challenge. Further, in the case of a once-off or recurring tax, assessment is required, with attendant administrative costs and behavioural responses.

Relatedly, valuation creates challenges. While some assets are easily valued, there is greater difficulty in valuing assets like corporate entities not listed on a stock exchange, works of art, non-fungible tokens (NFTs), or certain rights, such as the right to receive income under a benefit pension. One administratively-appealing response to the valuation challenge might be to remove assets that are difficult to value from the base. This would create distortions, however, as such assets would become more attractive due to their tax-exempt status. Furthermore, removing them from the base would contravene horizontal equity principles by having people of similar net wealth subject to differing levies based on how they hold their wealth.[104]

Given the mobility of capital, the risk of other distortions arises. The capacity to divert assets or economic activity through less heavily taxed forms, or to other jurisdictions, would be available to some of those persons who hold assets which might be considered part of a wealth tax base. The need to ensure both offshore and digital assets are accurately reported would also create a dependency on data shared from other jurisdictions by way of existing international agreements; and also necessitate the development of further international agreements. This applies not only to current forms of wealth but to forms that have

103 Lawless M. and Lynch D. (2018) Scenarios and Distributional Implications of a Household Wealth Tax in Ireland, IFO Institute, Munich.

104 Therefore, the optimal approach would appear to be a high threshold, low rate, no reliefs, and exemptions only for non-tradable assets such as human capital. Valuation could be self-assessed (like the LPT), with updated valuations required only every four or five years.

not yet been developed – cryptocurrency, for example, has emerged in recent years as a means to hold wealth.

Finally, liquidity challenges would also need to be addressed. The treatment of persons whose placement on the distribution of wealth does not correspond to their place in the distribution of income, and who would face difficulties in liquidating assets to meet wealth tax liabilities, is often cited as an insurmountable obstacle to a wealth tax. However, similar challenges have been surmounted in the past and it may be possible to address this issue through the introduction and use of deferral arrangements in this space.

7.5 THE COMMISSION'S APPROACH

In examining the topic, the Commission concluded that a new tax on net wealth should not be introduced without first attempting to substantially amend Ireland's existing taxes on capital and wealth. As an alternative to introducing a new tax on wealth, the Commission believes the more productive route is to substantially re-work CGT and CAT. These are existing taxes that have well-established, but distinct, bases and are well-understood in their operation. The Commission believes these taxes can be substantially reformed to deliver a higher yield from sources of wealth. The Commission has accordingly recommended major reforms to the taxation of land and property - see Chapter 14 (Land and Property) in tandem with a series of reforms to both CGT and CAT which are outlined in this chapter.

In making its recommendations in this area, the Commission has had regard to a number of considerations as follows:

1. *In line with its net revenue-raising approach, there is a requirement to increase the yield from capital taxes.*

When looked at on an aggregate level, the Commission believes that increasing the yield from capital taxes will lead to a fairer and more progressive taxation system (see section 7.3 on the distribution of wealth). This should, in turn, reduce the need to impose taxes in other areas which, as outlined in Chapter 5 (Balance of Taxation), are more distortionary and economically damaging.

2. *There are major deficiencies in the way in which CGT and CAT are currently structured, which should be addressed.*

The existing interactions between CGT and CAT can reduce the effectiveness of both taxes, ultimately reducing the amount of tax collectable on asset transfers (particularly intergenerational asset

transfers), and undermining the equity of the taxation system. The taxes in their current form can also give rise to bad economic incentives, such as encouraging the holding of assets until death in preference to lifetime transfers. This can create lock-in effects.

3. *Where the assets being transferred are going-concern businesses or farms, regard should be given to the role that these enterprises play in the economy, as well as the jobs and income that they generate.*

The Commission believes that family businesses and farms have strong social and community objectives and play a vital role in the economy. While there is a need to ensure that such businesses and farms can continue to operate and prosper, it is important, in the interests of equity, to ensure the beneficiaries of any transfer are required to pay an appropriate level of tax; with thresholds set having regard to the distribution of wealth in Ireland.

This Commission notes this is not an 'all-or-nothing' consideration and that there are several ways in which this issue could be accommodated within the tax code without undermining the viability of the enterprise; such as the introduction of deferral arrangements or of long payment schedules that give rise to minimal or no interest.

When considering potential reforms to CGT and CAT there are several factors to consider to ensure a balanced and equitable outcome, including the interactions between these taxes. The Commission is of the view that the current system is not achieving this outcome, and can allow for material capital assets to pass between generations with little to no tax arising. As such, it is clear that significant reforms are required.

Accordingly, the Commission is making a number of recommendations for both CGT and CAT. When implementing these recommendations, however, it is important to be cognisant of both the interlinkages between the two taxes as well as the impact of each recommendation on capital taxation as a whole. The most appropriate path forward for capital taxation is dependent on both the manner and the degree to which the recommendations in this chapter are implemented. Failure to implement any of the recommended reforms for one of these taxes may necessitate further reforms in the other.

As noted in section 7.2.1, land and property assets form a significant part of the stock of wealth in Ireland. To this end, the Commission is also recommending a series of reforms to how immovable property is taxed in Ireland to significantly increase the overall yield from these sources of wealth in the years ahead - see Chapter 14 (Land and Property). Those

reforms should be considered in tandem with the recommendations made in this chapter.

7.6 CAPITAL GAINS TAX AND CAPITAL ACQUISITIONS TAX REFORMS

Capital Gains Tax and Capital Acquisitions Tax were introduced as part of a three-tax package on capital and wealth in the mid-1970s.[105]

- *Capital Gains Tax (CGT)*
  CGT applies to the nominal appreciation in value between the price that was originally paid for an asset and the price at which it was disposed of. It applies to chargeable gains incurred on or after 6 April 1974. In calculating the increase in value that is chargeable to CGT (i.e. the chargeable gain), allowance is also made for enhancement expenditure, where relevant, and certain costs of acquisition and disposal (such as legal fees, Stamp Duty, etc.).

  If an asset has fallen in value at the time of disposal, the loss arising can be offset against other capital gains made in the same year or in future years.

- *Capital Acquisitions Tax (CAT)*
  CAT is a tax levied on the acquisition of a gift or inheritance. It is charged on the taxable value of the gift or inheritance. The taxable value is the market value of the asset less any relevant costs or expenses incurred by the recipient (including any consideration paid). Gift tax became payable on all gifts received on or after 28 February 1974 and inheritance tax became payable in respect of all inheritances taken from 1 April 1975.

  As noted in Chapter 5 (Balance of Taxation), the large majority of CAT comes from inheritance tax, with much smaller proportions from gift tax[106] (and discretionary trust tax[107]). In calculating the value of the acquisition that is chargeable to CAT (the taxable value), relief may be available depending on the relationship between the disponer and the beneficiary (see section 7.6.2.1). Material levels of relief may also be available for gifts and inheritances of businesses and farms (see section 7.6.2.2). The first €3,000 of a gift from any individual in a year

105 A recurrent wealth tax was also introduced, but this was abolished in the late-1970s.

106 Gift taxes are often used internationally as a supplement to inheritance taxes to minimise the opportunity to use lifetime transfers to avoid taxation of inheritance.

107 Discretionary Trust Tax is a tax on trusts where there is no immediate benefit to the beneficiary. The trustees manage and distribute the assets in the trust subject to the powers conferred by the deed or will.

is exempt from CAT (known as the 'small gift exemption').[108]

The overarching objective of these taxes was to tax capital and wealth in a more equitable and broad-based manner than was possible under the previous duty system, informally referred to as death duties (being estate duty, legacy duty and succession duty). Under the previous system, capital gains were generally untaxed and estate duty (which accounted for approximately 90 per cent of the yield from death duties[109]) could generally be avoided through the making of gifts prior to death.

Although CGT and CAT significantly broadened the capital tax base, the two taxes were also designed to provide a degree of support to intergenerational wealth transfers. This can be observed by examining the manner in which various CGT and CAT reliefs have interacted since the inception of the two charges in the 1970s. For instance:

- CGT Retirement Relief has traditionally interacted with CAT Agricultural Relief and CAT group thresholds (formerly relationship reliefs) to minimise the tax due on intergenerational wealth transfers relating to family businesses and farms, and
- CGT Principal Private Residence Relief has traditionally interacted with the CAT group thresholds to minimise the tax due on intergenerational wealth transfers relating to family homes.

The level of support offered by CAT and CGT reliefs has increased[110] over time, with relief for agriculture and business[111] in particular expanding significantly. The tax-free group thresholds currently available under CAT evolved from what was previously a reduced rate and band system. Full spousal exemptions for gifts and inheritances were also introduced in this period.

The interlinkages and interactions between these two taxes were bolstered by the introduction of the 'same-event credit' in 1985. The

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108 Where the relief applies, the taxable value the gift is reduced by €3,000, irrespective of its total value.

109 Source: White Paper on Capital Taxes 1974.

110 It is noted that some increases will relate to inflation adjustments.

111 Business Relief was not introduced until 1994. Prior to this intergenerational transfers of business property were protected only by relationship reliefs, including a favoured nephew/niece relief.

credit allows for any CGT[112] paid by one individual to be offset against any CAT due by another individual in scenarios where both CGT and CAT arise on the same asset transfer (i.e. same event). This effectively creates a ceiling on the overall level of capital tax that can arise on transfers that are within the charge to CAT,[113] despite the fact the two tax charges arise for separate and distinct purposes.

7.6.1 Reforms to Capital Gains Tax

7.6.1.1 Transfers on a death

Although the meaning of 'disposal' is broadly defined for CGT purposes, certain events are deemed not to be disposals for CGT.[114] One such example is the transfer of assets on death. In death cases the transfer of an estate to a personal representative as part of the administration process is not regarded as a disposal for CGT purposes.[115] The personal representatives of a deceased individual are deemed to have acquired the assets at their market value on the date of death. When the assets are ultimately passed to the beneficiaries, again no CGT arises. The individual who receives the assets is also deemed to have acquired them at the market value at the date of death. This is similar to the treatment of gifts, which are deemed to have been acquired by the recipient at market value. The acquisition of capital assets at market value is referred to as the step-up or uplift basis, where the base value of an asset is stepped up to current market values. Other countries that employ this treatment of capital gains at death include the UK, the United States, Portugal, France, Spain and South Korea.

The current treatment of asset transfers on a death[116] effectively exempts any unrealised capital gains accrued by the deceased individual from the date of purchase until their date of death. This treatment impacts on the total revenue yield from CGT. Where an individual holds an asset until death, all capital gains accrued in life are, from

112 Although the credit typically applies in CGT/CAT same-event scenarios, the credit may also be available where an event gives rise to both a CAT charge and an exit tax on a life assurance product or investment fund.

113 This ceiling can be distorted by the application of other reliefs or thresholds.

114 Although often viewed as the simple sale of assets, a disposal for CGT purposes can include gifts, the scrapping of assets or not enforcing a right in such a way that those rights can transfer to another person (e.g. squatter's rights).

115 However, CGT applies to any gains made on sales of assets during the course of the administration of the estate.

116 As provided for in section 573 TCA 1997.

a CGT perspective, 'washed out' of the system. While the total value of the asset, incorporating any lifetime gains made by the disponer, may ultimately be subject to CAT in the hands of the beneficiary; the group thresholds and reliefs that apply in the CAT system are such that these gains may not be adequately captured there either.

In addition to the impact on revenue, the non-taxation of capital gains on death is economically distortionary. It creates a disincentive for 'lifetime disposals', which means that owners of assets may hold them for longer than they would wish to in order to avoid a CGT charge, meaning that capital may be tied up in a particular asset when it could be used more productively. Where the asset is a business, this may be particularly problematic, since it may discourage passing on a business to the next generation in a timely way – resulting in proper business continuity planning not taking place. This is recognised in the CGT code through the existence of reliefs which mitigate the disincentive, but which also introduce further complexities into the system. While the Commission recommends the retention of Retirement Relief for the immediate future (see section 7.6.1.3), the implementation of CGT on a death would remove the primary distortion that Retirement Relief addresses. Furthermore, the effective non-taxation of capital gains on death, while capital gains arising during a lifetime remain subject to the charge, is contrary to the principle of horizontal equity whereby the same tax base should be subject to the same treatment. The Commission on Taxation 1982 to 1986, the OECD, and the Mirrlees review in the UK have all previously highlighted the distortionary effect of the non-taxation of capital gains on death.[117]

Accordingly, the Commission is recommending that CGT should be chargeable on gains arising from the transfer of assets on a death. The Commission notes that the net revenue impact of such a change will be limited in circumstances where an existing CAT liability can be offset by the same-event credit. Conversely, where a beneficiary does not have a CAT liability on an inheritance (due to the availability of their group threshold for example), then a new CGT charge on the asset transfer will ensure some contribution to the Exchequer on that inheritance. As such, these changes should improve horizontal equity, address

117 Commission on Taxation (1982) First Report of the Commission on Taxation; Direct Taxation (Chapter 13); Mirrlees J. et al (2011) Tax by Design, the final report from the Mirrlees Review, Oxford, OUP; OECD (2021) Inheritance Taxation in OECD Countries, OECD Tax Policy Studies, No. 28, Paris, OECD Publishing.

economic distortions and, when considered with other changes to capital and wealth taxes proposed, support the Commission's approach of increasing the proportion of revenue from such taxes over time.

In making this recommendation, the Commission is mindful that this would be a major change to the tax code, and that further detailed considerations at both policy and operational levels, would be required in order to give it effect. We are also mindful that death is a sensitive time, and that dealing with the financial implications of a person's death can be, in itself, difficult.

The Commission therefore believes that, on horizontal equity grounds, the existing rules, reliefs and exemptions that apply on lifetime disposals should also apply to transfers on a death.[118] This includes, for example, the availability of losses and the treatment of asset transfers between spouses and civil partners.

Furthermore, consideration should be given to the payment of the CGT charge. In the case of a lifetime disposal the chargeable person can typically fund the tax from the proceeds of their own disposal. This may be more difficult in the case of a CGT liability arising on a death, where there may not be sufficient cash funds or other liquid assets in the estate to discharge the liability. In addition, if there are multiple beneficiaries to the estate, it might not be feasible to liquidate assets, or the enforced sale of assets may deny beneficiaries their right to a particular inheritance. An enforced sale might also deny the beneficiary the opportunity to avail of particular reliefs or credits that may have applied to the inheritance of the original asset. The same-event credit should be available, to allow CGT on the deemed disposal of an asset at death as a credit against any CAT liability arising on the inheritance of that asset.

Finally, given the administrative and legal complexities attached to administering an estate certain matters should be modified in the case of death transfers. These include the valuation of some assets, the determination of assets' original base cost, the timing of payments of CGT liabilities, and the filing of associated returns. As with all hardship cases, the option to defer payment (subject to late payment interest) should be available depending on ability to pay.

On balance, the Commission believes that the complexities associated with the introduction of CGT on a death can be managed

118 Subject to any necessary adaptations to ensure alignment for death cases.

through effective design. The extent of the existing loss of revenues, and the behavioural impact of treating lifetime transfers and transfers on death differently on the overall system of capital taxes, is such that this measure is strongly merited on horizontal equity grounds.

Recommendation

7.1 The Commission recommends, on horizontal equity grounds, that the transfer of assets on a death is treated as a disposal for Capital Gains Tax purposes. The Capital Gains Tax treatment of assets transferred during a lifetime in terms of tax payable, exemptions and reliefs available should also apply to assets transferred on a death.

7.6.1.2 Principal Private Residence Relief

As is clear from the data set out in this chapter, property is the most significant form of wealth held by Irish households. Indeed, there is a striking disparity between the average wealth of those households who own a home, and those who do not, which is becoming an increasingly significant dividing line in Irish society (see Tables 6 and 12). As is discussed in Chapter 14 (Land and Property), however, the Commission strongly believes that the best way to tax land and property is through annual value-based taxes.

At the same time, the complete exclusion of Principal Private Residences (PPRs) from CGT is an anomaly. The taxation 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. Partial relief may apply where the property was not fully occupied as a main residence throughout the period of ownership or where the sale price reflects development value. There is currently no limit to the house value or gain that can qualify for PPR Relief.

There is currently very limited data on the cost of PPR Relief as a tax expenditure. The total consideration reported in 2019 and 2020 for disposals of PPRs was €906 million and €837 million respectively.[119] However, the current monetary value of CGT forgone is unknown, as is the number of claimants and number of properties it has applied to.

119 Revenue Commissioners (2022) Summary of Capital Gains Tax Returns.

Such data gaps are unhelpful. Like all other tax expenditures, the cost of PPR Relief should be measured and subject to regular review so that tax policy can be developed on an informed basis.

The rationale for PPR Relief is to ensure that the sale of a house, which will generally be replaced with another house, can be done on a tax-neutral basis. The tax savings from PPR Relief generate more disposable funds for the next purchase of a PPR.

Property values have increased substantially over recent decades, and these increases have arbitrarily increased household wealth. Maintaining the exclusion of PPRs in its entirety means that a proportion of these gains and a source of household wealth will go untaxed indefinitely. The uncapped nature of the relief may also create an incentive for people to invest in owner-occupied housing assets in a way which, in the long run, increases house prices and reduces investment in economically-productive assets. On the other hand, removing the exemption in its entirety is also problematic, as it could create lock-in effects at a time when it is important to avoid further distortions in the housing sector.

The OECD has previously suggested that policymakers should explore the phasing out of some of the tax advantages that favour home ownership and that tend to benefit better-off households, including by imposing a limit on the value of owner-occupied housing that benefits from an exemption from taxation on capital gains. In a 2018 report,[120] the OECD noted that higher income households are likely to purchase more expensive homes and have more of their savings directed towards owner-occupied housing, and that one way of mitigating the adverse distributional effects of an open-ended exemption on owner occupied housing would be to cap this benefit. The report suggests such a cap could be imposed at a relatively high level to ensure that only those properties, and the high end of the residential housing market, are affected.

The Commission has considered different mechanisms by which the PPR Relief could be curtailed. These include the imposition of a threshold based on the value of the property sold, or a cap on the relief based on the amount of the capital gain. However, given the disparity in house values across the country, it may be difficult to set one threshold that appropriately reflects regional differences, whereas

120 OECD (2018) Taxation of Household Savings, Paris, OECD Publishing.

different thresholds depending on location may lead to other inequities. Another option would be to apply a lower rate of CGT to disposals of PPRs. The latter option may be more equitable given regional house value differences and at a minimum, would ensure a contribution to the State from all profitable disposals of houses, as opposed to a relatively high threshold which may not yield as much in revenue.

The Commission's view is that, in the short term, the priority with regard to taxing PPRs should be to increase the yield from the LPT as outlined in Chapter 14 (Land and Property), and that PPR relief should be restricted over time, with the precise mechanism to achieve this requiring further consideration.

Recommendation

7.2 The Commission recommends that the Capital Gains Tax Principal Private Residence Relief should be restricted over time.

7.6.1.3 CGT relief on transfer of a business or farm

The Irish tax code contains a number of provisions to reduce or eliminate the tax burden on transferring a business or farm. From a CGT perspective, two significant reliefs are Retirement Relief and Entrepreneur Relief.

Both schemes give CGT relief on the transfer of similar business assets and shares; with Retirement Relief also extending to a wider range of farming asset transfers. While there is some duplication in terms of how both reliefs are used by asset owners, there are a number of differences between them which means that a merger of the two reliefs would not be a straightforward matter. These include differences in terms of the qualifying conditions, who can claim, the quantum of relief available and the policy rationale behind each scheme. The aim of Entrepreneur Relief is to improve Ireland's competitiveness and attract entrepreneurial investment; while Retirement Relief is designed to encourage earlier lifetime and intergenerational transfers of businesses and farms. The Commission considers that both schemes should continue to coexist for the immediate future.

The Commission recommends that Entrepreneur Relief should be extended subject to appropriate limits and conditionality in order to provide a greater incentive for third-party investment in early-stage

enterprises. Our recommendations in this area are discussed in Chapter 9 (Promoting Enterprise).

The Commission also considers that Retirement Relief should be modified in some respects. Currently, Retirement Relief applies to individuals aged 55 years or over who transfer business or farming assets, where those assets were both owned and used in the ten years prior to disposal. Despite its name, the individual does not actually have to retire from the business or farming in order to qualify. While the Commission does not, as a general rule, support distinctions in the tax code based on age, it accepts in this instance the use of an age limit (55 years and older) to determine eligibility for Retirement Relief. This limits the cost of the relief, and helps to maintain its focus on individuals approaching retirement.

The consideration on disposal of qualifying assets for Retirement Relief was €579 million in 2019 and €884 million in 2020, for 1,604 and 1,691 claimants, respectively.[121] However, due to limitations on the data collected for CGT, the cost to the State in terms of forgone CGT revenue is unknown. As per our comments on PPR relief, this is a tax expenditure that should be measured and subject to regular review so that future tax policy can be developed on an informed basis.

Since 2014, if the person disposing of the assets is between 55 and 65 years of age and the disposal is to the individual's child,[122] an exemption from CGT applies irrespective of the value of the assets disposed of to that individual. Otherwise, full relief is only available where the consideration received or the market value of the assets disposed of, is below a threshold, which varies depending on the age of the person making the disposal and whether the disposal is to the individual's child or to another person (see Table 13). These thresholds are lifetime limits and if they are exceeded, Retirement Relief is withdrawn and CGT is payable on the gains on all disposals. Marginal relief can apply if the consideration is in excess of the threshold, limiting CGT to half of the difference between the sale price or market value and the threshold. A higher lifetime threshold for individuals who

121 Revenue (2022) Summary of CGT returns and Costs of tax expenditures (credits, allowances and reliefs).

122 For the purposes of the relief, a child includes a stepchild or child of a civil partner, an adopted child, a child of a deceased child, a niece or nephew who has worked full-time in the business or farm for at least five years, and a foster child who was under the care of and maintained at the expense of the individual making the disposal for at least five years before reaching the age of 18.

transfer their business or farm before turning 66 years was introduced in order to encourage timely transfers and in particular to improve the age profile of farming.[123] Table 13 shows the current consideration thresholds that apply in legislation.

Table 13: Lifetime consideration thresholds for Retirement Relief

AGE OF INDIVIDUAL MAKING DISPOSAL	AGED 55 TO 65 YEARS	AGED 66 YEARS OR OVER
Disposal to a child	Full relief, no limit	€3,000,000 threshold
Disposal to a person other than a child	€750,000 threshold	€500,000 threshold

Source: Taxes Consolidation Act 1997

From a fiscal sustainability and equity perspective, the Commission is not in favour of unlimited tax expenditures and supports the introduction of a cap for all disposals to children that qualify for Retirement Relief.

The Commission is also cognisant that Retirement Relief helps to maintain the viability of businesses and farms, by eliminating the tax cost arising from intergenerational transfers. Therefore, any cap would need to be high enough to prevent the breaking up of smaller family farms and businesses in order to pay a tax liability. It should also be designed so that it does not unduly restrict the transfer of productive small and medium-sized family businesses and farms. Furthermore, where a business or farm is transferred between generations, it is important that the payment of an appropriate and fair level of tax does not undermine the viability of the enterprise. There are several ways to achieve this objective, including through the introduction of deferral arrangements or long payment schedules that give rise to minimal or no interest.

Recommendation

7.3 The Commission recommends the introduction of a lifetime limit on all disposals of businesses and farms to children that qualify for Retirement Relief.

123 Department of Finance (2011) Financial Statement of the Minister for Finance.

7.6.2 Reforms to Capital Acquisitions Tax

As noted previously in this chapter, the distributional impact of having received a gift or inheritance is significant; as is the variation in asset types that households report receiving. Approximately 10 per cent of households in the bottom net wealth decile report having received a substantial gift or inheritance, compared to 67 per cent in the top net wealth decile.[124] Some 40 per cent of households in the top net wealth decile report having received a business or farm, whereas none of the households in the lowest net wealth decile have reported having received such an asset.

Receiving a business or a farm, moves the household up in the wealth distribution, by almost 26 percentiles, relative to what would be expected on the basis of household income.[125] For these reasons, it is particularly important to ensure that these material transfers of wealth (whether as a gift or inheritance) are adequately taxed.

7.6.2.1 CAT group thresholds

The amount of CAT payable is dependent on the relationship between the individual providing the gift or inheritance (the disponer) and the recipient. Relationships are grouped for CAT purposes and different tax-free thresholds (group thresholds) apply to each group. The current CAT groupings are outlined in Table 14.

Table 14: Current Capital Acquisitions Tax groups (2022)

GROUP	RELATIONSHIP TO THE DISPONER	CURRENT THRESHOLD
A	Child (son or daughter, including step-children and certain foster children), or a minor child of a deceased child of the disponer. Parents also fall within this threshold only where they take an absolute inheritance from a child.	€335,000
B	Sibling (brother or sister), niece or nephew or a lineal ancestor or descendent of the disponer (where not included in A)	€32,500
C	Other than A or B	€16,250

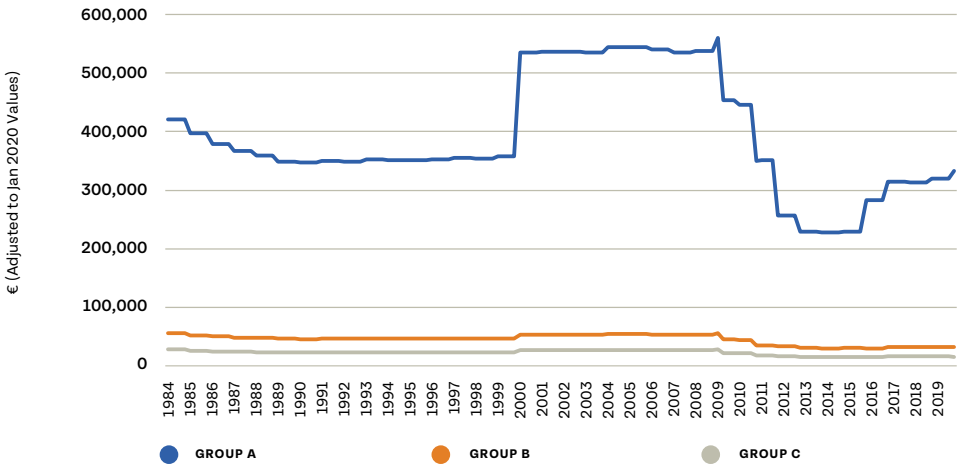
Source: Revenue website

124 CSO (2020) Household Finance and Consumption Survey 2018.

125 Gifts and inheritances in Ireland (2017), Martina Lawless and Donal Lynch, Working Paper No. 579.

The degree of relief afforded to beneficiaries by these thresholds can be significant. Figure 13 illustrates the level of the threshold for each group in recent decades; noting the thresholds were subject to indexation for the period 1990 to 2011.

Figure 13: Historical CAT group thresholds, adjusted to January 2020 values, 1984-2019



Source: Revenue Commissioners: Capital Acquisition Tax historical thresholds, adjusted to January 2020 values using CPI Inflation Calculator tool.
Note: where thresholds were in place across multiple years, prices for each relevant year are listed above, uprated to January 2020 prices.

While having a fixed, lifetime[126] threshold is a positive feature of the system, with regard to progressivity and administrability, the scale of the Group A threshold runs contrary to OECD guidance.[127] This guidance suggests that the difference between the treatment of direct descendants and relatives, should not be excessive.

The current level of the Group A threshold (€335,000) equates to:

- ten times median value of annual gross earnings or
- 14 times median equivalised household disposable income,

and is more than ten times the level of the Group B threshold. In 2020,

126 This lifetime limit applies to gifts and inheritances received on or after 5 December 1991.

127 OECD (2021) Inheritance Taxation in OECD Countries, OECD Tax Policy Studies, No. 28, OECD Publishing, Paris.

an overall wealth of €335,000 would have placed an individual within the wealthiest 40 per cent of net wealth holders in the State (see Table 7).[128]

Given the level of exemption provided to recipients in Group A, the group threshold for wealth transfers to children is a significant factor in determining the base for CAT and can have a fundamental impact on individual wealth. The current level of the Group A threshold may be beyond what some can gift or bequeath. This may explain why current Revenue estimates indicate that smaller reductions in the Group A threshold would only have a limited impact on yield (see Table 15). Additionally, of the cases where a gift or inheritance triggers a CAT liability, about half of CAT (whether number of cases or yield) is attributable to Group B.[129]

Table 15: Impact of movements in reduction of Group A threshold on Exchequer yield

LOWER GROUP A THRESHOLD	€320,000	€310,000	€300,000	€280,000	€250,000
Impact on Yield (in €m)	↑€13m	↑€22m	↑€30m	↑€48m	↑€74m

Source: Revenue Ready Reckoner, November 2021 edition

The current level of the Group A threshold appears to be both inequitable and regressive. Accordingly, the Commission is recommending that the Group A threshold be substantially reduced, thereby bringing the value of the Group A threshold closer to the value of the Group B and Group C thresholds. When determining the appropriate level of reduction for the Group A threshold, consideration could be given to aligning the group thresholds, particularly the Group A threshold, with an appropriate benchmark; potentially relating to household wealth generally.

Furthermore, notwithstanding the estimates illustrated in Table 15, in the course of our work, we noted some data limitations which affected our ability to establish the overall impact of the current group thresholds on the CAT base. Current CAT reporting requirements do not require an individual to report a gift or inheritance until they

128 CSO (2022) Household Finance and Consumption Survey 2020.

129 However, it should be noted that the volume of disponers to which Group B applies is significantly greater than to which Group A applies.

have used at least 80 per cent of the applicable group threshold.[130] We recommend that this 80 per cent requirement should be withdrawn and that steps be taken as part of the modernisation of tax administration - see Chapter 17 (Modernisation of Tax Administration) to make it easier for taxpayers to report capital taxes events, including the receipt of a gift or inheritance, as they occur.

Recommendation

7.4 The Commission recommends substantially reducing the Capital Acquisitions Tax Group A threshold, bringing the Group A threshold closer to the Group B and Group C thresholds. Furthermore, the Commission recommends that the reporting requirements relating to the utilisation of group thresholds be strengthened.

Finally, the Commission is aware of a disparity in CAT legislation with regard to the categorisation of foster children for group-threshold purposes. Foster-parent relationships were previously recognised for CAT purposes, and have been treated as parent-child relationships for the purposes of Group A since 6 December 2001. However, this change has not been extended to the wider family unit into which a child is fostered.

The Commission believes that the role of a foster child in the wider family unit should be fully recognised, and that Group B relationship thresholds should apply to foster sibling, aunt/uncle, grandparent relationships, etc. in the same manner that would have been applicable if the child in question was, in law, a child of his or her foster parents.

Recommendation

7.5 The Commission recommends that the Group B relationship thresholds for Capital Acquisitions Tax should apply to a foster child in the same manner that would have been applicable if the child in question was, in law, a child of his or her foster parents.

130 Unless a claim for Business Relief or Agricultural Relief is also made on the gift or inheritance.

7.6.2.2 CAT relief on transfer of a business or farm

As noted in this chapter, capital taxes in Ireland have traditionally supported intergenerational transfers of family farms and businesses. Although such ventures may be asset-rich, in many cases their income streams may be enough to allow for the continued operation of the business, but not sufficient to sustain the major capital tax charges that could occur on the transfer of ownership.

However, where a business or farm is transferred from one generation to the next, it is important, in the interests of equity that an appropriate level of tax is paid without undermining the viability of the enterprise. There are several ways to achieve this objective, including through the introduction of deferral arrangements or long payment schedules that would give rise to minimal or no interest.

While a degree of relief may be appropriate to support this transfer, the Commission believes that the current level of relief provided by way of Agricultural and Business Relief is excessive – with such reliefs effectively providing a reduction of 90 per cent to the value of a qualifying gift or inheritance that is subject to CAT. This level of relief allows for substantial assets to be transferred by way of gift or inheritance while attracting a minimal tax charge. As noted previously in this chapter, holdings of land and self-employed businesses are a substantially larger share of the net wealth for the highest net wealth decile, compared to any other decile (see Figure 12). Recent research by the Economic and Social Research Institute (ESRI) also suggests that the primary beneficiaries of such reliefs (with particular regard to Business Relief) are not those receiving small family businesses or farms, but those in receipt of more substantial ones.[131]

Furthermore, this level of relief represents an exponential jump on the level of relief provided by these measures when they were first introduced.[132]

Accordingly, the Commission is recommending that the level of these reliefs be curtailed.

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131 Kakoulidou, T. and Roantree B. (2021). Options for raising tax revenue in Ireland, Budget Perspectives 202201, Dublin, ESRI.

132 Agricultural relief has been in place since the first CAT Act and originally provided for 50 per cent relief up to the first £100,000 of agricultural property assets where certain farming conditions were met. Business Relief when introduced by Finance Act 1994 originally provided for a 30 per cent reduction on the first £250,000 of relevant business property and a 25 per cent reduction on the balance.

The appropriate level at which these reliefs should be set in the future should be determined having regard to their interaction with the CAT group thresholds, and the availability of deferral options. It is important to ensure that efforts to seek yield in this area do not cause undue hardship to small farmers and business owners. For this reason consideration could be given to progressive curtailment of the level of relief available beyond certain market values.

Finally, we note that both reliefs in their current format do not necessarily require the recipient to be actively involved in the day-to-day operations, or management, of the business or farm. This can result in the transfer of relatively passive assets (from the perspective of the beneficiary) without impacting the beneficiary's entitlement to relief, as they may decide to:

- in the case of farms qualifying for Agricultural Relief, lease any acquired farmland or
- in the case of businesses or farms qualifying for Business Relief, outsource the day-to-day operations or executive management functions of an active, trading businesses or farms received.

On this basis, the Commission believes that consideration should be given to restricting the availability of these reliefs to beneficiaries who are actively involved in either the day-to-day operation of the business or farm or, in the case of Business Relief, the executive management of the enterprise.

Recommendation

7.6 The Commission recommends that the level of Agricultural and Business Relief available for Capital Acquisitions Tax be reduced and that the qualifying conditions for both reliefs be amended to incentivise, and ensure active participation in the farm or business by the recipient.

7.6.2.3 Capital charge

Elsewhere in this report the Commission commented on the importance of maintaining a broad tax base in the interest of fiscal sustainability, as well as to sustain a sense of social cohesion, and to limit increases in tax rates. This logic applies in respect of taxes on income, but could also be extended to taxes on gifts and inheritances, as the imposition

of taxes on such windfall gains should have limited economic and labour-market implications.

Even with reduced thresholds, there is a case for applying a modest charge to gifts and inheritances generally. The existing CGT and CAT relief structure can allow for assets to pass untaxed between generations. Although the Commission has proposed the restriction of these reliefs as a general direction of travel - the degree to which each individual relief should be curtailed can be difficult to specify given their interconnected nature. To this end, it may also be appropriate to introduce a minimum CAT charge.

A minimum charge could be applied in a number of ways. One such approach could be to replace the current relationship-based tax-free group thresholds with modest-rate group thresholds. With such an approach, gifts and inheritances up to the group threshold amount would be subject to a modest rate (say one or two per cent), with the 33 per cent rate applying to any amount in excess of the group threshold. How this approach would impact the current rate structure is illustrated below:

RATE	GROUP A	GROUP B	GROUP C
Modest rate charge	First €32,500	First €335,000	First €16,250
33 per cent	Balance	Balance	Balance

For administrative purposes, the minimum charge should not be applied to gifts and inheritances with a nominal value. This exclusion could be aligned with the value of the small gift exemption (currently €3,000).[133]

Recommendation

7.7 The Commission recommends that a modest charge should be applied to gifts and inheritances generally.

133 Currently, the small gift exemption of €3,000 applies to all gifts and effectively operates as a discount of up to €3,000 on the taxable value of gifts. If a minimum charge was introduced in the manner outlined in this chapter, we do not believe a small inheritance exemption should operate in the same broad-based manner.

7.7 RECOMMENDATIONS

Chapter 7: Taxes on Capital and Wealth

7.1 The Commission recommends, on horizontal equity grounds, that the transfer of assets on a death is treated as a disposal for Capital Gains Tax purposes. The Capital Gains Tax treatment of assets transferred during a lifetime in terms of tax payable, exemptions and reliefs available should also apply to assets transferred on a death.

7.2 The Commission recommends that the Capital Gains Tax Principal Private Residence Relief should be restricted over time.

7.3 The Commission recommends the introduction of a lifetime limit on all disposals of businesses and farms to children that qualify for Retirement Relief.

7.4 The Commission recommends substantially reducing the Capital Acquisitions Tax Group A threshold, bringing the Group A threshold closer to the Group B and Group C thresholds. Furthermore, the Commission recommends that the reporting requirements relating to the utilisation of group thresholds be strengthened.

7.5 The Commission recommends that the Group B relationship thresholds for Capital Acquisitions Tax should apply to a foster child in the same manner that would have been applicable if the child in question was, in law, a child of his or her foster parents.

7.6 The Commission recommends that the level of Agricultural and Business Relief available for Capital Acquisitions Tax be reduced and that the qualifying conditions for both reliefs be amended to incentivise, and ensure active participation in the farm or business by the recipient.

7.7 The Commission recommends that a modest charge should be applied to gifts and inheritances generally.

RETURN TO CONTENTS

Chapter 8:
Taxes on Retirement Savings

8.1 INTRODUCTION

Tax expenditures associated with the provision of supplementary pensions are among the largest grouping of tax expenditures recorded. Although not explicitly referenced in the Commission's terms of reference, during the course of its work the Commission formed the view that a detailed examination of pension tax expenditures was warranted. This is because of their significant cost as well as their relevance to the key principle of equity, and the fact that overall levels of supplementary pension coverage remain low and levels of home ownership (an alternative form of post-retirement wealth) are falling.

Having also considered the potential impact of the recently announced Automatic Enrolment Retirement Savings Scheme (AE), the Commission notes the overall cost of funding supplementary pension provision into the future will likely increase. This will impact on the Exchequer both directly (through the direct contribution costs of AE) and indirectly through significant increases in the cost of related tax expenditures in this area.

The examination of pensions tax expenditures is also relevant to other principles that ground the work of the Commission, and reinforce the need for good data upon which to base policy decisions.

8.1.1 Outline of pension landscape and developments in Ireland

The pension system in Ireland is structured around three pillars, as follows:

- *First pillar: State pension system*
  This is designed to meet basic living needs and prevent poverty.

- *Second Pillar: Occupational pensions*
  This is designed to provide a standard of living related to pre-retirement income. These pensions are usually provided through occupational pensions that supplement the first pillar. This pillar will soon include Automatic Enrolment pensions.

- *Third Pillar: Voluntary pensions*

  This enables people to save if they wish to so. In Ireland, savings can be made through Additional Voluntary Contribution (AVCs) to occupational pensions or through various individual pension products such as Pension Retirement Savings Accounts (PRSA).

The Commission has focused its work on examining the cost and effectiveness of the tax expenditures associated with supplementary pensions under the second and third pillars. The first pillar encompasses the State pension, which falls outside the Commission terms of reference and has been examined extensively through the work of the Commission on Pensions which reported in 2021.[134]

The State provides support and incentives through the taxation system to support individuals to provide for their retirement through the deferral of income to supplement their income in later years. Supplementary pensions play a critical role in maintaining living standards and lifestyles in retirement. As explored further in Chapter 4 (Fiscal Sustainability), Ireland's population is ageing and people are also living longer and, therefore, living an increasing proportion of their lives in retirement. These demographic changes, along with the sharp decline in home ownership rates among recent generations, raise questions around the structure and sustainability of tax expenditures in this area. Section 8.2.1 sets out in detail the range of state supports in place to incentivise pension contributions and the estimated cost of those expenditures.

8.1.2 Supplementary pension coverage

Retirement income is likely to come from a variety of sources (for example, savings or investments). However, for many individuals the State pension will be their only or primary source of retirement income. Economic and Social Research Institute (ESRI) research, using the Longitudinal Study on Ageing, found that 55 per cent of men and 28 per cent of women were in receipt of supplementary pension income.[135] Central Statistics Office (CSO) data indicates that about 56 per cent of men and about 54 per cent of women were contributing to a pension in Q3 2020. Looking at the private sector alone, the Roadmap for Pensions Reform estimates that just 35 per cent of workers have supplementary

134 Pensions Commission (2021) Report of the Commission on Pensions.

135 Nolan, A., Whelan, A., McGuinness S. and Maître, B. (2019) Gender, Pensions and Income in Retirement, Dublin, ESRI.

pension cover despite the availability of extensive tax reliefs.[136] This analysis suggests that a high percentage of the working population is either not saving enough, or is not saving at all, for retirement, leaving large cohorts of people reliant on the State pension in future years.

It is for these reasons that the Government announced the development and implementation of an Automatic Enrolment retirement savings system in the coming years (discussed further in section 8.3).

The stated policy goal for pension tax expenditures was recently articulated in a Tax Strategy Group paper on pensions as follows:[137]

"It has been long established policy to encourage individuals on middle incomes to provide for some level of private pension which would (in addition to the basic State pension) help provide for an adequate replacement income in retirement".

Having regard to the level of supplementary pension coverage that currently exists in Ireland, the Commission is satisfied that, in the absence of AE, the stated policy goal is largely not being achieved for significant cohorts of low- and middle-income workers, despite the availability of generous tax incentives in this area.

The European Commission's Pension Adequacy Report 2018 discusses the relationship between home ownership and income protection in retirement and found that ownership is associated with lower levels of poverty. In Ireland, the average age of first-time buyers is increasing,[138] and the rising number of people living in rented accommodation[139] has the potential to have negative implications for the income protection aspect of pension adequacy. These factors also feed into decisions around what individuals choose to do with discretionary income at lower income deciles, as saving for a home may displace saving for retirement.

When considering the tax expenditures in this area it is important to consider to what extent current tax reliefs are appropriately targeted and the likely impact and effect of the new AE system reforms.

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136 Department of Social Protection (2019), A Roadmap for Pensions Reform.

137 Department of Finance (2012) Tax Strategy Group 12/21, Pension Taxation Issues.

138 Central Bank of Ireland (2019), Household Credit Market Report. In 1991 the average age of first time buyers was 26; by 2016 it had reached 34.

139 CSO (2016), Census of Population 2016 – Profile 1 Housing in Ireland: Tenure & Rent. The Percentage of households renting from private landlords or a voluntary body has risen from 8 per cent in 1991 to 20 per cent in 2016.

8.1.3 Outline of tax treatment of supplementary pension in Ireland

State support for supplementary pensions is neither new, nor unique to Ireland - most developed economies have fiscal supports for pensions. Support through the taxation system involves the deductibility of contributions made to supplementary pension arrangements for Income Tax purposes. The tax relief approach assumes that workers require an incentive to lock-up savings until they retire, in order to achieve the desirable policy objective of either increasing aggregate savings or encouraging citizens to pay for their retirement by deferring income and consumption today to provide for later years and maintain adequate living standards and lifestyles in retirement. The Commission is acutely aware that care must be taken in this area as changes to the system now can have knock-on effects on coverage later, with consequential impacts for the Exchequer.

Following the publication of the Roadmap for Pensions Reform in 2018, Government set up the Inter-Departmental Pensions Reform Group (IDPRTG) to consider certain tax-related matters relating to pensions assigned to it under the roadmap. It published a report in late 2021 which has informed the Commission's work.[140]

8.1.4 Exempt, Exempt, Taxed system of tax reliefs

Ireland, along with many other OECD countries, offers tax relief at certain points of the savings cycle (at deduction, at the point of investment) and applies taxes at drawdown. This is referred to as 'EET' referring to the 'Exempt (contributions), Exempt (return on investment), Taxed (pension Income)'. According to the OECD, 'EET' is the most commonly used system for taxation of pension savings, and is in use in 20 of the 42 countries included in their 2018 study (including Ireland).[141] The Commission endorses the 'EET' model of tax relief, but is of the view that there are significant deviations from the full application of the model that should be addressed from an equity perspective.

Ireland's approach to supporting supplementary pension provision has often attracted criticism on equity and fairness grounds. The OECD have noted that Ireland's EET regime is not appropriately applied[142] where certain income channelled through pensions is unlikely to be

140 Department of Finance (2020) Report of the Interdepartmental Pensions Reform and Taxation Group.

141 OECD (2018) Pensions Outlook 2018, Paris, OECD Publishing.

142 OECD (2008) Economic Survey of Ireland, OECD Observer, Paris, OECD Publishing.

taxed at any point in the life cycle. The OECD further notes that even where there is a consistent rate of taxation applied, there is a net fiscal cost associated with an EET system, which increases when three additional factors are accounted for:

1. The existence of a tax-free lump sum;
2. Under-funding and lower income replacement in retirement, which leads to a lower effective rate of taxation in a progressive taxation system;
3. Concessionary tax treatment for those over a certain age.

Effective tax rates are lower in retirement as workers typically earn more in their working life than they will in retirement. Effective tax rates are also lower due to specific elements of the tax code favouring retired citizens (e.g. Age Credit, specific USC treatment, PRSI exemption). This beneficial age-related tax treatment applies to income generally and not solely to pension income, and is considered further from an equity perspective in Chapter 6 (Tax Equity and Base Broadening).

8.1.5 Marginal rate relief on pension contributions

At present, the pension tax incentive system means that each taxpayer receives tax relief on pension contributions at their marginal tax rate (either 20 per cent or 40 per cent) subject to rules regarding caps and limits.

The pension tax relief system is long established but not universally accepted. Some stakeholders note that marginal relief on contributions is costly and favours those on higher incomes, while those on lower incomes receive a smaller or no incentive whatsoever. The contrary view is that taxation on pension contributions is deferred rather than relieved indefinitely, so marginal relief should be retained as tax will be paid upon drawdown.

The Commission considered potential changes to the existing marginal tax relief approach including through potentially allowing all contributors access the same tax level of relief at the higher rate, lower rate or a standard mid-point rate.

While there may be merit in moving all contributors to the same rate from an equity perspective, a number of concerns arise. These include the overall cost and deadweight associated with moving to a higher rate of relief, the disincentive effect that might result if contributors were standardised to a rate below their marginal rate

of tax, and the impact such a change might have on supplementary pension provision.

On balance, the Commission concluded that the existing approach of marginal relief was appropriate on the basis that such contributions represent a deferral of income. In addition such an approach is fair and equitable so long as pension income is fully taxed at the point of drawdown, and in the context of our recommendations on the Standard Fund Threshold (see section 8.5.4).

8.2 BRIEF OVERVIEW OF MAIN TAX EXPENDITURES AND COST

The tax treatment of pensions represents one of the larger Exchequer tax expenditures being worth at least €1.7 billion (2018 figures). In common with other countries operating an EET system, the exact cost of this treatment is difficult to quantify due to the general nature of tax expenditures, data difficulties and also specific pension-related challenges.[143]

8.2.1 List of tax expenditures

As part of its work the IDPRTG prepared a listing of the full range of pension-related tax reliefs offered in various ways and at various times. The nine reliefs identified are reproduced at Table 16.

143 Department of Finance (2020) Report of the Interdepartmental Pensions Reform and Taxation Group.

Table 16: Pension tax reliefs

STAGE	TAX EXPENDITURE	DESCRIPTION	BENEFICIARIES	COST €M
CONTRIBUTIONS	Employees' contribution to approved superannuation schemes	Contributions are allowable as an expense in computing Schedule E income (Sections 774 & 776).	663,900 (2018)	€677.7 (2018)
	Exemption of employers' contributions from employee BIK	Sums paid by an employer into an approved, statutory or foreign government employee retirement scheme are not chargeable to tax in the hands of the employee (Section 778).	413,000 (2018)	€658.3 (2018)
	Pension Contribution (Retirement Annuity and PRSA)	Figures in this field are a total for RAC's and PRSA's which are not available individually.	98,300 (2018)	€241.3 (2018)
	Employers' contributions to approved superannuation schemes	Contributions are allowable as an expense in computing Schedule D Case I or Case II income (Section 774).	431,000 (2018)	€173.2 (2018)
	VAT recovery	Employer value-added tax (VAT) recovery for pension fund management fees and set-up costs	No beneficiary or costing data available in the Tax expenditure report.	
	Employer PRSI	Relief from Employer PRSI on employers contribution	No beneficiary or costing data available in the Tax expenditure report.	
RETURN ON INVESTMENTS	Exemption of investment income and gains of approved superannuation funds (includes Stamp Duty, CGT, Exit Taxes, VAT exemption etc.).	Exempts the investment income of a fund held or maintained for the purpose of a scheme (Section 774 – Approved Fund, Section 785 – RSA, Section 787I – PRSA)	No beneficiary or costing data available in the Tax expenditure report.	
DRAWDOWN	Tax Relief on "tax-free" lump sums	The first €200,000 of a retirement lump sum is tax-free, the portion of a lump sum between €200,001 and €500,000 is taxed at the standard rate and the balance is taxed at the individual's marginal tax rate. Data is not available on the cost of this, as it is not possible to distinguish between redundancy-related lump sums and retirement lump sums.	No up-to-date beneficiary or costing data is available in the Tax expenditure report. Revenue published an estimate for this expenditure in 2014 of €134 million.	
	Beneficial inheritance treatment	Beneficial inheritance treatment of ARF/AMRF (approved minimum retirement fund)	No beneficiary or costing data available in the Tax expenditure report.	
TOTAL			At least €1,750m	

Source: Department of Finance, Tax Expenditure Report October 2021 and IDPRTG report November 2020, Revenue Commissioners Tax Expenditures Statistics Report

8.2.1.1 Data difficulties

Data difficulties cloud the overall understanding of pension tax expenditures in two ways. No data is collected on some expenditures, and the manner in which other expenditures are costed can understate the cost or impact the effect of these reliefs.

Areas of concern in this respect include investment income gains during that stage of the EET cycle and the cost of pension-related tax-free lump sums. Failure to provide costings means that the public may be unaware of the scale of the benefit that they derive from investing in a pension, and policymakers cannot gauge the scale of the tax forgone. For example, the omission of any figures on the implicit cost of employer contributions to unfunded public sector pension schemes is significant. According to the ESRI,[144] the cost of tax relief of these implicit contributions (on the basis that they represent a benefit-in-kind) was estimated at €778m in 2017. These costs are not recorded in the tax expenditure data, as there are no employer contributions made for such schemes. These and other missing costs are likely to be very significant and it is clear that the reported cost of pension tax expenditures (currently estimated at over €1.7 billion) represents a considerable understatement of the true cost of these expenditures.

It is also important to note the data-related limitations relating to costing methodologies in this area. Ireland, along with most OECD states, uses the revenue-forgone method of estimating the costs of tax expenditures. The behavioural assumptions upon which calculations are based will have implications for the estimated costs. All costings for pension tax expenditures should be treated with caution as they do not account for behavioural change.

8.3 AUTOMATIC ENROLMENT PENSIONS

The latest evolution of the supplementary pension system, Automatic Enrolment Retirement Savings Scheme (AE), was announced by the Government on 29 March 2022 and contains a number of intersection points with the current pension tax relief system, which proved pertinent to the work of the Commission.

AE will apply to all employees earning between €20,000 and €80,000 per annum who are not already enrolled in an occupational pension scheme. The Revenue Commissioners (Revenue) data indicates

144 Doorley, K., Callan, T., Regan, M., and Walsh, J.R. (2018), The tax treatment of pension contributions in Ireland, Dublin, ESRI.

that initially this will affect about 750,000 people.[145] For every €1 an employee contributes, the government will contribute €0.33 and the employer €1. This is roughly equivalent to a 25 per cent tax relief and is paid regardless of whether the employee is below the Income Tax threshold, or paying the standard rate or higher rate of Income Tax.

The contributions system will be phased in over a 10 year time period. When the scheme commences, employers and employees will make pension contributions at a rate of 1.5 per cent of the employee's gross salary. The 1.5 per cent will gradually increase every three years until it reaches a maximum of 6 per cent each in year 10 onwards.

8.3.1 Tax aspects of AE

Employee contributions will be paid out of after-tax income (unlike the current pensions tax system, where the employee contribution is paid out of pre-tax income). Employer contributions may be deducted from income of the employers' business. This will lead to an increase in associated tax expenditures of an estimated €200 million per year during full scheme operation, according to work carried out by the Department of Social Protection (DSP). As with supplementary pensions currently, it is expected that gains made during the investment period will not be taxed.

Government contributions will not be taxed at contributions stage. It is expected that the pension and taxation regime in force at point of drawdown will apply to these amounts. This means that under the EET system, drawdowns from the pension fund would be taxed (with the exception of any allowed tax-free lump sums).

The current system of tax relief will continue to apply for those either currently making private and occupational pension contributions outside the AE system, or who want to avail of it later. Salaries up to €80,000 will continue to be eligible for the AE scheme, attracting both State and employer contributions, but over that level no matching funds will be provided by the State.

Implementation of this final Government-agreed design has commenced and will continue into 2023, with a view to having the system up and running by the end of 2023 and ready to take first enrolments from early 2024.

145 Estimate based on 2019 employment figures.

8.3.2 AE cost implications and fiscal sustainability

As noted earlier, it is expected that AE will bring, approximately, an additional 750,000 people into the supplementary pension system largely made up of low- and middle-income earners. This should greatly increase the level of pension coverage across the State. The expected cost of AE will increase gradually over the first ten years until year ten (full operation), when it is expected to cost the Exchequer around €540 million annually in direct contributions. In addition to this, the tax expenditure relating to increased Employer contributions (offset against Corporation Tax) is expected to cost around €200 million annually, bringing the total cost to around €740 million annually, according to work carried out by DSP in preparation for the Government decision on AE. A number of further tax expenditures, which cannot be costed, will also increase, including the cost of increased tax-free lump sums, gains on AE fund investment gains and employer contributions.

Conversely, if AE was not implemented, modelling provided to the Commission by DSP suggests that the potential cost of that same cohort making similar contributions through the existing tax relief system would likely be in the region of €750 million. While this looks like a cost-neutral decision, it will represent a very significant uplift in the future financial commitments of the State. All AE participants already had the right to participate in existing tax relief supported measures but had not yet signed up to a participating pension policy. While the estimated increase in pension coverage that will be brought about by AE is welcome, it is clear that this will come with significant increased direct Exchequer and tax expenditure costs.

8.4 STRATEGIC OBJECTIVES

In considering its work in this area, the Commission has developed a number of ways of thinking about pension tax expenditures that have guided its rationale for arriving at the recommendations set out in this chapter. These include the level of supplementary pension coverage achieved by current and future policy, the equity of the existing system of reliefs and the overall cost of State support in this area.

8.4.1 Coverage

The Commission supports the continued use of tax expenditures as a mechanism to enhance the provision of supplementary pensions in Ireland and believes that such expenditures are justified on social and economic grounds. Although this system of deferred taxation

diminishes an individual's tax payments during their working life, it encourages citizens to save for their old age, when the deferred tax falls due. As outlined in Chapter 4 (Fiscal Sustainability), Ireland's dependency ratio is expected to dramatically rise in the coming decades, significantly increasing the burden of providing the State pension in the longer term. Providing effective supports to assist individuals to make adequate provision for their retirement is vital to supporting this transition. The Commission endorses the implementation of the AE scheme as a measure that directly tackles the persistently low levels of pension coverage among those with low to middle incomes and encourages individuals to commence saving for retirement early and in a sustainable manner.

8.4.2 Equity

The policy aim of pension tax expenditures should be, primarily, to encourage saving for retirement. The Commission supports the continued application of tax relief at marginal rates of tax on the basis that such an approach is fair and equitable so long as pension income is fully taxed at the point of drawdown. The Commission has identified a number of areas where reforms are necessary in order to protect the integrity of the 'EET' system of tax relief, including restricting the level of tax-free lump sum available to drawdown at retirement and addressing other anomalies in the tax treatment of different retirement arrangements.

8.4.3 Cost

Furthermore, the Commission notes the estimated cost of existing tax expenditures in this area and the potential fiscal impact of the roll out of the AE scheme. In this context, the Commission believes that consideration should be given to further limit the upper level of State support available for supplementary pension saving in order to limit the cost of tax expenditures and contribute both to the cost of implementation of AE and the broader coverage of supplementary pension provision generally. In tandem with these changes, the Commission also recommends that age-related restrictions on pension contributions be reformed, thus providing greater flexibility to savers to make contributions to their retirement as and when they can afford to do so. Such a recommendation accords with our view that the taxation system should be responsive and capable of adapting to the changing nature of work and the economic environment.

The Commission also notes the lack of availability of adequate data in the area of pension tax expenditures, which has impeded its ability to comprehensively evaluate the cost of associated tax expenditures. As illustrated in section 8.2.1, there is no data available in relation to a number of key expenditures in this area, including lump sums and investment gains. It is estimated that those un-costed tax expenditures are substantial and that the true cost of expenditures in this area is likely to be well in excess of those currently reported.

8.5 COMMISSION PROPOSALS

8.5.1 Comprehensive implementation of 'EET'

Ireland is somewhat unusual in Europe in having substantial pension tax-free lump sums.[146] In some countries lump sums are not permitted (Netherlands and Sweden, for example) while in others the amount of lump sum is linked to a proportion of the total pensions savings pot and it is taxed (UK, France and Belgium). Only Portugal, Malta and Ireland have some lump sum tax-free and Ireland is alone in having a monetary limit (€200,000 lifetime limit) rather than a percentage of overall final savings limit.

No beneficiary or costing data is available in the Department of Finance Tax Expenditure report for the cost of tax-free pension lump sums as it is not currently possible to disaggregate data from other non-pension lump sums. It should be noted that Revenue expenditure data from 2014 placed the annual cost of tax-free lump sums at €134 million at that time.

146 OECD (2015) Stocktaking of the tax treatment of funded private pension plans in the OECD and the EU, Paris, OECD Publishing.

Table 17: Tax treatment of lump sums

	PERMITTED LUMP SUM TAX-FREE THRESHOLD	TAX TREATMENT
Revenue Approved Pension Scheme members	1½ times final remuneration (or 3/80ths of final remuneration for each year of service over 40 years) to a maximum of €200,000	Tax free
RAC, PRSA	<€200,000	Tax free
Defined Contribution scheme members moving to an ARF	€201,000–€500,000	Standard rate
	>€501,000	Marginal rate

Source: Taxes Consolidation Act 1997, IDPRTG report

As can be seen from Table 17, different rules apply to the calculation of a lump sum entitlement depending on the savings vehicle, subject to an overall lifetime limit of €200,000 that encompasses all retirement lump sums paid to an individual on or after 7 December 2005. Furthermore, beneficial treatment is also provided for lump sum amounts between €201,000 and €500,000, which are taxed at the standard rather than marginal tax rate. As indicated earlier, the exemption of significant elements of pension income from tax at the point of drawdown raises questions about the equity of the pension tax relief system as all other income from supplementary pensions is taxable at the marginal rate and subject to USC.

While the Commission recognises the role the provision of a tax-free lump sum can play in incentivising individuals to save for retirement, the Commission believes that the existing level of exemption is excessive and should be reduced. On equity grounds, the existence of a large tax-free lump sum threshold is inconsistent with the full implementation of an 'EET' system of tax relief and the ongoing retention of marginal tax relief on pension contributions.

Recommendation

8.1 The Commission recommends more comprehensive implementation of the 'Exempt, Exempt, Taxed' model of pension provision including recommending a meaningful reduction in the overall level of tax-free lump sum available from its current level (worth over 4 times average earnings). Marginal tax rates should apply on all lump sums over the tax-free threshold.

Furthermore, the Commission also notes that there are scenarios where some individuals may receive a tax-free lump sum on departure from employment of up to €200,000 while also benefiting from a tax-free pension lump sum to the same amount. While the tax relief available on an ex-gratia lump sum may be reduced by the value of the pension lump sum from the occupational pension scheme associated with the job from which they are terminated, lump sums derived from PRSAs, RACs and other pension schemes are not currently included. The Commission suggests that such anomalies can be addressed through the introduction of a single lifetime limit to include both pension lump sums and any ex-gratia termination payments received.

Recommendation

8.2 The Commission recommends that there should be a single tax-free lump sum lifetime limit to include both pension lump sums and any ex-gratia termination payments received.

8.5.2 Approved Retirement Funds

Approved Retirement Funds (ARF) are a personal investment account into which individuals can (in certain circumstances) transfer part of their retirement fund at retirement instead of using those funds to purchase an annuity. Unlike an annuity, the use of an ARF allows an individual to pass on any unused capital as an inheritance without any clawback of pension Income Tax relief granted during the contribution phase.[147] ARF returns are not taxed but any amount drawn down is

147 Department of Finance (2020), Report of the Interdepartmental Pensions Reform and Taxation Group.

subject to Income Tax, USC and PRSI (where the individual is below the age of 66).

The amount payable from an ARF to the deceased individual's estate is treated as income of the deceased for the year of the assessment in which he or she dies, with some exceptions. Benefits payable from ARFs can be passed to a spouse or civil partner without payment of CAT or Income Tax (a tax rate of 30 per cent applies subsequently on the death of the spouse or civil partner). Benefits payable to a child under 21 are subject to CAT but not to Income Tax and benefits payable to a child over 21, either from the original ARF or subsequent to a transfer to a spouse/civil partner, are subject to income tax at the rate of 30 per cent (which is a ring-fenced final liability tax). Otherwise, ARFs are treated as if they had been drawn down on death and are subject to marginal rate Income Tax and also Capital Acquisitions Tax if inherited by strangers. Table 18 sets out the position in relation to Income Tax and CAT liability for different beneficiaries in respect of ARFs.

Table 18: Current tax treatment of ARF upon death

BENEFICIARY	DEATH OF HOLDER		DEATH OF SPOUSE/CIVIL PARTNER	
	Income Tax	CAT	Income Tax	CAT
Spouse/Civil Partner	No	No	N/A	N/A
Child under 21	No	Yes	No	Yes
Child over 21	Yes	No	Yes	No
Other	Yes	Yes	Yes	Yes

Source: Revenue Commissioners Pensions Manual, Chapter 23

As illustrated in Table 18, in a fund-inheritance scenario where an ARF transfers to a child of the deceased, there is no (or limited) clawback of the pension tax relief that was given during the accumulation/contribution stage, specifically to fund income in retirement, as the fund will not now be used to fund retirement. Such treatment acts as a disincentive to draw down income in retirement and, in doing so, undermines the integrity of the EET tax regime. The Commission recommends that this treatment should be amended to ensure that both Income Tax and CAT apply to ARFs, where ARF proceeds are inherited by a child, in order to encourage the deployment of tax-incentivised pension savings as intended.

Recommendation

8.3 The Commission recommends that Approved Retirement Fund (ARF) assets should be treated for inheritance tax purposes in the same way as other assets where inherited by anyone other than the individual's spouse. Both Income Tax and Capital Acquisitions Tax should apply. This supports the 'EET' model and maintains equitable treatment in the system.

8.5.3 Contributions

Employee contributions to supplementary pensions are deductible for Income Tax purposes, but are not deductible for employee PRSI and USC. Tax relief is given at the individual's marginal Income Tax rate, currently 20 per cent or 40 per cent. Two main limitations apply in relation to tax relief on such contributions.

1. Employee contributions are subject to age-related limits (see Table 19), restricting the proportion of remuneration that can be contributed free of Income Tax to a pension scheme. These limits are in place in order to encourage contributions throughout working life but are balanced against the need of some (often self-employed) people who may need to backload their pensions later in their careers.
2. In addition, the maximum amount of earnings taken into account for calculating tax relief on contributions is €115,000 per year. This applies whether an employee is contributing to a single pension product or to multiple pension products.

Table 19: Age-related percentage limits for tax relief on pension contributions

MAXIMUM EARNINGS TAKEN INTO ACCOUNT - €115,000

Age	Percentage limit	Example
Under 30	15%	**Example 1:** An employee aged 42 earns €40,000 pa: €40,000 x 25% = €10,000 This employee can get tax relief on annual pension contributions up to €10,000. **Example 2:** An employee aged 42 earns €200,000 pa. As the net relevant earnings limit is €115,000 the percentage is calculated on €115,000 rather than the actual income of €200,000. The employee can get tax relief on annual pension contributions up to €28,750.
30-39	20%	
40-49	25%	
50-54	30%	
55-59	35%	
60 or over	40%	

Source: Taxes Consolidation Act 1997, IDPRTG Report 2020

Analysis of tax expenditures in this area gives rise to equity concerns in respect of existing age-related contribution limits. There are limits on the contributions that can be accumulated by individuals, which exist for a range of reasons. The Standard Fund Threshold (SFT) – see section 8.5.4 - limits the amount of pension pot that can be supported by the Exchequer over a lifetime. The annual earnings limit of €115,000 limits the benefit in any one year, along with the age-related contribution limits which limits the proportion of the annual salary that can be contributed with a higher proportion of salary allowable at older ages.

The purpose of these restrictions is to protect the Exchequer from 'lumpy' contributions profiles over time, while also placing limits on the overall level of exchequer support provided for supplementary pensions. These are important administrative provisions. However, they do not take into account the changing nature and structure of work patterns where employees are now more likely to transition between a higher number of occupations and periods of training and development over their lifetime, along with related volatility in earnings across that time. The Commission considers that it would be more equitable, and provide a greater level of flexibility to savers, to allowing them to make higher levels of pension contributions at a younger age, where they are in a position to do so.

The Commission supports efforts to streamline pension rules and recommends that the age-related contribution limits should be removed on equity grounds, to be replaced by a single annual contribution rate,

which sets out the maximum proportion of earnings that can attract pension relief in a year.

Furthermore, on the basis that the SFT sets an appropriate lifetime limit on tax-relieved pension contributions, the Commission also recommends removing the current annual earnings limit of €115,000 on a phased basis.[148] This recommendation recognises that an individual's earning potential changes over time and that the taxation system should provide flexibility to taxpayers to set aside funding for retirement where they are able to do so regardless of age, provided that appropriate lifetime contribution limits remain in place.[149]

Recommendation

8.4 The Commission recommends the removal of age-related contribution rates to be replaced with a single annual contribution rate. The Commission also recommends the removal of the annual earnings cap on contributions subject to appropriate lifetime limits remaining in place.

8.5.4 Standard Fund threshold (SFT)

The SFT is the limit or ceiling on the total capital value of tax-relieved pension benefits that an individual can draw down in his or her lifetime from all of that individual's pension arrangements. The SFT was introduced in December 2005 and is currently €2 million (at inception in 2005 it was set at €5 million). Its objective is to limit State support for pension accrual for reasons of equity, in line with Government policy to provide fiscal support for pension saving capped at a certain level of income. Rather than applying restrictions to pension savings or accrual during the contribution phase, significant additional tax charges are imposed on the value of retirement benefits above set limits when they are drawn down, to claw back a portion of the relief previously accrued.

The SFT system works such that each time an individual becomes entitled to receive a benefit under a pension arrangement for the first

148 With such amount to be limited to an individual's actual earnings in that year instead.

149 If the upper earnings limit is fully withdrawn, consideration may need to be given to consequential amendments to other areas of the tax code including revisions to anti-avoidance rules and / or amendments to the High Income Earner's Restriction (See Chapter 6: Tax Equity and Base Broadening).

time (called a "benefit crystallisation event" (BCE)) they use up part of their SFT. At each BCE, a capital value is attributed to the benefits that crystallise and the value is then tested against the SFT, by the pension scheme administrator. When the capital value of a BCE, either on its own or when aggregated with prior BCEs, exceeds an individual's appropriate fund threshold a "chargeable excess" arises, and a tax charge at 40 per cent is immediately applied on the amount of the excess. In addition, when the remainder of the excess is subsequently drawn down as a pension (or, for example, by way of a distribution from an ARF or vested PRSA), it is subject to tax at the individual's marginal rate.

The SFT places a limit on the overall size of an individual's tax-relieved pension fund and, therefore, sets a limit on the overall combined cost of pension tax expenditures. Through the Commission's work and its public consultation, a number of questions arose around the appropriate level at which the SFT should be set, with some contributions calling for an increase due to the recent low interest rate environment and annuity market conditions, while others proposed a reduction in the SFT to limit the cost of tax expenditures and redirect support towards a broadening of pension coverage.

It has not been possible to fully establish the policy rationale underpinning the current SFT cap of €2 million and how it was arrived at. Estimates of the level of retirement income the current SFT cap could provide will depend upon an individual's pension strategy and prevailing market conditions at the point of drawdown and will vary over time. As indicated earlier in this chapter, the Commission notes the significant increases in the cost of pension tax supports that are expected to arise over the coming years and recognises the need to consider the long-term sustainability of those supports.

Therefore, the Commission recommends that the SFT threshold be reviewed and benchmarked regularly to an appropriate and fair level of retirement income having regard to prevailing market earnings.

Recommendation

8.5 The Commission recommends the periodic benchmarking of the Standard Fund Threshold to an appropriate and fair level of estimated retirement income.

8.5.5 Pension tax expenditures data limitations

As indicated in Chapter 16 (Tax Expenditure Review Process) the work of the Commission in the area of pension tax expenditures was hampered by a lack of data, including in getting up-to-date costings for tax expenditures, or beneficiary numbers, or getting disaggregated data. As outlined in that chapter, up-to-date and accurate data is essential in ensuring effective review of tax expenditures and facilitating decision-making around retention, reform or abolition of these very expensive tax expenditures. There are a number of initiatives underway to improve data collection in this area including:

- PAYE modernisation (see Chapter 17: Modernisation of Tax Administration), which offers an opportunity to improve information on those availing of pensions tax expenditures.
- The IDPRTG recommended that ARF providers and PRSA providers should be required to make annual data returns to the relevant regulatory authorities, including returns of ARF numbers, drawdown levels and distribution, asset allocation and fees.

The Commission welcomes these initiatives, but recommends that further steps be taken to remedy data gaps.

Recommendation

8.6 The Commission recommends an urgent review of the availability of appropriate and adequate data on the cost and distribution of pension tax expenditures. The absence of good data significantly inhibits the regular and rigorous evaluation of these costly expenditures.

8.5.6 Other possible anomalies

Through its work the Commission's attention was also drawn to a number of potential anomalies between the tax treatment of defined benefit and unfunded pension schemes, including those in the public sector and the broader private pension landscape.

Contributors to both types of pension attract many of the same beneficial tax reliefs. However, Commission members have noted that there are a number of areas where possible anomalies may exist, which could lead to inequitable treatment across pension arrangements.

Examples of possible anomalies include the potentially favourable application of capitalisation factors for defined benefit schemes in applying the SFT and, in the case of public sector schemes specifically, the availability of encashment options, longer repayment terms for tax liabilities and the inclusion of the Additional Superannuation Contribution (ASC) within annual contribution limits. It has not been possible to examine these areas in detail due to our accelerated timetable. However, the Commission is of the view that any anomalies leading to inequitable treatment across different pension arrangements should not persist and steps should be taken to eliminate them in so far as possible.

Recommendation

8.7 The Commission recommends that anomalies in the tax treatment of different retirement arrangements should be eliminated, as far as possible.

8.5.7 Phasing

The Commission notes that pensions, by their nature, are long-term arrangements and that sudden changes in tax treatment in this area can potentially result in significant dislocation for individuals who have been contributing to a pension for many years, or who have seen their pension arrangements legitimately as part of their overall remuneration package. In particular, any proposed reduction to the SFT will require careful consideration to ensure equity of treatment between those individuals with defined benefit and defined contribution pension arrangements. It is important, therefore, to provide for phased arrangements when policy changes are made in this area.

8.6 RECOMMENDATIONS

Chapter 8: Taxes on Retirement Savings

8.1	The Commission recommends more comprehensive implementation of the 'Exempt, Exempt, Taxed' model of pension provision including recommending a meaningful reduction in the overall level of tax-free lump sum available from its current level (worth over 4 times average earnings). Marginal tax rates should apply on all lump sums over the tax-free threshold.
8.2	The Commission recommends that there should be a single tax-free lump sum lifetime limit to include both pension lump sums and any ex-gratia termination payments received.
8.3	The Commission recommends that Approved Retirement Fund (ARF) assets should be treated for inheritance tax purposes in the same way as other assets where inherited by anyone other than the individual's spouse. Both Income Tax and Capital Acquisitions Tax should apply. This supports the 'Exempt, Exempt, Taxed' model and maintains equitable treatment in the system.
8.4	The Commission recommends the removal of age-related contribution rates to be replaced with a single annual contribution rate. The Commission also recommends the removal of the annual earnings cap on contributions subject to appropriate lifetime limits remaining in place.
8.5	The Commission recommends the periodic benchmarking of the Standard Fund Threshold to an appropriate and fair level of estimated retirement income.

8.6 The Commission recommends an urgent review of the availability of appropriate and adequate data on the cost and distribution of pension tax expenditures. The absence of good data significantly inhibits the regular and rigorous evaluation of these costly expenditures.

8.7 The Commission recommends that anomalies in the tax treatment of different retirement arrangements should be eliminated, as far as possible.

Part 3:
Policy Goals

Chapter 9: Promoting Enterprise

9.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"consider how Ireland can maintain a clear, sustainable, and stable taxation policy as regards Ireland's attractiveness to Foreign Direct Investment in a changing global taxation environment, including retention of the 12.5% corporation tax rate."*

and to

> *"review how best the taxation environment for SMEs and entrepreneurs can ensure that Ireland remains an attractive place to sustain and grow an existing business or to start and scale up a new business."*

This chapter considers the current tax landscape for both indigenous enterprise and Foreign Direct Investment (FDI) in Ireland and considers how best the tax system can support economic activity generally and provide a supportive environment for business to start and grow. A well-designed tax system is critical to a well-functioning economy. Undoubtedly, the Irish tax regime has had a significant impact on the shape of the Irish business landscape; maintaining a broad tax base and a low corporate tax rate has provided a supportive backdrop for both FDI and indigenous corporate businesses alike.

Through its work, the Commission has considered the impact of Ireland's approach to industrial and corporate tax policy and broadly endorses current Government strategy. It is important to recognise the positive impact of a low tax rates for businesses when considering other features of the broader taxation environment for Small and Medium Enterprises (SMEs) and entrepreneurs.

In considering the Commission's recommendations in this area, while well-designed tax incentives play an important role, it must be recognised that tax policy is only one of several levers that the State has at its disposal to support new business formation and growth. General trade policy, direct funding (grants, credit, loan and other

financing schemes), the regulatory environment, education, training, physical infrastructure, the cost of living, quality of life, etc., also play a role in ensuring that Ireland remains an attractive place to sustain and grow businesses and, therefore, a multi-layered and cross-Government approach to promoting enterprise is required.

In summary, while the Commission believes the underlying architecture of the Irish tax system contributes to what is an overall positive and supportive environment for economic activity, there are elements of the tax system which could be further strengthened. On the taxation environment for SMEs and entrepreneurs specifically, the Commission has identified and examined a number of areas where tax policy continues to play a key role in supporting new and growing SMEs as well as areas where further reforms could be examined.

9.1.1 Evolution of the Irish corporate tax strategy

Ireland's approach to industrial and corporate tax policy is one that has become increasingly open and outward-orientated over time.

From the 1950s, the State moved away from a protectionist economic approach, instead pursuing a policy of promoting inward investment from foreign (particularly US) firms in the context of national and global trade liberalisation.[150]

The regime for the taxation of companies was one of the key components of this policy, with targeted incentives and expenditures being provided through the tax system. The genesis of Ireland's 12.5 per cent rate as a tool to attract FDI can be seen in measures such as the adoption of Export Sales Relief[151] in 1956 and the subsequent introduction of reduced Corporation Tax rates for trading activities relating to manufacturing, Shannon Airport activity and financial services.

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150 Barry, F. and O'Mahoney, C. (2017). Regime Change in 1950s Ireland: The New Export-Oriented Foreign Investment Strategy, Irish Economic and Social History, 44(1), 46-65. The US had overtaken the UK as the major global source of FDI in the post-war world. Ireland's more benign attitude towards the US was an influential component in the politics of the change in FDI strategy in the 1950s with Irish Governments being much more open to advice from the US on industrial development policy in that period.

151 Export Sales Relief (ESR) was a tax relief on income from export sales of Irish-manufactured goods by corporates. ESR was initially introduced as a partial relief, extending to a full exemption in 1960. Ireland phased out ESR upon joining the EEC in 1973, but it was grandfathered for existing claimants until 1990.

The measures implemented resulted in an allocation bias towards foreign firms, a shifting of the labour-capital cost ratio towards capital and an erosion of the corporate tax base, further resulting in the application of a high tax rate to a relatively narrow tax base. This was particularly apparent in the context of the recessionary environment of the 1980s.

The resultant shift in industrial policy, in conjunction with the withdrawal of State Aid derogations for reduced Corporation Tax rates,[152] led to the introduction of a more standardised approach to Corporation Tax. This included the application of a low rate to a broad base of income, which was introduced on a phased basis, dropping from 40 per cent in 1995 to 12.5 per cent in respect of trading income in 2003.

The phased introduction of a lower tax rate, without specific incentives, improved the certainty and stability of the Irish corporate tax regime, particularly with regard to the application of rates and rules. This approach, against the backdrop of the formation of the EU single market in the 1990s, contributed to an influx of foreign investment into the State, leading to increased job creation, employment and general consumption. This can be observed from the growth of Exchequer receipts and employment data in that period, with much of the increase of employment occurring in the services sector.[153] Between 1995 and 2004, total Exchequer receipts increased by 158.79 per cent overall,[154] with:

- Corporation Tax receipts increasing by 265.8 per cent (approximately €1.46 billion to €5.34 billion)
- Value Added Tax (VAT) receipts increasing by 192.29 per cent (approximately €3.67 billion to €10.72 billion)

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152 The manufacturing, Shannon Airport and Financial Services regimes were found to be harmful tax regimes by the Code of Conduct Group on Business Taxation in the 1990s and the reduced rates were withdrawn thereafter on a phased basis.

153 CSO (2004) Ireland and the EU 1973-2003, Economic and Social Change. Both a rapid increase in employment and a sharp drop in the unemployment rate took place in the period from 1993 to 2003, with both movements attributed to sustained economic growth in this period. Much of this increase in employment occurred in the Services sector.

154 Source figures from Revenue's Statistical Reports Archive – percentages and euro conversions calculated by the Commission on Taxation and Welfare Secretariat. Figures refer to absolute changes not adjusted for indexation.

- Income Tax receipts increasing by 103.97 per cent (approximately €5.24 billion to €10.7 billion).

Current industrial policy has remained focused on attracting and retaining inward investment and FDI in particular, with a competitive corporate tax strategy being a key tenet of that approach.

The approach has been successful to date with regard to attracting FDI, which increased by nearly 770 per cent between 2005 and 2021 (standing at €1,222 billion in 2021).[155] Although foreign-owned enterprises account for just 9 per cent of the 184,000 Corporation Tax filers in 2020, such enterprises accounted for 33 per cent of the 2.4 million employments in all companies. Table 20 illustrates the contribution of foreign-owned companies across sectors, using a selection of relevant metrics.

In 2020, Corporation Tax accounted for over 17 per cent of total tax revenues with net receipts totalling €11.8 billion, of which foreign-owned multinationals account for the vast bulk, or 82.7 per cent of the total.[156]

155 OECD Statistics, as of May 2022.

156 CT accounted for approximately 19 per cent of total tax revenues in 2021. This is discussed in further detail in Chapter 4 (Fiscal Sustainability).

Table 20: Contribution of foreign-multinational companies across selected metrics (as a percentage of all companies in that sector and overall), 2020

	OVERALL SECTOR (BY CT RETURNS FILED)	SECTORAL CT LIABILITY	SECTORAL EMPLOYMENT	SECTORAL PAYROLL TAX RECEIPTS	VAT FOR SECTOR
Industry*	10.4%	94.9%	51.7%	71.8%	30.5%
Construction	3.8%	18.8%	9.2%	15.2%	41.9%
Distribution	6.5%	72.2%	33.8%	52.6%	56.6%
Services	9.2%	89.1%	29.1%	53.1%	29.7%
Financial and insurance services	23.2%	75.6%	60.3%	62.3%	N/A[157]
Agriculture, Forestry & Fishing	2.2%	7.0%	6.3%	11.4%	21.2%
Other Sectors	4.1%	36.4%	17.2%	23.0%	23.1%
Overall contribution of foreign MNC's across all sectors	9.0%	82.7%	32.5%	52.6%	45.6%

Source: Commission on Taxation and Welfare Secretariat calculations using Revenue data
Note: payroll tax receipts include Income Tax, USC and employer PRSI.
* *Industry in this instance refers to activities relating to manufacturing, mining, quarrying and utilities. CT – Corporation Tax, MNC – Multinational Company*

Output (Gross Value Added[158]) in the foreign-owned sector also represents a disproportionate share of total output in the business sector, with the latter accounting for 69 per cent of total output, or €174.9 billion in 2019. This disproportionately high level of output combined with a relatively lower share of total employment in the sector results in a disparity in output per worker (a measure of productivity) between the domestic and foreign sectors, where output per worker is 6.5 times greater on average in the latter than in the former.[159]

However, in the last decade, Ireland's corporate tax strategy has

157 VAT from FDI companies engaged in the Financial and Insurance Services Sector totalled €19 million in 2020. As VAT receipts in this sector as a whole were in a refund position in 2020, the proportionate contribution of FDI to VAT receipts in this area cannot be clearly expressed as a percentage.

158 Gross Value Added (GVA) is a measure of economic output, which is equivalent to the sum of compensation of employees and gross profits in a sector. Conceptually, it is similar to Gross Domestic Product.

159 CSO (2021) Business in Ireland 2019.

been increasingly shaped by international factors — with increasing focus placed globally on tackling aggressive cross-border tax planning and arbitrage (particularly addressing legislative mismatches arising in cross-border transactions), corporate substance, as well as the establishment of tax rules that are reflective of modern business practices arising from digitalisation and globalisation.

These factors, in conjunction with the aftermath of the financial crisis in the late 2000s, contributed to a sense that multinationals were not paying their fair share of tax. This led to the initiation of the Base Erosion and Profit Shifting (BEPS) Project by the OECD and G20 in 2013[160] and since 2018, the development by the OECD/G20 Inclusive Framework of a new tax framework to address the international tax challenges arising from the digitalisation of the economy. A number of measures have also been developed at EU level on the topic of fair taxation, which support and/or build on the work by the OECD/G20.

In response to this shifting international landscape, Ireland made a number of changes to its corporate tax strategy addressing concerns around fairness and stability. Ireland set out its international tax strategy in a 2013 document, Ireland's International Tax Strategy,[161] which confirmed Ireland's commitment to the BEPS project and to addressing aggressive tax planning while also continuing to maintain a competitive corporate tax strategy to attract FDI. Around this period, Ireland also made changes to its company residence rules to address a mismatch with residence rules in other jurisdictions, which had been exploited to create stateless companies for tax purposes.

Ireland continued to develop its corporate and international tax strategy by setting out its ongoing and future tax goals using roadmap documents. The initial roadmap, published in 2015, set out a timeline with targets and goals to facilitate Ireland in meeting its international commitments with the OECD/G20 and the EU to tackle aggressive BEPS strategies, meeting targets for implementing agreed actions to address BEPS in a timely manner, while also maintaining a competitive tax strategy.

The roadmap has become a key strategic tool for communicating Ireland's progress in the OECD/G20 and EU actions against BEPS.

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160 In 2015 the OECD and G20 released 13 reports covering 15 actions to combat BEPS. The actions centred on themes of coherence between jurisdictions, substance as well as transparency and certainty.

161 Department of Finance (2014) Ireland's International Tax Strategy.

It is updated on an iterative basis to reflect the current status of Ireland's commitments and obligations in the area of corporate taxation, while also maintaining strategic commitments relating to the use of a low rate and to the use of a regime that is seen to be fair, stable and competitive. Ireland also began to employ feedback statements in addition to other consultative methods[162] to ensure that the increasing number of complex and material changes to the corporate tax code were operationally effective.

This has allowed the State to make substantive changes to the corporate tax code in the past ten years, closing many gaps and mismatches in the international tax framework that could previously have been exploited by multinational enterprise, but in a way that has minimised disruption for businesses. Ireland's commitment to fairness in international taxation was further demonstrated in the Department of Finance's recently launched Tax Treaty Policy[163] which placed particular emphasis on ensuring fair tax treaty policy with Least Developed Countries (LDCs)[164] in a manner that aligns with whole-of-government policy relating to International Development.[165] The Commission strongly supports Ireland's strategic direction of travel in this area.

9.1.2 The role of Small and Medium Enterprises

A healthy and dynamic SME sector is a key driver in improving living standards in any advanced economy, providing a myriad of functions within the economy and society. Small-scale, high potential entrepreneurship that sparks innovation and advances in productivity is an independent driver of economic growth. SMEs, however, are not a homogenous group of enterprises that face a common set of issues, with many less productive and non-innovative SMEs playing an important role in the economy.

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162 Including the use of public consultations as well as an independent review of the Corporation Tax code by Mr Seamus Coffey in 2016.

163 Department of Finance (2022) Ireland's Tax Treaty Policy.

164 Least developed countries (LDCs) are low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets. There are currently 46 countries on the list of LDCs which is reviewed every three years by the Committee for Development (CDP).

165 Department of Foreign Affairs (2019) 'A Better World', Ireland's New Policy for International Development.

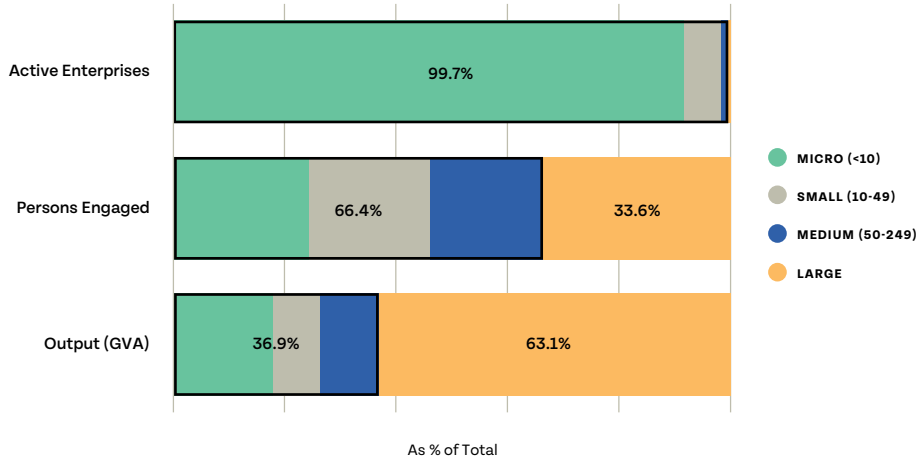
In 2019, SMEs accounted for 99.7 per cent (271,799) of all active enterprises in the business economy in Ireland, with the vast bulk of these enterprises consisting of micro-sized enterprises. This is in line with EU norms, where the same proportion of total enterprises in Ireland were composed of SMEs as the EU average in 2018.[166]

SMEs support a large proportion of total employment in the business sector, accounting for approximately two in every three persons (66.4 per cent) engaged in enterprises in 2019, or 1.2 million people in total. The number of persons engaged in SMEs in the business sector from 2014 to 2019 has increased each year by approximately 5 per cent on average. The 70 per cent proportion of persons engaged in SMEs in Ireland exceeded the EU average of 67 per cent in 2018.

However, an average SME produces proportionately less than its larger counterpart. Total output of the large enterprise sector (valued at €160 billion) is approaching twice that of the SME sector (€93 billion). Large enterprises are also more productive than SMEs. Output per person engaged in large enterprises is over three times that of those engaged in SMEs. In an international context, SMEs contributed a relatively smaller share to total output in 2018, with SMEs accounting for 41.5 per cent of total Gross Value Added, whereas the EU average was 56.4 per cent, reflecting the disproportionate contribution of large enterprises to output in Ireland.

166 European Commission (2019) The Small Business Act for Europe (SBA) 2019 Factsheet Ireland.

Figure 14: SMEs, share of key variables, 2019



Source: CSO – Business in Ireland 2019
Note: SMEs include micro, small and medium-sized enterprises.
Gross Value Added (GVA) is a measure of economic output, which is equivalent to the sum of compensation of employees and gross profits in a sector. Conceptually, it is similar to Gross Domestic Product (GDP).

Many SMEs face distinct challenges compared to their larger counterparts, which may prevent potential innovation and productivity increases from occurring that would otherwise happen in an efficient market. In recent years, various Government departments and agencies have developed policy responses to support SMEs, recognising the role of new and growing businesses in supporting economic activity and creating jobs. Tax policy has played a key role as part of this wider policy response and, through its deliberations, the Commission has identified a number of specific challenges faced by SMEs and sees a role for the tax system to play in aiding SMEs in overcoming these challenges. The challenges identified relate to:

- raising equity finance,
- conducting and accessing networks of research, development and innovation,
- attracting and retaining high value-added employment, and
- the administrative burden in claiming certain reliefs.

Ultimately, the Commission believes that these challenges explain much of the underperformance in SME productivity.[167] Ireland has a two-tiered economy and the pandemic is likely to have exacerbated the gap between domestic and export-orientated firms. SME productivity has been relatively stagnant in recent years compared to the highly productive large multinationals. The OECD[168] has identified prolonged use of low-productivity techniques, underinvestment in capital, low levels of innovation collaborations, underdeveloped management capabilities, insufficient digital technology adoption and limited direct entry into export markets as factors affecting Irish SME productivity. The OECD has also commented on Ireland's low business entry and exit rates relative to other OECD countries. Enterprise churn is often used as a proxy for business dynamism and the OECD has stated that a low enterprise churn is likely to adversely affect productivity growth, given a more limited resource reallocation from less productive firms to young innovative SMEs.

There are a wide range of State supports, including a vast array of tax incentives and administrative practices aimed at supporting SMEs in particular. It is important to be cognisant that there are also trade-offs to be made between considering supports for specific economic sectors and activities while also maintaining a broad tax base, and that Ireland must operate within EU rules. With this in mind and while acknowledging the strong and positive environment that already exists, the Commission has identified a number of areas of the tax code that could be further strengthened to assist SMEs in starting, sustaining and growing their businesses.

9.2 STRATEGIC APPROACH

In order to make meaningful recommendations on how the tax environment can be enhanced to support economic activity, the Commission is taking a macro, rather than a micro, approach, examining what can be done to maintain productivity and competitiveness over the medium to long term at both the indigenous level and in the international space.

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167 As noted, many factors affect aggregate SME productivity, which may stem from a relatively high level of SMEs located in towns and villages that play a role in supporting employment and sustaining communities, many of which may not have any intention of scaling up or exporting.

168 OECD (2019), SME and Entrepreneurship Policy in Ireland, OECD Studies on SMEs and Entrepreneurship, Paris, OECD Publishing.

In the course of our work, we have reflected on Ireland's long-term successes in attracting and retaining FDI and contrasted it with the ongoing challenges of our indigenous SME sector. We have considered the impact of ongoing international efforts to curb aggressive and/or harmful corporate tax practices as well as recent Governmental efforts to develop SMEs.

Through this exercise, we have considered the strengths and weaknesses of our existing strategic approach to corporate and business taxation and developed a number of general principles to guide our recommendations in this space:

1. *Domestic Corporation Tax and business Income Tax should be calculated on a stable and standardised basis.*

   Taxable profit should be relatively straightforward to calculate; with a clear starting point for calculating taxable profits across all domestic entities.

2. *Policy changes should be designed in a manner that minimises disruption and allows businesses to plan for change:*

   Substantive changes should be signposted by way of roadmaps or through the use of transitional measures.[169] Steps should be taken to ensure measures are operationally effective from their implementation date. Where required, the transposition of international legislation should take place in a faithful, sustainable and timely manner so as to mitigate uncertainties arising from large-scale international tax changes.

3. *Paying and filing of taxes should be as straightforward as possible:*

   The design and administration of taxes and their associated exemptions and reliefs should be kept as simple, understandable and unambiguous as possible. The Commission recognises this principle will need to be carefully balanced with the need to ensure that rules are robust enough to prevent misuse or aggressive tax planning and that reliefs are compliant with State Aid requirements. We also note this aspect may be improved with further modernisation of tax administration processes.

4. *Tax supports should be focused, designed and implemented to achieve their intended objective and should only apply where a market failure exists:*

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169 Except where a change is being made for anti-avoidance purposes.

Tax expenditures should not be considered in advance of examination of other policy options such as direct expenditure. There should also be a clear link between qualifying conditions and the policy objectives. Additionally the objectives of, and interactions between, different tax measures should be considered in tandem, rather than in isolation.

5. *There should be sufficient quality data collected to inform policy development and for evaluations of tax measures and reliefs to be assessed against a robust cost/benefit model:*

   Policymakers should have sufficient data and information available on all existing and proposed tax reliefs to allow for robust evaluation of the effectiveness of the measures under the tax expenditure review guidelines.

6. *The State must continue to be cognisant of international factors when designing tax policy:*

   The use of multilateral solutions to address international tax issues is becoming increasingly common. Failure to engage in such processes undermines the solidarity principles upon which multilateral solutions are built and potentially creates reputational risks that could affect Ireland's attractiveness to FDI.

7. *There is a rationale for a re-prioritisation of existing schemes towards those which are designed to help new businesses in the early start-up phase and to help productive enterprises sustain or scale up their business.*

   These objectives guided the recommendations set out in this chapter.

9.3 CORPORATE TAX STRATEGY

For over fifty years Ireland's industrial policy has been heavily focused on attracting and retaining FDI. A competitive corporate tax strategy is a key tenet of that policy, with the 12.5 per cent Corporation Tax rate on trading profits often viewed as central to that offering. Although a low rate is a core element of the Irish tax strategy, it is not the only relevant tax factor.

We note the following elements are often cited as factors influencing the Irish location decision:

- Ireland is generally perceived as a location where the payment of businesses taxes is relatively straightforward. The State is often regarded as competitive with regard to monetary and time costs of compliance.

- Tax policy changes are designed in a manner that minimises disruption, provides certainty with regard to the application of rules and allows businesses to plan for change.
- There is a clear starting point for calculating taxable profits across all domestic entities, being accounting profit. The domestic trading rate applies to a broad base of income, which results in little and limited rate variation.
- Location in Ireland provides access to a large tax treaty network. Ireland has signed comprehensive Double Taxation Agreements (DTAs) with 76 countries, of which 73 are in effect.[170]

Although often viewed through the lens of attracting FDI, these elements have the potential to support both domestic and multinational enterprise and have formed much of the basis of our strategic approach in this area for that reason. However, we believe that further action could be taken to ensure that the same degree of certainty with regard to application of rules is extended to the SME sector.

9.3.1 Use of roadmaps and feedback statements

Recent developments in the international space have created new complexities for many companies, particularly larger multinationals, with regard to ensuring corporate tax obligations are fully met.

The use of feedback statements and roadmaps have been of benefit to companies navigating recent corporate and international tax reforms, with feedback statements in particular allowing for both:

- complex and material changes to the corporate tax code to be thoroughly and transparently examined and evaluated by both the State and the general public, and
- the effectiveness of a measure, with regard to achieving its policy objective, to be properly considered - reducing the risk of administrability issues or avoidance opportunities arising.

The Commission believes that this is the appropriate framework in which substantive changes to the corporate tax code should be made as it allows for due consideration of complex issues, including all relevant domestic and international factors at a granular level – an exercise which is not feasible within the lifespan of this Commission,

170 Revenue Commissioners (2022) Double Taxation Treaties.

particularly as the ultimate impact of the following on the domestic corporate tax environment is not yet fully known:

- the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the Two-Pillar Solution), developed by the OECD/G20 Inclusive Framework on BEPS, and
- recently proposed changes to the US Global Intangible Low-Taxed Income (GILTI) regime.

This approach is generally not applied to substantive changes in the SME sector. However, the Commission believes that extending this framework to the SME sector could ensure that policy measures in this space are appropriately targeted from their implementation date and could also allow for smaller entities to better plan for change.

9.3.2 Ongoing international tax issues

In carrying out our work, we have considered the impact of low Corporation Tax rates on the Irish economy. As noted previously, we recognise that Ireland's 12.5 per cent Corporation Tax rate has been a key component in Ireland's economic policy, contributing towards its success in attracting investment and employment.

For this reason, it may appear that the adoption of a minimum jurisdictional tax rate of 15 per cent on corporate profits as part of the Two-Pillar Solution could potentially risk Ireland's existing competitive corporate tax offering.

However, we recognise that the goal of the minimum jurisdictional rate is not to eliminate tax competition; rather to prevent a race to the bottom by larger entities through the introduction of multilaterally agreed limitations to its scope, effectively placing a worldwide floor on tax competition, as well as ending the possibility for in-scope entities to engage in aggressive tax planning. The internationally agreed minimum tax rules are expected to impact those multinational groups which control approximately 90 per cent of global revenue, but only represent ten to fifteen per cent of companies worldwide.

Furthermore, technical work on the Pillar One model rules remains ongoing at the OECD level with a series of public consultations taking place on a rolling basis to allow stakeholders to provide input on the various aspects of the model rules. As such, the implications of Pillar

One on the Irish tax base are not yet fully known.[171]

However, we recognise that the Two-Pillar Solution will bring long-term stability and certainty to the international tax framework, building on BEPS measures introduced to date through the OECD and EU processes. Ultimately, we believe the introduction of this solution will bring greater fairness to the international tax framework as a whole. In the longer term, we hope to see further international developments with regard to fairness in taxation, particularly with respect to LDCs.

9.3.3 Rate of charge

Our terms of reference have asked us to,

> *"consider how Ireland can maintain a clear, sustainable, and stable taxation policy as regards Ireland's attractiveness to Foreign Direct Investment in a changing global taxation environment, including retention of the 12.5% corporation tax rate."*

Given the prominence of the 12.5 per cent domestic Corporation Tax rate in the existing strategy and ongoing discussions regarding its sustainability in the changing international tax environment, we believe it is appropriate to give due consideration to whether the 15 per cent rate should have a broader application beyond that envisaged by the Two-Pillar Solution. To that end, we considered whether the Corporation Tax rate on all trading profits should be increased to 15 per cent.

On preliminary review, the broad application of a 15 per cent domestic Corporation Tax rate may appear to have revenue-raising potential and promote equity by applying the same rate across the board. However, following a more detailed review, it is clear that there are many nuances pertaining to the Corporation Tax rate that must be considered:

- Although Pillar Two is commonly referred to as the application of a 15 per cent Corporation Tax rate, in practice, it does not involve applying 15 per cent to the Irish taxable profits of an entity nor is the tax applied at the entity level. Pillar Two instead provides for a jurisdictional 'top-up tax,' calculated by reference to the aggregate tax liability and accounting profits of all group entities in a jurisdiction. Where the

171 As noted in Chapter 4 (Fiscal Sustainability), the Department of Finance has tentatively estimated that the agreement could reduce Corporation Tax receipts by up to €2 billion annually. However it remains very difficult to accurately estimate the impact at this stage.

aggregated effective tax rate for a jurisdiction is below 15 per cent, a top-up is required.[172]

As the top up tax is subject to a different base than Irish Corporation Tax, ultimately the amount required to be paid at the jurisdictional level under Pillar Two may be lower than the amount that would be required if a 15 per cent Corporation Tax rate was applied at the individual entity level. From the perspective of companies in scope of the Pillar Two rules, the application of a domestic 15 per cent rate could, in some cases, represent further increased costs beyond those envisaged by Pillar Two and may impact on the corporate decisions made by these entities.

- Current estimates indicate that only 5 per cent of Irish companies will be affected by Pillar Two, whereas approximately 10 per cent of Irish companies filing Corporation Tax returns are part of either an Irish or foreign multinational group. The 12.5 per cent rate can continue to play a key role in retaining out-of-scope multinationals and in attracting emergent FDI. It should be noted that many of Ireland's main competitors for FDI will likely retain their existing FDI offering with regard to out-of-scope entities.
- Public assurances have been given by the Irish Government with regard to the retention of the 12.5 per cent rate for the foreseeable future and companies and groups have organised themselves on that basis. A change to the domestic rate now, particularly against the current backdrop of ongoing international change, could impede the stability and certainty that is granted by providing timely notice of key changes where practicable; a measure underpinning Ireland's corporate tax strategy.
- In practical terms, the Commission notes it is likely that many of the majority of unaffected companies represent smaller Irish indigenous businesses (approximately 90 per cent of Irish Corporation Tax filers). Such companies are less able to react to such a rate change through relocation and would effectively be obliged to pay the higher rate. However, as such companies only reflect approximately 12 per cent of Corporation Tax receipts, this increase would likely represent a further cost burden for less profitable entities, hindering re-investment by these

172 The top-up required may be reduced by reference to the substance of the entities in a jurisdiction (substance in this case refers to the level of payroll and/or assets in a particular jurisdiction).

companies and, ultimately, economic activity in the State. Allowing the rate to remain unchanged may allow Ireland an opportunity to support these entities without the need to develop, implement and monitor bespoke tax expenditures that must be compliant with State Aid criteria.

- Consideration should also be given to the limitations of corporate taxes generally as revenue-raising tools and the potential for rate increases in this space to cause distortions. As noted in Chapter 5 (Balance of Taxation), corporate taxes have previously been identified by the OECD as potentially harmful to economic growth. Studies also indicate that the incidence of increases in such taxes often fall disproportionately on wages levels and consumer prices instead of company shareholders.[173]

The Commission believes that the existing 12.5 per cent rate can continue to be of significance to the Irish corporate tax strategy going forward as:

- the rate can be retained to attract emergent FDI,
- the application of the top-up at the global minimum rate will remain competitive in comparison to jurisdictions which apply a higher corporate rate overall, and
- a low-rate/broad-base strategy reduces the need to develop, implement and monitor large volumes of targeted tax expenditures.

As noted in this section, the current corporate tax strategy operates against a backdrop of continued international reform and the scale of reform which has taken place in Ireland in the past decade cannot be underestimated. The impact of these reforms on the Irish corporate landscape is not yet fully known and should be evaluated before consideration is given to further significant strategic change.

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173 Arnold, J. (2008) Do Tax Structures Affect Aggregate Economic Growth?: Empirical Evidence from a Panel of OECD Countries, OECD Economics Department Working Papers, No. 643, Paris, OECD Publishing. Fuest, C., Peichl, A., Siegloch, S. (2017) The incidence of corporate taxation and its implications for tax progressivity, VoxEU CEPR. Baker S.R., Sun, S. T. and Yannelis, C. (2020) Corporate Taxes and Retail Prices, Working Paper 27058, Cambridge MA, National Bureau of Economic Research.

Recommendation

9.1 The Commission endorses Ireland's current corporate tax strategy, including Ireland's ongoing participation in international efforts to tackle aggressive and/or harmful corporate tax practices. The Commission also endorses the adoption of the Two-Pillar Solution to Address the Tax Challenges arising from the Digitalisation of the Economy, as well as the development of multilateral solutions to combat base erosion and profit shifting.

Recommendation

9.2 The Commission recommends the continued use of feedback statements and roadmaps which should be better applied to indigenous entities and Small and Medium Enterprises.

9.3.4 Legislative environment

The Commission recognises that the existing corporate strategy, particularly with regard to the certain and stable application of rules, could also be enhanced by streamlining existing legislation.

Although the enactment of the Taxes Consolidation Act (TCA) in 1997 was a seminal event for tax simplicity, condensing three tax Acts[174] and 30 years of change into one single Act, more than 25 Finance Acts have passed since its introduction. In that time, the TCA has nearly doubled in size. For that reason alone, a streamlining exercise is justifiable.

However, there are additional factors that make this consideration a timely proposal:

- A large amount of legislation relating to substantive international tax reform has been inserted into the TCA in a relatively brief amount of time. There may be scope to better integrate these measures into the tax code, without changing their intended operation.
- As the TCA has its origins in the Income Tax Act of 1842, the Act often uses antiquated language.

174 Being the Income Tax Act of 1967, the Corporation Tax Act of 1976 and the Capital Gains Tax Act of 1975.

- Although best efforts have been made over the years to organise sections across clear themes, this does not always happen.

These factors can make it difficult for many to understand their obligations without engaging significant levels of professional advice.

Lessons can likely be drawn from the tax law rewrite projects in the UK to improve the end-user experience by using simpler language to clarify the policy intent of legislation in a more comprehendible manner. Such lessons could be incorporated into the drafting process of future Finance Bills.

Consolidation of the TCA would represent a large undertaking and would require significant resources to be allocated to the Department of Finance, the Revenue Commissioners and the Office of the Parliamentary Council. Notwithstanding the scale of the undertaking, the Commission believes that reconsolidation and simplification of the tax code is a worthwhile exercise as it would provide greater clarity to end users, in both the FDI and indigenous SME space, as to their tax obligations as well as how to comply with those obligations.

Furthermore, given the annual volume of legislative amendments to the tax code, and in particular, the rapid pace of change in the international tax environment, we believe that consolidation exercises should happen on a more frequent basis in the future.

Recommendation

9.3 The Commission recommends that consolidation of the Taxes Consolidation Act 1997 (TCA) should be carried out periodically as a matter of principle. Consideration should be given to how greater simplification of existing tax codes can be achieved as part of this exercise.

9.4 SUPPORTING INVESTMENT IN SMES

The Commission supports the re-prioritisation of tax expenditures in the area of SMEs towards those which are designed to assist new businesses in the early start-up phase and to help productive enterprises sustain or scale up their business.

In an Irish context, SMEs typically place a large reliance on family and friends for investment and financial support, with consistently low

levels of SMEs seeking venture capital or investor finance.[175]

Newly issued equity financing only makes up a relatively low source of SME external financing, with 14 per cent and 4 per cent of external investment financing for micro and small firms derived from equity financing on average, and a negligible amount (less than 1 per cent) for both medium and large firms. This compares favourably, however, to the EU average of under 1 per cent for all enterprise sizes.[176]

Inadequate access to finance for SMEs can prevent potential economic activity from taking place that would otherwise have happened. In recognition of this risk, a number of State interventions exist to support SMEs in accessing appropriate financing e.g. through the Strategic Banking Corporation of Ireland, Ireland Strategic Investment Fund, Enterprise Ireland, etc. There are also a number of tax incentives that encourage equity investment in SMEs, such as the Employment Investment Incentive, Start-Up Relief for Entrepreneurs and Start-up Capital Incentive. The revised Capital Gains Tax (CGT) Entrepreneur Relief was also introduced to encourage entrepreneurs to invest in Irish businesses. These types of focused tax reliefs can effectively complement the wider range of financing supports available to SMEs.

9.4.1 Employment Investment Incentive (EII)

9.4.1.1 Overview of EII

The Employment Investment Incentive (EII) is seen as a key incentive, which seeks to provide SMEs and start-ups with an alternative source of funding to support the creation and retention of employment in SMEs across the economy.

The EII grants Income Tax relief to individuals who make an equity investment in a qualifying company. All unquoted micro, small and medium-sized companies, which are less than seven years old and which carry out qualifying trades, may use the incentive, as may certain older companies that are expanding into new products or geographic markets. The EII is subject to EU State Aid rules.[177]

Introduced in 2011 to replace the Business Expansion Scheme, EII has been extended several times and the amount of relief significantly

175 Department of Finance (2018) IFS 2020 Review of Access to Equity Finance, and SME Credit Demand Survey.

176 European Investment Bank (2021) EIB Investment Survey Ireland Overview 2021.

177 EII comes within the General Block Exemption Regulation (GBER). Any major changes to the scheme must be compatible with State Aid rules.

increased in that period. From the investor's perspective, since 2020 the amount of investment eligible for tax relief has increased from €150,000 to €250,000 per year where shares are held for four years, rising to €500,000 per year if the shares are held for seven years. Income Tax relief is given to the individual in the year of their investment. Any investment amount in a year above the thresholds, or the taxpayer's income in a year, can be carried forward and utilised against taxable income in future years. From the company's perspective, companies may raise up to €5 million per annum, subject to a lifetime limit of €15 million.

9.4.1.2 Future of EII

The Commission strongly supports the policy objectives behind EII, which encourage equity investment in productive SMEs and support job creation. However, the Commission has concerns regarding the complexity of the scheme and the difficultly enterprises can have in accessing the relief.

There are a number of conditions and administrative requirements associated with the relief, which smaller firms in particular can find it more difficult or costly to comply with. Certain conditions of the scheme, which the Commission commends, are linked to important policy objectives, for example, by requiring the funds raised to be reinvested in the trade, used for carrying out research, development and innovation or increasing employment.[178] Other conditions are requirements under State Aid rules. However, the combination of all these conditions and documentation requirements can act as deterrents for many potential claimants.

The Commission believes that EII could be substantially enhanced through improved accessibility and reduced complexity. The Commission's recommendation for enhancing the supports available to SMEs in accessing tax reliefs, including EII, is discussed in section 9.6 of this chapter.

The Commission acknowledges that certain businesses, particularly

178 The company must utilise the EII investment for a qualifying purpose within four years of the share issue. This includes using the funds raised for the purposes of carrying out relevant trading activities, or if the company has not yet commenced trading, to carry out relevant activities on research, development and innovation (RD&I). Further conditions requiring either an increase in the number of employees and total emoluments paid to employees, or an increase in expenditure on RD&I also apply.

higher-risk, research and development (R&D) intensive and pre-revenue generating firms, can find it more difficult to attract financial investment than other more established businesses. Accordingly, the Commission supports measures to ensure schemes like EII are accessible to and used by early-stage, high-risk and R&D intensive businesses to assist in attracting stable financial investment.

While Revenue collects data on users of EII in terms of their sector, size or income levels, the information gathered via the tax system is unable to provide deep insight into the funding capabilities of companies claiming the relief, or indeed companies that have not been able to access funding even with the added tax incentive to investors granted by EII.

The Commission therefore believes that it would be worthwhile for government to collect further data and analyse who is using the relief, both in terms of the type of investor that it attracts and the profile of companies that are raising funding through the scheme. This analysis should seek to understand the financing difficulties faced by SMEs and what funding alternatives were available to those who chose to use the scheme. This should enable an assessment of whether EII is reaching those firms most in need of financing and whether there is any significant deadweight or inefficiencies with the scheme. Following such a review, evidence-based policy changes could be introduced to better target the relief.

EII is currently set to end at the end of 2024. The Commission endorses the further extension of EII beyond 2024, subject to the continued use of sunset clauses and regular review as part of the tax expenditure review process. Consideration should also be given to further enhancement of the relief to improve access for those firms most in need of funding.

Recommendation

9.4 The Commission endorses the use of appropriately targeted taxation measures to support Small and Medium Enterprises in raising equity investment, and thereby supporting such firms to establish, grow and sustain employment. The Commission supports the continued use and development of investment-based schemes, such as the Employment Investment Incentive (EII). The Commission recommends that EII should be extended and enhanced to support early-stage, high-risk and research and development-intensive businesses in attracting stable financial investment.

9.4.2 Use of Capital Gains Tax (CGT) reliefs to attract investment

As noted previously, the Commission supports tax measures that assist new businesses in the early start-up phase or enable productive enterprises to sustain or scale up their business. In terms of raising financing, for the most part, the use of tax reliefs at the point of investment appears to be more effective at incentivising investment in a business at the start-up or growth phase. Previous studies of Entrepreneur Relief both in the UK and Ireland[179] suggest that the availability of CGT reliefs on disposal of a business are not the primary motivating factor when making decisions about investing in assets, and that the tax savings are less likely to be used for reinvestment in a new business than they are for other purposes.

Nevertheless, the design of tax reliefs at the investment stage, such as EII, are often complex or not effective for certain types of SMEs in attracting external equity financing. Therefore, where such tax measures are not appropriate, the availability of a tax relief like CGT Revised Entrepreneur Relief ("Entrepreneur Relief")[180] at exit stage can provide an alternative incentive to potential investors in those enterprises. The simplicity and design of the scheme also add to its appeal.

The current design of Entrepreneur Relief is targeted at employees

179 Indecon (2019) Evaluation of the Revised Entrepreneur Relief; Institute of Fiscal Studies (2017) Capital Gains Tax Entrepreneurs' Relief: Behaviours and Motivations, HMRC Research Report 456.

180 This relief replaced the Entrepreneur Relief that applied for the years 2014 and 2015. While its formal name is "Revised Entrepreneur Relief", we refer to the current scheme in this report as "Entrepreneur Relief" for convenience.

and directors of a trading business. In order for individuals to qualify for a reduced 10 per cent rate of CGT on disposal of their share in the business, they must have spent at least 50 per cent of their time working in a managerial or technical capacity, for at least three continuous years in the five year period prior to the disposal of their assets. This means the relief is not available to incentivise third-party investors.

A number of submissions to the Commission's public consultation, as well as proposals from the OECD's review of SME and Entrepreneurship Policy in Ireland and the subsequent National SME and Entrepreneurship Growth Plan,[181] recommended that Entrepreneur Relief be extended to third-party investors, or so called business angel investors.

Angel investors are typically high-wealth individuals who invest capital in companies during their early stage of development. In addition, they may contribute their know-how or experience in company management, share contacts from their professional network and usually seek active participation in companies in which they invest. Their involvement with multiple businesses at a time may mean that they cannot avail of Entrepreneur Relief in its current form due to the 50 per cent working time condition.

As part of its recommendation, the OECD noted that facilitating business angel investment could have a positive impact on SME productivity given the benefits to investee companies and on the general business population through potential spill-over effects. The OECD also referenced the strong reliance of Irish SMEs on straight debt for external finance, and the relatively low take-up of external equity by SMEs, noting that more activity from outside investors could, at least to some extent, help address investment gaps.

The Commission endorses the objective of supporting SMEs in attracting equity financing in order to promote employment and facilitate growth. Therefore, while preferring tax incentives at the point of investment, given that that such incentives are not always suitable for certain SMEs, there is a case for the extension of Entrepreneur Relief to angel investors subject to appropriate limits and conditionality.

Extension of the reduced CGT rate provided for by Entrepreneur Relief will require relaxation of the working-time conditions in that relief

181 OECD, SME and Entrepreneurship Policy in Ireland, 2019; Department of Enterprise Trade and Employment SME Growth Taskforce, SME and Entrepreneurship Growth Plan, 2021.

in order for third-party investors to qualify. The Commission proposes that such relaxation should be subject to an appropriate lifetime limit and the extended relief be subject to conditions such as:

- Relief for angel investors should only be available for third-party equity investors in early-stage micro, small and medium-sized trading companies less than seven years old;
- As this measure is aimed at aiding SMEs who are unable to benefit from supports like EII, angel investors should not be able to claim both EII or the Start-up Capital Incentive (SCI)[182] and a reduced rate of CGT on the same investment; and
- Consideration should be given at design stage to introduce some conditionality that targets the relief at serial entrepreneurship and encourages reinvestment.

Policymakers may also decide on other qualifying criteria at design stage as appropriate, as well as ensuring compliance with relevant State Aid considerations. Once implemented, the measure should be reviewed in accordance with tax expenditure review guidelines in order to assess the effectiveness of the measure in achieving policy objectives.

Recommendation

9.5 The Commission recommends that Entrepreneur Relief be extended to angel investors, subject to appropriate limits and conditionality.

9.5 RESEARCH AND DEVELOPMENT (R&D)

9.5.1 Overview of R&D in Ireland

A key component of high-potential entrepreneurialism is research, development and innovation. Enterprises that engage in R&D are associated with higher levels of productivity, exports and growth. Government policy has long been to encourage increased investment in R&D in Ireland, which is believed would happen at less than socially optimal levels in the private market in the absence of State intervention. In 2019, gross R&D expenditure in the State was €4.4 billion or 2 per

182 The Start-up Capital Incentive (SCI) is an Income Tax relief for family members / connected persons who make an equity investment in new start-up micro companies.

cent of GNI*, below the EU-27 average of 2.2 per cent of GDP and substantially below Germany's 3.2 per cent of GDP in that year.[183]

While SMEs represent the majority of firms engaged in R&D by number, the majority of R&D expenditure is undertaken by large enterprises. Similarly, while 25 per cent of all large enterprises engaged in R&D in 2019, just 0.6 per cent did so among SMEs. Furthermore, it is foreign-owned enterprises who spend the most on R&D, compared with Irish-owned firms who account for less than a third of the value of R&D expenditure in Ireland.[184]

It is the Commission's view that State support is an effective means of promoting R&D. However, the Commission believes that an insufficient level of R&D is carried out by SMEs due to barriers that exist for smaller enterprises to utilise available supports.

9.5.2 The R&D tax credit

The R&D tax credit is a tax incentive regime for companies who incur qualifying expenditure on R&D activities. The purpose of the scheme is to encourage R&D and innovation to be carried out in Ireland with a view to promoting the productive, high value-added sectors of the economy.

In addition to the normal Corporation Tax deduction at 12.5 per cent for R&D expenditure, further relief is given in the form of a 25 per cent tax credit.[185]

Revenue releases annual statistics on the usage and cost of the relief (see Table 21). The most recent data available shows that SMEs are regular users of the relief, with companies of less than 250 employees consistently accounting for approximately 90 per cent of the number of claimants of the relief.[186] While less large-sized companies (with 250 employees or more) claim the relief relative to SMEs, they represent the largest claimants of the relief in terms of the monetary value of claims and the annual Exchequer cost.

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183 Eurostat.

184 CSO, Business Expenditure on Research and Development, March 2021; CSO, Business in Ireland 2019, 2021.

185 In the first instance the credit is used to reduce the Corporation Tax liability in the current accounting period. Unused credits can be carried forward or they may also be carried back and offset against Corporation Tax paid in the previous year. Any unused credits can be refunded in three cash instalments over a three year cycle.

186 Revenue, R&D tax credit statistics, May 2022.

Table 21: Breakdown of R&D claimants by size (number of employees), 2017 - 2020

YEAR	2017		2018		2019		2020	
Number of employees	Number of claimants	Cost of credit €m	Number of claimants	Cost of credit €m	Number of claimants	Cost of credit €m	Number of claimants	Cost of credit €m
Less than 10	475	38	409	31	531	33	544	37
11 to 49	549	51	443	39	535	55	534	56
50 to 250	331	69	305	58	354	90	355	99
More than 250	150	290	146	226	181	449	183	466
Total	1,505	448	1,303	354	1,601	627	1,616	658

Source: Revenue Commissioners, R&D tax credit statistics, May 2022

9.5.3 Enhanced relief and guidance for SMEs

Finance Act 2019 contained a number of measures targeted at small and micro sized companies in order to make the R&D tax credit more attractive. Planned measures included an increase in the rate of the credit from 25 per cent to 30 per cent, a new provision allowing certain pre-trading expenditure to qualify and an enhanced method of calculating the payable element of the credit.

The Commission supports the policy intention behind these amendments that were targeted to enhance uptake by small- and micro-sized companies. However, these changes were subject to State Aid approval, which required modifications that would have created additional complexity and an administrative burden which would have been counterproductive to the aim of assisting small and micro companies.

The Commission believes that it is critically important that smaller businesses are encouraged to carry out R&D. If State Aid requirements constrain the introduction of a targeted small- and micro-firm element to the existing R&D tax credit system, then alternative measures should be found. This may involve the development of a two-tiered system or separate research and innovation focused relief for smaller firms, if possible. It is essential that the tax system is modified to encourage and improve uptake by smaller businesses, particular early-stage and

pre-revenue start-ups who are engaged heavily in R&D activity.[187] This needs to be done in a way that minimises the administrative burden and complexity faced by claimants as much as possible.

The timing of access to the refundable element of the credit was also raised as a concern for SMEs through our stakeholder consultation. An acceleration of the repayable credit may provide a valuable cash flow benefit to early-stage businesses. The Commission supports such a change and consideration should be given to an acceleration of the refundable element of the credit from three years to one. In order to minimise risk to the Exchequer such a change could be subject to an appropriately targeted cap thereby ensuring that the change provides maximum benefit to smaller enterprises. In addition to enhanced relief measures targeted at small and micro-sized firms, the Commission believes that access and uptake by SMEs more generally could be further improved through enhanced guidance and support in understanding the various requirements of the R&D regime. The guidance provided to, and the administrative process faced by, smaller firms should be simplified and streamlined in order to improve accessibility and reduce complexity. The Commission's recommendation for enhancing the supports available to SMEs in accessing tax reliefs, including the R&D tax credit, is discussed in section 9.6 of this chapter.

The Department of Finance has recently conducted a public consultation on the R&D tax credit, the purpose of which is to consider the current challenges facings firms who are active in the R&D and intellectual property space. Feedback from this consultation, which was not available at the time of writing, will be considered in the context of both Budget and Finance Bill 2023.

187 Current rules allow companies to make a claim for R&D expenditure incurred before they commence trading. The amount of the credit can be carried forward and used against the Corporation Tax liability of future periods.

Recommendation

9.6 The Commission recognises the important role played by the tax system in supporting and encouraging a strong innovation, research and development culture across the economy. The Commission also recognises the importance of the Research and Development (R&D) tax credit in this area and therefore recommends that enhanced relief measures be introduced which are targeted at small and micro-sized enterprises. Furthermore, more guidance and supports should be introduced to facilitate greater uptake by SMEs more generally. The Commission recommends that consideration be given to a limited acceleration of the refundable element of the R&D tax credit from three years to one in order to support early-stage and R&D intensive businesses.

9.6 ENABLING SME ACCESS TO TAX RELIEFS

The general business environment for SMEs in Ireland is positive, with a wide range of government supports designed to promote the establishment and growth of businesses. The Department of Enterprise, Trade and Employment (DETE) funds and promotes enterprise-led innovation through a range of programmes and supports, delivered for the most part through agencies such as Enterprise Ireland and IDA Ireland. Tax reliefs form only one part of a wider landscape of measures aimed at promoting entrepreneurial activity and business development across Ireland's economy. It is important that SMEs are made aware of the various State supports available and given assistance in claiming the form of relief best suited to their needs.

This strong and supportive ecosystem is why, for the most part, the Commission is not recommending significant change to a number of enterprise-based tax measures and has instead focused on a select few. Tax reliefs such as EII and the R&D tax credit in particular have attracted the Commission's attention in terms of being areas that warrant improvement.

Most claims by businesses and investors for tax deductions, reliefs and credits are processed based on self-assessment. This system can act as a disincentive for some smaller businesses and entrepreneurs to claim the reliefs. A common concern raised in the context of SMEs is their difficulty and lack of certainty in ensuring that they are compliant with

the qualifying conditions or are keeping the appropriate documentation for accessing various innovative and entrepreneurial-related tax reliefs.

Revenue publishes guidance on its website, provides online and telephone customer support and accepts complex technical queries from taxpayers and practitioners through the Revenue Technical Service in respect of each of the reliefs. The Commission supports the continued and indeed enhanced provision of these services. However, website guidance and general customer support is not enough to enable better uptake of often complex entrepreneurial tax reliefs by SMEs.

The Commission has concerns that the extensive records required, the cost of hiring a tax advisor (or scientific expert in the case of the R&D tax credit), the risk of an extended audit on claims and the cost of incorrectly claiming a relief can act as barriers to take up reliefs. These matters are more likely to affect smaller firms, who do not have the same capacity as larger companies to absorb the time and resource costs required to avail of reliefs. Uptake of certain reliefs could be further enhanced by creating supplementary, user-friendly and accessible material targeted at smaller firms. This may take the form of additional examples, standardised checklists of information and supporting documentation required and templates, to the extent possible, illustrating the basic requirements common to smaller-sized claimants.

A common request from SMEs is the introduction of a pre-approval process for first time tax relief claims, or some other form of advanced support from government, to help companies establish quickly and at a minimal cost whether proposed activities would qualify for a relief. This advanced assurance could bring certainty to businesses and minimise the cost of engaging advisors and/or the cost associated with incorrect claims. The Commission supports this position.

There are a number of government bodies that would be involved in developing an advanced assurance system in Ireland. As noted previously, DETE and its agencies typically provide enterprise-related supports, however, they are unlikely to be able to provide the level of assurance on tax technical matters that SMEs would like. Similarly, Revenue clearly has the tax expertise, but as the national tax administrator it is not appropriate for it to provide tax advisory services. Furthermore, neither body currently has the relevant in-house expertise to evaluate certain areas of SME uncertainty, such as the scientific test for the R&D tax credit.

The Commission recommends that Revenue, DETE and its agencies, work together to develop a mechanism to provide advanced assurance to firms of their eligibility for key entrepreneurial and innovation-related tax reliefs in order to enable wider access and understanding of the relevant criteria.

Recommendation

9.7 The Commission recommends that specialist resources and capabilities be allocated to the Revenue Commissioners, and the Department of Enterprise, Trade and Employment and its agencies to develop an advance assurance mechanism in order to enable wider access to tax incentives such as the Research and Development tax credit and Employment Investment Incentive.

9.7 ATTRACTING TALENT WITH SHARE-BASED REMUNERATION

Employers commonly use shares in companies as a mechanism for rewarding, incentivising and retaining employees, allowing them to participate in growing the value of the company. As set out in Table 22, share-based remuneration with a taxable value of €1.2 billion was reported to Revenue in 2020, having risen from €943 million the previous year and continuing the trend seen over the last number of years of increasing share-based compensation values and employee financial participation.

Table 22: PAYE data on share-based remuneration, 2019 and 2020

	2019		2020	
Company size (based on number of employees)	**Number of employers**	**Value of share-based remuneration (€m)**	**Number of employers**	**Value of share-based remuneration (€m)**
Micro (1-9)	117	19.0	107	12.9
Small (10-49)	174	63.7	186	50.3
Medium (50-249)	199	111.9	220	138.6
Large (250+)	174	749.0	169	998.7
Total	664	943.5	682	1,200.4

Source: Revenue Commissioners

Note: This table shows the number of employers that provided share awards to employees that were taxed via payroll in 2019 and 2020. This does not include share remuneration that was not taxed through PAYE, such as share options or share awards subject to tax relief.

In general, Income Tax, Universal Social Charge (USC) and employee Pay Related Social Insurance (PRSI) are chargeable on shares acquired by employees by virtue of their employment, where the shares are acquired free of charge or at a discounted price. There is no employer PRSI charge for share-based remuneration, making share schemes particularly attractive to employers based in Ireland as an alternative to cash-based payments, bonuses or awards.

The Commission believes there is an opportunity for greater harmonisation and equity in the treatment of different types of shares schemes and with other forms of employee remuneration. The Commission also recognises the growing importance of share-based remuneration in enhancing the employment offerings of smaller and younger firms. Start-ups and SMEs may not have the same cash resources as larger and more established firms to offer high salaries, so the ability to offer shares that may have a significant future value can compensate for lower pay at an earlier stage. The Commission, therefore, is making a number of recommendations in the area of share-based remuneration.

9.7.1 Key Employee Engagement Programme (KEEP)

A key issue faced by SMEs relates to their ability to attract and retain employees. Due to the availability of more resources, large enterprises can offer attractive compensation packages to employees that SMEs cannot. This widens the productivity gap between SMEs and large enterprises. Accordingly, the Commission sees a role for the tax system to play in attracting and retaining highly skilled employees in SMEs.

9.7.1.1 Overview of KEEP

The Key Employee Engagement Programme (KEEP) is a share option tax incentive that unquoted SMEs can offer to employees and directors. KEEP is intended to improve the attractiveness of the SME employment offering, through the form of a financial incentive linked to the success of the company that can be used to recruit and retain talent in a competitive labour market.

A share option is a type of award where an employer grants an employee an option to purchase company shares in the future at a predetermined price (the "option price"). If the employee exercises the

option, any gain on exercise will normally be subject to tax.[188] However, individuals who exercise KEEP options are exempt from Income Tax, USC and PRSI on any gain arising at exercise. Any uplift in value of the shares from grant to exercise is instead captured when the shares are sold, with CGT calculated on any gain at disposal using the option price as the base cost. This represents an employee tax saving of up to 19 per cent compared to standard share options.[189]

Since its introduction in 2018, several amendments have been made to encourage greater uptake of the incentive, including increases in the limit on the total market value of the share options that may be granted to any one employee. As a result, a slight increase is beginning to be seen in the number of companies offering KEEP options, together with a modest increase in the number of employees who have been granted or who have exercised KEEP options.[190] To date 53 unique companies have availed of KEEP.

The Commission believes that there has not been sufficient uptake of the relief so far and that more could be done to make it a more successful tax incentive. Feedback received through the Commission's public consultation was that while the intention behind KEEP and the generous tax relief granted to their employees are welcomed by SMEs, there are a number of features of the current design of the scheme that are limiting its effectiveness.

9.7.1.2 The future of KEEP

As noted previously, the Commission recognises that SMEs can find it more difficult to compete with larger firms in terms of their financial offering to employees and endorses the policy rationale behind KEEP. The scheme is currently only available for options granted between January 2018 and December 2023. Subject to the normal tax expenditure review and sunset-clause provisions, the Commission believes that KEEP should be extended beyond 2023.

As part of this extension, the Commission supports the

188 The exercise gain is the difference between the market value of the shares on the date of exercise and the option price (plus any amount paid for the grant of the option).

189 The tax saving may even increase to 42 per cent where the KEEP participant further qualifies for a reduced 10 per cent rate of CGT under Entrepreneur Relief.

190 Approximately 45 employees exercised their KEEP options in 2020 and 2021 each. The number of employees who were granted KEEP options rose from 99 employees in 2018 to 227 employees in 2021.

implementation of the amendments introduced in Finance Act 2019, which are awaiting commencement pending approval from the European Commission, as soon as possible. These changes, which include an extension of the relief to larger group structures and part-time employees, as well as the removal of the requirement that shares used in the scheme must be newly issued, will be particularly useful in broadening the scheme and making it more accessible.

When the Finance Act 2019 changes are implemented, KEEP legislation will allow for options to be issued in respect of shares in a qualifying company or, in the case of a group, in a qualifying holding company, as defined. It is important as part of this change, that corporate restructuring and growth is facilitated within KEEP.

If, for example, another company acquires a qualifying company, the employer may request that KEEP participants exchange or assign their option over shares in the acquired company for options over shares in the new takeover company. If that takeover company meets qualifying criteria set out in legislation and the new options are equivalent to the old options, then the Commission believes the future exercise of the new replacement options should qualify for relief under KEEP. This would be in line with provisions already in existence for the approved share schemes (Approved Profit Sharing Scheme 'APSS' and Save As You Earn 'SAYE'), where exchanges of shares or options are permitted for certain company reorganisations.

In addition, there are a number of qualifying conditions relating to the company, employees and share options qualifying for KEEP that could be changed to facilitate additional uptake of the scheme.

One condition of KEEP is that the total market value of the issued but unexercised qualifying share options of the company must not exceed €3 million at the date of grant of the KEEP option. This threshold may result in a company not being able to offer any more KEEP options to its employees until some of the options are exercised, which may not happen for several years,[191] or at all if the company share value drops. An increase in the €3 million cap, therefore, may enhance the scheme for SMEs, particularly enterprises whose share value has risen during the exercise period.

The extension and reform of KEEP coupled with the continued

191 Options under KEEP can be exercised by an employee up to ten years after grant, although the company can choose to set a shorter exercise period provided it is no less than 12 months.

limited exemption of employer PRSI contributions for share-based remuneration (discussed in section 9.8.3) should provide assistance to SMEs in attracting and retaining talent.

Recommendation

9.8 The Commission recognises the importance of share-based remuneration to support SMEs and indigenous enterprises in attracting and retaining talent and sees a role for the tax system in this area. The Commission does not believe that the Key Employee Engagement Programme (KEEP) is achieving its objectives in its current form and recommends that KEEP should be reformed to broaden its use.

9.7.2 Employer PRSI exemption for share remuneration

Unlike most other forms of employee remuneration, share remuneration is not subject to employer PRSI. There is no monetary limit on the employer PRSI exemption for shares and this can represent a significant saving and attractive alternative for employers compared with providing cash-based remuneration. Relief from the employer social insurance contribution applies regardless of the type of share scheme.[192]

The cost to the State of providing this exemption to employers, in terms of PRSI forgone and the financial impact on the Social Insurance Fund, is not currently calculated or monitored as part of government fiscal analysis. PAYE data from Revenue shows that the taxable value of share-based remuneration provided to employees was over €943 million and €1.2 billion in 2019 and 2020, respectively. This suggests that the employer PRSI forgone was at least €103 million in 2019 (at the 10.95 per cent rate) and €132 million in 2020 (at the 11.05 per cent rate). These tentative estimates do not take into account employer PRSI savings from share remuneration not taxed through PAYE, such as share options and share awards subject to tax relief, suggesting that the true annual cost is higher. The Commission believes that this level of relief cannot be justified from a fiscal sustainability point of view. The actual cost of this relief in terms of PRSI forgone should be

192 Some employee benefit plans offer cash payments to employees based on the value of company shares. Cash-settled awards cannot avail of the employer PRSI exemption and are taxed the same as other cash payments. The Commission does not propose any changes to the treatment of cash-settled share-based awards.

quantified in order to inform future policy decisions.

The Commission is also of the view that there should be greater horizontal equity in the treatment of employment income. Introducing an employer PRSI charge for share-based remuneration would bring the Irish treatment in line with many other EU and OECD countries that generally charge employer social security contributions on share awards.[193] Removing the bias in the system in favour of share-based remuneration over cash remuneration would also serve to broaden the PRSI base. The Commission's recommendations in this area are discussed further in Chapter 10 (Labour Markets and Social Protection Systems).

The Commission recommends that the exemption from employer PRSI for share-based remuneration should be subject to an appropriate cap per employer. Alternatively, consideration could be given to limiting relief to SMEs only (see section 9.8.3.1).

Share-based remuneration can often feature in the reward packages of internationally-mobile workers. Extending the PRSI charge on share-based remuneration should not affect the treatment of shares awarded to employees who temporarily relocate to work in Ireland, as such individuals will typically be retained in their home country social security system while on short-term assignment.

9.7.2.1 Impact on smaller-sized employers

As already outlined, the Commission is conscious of the difficulty smaller enterprises can have in attracting and retaining employees. Offering share-based remuneration that may have a significant future value can compensate for lower pay at an earlier stage and alleviate the use of a company's current cash resources. Data from Revenue shows that less than 17 and 21 per cent of the value of share-based remuneration taxed via PAYE in 2019 and 2020, respectively, was delivered by SMEs (see Table 22). Accordingly, the Commission considers that there is a justification for retaining a limited employer PRSI exemption to support micro, small and medium-sized enterprises, without unduly compromising fiscal sustainability objectives. As an alternative to the introduction of an appropriate cap on the exemption for all firm

193 Countries that generally charge employer social security contributions on share awards include France, Belgium, Germany, the Netherlands, Sweden and Norway. Employer social insurance may apply to share awards in the UK depending on circumstances.

sizes, consideration could be given to limiting the exemption to SMEs generally.

Recommendation

9.9 The Commission recommends that the exemption from employer Pay Related Social Insurance (PRSI) on share-based remuneration should be limited through the introduction of an appropriate cap or, alternatively, by restricting the exemption to micro, small and medium-sized enterprises.

9.7.3 Collection of tax on share options

As a general rule any tax on employment remuneration is collected through the Pay As You Earn (PAYE) system of tax deduction. Any liability is calculated by the employer at the tax and PRSI rates set out in the relevant Revenue payroll notification and remitted to Revenue by the employer. This treatment applies to most types of shares schemes and includes, for example, any USC and PRSI liabilities arising on the exercise of share options under an approved saving-related, or Save as You Earn (SAYE), share option scheme. An exception to this is unapproved share options, which are instead taxed under self-assessment.

Employees who exercise share options must file a Form RTSO1 and pay Income Tax, USC and PRSI on the exercise gain at a total rate of 52 per cent[194] within 30 days of exercise. The individual must also file an Income Tax return at year-end. Employers must separately report all grants and exercises of shares options by their employees during the year in an annual return to Revenue (Form RSS1).

There is no obvious rationale as to why the method of collecting and reporting tax on employee share options is different to that of other forms of employee share-based remuneration, particularly when USC and PRSI liabilities on SAYE options are collected via PAYE. A number of other countries, such as the US, Germany, France, Sweden and Belgium, generally oblige the employer to withhold employee taxes related to share options. The operation of PAYE by employers on all types of employee share options could facilitate better compliance and

194 Individuals who are standard-rate taxpayers, or whose final USC liability will be at a lower rate of USC may apply in advance for Revenue approval to pay tax at lower rates.

reduce the administrative compliance burden on employees. Assuming responsibility for the calculation and collection of tax may also assist employers in making a share option scheme more accessible and attractive for their employees.

Furthermore, tax legislation provides for a higher 0.0322 per cent rate of interest on late payment or underpayment of Income Tax on share option exercise gains, compared to the normal interest rate of 0.0219 per cent for Income Tax. The Commission considers this to be inequitable and recommends that the interest rates be equalised at the normal interest rate for Income Tax.

Recommendation

9.10 The Commission recommends that the taxation of employee share options should be moved from self-assessment to the PAYE system.

9.8 GLOBAL MOBILITY – ATTRACTING INVESTMENT AND TALENT

In a globalised environment where it is becoming increasingly attractive and easy for individuals to work in any location across the world, the focus on attracting and retaining highly skilled and talented workers becomes more acute. This is not only from the perspective of promoting enterprise and creating employment in the State, but also due to the importance of attracting and retaining FDI and corporate substance at a time when Ireland's scope for engaging in international corporation tax competition to attract FDI into the future may be narrowing.

Accordingly, the role of personal taxes, and related inducements in particular, in attracting and retaining talent (and the resultant investment) are becoming increasingly important and could be a potential differentiator when companies are making investment and location decisions.

However, such inducements give rise to Exchequer cost and equity concerns and, while there is growing evidence that taxes can affect the geographic location of people both within and across countries[195,196] the potential benefits of such inducements can be difficult to quantify.

195 Taxation and Migration: Evidence and Policy Implications.

196 Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence from a Panel of OECD Countries Arnold, J. (2008).

Furthermore, there is increasing scrutiny of such measures, most notably by the EU Tax Observatory,[197] [198] and the OECD.[199]

The availability of personal inducements can create not only vertical equity concerns (with regard to offering inducements to highly-skilled individuals who are typically highly paid) but also horizontal equity concerns. This is because, ultimately, they can result in two individuals in similar circumstances being treated differently because of arbitrary factors, such as domicile or residence status in prior periods.

This section examines a number of specific measures that can impact on employee mobility decisions. These include measures with a stated policy objective to encourage inbound or outbound mobility as well as provisions that have consequential impacts on mobility due to their current design, rather than a specific policy objective targeted at mobility. Therefore, in reviewing these measures, we have considered:

- their impact on equity and mobility,
- their stated policy objective, and
- whether they remain fit for purpose.

We recognise that tax measures with a cross-border dimension, such as those relating to mobility, can give rise to mismatch outcomes and that anti-avoidance rules, where appropriate, are important to ensure that double non-taxation events do not arise in this space.

9.8.1 Special Assignee Relief Programme

The Special Assignee Relief Programme (SARP) was first introduced in 2012 to provide Income Tax relief to employees assigned to Ireland from abroad. The relief seeks to facilitate further investment by multinationals in Irish operations by reducing the costs to businesses of attracting key employees overseas to work either in the Irish-based operations of their employer or an associated company.

Where the qualifying criteria have been met, the relief can be available for up to five years. Relief is given by way of disregarding 30 per cent of all employment income between €75,000 and

197 The EU Tax Observatory is an independent research laboratory hosted at the Paris School of Economics. The Observatory is co-financed by the European Union (under grant agreement n°TAXUD/2020/DE/326) and PSE-Ecole d'Économie de Paris.

198 New Forms of Tax Competition in the European Union: An Empirical Investigation.

199 Carbon Taxes, Billionaires' Taxes on Horizon: OECD Tax Head, Bloomberg Tax (2021).

€1 million for Income Tax purposes. This upper limit of €1 million was applied in 2019 in response to increasing Exchequer costs. An upper limit of €500,000 previously applied but was withdrawn in 2015, this meant that there was no upper limit on the relief for a period. The relief effectively applies an Income Tax rate of 28 per cent (i.e. 70 per cent of the higher rate) on employment income within this range. The relief also allows for certain schooling and travel expenses to be exempted from the charge to tax where certain conditions apply.[200]

The number of SARP claimants has risen steadily with 1,574 employees across 461 employers availing of the relief in 2019 alone. Following the application of the €1 million cap, the overall Exchequer cost has begun to fall with the measure costing €38.2 million in 2019; down €4.2 million on the previous year.

Despite this fall in Exchequer costs, the Commission has reservations about the ongoing use of the relief as it conflicts with its other objectives of broadening the tax base and ensuring equity of treatment where possible. The application of the relief is also highly concentrated – with conservative estimates indicating that €5.55 million of relief granted in 2019 relates to just 50 employees.[201]

Furthermore, we note that many multinational groups tend to use tax equalisation[202] measures to ensure that personal taxes are not a factor in the assignment decisions of employees. This means that the benefit of the incentive in those cases is mainly passed on to corporate employers located outside the State. In 2019, 35 per cent of SARP relief was reported to have been granted to employees subject to tax equalisation.[203]

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200 School fees of up to €5,000 per annum and expenses incurred on one trip home per year, where they are paid for by the employer, are not subject to Income Tax, USC or PRSI.

201 50 claimants had income of between €1 million and €3 million in 2019. Assuming all of these claimants had income of €1m, each would have had relievable income of €925,000 in 2019, which would give rise to a taxable income disregard of €111,500 per individual. €111,000 x 50 x 40% = €5.55 million.

202 Tax equalisation broadly means that an employee pays no more and no less tax while on international assignment than he/she would have paid had he/she remained in his/her home country. The company bears all the actual home and host country tax due. The employee's contribution to the tax burden is the hypothetical tax he/she would have paid had he/she not gone on assignment. If the actual tax due is higher than the hypothetical tax withheld, the employer pays the difference. If the actual tax due is lower than the hypothetical tax, the employer retains the difference.

203 Special Assignee Relief Programme - Statistics for 2019, Revenue.

However, this must be balanced with the fact that Ireland has a highly progressive personal tax system with high marginal rates at the top income deciles. Furthermore, many countries utilise similar competitive assignment regimes to attract FDI and labour, many of which provide support to much broader cohorts of assignees.[204] In the absence of SARP, many inbound assignment decisions at the employer- or employee-level may not have been made. This could have knock-on effects for decisions relating to investment location and could also affect corporate substance in Ireland.

An independent assessment of the SARP was conducted by Indecon in 2019[205] which concluded that the rationale for the measure remains valid and that cost-benefit modelling indicates that the scheme is appropriate. The report also identified additional benefits arising from the measure relating to employment, investment and increased Exchequer returns.

On balance, we believe that SARP should be retained for these reasons, but that there is scope for significant restriction of the measure. Potential restrictions that could be considered include:

- the application of a higher effective rate,
- further curtailment of the upper threshold of the relief, or
- restricting allowable expenses to those available to assignees generally – this would curtail allowable travel expenses and remove the allowance for school fees.

Recommendation

9.11 The Commission recommends that the Special Assignee Relief Programme (SARP) should be subject to further restriction and that its continuation should be subject to regular review as part of the tax expenditure review process.

9.8.2 Foreign Earnings Deduction (FED)

The Foreign Earnings Deduction (FED) is an Income Tax relief available to employees who spend a minimum of 30 days working overseas in certain territories. A qualifying individual can reduce their taxable

204 Indecon, Review of SARP, 2019.

205 Indecon, Review of SARP, 2019.

employment earnings, which can give rise to an Income Tax saving of up to €14,000.

FED was introduced with the aim of supporting efforts by firms to expand their exports operations into economic growth markets by incentivising employees to undertake marketing trips to BRICS[206] countries (the list of qualifying countries has significantly expanded[207] since the relief was first introduced).

However, the relief does not appear to be adequately targeted to achieve its policy objective. FED does not specify the type of work that must be carried out abroad, nor is it limited to particular sectors. In fact, there is no legislative requirement that the employee be engaged in export-related activity at all. Ultimately, this means it is possible to arrange for an employee to carry out duties on FED assignment that could have otherwise been completed in the State, without affecting entitlement to the relief. Additionally, it is possible for a claimant to engage in activity from non-internationally traded sectors.

Furthermore, there is no requirement that the duties carried out abroad be linked to an Irish operation. This means that an employee can arrive to a new Irish-based employer, having worked in a qualifying country, or resign an Irish-based employment to work in a qualifying country, and potentially be eligible for FED.[208]

As referred to in section 9.1.2, the OECD have identified limited direct entry into export markets as a factor affecting Irish SME productivity. For this reason, we believe that ongoing incentivisation of export activity by SMEs remains important and that the qualifying conditions of FED should be reviewed to ensure the overarching policy objective of the measure, being the encouragement of export-led activity, is met.

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206 Brazil, Russia, India, China and South Africa.

207 The list of qualifying countries is available on Revenue's Foreign Earnings Deduction webpage.

208 In practice an employee will typically avail of split-year treatment instead. However, FED could potentially be used where split-year treatment is not available to the taxpayer.

Recommendation

9.12 The Commission recommends that the qualifying criteria of the Foreign Earnings Deduction (FED) be reviewed to ensure the measure is utilised by claimants in a manner consistent with its original policy objective.

9.8.3 Remittance basis

As noted in Chapter 6 (Tax Equity and Base Broadening), individuals who are resident, but not domiciled, in the State are subject to a different personal tax treatment known as the remittance basis, whereby certain foreign income and gains are subject to Irish tax only to the extent they have been remitted to the State.

The measure was not originally intended as a relief for the globally mobile, rather it was a provision introduced to ensure that monies generated from overseas estates, required in law to be remitted on colonial ships in the 18th and 19th centuries, were properly taxed.

However, the remittance basis is now perceived as a broad-based mobility relief – and may play a role in attracting internationally mobile and/or highly skilled individuals to live, invest and work in Ireland.

To this end, and as noted in Chapter 6 (Tax Equity and Base Broadening), while we recommend that the remittance basis should be restricted to ensure that individuals with a substantive presence in the State pay their fair share of tax, we believe there is scope for its limited application as a broad-based relief for global mobility. Such a measure could be properly targeted at those individuals living or working in Ireland on a short term, or more transient basis, with no real ties to the State.

9.8.4 Restricted Stock Units (RSUs) and global mobility

The taxation of employment income is relatively straightforward when an employee is resident and working only in one country, with that country typically holding full taxing rights on the employment income. The tax position can become more complex when an international element is added, and can vary depending on the individual's tax residence position and where the duties of the employment are carried out.

The Irish tax treatment of internationally mobile workers who are in receipt of share options currently differs from the treatment of such

workers who have Restricted Stock Units (RSUs) and other similar share awards. A Restricted Stock Unit is a grant or promise to an employee that, on completion of a vesting period, the employee will receive a number of shares.[209] The Commission considers that the treatment of all employment-related share remuneration should be aligned in respect of mobile workers.

In the case of mobile workers who receive share options, any gain on exercise can normally be apportioned based on Irish workdays throughout the vesting period,[210] where the employee has worked in both Ireland and a jurisdiction with which Ireland has a double taxation agreement. This is in line with OECD recommendations regarding the taxation of share options.[211]

The position is different for RSUs and other similar share awards. These awards are treated as normal employment income. Since 2018, the statutory basis of assessment has been the 'receipts basis', meaning the tax is charged on the amount received by the employee by reference to the vesting or payment date (if sooner) of the award. This means that RSUs are fully taxable if they vest at a time when the holder is Irish tax resident, without any apportionment by reference to any part of the vesting period during which the holder was resident elsewhere. If the RSUs vest and the holder is no longer Irish tax-resident, the RSUs are not taxable in Ireland, regardless of the fact that the holder may have been tax resident in Ireland at the time of the grant and during the vesting period.

Ireland's approach to taxing share-settled RSUs on a receipts basis is currently broadly in line with how employment income is taxed

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209 As an alternative to delivering shares at the end of the vesting period, some RSU plans offer cash payments to employees based on the value of company shares. The Commission does not propose any changes to the treatment of cash-settled RSU awards.

210 Typically an employer will attach certain vesting conditions before an employee can receive share-based remuneration. Common vesting conditions include the passage of a specified period of time and/or the achievement of certain performance targets by the individual or at corporate level. The period of time between the date of grant of the shares and the date on which the vesting conditions are satisfied is known as the vesting period.

211 The taxation of share options for international assignees can vary depending on circumstances, including whether there is a Double Taxation Agreement (DTA) in place and the relevant provisions of that DTA. For further information on the various scenarios that can apply, see Revenue guidance in the Share Scheme Tax and Duty Manuals on www.revenue.ie.

in the State. However, this approach may not be reflective of where employment duties were carried out when earning the share awards. This treatment can result in full taxation in Ireland even though the shares may have been awarded in respect of employment duties carried out and income earned prior to arrival in Ireland.

This treatment can also influence the behaviour of taxpayers. For example, some employees may choose to defer the timing of their assignment to Ireland, or accelerate their departure from Ireland, in order to avoid an Irish tax charge on the RSU vesting.

This can lead to anomalous situations where the tax treatment in another country differs. Some countries tax RSUs by reference to residence, or on an apportionment or earnings basis depending on where employment duties were carried out over the vesting period. This variance of rules may result in double taxation, or double non-taxation, in two jurisdictions.

The Commission is of the view that the Irish taxation of RSUs is misaligned with the treatment of share options and can lead to gaps in Irish taxation, as well as influencing the behaviour of employees who are considering moving their tax residence to or from Ireland.

Recommendation

9.13 The Commission recommends that the taxation of internationally mobile employees who receive share remuneration (including Restricted Stock Units) should be aligned with the general treatment applicable to unapproved share options.

9.8.5 Tax treatment of trans-border workers

Trans-border Relief was introduced in Finance Act 1998, primarily to deal with Irish-resident and domiciled individuals living in border counties in Ireland who were subject to double taxation on their employment income by virtue of being employed in Northern Ireland. The relief is often referred to as cross-border relief.

The practical effect of the relief, where applicable, is that no Irish Income Tax or USC[212] is due on an individual's trans-border employment

212 Social security obligations are dependent on the work patterns of the individual and not this relief.

income or director's fees.[213]

Since the relief was first introduced, there have been significant increases in the level of globalisation and reductions in the cost of international travel. However, the qualifying conditions of the relief have not been updated to reflect modern commuting and working patterns. As such, the relief has application beyond what was originally envisaged and can apply to employments located and performed in double taxation agreement (DTA) countries worldwide, not just those in Northern Ireland.

Furthermore, the existing minimum working requirements relate to the holding of the employment only. This means that foreign employment contracts that require duties to be performed abroad for very short periods, or on an ad-hoc, rather than on an ongoing basis, can qualify for relief.

When trying to evaluate the scale of the relief, significant data limitations arose. Although an upward trend in the number of claims could be observed in the period from 2009 to 2019, the quantum of claimants and the cost of this relief could not be properly quantified.

No corresponding relief exists for individuals living in Northern Ireland (or any other DTA jurisdiction), and working in the State – in such circumstances, taxing rights are determined by way of the DTA. Therefore, trans-border relief, in its current format, ultimately results in the State giving up its taxing rights over foreign employment income in a manner not replicated elsewhere in the world.

During the pandemic, the relief was temporarily extended to Irish tax resident and domiciled workers forced to work remotely in Ireland while lockdown measures were in place. This approach, although necessary at the time, created tax inequities between employees carrying out similar duties in similar circumstances in the State, and would have given rise to competitiveness issues as well as other legal and taxing impracticalities had it been maintained beyond the lockdown phase of the pandemic. As such, the Commission welcomes the withdrawal of this concession.

However, the Commission also recognises the importance and value of the original policy objective of the relief, particularly in the context of the Shared Island Initiative. With this in mind, the Commission believes that the qualifying conditions of trans-border

213 Trans-border relief also applies to offices/directorships and references in this section to an employment also include the holding of an office.

relief could be reviewed in the context of modern working practices to ensure that horizontal equity is not overly distorted by this measure.

Recommendation

9.14 The Commission recommends that the qualifying conditions of trans-border relief be reviewed in the context of modern work practices.

9.8.5.1 Impact of digitalisation on trans-border workers

We recognise that digitalisation has led to significant labour market change and has facilitated an increase in the level of work that can be done remotely on a trans-border basis.

The pandemic has expedited this change, demonstrating that many roles can be done equally well, or more productively,[214] away from the office. The prevalence of such working patterns is expected to persist beyond the pandemic and potentially grow in some sectors.[215]

Concerns are growing that the degree of inter-jurisdictional remote working afforded by digitalisation may in the longer-term pose economic challenges to Income Tax, similar to those faced by Corporation Tax from digitalisation and globalisation,[216] and could potentially erode the Irish employment tax base.

However, the wide-scale transition to remote forms of work, at least on a cross-border basis, is likely to be hindered in the short to medium term due to practical considerations relating to corporate substance, foreign payroll and social security obligations as well as the risk of exposure to legal issues.[217] In practice, this has meant that permanent remote working policies often limit the number of days that can be worked abroad.

214 National Competitiveness and Productivity Council Bulletin 21-3 Remote Working: Implications for Competitiveness and Productivity.

215 The role of telework for productivity during and post COVID-19: Results from an OECD survey among managers and workers.

216 The Impact of Digitalisation on Personal Income Taxes.

217 Employees who work abroad will be subject to labour laws that the employer may not be familiar with (working time, rest periods, holidays etc.). There may also be immigration issues depending on the location of the employee. There is a general risk that the employer may inadvertently breach this legislation or incur significant cost in avoiding any issue arising.

The Commission considers that the tax and legal consequences of cross-border remote work and digital nomadism[218] should be discussed at a multilateral level in order to understand the true impact of digitalisation on trans-border workers.

9.9 RECOMMENDATIONS

Chapter 9: Promoting Enterprise[219]

9.1	The Commission endorses Ireland's current corporate tax strategy, including Ireland's ongoing participation in international efforts to tackle aggressive and/or harmful corporate tax practices. The Commission also endorses the adoption of the Two-Pillar Solution to Address the Tax Challenges arising from the Digitalisation of the Economy, as well as the development of multilateral solutions to combat base erosion and profit shifting.
9.2	The Commission recommends the continued use of feedback statements and roadmaps which should be better applied to indigenous entities and Small and Medium Enterprises.
9.3	The Commission recommends that consolidation of the Taxes Consolidation Act 1997 (TCA) should be carried out periodically as a matter of principle. Consideration should be given to how greater simplification of existing tax codes can be achieved as part of this exercise.

218 A digital nomad is a person who earns a living working online in various locations of their choosing (rather than a fixed business location).

219 Please note Dr. Tom McDonnell does not endorse the content of Chapter 9 and its related recommendations. Please see Annex 3 for further information.

9.4 The Commission endorses the use of appropriately targeted taxation measures to support Small and Medium Enterprises in raising equity investment, and thereby supporting such firms to establish, grow and sustain employment. The Commission supports the continued use and development of investment-based schemes,such as the Employment Investment Incentive (EII). The Commission recommends that EII should be extended and enhanced to support early-stage, high-risk and research and development intensive businesses in attracting stable financial investment.

9.5 The Commission recommends that Entrepreneur Relief be extended to angel investors, subject to appropriate limits and conditionality.

9.6 The Commission recognises the important role played by the tax system in supporting and encouraging a strong innovation, research and development culture across the economy. The Commission also recognises the importance of the Research and Development (R&D) tax credit in this area and therefore recommends that enhanced relief measures be introduced which are targeted at small and micro-sized enterprises. Furthermore, more guidance and supports should be introduced to facilitate greater uptake by Small and Medium Enterprises more generally. The Commission recommends that consideration be given to a limited acceleration of the refundable element of the R&D tax credit from three years to one in order to support early-stage and R&D intensive businesses.

9.7 The Commission recommends that specialist resources and capabilities be allocated to the Revenue Commissioners, and the Department of Enterprise, Trade and Employment and its agencies to develop an advance assurance mechanism in order to enable wider access to tax incentives such as the Research and Development tax credit and Employment Investment Incentive.

9.8 The Commission recognises the importance of share-based remuneration to support SMEs and indigenous enterprises in attracting and retaining talent and sees a role for the tax system in this area. The Commission does not believe that the Key Employee Engagement Programme (KEEP) is achieving its objectives in its current form and recommends that KEEP should be reformed to broaden its use.

9.9 The Commission recommends that the exemption from employer Pay Related Social Insurance (PRSI) on share-based remuneration should be limited through the introduction of an appropriate annual cap or, alternatively, by restricting the exemption to micro, small and medium-sized enterprises.

9.10 The Commission recommends that the taxation of employee share options should be moved from self-assessment to the Pay As You Earn (PAYE) system.

9.11 The Commission recommends that the Special Assignee Relief Programme (SARP) should be subject to further restriction and that its continuation should be subject to regular review as part of the tax expenditure review process.

9.12 The Commission recommends that the qualifying criteria of the Foreign Earnings Deduction (FED) be reviewed to ensure the measure is utilised by claimants in a manner consistent with its original policy objective.

9.13 The Commission recommends that the taxation of internationally mobile employees who receive share remuneration (including Restricted Stock Units) should be aligned with the general treatment applicable to unapproved share options.

9.14 The Commission recommends that the qualifying conditions of trans-border relief be reviewed in the context of modern work practices.

Chapter 10: Labour Markets and Social Protection Systems

10.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"review how best the taxation and welfare system can support economic activity and income redistribution, whilst promoting increased employment and prosperity in a resilient, inclusive and sustainable way and ensuring that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term."*

and to

> *"examine what changes, if any, should be made to the social insurance system, including structure and benefits coverage, while ensuring sustainability. This will include consideration of the NESC report No. 151 (November 2020) on the future of the Irish social welfare system and output from the Pensions Commission regarding sustainability and eligibility issues in respect of State Pension arrangements. It will also include examination of how welfare policy can work in tandem with the taxation system to support economic activity, and while continuing to support those most vulnerable in our society in a fair and equitable way, having regard in particular to experience gained during the COVID-19 Emergency."*

10.1.1 The interaction between employment and social protection

This chapter sets out how the Commission views the interaction between employment and social protection, and its overall strategic approach for both for the years ahead. It describes the direction of reform that the Commission is recommending, specific elements of which are elaborated further in Chapter 11 (Promoting Employment) and Chapter 12 (Inclusive and Integrated Social Protection).

The Commission views employment and the social protection system as inextricably linked. This has long been the case, with income support for those of working age having its origins in the provision of

support at times when they were unable to work. As well as the expansion of the labour force - see Chapter 3 (Objectives and Principles) - the understanding of what work means has broadened. In addition to more part-time work, the concepts of flexible and remote working are becoming more prevalent for some occupations. There is also growing scope for freelancing through technology-enabled platforms.

The range of contingencies covered by social protection has expanded considerably since its origins and has broadened to include the full range of those who are out of work, in part-time work and in full-time work. As the system has expanded to cover illness, disability and caring, scheme design has borne in mind the importance of engaging in some level of employment. Income disregards are set to ensure carers, people with disabilities and jobseekers can always take up work; similarly, many of the offerings of the Public Employment Service (PES) are available to anyone in receipt of income support. Even the parts of the social protection system relating to pension age are, in the first instance, predicated on contribution records built up largely through employment.

The effects of more expansive social protection design are worth highlighting. First, there has been a move away from a binary determination of employment status as the sole determinant of eligibility for income support. Instead, people who are unemployed can progress to part-time work and on to full-time work. Equally importantly, eligibility for secondary benefits is predicated less on employment status, or receipt of a primary payment, and is based more on household income.[220]

Second, recognising that arbitrary thresholds and boundaries create perverse incentives, minimising cliff-edges, step-effects and discontinuities is now a key consideration in the design of social welfare schemes. This report builds on this evolution by recommending the elimination of cliff-edges and by encouraging the use of the tapered withdrawal of benefits as a means of achieving the objectives of equity and efficiency. We acknowledge that tapered withdrawal of benefits implies a greater overlap (albeit a transitory one) between the benefits in the social protection system and earnings from employment, and at higher points on the earnings distribution.

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220 The term secondary benefits dates to when receipt of these benefits was premised on being in receipt of a primary income support payment. The term is used somewhat loosely here to incorporate other income support measures that are not necessarily part of the social welfare system as administered by the Department of Social Protection.

The overlap between social protection and employment will undoubtedly increase, with one outcome of the expansion of the labour force, as outlined in Part 1, being an increase in the number of future benefits based on social insurance contributions. At present, there is already a large overlap between the number of people in employment and in receipt of a social welfare payment.

For this reason, Chapter 11 (Promoting Employment) and Chapter 12 (Inclusive and Integrated Social Protection) consider the continuum of income and employment – the situations of those who are out of work and in receipt of income support, compared to those who are in employment at all points on the earnings distribution. A coherent approach to the design of the taxation and welfare systems will encourage labour force entry, encourage people to take up work, support people in work who are on low pay and facilitate progression from lower to higher earnings.

The consideration of the taxation and welfare systems in tandem is a prerequisite for making this kind of progression seamless. Taxes on labour, unemployment benefits, and in-work benefits all affect labour supply and should be designed with some degree of congruence. Similarly, the Commission has endeavoured to treat all remuneration from employment in a cohesive fashion, with measures applying to the full range of the earnings distribution with appropriately differentiated treatment.

10.2 SOCIAL PROTECTION SYSTEMS AND LABOUR MARKET MODELS

A key function of the social protection system is to act as a safety net for those at risk of poverty and social exclusion - see also Chapter 12 (Integrated and inclusive social protection). For those of working age, social protection systems serve to temporarily replace income lost to periods of unemployment, injury, disability, sickness, paternity or maternity. In cases where earnings from employment are insufficient to avoid poverty or social exclusion, social protection measures intervene to provide a floor below which income will not fall. The system also facilitates participation in employment and provides pathways to restoring people's earning capacity after any of the above contingencies. The social protection system is also the bedrock of the pensions system, with an average of approximately €132 million in contributory and non-contributory social welfare pensions being paid to over 740,000 beneficiaries every week.

In this sense, social protection is the fulcrum of the social contract

and social policy. However, it also represents a major investment by Irish society in its people, which goes beyond protecting individuals and families. In economic terms, social protection plays a major role in smoothing incomes and supporting aggregate demand for goods and services after an employment shock. In this way, it acts as an automatic stabiliser, protecting and enhancing human capital and productivity, contributing to inclusive growth and facilitating structural change. A common economic argument for social protection is its mitigation and sharing of risk. By pooling risks and insuring the individual against these risks, social protection allows people to undertake labour market activities with greater return, which stimulates economic growth. It is also the platform for major investment by Irish society in children, through the Child Benefit system, for example, which both recognises the value that society places on childhood, but also reflects the critical importance of early years in fulfilling human potential.

Ireland's social protection system has evolved over the course of the twentieth century, from the 'Poor Law' system established in the Victorian Era to the current system of statutory and non-statutory social welfare payments. This evolution has been, perhaps inevitably, somewhat piecemeal, moving from a system providing basic support to people suffering extreme destitution in the institutional setting of 'poor houses', to the introduction of an old age non-contributory pension in 1908, Unemployment and Sickness benefit in 1911, Child Benefit during the 1940s and the social insurance system in the 1950s.

The present system plays a critical role in Ireland's economic and social life, as noted above. It delivers millions of payments every week on which families depend, while in recent years its role has also developed as a provider of employment services through the PES, in line with the policy of developing a more 'active' system.

In comparing social protection systems across countries, it is common to refer to a number of social policy models or types of welfare state. While social protection systems often contain elements of more than one of these types, Ireland is generally seen to fall into the 'Anglo-Saxon' model, which is characterised by strong reliance on mean-tested social assistance schemes, as against the 'Nordic' model with its high levels of universal provision, the 'Continental' or 'Rhineland' model which is based on extensive social insurance, or the 'Mediterranean' model where public spending is concentrated on old age pensions.

European social and labour market models

As a framework to examine the current mix in Ireland, the former EU-15 member states (including the recently departed UK) can be grouped according to four social policy models.

- The Anglo-Saxon model (UK, Ireland): generous social assistance, weak labour market institutions, collective bargaining rights and infrastructure, wide earnings dispersion and high incidence of low pay.
- The Nordic model (Denmark, Finland, Sweden, the Netherlands): high levels of social protection spending and universal welfare provision, unregulated labour markets and active labour market policies, with compressed wage structures (lower wage inequality).
- The Continental, or Rhineland, model (Austria, Belgium, France, Germany, Luxembourg): extensive social insurance, employment protection and strong unions, as evidenced by the reach of collective bargaining to non-union firms.
- The Mediterranean model (Greece, Italy, Portugal, Spain): public spending is focussed on old-age pensions, employment is regulated, generous early retirement options reduce the number of jobseeker claims and wages are compressed.[221]

These typologies emphasise the fact that social protection systems have emerged over a long period of time and are strongly interrelated with other aspects of countries' long-run development paths, including education and training systems, its approach to labour market regulation, and its history of industrialisation. These interconnections also mean that comparing any one aspect of the Irish system with a similar component in other countries is inherently difficult. In reality, the Irish model is a mixed model made up of three main elements:

- Universal payments: where access to benefits is dependent only on the contingency experienced.
- Social insurance: where access to benefits is determined by an

221 See André Sapir, Globalisation and the Reform of European Social Models; competing typologies are also available – see Esping-Andersen's trio of corporatist regimes (work-oriented and based on individual contribution), social democratic regimes (universalist values) and liberal regimes (residualist systems where welfare is confined to those who are otherwise unable to manage).

individual's record of social insurance contributions.

- Social assistance: where access to benefits is determined by an assessment of need, and usually an assessment of means.

The universal elements of the social protection system comprises a small number of payments. The most notable is Child Benefit, which accounts for expenditure of €2.1 billion and was paid in respect of 1.2 million children in 2020.

The social insurance system in Ireland dates to the 1950s. As well as being an important vehicle of income redistribution, the current system is an expression of social cohesion and solidarity between generations as well as between those who, at a point in time, are in work and those who are not, including those who have retired. The social insurance system is a long-standing social contract between employers, employees, the self-employed and the Government, each of whom contribute to the Social Insurance Fund (SIF) in different ways. Social insurance contributions are collected over time from income and then redistributed to provide income support for contributors who, at a given point, are facing one of a set of contingencies covered under social insurance. The contributory aspect recognises that contributions are paid in when employed and give an entitlement to benefits when people are of pension age or temporarily out of work, for example, due to illness or unemployment. The contributory principle underpins the link between contributions paid and entitlements to social insurance benefits and reflects the idea of reciprocity, as people make contributions that entitle them, as of right, to benefits at a later stage.

Since 1988 a core component of social protection policy has been to widen social insurance coverage and to increase benefits in scope and number. Between 1988 and 1995, Pay Related Social Insurance (PRSI) coverage was extended to self-employed workers, part-time workers and public servants. The expansion in benefits to self-employed people has also been notable in recent years, with social insurance benefits amounting to approximately 93 per cent, by value, of all those paid by the SIF. Social insurance has also expanded with the introduction of new benefits (Paternity Benefit in September 2016, Parent's Benefit in 2019, and a new Jobseeker's Benefit scheme for the self-employed in 2019), and to include a PRSI charge on unearned income in 2014. As a result of this long-term policy approach, 82 per cent of those in receipt of social welfare pensions in 2020 received contributory

pensions due to having made social insurance contributions,[222] compared to 64 per cent in 2000.

This system of social insurance is complemented by a system of social assistance that ensures the provision of a floor below which living standards cannot fall. The current system of social assistance also includes incentives to take up work. Social assistance, therefore, has an important role in poverty alleviation and also in incentivising work. The current system meets both of these objectives for many cohorts; however, it does not reach others and creates some undesirable disincentives, meaning there are opportunities to strengthen the system(s) of support to further incentivise work and to reach more people. The majority of those in receipt of working-age social welfare payments (working-age income supports and working-age employment supports combined) in Ireland are on social assistance payments (84 per cent combined) as set out in Table 23.

Table 23: Recipients of working-age income supports by category, 2014-2019

SCHEME	2014	2015	2016	2017	2018	2019
Working-age Income Supports - Social Assistance	371,772	317,127	286,277	250,584	221,941	205,872
Working-age Income Supports - Social Insurance	76,098	66,525	63,576	64,328	62,262	63,005
Total Working-age Income Supports	**447,870**	**383,652**	**349,853**	**314,912**	**284,203**	**268,877**
Working-age Employment Supports - Social Assistance	82,348	74,306	67,801	60,559	50,864	43,986
Working-age Employment Supports - Social Insurance	1,432	1,612	1,873	394	2,426	2,956
Total Working-age Employment Supports	**83,780**	**75,918**	**69,674**	**60,953**	**53,290**	**46,942**

Source: Department of Social Protection Annual Statistical Report 2020

The Department of Social Protection (DSP) is also a major funder of employment services and Active Labour Market Programmes (ALMPs), such as education programmes, subsidies for long-term unemployed

222 Department of Social Protection, Annual Statistics Reports for 2000 and 2020 (figure excludes Widow's, Widower's and Surviving Civil Partners' Contributory Pension); the 2000 calculation also includes Retirement Pension, which was replaced by the State Pension (Transition) scheme, that closed to new applicants in 2014).

people and self-employment incentive programmes. Over the past decade, there has been a clear policy of developing the PES in line with international thinking that, for people of working age, social protection systems should be more 'active' i.e. provide support to jobseekers finding employment, as well as providing benefits.

10.2.1 Beyond the social protection system

The reach of the social protection system is partly shaped by underlying need at a point in time, and over a longer horizon, by the quality and quantity of employment available and the provision, or absence, of services. As outlined in Part 1, policy objectives are achieved through the interaction of various parts of the State's institutional architecture, and not just through the taxation and welfare systems.

An important aspect of any examination of the taxation and welfare systems is what net pay or income support is used to pay for. In other words, the fullest analysis considers gross and disposable incomes as well as the services that are publicly provided and, therefore, do not need to be purchased from disposable income. This is also a measure of how much better off people are from spending by Government on infrastructure and services – such services, whether free to the end user or subsidised, reduce the expenses that must be paid out of household income. This lens can be applied both to social welfare payment rates and the kind of remuneration offered for employment, both of which are set at levels that take account of the services people must purchase.

This wider context has application to our perception of the social protection system (and what it should extend to) but also to any analytical appraisal of how well it works. The analysis of the redistributive capacity of Ireland's taxation and welfare systems is framed within the broader context of public spending on infrastructure, public goods, and public services, where we cannot accurately identify benefits or burdens as readily as we can with personal taxes or the receipt of benefits.

While the provision of services is outside the scope of this Commission, it is important to note the role such services have as it frames the design of social protection policies and affects their impact. For example, the substantially lower employment and participation rate of lone parents and the fact that children in lone parent households are much more likely to experience poverty at least partly reflects the

absence of affordable childcare.[223]

10.3 KEY POLICY CONSIDERATIONS

The key policy considerations which framed the Commission's discussion in this area were:

- Earnings levels and dispersion
- Poverty
- Adequacy
- Labour force participation
- Discontinuities in the taxation and welfare systems
- Technological change
- Sustainability

10.3.1 Earnings levels and dispersion

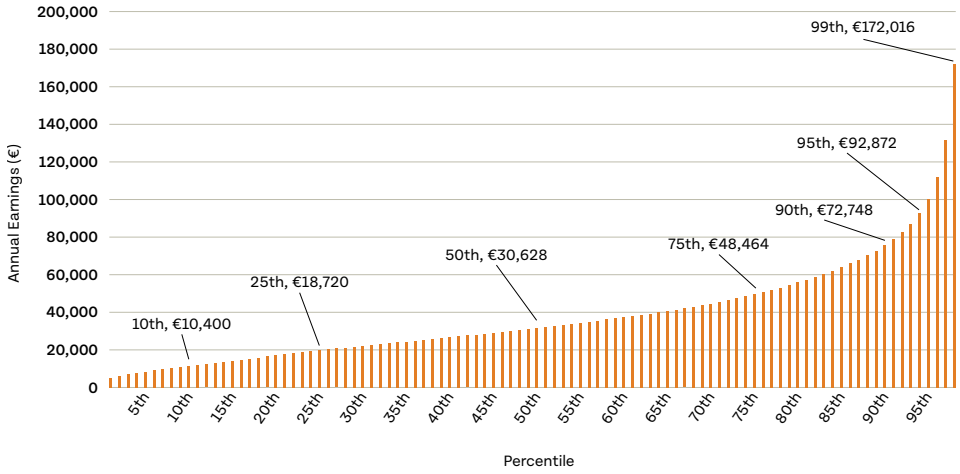
When countries are ranked by the incidence of high or low pay, Ireland is unusual in featuring prominently in both lists – in other words, it has a high incidence of people earning more than one-and-half times gross median earnings and also less than two-thirds of median earnings.[224]

Figure 15 shows the distribution of gross annual earnings from employment in 2019 by percentile, highlighting selected points, with the median value of earnings at €31,096.

223 Out-of-pocket (or "net") costs for parents are high in many OECD countries but are at one-third of female median earnings in Ireland; while net childcare costs are lower for low-earners than for better-off families they remain high in absolute terms and, for low-income households in Ireland with young children, one in four would like to use childcare, or purchase additional childcare hours, but cannot afford to do. See OECD (2020), "Is Childcare Affordable?" Policy Brief on Employment, Labour and Social Affairs, OECD, Paris, oe.cd/childcare-brief-2020.

224 The incidence of high pay is defined by the OECD as the share of full-time workers earning more than one-and-half times gross median earnings. For low pay, it is the proportion of those earning less than two-thirds of gross median earnings of all full-time workers.

Figure 15: Annual earnings by percentile (Every 5th Percentile), 2019[225]

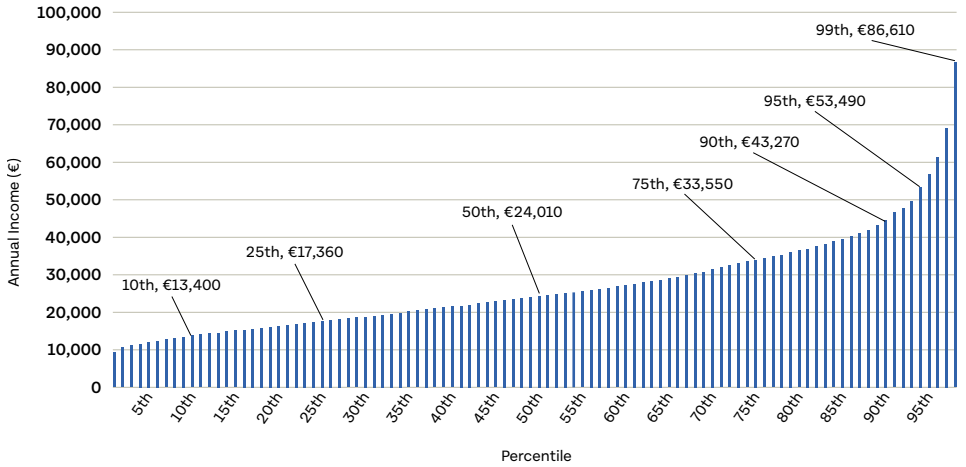


Source: CSO Ireland, 2019 Earnings Analysis using Administrative Data Sources (EAADS)
Note: From employee tax data provided by the Revenue Commissioners, the Central Records System of the Department of Social Protection, and the CSO's Business Register. EAADS includes bonuses and benefit-in-kind (BIK). It excludes pension payments and severance payments. EAADS excludes data from secondary employments earning less than €4,000 per annum, and extremely high earnings values.

Figure 16 shows the distribution of equivalised disposable income in 2019 by percentile, which is how household income is shared out after the taxation and welfare systems effect their changes. Disposable income consists of market income (including employee income, private and occupational pensions) plus social transfers (transfers relating to unemployment, housing, Child Benefit, etc.), minus taxes and social insurance contributions. Social welfare payments, along with most measures of income, are related to household size and composition, whereas earnings relate to the individual.

225 Excludes individuals with zero gross income.

Figure 16: Annual equivalised disposable income by percentile (Every 5th Percentile), 2019 reference year[226]



Source: CSO Ireland, 2020 Survey on Income and Living Conditions (SILC)
Note: 2020 SILC uses 2019 income reference period. Data in the figure above is therefore comparable to earnings data for 2019, used in the previous figure. Equivalisation is a method of attributing household income to individual household members.

The ratios between different percentiles can be used to examine how equally earnings are distributed between the top, bottom and middle.[227] Furthermore, the values can be compared internationally, regardless of the earnings level.

While point-in-time value is informative, it is important that the taxation and welfare systems take account of trends over time in the dispersion of earnings. Table 24 compares the Irish earnings dispersion with the OECD average at selected years between 2006 and 2018. Across OECD countries, while the 90:10 and 90:50 ratio have both decreased, so too has the 50:10 ratio In other words, average OECD earnings have become less concentrated and more equally distributed between high earners and low earners.

226 Excludes individuals with zero gross income.

227 For example, a 90:10 ratio of 3 can be interpreted as workers at the 90th percentile earning a wage that is three times that of workers at the 10th percentile.

However, in the Irish case, the 90:10 and 90:50 ratios have instead increased over time, with the 50:10 ratio decreasing. This trend suggests the ratio between the median and those lower in the distribution has decreased slightly, with the national minimum wage acting as a floor under the earnings distribution. At the other end, there has been an increase in the ratio between those at the higher end of the distribution and those below (both the middle and the bottom percentiles). Both measures that capture the earnings at the 90th percentile have increased but this appears not to be part of some global trend – the equivalent metrics for the EU and OECD show a narrowing between high earners and those at the middle or at the bottom of the distribution.

Alongside household composition and patterns of employment, earnings dispersion contributes to relatively higher levels of market income. The scale of the redistributive effort in Ireland is well known – the taxation and welfare systems are among the most redistributive across the EU or the OECD. However, to the extent that this trend continues, the taxation and welfare systems must evolve to either develop greater redistributive capacity or facilitate greater earnings capacity across the lower part of the distribution.

Table 24: Earnings dispersion, Ireland, EU and OECD, selected years

	90TH TO 10TH EARNINGS PERCENTILES RATIO			90TH TO 50TH EARNINGS PERCENTILES RATIO			50TH TO 10TH EARNING PERCENTILES RATIO		
YEAR	IRELAND	EU27	OECD	IRELAND	EU27	OECD	IRELAND	EU27	OECD
2006	3.59	3.42	3.54	1.92	1.98	2.06	1.87	1.72	1.72
2010	3.64	3.34	3.56	1.93	1.97	2.09	1.89	1.70	1.71
2014	3.60	3.27	3.49	1.95	1.96	2.07	1.85	1.67	1.68
2018	3.73	3.18	3.32	2.09	1.94	2.02	1.79	1.64	1.64

Source: OECD Employment Database

10.3.2 Poverty

Given the dispersion of earnings, a core measure of the effectiveness of our social protection system is the extent to which it reduces poverty and inequality. The official measure of poverty in Ireland is 'consistent poverty', an indicator which is based on the overlap of two component indicators:

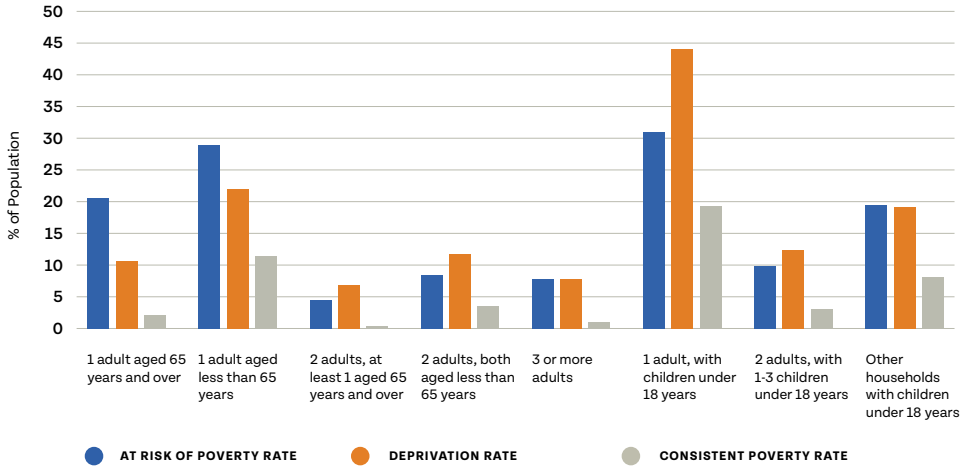
- at-risk-of-poverty – which identifies the share of individuals with equivalised incomes below 60 per cent of the national median, and
- material deprivation – which captures individuals unable to afford two or more of 11 basic necessities.[228]

Therefore, a person is in consistent poverty if they are both income-poor and deprived. Consistent poverty reflects a multi-dimensional understanding of poverty and is designed to identify the population which has the greatest needs in terms of both low income and lack of resources (see Figure 17).

The overall consistent poverty rate for the general population was 5 per cent in 2020. The consistent poverty rate by principal economic status shows that the rate was highest among persons unable to work due to long-standing health problems (17.0 per cent) and the unemployed (16.5 per cent), while it was lowest amongst those who were employed (1.7 per cent) and those who were retired (1.0 per cent). In terms of household composition, individuals living in households where there was one adult and one or more children aged under 18 had the highest consistent poverty rate at 21.6 per cent (see the child income support recommendations in Chapter 12 (Inclusive and Integrated Social Protection)). This can be contrasted with the position in the 1990s when older people were more likely to experience income poverty. However, the increases in the State pension which exceeded median income growth in the 2000s, and the protection of that pension in both real and nominal terms over the course of the economic crisis, helped mitigate against significant increases in material deprivation for this cohort. The policy success of mitigating the risk of poverty for that age cohort is an example of what the Commission believes must follow for other groups.

228 The measure, consistent poverty, was developed independently by the Economic and Social Research Institute (ESRI). It was devised in 1987 using indicators of deprivation based on standards of living at that time. These indicators were updated in 2007. See glossary for more information.

Figure 17: Absolute and relative poverty measures, Survey on Income and Living Conditions, 2019



Source: CSO Ireland, 2020 Survey on Income and Living Conditions
Note: 2020 SILC uses 2019 income reference period.

10.3.3 Child poverty

Children continue to be a group in society which experiences high levels of poverty and deprivation. In 2020, children (0 to17 years) experienced the highest consistent poverty rates of all age groups at 8 per cent. Household income has a positive causal effect on children's outcomes, including their cognitive and social-behavioural development and their health, particularly in households with low income to begin with.

Children living in one-parent families experience particularly high levels of poverty. The Survey of Income and Living Conditions (SILC) reports the consistent poverty rate among one-parent families being considerably higher than the rate for two-parent families (17.1 per cent compared to 6.1 per cent in 2019). Notwithstanding the effectiveness of income supports for lone parents, and other marginalised groups, there are limits to what income supports alone can achieve in reducing poverty. This is a core policy concern for the Commission, as reflected in a number of recommendations throughout this report. Investments in early life have large effects on later life outcomes, leading to improvements to both health and economic productivity in adulthood.

The SILC data, examined by the ESRI in 2021, also finds that people with disabilities are much more likely to experience poverty and social exclusion than people without disabilities.[229] This is also true in all European countries, not just Ireland. While being employed helps to considerably reduce the at-risk of poverty rate for all people, working people with disabilities experience higher at-risk of poverty rates than working people without disabilities. Again, this is true in all European countries. Ireland has one of the lowest at risk of poverty rates for employed people without disabilities, but, on average, the rate is much higher for people with disabilities. Analysis conducted as part of the Cost of Disability survey published in 2021 highlights the significant additional costs faced by people with disabilities, which are currently not met by existing programmes or by social welfare payments.

10.3.4 Adequacy

The success of the social protection system in countering poverty is in large part a reflection of whether social welfare payments are adequate. While the causes of poverty are multiple and complex, there is nonetheless a clear link between trends in poverty over recent decades and the adequacy of social welfare payments. The adequacy of social welfare supports can be interpreted in two ways – the coverage of the scheme design and the sufficiency of the payment rate. While the relationship between eligibility criteria and the relevant population is important, the concern of the Commission is about the need for analysis on the adequacy of social welfare payments.

The 1986 Commission on Social Welfare identified the challenges of the somewhat subjective question of adequacy: to decide on what constitutes an adequate level of payment, questions arise as to what it must be adequate for, who it must be adequate for and for how long it must be adequate. In other words, different families find themselves in different circumstances, and the appropriate or necessary level of social welfare payment varies accordingly. This implies that the appropriate level of payment may vary considerably between different categories of recipient. The tension between two aspects of equity – in treating people in similar situations in similar ways, and simultaneously providing for differentiated treatment on the basis of different circumstances – is to the fore of the exercise of determining adequacy. Income supports

229 ESRI, (2021) Identification of skills gaps among persons with disabilities and their employment prospects.

cannot fulfil their role in maintaining social cohesion without taking account of different household circumstances. At the same time, doing so increases complexity and presents a challenge to the other concept of horizontal equity between households.

The 1986 Commission on Social Welfare took as one of its principles that:

> *"...payment level should be adequate in relation to prevailing living standards",* noting that, *"to be adequate, payments must prevent poverty, and in our view poverty must be judged in the light of actual standards of living in contemporary Irish society".*

In the years following the report, its recommendations in respect of minimally adequate income played an important part in the debates about the adequacy of social welfare rates. In 1994, the Programme for Competitiveness and Work noted that, by the Budget of that year, all social welfare weekly payments had reached the Commission's priority rates and at least 90 per cent of the Commission's main recommended rates, and promised further progress towards those rates.

The most recent in-depth exercise/examination of adequacy was the report of the Social Welfare Benchmarking and Indexation Group, 2001 (established under the then Programme for Government). The group examined the concept of adequacy and the issues associated with the development of benchmarks for adequacy of adult and child welfare payments and the issue of indexation. Due to the variety of perspectives that can be brought to bear on the question of adequacy, the group acknowledged that it was not possible to derive an indisputable and universally accepted adequacy rate.

In the absence of a comprehensive exercise on benchmarking in the years since 2001, the debate on adequacy has been informed by an exercise of establishing a minimum essential standard of living (using focus group responses on the minimum expenditure and income needs of households living in Ireland) and analysis of SILC data. It has not been possible for the present Commission to develop benchmarking models within the time available to it, but it is timely to revisit the exercise and

establish a framework for the coming decades.[230]

Table 25 presents some of the headline poverty measures (both relative and absolute) as well as inflation measures and the personal rates of social welfare payments in recent decades.

Table 25: Headline poverty and inflation rates, and Social Welfare adequacy, 2004-2019

Year	AROP* (%)	Deprivation Rate (%)	Consistent Poverty Rate (%)	Annual average percentage change in CPI (%)	AROP threshold (weekly) (€)	Max. Jobseeker's rate as percentage of AROP threshold (%)	Max. Pension rate as percentage of AROP threshold (%)
2004	19.4	14.1	6.6	2.2	185.45	72.7	90.2
2005	18.3	14.8	7.0	2.5	191.99	77.5	93.4
2006	17.0	14.0	6.6	4.0	202.49	81.9	95.5
2007	16.5	11.8	5.1	4.9	227.60	81.6	92.0
2008	14.4	13.7	4.2	4.1	238.69	82.9	93.6
2009	14.1	17.1	5.5	-4.5	231.20	88.4	99.6
2010	14.7	22.6	6.3	-1.0	213.77	91.7	107.7
2011	16.0	24.5	6.9	2.6	208.68	90.1	110.4
2012	16.9	27	8.2	1.7	206.25	91.2	111.7
2013	16.2	30.5	9.0	0.5	206.78	90.9	111.4
2014	16.7	28.9	8.3	0.2	211.40	88.9	108.9
2015	16.3	25.4	8.5	-0.3	223.78	84.0	102.9
2016	16.2	21.0	8.2	0.0	233.78	80.4	99.8
2017	15.7	18.8	6.7	0.4	239.97	80.4	99.3
2018	14.0	15.1	5.6	0.5	263.00	75.3	92.5
2019	12.8	17.8	5.5	0.9	275.73	73.6	90.1

Source: CSO Survey on Income and Living Conditions; CSO Consumer Prices Annual Series; DSP Rates of Payment: SW19. Calculations by Commission on Taxation and Welfare Secretariat.

* *AROP – At Risk of Poverty*

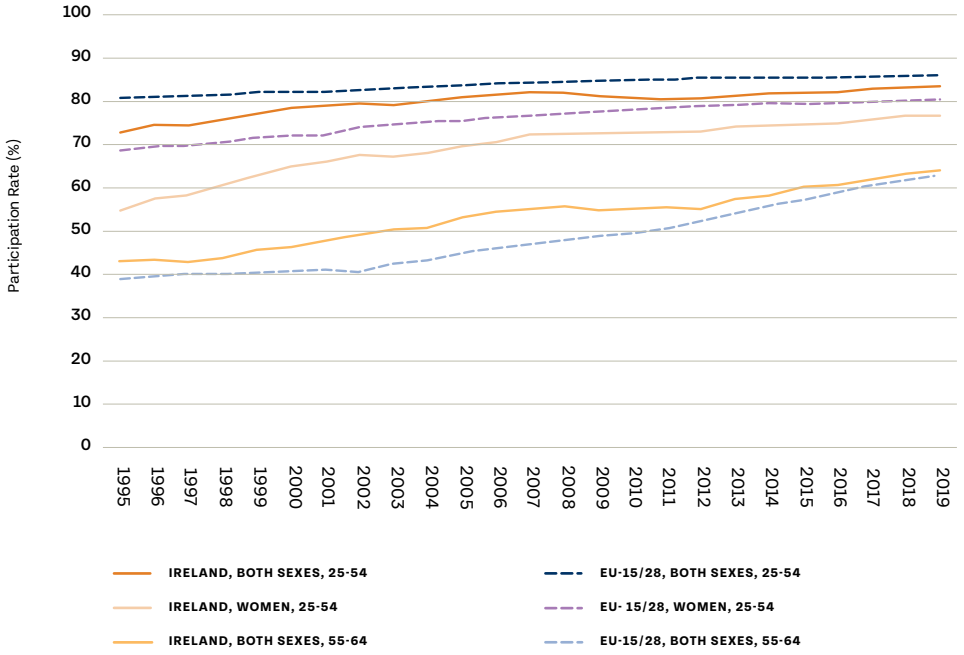
230 The Minimum Essential Standard of Living (MESL) database is an expenditure needs dataset that is adjusted annually for all household types, to reflect changes in prices and relevant changes to the social welfare and taxation systems. The MESL Update Report is published each year and presents analysis of the changing expenditure and income needs for a set of representative household types.

10.3.5 Labour force participation

The participation rate presents the number of people in the labour force (either employed or unemployed) as a share of the relevant population. The participation rate, particularly when disaggregated by age and sex, is an important headline indicator of progress towards an inclusive labour market that makes the best use of available skills. The participation rate captures not just the proportion of the population in employment, but also those searching for work and ready to commence employment.

Up to the late 1980s, female labour force participation in Ireland was noticeably low, with approximately only one-third of women participating in the labour market. Despite progress during the 'Celtic Tiger' period, at the turn of the century the labour force participation rate in Ireland remained below the EU average. Over the past twenty years, however, Irish female labour force participation has increased, towards a (rising) European norm, from 63.2 per cent and 52.7 per cent for women aged 35-44 and 45-54, respectively, in 2000 to 74.3 per cent and 73.1 per cent in 2020. The reasons for this are multi-faceted but the higher proportion of women, compared to men, with a third-level education over the past 20 years means the financial returns to work in prime working-age years has undoubtedly been a factor, which is also likely to further narrow the gap in the coming decades. Figure 18 shows Ireland's labour force participation rate for key groups over the past twenty years.

Figure 18: Participation rate, by age and sex, Ireland and EU average, 1995 – 2019



Source: Eurostat, activity rates by sex, age and citizenship, [data code - LFSA_ARGAN];
Note: EU values for 1995-2001 are EU-15 values, values for 2002-2019 are EU-28; annual values.

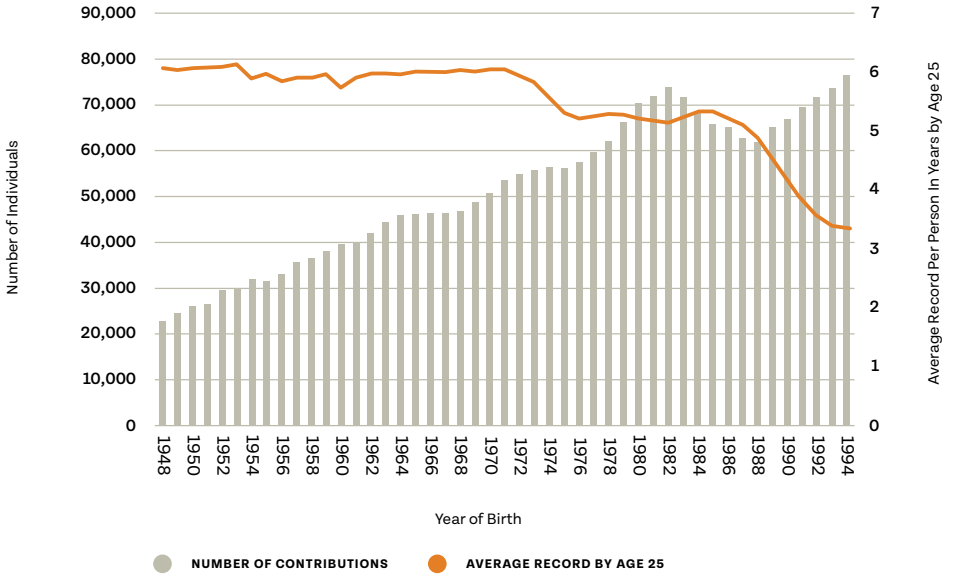
Aside from the changing trajectory of men and women, participation rates have also diverged for different age groups. For those under 25 years, a structural shift since the economic crisis in the 2000s has seen people aged 15-24 delay labour market entry to increase their education levels.

Figure 19 illustrates this later starting age of employment as evidenced by social insurance contribution commencements. It shows the average cumulative full-rate social insurance contributions, in years, by 25 years (for anyone who made at least one full-rate social insurance contribution). Those who have not made a social insurance contribution (or credited contribution) since 2012 are excluded from the data.

Those born since 1989 have a markedly lower average number of social insurance contributions by 25 compared to earlier generations. Of course, this dramatic decrease in labour force attachment by young people, whether measured in social insurance contributions or by participation rates, would be of concern were it not driven by greater

participation in education. The share of the population aged 15 or over having completed third level education has increased substantially in the past three decades – from 13.6 per cent in 1991 to 42 per cent in 2016,[231] with the share for women overtaking that of men during that period. This reflects higher proportions of second-level students completing their studies. The proportion of 20 to 24 year-olds with at least a higher secondary education (Leaving Certificate, including Applied and Vocational programmes or equivalent) has increased from 84 per cent in 2000 to 97 per cent in 2021.[232]

Figure 19: Social Insurance records by year of birth



Source: Actuarial and Investment Analysis Unit, based on DSP administrative data.
Notes: The introduction of social insurance coverage for part-time workers in 1991 means part-time jobs (including for those in education) appear in the data from this point. Truncated social insurance records for ages 16-25 increase during periods of high emigration (which is more pronounced for younger ages). Data include full-rate social insurance records only so Public/Civil Service new entrants start appearing from 1995 onwards.

As Figure 19 shows, there is growing labour market participation among older age cohorts. OECD research also shows that increasing

231 Census 2016: Profile 10 Education, Skills and the Irish Language.

232 CSO Educational Attainment: 20 to 24 Year Olds with at least a Higher Secondary Level Education.

educational attainment tends to result in greater labour market participation past normal retirement age.

The growth in employment achieved in Ireland in the past thirty years, therefore, has taken place against the background of a favourable demographic profile. A young, more educated workforce, with rising levels of female labour force participation, has been a key driver of an increased supply of labour, which has been augmented by significant inward flows of migrants. Migration flows have historically been affected by economic cycles and net migration rose significantly in the mid-2000s following EU enlargement in 2004.

In some ways, these periods of rapid employment growth are fortuitous events that cannot be repeated – spurred by a historically low base of female labour force participation and the once-off migration boost from the EU accession states in 2004. As shown in Chapter 4 (Fiscal Sustainability), the Irish population is rapidly ageing, and the rise in female participation can be expected, at some point, to level off. Labour supply growth, therefore, is likely to be more muted in the future.

10.3.6 Discontinuities in the taxation and welfare systems

The design of taxation and welfare systems balances competing priorities. These include the level of income support for those without earnings, the rate at which such support is withdrawn through benefit reductions and taxes, and the aggregate cost of income support. Additional complexity comes from the coexistence of in-work supports, where there are dual objectives of supporting low-income workers financially and encouraging greater work intensity leading, ultimately, to an end to receipt of these supports.

The Irish personal tax system is highly progressive, with the effective tax rate lowest for those on the lowest incomes and those on the highest of incomes paying the greatest amount of tax. Equally, a strongly progressive tax system features high marginal effective tax rates.

Measures such as the marginal effective tax rate (METR) measure the proportion of a change in gross income that is subject to tax, payments and forgone State benefit entitlements. It indicates the strength of the incentive for individuals to increase earnings through working more hours, or through promotion, qualifying for bonus payments or getting a better-paid job. A METR of zero means that an individual keeps all of any change in earnings, and a rate of 100 per cent means an individual keeps none.

At present, the taxation and welfare systems exhibits a number of discontinuities that shape incentives in a way that can blunt incentives to work or progress. Examples include:

- The imposition of employee PRSI from €352 on the entirety of earnings, and the application of the higher rate of employer PRSI on the entirety of earnings from €410 per week.
- The withdrawal of a jobseeker payment when part-time work exceeds three days of work in a week regardless of the number of hours worked in those three days.

In addition, as noted in the submission to the public consultation process by the ESRI, a range of secondary benefits, such as the National Childcare Scheme (NCS), the Housing Assistance Payment (HAP) and the medical card, add to the complexity, notwithstanding the desirable policy outcomes each seeks to achieve. The NCS, for example, increases the incentive to join the labour force by reducing the cost of childcare but also reduces the incentive to earn more or progress in the labour market due to its withdrawal rate, particularly in conjunction with other taxes and benefit withdrawal. This disincentive to earn more is particularly acute for families with two or more children in formal childcare or families using full-time care, who face a higher withdrawal rate than families with one child or families using part-time care. This highlights the need to ensure consistency of design across schemes and the need to coherently fit new and existing schemes within an overall system framework.

At present, a number of measures smooth and reduce step-effects and cliff-edges, such as the PRSI credit at the point the €352 weekly earnings threshold is exceeded and the 4 per cent rate of PRSI is applied. Similarly, the medical card is retained for a three-year period if a person has been in receipt of a social welfare payment for over one year.

The Commission acknowledges the complexity of designing an income support that marries adequate rates of payment and withdrawal rates so that METRs strengthen the incentive to progress in work and avoid cliff-edges. The Commission's recommendations are made in the knowledge that taxation and welfare systems that work well for a large majority of people is the objective, accepting that while some anomalies may persist in limited cases, they should be minimised.

10.3.7 Technological change

Technological advances lead to improvements in productivity, which is welcome, but they also have a distributional character. There are already differences in productivity between firms, where productivity improvements are unusually distributed in Ireland between SMEs and large multinationals.[233] Where technological advances increase the demand for capital and skilled labour over medium and low-skilled labour, they increase the impact of the skill premium and, all else being equal, increase market income inequality. This has implications for education spending, life-long human capital formation, and reducing barriers to investment in personal human capital development.

This is one reason why the taxation and welfare systems must evolve their redistributive capacity to respond to the technological advances (again, without specifying the extent to which market income should be redistributed through the taxation and welfare systems).

The Commission also realises that technological change can be overwhelmingly positive while still being responsible for displacement of some workers. Thus, the second and related objective is for the PES to facilitate workers increasing their skills, which could create a similar redistributive effect, albeit in a more resource-intensive and time-consuming way over a longer timeframe. In this way, the taxation and welfare systems face the dual challenges of facilitating people's resilience to risk and increase human capital in the long term, while responding in the short term by redistributing income.

While the impact of technological change on the labour market has often focused on manufacturing tasks carried out by workers being transferred to automated processes, the recent experiment in mass remote working could lead to greater offshoring of certain tasks in the service sector. Given Ireland's orientation towards this sector, there is potentially considerable flexibility in how these jobs can be configured. The possibility for virtual outsourcing of an increasing number of tasks has implications for how people gain skills and maintain these skills or learn new ones. There must be a capacity to respond to greater demand for training and support where people are unemployed due to sectoral decline, where tasks are transferred to automated processes. The skills developed must be relevant to emerging labour market requirements.

There is a related compositional question. While there may be

233 OECD, (2019) SME and Entrepreneurship Policy in Ireland.

some change in the sectoral make-up, the proportion of people in self-employment is showing no sign of increase, and so any increase in online platform work at this point is likely to be additional earnings.[234] However, if the number of people in self-employment were to increase, it is critical that the taxation and welfare systems are capable of responding. Such an increase would pose a significant labour regulation challenge where employment relationships may be evident in the monitoring of task completion but not the contractual obligations, a development outlined in "The rise of sharing and gig economy platforms" in Chapter 17 (Modernisation of Tax Administration). While this is not entirely within the remit of the Commission, it is reflected in how particular legal forms are treated. Treating similar activities in similar ways underpins the Commission's recommendation in Chapter 11 (Promoting Employment) on how dependent employment (Class A) and self-employment (Class S) are treated in the social insurance system.

10.3.8 Sustainability

As has been detailed throughout this report, Ireland faces a number of fiscal risks that will give rise to a need for higher aggregate levels of taxation in the period ahead. While the relationship between taxes on labour and the level of employment is by no means a precise one, nonetheless there are grounds to be concerned about the potential impact of higher labour taxes on employment growth into the future. The tax wedge in Ireland is currently low by European standards, which, it is reasonable to believe, might have been a contributory factor in driving employment growth. The imposition of limited or sometimes no personal taxes on low incomes (due to the existence of tax credits and exemption limits) has been part of what has generated a highly progressive Income Tax structure, and which has helped to underpin social acceptance of the Irish development model.

In the future, however, as the need for tax revenues increases, there will be pressure to increase taxes on labour. Increasing personal tax rates can increase revenue yield quickly and in a somewhat predictable manner – the uncertainty lies in how responsive top earnings will be to

234 This arises from the decline in the share of self-employed people working in agriculture, dropping from one-in-three to one-in-five over the past 20 years. There has been a small decline in self-employment as a proportion of total employment in the same period. Within self-employment, the share with and without paid employees remains stable (approximately seven in ten are solo self-employed). See QES04, Labour Force Survey, CSO.

changes in the marginal rate. While the Commission believes that there are important measures that should be taken to expand the personal tax base, as outlined in Chapter 6 (Tax Equity and Base Broadening), unless reforms are undertaken elsewhere in the tax code, this form of fiscal pressure has the potential to generate labour market problems over the longer term, such as a high tax wedge creating disincentives to work. The importance of avoiding over-reliance on taxes on labour is outlined in Chapter 5 (Balance of Taxation).

In that context, the sustainability of the social insurance system is a concern that can be, at least to some extent, addressed. The extension of social insurance coverage over time has, as intended, had a major impact on the numbers of recipients of social insurance payments. For example, recipients of the largest benefit by volume or expenditure, the State Pension (Contributory), increased from approximately 73,000 in 1990 to almost 450,000 by the end of 2020. These reforms, in tandem with the demographic changes described elsewhere in this report, present a major challenge for the financing of the social insurance system, which is currently operated through the Social Insurance Fund (SIF). The operation of the SIF is outlined in Box 3 below.

Box 3: How the Social Insurance Fund works

The Social Insurance Fund (SIF) is funded on a tripartite basis by PRSI contributions from employers, workers and the State where necessary. As in many other EU member states with developed social insurance systems, the SIF operates on a pay-as-you-go basis, which means that current contributions fund current payments. The SIF sits outside the Exchequer and comprises a current account managed by the Minister for Social Protection, and an investment account, managed by the National Treasury Management Agency on behalf of the Minister for Finance. All PRSI entitlements are recoverable from the SIF. Where there is a shortfall in the current account, the balance must be made up first from the investment account and otherwise from funds provided by the Exchequer as residual financier.

The long-term sustainability of the SIF is examined every five years in an actuarial review. The most recent was published in 2017, with the next expected in October 2022. The 2017 review envisaged expenditure exceeding income over the medium to long term (estimated from 2021 due to population impacts), with pensions making up a significant amount of the expenditure (increasing from 70 per cent of SIF expenditure in 2016 to 80 per cent in 2071).

The issue of fiscal sustainability, and in particular the impact of demographic change on the financing of social protection, has been to the forefront of the Commission's deliberations throughout. In 2021, the report of the Commission on Pensions included a number of proposals to address the sustainability of the SIF in terms of pension age, eligibility criteria, contribution rates, pension calculation methods and pension payment rates. While some of these issues lie outside the scope of this report, a number of the recommendations of the Commission on Pensions in respect of reforms to PRSI have informed our considerations and are reflected in our recommendations. In particular, we recommend a number of measures to broaden the PRSI base and to increase the revenues of the SIF, in a manner which is broadly in line with the revenue-raising proposals of the Commission on Pensions.

10.4 STRATEGIC APPROACH TO BUILDING INCLUSIVE LABOUR MARKETS AND INTEGRATED SOCIAL PROTECTION SYSTEMS

The strategic approach to strengthening the social protection system adopted by the Commission is based on an understanding of the policy considerations set out above, and on the principles of sustainability, reciprocity, adequacy, equity and efficiency, as described in Part 1 of this report. With these principles in mind, and recognising both the complexity and importance of the social protection system, the Commission has identified a number of strategic priorities for the further development of the social protection system. These are outlined in detail in the next two chapters, Chapter 11 (Promoting Employment) and Chapter 12 (Inclusive and Integrated Social Protection).

In our recommendations, the Commission has focused on identifying a number of concrete and realisable reforms which are consistent with this overall strategic direction of travel and which can lead to further reductions in poverty, including progress on addressing child poverty, which we believe should be a priority.

10.4.1 Adequacy

As noted earlier, there is a clear link between the adequacy of social welfare rates and the reductions in poverty that have been achieved in Irish society over recent years. Although there have been significant improvements in headline social welfare rates over recent decades, particularly in a period of rapid economic growth, it is not clear on what basis social welfare rates have been adjusted, or what the underlying rationale is for differences in payment rates for different categories of payment.

It has also been some time since the issue of adequacy has been fundamentally reviewed. Chapter 12 (Inclusive and Integrated Social Protection) outlines why it is important to adopt a more formal approach to adequacy in terms of personal rates and payments for dependants and to develop a multi-annual approach to increases in social welfare rates. This will be particularly important in the future as demands for resources to fund social welfare payments increase.

10.4.2 Social Insurance

The Commission believes that reciprocity is an important principle for the design of the taxation and welfare systems. While reciprocity is a system-level concept, in that we pay taxes and social insurance contributions in return for an array of services and entitlements, the construct of social insurance helps to reinforce a sense of reciprocity, since people can see a link between contributions paid and entitlement to benefits. Social insurance is payable by individuals, with no reference to the household. This accords with the basis on which social insurance benefits are paid – as of right rather than on the basis of a means test.

Generally, social insurance models redistribute across different points in an individual's life – intra-lifetime transfers – whereby people make contributions while in employment and receive benefits during one of the covered contingencies. The drawback is that this approach excludes those who have not made the required number of contributions. Meanwhile, the targeting that features heavily in social assistance models focuses on need at a point in time and involves vertical redistribution – examining the people who need income support at a point in time without reference to their employment record or intra-lifetime transfers. Which system to emphasise is largely a value judgement– any empirical input to the comparison of these models is restricted somewhat by the analytical tools typically used to examine

income distribution, which have a point-in-time focus.

Ireland's social insurance and social assistance systems apply in differing proportions to those of pension age and those of working age. For those aged 66 and over, a large majority are in receipt of the social insurance pension – the State Pension (Contributory) – while a decreasing minority are in receipt of the equivalent social assistance payment. For those of working age, the reverse is true – at a point in time, a larger proportion are in receipt of a social assistance payment compared to the number in receipt of social insurance payments.

In recent decades, the direction of social protection policy has been to expand the numbers of people in the social insurance system, which has both enhanced protection for people of working age, and improved pension coverage for older people. This expansion of the social insurance system has contributed to the reduction in poverty among the pension age cohort, through the increase in the number of people with more complete social insurance contribution records, and the increases in the rates of contributory pension rates of payment.

More recently, the expansion of benefits has been targeted, indirectly, at children under five years. This is in line with the First 5 whole-of-Government strategy to improve the lives of babies, young children and their families, and which identifies the antenatal to age five period as the most critical period in a child's life. Given that the primary channel of social insurance contributions is through employment, the expansion of benefits such as Paternity Benefit and Parent's Benefit in 2016 and 2019, respectively, is directed through parents. These benefits will be further increased in duration as part of the transposition of the Work Life Balance Directive.

The expansion of social insurance, so that it covers anything above part-time work, has been endorsed by, among others, the National Economic and Social Council (NESC) in a series of reports on social protection matters, one of which is referenced in the Commission's terms of reference. The Commission similarly endorses the move towards greater social insurance coverage, by maintaining a minimal threshold for access to social insurance.

Recommendation

10.1 The Commission recommends maintaining a low entry threshold for access to social insurance.

10.4.3 Base broadening and sustainability

As has been widely documented, the present system of funding for social insurance is facing multiple difficulties, and, in particular the ageing of the population in Ireland means that the proportion of people making contributions will fall and the proportion in receipt of pensions will increase. This challenge, however, is only one of many fiscal issues emerging as a result of an ageing population, and a joined-up response is required to meet them. The Commission believes that, as part of this overall response, there is a clear case for enhancing the income of the Social Insurance Fund, both to strengthen the social insurance system itself, and as part of the overall response to emerging fiscal challenges.

The Commission has made a series of recommendations on reform of PRSI in this chapter of its report, which stand on their own merits in terms of equity, but which will also improve the sustainability of the social insurance system. This is in line with the principled approach to design, with the recommendations seeking to eliminate situations where people in similar positions are treated differently.

In line with the premise that everyone should participate, and as an expression of reciprocity, the Commission favours broadening the PRSI base to include earnings below the present €352 threshold. Having balanced the distributional impact and yield against the objective of a wider range of people contributing, much like everyone does through consumption taxes, the Commission recommends that a nominal rate should apply to reflect the fact that treatment should be appropriately differentiated across the distribution of earnings while broadening the base of PRSI. This will also have the effect of minimising the step effect as earnings increase above €352, which is currently moderated by the PRSI credit.

Recommendation

10.2 The Commission believes that a lower nominal rate of employee PRSI should apply to earnings below the employee PRSI contribution threshold, currently €352 per week.

The same principle applies to higher earnings. As well as broadening the base by expanding the range of employees subject to PRSI, the Commission sees a strong argument for broadening the base by extinguishing the arbitrary exclusions from PRSI based on

income source. In particular, the Commission believes that the base should be broadened by including share-based remuneration within the scope of both employer and employee PRSI.[235] While, as outlined in Chapter 9 (Promoting Enterprise) we accept there is rationale for some limited exceptions from the application of employer PRSI on share-based remuneration, as a general rule, the Commission recommends broadening of the PRSI base and minimising PRSI exemptions for different forms of employment income in the interest of sustainable financing of the SIF.

A similar view informs the approach to capital taxes in Chapter 7 (Taxes on Capital and Wealth) – there should be as broad a base as is feasible with few large-scale exemptions and everyone making at least some contribution.

Recommendation

10.3 The Commission recommends that, with a view to broadening the PRSI base, PRSI should be extended to all sources of employment income including, as a general rule, share-based remuneration.

Similarly, extending PRSI to the supplementary pension income of those under 66 years is consistent with the approach to the tax treatment of pensions (exempt-exempt-tax) outlined in Chapter 8 (Taxes on Retirement Savings). An allowance may need to be made for some lower-paid modified rate contributors (pre-95 civil servants) who are treated differently within the social insurance system.

Recommendations

10.4 The Commission recommends that those over State pension age pay PRSI on all income other than social welfare payments.

235 Most share-based remuneration is already subject to employee PRSI. An exception to this is the employee PRSI exemption for Key Employee Engagement Programme (KEEP) share option gains, which the Commission endorses.

10.5 The Commission recommends removing the PRSI exemption on supplementary pension income (occupational and personal pensions, and public sector pensions).

Earnings from employment are not the only source of income. In the context of the Commission's remit to consider options for reform on the balance between the taxation of earned income, consumption, and wealth, and using the horizontal equity lens of treating income identically regardless of source, the PRSI charge on unearned income should maintain some connection with the employee PRSI charge incurred on employment income, currently 4 per cent. In the absence of this, unearned income could be subject to lower rates of PRSI than employment income, thereby treating income differently.

Recommendation

10.6 The Commission recommends that, in the interests of solidarity, the rate of charge for PRSI on unearned income should remain aligned to the higher rate of PRSI applicable to employees on their income from employment generally.

10.4.4 Labour force participation

The adequacy of social welfare rates is of critical importance in dealing with immediate needs, and an important aspect of social cohesion. In the longer term, for those of working age, and those who live in their households, sustainable work is a vital route out of poverty. It is important, therefore, that the social protection system should support the decision to take up work, and to increase earnings over time.

As described elsewhere in this report, the ageing of the Irish population means that the age dependency ratio is increasing, so it is also important from an economic perspective to increase labour market participation. A strong connection with the labour market, where people fully take advantage of their skills and their investment in education and training, is something the Commission wishes to encourage.

10.4.5 Cliff-edges

While Ireland has a progressive and redistributive tax and welfare system, the Commission has identified a number of undesirable cliff-edges and step-effects across the taxation and welfare systems. These

can result in individuals being left financially worse off as a result of taking up employment, increasing their hours of work or getting a pay rise. For example, in the such cliff-edges and step-effects currently arise when earnings surpass the liability threshold for PRSI (at €352 per week) and USC (at €13,000 per year), as well as when working more than three days a week on low levels of pay (leaving individuals ineligible for a partial jobseekers allowance payment).

Whilst acknowledging the complexities of designing systems to avoid such cliff-edges, the Commission is eager they be removed where possible, to reduce the occurrence of financial disincentives discouraging a person from increasing employment. The recommendations in this report on employee and employer PRSI charges are a step in this direction.

Given the range of incentives faced by different cohorts, it seems preferable that a working-age payment could encompass all of those who are unemployed or underemployed, and extend to those in work but on low incomes. This is outlined in greater detail in Chapter 12 (Inclusive and Integrated Social Protection).

Recommendation

10.7 The Commission recommends that cliff-edges in the taxation and welfare systems should be removed.

10.4.6 An 'active' system

The Commission believes employment services should go hand-in-hand with income support, with rights and responsibilities on the part of the PES and people in receipt of income support. Drawing further on the Commission's endorsement of reciprocity and fairness, the State has an obligation to provide people with decent opportunities (such as employment opportunities, and the possibility to improve employment prospects) while the entitlement to income support corresponds, to a varying degree based on capacity, with an onus on the individual to develop a greater ability to participate. In other words, there is a right to a payment and a responsibility to engage.

The function of the PES in improving people's employment prospects, and the requirement for individuals to take up employment or training opportunities, means concerns about the short-term financial incentive to work are mitigated. An activation regime

that aims to maximise employment and minimise unemployment durations is compatible with a wider range of payment levels (taking into consideration adequacy of income support, deadweight and total expenditure in transfers).

While the scope of the PES has grown over the past decade, less is known about how, precisely, the most successful product of engagement frequency and engagement type operates. At least something is known about the impact of the employment programmes, although, to be most useful, this needs to be kept up to date.

A long-term perspective shows the scale of the opportunity open to the PES - the future liability of current income support can be contrasted with the potential tax yield, social insurance contributions and contribution to output once the person gains employment. This is in addition to the other non-financial benefits outlined earlier and the Commission is convinced the PES has an important role to play in the future.

Pathways to Work 2021-2025 sets out the plan to expand the services of the PES beyond jobseekers, and to overcome the barriers faced by people with disabilities, lone parents and other groups with low levels of labour force participation. This includes ensuring that the PES can engage with people with disabilities in an effective manner and address the barriers they face.

10.4.7 Progressive reform

As described in Part 1 of this report, the performance of the Irish labour market over recent decades has been exceptional. An important element of future progress is to increase the domestic labour market supply. This is partly progressed through the recommendation to further individualise the Standard Rate Cut Off Point for Income Tax purposes, which will reduce the differences in Income Tax treatment between those who are married and those who are not – see section 11.3.4). This will be complemented by ensuring the income support system facilitates work at all stages and the PES assists people in developing their capacity.

A parallel approach is to reconsider how capacity to work is perceived. In as much as unemployment and employment are on a continuum rather than being binary categories, a more nuanced consideration of the capacity of other recipients of income support to contribute should be developed. This is already underway for lone parents – in recognition of their caring responsibilities, the requirement to seek work only applies to lone parents once the youngest child is 14

years. In addition, in recognition of the important role employment has to play in alleviating the high risk of poverty for that cohort, a higher disregard incentivises employment by currently allowing lone parents to earn €165 per week before the tapered withdrawal of the benefit begins.

At present, the income support basis for disability payments takes a binary approach. The Roadmap for Social Inclusion 2020-2025 notes that the current system considers people with disabilities to be either fully incapable of work or fully capable of work, with no recognition that work capabilities vary with type and severity of disability. Similarly, recipients of disability-related payments are treated uniformly on the issue of living costs, taking no account of the differing costs incurred, a point highlighted by a recent report, 'The Cost of Disability in Ireland', which was commissioned by DSP.[236]

Furthermore, social welfare individualisation is addressed in Chapter 12 (Inclusive and Integrated Social Protection) – it is, in part, a move to a more appropriate relationship between the State and social welfare beneficiaries. While individuals being treated distinctly and equally within the social welfare system is desirable in and of itself, it will also have a positive effect on labour force participation. In this regard, it is a change that makes the system more fit for the 21st century and also has the potential to boost employment.

The focus in this chapter, and those two that follow, is on ambitious but achievable reforms, which will have a significant impact on poverty, and child poverty in particular, and which will improve the position of households that experience poverty. In particular, the issue of child poverty, and the position of households where there is one adult and children under the age of 18, need to be addressed.

10.5 OTHER APPROACHES: UNIVERSAL BASIC INCOME AND REFUNDABLE TAX CREDITS

In considering the best approach to reform and develop the social protection system, the Commission has been mindful of its complexity, and the numbers of people who rely on it on a weekly basis. In 2019, over 1.3 million people were in receipt of a social welfare payment on a weekly basis, which was paid in respect of over 2 million beneficiaries in addition to a range of other services, including those delivered through

236 Indecon International Research Economists (2021), 'The Cost of Disability in Ireland', Department of Social Protection. See also Make Work Pay in Chapter 12 (Inclusive and Integrated Social Protection).

the PES.

As part of its deliberations, the Commission considered whether entirely different approaches, such as universal basic income or refundable tax credits, or wholesale administrative overhaul, similar to the introduction of Universal Credit in the UK, should be pursued. In developing proposals for reform, the Commission concluded it is important to build on what has been achieved in recent years, particularly in reducing poverty, by focusing on practical reforms within an overall strategic direction.

10.5.1 Universal basic income

As part of its extensive public consultation process, the Commission received some submissions in relation to the concept of universal basic income. These submissions called for the introduction of a universal basic income, which would be set at a level that would guarantee an income above the poverty line for everyone and which would replace most social welfare payments and Income Tax credits. The general concept of universal basic income assumes that everyone in society would receive a basic income payment that would be unconditional and tax-free. All other income would be taxed. This would require significant amendment to both the welfare and Income Tax systems. There are different models of basic income, so the cost of introducing a universal basic income would vary significantly depending on the specific design.

Modelling research from the OECD[237] warns that a universal basic income scheme would require large tax increases, provide less effective supports for the poor, and result in a large number of people gaining and losing from its introduction. This mirrors the findings of the International Labour Organization, which has examined this issue in some depth.[238] It found that a budget-neutral universal basic income would worsen poverty and inequality by decreasing the average amount received by benefit recipients under the current system and, thus, increasing the number of lower income households living below the poverty line.

Basic income has been examined in Ireland since the 1970s. In 1977,

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237 Immervoll, H. and Browne, J. (2017) Basic Income as a policy option: Can it add up?, Paris, OECD Publishing.

238 Ortiz, I., Behrendt, C., Acuña-Ulate, A. and Anh Nguyen, Q. (2018) Universal Basic Income proposals in light of ILO standards: Key issues and global costing, Geneva, ILO.

the NESC published a report on how personal tax and welfare transfers might be integrated. The report studied three options, one of which was basic income. In the 1980s, two reports looked at basic income (the 1982 to 1986 Commission of Taxation Report and the 1986 Commission on Social Welfare Report) but rejected the proposal. In 1994, the ESRI conducted a study and found that a tax rate of 65 per cent would be required to finance the basic income system proposed.[239] The report concluded that such a high tax rate would be a disincentive to people taking up employment and that the income distribution effect of the proposal did not benefit many low-income households, thus making a basic income unviable in Ireland. The Expert Working Group on the Integration of the Tax and Social Welfare Systems also concluded that it should not be pursued. The then Government prepared a Green Paper on basic income, which was published in 2002, and which outlined options for consideration on basic income.[240]

There are limited experiments with what might be referred to as "partial" basic income approaches underway or planned in other countries. The most well-known experiment in recent years has been the Finnish Basic Income Experiment, which ran for two years (2017-2018). This pilot is now complete and is not being pursued further by the Finnish Government.

A review of the evidence on universal basic income notes that while smaller basic income trials delivered some positive outcomes with respect to wellbeing, they did not noticeably affect employment or incentives to work. In the absence of a pilot programme that is large enough in sample size and over a long enough period of time, the fuller, long-term merits of universal basic income will remain unclear. Further, it is noted that resourcing such a pilot project may detract from the State's ability to fund means-tested welfare schemes, or other targeted measures to address poverty.[241]

Moving from our existing mixed model to a universal basic income model would be a fundamental and very costly change in policy – from both a social welfare and tax perspective. The Commission does not support this direction of travel, and believes that it is important to focus attention on concrete, affordable and achievable reforms, such as

239 Callan, T., O'Donoghue C., and O'Neill, C. (1994) Analysis of Basic Income Schemes for Ireland, Dublin, ESRI.

240 Department of An Taoiseach (2002) Basic Income: A Green Paper

241 Universal Basic Income in the United States and Advanced Countries.

those set out in Chapter 12 (Inclusive and Integrated Social Protection).

Recommendation

10.8 The Commission does not support the development of a Universal Basic Income in Ireland.

10.5.2 Refundable tax credits

In the context of its consideration of universal basic income, the Commission also reflected on refundable tax credits, a topic also considered by Commission on Taxation in 2009 and the Advisory Group on Taxation and Welfare in 2012.

The 2009 Commission on Taxation concluded that, on balance, refundable tax credits should not be introduced at that time. However, if there was not an appropriate level of uptake of direct expenditure support through measures like the Family Income Supplement after a period of five years, the question of refundable tax credits should be considered as a policy option to ensure a more equitable distribution of resources.

Since 2009, Family Income Supplement has been replaced by the Working Family Payment, with an increase in the number of recipients of this in-work benefit from 28,876 to 48,188 between 2011 and 2020.[242]

The 2012 Advisory Group's findings outlined disadvantages of refundable tax credits, such as increases to average Income Tax of 20 per cent for the majority of employees and differential treatment of social welfare recipients, particularly jobseekers. Overall, the Advisory Group concluded - due to the disadvantages and the costs involved - that it could not recommend the introduction of refundable tax credits at that time. The costs of introducing a system of refundable tax credits renders it prohibitively expensive and counter to the Commission net revenue-raising approach.

10.5.3 Universal credit

The introduction of Universal Credit reforms in the UK were the most significant changes to the benefits system in a generation. The main stated aims of the reforms were to boost the personal responsibility of claimants, smooth the passage to work and prepare out-of-work

242 Department of Social Protection 2020 Annual Statistics Report: Table G7.

claimants for their next job.

An overarching policy aim of Universal Credit is to assist households to budget, and to build and sustain their financial resilience. This is to be broadly achieved through six mechanisms:

1. Integration of six core benefits and tax credits into a single payment.
2. A shift away from a mix of weekly, fortnightly, four-weekly and monthly payments to a standard monthly payment.
3. A new fixed monthly assessment system that will replace the annual 'flexible' assessment period for tax credits, with payment monthly in arrears.
4. Payment of housing benefit to social tenants rather than directly to the landlord.
5. Introduction of a single recipient model where the award is paid into one bank account.
6. Extension of the capital allowance rule to all Universal Credit recipients.

Universal Credit was preceded by five years of economic stagnation in the UK and was introduced in the middle of a recession. Many households were already in debt and, in particular, many low-income households lacked the financial resilience to deal with economic changes – including those brought about by the introduction of Universal Credit – at a time of significant cuts to social welfare spending.

The Commission does not recommend the undertaking of a similar project in Ireland at this time in light of its enormous complexity, and the potential for severe consequences at the level of the household which may outweigh any purported benefits.

To the extent that proposals on universal basic income, refundable tax credits or the integration of benefits and Income Tax credits are motivated by concerns about adequacy, Chapter 12, (Integrated and inclusive social protection) outlines the recommendation for the benchmarking of the social protection payment rates as an alternative strategy.

The following two Chapters, 11 (Promoting Employment) and 12 (Integrated and inclusive social protection) develop issues discussed here and propose specific recommendations.

10.6 RECOMMENDATIONS

Chapter 10: Labour Markets and Social Protection Systems

10.1	The Commission recommends maintaining a low entry threshold for access to social insurance.
10.2	The Commission believes that a lower nominal rate of employee Pay Related Social Insurance (PRSI) should apply to earnings below the employee PRSI contribution threshold, currently €352 per week.
10.3	The Commission recommends that, with a view to broadening the Pay Related Social Insurance (PRSI) base, PRSI should be extended to all sources of employment income including, as a general rule, share-based remuneration.
10.4	The Commission recommends that those over State pension age pay Pay Related Social Insurance on all income other than social welfare payments.
10.5	The Commission recommends removing the Pay Related Social Insurance exemption on supplementary pension income (occupational and personal pensions, and public sector pensions).
10.6	The Commission recommends that, in the interests of solidarity, the rate of charge for Pay Related Social Insurance (PRSI) on unearned income should remain aligned to the higher rate of PRSI applicable to employees on their income from employment generally.
10.7	The Commission recommends that cliff-edges in the taxation and welfare systems should be removed.
10.8	The Commission does not support the development of a Universal Basic Income in Ireland.

RETURN TO CONTENTS

Chapter 11: Promoting Employment

11.1 INTRODUCTION

The objective of increasing employment is one worth pursuing across a number of dimensions – at the aggregate level, more employment leads to higher economic growth and makes use of productive capacity. At the level of the individual, being in employment affects people's opportunities, life satisfaction and their psychological and physical well-being. Promoting Employment is referred to in several of the terms of reference. For the purposes of this chapter, the focus is primarily on the following terms of reference:

> *"...how best the taxation and welfare system can support economic activity and income redistribution, whilst promoting increased employment and prosperity in a resilient inclusive and sustainable way..."*

> *"...changes...to the social insurance system, including structure and benefits coverage, while ensuring sustainability... [and] how welfare policy can work in tandem with the taxation system to support economic activity, and while continuing to support those most vulnerable in our society in a fair and equitable way, having regard in particular to experience gained during the COVID-19 Emergency.*

> *"...options for reform on the balance between the taxation of earned income, consumption, and wealth."*

Employment growth in Ireland over the past 30 years has been remarkable. As set out in Part 1 of this report, total employment in the State has doubled during this period. While there have been several shocks to the labour market that led to increased unemployment, over the past decade the labour market has twice rebounded rapidly towards full employment. At the same time, however, there are emerging trends in the labour market, and in the economy more generally, that mean complacency in respect of either employment growth or the quality of employment would be misplaced.

The major trend since the 1980s relates to employment in services

- one in two people in employment worked in services sectors in the 1980s, and now more than two in three people do so. Meanwhile, industry has decreased as a proportion of total employment, while human health and social work activity has increased (doubling in absolute terms). Alongside these two sectors, the largest sectors as measured by employment are retail, education, professional, scientific and technical activities and information and communications. The latter has been particularly notable: resilient under challenging employment conditions, and now more than double what it was in 1998. Meanwhile, the number of people employed in agriculture has declined significantly, decreasing by one-fifth.

Maintaining a high level of well-paid employment and a continuous flow of good job opportunities in the future has been a core concern of the Commission throughout its work. Anticipating how the world of work may change is addressed in Part 1. The focus here is to ensure the taxation and welfare systems are capable of effectively incorporating future changes in the world of work. This is reflected in numerous recommendations, particularly in Chapter 5 (Balance of Taxation). This chapter, which builds on Chapter 10 (Labour Markets and Social Protection Systems) in greater detail with regard to employment and the labour market, addresses a number of specific issues that are arising now or are likely to arise in the future, and sets out the Commission's recommendations as to how they can be addressed.

As outlined in Part 1, the trajectory of employment and the labour force (the sum of people who are employed and unemployed) from the late 1980s, after decades of low growth, has been remarkable. Of course, the trajectory has not been one of stable increase since the late 1980s. Employment grew particularly rapidly from 1998 to 2007 (from 1.55 million to 2.25 million people) but the financial crisis saw a fall of over 380,000, reaching its lowest level in 2012. The unemployment rate reached 15.8 per cent in Q1 2012, surpassing its 1989 high point. That earlier peak occurred while the participation rate was much lower (at 51.6 per cent), meaning a proportionately smaller labour force.[243]

In 2013, employment began to climb steadily, with the recovery both rapid and concentrated in full-time employment – part-time employment remaining stable. By 2016, the number of people in employment equalled what it had been ten years earlier in 2006. The

243 CSO (2022) Labour Force Survey.

employment rate, which is an expression of the number of people in employment adjusted for demographic factors, grew steadily to 67.8 per cent by 2007, before falling sharply to below 60 per cent and remaining there until 2016. It recovered to climb above 63 per cent in 2019.

From 2007 to 2020, those in professional occupations increased their share of all employment from 17.2 per cent to 21.6 per cent. In the opposite direction, elementary occupations decreased from 14.5 per cent to 10.7 per cent and skilled trades decreased from 18.5 per cent to 13.4 per cent. The increased importance of services and the shift away from sectors and occupations requiring physical labour tallies with the increases in educational attainment over recent decades.

11.2 STRATEGIC APPROACH

Throughout its work, the Commission has been mindful of the need to maintain a well-functioning labour market and to support the growth in well-paid employment. While the taxation and welfare systems are highly effective at redistributing income, such that disposable income is much more equally distributed than market incomes, there may be limits to how much further this can go. At the same time, income supports do not, on their own, provide a route out of poverty for many families. Promoting a high level of well-paid employment has to be central to any strategy for the tax and welfare systems of the future.

In the world of work, the taxation and welfare systems have considerable influence. Both systems should work to make transitions into the labour force attractive, make Ireland an attractive place for Foreign Direct Investment (FDI), and provide a suitable level of income support when individuals experience unemployment. With the objective of encouraging employment, the composition of total revenue should shift away from taxes on labour, towards other sources (such as taxes on capital and immovable property) in the medium term.

Given Ireland's demographic profile, increasing and maintaining labour force participation is an important plank of our approach. The taxation and welfare systems, and the interaction between them, are central to maximising the number of people who take up employment and/or who expand the number of hours that they work. As outlined in Chapter 10 (Labour Markets and Social Protection Systems), avoiding cliff-edges in the way that both tax and welfare function is important, so that people have an incentive to take up work, and do not artificially curtail the hours that they work in response to administrative rules.

Recessions are a fact of life, and there can be little doubt that in

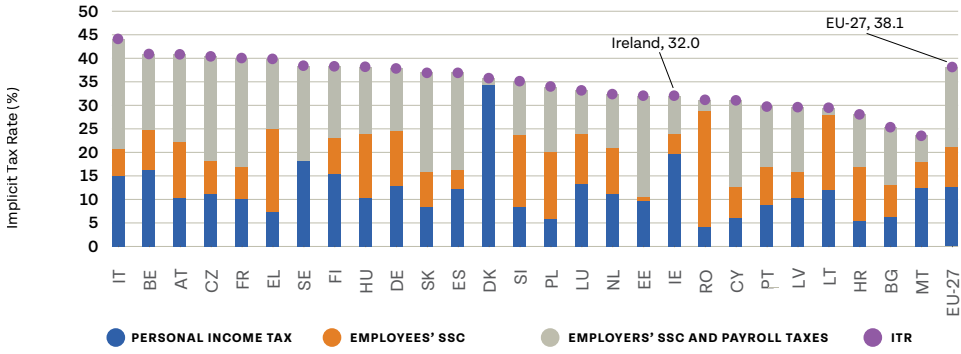
the years ahead there will be further downturns in the global economy that will affect the level of employment in Ireland. What matters is how well the tax and welfare systems respond to protect people against these risks and to support them to return to work as soon as possible. When people lose their jobs, either because of an economic downturn or due to technological change, it is vital that they have access to training and other supports to assist them in finding new employment. Technological change means that a high level of job destruction and job creation can be anticipated and that, as a consequence, people will need access to ongoing educational and training opportunities. At the same time, to avoid the build-up of long-term unemployment, it is important that Ireland sustains and enhances the services provided by the Public Employment Service (PES), to maintain an active rather than a passive social protection system.

Many of the changes to the tax system recommended elsewhere in this report are motivated by a desire to avoid mistakes that were made in the past, when there was excessive reliance on high rates of personal taxation. As noted in Chapter 5 (Balance of Taxation), shifting the balance between taxes on labour, consumption and wealth is a powerful tool in promoting employment, with a compositional move away from labour to consumption and wealth giving greater emphasis to the objective of increasing employment. The significance of this choice has grown over recent decades, a period of low interest rates and rising asset prices, and the urgency to develop this capacity to shift reliance on personal taxation may well increase due to technological change. Therefore, maintaining an appropriate balance of taxation is a core element of our recommended approach.

The implicit tax rate on labour is defined by the European Commission as the sum of all direct and indirect taxes and employees' and employers' social contributions levied on employed labour income, divided by the total compensation of employees. Figure 20 sets out the implicit tax rate on labour across European Union (EU) Member States in 2020, and further outlines the breakdown of components (i.e. personal income taxes; employees' social security contributions (SSC); and employers' social security contributions and payroll taxes). As can be seen below, over half of Ireland's implicit tax rate on labour is personal Income Tax (19.6 per cent), much higher than the EU average of 12.8 per cent. The proportion of Ireland's implicit tax rate made up by social insurance contributions (both employees' and employers') is

unusually low in an EU context.

Figure 20: Implicit tax rates on labour in EU-27, 2020



Source: European Commission, DG Taxation and Customs Union, based on Eurostat data

As highlighted in Chapter 5 (Balance of Taxation), the implicit tax rate on capital in Ireland is 14.4 per cent, which was the fourth-lowest rate in 2020 among EU-27 countries.[244] There is significant scope to shift the compositional balance of tax between labour and capital, as a means of encouraging employment. As also noted in that chapter, the implicit tax rate on consumption was 18.2 per cent in Ireland in 2020, close to the EU-27 average of 17.1 per cent, and also mid-ranking in an EU context (13th lowest out of EU-27 members).

11.3 COMMISSION PROPOSALS

11.3.1 Employment incentives

The available evidence suggests that the vast majority of people working in Ireland do not face a financial disincentive to do so.[245] Of those who do, a majority work in any event, suggesting a range of other factors also play a part in the decision (employment and earnings prospects over a longer timeframe, developing skills etc.).

However, income supports need to be designed to minimise any disincentives that may arise where earnings in the short term are not

244 Data not available for Bulgaria, Malta or Romania; EU average for available countries, 23.9 per cent.

245 Callan, T., C. O'Dea, B. Roantree and M. Savage (2016). Financial Incentives to Work: Comparing Ireland and the UK, Budget Perspectives 2017/2, Dublin, ESRI.

much higher than jobseeker's payments. The social protection system has sought to address this to an extent by including income disregards in the design of income supports (recipients can have some earnings without losing the benefit) and tapered benefits (the benefit is withdrawn gradually rather than suddenly as earnings increase). These disregards and withdrawal rates can differ depending on the type of payment a person receives and their circumstances. For example, a jobseeker has an income disregard of €60 per week and a lone parent has a disregard of €165 per week.

In addition, suitably designed income support payments have an important role in cushioning sudden income loss in the event of an employment shock; at the macro level, they also have a role to play as automatic stabilisers.

A further improvement in efforts to incentivise employment is that secondary benefits operate in parallel with receipt of a primary income support payment. Eligibility criteria for more recent initiatives, such as the National Childcare Scheme (NCS), are based not on receipt of a primary payment (or a particular employment status) but on household income levels. This trend, of providing access to benefits on the basis of household income levels, rather than employment status, reduces disincentives for households to either take up work (where employment is not financially advantageous in the short term) or to increase work (where doing so triggers some combination of benefit withdrawal and tax that makes them less well-off).

The trade-off is that the interface between policy objectives and income support design is more complex and requires careful interaction of income thresholds and other criteria. The withdrawal of these benefits will affect households at income levels considerably higher than the personal rate of a social assistance payment. Some of these people may, subject to other criteria, be in receipt of in-work support.

Increasingly, secondary benefits are being designed and operated outside of the Department of Social Protection (DSP) (e.g. the Housing Assistance Payment and NCS). Given their impact on decisions about employment, it is important to ensure that the design of secondary benefits, and any change to them, are carefully modelled before roll-out and that they are monitored on an ongoing basis. Similarly, the absence of a national differential rent scheme is contributing to inequity across local authorities and in the context of this chapter has an impact on employment incentives.

Furthermore, a greater degree of coherence across secondary benefits is necessary. The varying eligibility criteria for each scheme increases complexity for households making decisions on employment opportunities: some benefits take account of social welfare payments and household expenses, while others do not. The inclusion of earnings from employment in these schemes is appropriate to target the support from, and minimise the cost of, secondary benefits. In the event that employment income increases, access to a scheme may be withdrawn either entirely or on a tapered basis. Estimates of how starting work or increasing hours will affect jobseeker's payment and lone parent payments are provided by the DSP through a benefit of work estimator. Nevertheless, making households' decisions on employment opportunities straightforward should be an overriding objective.

The importance of employment incentives is also reflected in the recommendations made in Chapter 12 (Inclusive and Integrated Social Protection) which, relative to the current system, would improve the incentive to take up work.

Recommendation

11.1 The Commission recommends that secondary benefits for people of working age should be designed on cross-departmental basis to ensure coherence, with negative work incentives minimised and benefits targeted appropriately and effectively. To ensure appropriate integration and tapering of secondary benefits with the existing framework of income supports, an assessment of the impacts of any new benefit should be conducted before new schemes are introduced. Other departments should consult with, and take advice from the Department of Social Protection in respect of any means-tested payments. All agencies making decisions on eligibility should have access to the same high-quality information.

11.3.2 The tax wedge

Personal taxes and the subset of personal taxes that are direct taxes on labour create a tax wedge[246] that can potentially act as a disincentive

246 The tax wedge is a measure of the tax on labour income, which includes the tax paid by both the employee and the employer.

to employment. This occurs on both sides of the employer-employee relationship.

High marginal tax rates can have a negative impact on incentives to work. On the other side, increased labour costs, as employers offer higher salaries to attract employees, make firms less competitive. In the case where specific skills are in demand across multiple countries and the prospective employees are mobile, high marginal tax rates have a negative impact on the prospects of Irish businesses attracting those workers. Furthermore, high tax wedges particularly affect those who are most responsive to taxation.

At present, Ireland has a competitive tax wedge at median earnings. Income Tax and employer social insurance contributions combine to account for 89 per cent of the total tax wedge, compared with 76 per cent of the total OECD average tax wedge. Table 26 shows Ireland's current tax wedge ranking internationally amongst OECD countries by household type using 2020 data from the OECD Taxing Wages Report 2021.

Table 26: Tax wedge in Ireland by household type, 2020

HOUSEHOLD TYPE	AVERAGE WAGE	TAX WEDGE	RANK	OECD AVERAGE
Single, no children	100%	32.3%	25/37 (13th lowest)	34.6%
Single, two children	67%	1.3%	32/37 (6th lowest)	13.7%
Married, one earner, two children	100%	16.1%	30/37 (8th lowest)	24.4%
Married, two earners, no children	*100% & 67%	28.1%	28/37 (10th lowest)	33.0%
Married, two earners, two children	*100% & 67%	24.2%	27/37 (11th lowest)	28.9%
Married, two earners, two children	*100% & 100%	29.1%	25/37 (13th lowest)	31.3%

Source: OECD Taxing Wages 2021

* *Percentage of the average wage earned by each spouse.*

While recognising that the recommendations in this chapter and across the report will help to remove discontinuities and inequities in the tax and social welfare systems, the Commission is aware, nonetheless, that the cumulative effect of some of our recommendations will impact labour costs.

These recommendations, in addition to other policy developments beyond this Commission's scope, including for example, changes in respect of statutory sick pay, the introduction of a national living wage and auto-enrolment for pensions, could have significant impacts on the viability and sustainability of employment-generating enterprises. Such impacts need to be carefully managed, and the various policy changes need to be communicated and understood well in advance of implementation. There is also a need to use existing coordination and communication mechanisms to manage the phased introduction of policy reforms. In addition, once measures are implemented, it is important that the effects are monitored and analysed on a timely and regular basis.

Recommendation

11.2 The Commission notes that a number of recommendations in this report will impact the cost of employment and is cognisant of other policy developments (including, for example, changes in respect of statutory sick pay, auto-enrolment, etc.) that will also affect employers' costs over the medium term. There is a need to coordinate and manage the phased introduction of such reforms. The Commission therefore recommends the establishment of appropriate coordination mechanisms to monitor the cumulative effect of policy changes on enterprise.

11.3.3 Cliff-edges and discontinuities

One of the attempts to smooth incentives is the dual rate of employer Pay Related Social Insurance (PRSI). However, the effort to reduce the wedge for lower-paid employment causes an anomaly when the threshold for the lower rate is surpassed. This has been highlighted by the Low Pay Commission, particularly the high marginal rates triggered by any increase within a narrow range of earnings. Accordingly, in the Commission's view, the lower employer rate of 8.8 per cent, which currently applies on incomes up to €410 per week, should be phased out gradually, meaning that all income will be subject to one, uniform rate of employer PRSI, currently 11.05 per cent. This will remove the need to adjust the threshold each year in response to changes in the hourly national minimum wage rate.

Recommendation

11.3 The Commission believes that only one rate of employer PRSI equal to the higher rate (currently 11.05 per cent) should apply on all weekly incomes, and that the lower rate of employer PRSI, which currently applies on incomes up to €410 per week, should be gradually phased out.

The elimination of tax and social insurance differences, wherever possible, is desirable to ensure that similar activities are treated in similar ways. Horizontal equity suggests that the legal form through which people engage in economic activity should not determine the levels of tax or social insurance payable.

In practice, not all differences in treatment can be removed – some differences exist for clear policy purposes such as supporting enterprise or encouraging employment. However, this is not always the case. For example, the range of social insurance benefits available to contributors under Class A and Class S PRSI are almost identical, suggesting such contributors should be treated equally in respect of social insurance contribution rates – meaning that the rate applicable to Class S should be brought into greater alignment with the combined employer and employee rates applicable to Class A.

Additionally, while differences exist, certain legal forms may be rendered more advantageous by virtue of their tax or social insurance treatment alone. These differences could also be addressed by eliminating the distinctions between the Class A and Class S rates of PRSI, as well as by introducing rules to prevent the exploitation of any differences that are intended to serve a clear economic or policy purpose. The latter could include the introduction of targeted anti-avoidance rules to ensure that labour contracts or contracts for service are treated as employment contracts, where appropriate, irrespective of how the working arrangements have been structured.[247] This would allow bona fide entrepreneurial activity to be preserved.

247 Where an individual provides labour, existing legislation and case law can be examined to determine whether the individual is employed or self-employed for tax and insurance purposes. These examinations are complex, with nuanced points often changing the outcome of a case, limiting the effectiveness of such examinations at scale. In addition these examinations cannot be extended to individuals providing labour through a company structure.

While the equalisation of the PRSI rates between Class S and Class A would bring greater horizontal equity between the employed and self-employed, and might remove the incentive to exploit the disparities the differences in rates create, the Commission recognises that such equalisation would represent a large increase in cost for the self-employed, and accordingly is recommending a phased increase in the Class S PRSI contribution rate to correspond only to the employer contribution rate under Class A.

Taking account of broader objectives, it is noted that increases to social insurance charges are more desirable than Income Tax increases from a mobility perspective, as individuals who work in the State for a temporary period, but are retained on the social insurance system of another country, will not be exposed to these increases.

Recommendation

11.4 To minimise the distinctions between legal forms and to treat similar activity in similar ways the Commission endorses the principle that the rate of Pay Related Social Insurance (PRSI) on self-employment (Class S) should be aligned over time with the employers rate of Class A PRSI attaching to employment (currently 11.05 per cent).

Although not directly related to PRSI, the USC surcharge that applies to non-PAYE income above €100,000, is similarly inequitable. The tax treatment of all income earners should be aligned. The equal treatment of those with earnings above €100,000 can be effected in two ways – by either applying the surcharge to all income earners, or removing the surcharge entirely. The Commission believes that the alignment should be considered in tandem with its recommendation on increasing Class S PRSI.

Recommendation

11.5 The Commission recognises that the USC surcharge on non-PAYE income above €100,000 does not comply with the principle of horizontal equity and recommends that the tax treatment for all income earners should be aligned.

11.3.4 Household labour supply

Decisions about employment – who works and how much, and how to manage other responsibilities – are largely made at the household level. For good reason, income distribution is measured at the household level, as household composition reflects household need, employment capacity, etc.

Given trends in family formation over the past 30 years, including the increasing age at which people get married and the share of children born to parents who are not married, relying on marital status to capture the range of household types and to identify needs within a household is unsatisfactory (see Chapter 6 (Tax Equity and Base Broadening) for discussion of other personal circumstances). The Commission supports the principle of further individualisation in the Income Tax system and believes that more progress is necessary in this area. In particular, conferring Income Tax advantages on the basis of marital status alone is questionable as a feature of Ireland's taxation system for the forthcoming decades.

Over recent decades, the trend in EU Member States has been a move from joint to individual taxation on the grounds that it increases the labour force participation by secondary earners and improves equality.[248]

The process of Income Tax individualisation began in Ireland in 2000 with partial individualisation of the Standard Rate Cut off Point (SRCOP). The stated objective was to increase labour force participation and reduce the numbers of workers paying the higher rates of Income Tax.

There is a significant gap in the employment rate between men and women with children, compared to relative parity between women and men without children. Factors that narrow the gap include significant changes to child-care provision and individualisation in the income taxation system.

A move to full Income Tax individualisation would equalise the marginal tax rates of the primary and secondary earner and reduce the Marginal Effective Tax Rates (METR) for second earners in households, thereby facilitating the objective of increased employment and decreasing the significant gap in the employment rate between men

248 Islam, N., and Doorley, K., and Flood, L., (2020) Making the Switch from Joint to Individual Taxation in Luxembourg. Cost, Behavioural Response and Welfare Effects, Luxembourg, LISER.

and women. The evidence from the partial individualisation in Ireland in 2000 to 2002[249] and from analyses of a range of other countries (the US,[250] Sweden,[251] Canada,[252] and the Czech Republic[253]) is unequivocal, with higher labour force participation by married women and increases in hours worked.

Accordingly, the Commission believes that steps should be taken to further individualise the Income Tax system by moving on a phased basis towards complete individualisation of the SRCOP. This can be done over time by reducing the gap between the SRCOP applicable to single individuals and the joint SCROP applicable to single income married couples.[254] Once full individualisation of the SRCOP is completed, a review should be carried out to evaluate its impact. Consideration could then be given to full individualisation of tax credits.[255]

Recommendation

11.6 Rate Cut off Point as a step towards addressing disparities in the Income Tax system, facilitating increased employment, and decreasing the gap in the employment rate between men and women.

This move towards increasing household labour supply by further individualisation of the Income Tax system is complemented by the

249 Doorley K. (2018), Taxation, Work and Gender Equality in Ireland. IZA Discussion Papers 11495, Institute of Labor Economics (IZA).

250 LaLumia, S. (2008) The effects of joint taxation of married couples on labour supply and non-wage income," Journal of Public Economics, 92 (7), 1698-1719.

251 Selin, H. (2014) The rise in female employment and the role of tax incentives. An empirical analysis of the Swedish individual tax reform of 1971, International Tax and Public Finance, 21 (5), 894-922.

252 Crossley, T. F. and Jeon, S.H. (2007) Joint Taxation and the Labour Supply of Married Women: Evidence from the Canadian Tax Reform of 1988. Fiscal Studies 28 (3), 343-365.

253 Kaliskova, K. (2014) Labor supply consequences of family taxation: Evidence from the Czech Republic. Labour Economics 30 (C), 234-244.

254 All references to the tax treatment of married couples also applies to those in civil partnerships.

255 At present, each individual in a household is entitled to a basic personal credit of €1,700. Where a married couple is jointly taxed (jointly assessed) this is amalgamated into a joint personal credit of €3,400, irrespective of whether one or both individuals are earning.

move towards greater individualisation in the social welfare system where the adult dependants of jobseekers engage with the PES in their own right. In providing income support to a household, the social welfare system should extend its consideration of potential labour supply beyond the jobseeker to all working-age adults in that household, which is addressed in Chapter 12 (Inclusive and Integrated Social Protection).

11.3.5 The Public Employment Service

Chapter 10 (Labour Markets and Social Protection Systems) outlined some recent trends and emerging challenges for the PES, as well as highlighting the importance of an 'active' system. As noted in Part 1, future challenges to the activation process may include automation and digitalisation as well as long-term shifts in employment composition, with a decrease in the proportion of medium-skill jobs.

Over the past ten years, delivering income supports for jobseeker's has incorporated employment support services as a complement to income support. In order to ensure labour force resilience and mobility, the PES will be required to invest in education and training and to increase further its engagement with employers to meet future labour market needs. Jobseekers are not a homogenous cohort and the requirements of other cohorts may be even more diverse, requiring a range of responses from the PES. Scope for expanding activation includes the adult dependants of jobseeker's benefit recipients, and recipients of other income support payments (e.g. lone parents and people with disabilities – in a modified form, tailored to an individual's capacity to work and also cognisant of the barriers to participation that certain cohorts face). The Government strategy, Pathways to Work 2021-2025, commits to increasing caseload capacity of the PES and investing in digitalising PES to maximise its reach through blended service delivery. The Commission endorses this approach.

It may be that this will take the form of longer-term, coordinated services, where the PES helps people add new skills over time rather than in single interventions. With access to large-scale administrative data on unemployment, the PES should provide advice based on the employment trajectories of people with similar characteristics. Also, analysis of the outcomes of PES programmes will lead to a greater understanding of the suite of interventions that should be on offer, and which cohorts should be directed towards particular programmes at specific points in the economic cycle. This applies not just to measuring the value of one programme to jobseekers with particular characteristics, but also,

to identifying the sequence of interventions that is most effective from the perspective of improving jobseekers' employment prospects. In this way, the PES can iteratively improve the services offered as outlined in Pathways to Work, which commits to formal analysis of programme and scheme impacts, and conducting a data audit exercise of DSP administrative data with a view to facilitating longitudinal analysis of outcomes.[256]

Recommendation

11.7 The Commission recommends that the Public Employment Service (PES) should provide advice based on the employment trajectories of people with similar characteristics, with analysis of the outcomes of PES programmes informing the particular programmes at specific points in the economic cycle.

The importance of identifying the impact of active labour market programmes relates not only to the credibility of the activation process, particularly where conditionality is involved, but also the long-term impact on the individual (and the aggregate impact on employment). The Commission notes the ongoing effort to identify the net impact of the programmes offered to jobseekers, through evaluation, and is firmly of the view that the range of offerings should be led by rigorous evidence of their net impact on the jobseeker's long-term employment prospects.

Recommendation

11.8 The Commission believes the range of Active Labour Market Programme offerings should be led by rigorous evidence and evaluation of their net impact on the jobseeker's long-term employment prospects.

The PES also manages employer relations, meaning it is well-placed to coordinate with local employers on vacancies and skill requirements

256 Department of Social Protection (2021) Pathways to Work, Chapter 6: Working with Evidence – Governance and Reporting.

at a regional level. Education and Training Boards (ETBs) take account of input from regional divisions and tailor provision to ensure services build on existing skills and are responsive to the specific needs of employers in the region.

This underscores the point that relevant course content and flexible delivery of courses are critical factors, without which the PES cannot function. While outside the scope of its terms of reference, the Commission notes that the provision of suitable education and training is a foundational part of a functioning labour market – see section 11.3.6.

Recommendation

11.9 The Commission recommends expanding employment services to recipients of other income support payments. The Public Employment Service must be adequately resourced to deliver these services.

The Commission recommends expanding employment services provided to the adult dependants of jobseekers recipients and to recipients of other income support payments as appropriate. In providing income support to a household, the welfare system should extend its consideration of potential labour supply beyond the jobseeker to all working-age adults in that household. This aligns with NESC recommendations on welfare individualisation of adult dependants - see Chapter 12 (Inclusive and Integrated Social Protection) which were contained in its November 2020 report.[257] The Commission is acutely aware that a significant expansion requires additional resources and believes the allocation of resources to the PES underpins the commitment to encouraging employment.

The Commission believes a model of employment support, similar to that currently in place for lone parents, should be extended to adult dependants of jobseekers. This approach varies the level of engagement with the PES according to the age of the youngest child, if any. For lone parents, this begins when their youngest child is between the ages of seven and 14 years. This seven-year window is an important opportunity for the PES to work with lone parents to support them to

257 NESC (2020) The Future of the Irish Social Welfare System: Participation and Protection, No. 151.

access training and educational opportunities, as well as employments supports and advice to enter the labour market. A similarly flexible arrangement could work well for adult dependants of jobseekers who have children. The importance of access to affordable and adequate childcare is a key component of the model for lone parents and will be important for qualified adults also.

Recommendation

11.10 The Commission recommends that a model of employment services, similar to that currently in place for lone parents, be extended to qualified adults.

11.3.6 Further education and training

As noted above, technological change adds to the range of economic activity people engage in and the Commission recognises the significant improvements it can make to the world of work. However, at an individual level, people will have to change job in reaction to sectoral decline, automation and changes in consumer preferences. In the expectation that people will be able to extend their working lives, it is also reasonable to expect people to experience these changes more frequently.

All of this requires a PES that can make a transformative change to the employment prospects of people who need its assistance in finding work or changing career. For this to happen, further education and training provision must be widely accessible and responsive to the skills that employers seek. At present, ETBs coordinate with employers on vacancies and skill requirements at a regional level to ensure services are responsive to specific needs in a given region. They also coordinate with the employer relations function in the PES to gauge the skills needed to help unemployed people find work or, more generally, to bring people into the labour force.

This relationship will require ongoing focus to ensure coherence of the taxation and welfare systems' contributions to employment: a well-designed system of income support, empirically-grounded referrals to Active Labour Market Programmes (ALMPs), and coherence between employer requirements, PES assessments of the skills base at a local or regional level, and content and delivery that is responsive to the aforementioned elements.

11.4 COVID-19 LESSONS LEARNED

The Commission's work is framed in the terms of reference as taking account of "relevant issues such as the impact of the COVID-19 Emergency" and examining how "welfare policy can work in tandem with the taxation system to support economic activity, and while continuing to support those most vulnerable in our society in a fair and equitable way, having regard in particular to experience gained during the COVID-19 Emergency".

In many ways, it is too early to make a definitive pronouncement on the lessons learned from the pandemic. Much changed - physical work locations and commuting patterns, job titles and teams, childcare arrangements, the balance between online and in-person activity across work and leisure. Statistical measures of employment and unemployment were stretched beyond breaking point and income support programmes were designed and delivered at breakneck speed.

The aspects most applicable to the work of the Commission are how the taxation and welfare systems intervened in an unprecedented situation. Even still, judging the impact of these interventions is challenging when the fallout seems incomplete.

As public health restrictions eased, the focus was on metrics such as the number of people in employment – returning to its pre-pandemic level was a remarkable milestone. Now that it has been achieved, and surpassed, the focus is on how matches between employers and employees are achieved within that overall employment total.

This is worthy of further analysis to help interpret the experience gained during the pandemic. First, wage subsidies were a large scale expansion of Ireland's short-time work arrangements. Short-time work schemes are favoured as labour market interventions during a short-term downturn to maintain the connection between employees and employers, thereby retaining valuable firm-specific skills and helping to restore output as rapidly as possible. In parallel, a large-scale income support scheme was developed but at rates of payment much higher than previous rates of income support in the case of single people.

A fruitful line of analysis would be to come to some conclusion about the situations in which these two types of support – one where an unemployment payment replaces a certain level of income for unemployed people, typically based on contributions, and one where the support is delivered via employers – are deployed in future. It may be that different scenarios call for a different mix of the two, or a particular

sequence (such as identifying and exhausting the demand for short-time work before using unemployment insurance type arrangements to cover the rest).

Much like the short-time work schemes that have been in existence for much longer, the pandemic wage subsidies maintained firm-specific skills – something that benefits both employers and employees – while retaining the capacity to rapidly resume output at previous levels.[258]

However, the experience of the labour market since the easing of restrictions, informed by analysis of the employment destinations of Pandemic Unemployment Payment (PUP) recipients, suggests it may not be preferable in all instances. The sudden experiment in remote working, for some occupations, has led to a revaluation of the trade-off between availability at the physical location and availability to take up a job. This is particularly true where specific skills are required. How the job is compensated may now be influenced to a greater degree by the flexibility (hours, location etc.) that may be offered or required.

Some degree of frictional unemployment is unavoidable, and a strong social protection system facilitates it so that better labour market matches, between employers and employees, can be made. Any mass shutdown of economic activity has unusual impacts, one of which is the generation of a large-scale rupture between employees and employers. Few people assumed that everything would revert to what it was before, with exactly the same people returning to exactly the same positions, but an ongoing increase in labour demand suggests the matches that would otherwise happen are not happening. This is reflected in both official job vacancy statistics produced by the CSO and in partial views of labour market demand levels provided by recruitment company analysis.[259]

This might happen if there were alternatives to employment that were suddenly financially more attractive. The design of PUP, where the rate of payment was linked to previous earnings, meant few people could be in receipt of a payment higher than what they had been earning in 2020. Theoretically, it is possible some people adjudged they would earn less in 2021 than they had in 2020 and, consequently, may have

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258 Department of Social Protection (2022) Short-Time Work Support.

259 Compared to a pre-pandemic baseline, job postings are elevated - the continued high level of job postings is reflective of many organisations still having staffing gaps to fill following a period where recruitment conditions for many have been challenging (see hiringlab.co.uk).

considered receipt of PUP to be a preferable option. However, the evidence shows rapid outflows from PUP once economic activity recommenced.[260]

What seems a plausible explanation is a much larger volume of movement away from pre-pandemic employers and, in some cases, away from sector in which the employee previously worked. There is nothing unusual in this – many people perform tasks that are required across a range of sectors. What might be different now is an awareness of other options people have of other occupations, other sectors, other working arrangements. This may well be part of the process of labour market resettling, which has continued on even after the number of people in employment has returned to pre-pandemic levels. Although disruptive to employers in the short term, the process of forming new matches between employers and employees is entirely compatible with a better functioning and larger labour market in the medium term. This will also, presumably, take into account different priorities of employers and employees of wages, conditions and the flexibility offered or required.

Both PUP and wage subsidies are useful tools for policymakers. They protected incomes where economic activity ceased suddenly and delivered income support that allowed people to maintain expenditure levels (in a manner similar to pay-related benefits).

In a period where differentiating between liquidity and solvency problems seemed close to impossible, protecting existing employment (during an acute employment shock) seems a reasonable response. The longer this protection goes on, the more it creates divergent outcomes between people who were in employment at some arbitrary point and a more dispersed population who would otherwise have enjoyed better opportunities. These categories correspond to a well-defined and easily identifiable group who would otherwise have lost something specific and valuable (in the absence of wage subsidies) and a more nebulous cohort whose opportunities would have been better in the absence of the policy. In other words, those in employment just before a point in early 2020 benefit from either a higher rate of jobseeker payment, or a wage subsidy that protects their connection to their employer – those who were about to enter the labour market just after that point get neither,

260 Dwan-O'Reilly J. and McNelis M. (2022) Trends in Post-PUP Employment: Examining the employment transitions of those closing their Pandemic Unemployment Payment claims, Department of Social Protection.

and also have the disadvantage of reduced labour market churn.[261] The longer the policy continues, and with consumers' preferences for goods and services changing, the less likely the matches between firms and workers formed prior to early 2020, and maintained by wage subsidies, continue to be the optimal matches.

Whether future policymakers will draw on the tools used during the past two years depends on whether future recessions resemble the highly specific circumstances of a global pandemic, where the public health response has a major impact on particular sectors. The weighing of the benefits and costs has to take into account the more obvious impacts as well as the more subtle ones that, nonetheless, are part of the policy consideration.

For these purposes, the PUP provides an example of a payment that, subsequent to the initial design of a flat-rate payment, retained a relationship between earnings from employment and a rate of payment when people are unable to work.[262] Although difficult to disentangle from the various other impacts of a global pandemic that was met with public health restrictions that dampened much economic activity, the existence of a payment at a relatively high level may well have enabled the kind of labour market mobility that is an argument for a pay-related benefit. This is because the individuals concerned no longer had a connection to a particular employer and the higher rate of payment under the PUP potentially allowed for additional time to consider options when securing a new job. The analysis of former PUP recipients' transitions between employers and sectors, for example, provides an example of this kind of mobility, albeit in circumstances that may not be applicable to the normal economic cycle.[263] In contrast, it is not yet clear which firms who retained employees on wage subsidies will maintain viability into the future.

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261 This is not to suggest a fixed number of jobs at any point, or a zero sum view of employment.

262 If we use the International Labour Organisation (ILO) definition of unemployed, PUP was paid to people who were unemployed or inactive - during a time when public health restrictions on economic activity are in force, many more people will not correspond to the ILO definition of unemployed.

263 Department of Social Protection (2021) PUP labour market transitions analysis.

11.5 RECOMMENDATIONS

Chapter 11: Promoting Employment

11.1 The Commission recommends that secondary benefits for people of working age should be designed on a cross-departmental basis to ensure coherence, with negative work incentives minimised and benefits targeted appropriately and effectively. To ensure appropriate integration and tapering of secondary benefits with the existing framework of income supports, an assessment of the impacts of any new benefit should be conducted before new schemes are introduced. Other departments should consult with, and take advice from the Department of Social Protection in respect of any means-tested payments. All agencies making decisions on eligibility should have access to the same high-quality information.

11.2 The Commission notes that a number of recommendations in this report will affect the cost of employment and is cognisant of other policy developments (including, for example, changes in respect of statutory sick pay, auto-enrolment, etc.) that will also affect employers' costs over the medium term. There is a need to coordinate and manage the phased introduction of such reforms. The Commission therefore recommends the establishment of appropriate coordination mechanisms to monitor the cumulative effect of policy-related labour cost changes on enterprise and the self-employed.

11.3 The Commission believes that only one rate of employer Pay Related Social Insurance (PRSI) equal to the higher rate (currently 11.05 per cent) should apply on all weekly incomes, and that the lower rate of employer PRSI, which currently applies on incomes up to €410 per week, should be gradually phased out.

11.4[264] To minimise the distinctions between legal forms and to treat similar activity in similar ways the Commission endorses the principle that the rate of Pay Related Social Insurance (PRSI) on self-employment (Class S) should be aligned over time with the employers rate of Class A PRSI attaching to employment (currently 11.05 per cent).

11.5 The Commission recognises that the Universal Social Charge surcharge on non-Pay As You Earn (PAYE) income above €100,000 does not comply with the principle of horizontal equity and recommends that the tax treatment for all income earners should be aligned.

11.6 The Commission recommends a phased move towards individualisation of the Standard Rate Cut off Point as a step towards addressing disparities in the Income Tax system, facilitating increased employment, and decreasing the gap in the employment rate between men and women.

11.7 The Commission recommends that the Public Employment Service (PES) should provide advice based on the employment trajectories of people with similar characteristics, with analysis of the outcomes of PES programmes informing the particular programmes at specific points in the economic cycle.

264 Please note Rena Maycock does not endorse recommendation 11.4. Please see Annex 2 for further information.

11.8 The Commission believes the range of Active Labour Market Programme offerings should be led by rigorous evidence and evaluation of their net impact on the jobseeker's long-term employment prospects.

11.9 The Commission recommends expanding employment services to recipients of other income support payments. The Public Employment Service must be adequately resourced to deliver these services.

11.10 The Commission recommends that a model of employment services, similar to that currently in place for lone parents, be extended to qualified adults.

Chapter 12:
Inclusive and Integrated Social Protection

12.1 INTRODUCTION

The terms of reference asked the Commission to:

> "review how best the taxation and welfare system can support economic activity and income redistribution, whilst promoting increased employment and prosperity in a resilient, inclusive and sustainable way and ensuring that there are sufficient resources available to meet the costs of public services and supports in the medium and longer term."
>
> and to
>
> "examine what changes, if any, should be made to the social insurance system, including structure and benefits coverage, while ensuring sustainability. This will include consideration of the NESC report no 151 (November 2020) on the future of the Irish social welfare system and output from the Pensions Commission regarding sustainability and eligibility issues in respect of State Pension arrangements. It will also include examination of how welfare policy can work in tandem with the taxation system to support economic activity, and while continuing to support those most vulnerable in our society in a fair and equitable way, having regard in particular to experience gained during the COVID-19 emergency."

A key function of the social protection system is to act as a safety net for those at risk of poverty and social exclusion. The Irish social protection system covers a range of supports, covering contingencies such as unemployment, old age, disability, maternity, and insufficient care support, particularly for children and adult dependants. Social protection plays a major role in smoothing incomes and supporting aggregate demand for goods and services after an employment shock. In this way, it acts as an automatic stabiliser, protecting and enhancing human capital and productivity, contributing to inclusive growth and

facilitating structural change.

For those of working age, social protection systems serve to temporarily replace income lost to periods of, for example, unemployment, injury, disability, sickness, paternity or maternity. In cases where earnings from employment are insufficient to avoid poverty or social exclusion, social protection measures provide a floor below which income will not fall. The social protection system also facilitates participation in employment and provides pathways to restoring people's earning capacity after any of the above contingencies. The principal economic argument for social protection is the mitigation and sharing of risk across society. While some exposure to risk is unavoidable, this exposure – as well as the ability to cope with the exposure – varies over the life cycle. Risk is unequally distributed across individuals. By pooling risks and insuring the individual against these risks, social protection allows people to undertake labour market activities with greater return, which stimulates economic growth.

The social protection system is much broader than just the part that relates solely to the labour market. Children are a very clear example of this – the function of child income supports is a critical part of our social protection system.

Building on Chapter 10 (Labour Markets and Social Protection Systems), this chapter outlines the key recommendations the Commission has prioritised in this area. The Commission has focused on a number of reforms which are ambitious but achievable, and which it believes will have a significant impact on poverty, and child poverty in particular.

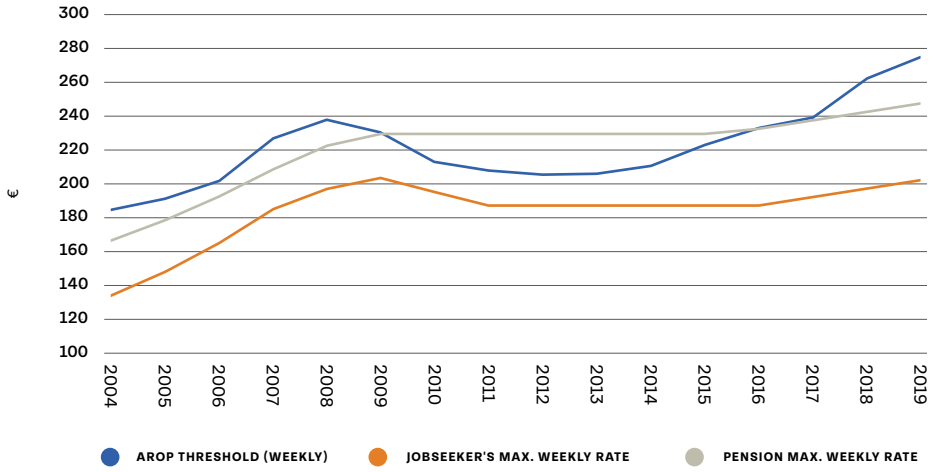
12.2 ADEQUACY AND BENCHMARKING

A key function of the social protection system is to act as a safety net for those at risk of poverty. It follows, therefore, that social welfare rates must be adequate in order to effectively provide such a safety net. Adequacy and the policy surrounding it has been outlined in Chapter 10 (Labour Markets and Social Protection Systems). To address the complexity of adequacy, the Commission believes that a transparent and evidence-led process is required for setting welfare rates. Linked to adequacy is the tapering of social welfare income supports to prevent a 'cliff-edge' when payments are removed. This will reduce poverty and unemployment traps, and ease the transition to work. A key principle to be borne in mind when deciphering appropriate tapering is the adequacy of the income support.

Social welfare rates and poverty are inextricably linked. As stated in the previous section a key function of the social protection system is to act as a safety net for those at risk of poverty. The Survey on Income and Living Conditions (SILC) began in 2003 and, thus it has been possible to examine the relationship between poverty rates and social welfare rates since then. Figure 21 illustrates the trends of jobseeker's rates and pensions rates compared to the at-risk-of-poverty threshold over time and shows the following:

- The maximum weekly personal rate of jobseeker's payment was increased in the mid-to-late-2000s to €204.30 - a 51.6 per cent increase in the space of five years. In 2011, during the economic crisis, this rate was cut to €188, and stayed at this value in nominal terms until 2017.
- The value of median income fell during the economic crisis and, thus, so did the at-risk-of-poverty threshold. This resulted in a modest improvement in the ratio of the maximum jobseeker's payment relative to the poverty threshold, even though jobseekers payment rates were reduced during this time.
- In 2010, a jobseeker's payment was 91.7 per cent of the poverty threshold. This figure gradually dropped over time as the value of median income rose and was 73.6 per cent in 2019.
- Similarly, the weekly pension rate increased by 37.7 per cent between 2004 and 2009. Unlike jobseeker's payments, however, pension rates were not reduced during the economic crisis and remained at this rate, before beginning to increase again in 2016.
- This meant that, in 2012, the maximum weekly contributory pension was equal to 112 per cent of the at-risk-of-poverty threshold. The value of pensions relative to that threshold has since fallen, but remained high at 90 per cent in 2019.

Figure 21: At risk of poverty (AROP) rate and Social Welfare adequacy, 2004-2019



Source: CSO Survey on Income and Living Conditions; CSO Consumer Prices Annual Series; DSP Rates of Payment: SW19. Graph by the Secretariat.

12.2.1 Secondary benefits and disregards

Individuals and households in receipt of social welfare income support are often entitled to secondary benefits. In addition, depending on which social welfare income support they are in receipt of, an earnings disregard may apply. These benefits and disregards can often determine whether a household is above or below the at-risk of poverty threshold. In the past, secondary benefits have traditionally been benefits that an individual may be entitled to when claiming a primary social protection income support, with some benefits also dependent on household income. However, eligibility for more recent initiatives, such as the National Childcare Scheme (NCS) and the Housing Assistance Payment (HAP), is not based on receipt of a social welfare income support (linked to employment status), but on household income levels, including from employment.

This trend, of providing access to benefits on the basis of household income levels, rather than employment status, is intended to alleviate disincentives for households to either take up work (where employment is not financially advantageous in the short term) or to increase work (where doing so triggers some combination of benefit withdrawal and tax that makes them less well-off). This results in more complex policy design and requires careful interaction of income thresholds and

other criteria.

As a consequence, the relevant population for secondary benefits is a broader cohort than just people in receipt of social protection income supports. Although these individual secondary benefit schemes may be outside the social protection system on the basis that they are not administered by the Department of Social Protection (DSP), their impact is relevant to decisions taken around how much someone works, or whether they chose to work at all, and may have a more material impact on employment in addition to the tax and welfare systems.

These benefits and disregards are harder to measure against the at-risk-of-poverty threshold. Nevertheless, certain secondary benefits have a material impact on the financial incentives for employment, for example, the Medical Card, the NCS and the HAP.[265] The HAP, and other social housing supports, require the recipient to pay a differential rent to their respective local authorities. As outlined in Chapter 14 (Land and Property), the absence of a national differential rent scheme is contributing to inequity across local authorities and, in the context of this chapter, may have impacts on employment incentives and adequacy of household income.

Social protection supports for those with illness or disability, and those with caring responsibilities, represent the second largest category of expenditure in the social protection system, representing 21 per cent of social welfare expenditure in 2019, behind pensions. In 2018, Ireland had the second highest expenditure on means-tested social protection benefits as a percentage of total expenditure on social protection benefits (approximately 27 per cent), compared to other EU Member States – only Denmark has a higher percentage than Ireland (approximately 36 per cent). The EU average was approximately 11 per cent. The number of social insurance and social assistance systems apply in differing proportions to those of pension age and those of working age. For those aged 66 and over an increasing majority are in receipt of the social insurance pension – the State Pension (Contributory) – while a decreasing minority are in receipt of the equivalent social assistance payment, the non-contributory State pension. For those of working age, the reverse is true, the majority of those of working age are in receipt of social assistance payments.

265 Maître, B., Privalko I. and Watson D. (2020) Social Transfers and Deprivation in Ireland: A study of cash and non-cash payments tied to housing, childcare, and primary health care services, Dublin, ESRI and the Department of Social Protection.

In terms of adequacy, a means-testing process (social assistance) can create poverty traps, where a person or their family are better off remaining below a certain income threshold. It is for this reason that income disregards apply to social assistance means tests, so that step-effects are minimised. Different social assistance payments have different income disregards to reflect the nature of what the payment is trying to support and the associated economic burden to be overcome. For example, disregards range from €60 per week for jobseekers, to €350 per week for Carer's Allowance. In the case of lone parents the disregard is €165 and, for those in receipt of Disability Allowance, the first €140 is disregarded, and between €140 and €375 is assessed at 50 per cent. Earnings over €375 are assessed in full.

While income disregards are intended to address step-effects, there is some evidence to suggest that they may induce an individual to earn up to, but not beyond, the income disregard. The Roadmap for Social Inclusion contains commitments to examine income disregards and income thresholds, which will use more current research and data and which will feed into the recommended process of benchmarking outlined below.

12.2.2 Disability supports and adequacy

Adequacy is not limited to the level of income support provided. For example, in the case of persons with a disability, while it is important that income supports are adequate, there also need to be wraparound supports in place to facilitate the participation and employment of people with disabilities.

The Pathways to Work strategy notes that, as currently structured, the welfare system largely treats people who are disabled in a binary matter and, in general, does not recognise that there is a continuum of abilities/disabilities. Pathways to Work commits to adjusting payment rates and employment supports to explicitly recognise the different challenges faced by people at different points of the disability continuum. In doing this, the 2021 report from Indecon[266] on the additional costs incurred by people with disabilities is important, as it may assist with determining an adequate level of income for a person with a disability.

The Roadmap for Social Inclusion 2020–2025[267] also sets targets

266 Department of Social Protection (2021) The Cost of Disability in Ireland - Research Report.

267 Government of Ireland (2020) Roadmap for Social inclusion 2020-2025.

to reduce poverty, and improve employment outcomes for people with disabilities.

The Make Work Pay report (2017)[268] specifically considered the complex interaction in the benefit system, including the Medical Card, the additional costs of work associated with disability, and the net income gains in employment. The evidence considered as part of that report suggested that improved incentives to work encourage people with disabilities to combine work and welfare, but not to leave the benefit system. The fear of potentially being worse off if a job does not work out is a major inhibiting factor for people with disabilities taking up employment

It is acknowledged that financial incentives are an important component of a more comprehensive employment strategy for those in receipt of disability payments. This cannot be viewed in isolation either, incentives must be balanced with providing adequate payments and supports. While the primary purpose of disability payments is to prevent poverty risks for people with disabilities, it is not their intention to create or sustain poverty traps.

12.2.3 Future direction for adequacy

Ultimately, the setting of rates of payment for social welfare income supports in a democratic society involves political judgement and decision. However, the Commission believes that it is both possible, and necessary, to improve on the existing system to make it more transparent and evidence-based. Many other OECD countries have developed and implemented a system of benchmarking rates of pension payments, and some also apply a version of this to working-age payments.

It has not been possible for the present Commission to undertake an in-depth analysis of benchmarking models within the timeframe of its deliberations. However, the Commission notes that the Government has committed to introduce a system of benchmarking State pension payments and a proposed approach known as the 'smoothed earnings' method which was outlined in the Roadmap for Social Inclusion (2020) – an approach that was reviewed and endorsed by the Commission on Pensions (2021). This Commission understands that the DSP is undertaking preparatory work on this in respect of pensions.

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268 Department of Social Protection (2017) Make Work Pay.

The Commission is aware of commitments[269] to examine this approach in the context of working-age income supports also. Whether as part of that process or as an independent exercise, the Commission believes an in-depth analysis of benchmarking should be undertaken similar to that undertaken in 2001 through the work of a social welfare benchmarking group. The Commission is also recommending, elsewhere in this chapter, significant policy changes in terms of working-age supports and child income supports. The benchmarking exercise should take account of the recommendations the Commission is making for reform.

The benchmarking exercise should examine the current personal rates of payment for the range of contingencies covered in the social protection system and the relationship between these rates and household consumption. Furthermore, a substantial question that requires empirical input is how the social welfare system caters for household composition – in other words, the extent to which additional payments for dependent adults and children satisfactorily capture the extra needs of households and reflect the economies of scale available to households. This exercise should also utilise a range of data sources, including official statistics, administrative data and other sources. The output of this exercise should be a mechanism for increasing social welfare rates, with a particular focus on the adequacy of payments for people most at risk of poverty.

While it took a long time to achieve the levels of adequacy called for by the 1986 Commission on Social Welfare, it did at least establish a clear direction of travel. In establishing a system of benchmarking, there is an opportunity to set multi-annual pathways for improvements in social welfare rates. It is important that annual rate increases are based on a transparent and evidence-led process.

As the DSP noted in its submission to the Commission, the present system includes differences in levels of payment for certain contingencies, which seem anomalous since they are not based on the needs of the recipient. This is an issue which can be addressed by a benchmarking exercise in order to establish a clear rationale for any variations in rates that may be deemed appropriate between different benefits in the future.

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269 Government of Ireland (2020) Roadmap for Social inclusion 2020-2025, Commitment 25.

Recommendation

12.1 The Commission recommends that Government undertakes a benchmarking exercise in respect of all working-age income supports (including supports for people who are unemployed, people with disabilities and people parenting alone), following which multi-annual targets should be set for social welfare rates which provide for regular incremental progress. Annual increases in social welfare rates should be based on a transparent and evidence-led process.

12.3 WORKING-AGE INCOME SUPPORTS

12.3.1 Working-age assistance payment

In the setting of social welfare payment levels for working-age adults, there is a balance that must be struck between, on the one hand, assuring income adequacy and dignity to people who cannot work and, on the other, ensuring that there are financial incentives for people to take up work at fair rates of pay. However, while the relationship between benefit rates and earnings needs to be monitored, the Commission is not convinced that rates of social welfare payments are supressing labour supply at present in Ireland.

There is research which has documented work incentives in Ireland and which has highlighted the lack of in-work supports for low-income individuals without children. The lack of such an in-work support is likely to negatively affect their incentive to work, along with their standard of living. In-work supports for individuals or couples who do not have children exist in other countries, such as the Working Tax Credit in the UK and Earned Income Tax Credit in the US.

Other features of the Irish tax benefit system provide a disincentive to progress in the labour market. Means-tested access to services and social welfare schemes are accompanied by an inherent trade-off between weakening work incentives and the generosity of the transfer from the government. For example, the NCS provides a means-tested childcare subsidy to low-income families with children in formal childcare. While the NCS increases the incentive to join the labour force by reducing the cost of childcare, it also reduces the incentive to earn more or progress in the labour market due to its withdrawal rate that in effect depends on household size, composition and hours of childcare usage.

The social protection system has, in particular over the past 20 years, greatly increased rates of benefit and, in parallel, introduced flexibilities in order to balance these increases in payment rates with an increasing array of exemptions or disregards to maintain the incentive to work. The nature of this system, or indeed any system, that is based on income, or days-of-work thresholds and cut-off points, is such that the jobseeker can face earnings cliff-edges. This is particularly the case in situations where welfare income is certain but hours of work or employment earnings fluctuate.

In addition, flexibilities have led to complexity in understanding the array of available in-work benefits available to those transitioning to the labour market, which can lead to less than optimum experiences for individuals when engaging with the social protection system.

12.3.2 Working Family Payment and Jobseekers Allowance

Having separate in-work supports (Working Family Payment) and out-of-work supports (Jobseekers Allowance) can lead to differential treatment and disincentives.

Jobseekers Allowance is an out-of-work support, which can be accessed by households with and without children. It can also act as an in-work support in certain cases, albeit it is inflexible as it is based on full days not worked. Working Family Payment is an in-work support that is only accessible to households with children, and the amount received is linked to hours worked and income level.

The effect of these two approaches is to create different levels of support and incentive for people that are in the same circumstances.

The Commission believes that there is a need to reform in-work supports by moving towards a tapered working-age assistance payment available to all households. The delivery of this payment could leverage recent digital services development in the DSP and the Revenue Commissioners (Revenue). For example, the implementation of PAYE modernisation has created, we understand, a platform that can be used to directly link jobseeker welfare payments to earnings in close to real-time, presenting the potential to move away from an 'all or nothing' approach based on 'days of work' thresholds.

A key lesson from the experience of the Pandemic Unemployment Payment (PUP) has been that the administration of PUP is heavily reliant on data that is submitted to Revenue by employers. The integrity of this data needs to be high if used in future, for example, to introduce a working-age assistance payment as the Commission is suggesting.

The modernisation of information technology systems in the DSP has also provided the capability, as in the example of PUP, to utilise this information in calculating and setting individualised rates of payment. This makes the realisation of a working-age assistance payment, which provides a more responsive and tapered support as income increases, more achievable in the short to medium term.

The 2020 NESC report (No 151) recognised the Irish social welfare system as being modern and reasonably well functioning. That report made an extensive set of recommendations, from minor adjustments of practice or process to major policy changes, for example, the introduction of a new working-age in-work benefit. In this regard, NESC recommended that Working Family Payment be extended to households without children.

While referred to as an extension to Working Family Payment by NESC, the reform this Commission is recommending is the introduction of a separate working-age assistance payment, with a tapered withdrawal as household income rises, much like the current Working Family Payment. For people without any work, an adequate core rate of payment should be maintained. The parameters, such as hours and income thresholds, of a new working-age assistance payment should be carefully designed.

If designed correctly, a working-age assistance payment would also help to address the challenges in respect of the interaction of in-work supports and unemployment benefits. The precise design of the scheme should mitigate unintentional subsidisation of low-paid employment.[270] It will also be important that appropriate transitional arrangements are put in place to minimise the disadvantage to households at greatest risk of poverty who are currently in receipt of working-age payments.

The introduction of a working-age assistance payment would also mitigate in-work poverty being experienced by households regardless of family composition. In-work poverty, while low in Ireland, is concentrated among a few key groups such as older minimum wage workers and lone parents. In-work income supports play an important role in redistributing income and sustaining families, while a tapered withdrawal ensures the incentive to increase earnings is maintained.

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270 Azmat, G. (2019) Incidence, salience, and spillovers: The direct and indirect effects of tax credits on wages, Quantitative Economics, Econometric Society, vol. 10 (1).

Recommendation

12.2 The Commission recommends that working-age payments should be reformed to move towards an income related working-age assistance payment available to all households. The payment should be designed so as to avoid subsidising low-paid employment.

12.3.3 Pay-related jobseeker payment

The current Programme for Government and Pathways to Work contains a commitment to progress the delivery of a pay-related social insurance jobseeker payment. Internationally, there are different models of social insurance systems, some of which have a greater pay-related component than others. However, there is currently no agreed definition of what a pay-related benefit system is, nor is there any indication of what type of system is proposed under the above-mentioned commitments.

In keeping with the principle of reciprocity, there is a role in a strong social protection system to provide a safety net such that a reasonable match, based on skills and experience, is the driver of a return to work rather than the necessity to alleviate imminent poverty driving an immediate return. This is particularly the case where greater income certainty for the duration of the benefit ensures short-term financial commitments can be met while in search of employment.

Pay-related benefits are of advantage in maintaining the short-term expenditure commitments of people with higher previous earnings, but it is arguable that, in the first instance, an individual's own resources should be drawn on to maintain expenditure patterns. At present, individuals with greater means (including savings) can qualify for and receive Jobseeker's Benefit, even if they have the means to support themselves without recourse to State support. This element of deadweight is a design feature of social insurance where an entitlement to a benefit comes as of right once the contingency has been established.

Pay-related benefit is premised on the notion that previous earnings are used to determine a rate of payment. By paying different levels of benefit based on previous earnings, pay-related benefits may not confer the same level of benefit on people whose contributions are of lower monetary value but who have an identical contribution record. People with similar needs (i.e. they have recently lost their employment and need income support) are currently treated similarly but will be treated

differently if payment rates are based on past earnings.

There are a variety of models, across Europe and elsewhere, of pay-related benefits – each with distinctive features and, as a result, different costs associated with their delivery. If a pay-related jobseekers payment is to be introduced, the Commission recommends that the following points should be borne in mind during the policy design phase:

- The design of pay-related benefit should have regard to the incentive to work and such benefits should only be payable for a limited period of time. This period should be shorter than the current duration of Jobseekers Benefit, which is currently six or nine months depending on the recipient's contribution record.
- A pay-related benefit should be designed having regard to the existing funding challenges facing the social insurance fund.
- In the interests of equity, a pay-related benefit should be subject to an earnings cap.
- Existing and new linkages between DSP and Revenue could be progressed to design a process to deliver a pay-related benefit.

In addition to Jobseekers Benefit there is a case for linking other benefits to previous earnings. For example, linking Maternity Benefit to new mothers' previous earnings could reduce the gender wage gap, while a similar reform to Illness Benefit could have public health benefits.

Furthermore, if a system of pay-related benefits is introduced, and if such payments are taxable, consideration should be given to exploring the application of PAYE by DSP as the payments are being made.

Recommendation

12.3 The Commission notes the intention of the Government to introduce a greater element of pay-related benefits within the Social Insurance system. The Commission recommends that the design of such benefits should take account of incentives to work and the sustainability of the Social Insurance Fund. If introduced any such benefit should be short in duration, subject to a cap, and progressively extended to include maternity, paternity, parents' and illness benefit.

12.4 CHILD INCOME SUPPORTS

Children, as noted in Chapter 10 (Labour Markets and Social Protection Systems), are most at risk of experiencing consistent poverty compared to other age cohorts of the population.[271] Certain types of households with children are also more at risk of experiencing poverty, for example, lone parent households and households where adults are not engaged in the labour market. Improving the financial situation of these households will not only benefit children in the short term, but in the long term it has the potential to break the cycle of intergenerational disadvantage. The Commission has been mindful throughout this report of seeking to address intergenerational inequities. Our proposals in terms of income supports in households where there are children are an example of this.

Household income also has a positive causal effect on children's outcomes, including their cognitive and socio-behavioural development and their health, particularly in households with low income. Notwithstanding this, high quality affordable services are also required in addition to income supports to prevent poverty and support participation in the labour market.

12.4.1 Child Benefit

The Commission believes that, while protecting the achievement of recent decades in reducing poverty among older people, a particular focus is required to reduce child poverty.

Child Benefit currently constitutes one of the largest financial commitments in the social protection system.[272] The universality of Child Benefit is an important feature of the system, which acknowledges the importance that society places on childhood and children since it was introduced.

The Commission has considered the issue of whether Child Benefit should be subject to taxation. The various commissions and working groups that have examined child income support payments in the past have also considered the question of retaining Child Benefit in its universal and non-taxable form. While there has generally been agreement that Child Benefit should remain universal, these previous examinations focused on how the payment could be made more targeted,

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271 According to SILC 2021 data the at-risk-of-poverty rate for children was 13.6%.

272 The other components of chid income supports are; Working Family Benefit, Child Dependant increases, Back to School Clothing and Footwear Allowance and the Back to Work Family Dividend.

for example, in the recommendations of the Commission on Taxation (2009) and the advisory group on Tax and Social Welfare (2012).

The arguments made in favour of retaining a universal child benefit payment, and which remain pertinent today, can be summarised as follows:

- At a societal level, a universal payment makes a strong statement that children matter and that society values children and wishes to share in the cost of raising children.
- A universal payment is easy to understand and administer and generally results in a high level of take-up.
- A universal payment is employment- and income-neutral and, therefore, avoids labour market disincentive effects.
- A universal payment avoids branding the families that receive it as poor and "as such" is free of stigma. This in turn ensures a high level of take-up.
- A universal payment avoids fluctuations in the level of payment being provided to families and, thus, ensures certainty. This can aid budgetary considerations within the family unit and increase the likelihood that the payment is used for the welfare of the children.
- A universal payment facilitates intra-household distribution of resources.

Means testing of Child Benefit could result in some families not receiving any child income support from the State. While income or means testing of Child Benefit has the potential to improve targeting of resources, it also would have considerable administrative consequences, as the scale of means testing would be considerably greater than anything required by the current system. For example, at present only recipients of social assistance income supports are means tested; social insurance recipients, in general, are not.

This Commission has considered how best to treat Child Benefit in the future and has concluded that taxing Child Benefit at existing levels would be likely to have negative impacts on families on low incomes, and to be contrary to the policy objective of Child Benefit to provide a universal financial support in respect of children. Accordingly, the Commission is not recommending that Child Benefit should be subject to tax.

Recommendation

12.4 The Commission does not recommend that Child Benefit should be subject to tax.

In 2012, the advisory group on Tax and Social Welfare examined the treatment of children in the social welfare system in detail. Its preferred option at that time, in addition to maintaining a universal child benefit in respect of all children, was a two-tier child income support payment. More recently, the 2020 NESC report (No. 151) made a recommendation to introduce an additional tier of child income support that would comprise a universal child benefit paid in respect of all children, with an automatic supplement payable in respect of children in low-income families, whether these families are in receipt of a social welfare payment or in low-paid employment. This would seek to address some of the cliff-edges currently experienced by individuals transitioning from welfare to work and could also act as an incentive to work.

This Commission is making recommendations to further integrate the child income support system with a targeted component. These recommendations are akin to what was most recently advocated by NESC. This Commission is not recommending that the universal element of Child Benefit be reduced at this point in time.

12.4.2 Other child income supports

In addition to universal child benefit, targeted family benefits suppose the presence of a child but currently have additional eligibility criteria such as low income or being a single parent – the primary example of this in the Irish system being increases for qualified children. The Commission has examined practices in a number of other countries as part of its deliberations in this regard. For example, Denmark and Norway provide family benefits specifically targeted towards single parents through universal benefits and a supplement. The UK and US target family benefits through a tax-credit approach. Germany provides a means-tested supplement. The UK and Ireland have universal child benefits and eligibility for other financial supports when income is below a certain level. This is the poverty-targeted policy model.

The research considered by the Commission shows that targeting alongside universalism is an effective tool to tackle poverty, which

ensures that all families receive some support in recognition of the fact that they are rearing children. It is within this policy framework that the Commission has sought to make its recommendations in this area. Most OECD countries have supplementary child income supports based on levels of income or on family status. The effectiveness of child-contingent cash transfers by removing the eligibility link between them and social welfare receipt is important.

An integrated child income support payment could replace the existing separate child income support payments (Child Benefit, Qualified Child Payments and, potentially, Working Family Payment) with a system, including:

- A child benefit payment providing a universal platform.
- Additional support, the level of which would be determined on the basis of household income, to be provided to those with household income up to a certain threshold as follows:

    (a) Households whose entire income is social welfare would automatically receive a support that is a successor to qualified child payments and that would essentially replace the current qualified child payments.

    (b) Households with children where the parent(s) are working but who are low-income households would receive an in work support. These households may or may not be currently receiving an in-work support like Working Family Payment.

This model provides for a targeting of support on the basis of household income and aligns with policy developments elsewhere in Ireland, and internationally,[273] which have sought to move away from support based on employment status and towards income as the basis for determining need. An integrated child income support is likely to extend coverage to more low-income families compared to current supports, and it is acknowledged that there will be a cost associated with reforming child income supports.

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273 Very few other countries link their supplementary child income supports to receipt of social welfare. Most OECD countries have supplementary child income supports based on levels of income or on family status.

Recommendation

12.5 The Commission recommends that the existing system of child income supports should be reformed to facilitate the introduction of a second tier of an income related child income support in addition to Child Benefit that combines existing supports and that would be provided to all low-income households, whether in receipt of a social welfare payment or not.

Within an overall framework of the benefits of focusing on children not only in the short term, but also in the context of the long-term economic benefits of interventions targeted towards children, there is a strong economic rationale for continued government investment in early-learning and care. The cognitive and socioemotional development of children who attend high-quality early-learning care facilitates improved educational, behavioural and labour market outcomes into adulthood.[274] Access to high quality affordable early-learning care also enables female labour market participation, as does the availability of affordable early-learning care when it comes to the decision-making of families to have children.

The Commission believes that the policy and administrative framework now exists to make changes such as the introduction of a new tapered working-age assistance payment as outlined in section 12.3.1, and a second tier of child income support, a reality. This is confirmed by the submission to the Commission from the DSP.

While the Commission's recommendations in respect of a child income support payment and a new working-age assistance payment each stand on their own merits, there are administrative benefits to developing both in tandem or, possibly, integrating the two proposals.

12.5 TOWARDS GREATER SOCIAL WELFARE INDIVIDUALISATION

The social protection system is based on the individual but takes account of household structures. Social insurance benefits include features that take account of the household, for example, adult and child dependant allowances. Qualification for social assistance benefits are generally assessed on the basis of household income rather than

274 Government of Ireland (2020) Roadmap for Social Inclusion (Action 36).

just that of the individual. The corollary of this is that the presence of a spouse or partner, and any children, is a factor in determining the final payment rate through the payment of extra amounts for adult and child dependants. Social welfare individualisation, as distinct from Income Tax individualisation on which the Commission has made recommendations in Chapter 11 (Promoting Employment), consists of a series of changes that can be undertaken to ensure that individuals are treated distinctly and equally within the social welfare system.

Social welfare individualisation is significant in terms of delivery of social welfare policy objectives and supports. It can bring about a number of benefits, particularly for women, given that the majority of dependant adults are women.

There are ongoing developments in the area of social welfare individualisation. For example, the Roadmap for Social Inclusion includes an action to review the current system of classifying second adults in households as 'dependant adults', with a view to individualising welfare payments and supports.[275] Notwithstanding this, the purpose of the Commission's examination and recommendations in relation to social welfare individualisation are intended to give further impetus to the progression of social welfare individualisation and to provide an overarching framework for same.

The 2020 NESC report (No. 151) reinforced the principle that the social welfare system should reflect changing patterns of household and family formation, with a commitment to equal gender roles and rights, and a sharing of family responsibilities, and recommended the individualisation of qualified adult payments. The report of the Citizens Assembly on Gender Equality (2021) also called for a fully individualised social welfare system to reflect the diversity of today's lives and to promote an equal division of paid work and care.

The Commission has considered both of these reports as part of its deliberative process and is of the view that further social welfare individualisation is necessary, specifically in relation to qualified adults whose partners are in receipt of means-tested social assistance benefits. Despite the changing nature of families and their formation in recent years, the core social welfare system remains predicated on the adult-plus-'dependant'-partner plus-dependant children model – a version of the traditional male bread-winner model.

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275 Government of Ireland (2020) Roadmap for Social Inclusion (Action 36).

Notwithstanding this, it remains important to take into account the caring role of dependent adults with young children, while also moving towards greater individualisation in the treatment of these adults. In this context, it will be important to ensure that adequate secondary benefits, income disregards and/or responsive in-work supports are in place, if dependant adults are to be encouraged to increase participation in the labour market as part of social welfare individualisation.

The Commission believes that the challenge for reform in this area is to strike the balance between accommodation of, and respect for caring responsibilities, and the promotion of labour market equality for both women and men. A number of options to progress social welfare individualisation either on a cumulative or phased basis have been considered and the Commission is making a recommendation in this regard. This recommendation should be furthered based on the following policy principles:

- All adult dependant allowances paid in respect of working-age payment should be paid directly to the dependant adult, in order to ensure that there is a direct relationship between the dependant adult and the social protection system.
- Household income should be used to determine the amount of payment to each adult in a household. Determining household income is inextricably linked to the benchmarking exercise recommended by the Commission in section 12.2.3.
- Related to household income, in determining individual rates of payment, due regard should be given to the adequacy of the individual income and the household income.
- In households where children are present, consideration should be given to whether any child-related payment should be paid directly to the adult in receipt of Child Benefit.

Recommendation

12.6 The Commission recommends that the individualisation of payments made to qualified adults be progressed. This should be guided by the set of principles outlined by the Commission.

12.6 RECOMMENDATIONS

Chapter 12 : Inclusive and Integrated Social Protection

12.1 The Commission recommends that Government undertakes a regular benchmarking exercise in respect of all working-age income supports (including supports for people who are unemployed, people with disabilities and people parenting alone), following which multi-annual targets should be set for social welfare rates which provide for regular incremental progress. Annual increases in social welfare rates should be based on a transparent and evidence-led process.

12.2 The Commission recommends that working-age payments should be reformed to move towards an income related working-age assistance payment available to all households. The payment should be designed so as to avoid subsidising low-paid employment.

12.3 The Commission notes the intention of the Government to introduce a greater element of pay-related benefits within the Social Insurance system. The Commission recommends that the design of such benefits should take account of incentives to work and the sustainability of the Social Insurance Fund. If introduced any such benefit should be short in duration, subject to a cap, and progressively extended to include maternity, paternity, parents' and illness benefit.

12.4 The Commission does not recommend that Child Benefit should be subject to tax.

12.5 The Commission recommends that the existing system of child income supports should be reformed to facilitate the introduction of an income related second tier of child income support in addition to Child Benefit that combines existing supports and that would be provided to all low-income households, whether in receipt of a social welfare payment or not.

12.6 The Commission recommends that the individualisation of payments made to qualified adults be progressed. This should be guided by the set of principles outlined by the Commission.

Chapter 13:
Moving to a Low-carbon Economy

13.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"examine how the taxation system can be used to help Ireland move to a low-carbon economy as part of the process of meeting its climate change commitments as set out in the Climate Action and Low Carbon Development (Amendment) Act 2021. This will include ensuring the sustainability of environmental tax revenue resulting from decarbonisation of the economy."*

Addressing the climate crisis and transitioning to a net-zero emissions economy and society is one of the defining challenges of our time. Urgent action is required.

Indeed, a number of noticeable effects of climate change are already being experienced by Ireland and other countries around the world. Climate change also has important implications for both energy and food security; highlighting the pressing need to reduce Greenhouse Gas (GHG) emissions.

In addressing the climate change crisis, the Commission is conscious that taxation is only one policy lever at the Government's disposal. Taxation policy by itself cannot achieve the necessary GHG emissions reductions (measured in carbon dioxide equivalent); however, as this is an economy–wide problem, taxation has an important role to play.

To achieve decarbonisation in an efficient manner from an economic perspective, carbon should be appropriately priced to discourage its consumption. This is not simply a matter of increasing the Carbon Tax. A number of pre-existing provisions in the tax code effectively act as fossil fuel subsidies, and these need to be addressed in combination with specific environmental tax measures such as the legislated-for Carbon Tax increases, so that the overall tax treatment of any product is reflective of the amount of emissions that it produces. Pricing fossil fuel energy products in proportion to the amount of GHGs

they emit is important in order to achieve emissions reduction at the lowest possible cost.

Beyond GHG emissions reductions, the Commission is conscious that improving air and water quality, reducing pollution, improving biodiversity, managing waste and developing a circular economy are also important elements of Ireland's environmental policy objectives. While these other policy objectives are outside the remit and scope of its terms of reference, the Commission supports the Government taking the appropriate and necessary measures to achieve these goals.[276]

The Commission is extremely conscious that during the course of its work there has been a surge in inflation, which has affected living standards for households, notably in respect of energy bills. Higher energy prices also feed through to production and distribution costs, and higher consumer prices in a whole range of goods, including food. The Commission is mindful of the implications of this inflationary environment for standards of living, and indeed for poverty and inequality. Nonetheless, the Commission's mandate is to look at policy through a medium- and long-term perspective, and the objectives of achieving a low-carbon economy are a core policy objective. If anything, the experience of the past twelve months points to the importance of having a coherent medium-term strategic approach, and a clear policy framework in place for using the taxation system to address the urgent climate crisis. It also points to the importance of developing fiscal and other strategies to ensure a 'just transition'.

276 Department of Environment, Climate and Communications (2021) Climate Action Plan 2021 and Department of Environment, Climate and Communications (2019) Climate Action Plan 2019.

13.2 CONTEXT

13.2.1 Economic activity and emissions

Since 2005, GHG emissions have fallen by around 12 per cent, from around 70 million tonnes of carbon dioxide equivalent in the mid-2000s to just over 62 million tonnes of carbon dioxide equivalent in 2021 (latest year for which data are available).[277] This amounts to around a 1 per cent reduction per year, and is significantly below Ireland's annual target of 7 per cent emissions reductions.[278]

Trends in Ireland's GHG emissions since 2010 demonstrate that the link between economic activity and GHG emissions has not yet been decoupled.[279] GHG emissions declined during the period 2008 to 2010, primarily due to the sovereign debt crisis and global economic recession.[280] However, with economic recovery, Ireland's GHG emissions grew by 8 per cent over the period from 2014 to 2018. Similarly, Ireland's GHG emissions reduced by 6 per cent due to the periods of lockdown during the COVID-19 pandemic , the biggest annual fall since the 2008 financial crash.[281] However, this effect is expected to be temporary (the decline in 2020 was just 3.6 per cent), and is also well below Ireland's annual target of 7 per cent emissions reduction.[282]

277 Environmental Protection Agency (EPA) (2021) Greenhouse Gas Emissions 1990 – 2020 and EPA (2022) Ireland's Greenhouse Gas Emissions Projections 2021 – 2040.

278 Annual emissions reductions of 7 per cent between 2021 and 2030 are required to achieve the target of 51 per cent economy wide emissions by 2030, as set out in the Climate Action and Low Carbon Development (Amendment) Act 2021, and there is a commitment in the Programme for Government to achieving this as well.

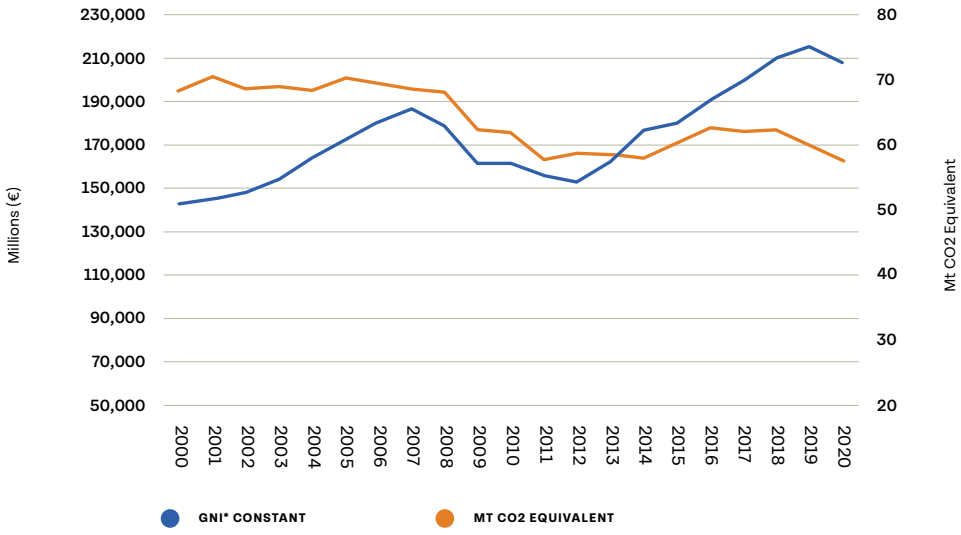
279 OECD (2021) Environmental Performance Reviews: Ireland 2021 Paris, OECD Publishing.

280 Bruin, D., Monaghan E., and Yakut M. (2020) The environmental and economic impacts of the COVID-19 crisis on the Irish economy: An application of the I3E model, ESRI Research Series 106, Dublin, ESRI.

281 EPA (2021) Greenhouse Gas Emissions 1990 – 2020.

282 Bruin, D., Monaghan E., and Yakut M. (2020) The environmental and economic impacts of the COVID-19 crisis on the Irish economy: An application of the I3E model, ESRI Research Series 106, Dublin, ESRI.

Figure 22: Economic activity and GHG emissions, 2000-2020



Source: EPA and CSO

Note: left axis is GNI in constant prices. Emissions (right axis) are measured in millions of tonnes of carbon dioxide equivalent.*

13.2.2 International targets and commitments

In an international context, Ireland must meet targets that are set at a European level.

The European Union distinguishes between two categories of GHG emissions, those which come into the Emissions Trading System (ETS) and those which do not.[283] Emissions from electricity generation and large industry are in the ETS, which is a "cap and trade" system.[284]

Emissions from agriculture, transport, the built environment, and small industry are not currently in the ETS system. Instead, they are covered under the EU Effort Sharing Regulation, which provides a target for Ireland of a reduction of 30 per cent of non-ETS emissions (compared to 2005 levels) by 2030.[285]

283 European Commission, Emissions Trading System.

284 The 'cap' on greenhouse gas emissions that drive global warming is a firm limit on pollution. The cap gets stricter over time. The 'trade' is a market for companies to buy and sell allowances to emit certain amounts. Trading gives companies a strong incentive to save money by cutting emissions in the most cost-effective ways.

285 European Commission, Effort Sharing Regulation.

In July 2021, the European Commission published a set of legislative proposals known as the 'Fit for 55' package, which are currently in the process of being negotiated and which propose to increase Ireland's emissions reduction target to 42 per cent.[286] These proposals are intended to provide a framework to achieve a reduction of at least 55 per cent of Europe's GHG emissions (compared to 1990 levels) by 2030.

The key tax policies provided for in the Fit for 55 package to achieve the aims of the European Green deal are the revision of the Energy Tax Directive (ETD), and a potential Carbon Border Adjustment Mechanism. The proposed revision of the ETD includes the gradual phasing out of the exemption from taxation for fuels used in the commercial aviation and maritime sectors.

In the case of aviation, a phased introduction of a minimum rate of Excise Duty on aviation fuel for intra-EU flights by 2033 is proposed. While the Commission supports this proposal, it believes that greater ambition is required in this area.

Additionally, the ETD proposals provide for the application of a separate ETS to road transport and buildings. As these sectors are currently subject to the Carbon Tax, the application of a separate ETS could effectively result in the imposition of a double taxation on emissions associated with the energy use in these sectors. While the Commission favours the current Carbon Tax policy over the expansion of the ETS to other sectors, and while we have based our recommendations in respect of Carbon Tax on the assumption that the status quo in respect of the ETS will be maintained, our recommendations in respect of Carbon Tax (section 13.4.1) must ultimately be considered in light of the outcome of the ETD negotiations[287].

In light of the energy market disruptions caused by Russia's illegal invasion of Ukraine, the EU launched a plan, REPowerEU, in May 2022 to reduce the EU's dependence on Russian oil and gas and speed up Europe's green transition.[288] There are three strands to this plan; energy savings, diversification of energy supplies and the accelerated roll-out

286 Council of the European Union (2022) Fit for 55 Package.

287 The European Parliament voted on 22 June 2022 against retaining the European Commission's proposal to extend the EU ETS to private buildings and road transport, taking the position that the ETS should only apply to commercial transport, buildings and process heating over the period 2025 – 2028. However, by 2026 the Commission has been tasked with assessing whether the ETS can be extended to households in 2029.

288 European Commission (2022) REPowerEU Press Release.

of renewable energy sources.

Elsewhere in the international sphere, Ireland has ratified the UN Framework Convention on Climate Change (UNFCCC) and the Paris Agreement.[289] The Paris Agreement is a legally binding international treaty adopted by 196 countries that aims to limit global warming to below two degrees Celsius, and preferably to 1.5 degrees Celsius, compared to pre-industrial levels.

In addition, as part of the Conference Of the Parties 26 (COP 26) Agreement (the Glasgow Climate Pact), which is a follow-up to the Paris Agreement, Ireland has committed to accelerating technologies and policies that enable the transition to low emissions energy systems, including phasing out fossil fuel subsidies and providing targeted support towards facilitating a 'just transition'.[290]

13.2.3 Domestic targets and policies

Ireland has committed to reducing its GHG emissions by 51 per cent (compared to 2018 levels) by 2030 and has set an ambitious target of reaching net-zero GHG emissions by 2050.[291] These targets are contained in the 2020 Programme for Government and the Climate Action and Low Carbon Development (Amendment) Act 2021. The climate and environment policies set to achieve these emissions reductions targets are set out in the 2019 and 2021 Climate Action Plans, which focus in particular on sectors not covered by the EU-wide ETS (which, as noted in 13.2.2, are currently agriculture, transport, the built environment and small industry).

The Climate Action and Low Carbon Development (Amendment) Act 2021 provides a legal framework for the implementation of carbon budgets. Carbon budgets set out the total amount of economy-wide GHGs that may be emitted in the State during a five-year period, with the first carbon budget for the period 2021 to2025 capped at 295 million tonnes of carbon dioxide equivalent.[292] These carbon budgets are overseen by the Oireachtas and will include sectoral emissions

289 United Nations Framework Convention on Climate Change (2016) The Paris Agreement.

290 United Nations Framework Convention on Climate Change (2021) Glasgow Climate Pact Cover Decision.

291 As set out in the Climate Action and Low Carbon Development (Amendment) Act 2021.

292 Department of Environment, Climate and Communications (2022) Carbon Budgets.

ceilings setting out a decarbonisation target (within a range) for individual sectors.

13.2.4 The cost of not meeting Ireland's legally-binding emissions reductions targets

Significant investment is required to achieve net-zero emissions by 2050 in both the European Union and globally.[293] A significant level of public funding and investment will also be required in order to help Ireland achieve its emissions targets.

The National Development Plan (NDP) outlines Ireland's capital investment plans, including climate-related expenditure.[294] The cost of capital projects must now incorporate the abatement cost of emissions that will result from the project. The NDP sets out a total of public investment of €165 billion over the period 2021 to 2030.

If sufficient investment, particularly capital investment, is not undertaken in a timely manner, it is likely that Ireland will not meet its emissions reductions targets.[295] The EU obliges Member States who do not meet the emissions reduction targets set at EU level to purchase allowances or credits to achieve technical compliance. Consequently, there will be a significant cost for Ireland if it does not meet its 2030 EU targets. A total of €121 million was spent on acquiring carbon credits to meet Ireland's targets for the period from 2008 to 2020.[296] However, it is anticipated that the purchase of carbon credits to meet Ireland's future obligations will become more expensive.

Ireland has a mandatory target of at least 16 per cent of gross final energy consumption to come from renewable sources by 2030 and is projected to fall short of this target.[297] It is estimated that this could result in costs of the order of €110 million, depending on prevailing

293 McKinsey Sustainability (2020) How the European Union Could Achieve Net Zero Emissions at Net-Zero Cost. McKinsey Sustainability (2022) The Net Zero Transition: What it would cost, what it could bring.

294 Department of Public Expenditure and Reform (2021) National Development Plan 2021 – 2030.

295 EPA (2022) Ireland's Greenhouse Gas Emissions Projections 2021-2040.

296 Comptroller and Auditor General (2019) Annual Report on the Accounts of the Public Services 2018, Chapter 9 "Greenhouse Gas Related Financial Transactions".

297 DPER (2020) Briefing Note: Compliance Cost associated with 2020 & 2030 Climate & Energy Targets.

market conditions.[298] Ireland achieved approximately 85 per cent of the required progress towards the 2020 target (13.5 per cent achieved versus a 16 per cent target) and partially met the EU obligations by purchasing statistical transfers from Denmark and Estonia at a cost of €50 million.[299]

However, the potential compliance cost of not meeting the 2030 targets is complex and quite speculative.[300] If Ireland fails to reduce emissions in accordance with the linear trajectory required under the Effort Sharing Directive, Ireland will have to purchase compliance from Member States who have overachieved on their annual targets. Currently, such carbon credits to purchase compliance are readily available. However, overachievement cannot be carried forward and, as Member States have more stringent 2030 targets, there is no guarantee there will be a surplus available for sale. Consequently, it is likely carbon credits will become increasingly expensive, thus increasing the cost of non-compliance significantly.

Ultimately, whether or not Ireland meets its emissions targets, this means that there will be a significant impact on the public finances.

13.2.5 Ireland's emissions profile

Ireland has a unique emissions profile that poses distinct challenges for reducing Ireland's GHG emissions (Ireland's GHG emissions profile by sector over time is illustrated in Figure 23). The agriculture sector is responsible for a greater proportion of Ireland's GHG emissions when compared to the EU or OECD average, while energy industries, manufacturing, construction and transport are responsible for slightly lower than average emissions, reflecting the fact that Ireland's economy tends to be more agricultural and services based than manufacturing based.[301]

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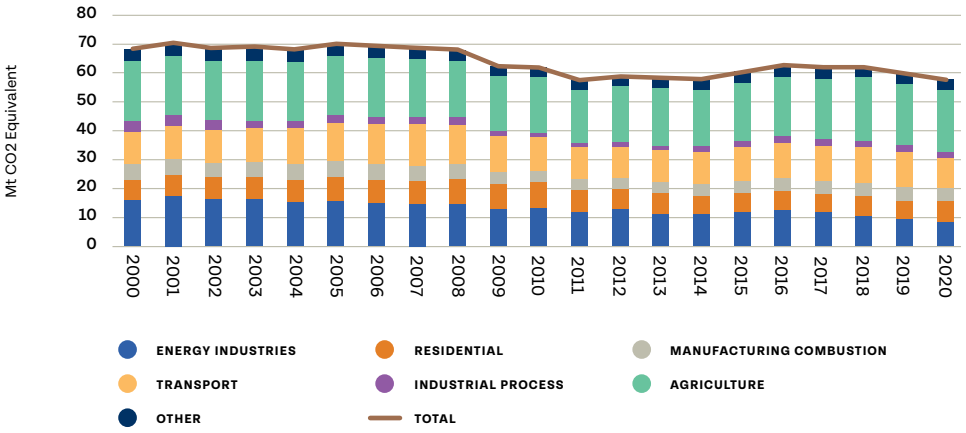
298 Comptroller and Auditor General (2019) Annual Report on the Accounts of the Public Services 2018, Chapter 9 "Greenhouse Gas Related Financial Transactions".

299 Debate of the 33rd Dáil Éireann, Proposal re Agreement with the Danish State on Statistical Transfer of Energy from Renewable Sources: Motion, (16 December 2020).

300 DPER (2020) Briefing Note: Compliance Cost associated with 2020 & 2030 Climate & Energy Targets.

301 OECD (2021) Environmental Performance Reviews: Ireland 2021, Eurostat and OECD Statistics.

Figure 23: Greenhouse gas emissions by sector, 1990 - 2020



Source: EPA

13.3 STRATEGIC APPROACH

13.3.1 The role of environmental taxes

While, as noted in the introduction, taxation is not the only policy lever available to achieve environmental policy objectives and to meet emissions reductions targets, the Commission recognises that it has an important role to play, in particular through incentivising behavioural change. Increased prices of high-emitting, environmentally harmful goods and services (through higher taxation and removal of tax expenditures) will reduce the demand for them. Additionally, on the supply side, taxation measures have the potential to stimulate investment in alternative, low-carbon technologies, particularly if there are clear and credible, medium-term policy approaches to give reasonable levels of certainty about the direction of travel in carbon pricing.

From an economic perspective, taxing environmentally harmful goods and services can internalise the cost of negative externalities.[302] These negative externalities are global in scale and serious in nature and include the effects of climate impacts, such as extreme weather

302 Metcalf, G.E. (2021) Carbon Taxes in Theory and Practice, Annual Review of Resource Economics 13:1, 245-265. O'Malley, S., Roantree, B., and Curtis J. (2020) Carbon Taxes, Poverty and Compensation Options, Dublin, ESRI.

events, desertification, rising sea levels, displaced populations, changes to the natural world, loss of biodiversity, and negative effects on human health, which are already starting to be experienced but are not fully reflected in the current market price.

Effectively, using carbon pricing to reflect the cost of negative externalities means that the price of those goods or services reflects the broader environmental and societal cost and negative impact beyond the individual (this is similar to the operation of 'sin taxes' on alcohol and tobacco).

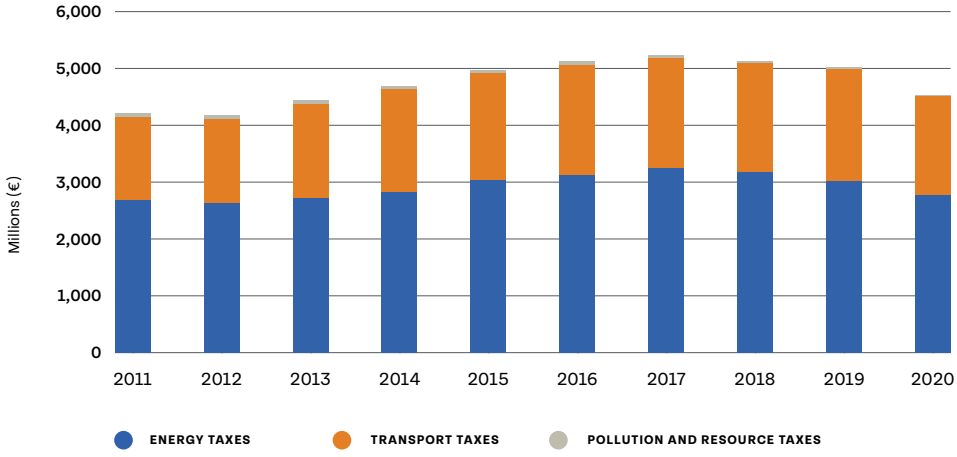
Carbon pricing is not just a matter of the level at which the Carbon Tax is set. Other embedded subsidies in the form of legacy tax expenditures (such as reduced rates of Excise Duty) must also be taken into account to better reflect the carbon impact. In order to achieve carbon reduction at the lowest possible cost, products should be taxed in proportion to the amount of carbon that they emit, i.e. the higher the level of carbon that is emitted, the higher the level of overall tax.

13.3.2 Fiscal sustainability

Notwithstanding the use of tax to change behaviour, environmental taxes as they currently exist, such as the Carbon Tax, Excise Duty on fuel, Vehicle Registration Tax (VRT) and Motor Tax, are important sources of revenue for the State. At present, they typically contribute approximately €5 billion annually of tax revenue and account for an average of just under 8 per cent of total tax revenue.[303] As described elsewhere in this report, this presents a significant risk to fiscal sustainability as the achievement of a low-carbon economy will naturally lead to lower revenues from these sources. Therefore, it is important to consider how these revenues can be replaced in an environmentally appropriate fashion.

303 CSO (2021) Statistical Release Environment Taxes. Commission on Taxation and Welfare Secretariat calculation based on CSO figures for total environmental taxes as a percentage of total tax revenue.

Figure 24: Total environmental tax revenue, 2011 - 2020



Source: CSO

13.3.3 Just transition

The Commission is conscious that the impact of moving to a carbon-neutral and climate-resilient society will not be the same for everyone. As environmental taxes are generally consumption taxes, the Commission also recognises that such taxes can be regressive in nature; and, even if such taxes are applied to the producer (generally a business), the incidence may end up falling on the end user or consumer.[304] Consequently, we are mindful that such taxes can impose a heavier burden on low-income households than on high-income households, as the former spend a larger proportion of their overall income on energy products. The Commission also notes that it is challenging for certain individuals and businesses to change their behaviour due to:

i. a lack of alternatives; or,

ii. a lack of means to afford the upfront investment required to avail of any available alternative options.

304 O'Malley, S., Roantree, B., and Curtis J. (2020) Carbon Taxes, Poverty and Compensation Options, Dublin, ESRI. Bruin, D. and M. Yakut (2018) The economic and environmental impacts of increasing the Irish carbon tax, ESRI Research Series 79, Dublin: ESRI.

The Commission supports the use of revenues from the increase in the Carbon Tax to help with the just transition and temporary measures to mitigate the impact of the increased Carbon Tax on those most vulnerable and least able to change their behaviour.[305] In the same vein, the Commission recommends that measures to address energy price and supply pressures should be targeted at the most vulnerable persons in terms of fuel and energy poverty rather than being provided as generalised supports.

Additionally, the Commission notes that the measures required to reduce carbon emissions, address climate change and achieve a green transition will necessarily result in changes to the nature of employment and what jobs and skills are required in the low-carbon economy.[306] Consequently, the Commission believes that education, retraining and reskilling will be crucial to assist individuals and businesses to adapt to and thrive in the new low-carbon and climate-resilient economy and society. The green transition will necessarily also influence the future of work.

The Commission welcomes the proposal in the Climate Action Plan 2021 to establish a Just Transition Commission to consider how to address these issues further.[307] In particular, we note the importance of ensuring that tax changes to support compliance with emission reductions targets are evaluated and implemented in a way that is fair and inclusive.

13.4 COMMISSION PROPOSALS

The Commission notes that there are a number of existing taxation measures in place related to climate and the environment. The main measures fall under Mineral Oil Tax (which is made up of two components - Carbon Tax and Excise Duty), Vehicle Registration Tax and Motor Tax.

The application of Excise Duty to products used for heating and transport, as well as electricity, is governed by the ETD. The ETD sets a minimum level of taxation that must be applied to energy sources, with

305 Department of Public Expenditure and Reform (2022) The Use of Carbon Tax Funds 2022.

306 McKinsey Sustainability (2020) How the European Union Could Achieve Net Zero Emissions at Net-Zero Cost.

307 Department of Environment, Climate and Communications (2021) Climate Action Plan 2021.

the aim of encouraging a low-carbon and energy-efficient economy.[308] Member States may design their own taxes within the framework of the ETD and can determine domestic rates, provided they meet the ETD minimum. This means that the rates of Excise Duty, in the form of Mineral Oil Tax (Carbon Tax and Excise Duty combined), applied in Ireland must be at least the minimum provided for by the ETD.

13.4.1 The Carbon Tax

The Carbon Tax was introduced in Budget 2010 following a recommendation of the 2009 Commission on Taxation.[309] The Carbon Tax price is applied on the basis of a monetary amount per tonne of carbon dioxide emitted and, consequently, it reflects the respective levels of emissions of different fuels. It is one of the key environmental taxation measures in Ireland and is set to increase to €100 per tonne of carbon dioxide emitted by 2030, with annual incremental increases to that level provided for in legislation.[310]

The Commission considered whether the rate of the Carbon Tax should be increased more quickly than is currently provided for, with the aim of achieving the intended behavioural change and associated emissions reductions sooner and potentially increasing the yield from the Carbon Tax more quickly. However, the Commission recognises that broad consensus and societal buy-in has been achieved in support of the current pace of increasing the rate of Carbon Tax up to 2030 and it is important that this be maintained.

Nevertheless, the current rate of Carbon Tax does not fully reflect and capture the entire cost in terms of emissions in the longer term.[311] Therefore, the Commission believes that the rate should be further

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308 For the purposes of the Energy Tax Directive (see Article 4 of the Directive) the 'level of taxation' relates to the total charge levied in respect of all indirect taxes (except VAT), calculated directly or indirectly on the quantity of energy products and electricity at the time of release for consumption.
Consequently, Member States should be permitted to comply with the Community minimum taxation levels by taking into account the total charge levied in respect of all indirect taxes which they have chosen to apply, excluding VAT.

309 Commission on Taxation (2009) Report of the Commission on Taxation. Finance Act 2010, No. 5 of 2010 Dublin, Stationery Office.

310 Schedule 2A Carbon Charge, Finance Act 2020, No. 26 of 2020, Dublin: Stationery Office.

311 World Bank (2022) State and Trends of Carbon Pricing 2022. State and Trends of Carbon Pricing, Washington, DC, World Bank. World Bank (2022) Carbon Pricing Dashboard, Washington, DC, World Bank.

increased after 2030 in order to help Ireland meet its net-zero emissions target by 2050 and better reflect the societal cost of carbon dioxide emissions. Furthermore, we believe that the level of the increase should be signalled in advance. This would provide certainty for individuals and businesses, enabling them to plan and adapt appropriately. Additionally, this timeframe should allow for the further development and availability at scale of viable and affordable alternatives.

Recommendation

13.1 The Commission recommends that the phased increase in the Carbon Tax to €100 per tonne of carbon dioxide emitted by 2030, as set out in the Schedule 2 to Finance Act 1999 (Mineral Oil Tax) as amended, is implemented. Increases in Carbon Tax after this date should be clearly signalled and linked to the societal cost of carbon.

13.4.2 Excise Duty on fuels

The Finance Act 1999 provides for the application of Excise Duty to specified mineral oils, such as petrol, diesel, and kerosene that are used as motor or heating fuels.

Excise duties are a particular form of consumption tax. Unlike the Carbon Tax, the rate of Excise Duty applied is not related to the level of emissions from the underlying fuel and, consequently, this distorts the carbon pricing mechanism of the Carbon Tax.

Table 27 shows the tax applied to selected fuels (these have been chosen on the basis of their general use by individuals and households).[312]

312 A complete list of the Rates of Mineral Oil Tax applied to all fuels is available on www.revenue.ie. This is updated on a regular basis.

Table 27: Tax applied to selected fuels (€ per 1,000 litres)

PRODUCT	FUEL EXCISE DUTY	CARBON TAX	TOTAL RATE OF MINERAL OIL TAX	VAT	ETD MINIMUM
Petrol	€371.11	€94.87	€465.98	23%	€359.00
Auto-diesel	€295.64	€109.74	€405.38	23%	€330.00
Marked Gas Oil ('green diesel')	€0.00	€111.14	€111.14	13.5%	€21.00
Kerosene (heating)	€0.00	€103.83	€103.83	13.5%	€0.00
Aviation Fuel	Exempt	Exempt	€0.00	Zero rated	Exempt

Source: Revenue Commissioners Excise Duty Rates (as at 1 May 2022)

As shown in Table 27, the rate of Excise Duty applied to auto-diesel is lower than that currently applied to petrol.

When introduced, the rationale for this lower rate of Excise Duty on auto-diesel was that businesses, particularly in heavy goods haulage, were reliant on diesel and had little or no alternative fuel source or transport modes available, and the lower rate was a policy measure intended to protect the competiveness of such businesses. However, in addition to assisting business, the policy of a lower rate of Excise Duty on auto-diesel had a significant impact on behaviour in terms of increased private use and ownership of diesel cars.[313]

While the lack of alternatives may remain an issue for business, the continuation of the lower rate of Excise Duty applied to auto-diesel is not justified from an environmental perspective or on public health grounds (diesel emits higher levels of Nitrogen Oxides (NO_X) compared to petrol).[314] Equalisation of the rate of duty with that applied to petrol has the potential to prompt investment in and the development of suitable alternatives for heavy commercial vehicles.

313 Department of Finance (2021) Tax Strategy Group Paper 21 - 09 Climate Action and Tax.

314 Department of Finance (2021) Tax Strategy Group Paper 21 - 09 Climate Action and Tax.

It is estimated that equalising the rate of Excise Duty on petrol and diesel could reduce Irish carbon emissions from diesel by up to 7 per cent.[315] The estimated yield from increasing the rate of Excise Duty applied to diesel to match the current rate of Excise Duty on petrol is an additional €400 million per annum (including both the additional Excise Duty and Value Added Tax (VAT) that would also arise but not accounting for any behavioural change).[316] Equalising the rate of Excise Duty on auto-diesel with petrol will also further remove the incentive for consumers to choose diesel cars.

The Commission is of the view that there is no policy rationale for the tax system to provide a preference for auto-diesel over petrol, particularly when a move away from both petrol and diesel cars to electric vehicles is both envisaged and encouraged. Additionally, at a European Level, as part of the ongoing Fit for 55 negotiations, the European Council (comprised of EU environment ministers) reached agreement to legislate for a ban on the sale of any cars and vans that are not zero-emissions from 2035 (this does allow for the possibility of the use of zero-emissions synthetic fuels as well as electric vehicles). There is a proposed 2026 review clause to assess the state of the motor vehicle industry at that point.

Recommendation

13.2 The Commission recommends the equalisation of the rate of Excise Duty on auto-diesel and petrol in the short to medium term.

Furthermore, the Commission takes the view that the unequal application of Excise Duty rates across fuel types undermines the policy objective of the Carbon Tax, which is to ensure that the price for the product reflects the levels of emissions of carbon from each fuel type and, consequently to encourage behavioural change to reduce emissions. The Commission considers that the rate of Excise Duty on any fuel, when combined with Carbon Tax, should reflect the relative amount of carbon dioxide emissions that each fuel generates. This would result

315 Morgenroth, E., Murphy, M. and Moore K. (2018). The environmental impacts of fiscal instruments, Dublin, ESRI and EPA.

316 Revenue Commissioners, Ready Reckoner (November 2021 - Post Budget 2022).

in more accurate, effective and robust carbon pricing.

13.4.3 Fossil fuel subsidies in the form of tax expenditures

Embedded and systemic reliance on fossil fuels, perpetuated through fossil fuel subsidies, is one of the most significant barriers to reducing emissions and transitioning to renewable energies. Fossil fuel subsidies, which have developed over time to assist with the cost of living and the cost of doing business, directly or indirectly subsidise the cost of fossil fuels. This is done either through providing tax breaks or direct payments towards the cost of their production, or by reducing the price of fuel below market rate for the end user. Consequently, such fossil fuel subsidies distort the price of carbon across fuel sources, undermining the aim and effectiveness of the Carbon Tax. Ireland is committed to phasing out inefficient fossil fuel subsidies under COP26.[317]

Ireland had the second largest share of fossil fuel subsidies as a proportion of GDP in the OECD in 2017.[318] Fossil fuel subsidies in the form of tax expenditures accounted for €2.1 billion in revenue forgone to the State in 2019.[319] In the same year, total fossil fuel subsidies were 4.8 times greater than Carbon Tax revenues.[320] In 2020, fossil fuel subsidies were an estimated €2.2 billion compared to €2.8 billion in value in 2019 and this decrease was largely due to the reduction in the consumption of fossil fuels used in transport, particularly aviation.[321] €2.8 billion of revenue was raised from energy taxes in 2020.

The Commission's focus here is on tax-related fossil fuel subsidies that take the form of tax expenditures, three of which are in the top ten tax expenditures by cost – the reduced rate of Excise Duty on kerosene, marked gas oil, and auto-diesel.[322] These tax expenditures are calculated on the basis that the rate of Excise Duty applied is lower than the benchmark of the rate of Excise Duty applied to unleaded petrol.

The main policy rationale for the introduction of these tax

317 United Nations Framework Convention on Climate Change (2021) Glasgow Climate Pact Cover Decision.

318 Bruin, D., Monaghan, E. and Yakut, M. (2019). The impacts of removing fossil fuel subsidies and increasing carbon tax in Ireland, ESRI Research Series 98, Dublin, ESRI.

319 CSO (2021), Statistical Release Fossil Fuel Subsidies 2019.

320 CSO (2021), Statistical Release Fossil Fuel Subsidies 2019. Department of Finance (2021) Tax Strategy Group Paper 21-09 Climate Action and Tax.

321 CSO (2022) Statistical Release Fossil Fuel Subsidies 2020.

322 Department of Finance (2021) Budget 2022 Report on Tax Expenditures.

expenditures was to provide support for individuals and sectors where there were no alternative, or no affordable alternative, options to heat their homes and run their businesses and, consequently, little or no ability for them to change their behaviour. However, it has been estimated that their removal could reduce economy-wide carbon dioxide emissions by 20 per cent by 2030 compared to a business-as-usual scenario.[323]

The Commission considers that these fossil fuel subsidies run contrary to the objective of reducing GHG emissions, and believes that they should be reduced and, ultimately, eliminated over time. We do, however, also recognise that there may be a case for supporting individuals, households and businesses in situations where the removal of these fossil fuel subsidies, such as on kerosene and MGO, would otherwise result in significant increases in cost where alternatives are not readily available or affordable.

The Commission also notes that the revised ETD proposes, among other things, that tax-based fossil fuel subsidies, including the exemption from taxation on commercial aviation fuel, be completely phased out over the period from 2023 to 2033, a move which we support.

Recommendation

13.3 The Commission supports the principle that embedded tax fossil fuel subsidies should be reduced on a phased basis over time, with the aim of ensuring that the taxation of fuel reflects the amount of carbon emitted. Those most environmentally harmful tax fossil fuel subsidies should be prioritised for early removal. Government should publish a roadmap by 2023 setting out ambitious targets for the elimination of subsidies by 2030.

323 ESRI, The Impacts of Removing Fossil Fuel Subsidies and Increasing Carbon Tax in Ireland (December 2019).

13.4.4 The taxation of electricity

Increasing the supply of renewable energy and encouraging electrification is a core element of environmental policy and of achieving emissions reduction targets overall. Renewable energy will enable the decarbonisation of a number of sectors, including transport and housing, through the increased electrification of those sectors.

Consequently, the Commission is very aware that the tax treatment of electricity has an important role to play in influencing the decisions of individuals and businesses and in incentivising the uptake of electric options, which is desirable from a climate perspective.

Ireland has a comparatively low rate of tax on electricity in the form of both Excise Duty and VAT.[324] Electricity is considered a service for the purposes of VAT in Ireland, whereas it is treated as a good by most other EU Member States. The VAT rate charged in Ireland on electricity usage generally is a standard reduced rate of 13.5 per cent as opposed to the standard rate of 23 per cent.[325] Additionally, there is an exemption from Excise Duty on electricity used by households.[326]

In the Commission's view, the low rate of taxation on electricity presents both an opportunity and a risk in terms of environmental tax revenues, and there is potentially scope to raise additional revenue through increasing the rate of taxation of electricity in the medium to longer term.

The proposed revision of the ETD provides for the introduction of a minimum rate of Excise Duty applied to electricity for non-business use of €0.57 per MWh from 2023 with this increasing to €0.67 per MWh in 2033, meaning that Ireland will not be able to retain the current exemption from Excise Duty on electricity used by households after this time.

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324 Department of Finance, Tax Strategy Group Paper TSG 21 - 09 "Climate Action and Tax" (September 2021) (referencing the Taxes in Europe Database).

325 At the time of writing, the rate of VAT applied to electricity has been temporarily reduced to the special reduced rate of 9 per cent as part of Government measures in respect of inflation.

326 Energy Tax Directive.

Recommendation

13.4 The Commission notes the changes at EU level in respect of the future taxation of electricity, including the anticipated mandatory application of a minimum rate of Excise Duty to electricity for household use. The Commission also recognises the need for the Exchequer to generate additional revenue from tax on electricity in the medium to long term (post-2030) to replace revenues from fossil fuels. The Commission recommends that any such increases should be carefully timed, clearly signalled in advance and should not act as a disincentive to the use of renewable electricity sources in carbon-intensive activities.

13.4.5 Vehicle Registration Tax (VRT) and Motor Tax

Vehicle Registration Tax (VRT) and Motor Tax on non-commercial vehicles are currently based on the levels of emissions. This reflects the fact that private motorists have more scope to change their behaviour and reduce their carbon dioxide emissions. Currently, commercial vehicles are taxed on the basis of weight.

VRT is a transactional tax that is applied on the purchase of a vehicle. The amount of VRT due is based on the levels of carbon dioxide emissions from the vehicle – the higher the emissions the higher the VRT. This creates an incentive for the purchaser to choose a lower-emission vehicle.

Motor Tax is an annual charge on motor vehicles registered in the State. Cars registered from July 2008 are taxed based on their carbon dioxide emissions level with rates ranging from €120 to €2,350, again providing a fiscal incentive to motorists to acquire lower-emitting vehicles.

The Commission recognises the importance of environmental tax receipts to the Irish Exchequer. It also recognises that one consequence of environmental taxes being successful in changing behaviour is that, without modifications, the revenue stream from taxing the undesirable behaviour may not be sustainable, as the desired behavioural change will result in a decrease in tax revenue.

To ensure the sustainability of tax receipts overall and Ireland's longer term fiscal sustainability, it will be necessary to find alternative sources of tax revenue.

The Motor Tax regime currently contributes the second largest source of environmental tax revenue to the State, after energy taxes. Accordingly the proposed scale of electrification of the national car fleet poses a significant Exchequer risk. If the Climate Action Plan 2019 target of 840,000 electric passenger cars on the road by 2030 is reached, the Exchequer will lose approximately €1.5 billion in revenue annually from Motor Tax, VAT, and Excise Duties on fuel combined.[327]

As the shift to electric vehicles is made in the medium to longer term, the Commission is conscious that the emissions-based nature of Motor Tax and VRT will no longer be a suitable or relevant basis on which to apply these charges to vehicles. However, a charge is still justified given the cost of maintaining road infrastructure, the environmental cost of the materials and resources used to manufacture the cars, and on the basis of maintaining tax revenues from vehicle usage.

Aside from the level of emissions produced by the vehicle, alternative criteria to use as a basis for the application of VRT and Motor Tax on vehicles include the value of the vehicle, the energy efficiency of the vehicle or the application of a flat charge.

Consideration should also be given to reforming VRT and Motor Tax for commercial vehicles in order to strengthen the link between these taxes and the emissions from such vehicles. Providing for emissions-based taxation of commercial vehicles would constitute an important incentive to develop low emitting alternatives to the current diesel-run commercial vehicles.

The taxation of motor vehicles should differentiate between purchase, ownership and usage of vehicles. This approach allows for the application of a low rate of tax in each case as well as capturing a broader base. For example, VRT is a once-off tax on the purchase of a vehicle and can be used to influence consumer choices, Motor Tax is a recurring annual tax on the ownership of a vehicle.

The proposed introduction of new road usage charges as recommended by the Commission is outlined in section 13.4.6. This is intended to maintain tax revenue from motor vehicles and road usage as well as influence behaviour.

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327 DPER Spending Review 2019, Incentives for personal Electric Vehicle Purchase (August 2019) and see also Parliament Budgetary Office, An Overview of Electric Vehicles and their Impact on the Tax Base (2021).

Recommendation

13.5 The Commission recommends that Motor Tax and Vehicle Registration Tax on commercial and non-commercial motor vehicles be redesigned in the medium to long term, in a manner that is consistent with environmental objectives and ensures that tax revenues from motor vehicles are maintained.

13.4.6 Road usage charges

Currently, road usage is effectively taxed through Excise Duty on fuel. However, with the intended move to electric vehicles, new charges on usage are envisaged by the Commission. The intention of these charges is to:

- discourage driving where possible and where alternative transport options exist,
- capture the negative externalities of driving and congestion, and
- raise revenues to fund investment in road and other transport infrastructure.

Road usage charges are generally applied based on the distance driven, with the level of charge also ideally dependent on the location and time of driving. They may be applied to either passenger vehicles or commercial vehicles, or both.

Tolls are one example of road usage charging that is already in place in Ireland (however, in many cases the toll fees go to privately-owned firms rather than to the Exchequer).

From a technical perspective, there are a number of ways to calculate road usage charges:

- Odometer readings of the vehicle.
- Automatic vehicle identification devices (such as those used by speed cameras).
- Equipping on-board units in cars with a GPS chip (which can calculate the distance as well as the actual road that has been travelled on).
- Use of a mobile application and mobile GPS system for older cars.

While this technology already exists and is in use, albeit for other purposes, the Commission notes that there may be taxpayer confidentiality and data protection issues that would have to be appropriately addressed as part of designing and implementing road usage charges.

A number of EU Member States including Belgium, Estonia, Hungary, Lithuania and Sweden, already have road usage fees in place.[328]

There is an environmental rationale to road usage charges, whereby the greater the distance that is travelled, the more GHG emissions will be released by a vehicle. However, there is also a non-environmental policy rationale for road usage charges that will remain valid, even when the majority of vehicles are electric and low- or zero-emitting, not least because electric vehicles are in general heavier than similar-sized internal combustion engine vehicles. Similar to VRT and Motor Tax, road usage charges can contribute to the cost of building and maintaining road infrastructure, and can also be used to address other well-recognised negative externalities associated with road usage.

Recommendation

13.6 The Commission recommends the introduction, in the medium term, of distance, location and time-based road usage charges. Planning for such charges should include early identification of the appropriate technology to be used in calculating and applying them.

13.4.6.1 Congestion charges

Pending the rollout of distance, time and location-based road usage charges, which will need time to develop and implement, congestion charges should be introduced in certain urban areas.

Congestion charges or congestion pricing is a surcharge on the use of roads, particularly in cities. Many cities such as London, Stockholm and Milan apply such charges. In London, for instance, a congestion charge is applied at a daily rate of £15 for cars driving in the congestion

328 See the European Environment Agency, EEA database on greenhouse gas policies and measures in Europe and the European Automobile Manufacturers' Association (ACEA) Tax Guide 2022.

charge zone and yields around £232 million per annum.[329]

Congestion charges are intended to change behaviour and reduce the amount of cars and, consequently, congestion in urban areas and to encourage the use of alternatives, such as public transport. The environmental rationale for congestion charges is the reduction of GHG emissions and air pollution from cars by discouraging their use in specific areas.

However, there is also a wider, non-environmental policy rationale for congestion charges that will remain valid, even when the majority of vehicles are electric and low- or zero-emitting. Congestion has been shown to have a significant cost as well as having a negative impact on people's quality of life, particularly when experienced as part of a regular commute to work.[330] Congestion charges can also promote public health through improving air quality, as well as encouraging more active forms of transport such as walking and cycling. In addition, they reduce well-recognised negative externalities such as noise pollution and road traffic collisions.

In conjunction with congestion charges, and to facilitate a viable and meaningful change in behaviour and reduction in emissions, the Commission is of the view that alternatives to driving should be improved, including improved public transport services and easier, more accessible and safe options for cycling and walking for undertaking shorter journeys.

As road usage charges are introduced, congestion charges should be re-examined with a view to incorporating and integrating them into the location-based element of road usage charges. This would also simplify the taxation of road usage overall.

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329 London Assembly Question: https://www.london.gov.uk/questions/2021/0586 https://www.london.gov.uk/questions/2021/0586.

330 See the Department of Transport, Tourism and Sport, Cost of Congestion Report (July 2019), European Commission, Internalisation of transport external costs (that estimates a cost of €14.3 billion or 5.7% of GDP for total external costs of road transport, primarily due to congestion), EU Quality of Life Survey 2016, and Department of Transport, Five Cities Demand Management Study (November 2021).

Recommendation

13.7 The Commission recommends the introduction of congestion charges in key urban areas, based on a number of key metrics linked to environmental and individual impact. These charges should be reviewed following the introduction of road usage charges.

13.4.6.2 Car parking duty

The availability of car parking, particularly in urban areas, is a factor that influences the number of cars that travel into and use such areas.

In the case of private car parks, car parking charges are determined by the owner of the car park.

There is also public parking, which is provided by local authorities. For example, in Dublin city, public parking is determined by Dublin City Council and is zone-based with different charges for different zones.

The Commission considers that an additional car parking duty should be introduced, which could be combined effectively with congestion charges to strengthen the disincentive to drive a vehicle into urban areas where alternative transport options are available.

In addition, where car parking facilities are provided by an employer to employees in those areas, steps should be taken to ensure that the cost of the duty is borne by the employee and that no deduction should be allowed for the employer.

Recommendation

13.8 The Commission recommends the introduction of an additional duty on non-residential car parking, both public and private, and not limited to employer-provided car parking in the same key urban areas identified as suitable for congestion charges.

13.4.7 The role of tax expenditures

While recommending the careful removal of fossil fuel subsidies in the form of tax expenditures as outlined in section 13.4.3, the Commission recognises that tax expenditures can play a positive role in achieving emissions reductions targets by providing an incentive to take up more

environmentally friendly, lower-emitting alternatives.

Consequently, in recognition of the role that environmental taxes have in changing behaviour, the Commission supports the limited and focused use of tax expenditures to incentivise the uptake of and investment in low-emitting technologies (such as those in place for electric vehicles) in the short term in order to help to achieve the necessary emissions reductions. The Commission also notes that direct expenditure and regulation, amongst other policy levers, will also have a vital role to play in reaching net-zero emissions.

Recommendation

13.9 The Commission accepts the rationale for the use of targeted taxation expenditures to support the achievement of Government policy goals with respect to decarbonisation, and to address the gap between the upfront costs of investment and the timeframe for return on same. Such measures should have a clearly identified policy objective, be targeted in nature, and be in place for a limited period to help influence the behavioural change required.

The Commission is also aware that there are a number of additional tax reliefs and expenditures which, while in place for a number of policy reasons, may be of concern from a broader environmental perspective. While due to the nature of our terms of reference, detailed examination of such expenditures is outside of our remit, in line with our recommendations in Chapter 16 (Tax Expenditure Review Process), we consider that it is important that a robust review is undertaken of those expenditures. Furthermore, we believe that any proposed new expenditures are reviewed in advance to ensure that they are not contrary to environmental objectives.

13.5 RECOMMENDATIONS

Chapter 13: Moving to a Low-carbon Economy

13.1	The Commission recommends that the phased increase in the Carbon Tax to €100 per tonne of carbon dioxide emitted by 2030, as set out in the Schedule 2 to Finance Act 1999 (Mineral Oil Tax) as amended, is implemented. Increases in Carbon Tax after this date should be clearly signalled and linked to the societal cost of carbon.
13.2	The Commission recommends the equalisation of the rate of Excise Duty on auto-diesel and petrol in the short to medium term.
13.3	The Commission supports the principle that embedded tax fossil fuel subsidies should be reduced on a phased basis over time, with the aim of ensuring that the taxation of fuel reflects the amount of carbon emitted. Those most environmentally harmful tax fossil fuel subsidies should be prioritised for removal along with those for which viable alternatives exist. Government should publish a roadmap by 2023 setting out ambitious targets for the elimination of subsidies by 2030.
13.4	The Commission notes the changes at EU level in respect of the future taxation of electricity, including the anticipated mandatory application of a minimum rate of Excise Duty to electricity for household use. The Commission also recognises the need for the Exchequer to generate additional revenue from tax on electricity in the medium to long term (post-2030) to replace revenues from fossil fuels. The Commission recommends that any such increases should be carefully timed, clearly signalled in advance and should not act as a disincentive to the use of renewable electricity sources in carbon-intensive activities.

13.5 The Commission recommends that Motor Tax and Vehicle Registration Tax on commercial and non-commercial motor vehicles be redesigned in the medium to long term, in a manner that is consistent with environmental objectives and ensures that tax revenues from motor vehicles are maintained.

13.6 The Commission recommends the introduction, in the medium term, of distance, location and time-based road usage charges. Planning for such charges should include early identification of the appropriate technology to be used in calculating and applying them.

13.7 The Commission recommends the introduction of congestion charges in key urban areas, based on a number of key metrics linked to environmental and individual impact. These charges should be reviewed following the introduction of road usage charges.

13.8 The Commission recommends the introduction of an additional duty on non-residential car parking, both public and private, and not limited to employer-provided car parking, in the same key urban areas identified as suitable for congestion charges.

13.9 The Commission accepts the rationale for the useof targeted taxation expenditures to support the achievement of Government policy goals with respect to decarbonisation, and to address the gap between the upfront costs of investment and the timeframe for return on same. Such measures should have a clearly identified policy objective, be targeted in nature, and be in place for a limited period to help influence the behavioural change required.

Chapter 14:
Land and Property

14.1 INTRODUCTION

The Commission has been tasked with looking at the role of the tax and welfare systems over the medium to long term, with particular regard to the role these systems have in achieving housing policy objectives. Specifically, the terms of reference ask the Commission to:

> "*consider the appropriate role for the taxation and welfare system, to include an examination of the merits of a Site Value Tax, in achieving housing policy objectives. This consideration should include reviewing the sustainability of such a role. It should also have regard to the experience of previous interventions in the housing and construction market and the current significant State supports for housing provision.*"

In the decade following the financial crisis, Ireland has experienced historically low levels of housing supply and increasingly unaffordable housing costs, in terms of both rents and house prices, which have risen by 86 per cent and 118 per cent, respectively, since 2013.[331] Many factors have contributed to increased housing costs. Supply has been sluggish in part because of structural issues relating to input costs and viability, financing, planning and land use, while demand has been strong as a result of low interest rates, strong income growth, falling headship rates and an increasing population. This has resulted in a high degree of pent-up demand for housing on top of future housing needs relating to changing demographic trends.

331 Central Statistics Office and Residential Tenancies Board; as of July 2022.

In its Housing for All strategy,[332] the Government has signalled that there will be a need for 33,000 homes to be delivered per annum on average between now and 2030. Other estimates report the need for as many as 50,000 homes per annum between now and 2050.[333] While prices and rents continue to grow year-on-year, residential unit commencements have increased steadily since 2015, albeit from a low base. With the sector having rebounded from the pandemic restrictions, commencements in 2021 amounted to just over 30,000 units[334] and the Central Bank forecasts housing completions to reach 33,000 by 2024. However, cost inflation, rising interest rates, supply chain disruptions and labour supply challenges in the construction sector could have an impact on these forecasts.[335]

The Government's Housing for All strategy commits to investment in housing of over €4 billion per year to 2030, targeting the building of 300,000 homes over the decade, of which just under half will be cost rental, social and affordable purchase homes. Of relevance to the Commission's work, the strategy commits to the introduction of a Zoned Land Tax, a land-value uplift mechanism and the collection of data on vacancy with a view to introducing a vacant property tax.

This chapter sets out the recommendations of the Commission in relation to achieving housing policy objectives, and the taxation of immovable property (land and buildings) generally.

14.2 COMMISSION OBJECTIVES

In considering its work in this area, the Commission has developed a number of objectives that have guided its deliberations.

Firstly, the Commission firmly supports the adoption of a long-term, sustainable approach to taxation in the property market. Specifically, the Commission recommends an approach that looks beyond discretionary and reactionary tax measures, aimed at stimulating responses at specific points in the property market cycle, toward a transparent and stable tax policy that acts to stabilise prices, encourages the efficient use

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332 Department of Housing, Local Government and Heritage, Housing for All - a New Housing Plan for Ireland, September 2021.

333 Ronan Lyons, Identify Consulting, Institutional Investment and the Private Rental Sector, 2021; Central Bank of Ireland, Population Change and Housing Demand in Ireland, 2019.

334 Department of Housing, Local Government and Heritage – Commencement Notices, 2022.

335 Central Bank of Ireland, Quarterly Bulletin Quarter 2 2022, April 2022 .

of land and property and collects a stable and relatively acyclical revenue stream to fund future public services. In line with this approach, the Commission does not support tax expenditures or measures aimed at the short-term stimulation of construction activity in the property market.

This view is largely informed by past experience of interventions in the market, particularly in the decade prior to the financial crisis. While many tax incentives may have achieved their intended outcomes, i.e. delivered an increase in the construction activity sought in certain areas, the Commission is of the view that many previous interventions were ultimately damaging and had a number of long-term negative impacts on the sector. Tax incentives were generally introduced in a manner that was not time-bound, contributing to cost inflation and, ultimately, contributing to higher prices and often a misallocation of construction activity toward areas where there was less need for such construction. This also led to a significant transfer of public funds to private construction for activity that would likely have occurred in any case.[336] On the other hand, the Commission believes that, among other advantages,[337] a long term and permanent shift towards recurring property taxes can act to reduce price volatility in land and property markets over the long run.

Secondly, tax measures that lead to increased demand in a market where demand already outstrips a constrained supply only leads to further increases in prices and should be avoided. Research has shown that increased demand in a market with inelastic supply can lead to further price growth in areas where supply is particularly constrained, the beneficiaries of which are the land owners and developers at the expense of forgone revenues.[338]

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336 See ESRI, Tax Breaks and the Residential Property Market: ESRI tax breaks, 2015; Indecon – Budget 2006: Review of Tax Schemes, 2005; Regling, K. and Watson, M, A Preliminary Report on the Sources of Ireland's Banking Crisis, 2010; OECD, Ireland's Housing Boom: what has driven it and have prices overshot?, 2006.

337 OECD, The Stabilisation properties of immovable property taxation, 2015; IMF, Can Property Taxes Reduce House Price Volatility?, 2016.

338 ESRI, Tax Breaks and the Residential Property Market: ESRI tax breaks, 2015, page 9. See also evidence from the Centre for Economic Performance (2020) on a similar demand-side scheme in the UK (Help-to-Buy equity loan scheme), where increased construction occurred only in locations where house prices were relatively affordable, while leading to increased house prices in London with no evidence of increased supply.

The Commission has also considered the role of the tax system in supporting different housing tenure types. While the Commission recognises the role Government policy can play in widening access to home ownership, particularly in light of emerging trends in overall levels of home ownership, the Commission nonetheless recommends that the tax system should be neutral in its treatment of taxpayers who rent or purchase their homes. The Commission recognises the different tenure needs across society, with different tenure types suiting different people at various points in their lives, or depending on their ability to pay. Tax measures should not confer preferential treatment to one tenure type over another and any future Government supports in this area should be provided outside the tax system.

Recurrent taxes on immovable property (i.e. land and buildings) involve the annual taxation on either rents associated with, or the value of, the property. The Commission fully endorses the recurrent taxation of property from the perspective of revenue stability (as revenue streams are less cyclical), while also being less distortionary than taxes on the transfer of property. Similarly, recurrent taxation of property can help reduce inequality and is considered the most efficient form of raising revenues, as it does not impact on economic activity to the same extent as other taxes.[339] These arguments are covered in more detail in Chapter 5 (Balance of Taxation) and Chapter 7 (Taxes on Capital and Wealth). Such taxation should apply to the property owner and the rate should not deviate across locations. Exemptions and special rates should be kept to a minimum.

339 Taxing land is equivalent to taxing an economic rent. See Mirrlees et al., (2011) for more information.

14.2.1 Existing recurrent taxes on immovable property

There are two main recurrent taxes on immovable property in Ireland:[340]

1. Commercial Rates

Commercial rates are an annual charge levied on business-owners based on the rental valuation of the premises. Local authorities administer the charge and set the rate of valuation on an annual basis. In its latest full year of collection,[341] Commercial Rates revenues amounted to €1.43 billion. Revenues averaged €1.35 billion in the previous six years, with revenues increasing steadily since the financial crisis.

2. Local Property Tax (LPT)

LPT is an annual tax on the self-assessed market value of residential properties. It is centrally administered by the Revenue Commissioners (Revenue). Tax revenues from LPT amounted to €552.2 million in 2021.[342]

Box 4 shows the share of revenues that comes from immovable property in Ireland and in an international context. While Ireland sits in the middle of OECD countries in terms of its share of taxes coming from recurrent taxes on immovable property, it only collects one in every 40 euro from such sources; countries such as the US, UK and Canada collect roughly one in every ten euro in revenues from recurring immovable property taxes.

Box 4: Recurrent immovable property taxes in an international context

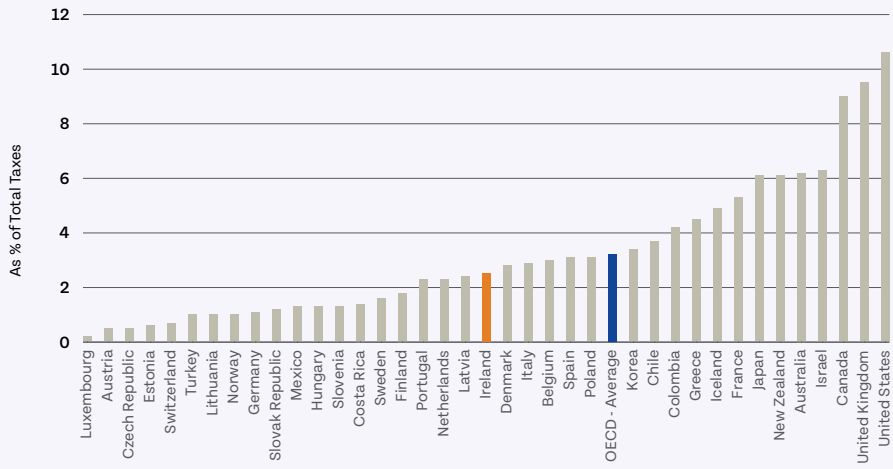
Taxation of immovable property varies considerably across OECD countries, ranging from 0.16 per cent of total taxes in Luxembourg to 10.6 per cent in the US in 2019. Ireland sits mid-table in terms of the tax burden on immovable property on a recurrent basis or 16th highest. As a share of total Irish revenues in 2019, recurrent taxes on immovable property account for 2.4 per cent of total revenues (or €1.93 billion).

340 Currently, the Vacant Site Levy is a recurrent charge on the market value of sites on the local authorities' vacant site register; however it is to be replaced by the Zoned Land Tax in 2024.

341 2019 was the latest full year of collection. Commercial Rates were waived in 2020 and 2021 for businesses substantially impacted by Covid-19 restrictions.

342 Revenue, LPT Statistics 2021, 6 January 2022.

Figure 25: Recurrent taxation of immovable property in the OECD, 2019



Source: OECD
Note: Recurrent taxes on immovable property are defined as 'taxes levied regularly in respect of the use or ownership of immovable property (land and buildings)'. Total taxes include social security contributions.

Countries such as Austria, Luxembourg and the Czech Republic collect a very low share of tax revenues via recurrent immovable property taxes; the opposite is the case for the United States, United Kingdom, Canada, Australia and New Zealand. Unlike the latter-named countries, Ireland derives a relatively low share of the taxes from immovable property on a recurrent basis. In a European context, Ireland has the 11th highest recurrent immovable property tax burden in the EU-28. As a share of national income, these tax revenues account for 0.9 per cent of GNI*, also below the OECD average of just over 1 per cent of GDP.

As discussed in Chapter 7 (Taxes on Capital and Wealth), the Commission believes that recurrent taxation of property and land can serve as an effective form of partial wealth tax. The majority of the value of wealth in Ireland is held in the form of immovable property, accounting for 74 per cent of gross wealth of all households in 2020. The household main residence, other real estate and land each make up 30 per cent, 18 per cent and 17 per cent (i.e. a total of 65 per cent) of the gross wealth of the richest ten per cent of households.[343] The burden on asset-rich but cash-poor individuals can be alleviated by allowing

343 CSO - Wealth, Household Finance and Consumption Survey 2020, 2022.

deferrals of payments, while the progressivity of property taxes can be calibrated through the number and level of rates.

As regards the private rental market, the Commission is of the view that supports for renters are best provided through the social welfare system, Approved Housing Bodies and local authority measures, rather than via the tax system. Eligibility criteria for such supports are mainly based on need as well as household income and, therefore, are better targeted than tax credits or other tax supports, which are available on a broader basis.

14.3 SITE VALUE TAX (SVT)

The Commission is recommending the introduction of a Site Value Tax (SVT) on all land currently not subject to the Local Property Tax (LPT). This includes all commercial (developed and undeveloped), mixed-use, agricultural and undeveloped zoned residential lands, and State-owned lands, as well as all land on which derelict and uninhabitable premises sit. Through the introduction of SVT, the Commission also recommends that the present system of Commercial Rates can be replaced with a modern system of taxation for non-residential property.

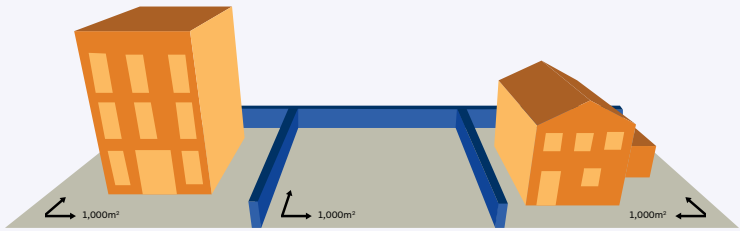
14.3.1 Merits of a SVT

A Site or Land Value Tax is an annual tax on the undeveloped value of a given area of land. Unlike LPT, which applies to a residential property and surrounding land up to one acre, a SVT does not take account of the building on the land, but merely the underlying site value. The value of a site is determined primarily by its location and, secondly, by its planning designation.

For example, land in a city or large town with potential for development is of higher value than a similar sized plot in a rural village. Similarly, a zoned residential plot of land generally attracts a higher site value than a similarly sized commercial plot in the same location, as demand tends to be higher for the former given its potential for residential development. The owner of a property benefits from increased public investment in schools, transport links and parks and from being located in large employment and commercial centres. The value of land can increase based on the contributions of society, irrespective of any effort exerted by the landowner.

Box 5: Application of a SVT: worked example and wider implications

The following illustration presents a simplified example of how a typical SVT would apply across various property types. Property A is a three-storey derelict property, Property B is an undeveloped plot of land and Property C is a two-storey active business. All three sites are zoned for commercial use. As the value of a site is determined by locational factors and zoning designations alone, the SVT is a pure tax on the estimated value of the undeveloped site. Consequentially, the status (whether vacant, derelict or active) and value of the buildings (height, age, materials used, etc.) on the land make no difference to the liability ultimately paid.



Property A: Derelict | Property B: Undeveloped (empty) plot | Property C: Trading grocery store

Calculating the liability

The liability of Property A, which is paid by the landowner, is calculated as follows:

1. The per square metre site value for the location is multiplied by the area of the parcel of land (1,000 m^2 for Property A).
2. Property A's site value is then multiplied by the tax rate to get the final liability.

Given that the sites in our example are in the same geographical location, are all zoned for the same use and are all the same size by square metre area, the liability would be the same for Properties A, B and C.

Implications of efficient land use

A SVT would present a significant change from how property taxes are typically applied both in Ireland and internationally. Typical, property taxes (such as the LPT and Commercial Rates) are associated with

the market value (and the closely related rental value) of the property, which comprises the building and the undeveloped land component. As such, market value represents, to an extent, the value-added of the location in which the property is situated. However, such taxes may discourage the development of land in an efficient manner. The landowners of Properties A and B (above) face little incentive to bring their sites into active use as dereliction and under-utilisation are not subject to an effective property tax. Under a SVT, efficient land use is not discouraged, as a landowner who invests in their property does not face the prospect of a higher tax charge on doing so; on the contrary they are incentivised to do so by the SVT, which applies to all land regardless of use. However, encouraging efficient land use presents a number of issues that the Commission has considered in its deliberations:

- A landowner of a site on which a low-rise building sits would face a similar tax bill to an adjacent identical site on which a high-rise building sits. While this encourages more efficient use of land, it would likely lead to distributional changes and may lead to concerns around fairness. A SVT would best be introduced on a graduated basis to ensure that taxpayers would not face any sudden increase in liabilities.
- In theory, a SVT would encourage denser premises which may result in more high-rise development of buildings generally. This could act to reduce land and property prices, while leading to more compact construction and less dereliction and vacancy. Planning laws, however, will ultimately dictate land use in accordance with economic, environmental, cultural and societal strategies.
- A site value is not as easily ascertained as a market value, as sites on which buildings sit are not traded without also including the building that is built on the site. As such, taxpayers may find it difficult to understand how their liabilities are calculated. As such, methods of site value estimation would have to be clearly communicated.

In its deliberations, the Commission considered these issues in the round and concluded that the potential benefits of a simple, efficient and equitable tax based on the site value outweighs the potential costs and implementation challenges.

The recurrent taxation of the pure value of land has many theoretical advantages over other taxes. These include:

1. *Housing objectives:*

The recurrent taxation of land reduces the incentive to retain ownership of land in anticipation of higher prices as it places an annual tax on its value. It encourages the development of undeveloped land by reducing its net present value (the sum of discounted net future revenue streams),[344] while encouraging the activation of derelict or uninhabitable property by creating an increased opportunity cost to the landowner for choosing not to invest in or sell the property. Land prices are highly volatile as land is a uniquely fixed and inelastic resource unlike any other, and volatility in property markets are largely driven by increased demand for the uniquely scarce resource that is residential land.[345] Land currently accounts for the single largest input in the cost of construction, with land and acquisition costs making up 16 per cent of the cost of a three-bedroom semi-detached house[346] and 11 per cent of a two-bedroom apartment on average.[347]

2. *Efficiency:*

Recurrent taxation of land does not have an impact on its supply as land cannot be withdrawn from the market in any practicable way. Labour and capital can be moved across borders easily, while land and buildings cannot. The taxation of land in particular is a preferable form of property taxation from an efficiency perspective, as it does not discourage development of the property. Taxes on the market value of residential and commercial properties can act as a disincentive to invest in the property, as the liability increases with market value.

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344 See evidence of this effect in Denmark – Hoj A. et al., Land Taxes and Housing Prices, 2017.

345 See land and house price volatility in the UK (no such data exists for Ireland): Chesire P., Urban containment, housing affordability and price stability, 2009.

346 SCSI, Real cost of housing of new housing delivery report 2020, 2020.

347 SCSI, Real cost of new apartment delivery report, 2021.

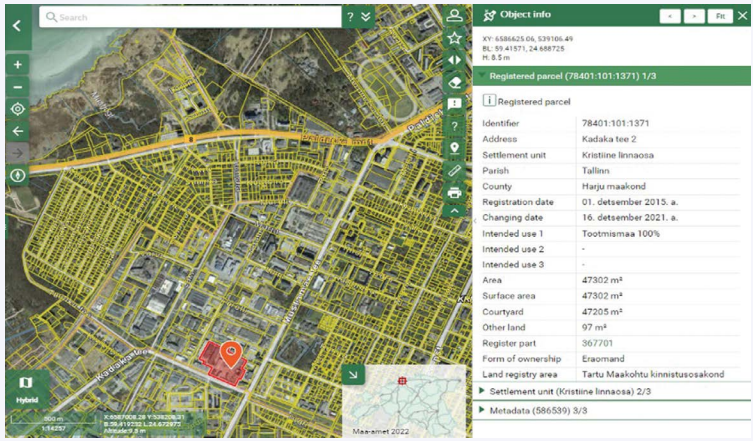
3. *Sustainability:*
As the taxation of land is inelastic, it is a relatively stable and reliable tax base. Recurrent taxation of land and property is less procyclical than transactional taxes on property and many other non-property related taxes such as income and corporation taxes.

4. *Equality:*
As the efforts of society can add to the landowner's wealth (through public investment in infrastructure etc.), an annual tax on the value of the land can be used to return this increased value to the community. With the introduction of a SVT, land faces a recurring tax on its value and relatively more productive assets (that do not face such a charge) become more attractive from an investment perspective. Additionally, the vast bulk of the value of wealth in Ireland is held in the form of immovable property in Ireland.

While virtually all OECD countries levy some form of a property tax, there are limited examples of jurisdictions that apply a pure land or SVT. In Europe, Denmark and Estonia levy land value taxes (see Box 6), while Pennsylvania in the US and New South Wales in Australia apply variations of land value taxes. Many countries in the OECD, including Austria, Belgium, Germany, New Zealand and Japan, levy recurrent agricultural land taxes, with the majority giving preferential treatment in some form.

Box 6: Estonia's land tax

Estonia introduced a site/land value tax in 1993,[348] with land valuation based on the undeveloped value of residential, agricultural and commercial land without regard for any buildings on the land. Valuations are carried out by a central valuation authority that utilises data provided by national and local government agencies.



Detailed maps of the area of parcels of land are collected and are publically available. Land valuations occur regularly and land values vary across districts. The tax rate is set by municipal councils and must be between 0.1 and 2.5 per cent. Estonia typically collects just 0.6 per cent of total tax and social security revenues from its land tax, or €59 million in 2021.[349]

14.3.2 SVT and residential land

While the Commission debated the merits of including developed residential property within a wider SVT system, it was ultimately decided that the LPT system currently in place, while not perfect, achieves many of the policy objectives sought, represents a fair approach to raising taxes from residential property and is generally well-understood by the public. In addition, given that LPT represents recurrent tax paid for the provision of local services available to homeowners, there is a case that there should be some level of recurrent tax on the

348 Emta.ee; Land Tax Act.

349 Stat.ee.

improved value of residential property. Therefore, the Commission recommends the retention of the existing LPT system, subject to the related recommendations set out in section 14.4. The Commission does not propose to replace LPT with SVT over time.

The concept of a Site Value Tax is generally understood to encompass all types of land, including residential land. Therefore, while we use the term 'Site Value Tax' throughout this chapter, an alternative name, such as a Land Value Tax, may be more appropriate given the exclusion from our proposal of developed residential sites subject to LPT.

14.3.3 The Commission's proposed SVT

The Commission is recommending the introduction of a Site Value Tax (SVT) on all land currently not subject to Local Property Tax (LPT). This includes all commercial (developed and undeveloped), mixed-use, agricultural, undeveloped zoned residential lands, and State-owned lands as well as all land on which derelict and uninhabitable premises sit. The key features can be summarised as follows:

- The tax would be levied annually on the owner of the land, with the owner required to pay the liability.
- The tax base would be the unimproved value of land i.e. the site value without regard to buildings or other structures on the land.
- The tax would be centrally administered by Revenue, and the Valuation Office would conduct site valuations.
- The rate (or rates) would be nationally set and administered to avoid rate differentials across county borders.
- The SVT would replace Commercial Rates and other immovable property-related levies and taxes (for example the Derelict Site Levy). The Commission supports the policy rationale behind the new Zoned Land Tax and believes that there is merit in this tax being subsumed into the SVT over time, resulting in a single tax on land. The SVT could exist alongside the proposed land-value uplift mechanism from Housing for All.
- A higher tax rate would apply to socially suboptimal use of lands, such as undeveloped zoned lands suitable for residential use.
- There should be differential treatment for the application of SVT to

agricultural land.[350]

- Other types of land may also warrant special treatment, such as mixed-use lands and lands used for conservation, recreational, charitable and community purposes.
- Exemptions from the tax should be minimal as a principle (for example, all State-owned land would be subject to the tax).
- Income deferral thresholds should apply where the owner has limited means to pay.

A SVT apparatus would involve significant upfront costs and would take a number of years to implement. However, the Commission believes that the potential long-run benefits of the tax would far outweigh these initial implementation challenges.

Due to current data limitations and pending full analysis of the impact of the transition away from the existing Commercial Rates system, the Commission is not recommending a specific rate (or rates) of tax that would apply to the SVT. It is recommended that, over time, the SVT should collect overall revenue well in excess of what is currently collected from Commercial Rates and other existing taxes in this area.

Currently, revenues from Commercial Rates and LPT are distributed to local authorities based on where properties are located. The Commission's terms of reference do not extend to consideration of local authority financing and we do not have a strong view on how revenues from a SVT should be utilised. Ultimately, the Commission is recommending that overall revenues from recurrent taxes on property increase significantly over the medium term and should materially exceed existing revenues from Commercial Rates in time. It will be a matter for consideration by Government as to where such revenues should be directed to best meet future financing needs, including the long-term funding of local government.

14.3.3.1 Scope

The Commission is of the view that all land should ultimately be subject to some kind of recurrent tax and recommends that the base for SVT should be as broad as possible. The Commission's proposed SVT would apply to all land, other than developed residential property currently subject to LPT.

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350 For the purposes of this Chapter, agricultural land encompasses lands also used for commercial forestry.

Primarily, land is a uniquely scarce resource that should be put to its most efficient use, within the constraints of planning regulations. In the absence of a SVT, sites of all types present passive investment opportunities that do not necessarily benefit society.

Taxing all land also reduces horizontal inequities stemming directly from commercial decisions as to how land is utilised. Similarly, the Commission recommends that all State-owned lands and land owned by non-governmental organisations should come under the charge to tax in the interest of encouraging efficient use of land by all landowners. While the State effectively paying itself may seem circular, it would better demonstrate the opportunity cost to society (and potential revenues) of State-bodies' decisions as to how land is utilised.

The Commission believes that taxing one form of land and not another would distort investment toward land with no recurring tax. For example, the taxation of zoned residential land alone would reduce the incentive to invest in such land, while increasing the relative incentive to speculate in land that investors believe may become zoned residential in the future or in commercial land instead.

The Commission is of the view that there are only limited circumstances where different treatment may be warranted and that exemptions from SVT should be extremely rare. These limited exceptions are considered further in section 14.3.5.

14.3.3.2 Tax incidence

Under a SVT, the landowner would be liable to the tax as the legal owner of the asset. Therefore, the owner of the land would be obliged to pay-and-file the tax. The landowner is the ultimate beneficiary of locational factors, whether that be through increased rents brought about by amenities and commercial centres or asset value when sold. This would result in the statutory incidence of the current system of Commercial Rates shifting to the owner of the land, as opposed to the occupier of a premises on that land.[351]

14.3.3.3 The tax base

The tax base is the estimated site value that does not include the

351 The Commission recognises that the economic incidence of the tax is likely to differ from the statutory incidence to some extent. For example, the owner of the land may seek to recover this taxation from a tenant. However, given that the supply of land is relatively inelastic, it is expected that the economic incidence will fall largely on the landowner rather than any tenant.

value of any buildings or other structures on the land. A site's value is generally determined by the location and designation of the land alone. An estimation model that distinguishes between factors contributing to the price of a property (for example a hedonic price model)[352] could be used to estimate the site value. Rights to appeal valuations would be available for all taxpayers.

14.3.3.4 Valuations and Tax Administration

The Valuation Office currently estimates valuations of State-owned assets and rental valuations of premises subject to Commercial Rates. As such, it would be best placed to carry out site valuations with input and assistance from local authorities and other organisations. Resources would need to be dedicated to building up the capacity of the Valuation Office to carry out these valuations, with input from other State bodies as appropriate.

Revenue should be responsible for administering the tax. The statutory collection and enforcement powers and resources of Revenue are far greater than those of local authorities, and as such, compliance levels should be higher.

14.3.3.5 National rates

The Oireachtas would be designated as the rate-setting body. The rationale for this is that allowing deviations at a decentralised level can lead to inequitable and inefficient outcomes across local authority boundaries. A rate set as part of the national legislative process would result in equity and fairness across the country. The tax rate would apply to the per unit squared area of the estimated site value in a given district. The Commission does not recommend that local authorities be permitted to vary the basic rate, as is currently provided for under LPT.

14.3.4 Impact on existing property and land taxes

The Commission recommends that the base for SVT should be as broad as possible, with limited exceptions. Other than in the case of LPT, the new SVT should replace current and other planned levies

352 This econometric model uses a rich dataset on various internal property characteristics such as land size, property price, premises size, and number of rooms, number of floors, number of bathrooms etc. and locational metrics such as geolocation, distance from town centres, transport links and schools to isolate the value added of the various locational factors that determine the site value. See for example: Ronan Lyons, Identify Consulting – Residential Site Value Tax in Ireland, 2011.

and taxes on land.

The Commission supports the view that the Derelict Site Levy has been an ineffective tool for bringing derelict sites into active use, with the effective application of the levy varying considerably across local authorities.[353] As such, the proposed SVT would apply to all lands, whether derelict residential, derelict and/or vacant commercial or otherwise, in order to encourage their activation for use. Similarly, uninhabitable property that is unsuitable for use as a dwelling is not currently subject to LPT. The Commission is recommending that such properties be liable to tax based on their site value.

The SVT should also replace the Commercial Rates system. The Commission believes that the current Commercial Rates system is in need of significant reform as it applies differential rates across council borders and the yield collected by a local authority is a function of its specific budgetary needs, vacancy levels in a council area, delays in bringing new properties into the charge, and delayed revaluations.[354] Under the Commercial Rates system, the Annual Rate of Valuation varies across both location and time resulting in horizontal inequities and uncertainty. The Commission supports the introduction of a tax on the site value that applies to the landowner (as opposed to the tenant) as a more efficient means for encouraging use of commercial land and for commercial activity more generally.

The Commission was asked to consider the merits of a SVT in the context of achieving housing policy objectives. As part of this, we considered the interaction of SVT with the new Zoned Land Tax (ZLT), which is designed to encourage the timely development of land for housing. While the Commission endorses the key principles underlining the ZLT, the charge only applies to zoned and serviced land, leaving many undeveloped zoned lands suitable for residential development exempt from the charge. In the context of a SVT, not taxing certain types of land could lead to perverse incentives to invest in non-taxed lands. While it would be possible to implement both taxes on lands captured by the ZLT, the Commission believes there may be merit in incorporating

353 There were 1,369 sites on the Derelict Sites Register at the end of 2021, relating to derelict sites in urban areas. While nearly €5.5 million was levied on sites in 2020, just €378,763 was collected from these sites – Source: Parliamentary Question 53525/21. GeoDirectory.ie estimates that there were approximately 22,000 derelict residential address points in the State in their latest (Q4 2021) estimate.

354 Department of Housing, Local Government and Heritage, An Overview of Commercial Rates in Local Authorities, December 2018.

the policy objectives of the ZLT within the SVT in due course.

In such circumstances, it may be possible to set the rate of SVT on such lands to be greater than the central rate of tax. There are two key justifications for this:

1. A higher rate reflects the relatively higher costs that are placed on society by underdevelopment of such lands for housing purposes. A new tax that would apply the same rate of tax to a plot of land actively in use for commercial purposes as to an inactive/idle plot that is zoned and serviced for residential use could undermine the objective of the proposed ZLT (i.e. to encourage the supply of housing on lands suitable for residential development).
2. A rate of SVT that is below the rate currently being proposed for the ZLT would represent a reduction in the rate of tax for lands within the charge to ZLT. As we are attempting to encourage the activation of high-return lands, the SVT rate should be sufficiently high to create a strong disincentive to invest in such passive and socially damaging forms of investment.

The Commission supports the principle that land that is both serviced and zoned for residential use should incur a higher rate of SVT, following the meeting of both criteria, in order to stimulate timely delivery of housing. Servicing is dependent on third parties (e.g. local authorities and Irish Water) and, until services are provided, the land cannot be developed. Therefore, where land has been zoned and serviced for longer than an acceptable period, it should be charged SVT at a higher rate until the residential properties are developed and become liable to LPT.

As indicated, it is possible to operate these two taxes side-by-side and the Commission supports the policy intent behind the ZLT. Therefore, the introduction of an SVT should not delay the implementation of the ZLT. Rather, consideration should be given to potentially replacing ZLT through the proposed SVT in due course.

The Commission has also considered the impact of SVT alongside the Government's proposed land-value sharing mechanism from the Housing for All strategy.[355] The outline of this policy was published as part of the Land Value Sharing and Urban Development Zones Bill

355 Department of Housing, Local Government and Heritage, Housing for All - a New Housing Plan for Ireland, September 2021.

2021 and is expected to be finalised later this year. The SVT is a tax on a stock of wealth and it does not tax the uplift in land values following rezoning decisions; as such, a land-value sharing mechanism could exist alongside our proposed SVT.

In summary, the Commission recommends that a SVT could potentially subsume all existing recurrent property taxes that apply at national and local government level, with the exception of LPT. A single well-designed tax applying to all of the aforementioned lands could increase the effectiveness of what is intended by those taxes and lead to greater simplicity in the tax code.

14.3.5 Charge to SVT

14.3.5.1 Rate of SVT

Data is not currently collected or published on a number of key inputs required to estimate site values and to determine a rate (or rates) of tax. Therefore, the Commission is not in a position to provide estimates of what site values might be across the country or what the typical liability would be. Ultimately, the latter would depend on the desired yield and the extent of differential treatment for different lands (for example agricultural land and undeveloped land suitable for residential use).

14.3.5.2 Agricultural land

While it is the Commission's view that no land should be exempt from the SVT, the Commission has specifically considered the impact of its recommendations on the agricultural sector and is recommending that agricultural land be treated differently to other lands given its unique role in the production process of this sector. Differential treatment for agricultural land is common in other jurisdictions that have implemented a form of SVT or land tax. On this basis, the Commission recommends that agricultural land should be subject to differential treatment for the purposes of applying SVT. For example, this could take the form of a lower rate of SVT, through the use of offsets or rebates where land is in productive use or through an adjusted valuation base compared to that of other land designations. Ultimately, the appropriate method of taxing agricultural land will require careful consideration at design stage.

14.3.5.3 Application to other designated/zoned lands

As noted in section 14.3.4, the Commission recommends that a higher

rate of SVT should apply to socially suboptimal use of lands, such as undeveloped zoned lands suitable for residential use. This will apply until the residential properties are developed and become liable to LPT.

The Commission recognises that lands used for conservation, recreational, charitable and community purposes may also be affected by the introduction of a SVT and may require special treatment. However, a site value is influenced by the designation of land zoned for particular use. Community, conservation and recreational spaces would generally have very low site values, as their development potential for other purposes is nil. A listed building has a low site value for this same reason.

The Commission also recognises that mixed-use lands will need to be treated differently and there is precedence for such properties receiving different treatment. Currently, owners of apartment blocks with commercial activities on the ground floor pay LPT and the business owner pays Commercial Rates. Likewise, a building that contains a ground floor shop with living quarters overhead or a basement-level 'granny flat' is also liable to LPT on the dwelling part of the building. If a SVT were to be introduced, the interaction of LPT and SVT would need to be considered in these instances.

There are a number of ways these issues could be approached and they would need to be considered further and addressed at design stage.

14.3.6 Other considerations

14.3.6.1 Income deferral thresholds

While a recurrent tax on land would disproportionately impact high-income, high-wealth households, there are also likely to be some lower-income, high-wealth households affected.[356] Such taxpayers who are unable to pay the SVT should have the option to defer their liabilities subject to an appropriate interest rate. This deferral could potentially apply until the point of disposal, whereby the seller (or inheritor in the case of death) would pay the accumulated deferral, including accrued interest.

14.3.6.2 Implementation challenges

A fair and robust SVT would take time to design and implement, and the transition of businesses from the current Commercial Rates system to SVT will require careful analysis and preparation. The SVT apparatus

356 Lawless M. and Lynch D., – Scenarios and Distributional Implications of a Household Wealth Tax in Ireland, 2016.

would require the collation of a number of data sources on land, property prices and other property characteristics, with the aim of developing a comprehensive register of sites. This would be a key input in successfully implementing a SVT. It would also require the allocation of additional resources to Revenue, the Valuation Office and other organisations to carry out this work.

Once these data sources are collated and an estimation model put in place, site valuations will not be as difficult to revalue as various data sources would be collated and updated regularly. Once a robust estimation apparatus is in place, lands should be subject to regular revaluations.

It is recommended that the tax be introduced on a graduated basis to ensure that taxpayers do not face any sudden increase in liabilities.

14.3.6.3 Yield from SVT

In its latest year of full collection (2019), Commercial Rates amounted to €1.43 billion in revenues for local authorities. However, the SVT would apply to land that is currently outside of the tax net, i.e. all derelict and vacant commercial land, agricultural land, zoned development land and derelict/uninhabitable residential land. As such, we are recommending that a tax yield significantly greater than €1.43 billion is collected from SVT over time.

Recommendation

14.1	The Commission recommends the introduction of a Site Value Tax (SVT) on all land currently not subject to Local Property Tax. This includes all commercial (developed and undeveloped), mixed-use, agricultural, undeveloped zoned residential lands, and State-owned lands as well as all land on which derelict and uninhabitable premises sit. SVT should replace the existing system of Commercial Rates over time.
14.2	The Commission recommends that there should be differential treatment in the application of Site Value Tax to agricultural land.

14.4 LOCAL PROPERTY TAX

14.4.1 Overview of the charge

The Local Property Tax (LPT) was introduced in 2013 following the recommendation of an annual property tax on residential property by the Commission on Taxation 2009. The tax is payable by the owner of the property every year under self-assessment. It applies to most residential properties with some limited exceptions. The tax is collected and administered by Revenue, with local authorities retaining 100 per cent of the LPT receipts from residences in their jurisdiction.

The charge is based on the open-market value of the residential property. There is a degree of progressivity in the charge, with higher rates applying to higher value properties. There are 20 valuation bands taxed as follows:

Table 28: LPT valuation bands, 2022

VALUATION BAND NUMBER	PROPERTY VALUE	APPLICATION OF LPT
1	€0 to €200,000	The LPT charge is fixed at €90
2	€200,001 to €262,500	The LPT charge is fixed at €225
3 to 11	€262,501 to €1,050,000	A rate of 0.1029 per cent is charged on the mid-point of the valuation band
12 to 19	€1,050,001 to €1,750,000	A rate of 0.1029 per cent is charged on the first €1.05m. The difference between the mid-point of the valuation band and €1.05m is charged at 0.25 per cent
20	> €1,750,000	A rate of 0.1029 per cent is charged on the first €1.05m, 0.25 per cent on the next €700,000 and a higher rate of 0.3 per cent on the balance over €1.75 million

Source: Revenue Commissioners

Each year local authorities can vary the basic rate that applies by either increasing or decreasing it by 15 per cent. This is referred to as the local adjustment factor.

Revenue publishes annual statistics on LPT and there is regularly a strong level of voluntary compliance with payment of the tax by property owners. This is facilitated by the wide range of payment options, either through single or phased payment, online or through deduction at source from salary, pension, Department of Social Protection payments and other methods.

For the period 2013 to 2021, the LPT charge was based on the value of properties on 1 May 2013. New properties purchased from 2013 onwards were not liable to LPT. The Finance (Local Property Tax) (Amendment) Act 2021 introduced a new structure for LPT from 2022 onwards. The changes provide for new residential properties built since 2013 to be brought into the charge. LPT for the years 2022 to 2025 will be based on property values on 1 November 2021.

Revenue statistics for 2022 returns show that, of returns filed as of 11 May 2022, there are 1,567,100 properties liable to LPT, with exemptions claimed for a further 18,300 properties and payment deferrals claimed for an additional 11,800 properties.[357]

14.4.2 Guiding features of LPT

The Commission acknowledges that LPT is, for the most part, a broadly effective system that is well administered; ease of payment is built into its design and there is a consistently high level of compliance.

While the Commission debated the merits of a change in the current structure of the LPT charge, including potential inclusion of residential property within a wider SVT system, it was ultimately decided that the LPT system currently in place, while not perfect, achieves many of the policy objectives sought, represents a fair approach to raising taxes from residential property and is generally well-understood by the public. Therefore, the Commission supports the long-term retention of the LPT system subject to some enhancements, as described in section 14.4.3.

14.4.2.1 Market value basis should continue

The Commission supports the continued use of a property's market value as the basis for applying LPT. A market value approach to housing is related to the characteristics of the building itself, the site on which it is located and the features and amenities of the neighbourhood. There is, therefore, a relationship between the market value of a house and the benefits to the owner in terms of enjoyment of the amenity value of the properties.

One alternative considered was levying the tax on the equity value of a property, being the net value of the property after a reduction for outstanding debt/mortgage. However, the Commission considers that there are several administrative issues, distortions and inequities that could arise from such treatment and, therefore, does not recommend

357 Revenue, LPT 2022 Statistics Update, 11 May 2022.

such a change.

14.4.2.2 Exemptions should be kept to a minimum

The recent changes to the LPT system removed, or provided for the future cessation, of several exemptions from LPT. An exemption has been claimed for 18,300 properties in LPT returns filed as of 11 May 2022, compared to approximately 49,000 claims for exemption from returned properties for 2021.

The Commission supports the principle of a wide tax base and keeping exemptions from the LPT charge to a minimum.

14.4.2.3 Revaluations should occur regularly

Annual LPT charges for the period 2013 to 2021 were based on the value of the property on 1 May 2013. Despite legislation providing for a review of property valuations, these reviews were deferred several times, with no revaluations occurring for over eight years.

From 2022 onwards, the rules were amended to allow for regular revaluations and to bring in all newly built properties into the charge. For the years 2022 to 2025, the LPT liability will be based on the valuation on 1 November 2021, with revaluations to occur every four years. This is intended to achieve a balance between the timely capture of changes in the property market and the need to limit compliance and administration costs. In most instances, property owners will only be obliged to file one LPT return per property every four tax years.

As a point of principle, the Commission strongly endorses the regular revaluation of properties. This will negate a step-effect where revaluations do not occur during long periods of house price inflation and provide for smoother changes in revenues as property values fluctuate. We support the recent changes to LPT where automatic/continuous revaluation is provided for in legislation every four years going forward, with deferrals of these valuations to be avoided.

Recommendation

14.3 The Commission recommends that the current structure and broad features of Local Property Tax should remain. This includes a market value basis for applying the charge, keeping exemptions to a minimum and the continued use of regular revaluations.

14.4.3 Main recommendations for changing LPT

14.4.3.1 LPT revenues

LPT was designed to broaden the domestic tax base and to replace some of the reliance on State revenue from transaction-based taxes. Non-recurrent or transactional forms of taxation of property, e.g. Stamp Duty receipts, derive from the value of the property at the point of transfer. Both the level of transactions and associated values of the assets being traded tend to be procyclical in nature, i.e. they tend to increase in a boom and decrease in a downturn. Furthermore, transaction taxes on property can be particularly distortive, as they can impact both investment decisions and labour mobility and distort transfers through lock-in effects.[358]

Recurrent taxation of immovable property is widely considered to be less volatile and more sustainable, as it is an annual tax on the stock of property as opposed to the flow of transactions. Buildings and land are not mobile. The supply of land is fixed and cannot be withdrawn from the market by the owner, i.e. it is less sensitive to taxation.

A key consideration in designing the 2022 changes to LPT was the significant house price increases witnessed across the country since the last property valuation date in 2013. Using a new valuation date of 1 November 2021 would likely mean an increase in many instances of the valuation used for determining the LPT liability. Therefore, a decision was taken whereby the rates and valuations bands were adjusted to minimise the increase in LPT liabilities faced by homeowners. The 2022 changes are estimated to bring approximately 100,000 additional new properties within the scope of LPT.

As discussed in Box 4 in section 14.2.1, the current level of receipts from recurrent taxation of immovable property compared to other jurisdictions, informed the Commission's deliberations. The Commission's view is that there is scope to increase the contribution of land and property taxes to the State's finances, without this resulting in Ireland being an outlier compared to other jurisdictions.

The Commission acknowledges that recurrent taxation of immovable property is a stable and sustainable source of revenue for the State. The Commission considers that there is additional scope to increase the yield from LPT and for it to form a larger proportion of

358 European Commission, Immovable Property Taxation for Sustainable and Inclusive Growth, January 2022.

the overall tax take.

As a share of overall tax receipts, the Commission recommends that revenues derived from LPT should increase substantially over time. This could be achieved via an adjustment of the LPT basic rates and, potentially, through an adjustment of valuation bands. The Commission is not proposing specific changes to rates or bands, as it believes that specific decisions on exact percentage changes that should apply should be made by Government having regard to prevailing economic conditions. However, it is recommended that, at the very least, the valuation bands should not be widened further to reflect increased property prices, as this can undermine the effectiveness of the tax.

14.4.3.1.1 Local adjustment factor

While the basic rate of LPT is set at national level, local government can increase or decrease this rate by up to 15 per cent using the local adjustment factor. However, the ability of local authorities to vary the rate of LPT each year can lead to inequities across county borders. In 2022, all of the four Dublin-based local authorities reduced the rate, while 22 local authorities increased the rate to different degrees. The remaining five did not vary the rate.[359]

In the context of our recommendation to increase the overall yield from LPT, the Commission recommends that discretion to decrease the basic rate of LPT should be removed. In other words, only the ability to maintain or increase the basic rate by up to 15 per cent should be retained.

14.4.3.1.2 Ability to pay

Property owners have the ability to defer their LPT liability, with interest, where certain criteria are met with regard to ability to pay.[360] Increases in the LPT charge would need to factor in potential changes to the payment deferrals available to those who could face financial hardship because of the increased liability. As an example, the 2022 LPT reforms were accompanied by an increase in the deferral income thresholds and a reduction in the late payment interest rate to allow more of those

359 Revenue, Local Adjustment Factors for 2022.

360 Full and partial deferrals can be claimed based on the gross income thresholds of households. Full deferrals can be claimed where the gross income of the liable taxpayer does not exceed €18,000/€30,000 for a single person or widow(er)/couple. Partial deferral of 50 per cent can be claimed where gross income does not exceed €30,000/€42,000 for a single person or widow(er)/couple.

with low-incomes living in high-value properties to defer the charge.

The Commission supports the continued use of a payment deferral system based on ability to pay. There is potential to expand the deferral thresholds to accompany rate increases proposed.

Recommendation

14.4 Revenues deriving from Local Property Tax (LPT) should increase to form a substantially larger share of total revenues through the adjustment of the basic rates of taxation and potentially through an adjustment of valuation bands. The ability of local authorities to decrease the basic rate of LPT should be removed.

14.4.3.2 NPPR surcharge

The most recent Revenue data available shows that of the 2022 LPT returns filed as of 11 May 2022, there are 166,300 multiple-property owners in addition to 1,084,300 single-property owners. Data is not yet available on the number of properties owned by those multiple-property owners. According to 2021 LPT returns there were around 181,000 owners of two or more properties, covering 573,000 properties.[361]

Multiple-property owners may hold second properties for rental purposes, as a holiday home, for occupation by a relative, or a number of other reasons. Ownership of multiple properties represents an additional form of wealth.

When LPT was being designed, there was a recommendation in the 2012 Thornhill report362 for the €200 non-principal private residence (NPPR) charge to:

> *"be absorbed into, and aligned with, the LPT as a separate supplemental tax in addition to the LPT at the existing level applying to non-principal private residences".*

This recommendation was not ultimately adopted.

Furthermore, the OECD has previously recommended that a broad-based tax concerning all residential property with higher rates on more

361 Revenue, LPT Statistics for 2021, 6 January 2022.

362 Report of the Inter-Departmental Group, Design of a local property tax, 2012.

valuable property and/or higher rates on second or third properties would have positive outcomes for efficiency and equity[363]

The Commission recommends that property owners should be liable to an additional LPT charge where they own two or more residential properties. In order to encourage the use of second homes for housing purposes, this surcharge should only apply where the property is not occupied as the principal private residence of the property owner or a registered tenant.

A registered tenant is where there is a tenancy agreement registered with the Residential Tenancies Board. The Commission acknowledges that there may be short periods between lettings, or before the commencement of a first tenancy of a new rental property, where a rental property is not occupied by a registered tenant. The NPPR surcharge should not apply in such circumstances.

For the purposes of applying the NPPR surcharge, individuals may only have one property designated as their principal private residence at any given time.

Recommendation

14.5 The Commission recommends that, in the case of multiple property owners, a Local Property Tax surcharge should apply to properties not occupied as the principal private residence of the property owner or a registered tenant.

14.4.3.3 Vacancy surcharge

LPT currently applies to habitable residential property (suitable for use as a dwelling), regardless of the length of period of use.[364] Ireland is currently experiencing a chronic lack of housing supply, with a multitude of reasons for this. Of interest is that there were 90,158 dwellings recorded as vacant in Q4 2021 according to a report from GeoDirectory.[365] This compares to preliminary Census 2022 data from

363 OECD, Housing and Inclusive Growth, September 2020.

364 Vacant residential properties here refer to vacant properties that are already subject to LPT (i.e. suitable for use as a dwelling and habitable).

365 GeoDirectory Residential Buildings Report Q4 2021, 18 January 2022.

the Central Statistics Office, which showed 166,752 vacant properties.[366] The most recent LPT return requested details of vacant residential properties as at 1 November 2021, and recent preliminary analysis of those returns showed 57,206 properties were indicated by their owners as being vacant.[367] Methods of measuring vacancy differ across various data sources.

While current figures demonstrate that any tax on vacancy may apply to a relatively small cohort of properties, the Commission believes that vacancy should be discouraged as a point of principle. As such, the Commission recommends that the current LPT framework should be modified to include a surcharge for properties that are vacant for an unreasonable length of time. The intention of this measure is to encourage productive use of the housing stock and to discourage speculation or hoarding of property wherever it may exist. The surcharge should apply whether the property owner has one or more properties (for example, in circumstances where the owner of an Irish property lives abroad and the property is left vacant on a long-term basis).

Specifying what an "unreasonable" length of vacancy is will require careful design and may vary depending on the reason for the vacancy. Of note is the existing exemption for certain properties vacated by their owners due to illness and other reasons. The Commission supports the retention of such exemptions, so the vacancy surcharge proposed would not apply in such instances, subject to appropriate time limits and regular review.

A residential property is not liable for LPT if it is uninhabitable or unsuitable for use as a dwelling on the liability date. As the proposed surcharge measure is intended to encourage productive use of existing housing stock, it is considered that the surcharge should only apply to properties already within the scope of LPT (i.e. properties that are habitable or suitable for use as a dwelling).

As discussed in section 14.3.4, the Commission is recommending

366 Notably the Census data represents vacancy at a point in time. Various reasons were given for vacancy, such as: the use as a rental property (including short-term lettings and properties between lettings), renovation, for sale or a new build or an abandoned farmhouse, or the owner was recently deceased, in hospital or in a nursing home. Approximately 48,000 of the same properties were vacant on both Census nights in 2016 and 2022.

367 Revenue, Local Property Tax (LPT) for 2022 Preliminary Vacancy Analysis, data as at 20 June 2022. This report also includes analysis of why LPT data differs from the Census data.

that a new Site Value Tax should apply to uninhabitable or derelict property[368] (i.e. property not subject to LPT, as it is not habitable) and all undeveloped land suitable for residential use, in order to stimulate efficient use of under-utilised residential land.

Recommendation

14.6 A Local Property Tax surcharge should be introduced for vacant properties.

14.4.3.4 Interaction of NPPR and vacancy surcharge

Currently LPT returns are filed every four years. Property owners who are subject to the NPPR or vacancy surcharges should be obliged to self-assess and file a supplementary short return for every year a surcharge is due.

The surcharges can operate within the existing pay-and-file system of LPT rather than requiring the design and implementation of a new tax, or the registration by taxpayers for a new tax.

Second homes, holiday homes, etc. that are not occupied as the principal private residence of the owner or a registered tenant will be instantly liable to the NPPR surcharge. In comparison, the vacancy surcharge should only apply after a residential property has been vacant for an unreasonable length of time (a period which will need to be carefully considered and defined at design stage).

It is not the Commission's intention that a property should be liable to both LPT surcharges simultaneously.

For example, in the case of a multiple-property owner who has a rental property, the property will in the first instance be liable to the NPPR surcharge if it is not occupied as the principal private residence of a registered tenant. If that investment property is left vacant for an unreasonable length of time, it will become liable to the vacancy surcharge instead of the NPPR surcharge.

368 Estimates of dereliction vary, but a report by GeoDirectory estimates there to be 22,096 derelict residential address points in the State. GeoDirectory Residential Buildings Report Q4 2021, 18 January 2022.

14.5 THE ROLE OF TAXATION AND WELFARE SYSTEMS IN ACHIEVING HOUSING POLICY OBJECTIVES

The Commission has deliberated over the appropriate role for the tax and welfare systems in achieving housing policy objectives. There are a number of challenges facing Ireland's housing market, particularly in relation to affordability, viability and supply.

The proposals in the previous sections are intended to enhance the overall contribution of land and property through recurrent taxation. In addition to annual land and property taxes, there are a number of other features in the tax code that can impact on and interact with the housing market. These include charges on income from property (such as Income Tax and Corporation Tax on rental profit) and charges on the transfer of property (e.g. VAT, Stamp Duty, CAT and CGT), and the various reliefs and exemptions from those charges. A number of changes to these taxes and incentives have occurred over the years.

14.5.1 The role of tax incentives

The terms of reference for this Commission asked us to have regard to the experience of previous interventions in the housing and construction market and the current significant State supports for housing provision.

In addressing this aspect of our terms of reference, the Commission has considered the role of tax incentives in supporting the supply of housing. Past interventions in this area included various reduced rates and exemptions from Stamp Duty on the acquisition of residential property and a multitude of property and area-based capital allowance and expenditure deduction regimes. These were commonly referred to as owner-occupier reliefs and section 23 type reliefs for landlords; and included the Living over the Shop scheme, the Student Accommodation scheme and the Urban, and the Town and Rural Renewal schemes.

Tax measures and incentives can take a number of years to influence behavioural change in land and property dealings, reflective of the long-term nature of planning, construction and development and the levels of associated financial commitments. Tax expenditures can become particularly costly to the State if wide in scope or continuously extended. With this in mind, and reflecting on recent history of tax-related supports targeting supply of property (both in Ireland and abroad), the Commission believes there is strong evidence that the tax system should not be used to respond to short term or cyclical

changes.[369] Instead, the tax system should provide confidence to the market that it and the investment landscape for such activity is fair, transparent and consistent, providing certainty over the longer term.

The Commission does not recommend the use of tax incentives in order to stimulate the supply of housing. The Commission also cautions future policymakers against short-term, reactionary tax measures to tackle cyclical housing challenges. Instead, issues in the housing market should be addressed through careful regulatory, planning and other non-tax related policy.

Recommendation

14.7 The Commission recommends that tax incentives should not be used in order to stimulate the supply of housing.

14.5.2 State-supported housing

The Commission has also considered the interaction of the tax and welfare systems in the context of the impact of housing supports and its effect on incentives to work.

Public commentary (including feedback to this Commission's public consultation) often focuses on the level of the State's expenditure on private rented accommodation. The total current expenditure on direct delivery of housing in 2020 was over €1 billion. It is estimated that some 113,000 households, over a third of the private rental sector, are supported by some form of State subsidy.[370] Recommendations have been made that the State should reduce its reliance on welfare and rental supports over time and redirect resources towards capital spending, with the State building public homes on public land.[371]

369 See ESRI, Tax Breaks and the Residential Property Market: ESRI tax breaks, 2015; Indecon, Budget 2006: Review of Tax Schemes, 2005; Regling, K. and Watson, M., A Preliminary Report on the Sources of Ireland's Banking Crisis, 2010; OECD, Ireland's Housing Boom: what has driven it and have prices overshot?, 2006.

370 Parliamentary Budget Office, Housing Ireland: Trends in Spending and Outputs of Social and State Supported Housing 2001-2020, March 2022. Current expenditure includes amounts relating to Rent Supplement, Rental Accommodation Scheme (RAS), Social Housing Current Expenditure Programme (SHCEP), the Housing Assistance Payment (HAP) scheme, the Capital Loan Subsidy scheme, and the funding of Homeless services.

371 See McQuinn, K., With 'g' greater than 'r', should we be borrowing to increase Irish housing supply?, 2021.

The Government has set out its plan for housing to 2030 in the Housing for All Strategy.[372] This strategy contains a number of commitments in relation to Approved Housing Body, social and local authority housing, including significant increases in capital spending. This Commission is also conscious of the establishment of a Housing Commission, which has been tasked to examine issues such as tenure, standards, sustainability and quality-of-life issues in the provision of housing. The Housing Commission is due to report to the Minister for Housing, Local Government and Heritage by the end of July 2023.

This Commission's view is that support for households is best enabled via welfare measures rather than via tax incentives, as these State supports are based on income criteria and needs assessment and are better targeted.

One area where the Commission recommends improvements could be made is in the application of local authority differential rents. Local authority accommodation is operated on a differential rent system, where the rent payable by local authority tenants is determined by their household income (with higher income tenants paying higher rents and vice versa). There are 32 differential rent schemes across 31 local authorities, with no standard method for calculating rents.[373] Therefore, tenants on similar household incomes but in different areas may pay different rents depending on the criteria stipulated by the local authority for the area where they reside. This can lead to a lack of horizontal equity and an inconsistency in the adequacy of income remaining once rent has been paid.

The Commission supports the Government commitment in the Housing for All Strategy to reform the system of differential rents. Proposals are currently in development for a national scheme that will standardise differential rents to ensure fairness across local authority areas. The Commission encourages this review to ensure tenants pay an equivalent amount of rent based on their ability to pay and regardless of their location.

One of the benefits identified from the ongoing transfer of long-term recipients of Rent Supplement to the Housing Assistance Payment (HAP) scheme has been the removal of a potential barrier

372 Department of Housing, Local Government and Heritage, Housing for All - A New Housing Plan for Ireland, September 2021.

373 Doolan M., Roantree B and Slaymaker, R., Low income renters and housing supports, May 2022.

to employment by allowing recipients to remain in the scheme if they gain full-time employment. The Commission supports the continued periodic review of secondary benefits, which include housing benefits such as Rent Supplement, HAP and the Rental Accommodation Scheme (RAS). Housing benefits need to be considered in the wider context of secondary benefits. These can have a material impact on incentives to work and it is vital they remain accessible, equitable and appropriate.

Recommendation

14.8 The Commission supports the reform of the differential rent schemes towards a national system based on ability to pay. Any proposed changes to social housing supports should fully consider the potential impact on incentives to work.

14.5.3 Supporting tenure type

The Irish tax system, as is the case in many other OECD countries, includes a number of provisions to support owner-occupation over other forms of housing tenure. This is evident through features of the tax system such as the Capital Gains Tax (CGT) exemption on disposal of a home occupied as the owner's principal private residence[374] (compared with the CGT charge applying to disposals of residences held as investments), previous approaches to mortgage interest relief and the structure of the Help to Buy (HTB) incentive.

The Commission has considered the role of the tax system in supporting different tenure types. While the Commission recognises the role of Government policy in improving access to home ownership, in light of emerging trends in overall levels of home ownership, the Commission recommends that the tax system should be neutral in its treatment of different tenure types.

14.5.3.1 Support for first-time buyers

The Commission recognises the role of Government policy in widening access to home ownership. However, the Commission has concerns that mechanisms such as the HTB scheme can act to increase demand (and also potentially house prices) in an already supply-constrained market.

374 The Commission's recommendation in relation to CGT Principal Private Residence Relief is discussed in Chapter 7 (Taxes on Capital and Wealth).

The HTB scheme for first-time buyers of newly-built homes and once-off self-build homes gives a refund to claimants of Income Tax and Deposit Interest Retention Tax (DIRT) paid in the previous four tax years. The scheme is intended to assist individuals with funding the cost of a deposit for a new house or apartment and to help encourage the building of additional new properties. HTB does not apply to investment properties, properties valued above €500,000 or second-hand homes.

There are some concerns about HTB in that it could serve to increase prices against a backdrop of constrained supply, and thus, undermine the policy objective of increasing supply of affordable new-builds.[375] The Commission is concerned that the relief is inequitable in that it only supports first-time buyers (and owner-occupier homeownership over other tenures) and taxpayers who have paid more Income Tax in the preceding four years benefit the most. The scheme is associated with high levels of deadweight, with significant numbers of claimants having sufficient savings for a deposit in any case. The increasing cost of the scheme is also a concern.

HTB is due to expire at the end of 2022 and the Commission supports allowing this relief to end as planned. While the Commission acknowledges Government policy in widening access to home ownership, it recommends that such supports, if appropriate, can be provided more equitably outside of the taxation system. Such a change is consistent with the Commission's view that the tax system should be neutral in its treatment of taxpayers that rent or purchase their homes.

Recommendations

14.9 The Commission recommends that the tax system should be neutral in its treatment of different tenure types.

14.10 The Commission recommends that the Help to Buy scheme be allowed to expire as planned at the end of 2022.

375 ESRI, Post-Budget Briefing, October 2020; Indecon, Impact Assessment of the Help to Buy Tax Incentive. September 2017; ESRI, Tax Breaks and the Residential Property Market: ESRI tax breaks, 2015, page 9; See also evidence from the Centre for Economic Performance (2020) on a similar demand-side scheme in the UK (Help-to-Buy equity loan scheme), where increased construction occurred only in locations where house prices were relatively affordable, while leading to increased house prices in London with no evidence of increased supply.

14.5.4 Institutional investment in housing

The tax regime for property investment funds and other institutional investors has attracted increased attention in the context of housing. Institutional investors play a critical role in the supply of housing, particularly for apartments where viability can be a key challenge. There are a number of features in the tax system aimed at facilitating collective and international investment in the Irish property market, including, for example, tax-free gross roll-up in funds and Real Estate Investment Trusts (REITs). These are supplemented by various targeted measures to ensure a fair share of tax is paid, for example, the Irish Real Estate Fund (IREF) withholding tax regime, the 10 per cent Stamp Duty rate on the bulk purchase of certain residential properties and Finance Act 2016 changes to section 110 companies who have debt deriving its value from Irish property. The Commission believes that it is timely for these tax regimes to be reviewed.

In Chapter 6 (Tax Equity and Base Broadening) the Commission has therefore recommended a working group be established to undertake a review of the REIT, IREF and section 110 tax regimes in the context of the increasing role and impact of institutional investment in the Irish property market.

14.6 RECOMMENDATIONS

Chapter 14: Land and Property

14.1 The Commission recommends the introduction of a Site Value Tax (SVT) on all land currently not subject to Local Property Tax. This includes all commercial (developed and undeveloped), mixed-use, agricultural, undeveloped zoned residential lands, and State-owned lands as well as all land on which derelict and uninhabitable premises sit. SVT should replace the existing system of Commercial Rates over time.

14.2 The Commission recommends that there should be differential treatment in the application of Site Value Tax to agricultural land.

14.3 The Commission recommends that the current structure and broad features of Local Property Tax should remain. This includes a market value basis for applying the charge, keeping exemptions to a minimum and the continued use of regular revaluations.

14.4 Revenues deriving from Local Property Tax (LPT) should increase to form a substantially larger share of total revenues through the adjustment of the basic rates of taxation and potentially through an adjustment of valuation bands. The ability of local authorities to decrease the basic rate of LPT should be removed.

14.5 The Commission recommends that, in the case of multiple property owners, a Local Property Tax surcharge should apply to properties not occupied as the principal private residence of the property owner or a registered tenant.

14.6 A Local Property Tax surcharge should be introduced for vacant properties.

14.7	The Commission recommends that tax incentives should not be used in order to stimulate the supply of housing.
14.8	The Commission supports the reform of the differential rent schemes towards a national system based on ability to pay. Any proposed changes to social housing supports should fully consider the potential impact on incentives to work.
14.9	The Commission recommends that the tax system should be neutral in its treatment of different tenure types.
14.10	The Commission recommends that the Help to Buy Scheme be allowed to expire as planned at the end of 2022.

Chapter 15:
Promoting Good Public Health

15.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"Examine how effectively good public health is promoted in Ireland, and present relevant reforms to advance and incentivise this goal."*

Public Health is concerned with improving and protecting the health of the population as a whole. Public health is a key aspect of the wider health system and can play an important role in improving the effectiveness and efficiency of health system delivery. In Ireland, public health policy is focused on many of the factors that influence public health outcomes. Public policy in recent decades has focused on health promotion, education and a number of direct interventions promoting better public health outcomes, including through the taxation system.

In addressing this part of its terms of reference, the Commission examined the current situation regarding public health in Ireland and how good public health is promoted, in particular through current taxation policies focused on this area.[376] Taxes that target public health are imposed on products that have a negative public health impact, including tobacco, alcohol and sugar-sweetened beverages. In Ireland, such products are primarily targeted through the application of Excise Duties. The Commission examined how the current Excise Duty system evolved from one that was purely revenue raising to one more focused on influencing public health outcomes and, in particular, considered the role of "sin taxes" on products such as alcohol, sugar and tobacco. The Commission fully endorses the continued use of Excise Duty as a lever to influence good public health choices in these areas. In particular, the Commission supports the evolution and implementation of the sugar-sweetened drinks tax introduced in recent years.

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376 This chapter focuses on fiscal policies directly targeting public health, other chapters examine issues such as air quality and encouraging active transport which also have public health benefits.

The Commission examined further the issue of obesity and how Ireland, like much of the world's population, is seeing significant and increasing rates of overweight and obesity. Ireland has one of the highest levels of obesity in Europe, with 60 per cent of adults and over one in five children and young people living with overweight and obesity. The economic costs of obesity rates are also significant, running into billions of euro a year. In this context, the Commission also notes the recent publication of the Government's Obesity Policy and Action Plan and Roadmap for Food Product Reformulation in Ireland and the potential impact of the plan on tax policy in this area. The Commission supports the objectives of the action plan and roadmap and, in particular, supports the view that the voluntary framework approach contained in the Reformulation Roadmap may need to be supplemented with additional credible fiscal and/or mandatory reformulation measures that are capable of implementation.

15.2 PUBLIC HEALTH IN IRELAND

Public health has been defined as "the science and art of preventing disease", prolonging life and improving quality of life for people and their communities through organised efforts and informed choices of society, and individuals.[377]

In Ireland, general improvements in public health in recent decades have seen life-expectancy increase significantly. Life expectancy at age 65 has risen strongly between 1926 and 2016. Life expectancy for men at age 65 was 12.8 years in 1926 but by 2016 it had increased by more than 5 years to 18.3 years. For women, life expectancy at age 65 rose from 13.4 years to 21.0 years over the same time period, a gain of 7.6 years.[378] These increases have had a significant demographic impact leading to growth in the number of people aged over 65. Currently, each year this cohort increases by almost 20,000 people. This trend is set to continue and will have implications for future planning and health service delivery, as explored in detail across earlier sections of this report.[379]

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377 Institute of Public Health.

378 CSO (2020) Irish Life Tables, Life Expectancy Data statistical release.

379 Department of Health (2020) Health in Ireland Key Trends 2019.

Despite overall improvements in life expectancy in Ireland, deprivation, social class and education level continue to have a significant impact on life expectancy. CSO data shows that for those with limited or low levels of education, those living in deprived communities, and those from an unskilled social class, life expectancy at birth is much lower than for the rest of the population with professionals and those with a third-level education living longer. These non-medical factors that influence health outcomes are known as social health determinants, which include income and social protection, education, socio-economic status, gender, age, and employment amongst others. Low income is also associated with less control over individual lifestyle factors that affect health. For example, the diet of those in the lowest socio-economic groups is more likely to include insufficient fruit and vegetables. People in those groups are more likely to smoke and less likely to exercise regularly than people with higher incomes.[380] Inequality in life expectancy and public health outcomes represents a loss in terms of human health with consequent losses of productivity and costs to the social protection system. Therefore, a core aim of public health is twofold, to give everyone a chance to reach their potential to live a healthier life and to allow society to accrue benefits from those healthier lives.

The impact of income inequality on health can be further seen through self-perceived health status data, with fewer low-income earners reporting good health both in Ireland and across the EU. However, Ireland has the highest self-perceived health status in the EU, with 85 per cent of persons rating their health as good or very good. The number of people reporting a chronic illness or health problem is also better than the EU average, at around 27.7 per cent of the population.[381]

380 Barrington R. (2004) Poverty is Bad for your Health, Dublin, Combat Poverty Agency.

381 Department of Health (2020) Health in Ireland Key Trends 2019.

In terms of mortality, cancer is a leading cause of death in Ireland, causing some 9,000 deaths in 2018 followed by diseases of the circulatory system and respiratory diseases.[382] Chronic diseases, which are conditions that are long-lasting and require ongoing medical attention, are major drivers of healthcare costs, in addition to exacting a huge human toll. It is notable that 90 cent of our total healthcare costs are spent on the 30 per cent of the population with chronic diseases. Ireland has a significant rate of multi-morbidity, which is the coexistence of two or more chronic conditions in the same individual. Of those aged 52 to 85, 39 per cent have two or more medical conditions.[383] Evidence suggests this is the norm rather than the exception in older adults in Ireland.[384]

Many of these diseases are caused or worsened by risk factors such as tobacco use, overweight and obesity, alcohol consumption and physical inactivity. Figure 26 sets out the number of deaths by reference to risk factors in Ireland. Prevalence of chronic conditions and accompanying lifestyle factors are also strongly influenced by socio-economic status, level of education, employment and housing.[385] As the Health Service Capacity Review demonstrated, the Irish healthcare system will be faced with major demand increases in the years ahead and it is important that public health measures play a role in improving population health and reducing demand especially on acute services.

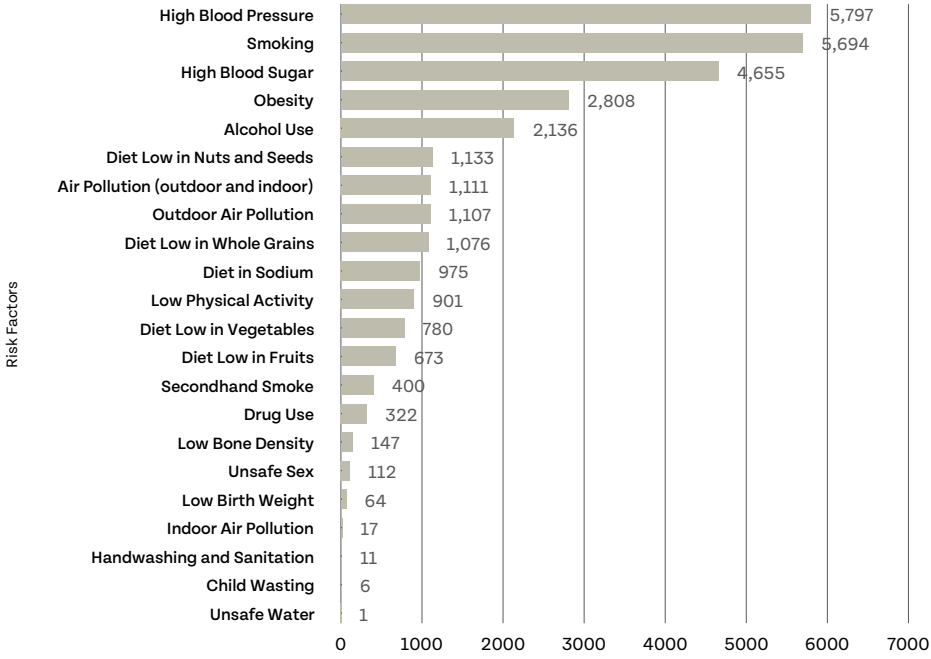
382 Malone P. (2020) Irish Population Health: life expectancy and mortality, Dublin, Publicpolicy.ie.

383 Hernández, B., Voll, S., Lewis, N.A. et al. (2021) Comparisons of disease cluster patterns, prevalence and health factors in the USA, Canada, England and Ireland. BMC Public Health 21, 1674.

384 Kenny R.A., Scarlett S. and O'Mahoney P. (2020) The Older Population of Ireland on the Eve of the COVID-19 Pandemic, The Irish Longitudinal Study on Ageing, Trinity College Dublin.

385 Royal College of Physicians (2017) Sugar Sweetened Drinks Tax Response to Department of Finance Public Consultation.

Figure 26: Number of deaths by risk factor in Ireland (all ages and genders), 2017



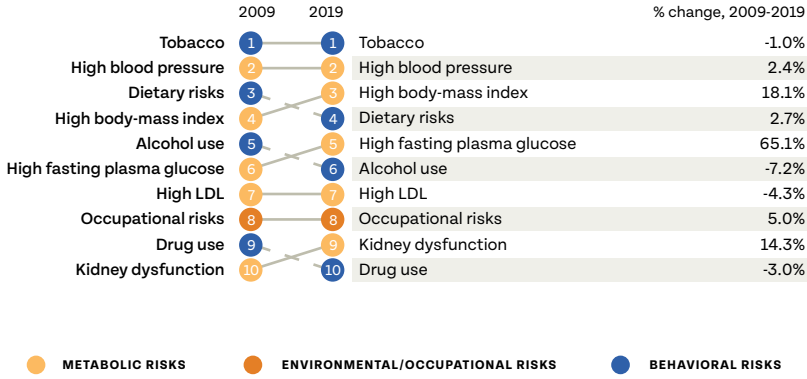
Source: Institute for Health Metrics and Evaluation (IHME), Global Burden of Disease.

Public health policy has been focused on tackling the drivers causing these chronic diseases, including through the application of Excise Duties on tobacco and alcohol in particular and, more recently on sugar in sugar-sweetened drinks.

Figure 27 shows recent trends in the top 10 risk factors that drove the most death and disability from 2009 to 2019 in Ireland. Tobacco remains the top risk factor although showing a slight decline, with alcohol also declining. However, of particular public health concern is the rise in other risk factors often associated with obesity and poor diet and lifestyles, such as high body mass index, blood glucose and blood pressure. For example, the number of deaths from diabetes rose from 514 in 2010 to 564 in 2017, an increase of 10 per cent.[386]

386 CSO (2020) Ireland's UN SDGs 2019 - Report on Indicators for Goal 3 Good Health and Well-Being.

Figure 27: Ireland Top 10 risks contributing to total number of DALYs, 2019 and percentage change 2009–2019



Source: Healthdata.org (DALY: Disability-adjusted life years): The disability-adjusted life year is a measure of overall disease burden, expressed as the number of years lost due to ill-health, disability or early death.

15.3 ROLE OF TAXATION IN PUBLIC HEALTH

Taxes that promote public health are imposed on products that have a negative public health impact, including tobacco, alcohol and sugar-sweetened beverages. In Ireland, such products are targeted through the application of Excise Duties. With the completion of the EU Single Market in 1993 and the widespread adoption of Value Added Tax (VAT) across the EU, much of Ireland's Excise Duties were eliminated, with tobacco, alcohol, energy products and vehicles remaining as the primary subjects of Excise Duty. In Ireland, the primary aim of Excise Duties is to raise revenue for the Exchequer and they were not originally designed with the primary objective of promoting good public health. However, in recent years, these Excise Duties have been adopted as a means of deterring the consumption of harmful products reflecting the cost placed on society arising from their consumption. As the effectiveness of Excise Duty on alcohol and tobacco products is well known and endorsed by the WHO, using Excise Duty as a means of tackling the over-consumption of sugar and the growing problems arising from obesity led to a sugar-sweetened drinks tax being designed as an Excise Duty and introduced in Ireland in recent years.

Having examined how the current Excise Duty system evolved from a revenue-raising system to one more focused on influencing public health outcomes, the Commission fully endorses the continued

use of Excise Duty as a lever to influence good public health choices in these areas. In particular, the Commission supports the evolution and implementation of the sugar-sweetened drinks tax introduced in recent years in helping to tackle obesity. The Commission believes that further action on obesity is warranted, including the potential introduction of additional fiscal measures.

15.4 TAXATION OF ALCOHOL

15.4.1 Alcohol and public health policy

Alcohol consumption, in particular problematic drinking behaviour, is a major social problem and places considerable pressure on healthcare systems. By international standards, Ireland has a high rate of per capita consumption of alcohol. Ireland has the ninth-highest per capita alcohol consumption rate of OECD countries.[387] Ireland's consumption is 13.4 per cent higher than per capita consumption in the UK.[388] Alcohol mortality data from the National Drugs Related Death Index (NDRDI) analysed for the period from 2008 to 2017 showed 10,803 alcohol-related deaths recorded, which accounted for 3.7 per cent of all deaths in Ireland during this time. There were 1,094 such deaths in 2017 alone. According to the Department of Health, in 2013, alcohol-related illness cost the healthcare system €793 million, alcohol-related crime cost an estimated €686 million and alcohol-related road accidents cost an estimated €258 million. The cost of lost economic output due to alcohol was estimated to be €641 million in 2013 (e.g. €195 million due to absenteeism, €185 million due to accidents at work, €169 million due to suicide and €65 million due to premature mortality).

The relationship between price and alcohol consumption is clear. Increases in Excise Duty have either decreased or halted increases in alcohol consumption in recent years.[389] Between 2013 and 2019, consumption has remained relatively stable, rising just 2.9 per cent from 10.5 litres to 10.8 litres per person per year over that period. According to the Health Research Board, the 2012 and 2013 increases in Excise Duty might have prevented the sharp spike in alcohol sales witnessed during

387 Doyle, Anne (2021) Alcohol consumption, alcohol-related harm, and alcohol policy in Ireland. Drugnet Ireland, Issue 78.

388 O'Dwyer C., Mongan D., Doyle A. and Galvin B. (2021) Alcohol consumption, alcohol-related harm and alcohol policy in Ireland. HRB Overview Series 11, Dublin, Health Research Board.

389 Department of Finance (2020) Tax Strategy Group 20-08 General Excise.

Ireland's last period of economic growth.[390] No changes in Excise Duties on alcohol have been implemented since 2014. However, aside from fiscal measures, Minimum Unit Pricing was introduced on 4 January 2022. Minimum Unit Pricing raises the price of certain alcohol products without increasing the Excise Duty rate.

15.4.2 Alcohol Products Tax (APT) Excise yields

Excise duty on alcohol and alcohol products is known as the Alcohol Products Tax (APT). Various rates apply and the tax can be charged on both businesses and individuals. Excise Duty receipts from alcohol make a significant contribution to the Exchequer, consistently raising over €1.2 billion in recent years. In addition, alcohol sales also raise significant VAT receipts for the Exchequer. The Commission supports the continued focus on taxing alcohol products at a high rate.

15.5 TAXATION OF TOBACCO

The current rates and structures of Excise Duty on tobacco products are harmonised across the European Union through Directive 2011/64/EU, known as the Tobacco Products Tax Directive. The Directive defines and classifies various manufactured tobacco products according to their characteristics and lays down the relevant minimum rates of excise duty for the different types of products. The EU Council issued an outcome of proceedings in June 2020, stating that updates to the directive are needed for the proper functioning of the internal market and a high level of health protection across the EU.[391] The European Commission has identified the three key focus areas of its review of the Directive as:

1. minimum Excise Duty rates,
2. harmonisation of the taxation of new products, and
3. the fight against contraband.

The EU Commission has indicated that a legislative proposal to revise the Directive could be presented shortly.

15.5.1 Tobacco and public health policy

Tobacco smoking is the biggest single cause of ill-health and death in

390 O'Dwyer C., Mongan D., Doyle A. and Galvin B. (2021) Alcohol consumption, alcohol-related harm and alcohol policy in Ireland. HRB Overview Series 11, Dublin, Health Research Board.

391 Council of the European Union (2020) Council conclusions concerning the structure and rates of excise duty applied to manufactured tobacco.

Ireland and, according to data from the Global Burden of Disease study, it remains the leading preventable cause of ill-health, disability and premature mortality in this country.[392] Similarly, the Department of Health indicates that smoking remains the leading cause of preventable death in Ireland, accounting for nearly 6,000 deaths annually. It is estimated that one out of every two long-term smokers will die of a disease related to their tobacco use. In Ireland, the Tobacco Free Ireland Action Plan aims to achieve a tobacco free society with a smoking prevalence rate of less than 5 per cent of the Irish population by 2025. In 2019, 13.8 per cent of the Irish population aged 15 years or more reported that they were daily cigarette smokers.

Tobacco consumption continues to be the leading cause of preventable cancer, with 27 per cent of all cancers attributed to tobacco use. By eliminating tobacco use, nine out every ten cases of lung cancer could be avoided.[393] Tobacco taxation is one of the most effective instruments to fight tobacco consumption, particularly in deterring young people from taking up smoking.

Tax increases that substantially increase the retail price of cigarettes, together with continuing strong enforcement activity to fight criminal activity seeking to profit from selling such products without Excise Duty charges are considered the most effective measures to reduce tobacco demand.

The Commission endorses the approach of using tobacco taxation to fight tobacco consumption, particularly in deterring young people from taking up smoking.

15.5.2 Tobacco products tax rates and yields

Ireland has some of the highest rates of Excise Duty on tobacco products in the EU. This reflects a long-standing government policy of levying high rates of Excise Duty on tobacco products to meet public health targets. The Programme for Government supports further increases in Excise Duty on tobacco products in the coming years in an effort to further discourage smoking. Excise Duty on tobacco products has increased consistently in every budget over the past twenty years, with the exception of Budgets 2005, 2006 and 2010. Rate increases of €0.50 on a packet of 20 cigarettes, which is the most popular price category, have been implemented in each of the last six budgets with

392 Institute for Health Metrics and Evaluation (IHME) (2022) Health Data Ireland.

393 European Commission (2021) Europe's Beating Cancer Plan.

pro rata or higher increases applied to roll-your-own (RYO) tobacco. Recent increases in Excise Duty have resulted in the average price of tobacco increasing by about 20 per cent between March 2017 and March 2020.[394] The Commission supports the continued focus on taxing tobacco products at a high rate.

Recommendation

15.1 The Commission supports the use of taxation in promoting public health in Ireland. In particular, it supports the levying of excise duties/taxes at high rates related to the social cost arising from the consumption of alcohol, tobacco and sugar-sweetened drinks. The Government should seek to strengthen the link between the public health rationale and design of these taxes over time.

15.6 OBESITY

15.6.1 Obesity in Ireland

The Commission has examined the issue of obesity and how Ireland, like much of the world's population, is seeing significant and increasing rates of overweight and obesity.[395] The World Health Organization (WHO) predicts that Ireland's population will be one of Europe's most overweight countries by 2030.[396] With one in four children and two in three adults carrying excess weight, obesity is at an unacceptably

394 Department of Finance (2020) Tax Strategy Group 20-08 General Excise.

395 Definitions of overweight and obesity: The WHO definition of obesity is widely used for adults and often also for adolescents. It defines overweight in adults as a body mass index (BMI) equal to or greater than 25 kg/m^2 and obesity as a BMI equal to or greater than 30 kg/m^2, further subdivided into class I obesity when the BMI is 30.0–34.9 kg/m^2, class II with BMI 35.0–39.9 kg/m^2 and class III obesity with a BMI of 40 kg/m^2 and above. However, when it comes to childhood and adolescent overweight and obesity, the WHO definitions, based on a number of standard deviations above the respective WHO Growth Reference medians, are not as universally applied, and many definitions prevail. Hamilton, D., Dee, A. and Perry I.J. (2018) The lifetime costs of overweight and obesity in childhood and adolescence: a systematic review, Obesity Reviews 19, 4.

396 Breda, J. and Webber, L. (2015) WHO projections in adults to 2030, Obesity Facts, European Journal of Obesity, 8, 18.

high level.[397] These rates have changed little in recent years, despite evidence-based policy change such as healthy eating and awareness programmes.[398] The lifetime risk of chronic disease from these rates of obesity is significant, as greater time spent living with obesity can infer a greater health risk.

As also demonstrated in other jurisdictions, Ireland shows a health equity gradient where the most deprived suffer obesity at rates much greater, and much more dangerous, than the least deprived. Individuals living in deprived areas are more likely than individuals living in affluent areas to be overweight or obese (65 per cent and 55 per cent, respectively). Among those aged under 35, 50 per cent of those living in deprived areas are overweight or obese, compared to 37 per cent of those living in affluent areas.[399]

15.6.2 Cost of obesity in Ireland

The estimated lifetime costs of obesity in Ireland is €4.6 billion, which amounts to €16,036 per person and demonstrates the economic as well as the Public Health rationale for tackling this issue.[400]

At the macroeconomic level, overweight will reduce Ireland's GDP by 3.2 per cent over the next thirty years according to the OECD.[401] The OECD also notes that overweight has a significant impact on fiscal pressure (where tax increases per capita will be needed to cover the cost of obesity – see Figure 28) in particular countries, including Ireland along with Belgium, Denmark and the USA.[402]

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397 Layte, R. and McCrory, C. (2011) Growing Up in Ireland. Overweight and Obesity among 9-year olds, Department of Children and Youth Affairs. Keane, E. Kearney, P.M., and Perry, I.J. (2014) Trends and prevalence of overweight and obesity in primary school aged children in the Republic of Ireland from 2002-2012: a systematic review, BMC Public Health, 14, 974.

398 Safefood Ireland (2021) Whole systems approach to childhood obesity: A review of the evidence.

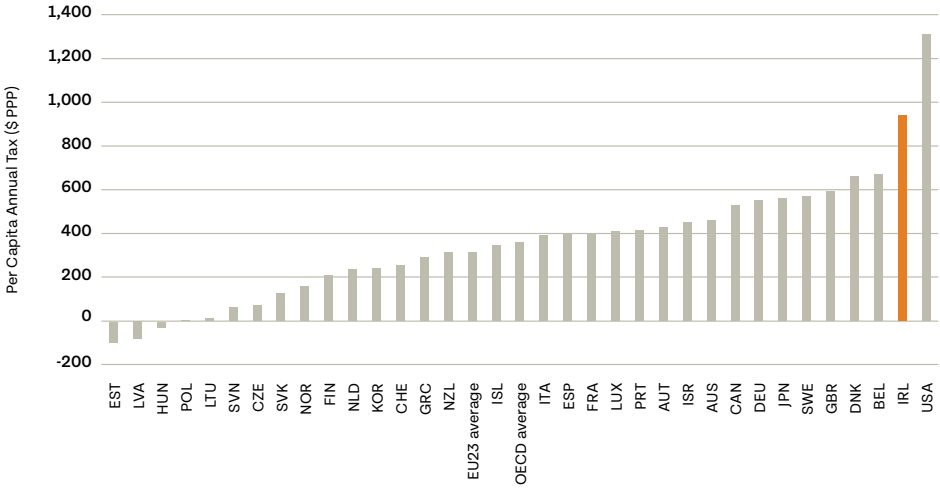
399 Department of Health (2019), Healthy Ireland: Summary Report 2019.

400 Safefood (2017) What are the estimated costs of childhood overweight and obesity on the island of Ireland.

401 OECD (2019) The Heavy Burden of Obesity, OECD Statlink.

402 OECD (2019) The Heavy Burden of Obesity: The Economics of Prevention, OECD Health Policy Studies, Paris, OECD Publishing.

Figure 28: Equivalent per capita annual tax needed to cover the increased fiscal pressure due to overweight, in US$ purchasing power parity, average 2020-2050

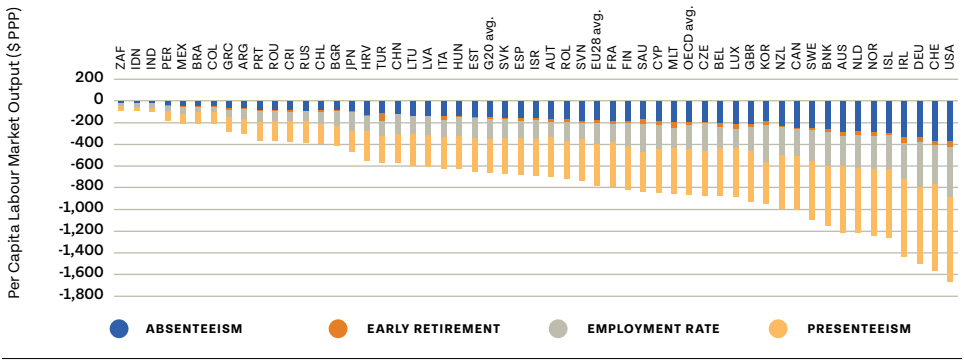


Source: OECD analyses based on the OECD Strategic Public Health Planning for Noncommunicable Diseases (SPHeP-NCDs) model & OECD long-term economic model, 2019.

Obesity reduces the employment rate, and increases early retirement, absenteeism and productivity. By measuring absenteeism, early retirement, employment rate and presenteeism.[403] Figure 29 shows how the labour market in Ireland will be amongst the most affected countries in terms of overweight and obesity in the OECD, comparable to Germany and the USA, in the coming decades.

403 Presenteeism refers to employees who are present at work but less productive.

Figure 29: Economic impact of overweight on per capita labour market output based on average wages, per year, in US$ Purchasing Power Parity, average 2020-2050



Source: OECD, The Heavy Burden of Obesity

The determinants of overweight and obesity are multiple and include the environment, access to healthy and affordable food, physical activity, exercise and leisure activity, cultural and societal norms, education and skill levels, genetic makeup and lifestyle choices.[404] This complex mix of factors means that solutions to the problem of overweight and obesity are not simple. However, it is generally recognised that the food environment forms an integral part of addressing the issue.[405] The 'food environment' is the wide range of interconnected factors such as food production, processing, marketing, and distribution that characterise our food system and largely determine our dietary intakes.[406] Unhealthy food environments encourage the consumption of unhealthy foods (i.e. ultra-processed, energy-dense, nutrient-poor products) which are intensely promoted and easily accessible.[407] In this context, the Commission examined the potential fiscal measures that could be introduced to influence the food environment in Ireland and improve health outcomes.

404 Department of Health (2016) A Healthy Weight for Ireland: Obesity Policy and Action Plan 2016 - 2025.

405 Institute of Public Health (2013) Proposed Sugar Sweetened Drinks Tax: Health Impact Assessment Full Report.

406 Harrington J.M., Griffin C., and Vandevijvere S. (2020) The Healthy Food Environment Policy Index (Food-EPI): Evidence Document for Ireland 2020, Cork, School of Public Health, UCC.

407 Harrington J.M., Leydon C.L., Twohig C.H., and Vandevijvere S. (2020) Policies for Tackling Obesity and Creating Healthier Food Environments in Ireland, Cork, School of Public Health, UCC.

15.6.3 Need for action on obesity

Public health experts focusing on obesity in Ireland believe there is a critical and urgent need for cross governmental and cross sectoral policies and initiatives, which will address the effects of an unhealthy environment through meaningful legislative change and societal factors. Common population-level primary prevention strategies include taxation of unhealthy food and drinks, limiting food and beverage advertising, affordable physical activity options, and addressing the social determinants of health. The important role of such initiatives should be emphasised.[408]

The findings of research and expert bodies, which track obesity in Ireland and its economic cost, continue to highlight the need for significant investment in research to examine the influence of fiscal and other policies on consumer purchasing and their impact on overweight and obesity. Such research should include, for example, risk-benefits assessment of taxation that supports healthy eating and active living and subsidies for healthy food such as fruit and vegetables.[409]

The Irish Healthy Food Environment Policy Index 2020, which benchmarked the Irish Government's level of support for improving the healthiness of the food environment against international standards, found that Ireland falls behind international best practice for implementing policies such as tackling the promotion of unhealthy foods to children, and utilising fiscal policies to support healthy food choices and food composition targets.[410]

15.6.4 Obesity and ultra-processed foods

A study in the Journal of Public Health Nutrition in 2018, shows that Irish shopping baskets contain 45.9 per cent ultra-processed foods, making Ireland the third-highest consumers of such foods after the UK (51 per cent) and Germany (46.2 per cent).[411] This research and other

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408 Health Service Executive (2021) Model of Care for the Management of Overweight and Obesity.

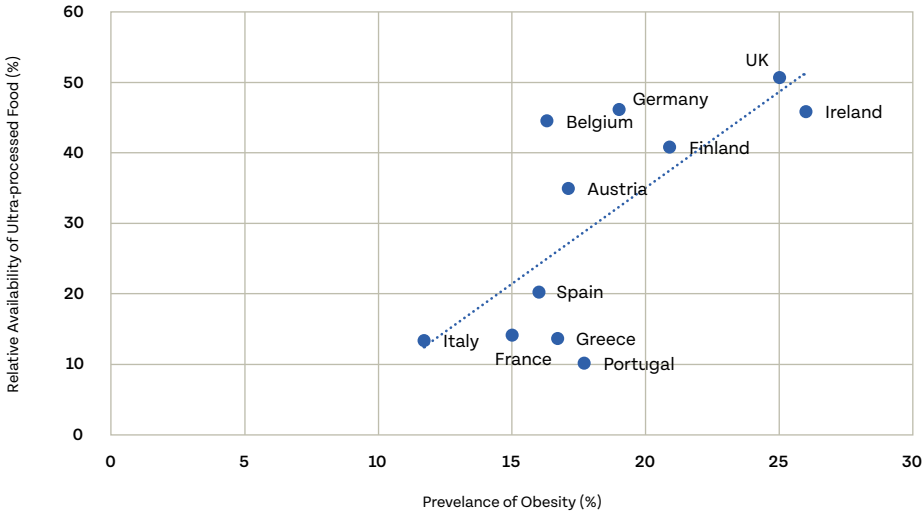
409 Safefood Ireland (2012) The cost of overweight and obesity on the Island of Ireland.

410 Harrington J.M., Leydon C.L., Twohig C.H., and Vandevijvere S. (2020) Policies for Tackling Obesity and Creating Healthier Food Environments in Ireland, Cork, School of Public Health, UCC.

411 Monteiro, C., Moubarac, J., Levy, R., Canella, D., Louzada, M., & Cannon, G. (2018) Household availability of ultra-processed foods and obesity in nineteen European countries, Public Health Nutrition, 21(1), 18-26.

studies have shown that where countries have a high availability of ultra-processed foods, there are corresponding high rates of obesity.

Figure 30: Regression of prevalence of obesity among adults v. household availability of ultra-processed foods in selected Western European countries



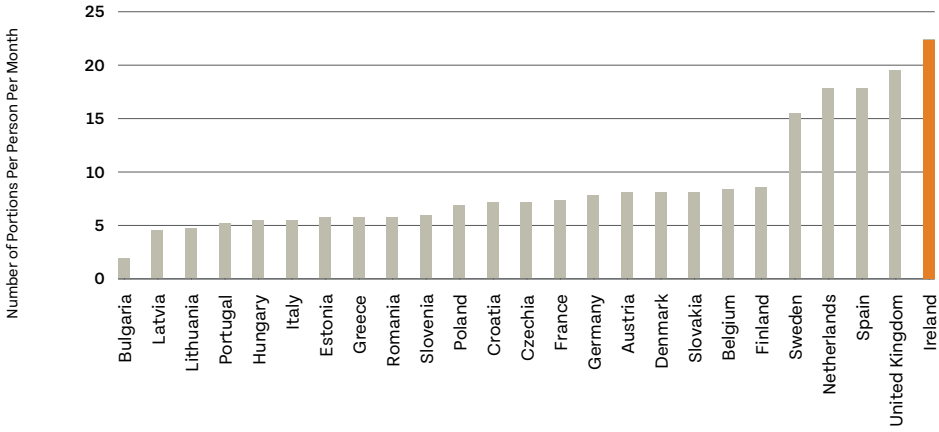
Source: Public Health Nutrition: 21(1), 18–26, updated with Eurostat Overweight and obesity - BMI statistics 2019.

Ultra-processed foods are formulations industrially manufactured mostly or entirely from substances that have already been processed, such as sugar, salt, oils and fats, and starches.[412] The ingredients of ultra-processed foods are not used in domestic kitchens, such as hydrogenated fat, high-fructose corn syrup, emulsifiers, preservatives, and flavours,

412 NOVA Food Group 4: Ultra-processed foods include sweet, fatty or salty packaged snack products; ice cream, chocolate, sweets; mass-produced packaged breads, cookies, pastries, cakes; breakfast cereals; 'energy' bars; preserves; margarines; carbonated drinks, 'energy' drinks; milk drinks, including 'fruit' yoghurts; cocoa drinks; infant formulas, follow-on milks, other baby products; 'health' and 'slimming' products such as powdered or 'fortified' meal and dish substitutes; and many ready-to-heat products including pre-prepared pies and pizza dishes, burgers, hot dogs, poultry and fish 'nuggets', and other reconstituted meat products, and powdered and packaged soups, noodles and industrial desserts. Monteiro, C.A., Cannon, G., Lawrence, M., Costa Louzada, M.L. and Pereira Machado, P. (2019) Ultra-processed foods, diet quality, and health using the NOVA classification system, Rome, FAO.

colours and other additives used to make the product more appealing.[413] The most commonly consumed ultra-processed foods in Ireland are some packaged breads, confectionery, cakes, cookies and other baked products, reconstituted meat products and sugar-sweetened beverages. In a European context, Ireland had the highest prevalence of sweet and savoury snack consumption and the second-highest confectionery consumption among twenty four EU countries and the UK in 2016.[414]

Figure 31: Prevalence of sweet/savoury snack consumption (Number of 35g sweet/savoury snack portions/person/month), 2016



Source: Euromonitor International/Global Obesity Observatory

Dietary intake of ultra-processed foods has been found to be a key driver of increasing incidence of overweight and obesity and associated chronic diseases.[415] Limiting consumption of ultra-processed food may be an effective strategy for obesity prevention and treatment.[416]

413 Monteiro, C., Moubarac, J., Levy, R., Canella, D., Louzada, M., & Cannon, G. (2018). Household availability of ultra-processed foods and obesity in nineteen European countries. Public Health Nutrition, 21(1), 18-26.

414 Global Obesity Observatory (2016) Ireland Report Card, London, World Obesity Federation.

415 Howard Wilsher S., Harrison F., Fearne A., Jones A. (2022) Food Sales and Adult Weight Status: Results of a Cross-Sectional Study in England. Nutrients. 2022; 14(9).

416 Hall, K.D., Ayuketah A., Brychta R. (2019) Ultra-Processed Diets Cause Excess Calorie Intake and Weight Gain, Cell Metabolism 30.

Ireland's national Obesity Policy and Action Plan, initially launched in 2016, includes a strategy for reformulation of food products. Reformulation is defined as changing the nutrient content of a processed food product to either reduce the content of negative nutrients such as sodium, saturated fat, trans fat or energy (as measured in kilojoules) or to increase the content of beneficial nutrients such as dietary fibre, wholegrains, fruit, vegetables and unsaturated fats.

The Action Plan has already seen the introduction of the Sugar Sweetened Drinks Tax (SSDT), which has driven the reformulation of many sugar-sweetened beverages. The SSDT came into effect on 1 May 2018 and applies to water- and juice-based drinks. The scope of the tax was extended with effect from 1 January 2019 to include certain drinks containing milk fats and plant protein drinks. The SSDT operates as an Excise Duty and is administered on a self-assessment basis.

A similar sugar-sweetened drinks tax operates in the United Kingdom. The Commission noted the UK National Food Strategy 2021, which recommended, amongst a range of measures, the introduction of a Sugar and Salt Reformulation Tax. This tax would be charged as a £3 (€3.57) per kg tax on sugar and a £6 (€7.15) per kg tax on salt sold for use in processed foods or in restaurants and catering businesses. This tax would supersede the UK's tax on sugar-sweetened beverages. The strategy proposes that this tax would encourage manufacturers to reformulate their products to use less sugar and salt, in order to keep costs down. In some cases, where products cannot be reformulated and, therefore, remain extremely high in sugar and salt, the increased cost might be passed on to the consumer. The strategy suggests that this would make such products less appealing. In terms of salt content, the tax would apply at a rate of £6 (€7.15) per kg to all salt sold for use in food manufacturing. As salt is used in much smaller quantities than sugar, the rate needs to be higher in order to achieve an impact.[417]

In recent years, the UK has set voluntary salt and sugar reduction targets for manufacturers; however, these targets have produced limited results. Mandatory interventions have been more successful.[418] A tax on the amount of sugar and salt used in these foods is expected to create

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417 The National Food Strategy (2021) The Plan.

418 Public Health England (2020) Sugar reduction: Report on progress between 2015 and 2019. Public Health England (2019) Advancing our health: prevention in the 2020s – consultation document. The UK Soft Drinks Industry Levy (SDIL) had by 2019 removed the equivalent of over 45,000 tonnes of sugar from UK shelves.

a significant incentive for companies to reformulate their products so as to avoid having to increase prices, which would be damaging to their business in the UK's highly competitive and price-sensitive food market.

In December 2021, arising from the Obesity Policy and Action Plan Progress Report, the Minister for Health launched A Roadmap for Food Product Reformulation in Ireland.[419] As the roadmap outlines, it is now understood that food reformulation is a critical element in achieving population nutrient goals consistent with the prevention of obesity and chronic disease and the promotion of health and wellbeing.[420] The roadmap further notes that there is "a clear and urgent need to achieve further substantial reductions in the salt, sugar, saturated fat content, calorie density and/or single-serving portion size across a wide range of major food and drink products in Ireland.".

To improve the food choice environment for Irish citizens, the roadmap also outlines that voluntary agreements with the food industry should be used as a first step to reduce sugar, salt and other ingredients deemed harmful to public health. The roadmap does note that the option of statutory or fiscal approaches to reformulation need to be retained, given the personal, economic and broader societal costs of obesity and nutrition-related chronic disease. Depending on progress, the voluntary framework may need to be supplemented with additional fiscal and/or mandatory reformulation measures (with robust and transparent monitoring). The Commission believes this option should remain under review.

The Commission has noted that voluntary and industry-led reformulation strategies targeting unhealthy food products can have the effect of delaying more substantive strategies to get rid of the most harmful products altogether. Voluntary reformulation strategies can be employed by industry as a tool to divert policy away from mandatory measures, including taxation.[421] The Commission notes that evidence suggests that the SSDT had the effect of driving reformulation on account of its mandatory application.[422]

It should be noted that the Obesity Policy and Action Plan to

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419 Department of Health (2016) A Healthy Weight for Ireland: Obesity Policy and Action Plan 2016 – 2025.

420 Department of Health (2021) A Roadmap for Food Product Reformulation in Ireland.

421 Campbell, N. and Finucane F., (2019) The food system needs a revolution, The Conversation UK.

422 Department of Health (2021) A Roadmap for Food Product Reformulation in Ireland.

2025 includes a specific action to develop proposals on the rollout of evidence-based fiscal measures to support healthy eating and lifestyles with the Department of Health and the Department of Finance as lead partners. This action has not been progressed to date.

The Commission reviewed the Obesity Roadmap, which notes that the option of statutory or fiscal approaches to reformulation need to be retained, given the personal, economic and broader societal costs of obesity and nutrition-related chronic disease. Depending on the progress, the Commission supports the view that the voluntary framework approach contained in the Obesity Roadmap may need to be supplemented with additional fiscal and/or mandatory reformulation measures. In order to support such efforts, a credible fiscal response that is capable of implementation should be developed by the Department of Finance and the Department of Health. If, ultimately, the implementation of a fiscal response is deemed necessary, the Commission proposes that responses could be informed by the UK Sugar and Salt Reduction Levy contained in the UK National Food Strategy.

Recommendation

15.2 The Commission recommends that Government develop fiscal measures which could be introduced to encourage a reduction in the consumption of ultra-processed foods, to support reformulation measures to reduce the harm of such foods and promote healthier eating. In developing such proposals, Government should be conscious of the distributional effect of proposed changes and the influence of fiscal and other policies on consumer purchasing and their impact on overweight and obesity.

15.7 VAT TREATMENT OF HEALTHY AND UNHEALTHY FOOD

In tackling obesity with fiscal measures, the Commission investigated the possibility of using VAT as a lever for influencing pricing for unhealthy food products, in particular ultra-processed foods.

In Ireland, the zero rate of VAT applies to the supply of most foodstuffs, such as most breads, butter, cheese, cereals, condiments, flour, fruit, herbs, meat, milk, pasta, pastes, sauces, soup, spices, sugar, and vegetables (fresh or frozen).

The second reduced rate of VAT (currently 9 per cent) applies to

the supply of heated or ambient food and drink. Therefore, the supply of hot takeaway food is liable to VAT at the second reduced rate. This includes food heated, retained heated or supplied while still warm.

The reduced VAT rate (currently 13.5 per cent) applies to products including cakes, crackers and certain biscuits and wafers, but excluding items in this category that are subject to the zero or standard rate of VAT.

It is open to Member States to legislate to prescribe the types of foodstuffs to which the standard or reduced rate of VAT could apply. Ireland has two current reduced rates of VAT, 13.5 per cent and 9 per cent, and it is permissible to apply one of the current reduced rates to certain food products. The Court of Justice of the European Union (CJEU) has recently ruled that the application of the reduced rate of VAT, under Article 98 and Annex III of the VAT Directive, can be selective and restricted to "concrete and specific aspects" of a category in that Annex, provided it does not infringe on the principle of fiscal neutrality. As such, similar products cannot be rated differently e.g. a 'normal burger' versus a 'healthy burger'. Therefore, it appears that if a particular rate is applied, whether it is standard or reduced, it must be applied to all 'burger' products.

The introduction of two rates of VAT for similar food products would create both legal and administrative difficulties as the composition of the products is generally the same or similar. This would lead to the opportunity for tax planning, the development of competition issues in the marketplace, fiscal neutrality issues for taxpayers, added complexity in the marketplace for suppliers, importers, wholesalers and retailers and administrative difficulties for business and the Revenue Commissioners.

Trying to distinguish a zero-rated healthy food product from a similar zero-rated food product (unhealthy) would be extremely difficult; there would be serious difficulties and complexities in drafting legislation to provide for such distinctions. Taxation legislation must be clear and effective and the legislature would face the difficulty of attempting to distinguish between two versions of multiple products so that two different rates of VAT can apply. The task of examining the ingredients of several thousand products would have to be undertaken. The likely outcome could involve a significant amount of lengthy litigation with taxpayers, resource-intensive work on the administration of the tax and disagreements over the constitution of ingredients of products and what can act as a substitute.

Following the examination of the potential role of VAT in this area,

the Commission decided against proposing that VAT be used as a fiscal tool to influence the food environment for those reasons.

15.8 INTERNATIONAL PUBLIC HEALTH TAXES

Health-related taxes have been recommended by the World Health Organization.

Early adopters of such a taxation strategy include Mexico (2014), Hungary (2012), and Finland (2011). These countries introduced taxes not only on sugar-sweetened beverages but also on other unhealthy foods, including high sugar snacks. In Mexico, for example, all "non-essential foods" with 275 or more kcal/100 g are taxed at 8 per cent, including biscuits and cereal bars. In Hungary, prepacked high-sugar sweets with more than 25g of sugar are taxed at €0.40 per kilogram. Finland had a tax on sweets and ice cream (about €0.95 per kilogram) between 2011 and 2017. Existing evaluations suggest that the tax in Hungary, which also applied to products high in salt, reduced purchases of the taxed foods by 3.4 per cent. In Mexico, the tax on non-essential foods was estimated to have reduced purchases by 5-6 per cent, with greater effects (reduction by 12.3 per cent) among those with higher baseline purchases of taxed foods.

While the Hungarian tax is still in operation, the Finnish tax has been amended to just sugar-sweetened beverages due to issues with EU rules. It is important to note that any potential fiscal measures must comply with EU State Aid Rules.

15.9 TAX RELIEF ON PRIVATE HEALTH INSURANCE

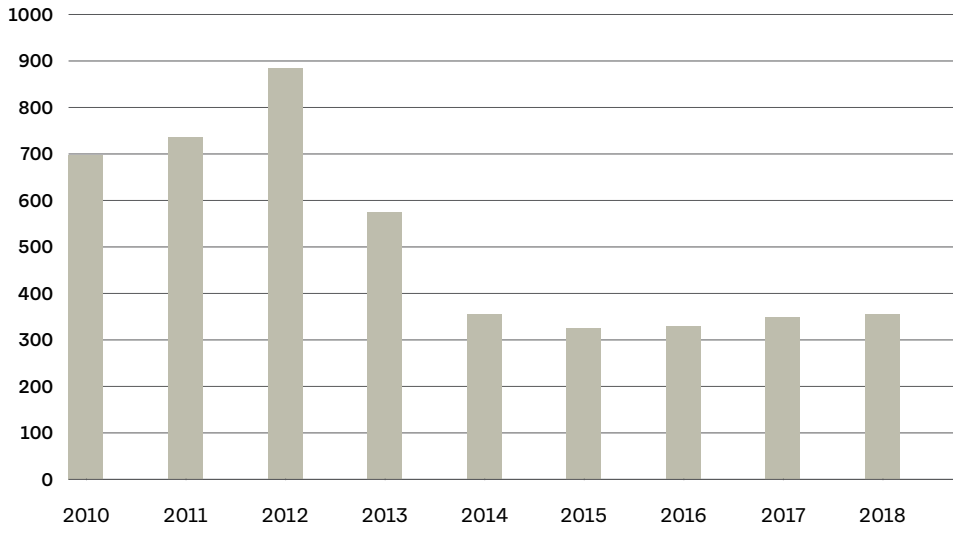
Tax relief is currently available for premiums paid for private health insurance. Those who privately purchase individual health insurance policies automatically receive tax relief on their premiums at source. In general, the relief is given as a deduction of a percentage, equivalent to the prevailing standard rate of Income Tax (currently 20 per cent), from the gross premium. From 2014, the maximum amount of a gross premium eligible for the relief is capped at €1,000 per adult and €500 per child.

According to 2019 data, Medical Insurance Relief was availed of by over 1.25 million individuals and, in terms of revenue forgone, cost the exchequer €355.2 million. This compares to 1.27 million claimants in 2017 at a cost of €350 million.[423]

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423 Revenue Commissioners (2021) Costs of tax expenditures.

Figure 32: Medical Insurance Relief cost, 2012-2019



Source: Revenue Statistics: Cost of tax expenditures 2010-2019

Tax reliefs on private health insurance form part of a structure of healthcare that has an unusual degree of overlap between public and private provision which is not seen to the same extent in most developed countries. The Commission recognises that Sláintecare aims to address a number of issues in the Irish healthcare system. The strategy's ambition is to ensure full equity in the delivery of public hospital services. Sláintecare aims to completely separate public and private healthcare provision on a phased basis to deliver a single-tier public hospital system. Holders of private health insurance will continue to be able to purchase care from private healthcare providers only.

Accordingly, it is the Commission's view that it is not appropriate to retain this relief in the long term and that it should be phased out in the context of the implementation of the Sláintecare Strategy.

Recommendation

15.3 In the context of the implementation of Sláintecare, tax relief for private health insurance should be phased out over time.

15.10 RECOMMENDATIONS

Chapter 15: Promoting Good Public Health

15.1 The Commission supports the use of taxation in promoting public health in Ireland. In particular, it supports the levying of excise duties/taxes at high rates related to the social cost arising from the consumption of alcohol, tobacco and sugar-sweetened drinks. The Government should seek to strengthen the link between the public health rationale and design of these taxes over time.

15.2 The Commission recommends that Government develop fiscal measures which could be introduced to encourage a reduction in the consumption of ultra-processed foods, to support reformulation measures to reduce the harm of such foods and promote healthier eating. In developing such proposals, Government should be conscious of the distributional effect of proposed changes and the influence of fiscal and other policies on consumer purchasing and their impact on overweight and obesity.

15.3 In the context of the implementation of Sláintecare, tax relief for private health insurance should be phased out over time.

Part 4:
Better Systems

Chapter 16:
Tax Expenditure Review Process

16.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"examine the process for reviewing taxation measures and expenditures in order to ensure it is aligned with best practice and, where appropriate, to make recommendations as to how it can be improved."*

In approaching this aspect of its work, the Commission has considered fully the existing process for the evaluation of tax measures and expenditures in Ireland. This work has included an examination of the definition of a tax expenditure and the benchmark tax system, the process of costing of tax expenditures, and the approach to ex-ante and ex-post reviews of proposed and existing expenditures. It has also considered the quality and depth of existing tax expenditures reviews and associated availability of appropriate data to support such analysis. Given the timeline for completion of the Commission's work and the breadth of its mandate, it was not feasible for the Commission to examine all tax expenditures individually.

16.2 BACKGROUND TO TAX EXPENDITURES

16.2.1 What is a tax expenditure?

A tax expenditure is a transfer of public resources achieved by either reducing tax obligations with respect to a benchmark tax (rather than by direct expenditure), or provisions in tax legislation that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to the tax base.[424] Tax expenditures are generally introduced into the tax code for some specific purpose, typically to achieve certain economic and social objectives, such as to reduce the tax burden for a particular class of taxpayer or to promote

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424 Definition as contained in the EU Directive on requirements for budgetary frameworks of the Member States (2011/85/EU) which was transposed into Irish law by statutory instrument (S.I. No. 508/2013).

a particular type of activity. Tax expenditures involve decisions to forgo tax revenue from a benchmark tax level. They are equivalent to Government expenditures insofar as both involve the allocation of scarce resources towards achieving Government policy objectives.

A tax expenditure may take the form of a relief, exemption, or deduction from tax due, rate relief, deferral or other tax incentive. Some examples of tax expenditures are given below:

Table 29: Examples of different tax expenditures

TYPE	EXAMPLE
Relief	Capital Gains Tax Retirement relief provides relief for disposals of business and farming assets
Exemption (Exclusions from the tax base)	Pay Related Social Insurance exemption >65 year olds
Credits (Deduction from tax due)	Single Person Child Carer Credit
Rate relief (Reduced rate of tax applied to a class of taxpayers)	Zero-rated VAT
Deferral	Local Property Tax deferral
Tax incentive (measures to encourage behavioural change)	Help to Buy incentive, Home Renovation Incentive

Source: Secretariat

The OECD sets out what is good practice with regard to the review of tax expenditures. This good practice is largely followed by the EU Commission in setting out requirements for Member States to publish information on tax expenditures.

Meaningful reporting of, analysis on, and decision-making about tax expenditures is facilitated by:

- Availability of objective and timely data (see section 16.5)
- Knowing what is in the benchmark (what is in the tax base? - see section 16.7)
- Appropriate costing methodologies (see section 16.5).

The Commission supports the generally accepted principle that tax expenditures should be considered as equivalent to direct expenditure as they involve Government choices to support policy objectives. Therefore, equivalent analysis and oversight should be applied to the decision-making process surrounding these expenditures.

16.2.2 When is it appropriate to use a tax expenditure?

The 1982 to 1986 Commission on Taxation outlined that there are three occasions on which it is appropriate to consider introducing a tax expenditure ahead of direct expenditure. These are to correct a market failure, to attract mobile investment and to offset shortcomings in other areas of public policy.[425] While the 2009 Commission on Taxation agreed with this position, the current Department of Finance evaluation guidelines[426] are more restrictive. Since 2014, Government policy[427] has been that a tax expenditure should not be incurred unless it addresses a market failure (see definition below) and then it should only be used where such a tax expenditure is more efficient than a direct expenditure intervention. The Commission fully endorses and supports this approach.

What is a market failure?

In economic theory, a free market produces the most efficient outcome from a societal perspective (See, e.g., Atkinson, A.B. & J.E. Stiglitz (1980), Lectures on Public Economics, pp5-8). However, there are often occasions where this is not necessarily the case in practice. A market failure occurs where those engaged in the market produce societally insufficient levels of 'goods' (such as Research and Development, a key driver of economic growth), or overproduce societal 'bads', such as pollution. In other words, those engaged in the market account solely for their own private gains, while failing to internalise the wider societal impacts of their choices (referred to as externalities). In such circumstances the market clearly fails to bring about the desired allocation of resources absent intervention. Tax expenditures are used to reflect, via reduced costs to the claimant, the wider societal benefits of the claimant's decision to undertake a particular activity which delivers a societal 'good'.

16.2.3 Impact of tax expenditures on revenue

Tax expenditures erode the tax base. They also result in deliberately uneven distributional impacts (affecting some people and not

425 Commission on Taxation (1984) Direct Taxation -The Role of Incentives.

426 Department of Finance (2014) Report on Tax Expenditures with Guidelines for Tax Expenditure Evaluation.

427 Department of Finance (2013) Medium Term Economic Strategy 2014-2020.

others). Poorly designed expenditures can give rise to the following consequences:

- Encouraging persons to engage in artificial steps in order to avail of benefits in a manner that does not align with the objective of the expenditure.
- Providing benefits to persons who would have engaged in the incentivised activity whether or not the expenditure existed (often referred to as deadweight).

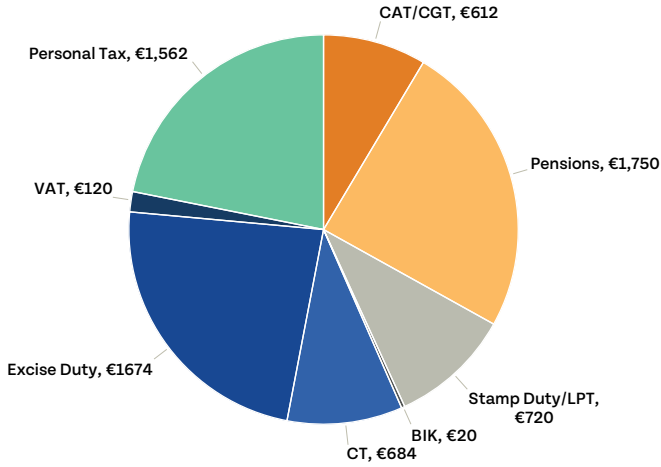
Since 2015, the Department of Finance has published an annual report on Tax Expenditures containing estimates of the fiscal impact of tax expenditures as required under the EU Budgetary Framework Directive. Figure 33 shows the amount of tax forgone in millions by tax head as shown in the most recent annual report (2021) published by the Department of Finance as part of Budget 2022.[428]

Published estimates of the scale of tax forgone in Ireland vary, with both the Department of Finance and the Revenue Commissioners (Revenue) publishing data. Variation between the two sources is due to definitional issues around what a tax expenditure is and what is considered an integral or structural component of the tax system (discussed further in section 16.7). The Department of Finance 2021 Tax Expenditures Report estimates total revenue forgone at €7.1 billion. This is a highly conservative figure for a number of reasons including:

- data not being available in relation to circa 7 per cent of the tax expenditures listed (by number), including a number of likely high cost tax expenditures (PPR relief etc.) - see section 16.5; and
- the limited nature of costing methodologies used, which rely heavily on estimates of revenue forgone that does not always take account of associated behaviour effects of measures.

428 Department of Finance (2021) Tax expenditures report 2021.

Figure 33: Estimated cost of tax expenditures (€ millions), 2020



Source: Department of Finance, Tax Expenditures Report 2021

16.3 NATIONAL AND INTERNATIONAL CONTEXT

Many improvements to the review and assessment of tax expenditures have been introduced since the 2009 Commission on Taxation. At various times over the last 10 years, the Department of Finance, EU Commission, the Parliamentary Budgetary Office, the Budgetary Oversight Committee and others have made contributions in this area, and many improvements have been made and implemented as a result of these interventions. These improvements include the publication of tax expenditure evaluation guidelines by the Department of Finance in October 2014 and the introduction of annual reporting as outlined above. However, recent commentary from both the EU Commission[429] and the Budget Oversight Committee[430] suggests that significant shortcomings in the overall approach to tax expenditures remain.

429 EU Commission (2020) Staff Working Paper on the Review of the Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.

430 Committee on Budgetary Oversight (2021) Budgetary Oversight Committee interim pre-Budget 2022 Report.

In 2018, the Parliamentary Budget Office (PBO) published a briefing paper "Tax Expenditures in Ireland: Key issues for consideration", which examined how tax expenditures are defined, costed and reviewed, and emphasised certain key issues in respect of each of these three areas.

In this paper the PBO also advised that a more detailed consideration of such expenditures should be included as part of the wider Budget scrutiny process. The four key messages/issues for consideration set out in the PBO's briefing paper relate to:

1. defining the benchmark system;
2. methods for costing tax expenditures;
3. data accessibility and transparency; and
4. systematic review and evaluation.

Building upon the PBO report, the Budgetary Oversight Committee (BOC) conducted an examination of tax expenditures and the Committee published a report in 2019.[431] The BOC followed this work up in 2021 with a further examination of tax expenditures and an interim Pre-Budget report that contained further tax expenditure related commentary and this work is continuing throughout 2022.

The 2019 BOC report provides a general overview of tax expenditures and the level of scrutiny conducted on those expenditure. It examined the Department of Finance's 2014 guidelines, analyses the data provided to the Committee by the Department following its appearance before the BOC and examines the issue of sunset clauses. The report also included an examination of international best practice, and how Ireland compares. The report draws four conclusions and makes eight recommendations.

The four conclusions reached by the Committee concerned:

1. parliamentary scrutiny of tax expenditures,
2. difficulties in making international comparisons in this area,
3. further progress needed in reviewing tax expenditures, and
4. acknowledging a list of tax expenditures prepared by the Department of Finance.

431 Committee on Budgetary Oversight (2019) Report on Tax Expenditures.

The eight recommendations made in the Report (separate to the conclusions) relate to:

1. the provision of annual updates by the Department,
2. better alignment of the Revenue and Department of Finance reporting formats,
3. provision of further information in relation to reviews, in particular, where reviews have not been carried out, and
4. the publication of scrutiny of budget measures (ex-ante and ex-post).

The report also recommends that that the Department of Finance review its existing guidelines regarding the evaluation of tax expenditures with a view to implementing a rigorous and regular system of reviews for tax expenditure measures.

In its interim pre-Budget 2022 report,[432] the Committee noted again that:

> *"the lack of transparency around tax expenditures is a significant issue for the Committee. In particular, the scrutiny of tax expenditures is complicated by the lack of information around the cost of many tax expenditures".*

16.4 EXISTING APPROACH TO TAX EXPENDITURE REVIEW

The Department of Finance published guidelines for tax expenditure evaluation in October 2014. These guidelines set out best practice for ex-ante (before implementation) and ex-post (after implementation) evaluation of tax expenditures. They seek to explain the role and key economic features of tax expenditures in an Irish policy context and to set out the limited circumstances in which tax expenditures should be used as a policy tool. They set out how the Department of Finance approaches the evaluation of tax expenditures, either before the tax expenditure is introduced or in reviewing a tax expenditure that is already in existence. They establish the key economic principles governing the evaluation of tax expenditures (neutrality and market failure) and those governing evaluation (deadweight, displacement and opportunity costs). They indicate timelines for regular review of schemes, guided by scheme size.

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432 Committee on Budgetary Oversight (2021) Interim pre-Budget 2022 report.

As outlined in Part 1 of this report, good tax policy, and hence also system-wide approaches to tax measures and expenditures, should adhere to key principles of good policy design and administration.

16.4.1 Need for regular review

A key requirement in order to ensure that a tax expenditure is functioning well is the need for regular review. It assesses that the original market failure which required the tax measure is still valid and remains in existence, that the tax expenditure is still performing adequately as regards deadweight and displacement and that the policy has not become inequitable, lost its tax-neutral stance or otherwise developed negative unintended consequences. Without regular review, a tax expenditure can persist for an extended period, perhaps even years beyond the original policy intention. In some cases, a tax expenditure can eventually run counter to current Government policy, for example, certain carbon-related tax expenditures, private health insurance[433] and other reliefs.

The 2014 guidelines envisaged that all tax expenditures would be examined over a five year period. Full implementation of this review timetable has not been possible during the seven years since the publication of the guidelines, with the Department of Finance citing the resource and/or practical constraints that can limit the amount of review work that may be carried out by, or on behalf of, the Department in any one year.[434] A summary of the expenditure reviews that have been completed since 2014 is set out in Table 30.

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433 An example of this may be Private Health Insurance tax relief which was introduced at a time when, against a background of constrained public finances and weak economic growth, public policy was to support people who could pay for their care in a public hospital to do so (Health Insurance Authority, The Irish Healthcare System: An Historical and Comparative Review 2018). In the context of the implementation of Sláintecare, which aims to tackle unequal access to health care and removing the need for large parts of the population to purchase private health insurance plans or pay fees to access primary health care, such a relief may no longer be warranted. See Chapter 15 (Promoting Good Public Health).

434 Department of Finance (2019) Statement to the Committee on Budgetary Oversight hearing on Tax Expenditures.

16.4.2 Annual tax expenditures reports

The EU Directive on requirements for budgetary frameworks of the Member States[435] is the relevant EU legislation relating to tax expenditures. The legislation adopts the OECD definition of a tax expenditure (as also recommended in the Commission on Taxation Report 2009) and commits to the annual publication of detailed information on the impact of tax expenditures on revenues.

Non-regular publication of information about tax expenditures previously available across the EU was seen as acting to both hinder the effectiveness and efficiency of fiscal policy making by Member States, and thereby making the identification of possible improvements to fiscal and tax arrangements more difficult.[436]

The Department of Finance meets these obligations through the publication of its annual tax expenditure reports which are published alongside the budget each year.

16.4.3 Tax expenditures reviewed since 2014

Table 30 lists the tax expenditure reviews published by the Department of Finance since the publication of the Tax Expenditure Guidelines in 2014. It should be noted that occasionally other reviews have been conducted which have not been published due to timing issues. Some reliefs are considered as part of the annual Tax Strategy Group process. The cost figures are taken (where available) from the 2021 Tax expenditures review report published alongside Budget 2022 in October 2021. Most costs are the most recent published (usually from 2019 or 2020) but, in certain cases (marked with an asterix), the costs are taken directly from the review mentioned.

435 The EU Directive on requirements for budgetary frameworks of the Member States (2011/85/EU) was transposed into Irish law by statutory instrument (S.I. No. 508/2013).

436 European Commission (2014) Tax expenditures in direct taxation in EU Member States.

Table 30: Tax expenditure reviews published since 2014

YEAR PUBLISHED	REVIEW TITLE	TAX HEAD	ANNUAL COST (2019) €M
2021	Review of CT relief for Start-up companies	CT	6.2
2021	Review of young trained farmer Stamp Duty relief of the age limits applicable to certain Agri-tax reliefs (2021)	Stamp Duty	11.9
2021	Equality Budgeting from a Tax Perspective	-	-
2020	Review of the Accelerated Capital Allowance scheme for Energy Efficient Equipment	CT	4.5
2020	Review of Stamp Duty Consanguinity Relief	Stamp Duty	51.2
2020	Analysis of High-Income Individuals' Restriction 2018 (Revenue)*	Income Tax	26.6
2020	Review of Residential Development (Stamp Duty) Refund Scheme	Stamp Duty	12.2
2020	Review of Stamp Duty Farm Consolidation Relief	Stamp Duty	1.2
2019	Review of Section 604B – Capital Gains Tax Relief for Farm Restructuring (2019 Cost)*	CGT	1.6
2019	Report of the Office of the Revenue Commissioners: Analysis of the Special Assignee Relief Programme (SARP)	Income Tax	42.4
2019	Indecon Review of the Special Assignee Relief Programme (SARP)	Income Tax	42.4
2019	Review of the Home Carers Tax Credit	Income Tax	90
2019	Indecon Review of the Foreign Earnings Deduction (FED)	Income Tax	5.4
2019	Indecon Evaluation of the Revised (CGT) Entrepreneur Relief	CGT	N/A
2019	Review of Local Property Tax	LPT	23.2
2018	Taxation of Deposit Interest Retention Tax* and Life Assurance Exit Tax*	Income Tax	96 165
2018	Progress Implementation Update of the Agri-taxation Review 2014*		800
2018	The independent (Indecon) evaluation of the Employment and Investment Incentive (EII) and Start-Up Refunds for Entrepreneurs (SURE)	Income Tax	14.5 0.8
2018	Review of the Application of Stamp Duty to the Stocks and Marketable Securities of Irish Incorporated Companies	Stamp Duty	(200-400)
2018	A Cost Benefit Analysis of Section 481 of the TCA 1997 (Relief for investment in films)	CT	34.9

YEAR PUBLISHED	REVIEW TITLE	TAX HEAD	ANNUAL COST (2019) €M
2018	Indecon Ex-Post Cost-Benefit Analysis of the Help to Buy Incentive		143
2017	Revenue Commissioners Review of the Operation of the Dwelling House Exemption (CAT)	CAT	50.1
2017	Summary of Indecon Impact Assessment of the Help to Buy Tax Incentive		143
2016	Economic Evaluation of the Research and Development (R&D) Tax Credit	CT	626
2016	Review of appropriate treatment for tax purposes of trade union (2016 costs) subscriptions and professional body fees (2020 costs)		39.5 3.75
2016	Income averaging for artists	Income Tax	N/A
2016	Review of the Living City Initiative	Income Tax	0.2
2016	Review of taxation of share-based remuneration (SRSOT, APSS, SAYE and ESOT)*	Income Tax	5.3
2015	Review of the Single Person Child Carer Credit	Income Tax	99.1
2015	Review of the Artists' Tax Exemption	Income Tax	10
2015	Report on the Outcome of Public Consultation on the Potential of Taxation Measures to Encourage Development of Zoned and Serviced Land		No cost
2015	Review of Relief from Tax for Certain Start-up Companies – section 486C Taxes Consolidation Act 1997 *		4.9
2015	Knowledge Development Box *		50
2015	Marine Tax Review (summary) *		2.12
2015	ESRI Report: Tax Breaks and the Residential Property Market (summary)		No cost
2015	Tax and Entrepreneurship Review (summary)		No cost
2014	Agri-taxation review- report of working group *		340
2014	Review of Foreign Earnings Deduction	Income Tax	5.4
2014	Review of employment and Investment Incentive and Seed Capital Scheme (EII & SCS- costs given are for SURE)	Income Tax	14.5 0.8
2014	Review of SARP	Income Tax	42.4

Source: Department of Finance Tax Expenditure Reports 2014-2021. *Costs from 2021 Tax Expenditure report, where available, otherwise figures as reflected in original report marked with an '*'.*

Since the commencement of the regular publication of information on tax expenditures, measures with an estimated revenue forgone of just over €2.6 billion have been reviewed, representing a fraction of the Department of Finance's conservative estimates of the revenue forgone. In some cases, (e.g. Help to Buy, SARP and R&D tax credit) there have been multiple reviews while many of the largest tax expenditures by cost have never been reviewed (for example pension tax reliefs, Excise Duty rate on auto-diesel, exemption from tax of certain social welfare payments, zero-rated VAT categories).

16.5 TAX EXPENDITURE DATA

In some cases, no regular data is collected or published on the amount of revenue forgone, either because it was not a requirement under legislation when the tax relief was put in place and, therefore, no data is available, because it is not covered by a 'such other information as Revenue may require' condition in the legislation or to avoid identifying small numbers of taxpayers using the expenditure, in line with Revenue's obligation to protect taxpayer confidentiality. Non publication of data does not mean that these tax expenditures should not be reviewed. Similarly, the Department of Finance has acknowledged[437] that some tax expenditures have been in place for considerable time to the extent that they have become part of the benchmark tax system. An example in this regard would be the Stamp Duty relief concerning transfers between spouses/civil partners (section 96 of SDCA 1999) which, while listed by the Department of Finance as a tax expenditure, may be seen by many as elements of a benchmark tax system.

In addition to difficulties relating to the identification and definition of tax expenditures and methodological difficulties associated with costing tax expenditures, there are also ongoing limitations imposed upon analysts due to data quality and availability issues.

Both Revenue and the Department of Finance publish annual data in relation to tax expenditure measures; however, the publications are prepared to address different purposes which can lead to confusion. Revenue publishes annual 'Cost of Tax Expenditures' tables as part of its official statistics and open data releases, meaning that the methodologies used are validated against a set of statistical criteria reviewed with the Central Statistics Office and are made available in open and accessible formats. The Department of Finance has produced

437 Department of Finance (2019) Tax Strategy Group Tax Expenditures.

annual tax expenditures reports as part of the budget process since October 2014, in line with obligations under Article 14(2) of EU Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States. For reference, the Revenue data, which contains current as well as historic tax expenditures, contains 51 tax expenditures with data for 2020 worth over €38 billion. The Department of Finance Oct 2021 Tax Expenditure report list contains 153 (net of measures being phased out) tax expenditures valued at around €7.1 billion.

The Department of Finance Tax Expenditure Report 2021 estimated that 7 per cent of all tax expenditures have no published data and that in a number of cases the information published is many years out of date. Some of these tax expenditures are potentially quite large, such as Capital Gains Tax (CGT) Principal Private Residence Relief and exemption of investment income and gains of approved superannuation funds.

The self-assessed nature of tax returns means that it can be at best, two years, and at worst four years[438] before information is available, making timely decision-making difficult. Furthermore, the use of a tax expenditure can be subject to some uncertainty, an undesirable quality for both expenditure control and also for any recipient. A requirement to specify the data that will inform the review when a tax expenditure is introduced could help facilitate more timely information for the purposes of efficient tax expenditure evaluation. This could be allied with a review of existing data collection powers to ensure more frequent and rigorous evaluation.

The work of the Commission in this area was impacted by the lack of good quality data. This deficiency also has knock-on effects on the quality of review that will be possible on these expenditures.

16.5.1 Costing tax expenditures

The three common approaches to costing tax expenditures are:

1. Initial revenue forgone:

This is the reduction in tax revenue upon introduction of the tax expenditure, assuming no behavioural change nor interaction effects with other measures.

438 For example, 2021 filings (which are made 7-9 months after year end) will be available in 2023, as data must be cleaned and presented. There is a four year limit for revisions after the filing date which provides a final availability date for the information.

2. *Final revenue forgone:*
This is the reduction in tax revenue upon introduction of the tax expenditure, with assumptions around behavioural change and interaction effects with other measures.

3. *Outlay equivalence:*
This is the equivalent direct expenditure required to achieve the same after-tax effect on taxpayer income.

The method used by the Department of Finance, along with most tax administrations worldwide, is to calculate initial revenue forgone as a result of the tax expenditure, primarily due to the administrative simplicity of the approach.

The PBO notes that because this estimate does not take into account behavioural change, abolition of a tax expenditure does not necessarily result in a corresponding tax increase, as people's behaviour may change. When introducing a tax relief, the cost is often understated because of people changing their behaviour in order to avail of the relief. The PBO also suggests that consideration be given to using a more dynamic cost modelling approach such as the final revenue-forgone approach which incorporates behavioural effects and the interaction of different policy measures. Drawbacks with this approach are its increased complexity and the fact that it requires up-to-date, high quality data in order to work. The Department of Finance guidelines recognise that the initial revenue-forgone method is likely to be used in the majority of evaluations for practical reasons, but recommends that where possible evaluations may also opt to use either of the other two methods. The Commission supports and endorses this pragmatic approach.

16.5.2 Resources required for effective tax expenditure review

The Commission considers that the level of data currently available and collected is insufficient to allow comprehensive evaluation of tax expenditures. Where data is not available, it is not possible to evaluate the cost or effectiveness of an expenditure and make informed decisions around the appropriateness of continuation, reform or abolition.

Government policy requires that tax expenditures should be reviewed regularly,[439] and that timely and accurate data should be available in relation to the efficiency, efficacy and cost of individual measures. The Commission does not believe that these standards are fully applied in an Irish context at this time.

Analysis indicates that 63 per cent of tax expenditures by value (2019 estimates) included in the annual reporting by the Department of Finance have not been reviewed in the seven years since the introduction of the annual reporting of expenditures.[440] Furthermore, it is notable that tax expenditures that contain sunset clauses are more likely to be reviewed than those legacy expenditures that do not. The low level of evaluation over the last seven years, along with Department of Finance statements to the Budgetary Oversight Committee in 2019, signal that availability of resources to undertake systematic tax expenditure review is an issue.

While many improvements relating to the evaluation of tax expenditures have been introduced since 2009, the Commission considers that significant shortcomings still remain and that improvements to the application of existing guidelines and the introduction of further reforms can provide significant improvements in the oversight and evaluation of existing and future tax expenditures. A number of related recommendations are made as follows:

Recommendation

16.1 The Commission recommends that the Department of Finance should ensure that adequate evaluation data on tax expenditures is collected, and where necessary propose legislative amendments in order to allow collection. This will address existing data gaps and allow more comprehensive understanding of the taxes forgone, the objectives achieved and at what cost.

439 Department of Finance (2013) Medium-Term Economic Strategy 2014-2020, A Strategy for Growth.

440 Commission on Taxation and Welfare Secretariat analysis of Department of Finance, Tax expenditures report 2021, and earlier reports which shows that about €2.6 billion of tax expenditures have been evaluated over the last seven years out of a 2021 tax expenditure report total of €7.1 billion.

Recommendations

16.2 The Commission recommends that the Department of Finance and the Revenue Commissioners should regularly examine the most appropriate way to cost tax expenditures on a case-by-case basis and consider alternative costing methodologies where data becomes available.

16.3 The Commission supports the continued inclusion of sunset clauses for the review of all new tax expenditures, Government should also consider the retrospective inclusion of sunset clauses in respect of existing tax expenditures. This would provide a statutory basis for the regular review of all tax expenditures.

16.4 The Commission recommends the expansion of dedicated economic evaluation capacity within the Department of Finance to work specifically on tax expenditures with the aims of providing more and better information on tax expenditures and introducing a greater degree of rigour and consistency in the quality of the evaluation process. This evaluation work should also be peer-reviewed by an appropriate outside body.

16.6 STRENGTHENING TAX EXPENDITURE EVALUATION

16.6.1 Ex-ante review of tax expenditures

An ex-ante evaluation is one that takes place before the introduction of a tax expenditure. As such, ex ante evaluations particularly address issues related to the rationale for the intervention and its planning and design. While the Department of Finance guidelines do not require that an ex-ante review be carried out before a new tax measure is put in place, they make it clear that it is best practice.

Deciding to advance tax measures is a policy consideration and is therefore within the purview of the Minister for Finance. However, failure to conduct a robust ex-ante evaluation means that a tax measure is launched, often with little underlying data, little idea of the likely economic impact, or little evaluation of whether a tax measure is the most appropriate way to proceed instead of through direct expenditure. In the absence of good existing data upon which to base costs, the quality of budget estimates produced can be limited. Therefore,

the Commission supports the more widespread use of ex-ante evaluations as a valuable input into the policy development and decision-making process.

A further benefit of conducting ex-ante evaluations is that it can provide an opportunity to strengthen the stakeholder engagement in developing new tax policy. Advance consultation can identify operational issues that can be addressed before the legislation underpinning a tax expenditure is finalised. The January 2021 Update to the Corporation Tax Roadmap commits to putting in place an annual stakeholder engagement process, which could be used as a template for further initiatives in the wider area.

16.6.2 Ex-post review of tax expenditures

An ex-post evaluation is one that takes place after the introduction of a tax expenditure, usually a number of years after it has commenced operation. An ex-post review is concerned with the ongoing relevance, actual cost, impact and efficiency of a tax expenditure.

Department of Finance guidelines on the level and frequency of tax expenditure review are outlined in Table 31.

Table 31: Levels of expenditure evaluation

ESTIMATED ANNUAL COST	LEVEL	EX-ANTE	EX-POST	TIME LIMIT/ REVIEW
Between €1m and €10m	Level 1	Ex-ante assessment and identification of criteria for ex-post evaluation.	Application of ex-post criteria.	Five years to review.
Between €10m and €50m	Level 2	Detailed assessment- scenario-based analysis or similar and statement of proposed methods and data requirement for full ex-post cost-benefit analysis.	Full ex-post analysis.	Five years to trigger review. Interim review after three years if annual costs exceed €25m.
Greater than €50m	Level 3	Full ex-ante cost-benefit analysis and statement of methods and data requirements for full ex-post cost-benefit analysis. Pilot scheme if possible. Pilot scheme if possible.	Full ex-post cost-benefit analysis	Interim review after three years.

Source: Department of Finance Tax Expenditure Guidelines 2014

These guidelines make clear, implicitly at least, that all tax expenditures should be reviewed ex-post at least every five years. At present, many of the ex-post reviews published by the Department of Finance are ex triggered by a legislative sunset clause, rather than being part of a systematic review process, and few involve cost-benefit analysis.

16.6.3 Rigour of review

The 2014 guidelines contain guidance on how to structure evaluations. At a minimum, ex-ante evaluations should take into account the objective, market failure, best approach to tackle identified failure, impact and cost of a tax measure. The Commission notes that the majority of evaluations carried out over the seven years since the guidelines were published are ex-post evaluations, which should also take into account the continuing relevance of the expenditure, its actual cost, the impact and its efficiency.

The Commission further notes that the quality and depth of expenditure reviews has varied widely across the seven years since implementation of the guidelines. A wide range of approaches have been adopted. For example, a number of reviews have been structured around public consultation exercises (e.g. Review of Stamp Duty Consanguinity Relief (2020)), desk-based reviews (e.g. review of income averaging for artists (2015)), while others have been conducted as structured cost-benefit analysis (e.g. A Cost Benefit Analysis of section 481 of the Taxes Consolidation Act (TCA) 1997 (Relief for investment in films) (2015)). Mainly smaller reviews are conducted in house (by the policy holders themselves), while many larger or more technical reviews are contracted out to third-party professional evaluators.

Counterfactual impact evaluation is regularly required for direct expenditure reviews. Applied to a tax expenditure context, this method considers what may have happened had the affected taxpayer units not received the treatment (benefit of tax expenditure). This is the only type of review that can identify whether a measure has had a net impact and, accordingly, place the estimated cost of the measure in context. There are recent, very welcome, examples[441] of such an approach being adopted, but it should be a much more common part of the Department of Finance's evaluation toolbox in future.

441 Acheson J. and Malone R. (2020) Respect your elders- Evidence from Irelands R&D tax credit reform, The Economic and Social Review, 51 (1).

The Commission recognises and accepts that there can be both resource and practical constraints that impact on the current approach to evaluations. However, given the potential scale, cost and impact of such expenditures, the Commission recommends that a strategic approach to implementing the review guidelines is required.

16.6.4 Commission views on strengthening the tax expenditure review process

The Commission recognises that tax expenditures play an important role in the Irish taxation system and can be an appropriate policy response in specific circumstances. However, tax expenditures should only be pursued in limited circumstances and where they meet three key tests as set out in the Department of Finance 2014 Guidelines. Ex-ante consideration of new tax expenditures or material changes to existing tax expenditures form an important input into evidence-based policymaking. The Commission recommends that more rigorous implementation of existing guidelines is required to improve this aspect of the tax expenditure review process.

Recommendation

16.5 The Commission calls for strengthening the ex-ante evaluation of tax expenditures ahead of their introduction to ensure better policy outcomes. This should include clear articulation of what the objective of the tax relief is, what market failure it is designed to address (if any), the distributional impacts of the planned tax relief and why it is being addressed via tax relief rather than direct expenditure. Annual tax expenditure reports should also include forecasts for coming years in line with guidelines on forecasts for direct expenditure. Ex-post reviews should be similarly rigorous.

16.7 STRATEGIC CHANGES TO THE TAX REVIEW PROCESS

16.7.1 Defining the benchmark tax system

If tax expenditures are defined as 'reducing tax obligations with respect to a benchmark tax', then it is important and necessary to clearly define what the national benchmark tax system is, in an Irish context.

The World Bank and the OECD identify the benchmark tax system as including the rate structure, accounting conventions, deductibility of compulsory payments, provisions to facilitate tax administration and international fiscal obligations. No two countries define their benchmark in the same way. The European Commission has noted:

> *"Since tax expenditures are a deviation from a benchmark tax system, they are generally rather difficult to identify in a straightforward and unequivocal way. For example, the same tax relief could be classified as tax expenditure in one country, while being considered as a part of the benchmark tax system in another."*
>
> EU Commission, 2014

The 2009 Commission on Taxation highlighted the difficulty in clearly defining a benchmark tax system, when it indicated that out of a total of 245 tax-relieving measures, there were 115 that could be regarded as tax expenditures and 130 that it considered were part of a benchmark tax system in Ireland. That Commission considered that there are valid reasons why a tax system might need to incorporate relieving measures and exemptions; for example, to help it function equitably and efficiently and to interact with other systems at an international level. Such measures, they asserted, while they may reduce the tax base as compared with circumstances where they did not apply, may reasonably be regarded as part of the structure of the tax system or, if not inherently structural, are desirable elements that make the tax system function efficiently. The 2009 Commission considered these tax measures to be an essential part of the tax benchmark system and classified them into five categories, as follows:

Table 32: Five categories of tax-relieving measures included in the Irish tax benchmark system

CATEGORIES OF TAX MEASURE CONTAINED WITHIN THE BENCHMARK SYSTEM	EXPLANATION/EXAMPLES
Measures that are inherent in the design of the tax system including avoidance of double taxation and complying with international (fiscal) obligations together with minor reliefs and measures to facilitate tax administration	S153 TCA: Non-residents are exempt from Income Tax on dividends from Irish companies. The tax due on such dividend income is properly payable in the country in which the individual is resident. If Ireland was to tax such income, relief would ultimately be due for the foreign tax paid.
Those related to the unit of taxation and measures that are tax neutral	S461 TCA: Personal tax credits for single and married persons for Income Tax. S584-S587 TCA: Capital Gains Tax is deferred on amalgamation or reorganisation of a Company. Although a group of companies are made up of separate legal entities, they are not necessarily separate for tax purposes if they have a common owner. In the case of a reorganisation or amalgamation within such a group, it would be inefficient to tax one and give relief to another when the result is neutral within the group itself.
Deductions in respect of expenses incurred in earning income	S268-S282 TCA: There is a tax depreciation allowance for industrial buildings for Income Tax or Corporation Tax. This reflects the wear and tear arising from the use of the building over time.
Measures related to the State	S36-S50 TCA: Tax exemptions are available for income from Government and other public securities. S607 TCA: Various Government and other public securities are exempt from Capital Gains Tax. This reflects an efficiency from the State's perspective as if such items were taxed, they would go to the Exchequer in any event.
Awards by the Court and compensation payments	S189 TCA: Income and gains derived from the investment of funds received in compensation of personal injury are tax exempt where the income represents more than 50 per cent or more of total income. This reflects the compensatory element of the payments, which are not received in advancement of profit or gain in the first instance.

Source: Commission on Taxation Report, 2009

The Commission has considered the approach adopted by the 2009 Commission in this area and broadly supports its analysis and findings.

When a tax measure is considered part of the benchmark tax system there are a number of implications of this classification. If considered part of the benchmark, a tax measure is unlikely to face regular review, or to have to meet the requirement to demonstrate a market failure before a tax expenditure can be put in place, or renewed.

If something is part of the national tax benchmark system, then it is not included in a mandatory annual EU report,[442] i.e. the Department of Finance's Annual Report on Tax Expenditures. Most importantly, it is not seen in the context of the annual budgetary cycle as a political or policy choice made by the Government of the day to preferentially support one group of taxpayers over another. It simply rolls on from year to year.

The definition of a benchmark tax system is something that varies considerably across jurisdictions and, notwithstanding the findings of the 2009 Commission on Taxation, there continues to be a lack of consensus in Ireland regarding which measures should be considered as belonging to the benchmark system. For example, while the Department of Finance considers personal Income Tax credits to be a part of the benchmark system, Revenue includes personal Income Tax credits in its reporting on the costs of tax expenditures. The Department of Finance and Revenue acknowledged in 2019[443] that working towards an agreed approach to classification of benchmark measures and tax expenditures is something that could be addressed in the medium term. To date there has been no agreement.

The EU Commission recommend that Member States, in framing the benchmark, provide an explanation of the main approaches. This reporting should include cost estimates and a broad coverage of all areas of taxation including social insurance contributions and local taxes.

16.7.2 Importance of agreeing a benchmark

Lack of clarity around the explicit definition of the benchmark in Ireland can lead to a range of difficulties. It can lead to confusion around what is a tax expenditure and what is simply a tax measure necessary to make the system function. It can also lead to uncertainty around the true resources involved in reviewing the tax expenditures, and can allow the publication of inaccurate information about the range of tax expenditures offered by Ireland in international publications. Most importantly, lack of clarity masks the true size of the costs of tax expenditures, potentially leading to a lack of transparency in the

442 The EU Directive on requirements for budgetary frameworks of the Member States (2011/85/EU) was transposed into Irish law by statutory instrument (S.I. No. 508/2013) and resulted in the annual publication, since 2014 of tax expenditure reports.

443 Committee on Budgetary Oversight (2019) Report on Tax Expenditures.

budgetary process around tax expenditure decisions.

This grey area between the benchmark and the tax expenditure list is an impediment to effective organisation of a multi-annual strategic tax expenditure review process.

16.7.3 Strategic review of tax expenditures

The Commission believes that the current approach to defining the benchmark tax system is suboptimal, straddles across multiple bodies and gives rise to difficulties in examining the transparency and overall cost of tax expenditures. Failure to define the benchmark results in ambiguity between it and tax expenditures, where measures are assumed to fall into one because they are not included in the other. Lack of benchmark definition also means that it is very difficult to accurately understand the true extent and cost of tax expenditures in Ireland and ensure that they are evaluated in a systematic and strategic way. It means that there is no regular examination of revenue forgone over time, as society and economic conditions change. Collection and publication of data about aspects of the tax system that fall within the benchmark, and which are required for analytical or costing purposes, should happen regardless of the speed of progress on defining the benchmark.

Recommendations

16.6 The Commission recommends that the Department of Finance, with support from the Revenue Commissioners should publish and maintain a single agreed definition of the benchmark tax system and compile a master list of all tax expenditures. This would ensure that tax measures are systematically included either in the benchmark or the tax expenditure list.

16.7 The Commission recommends that the Department of Finance should devise a strategic plan to regularly and rigorously evaluate all tax expenditures in line with relevant guidelines.

16.8 RECOMMENDATIONS

Chapter 16: Tax Expenditure Review Process

16.1 The Commission recommends that the Department of Finance should ensure that adequate evaluation data on tax expenditures is collected, and where necessary propose legislative amendments in order to allow collection. This will address existing data gaps and allow more comprehensive understanding of the taxes forgone, the objectives achieved and at what cost.

16.2 The Commission recommends that the Department of Finance and the Revenue Commissioners should regularly examine the most appropriate way to cost tax expenditures on a case-by-case basis and consider alternative costing methodologies where data becomes available.

16.3 The Commission supports the continued inclusion of sunset clauses for the review of all new tax expenditures, Government should also consider the retrospective inclusion of sunset clauses in respect of existing tax expenditures. This would provide a statutory basis for the regular review of all tax expenditures.

16.4 The Commission recommends the expansion of dedicated economic evaluation capacity within the Department of Finance to work specifically on tax expenditures with the aims of providing more and better information on tax expenditures and introducing a greater degree of rigour and consistency in the quality of the evaluation process. This evaluation work should also be peer-reviewed by an appropriate outside body.

16.5 The Commission calls for strengthening the ex-ante evaluation of tax expenditures ahead of their introduction to ensure better policy outcomes. This should include clear articulation of what the objective of the tax relief is, what market failure it is designed to address (if any), the distributional impacts of the planned tax relief and why it is being addressed via tax relief rather than direct expenditure. Annual tax expenditure reports should also include forecasts for coming years in line with guidelines on forecasts for direct expenditure. Ex-post reviews should be similarly rigorous.

16.6 The Commission recommends that the Department of Finance, with support from the Revenue Commissioners should publish and maintain a single agreed definition of the benchmark tax system and compile a master list of all tax expenditures. This would ensure that tax measures are systematically included either in the benchmark or the tax expenditure list.

16.7 The Commission recommends that the Department of Finance should devise a strategic plan to regularly and rigorously evaluate all tax expenditures in line with relevant guidelines.

Chapter 17:
Modernisation of Tax Administration

17.1 INTRODUCTION

The terms of reference asked the Commission to:

> *"...consider how the tax administration system should be modernised, building on real time payroll reporting which underpinned the existing modernisation of the PAYE system, and ensuring that the tax administration system meets best international standards. This will also include consideration of the potential for improvements in simplicity and administrative efficiency from integrating the taxation and welfare systems..."*

The quality of tax administration has long been recognised as being of fundamental importance in determining how tax policies operate in practice as well as their ultimate impact on taxpayers. As far back as 1776, Adam Smith (himself a Commissioner of Customs) emphasised the importance of certainty, convenience of payment and economy of collection as fundamental canons of taxation. These canons are clearly linked to the quality of administration and have been central tenets of the work of every Commission on Taxation since the foundation of the State.

In parallel, the administration of the social welfare system and how it interacts with its customers is central to the way in which social policies operate in practice. Timely appraisal of claims and access to cash payments are an important part of social protection policy.

The fundamental mechanics underpinning the operation of these systems, and how they interact, must now be considered against the backdrop of an ongoing revolution in information technology, which has fundamentally altered (and continues to alter) business processes as well as service delivery channels across large swathes of the economy. The expectations of the public with regard to how these services are and will be delivered has, and will continue to change.

However, this is not a negative prospect. Ultimately, the revolution

in technology has created an opportunity to provide better, more digitally-innovative services to the public. It can reduce administrative burdens and increase compliance, as well as improve the service to individuals applying for, or in receipt of, social welfare payments. Opportunities also exist to use technology to design and implement new policies that previously would not have been practicable.

Modernisation of the administration of the tax and welfare systems is not only a matter of operational efficiency. Improving how the public engages with these services strengthens the public's understanding of their obligations and entitlements, which ultimately enhances tax morale[444] and supports the collective solidarity upon which these systems are based.

Ultimately, digital transformation of administration supports the ongoing operation of the tax and welfare systems, as well as the delivery of our recommendations, in a manner consistent with the principles of design underpinning our work. The modernisation of the Pay As You Earn (PAYE) system and the payment of supports over the COVID-19 pandemic show what can be done.

The Commission's terms of reference in the area of administration are specific and two-fold. Its first concern is to examine options for modernisation of tax administration building on recent achievements. The second relates to consideration of the improvements that can be derived from greater integration of the taxation and welfare systems.

17.2 CONTEXT

17.2.1 Evolution in the of use of technology for tax administration

The use of technology to modernise tax processes has long been a feature of the Revenue Commissioners approach since its first computer, an ICL 1301, was switched on in 1963. This was only the second computer installed in an Irish organisation – the first was in the Irish Sugar Company, only a few years earlier. The computer was introduced on foot of a recommendation by the then Commission on Income Taxation in 1962 to address the volume of work generated by the introduction of PAYE in 1961 – a move which had proven to be both a labour and time intensive endeavour.[445]

While there have been many developments in the intervening

444 Tax morale refers to the general opinion of paying taxes in a country and the level of satisfaction relating to the services received in return.

445 Revenue Commissioners (1998) Revenue Over the Years.

years in terms of e-filing and analytics, the underlying filed return often remains, in essence, a digital version of the original paper-based form, preventing Revenue from fully leveraging the benefits arising from emerging technologies. Such benefits can likely not be realised without a full digital transformation of tax administration as a whole – a view which the Commission notes is gaining ground internationally and which has been the focus of the OECD's Forum on Tax Administration in recent years.[446]

What is Digital Transformation?

There is no single agreed-upon definition of digital transformation. The majority, however, refer to a broader reimagining of how things are done in light of technological change, and are synonymous with digital innovation. Such transformations revolve around the use of digital technology and digital strategy to enhance an organisation by using technological solutions to:

- build new business processes and systems, and
- enhance the customer experiences and organisational culture.

The concept represents an evolution of the pre-existing concepts of:

- *Digitalisation:* which refers to improving existing processes using digital technologies. Although elements of processes improve incrementally, the wider process operates in broadly the same way. An example in a tax context would include the introduction of e-filing of returns.
- *Digitisation:* which refers to the initial transition from analogue to digital, such as the transition from the keeping of paper financial records to using digital accounting or spreadsheet software.

As part of a digital transformation, and in light of emerging technologies, the question arises as to whether a return actually remains the best way to collect tax data.

As referred to in the Commission's terms of reference, Revenue recently undertook an exercise to further evolve the PAYE system; completely rethinking and redesigning the administration of

446 OECD (2020) Tax Administration 3.0: The Digital Transformation of Tax Administration, Paris, OECD Publishing.

employment taxes using advancements in technology to introduce a real-time approach to taxation. This approach allows for continuous visibility of liabilities and trends as and when they change, rather than snapshots of liabilities at a particular point in time.

This was a significant programme, as PAYE accounts for approximately one-third of total Exchequer receipts. The redesign programme, known as PAYE Modernisation (PMod), represented the most significant development to PAYE since its introduction and demonstrated the benefits that can be derived from digital transformations.

Box 7: Modernisation in Action - PAYE Modernisation (PMod)

The administrative mechanism for employment taxes was transformed into a by-product of existing business activity (being payroll). Employers now submit full pay and tax details to Revenue in real time as part of the payroll process, thereby avoiding the need for separate reporting and reducing the likelihood of error.

The main objective of the programme was to embed proper tax compliance into the administration of payroll by employers (often referred to as *compliance by design*). This ensures that the right tax is paid at the right time, reducing the cost of collection for both the employer and Revenue. The approach has also facilitated timelier analysis of PAYE data and intervention where anomalies are noted.

To achieve this development, Revenue adopted a co-design approach with external stakeholders which optimised the design and gained buy-in.

Real-time payroll reporting led to overall Exchequer increases of at least €52.6 million[447,448] in 2019 alone, with such increases likely being sustainable into the future as compliance has been designed into the payroll process itself.

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447 Revenue estimate that the PMod Programme as a whole gave rise to additional tax receipts of €64.6 million. Of this amount, €52.6 million relates to improvements arising from the collection and use of real-time PAYE data. A further €12 million relates to improvements in data-sharing arrangements for taxable social welfare payments - such payments currently remain outside of the PAYE system (see section 17.5.1).

448 Revenue Commissioners (2020) Evaluation of Budget 2019 Compliance Measures.

The generation of real-time employment tax data also has positive applications beyond Exchequer increases. The data has facilitated the development of better quality statistics and metrics by both Revenue and the CSO, which can assist with the formation of policy. This was of particular relevance when analysing the impact of the pandemic on the labour market. The availability of real-time data also facilitated the development of real time income supports during the pandemic.

As part of PMod, real-time employee data was also embedded into the Revenue customer interface allowing employees to better understand their employment taxes and to view personal tax details on demand, allowing individuals to have a sense of ownership over their own data. Employees can also flag anomalies in this data, further embedding employer compliance.

The modernised PAYE system is in the vanguard of digital transformations of tax administration internationally - building on Revenue's longstanding approach of utilising technology and analytics to simplify tax administration processes, which supports Ireland's reputation as a location where it is relatively easy to pay and file taxes.

17.2.2 Ongoing challenges

There are, however, persistent frictions in the tax administration system. Obstacles remain that prevent the full benefits of emerging technologies from being leveraged across the administration of all taxes. The underlying legal and administrative framework for many taxes often reflects the prevailing economic conditions and what was administratively feasible at the time the tax was introduced. As such, there has been limited opportunity to take the time to rethink how things can be done better, limiting digital innovation to the introduction of "e" solutions (such as e-filing, e-payment) for paper processes in many cases.

Although "e" solutions have improved tax administration, they cannot fully address certain structural limitations embedded in the underlying administrative process such as:

- *Reliance on voluntary compliance and/or self-assessment:*
  Where taxpayer choices exist (such as what to file and when), non-compliance can arise, whether through inadvertent error or otherwise. Compliance can also be costly for taxpayers, both in terms of monetary cost and effort. Identifying points where the compliance process can

be automated (such as through pre-population of returns) can reduce a taxpayer's compliance burden and also make it difficult not to comply.

- *Timing of reporting and payment:*
  Final tax reporting and/or payment often occurs long after the taxable event, typically at the end of a set assessable period. Only then is the information subject to verification, analysis and (where required) intervention. These delays create payment risks and increased collection costs that can adversely affect Exchequer returns.

- *Taxation is often a stand-alone activity:*
  The application of a more joined-up approach to the administration of Government and agency services, including taxation, is still in its infancy. Government and agency systems have typically evolved in isolation and are at different stages of maturity – a fact reflective of the diverse requirements and priorities across the various wings of the State. In addition, there are currently limitations on the ability to use identity credentials across those Departments and agencies, as well as General Data Protection Regulation (GDPR) concerns. These factors have hampered progress in considering potential interdepartmental synergies and the steps required to achieve them. This lack of a joined-up approach can create an additional burden for taxpayers, by requiring them to duplicate information, and increases the scope for error and omission.

Furthermore, existing processes may not be flexible enough to adapt to the rapidly evolving manner in which economic activity is conducted, including:

- *The rise of sharing and gig economy platforms:*
  The rise of such platforms has led to more individuals taking on self-employed income streams (and the obligations associated with same[449]) in addition to their standard salaried employment, or as their sole source of income.

- *Changing technology and business models:*
  The manner in which business is done has changed significantly in the past few decades. This is due to more complex and increasingly cross-border transactions, increased use of technological solutions, as well as the use of emerging forms of wealth such as cryptocurrency for

449 Such as filing returns, paying taxes not deducted at source, VAT registration etc.

payment and investment.[450] Such business models were not envisaged when the administration system was originally designed.

Notwithstanding these challenges, the Commission believes that, as the PMod programme demonstrates, significant improvement in how taxes are administered is possible. While we recognise that reaching the PMod standard in other taxes will be challenging, we firmly believe transformation is achievable with the development of a number of key pillars (see section 17.4). Furthermore, we believe that given the pace of technological change in the wider economy, the risks of standing still are simply too great.

Accordingly, in our view, continued and increased emphasis must be placed on true digital transformation and not just on the use of technology to deliver existing processes. Such an approach will mitigate against current structural limitations, while improving administrative efficiency. It will also provide a fit-for-purpose, resilient service that meets customer needs and expectations in the digital age.

17.3 BENEFITS AND OPPORTUNITIES OF MODERNISATION

The digital environment has created an opportunity to r-imagine tax administration in a manner that can reduce the administrative burden for both taxpayers and Revenue - reducing errors, speeding up services and driving down costs. Importantly, it can also assist in designing out non-compliance to ensure that the correct amount of tax and duties are collected at the right time.

Processes relating to the collection and calculation of taxes represent a very large proportion of the transactions undertaken by the Civil Service as a whole. In 2021 alone, Revenue administered the taxes of approximately six million customers,[451] collected €67.5 billion in Exchequer receipts, addressed over 25 million customer service contacts and completed 463,000 compliance interventions.[452, 453]

Taking the time to rethink not only what taxpayer-related data is collected, but more importantly how it is collected and used, especially in light of changing business models, could lead to significant

450 Cryptocurrency transactions are often stored on decentralised ledgers, making the source of such monetary flows unclear.

451 Figure includes multiple employments for the same individual, employers and couples who are treated as a single taxpayer unit for self-assessment purposes.

452 Revenue Commissioners (2022) Revenue Headline Results 2021.

453 Revenue Commissioners (2022) Revenue Annual Report 2021.

operational efficiencies.

Furthermore, the Commission recognises that individual interactions with government administrations and agencies often take place at busy or stressful intervals and that businesses often balance a large volume of day-to-day administrative duties with ensuring their tax obligations are up to date.

Therefore we believe that tax administration processes should be integrated with *natural taxpayer systems* where possible. This means that individuals or businesses should be able to fulfil their tax obligations as part of their day to day activities (such as payroll in the case of PMod) rather than having to engage in a specific interaction with Revenue, effectively embedding compliance into the system (a process often referred to as *compliance by design*). This approach facilitates the pre-population of returns in as far as possible, or in some cases the removal of the requirement to complete and file a return entirely; as well as ensuring taxpayer balances are updated in real time with immediate payment of any tax due where feasible.

Where taxpayer data is pre-populated from appropriate sources such as business accounting packages, tax authorities in other jurisdictions, other government departments and agencies, or private actors such as payroll service providers, banks or sharing economy platforms, an opportunity arises to not only ensure that the right amount of tax is collected at the right time but to better explain to taxpayers how taxes and charges have arisen. This facilitates understanding and acceptance of the tax rules, supporting tax morale. In addition, taxpayers can make significant time savings, needing only to confirm the existing information as accurate before submission. This should also lead to a saving in review costs for Revenue.

Additionally, with better integration, Revenue should be in a better position to prompt or inform taxpayers of any obligations or entitlements arising, incorporating an element of reciprocity into the tax administration process.

The opportunity to modernise tax administration is happening at a time when the wider Civil Service is in the process of examining how to digitally transform its public offering - with a key goal of Civil Service Renewal 2030[454] being the development of a Digital First Civil Service where public services are available online and are customer focused.

454 Government of Ireland (2021) Civil Service Renewal 2030 Strategy 'Building on our Strengths'.

This plan builds on a growing culture within the public service to provide a better more joined-up service for individuals and businesses through the development of whole-of-government solutions to:

- emphasise the need for greater collaboration and coordination across departments and agencies,
- help deliver seamless services for individuals and businesses by optimising resources and eliminating duplication, allowing the delivery of coherent and integrated Government policies,
- facilitate the application of an only once principle – ensuring that persons do not have to provide the same information to the State more than once; allowing information to be re-used and exchanged between departments and agencies as required - subject to relevant data protection provisions, taxpayer confidentiality and consent requirements being met.

The Commission believes that modernisation of tax administration, in conjunction with the introduction of this whole-of-government approach to administration where possible, represents a real opportunity for Revenue and the wider Civil Service administration to provide better quality customer service to taxpayers in real time and in a manner that could mitigate the scepticism and personal data concerns that can sometimes accompany digital transformations. It also presents economic benefits to the State by reducing cost of compliance, while raising the 'digital bar' across business - further enhancing Ireland's reputation for digital excellence.

Alongside the benefits to the taxpayer, and Revenue in its role as the tax administration, the Commission considers that the development of further real-time reporting solutions provide significant opportunities for more accurate data collection. This will facilitate the creation of more timely statistics and better modelling, which can be used to better inform policy decisions. In this regard, the Commission notes that the PMod programme has facilitated the analysis of employment data at a more granular and timely level than was previously possible. Datasets can now be produced and analysed on current trends, which, as previously noted in this chapter, was of particular relevance when analysing the impact of the pandemic on the labour market.

Recommendations

17.1 The Commission believes that digital transformations are fundamental to the successful modernisation of tax administration processes. The Commission recommends that such transformations should be a central tenet of a structured programme of tax administration reform that should be commenced as soon as possible.

17.2 The Commission recommends that, in so far as possible, compliance obligations should be built into natural taxpayer systems and that due consideration should be given by the Revenue Commissioners, in conjunction with other Government Departments as required, as to how such systems should be leveraged in order to improve real-time reporting.

17.3 The Commission endorses the use of whole-of-Government solutions to improve service delivery.

17.4 KEY PILLARS OF MODERNISATION

While fully endorsing the modernisation of tax administration, the Commission recognises that full digital transformation will present a challenge for Revenue and will fundamentally change the nature of its relationship with taxpayers and agents. Accordingly, any programme of modernisation will require continued and extensive collaboration with both public and private actors.

In our view, in order for modernisation to be successful, and in line with international best practice,[455] a number of core elements need to be present to facilitate the ongoing development of an agile and progressive administration. These include:

- Legislation
- Technical architecture/environment
- New employee skillsets

455 OECD (2020) Tax Administration 3.0: The Digital Transformation of Tax Administration, Paris, OECD Publishing.

- Taxpayer acceptance
- Mechanisms to address digital exclusion

Although the focus of this chapter, in line with our terms of reference, is the modernisation of tax administration, the Commission recognises that the interactions between Revenue and the Department of Social Protection (DSP) systems, which are discussed further in section 17.5, are fundamental to determining the obligations and entitlements of the citizen. Therefore, we note that the core elements of modernisation also have some application for DSP and indeed other departments and agencies, and that development of these pillars should not be limited to Revenue.

17.4.1 Legislation

Modernisation of tax administration needs to be fully underpinned by legislation that is capable of being implemented in a timely manner, and that facilitates an increasingly digital approach to administration. In the context of modernisation of tax administration, legislation has two key roles:

- *Shaping how a taxing measure will be operated and the tax collected*
  The Commission recognises that failure to think about how a tax measure will be administered as part of the process of developing the underlying legislation can give rise to unnecessary complexity. The operation and collection of taxes and charges is central to tax policy design and should be properly considered at the drafting stage of any measure.

- *Authorisation of the collection, use and sharing of data*
  Legislation needs to provide a proper legal basis for the collection, use and sharing of taxpayer data, which includes taking account of specific concerns in relation to GDPR in respect of data requests from individual taxpayers. As such, it is crucial to ensure that the collection, use and sharing of relevant data is properly authorised.

Furthermore, the legislation underpinning existing administrative processes should be reviewed to ensure that it can support an increasingly digital environment.

Recommendation

17.4 The Commission recommends that the necessary steps are taken to ensure that modernisation of tax administration is fully supported by legislation.

17.4.2 Technical architecture/environment

In the context of the modern business environment, the Commission recognises that modernisation necessitates the further evolution of the underlying technical architecture applicable to tax administration. Otherwise, solutions will be built on less efficient legacy foundations. However, given the pace of technological change, introducing infrastructure overly-reliant on new technologies and standards for newness sake would only push current administrative challenges down the road.

For this reason, solutions need to be agile and flexible enough to cope with further technological change as well as economic and tax policy changes. Relevant legacy data should be preserved and properly incorporated into any new system,[456] rather than incurring the expenses associated with maintaining a *'two-speed'* system where possible.

As a by-product of technological change, the Commission recognises that individuals and businesses are generating increasing amounts of data. We believe that this presents an opportunity for Revenue to continue to develop infrastructure to better target the collection and use of relevant data to improve its service offering, and in a manner which has due regard to the taxpayer.

This can be achieved by rethinking taxpayer 'touchpoints' with Revenue. These are the points where taxpayers interact with the tax system. Touchpoints can allow for direct interaction with Revenue through Revenue-provided online services and information facilities, telephone services and paper-filing facilities. Touchpoints can also provide for indirect interaction through other Government Departments or agencies (where data is shared with Revenue), or trusted third parties or private actors such as banks or payroll software providers.

456 Subject to any relevant data retention rules/policies.

Embedding touchpoints in such interactions facilitates tax *just happening* in an organic manner, as an automatic consequence of an individual or business carrying out their day-to-day activities (i.e. as part of their *natural systems*), bringing the tax administration process closer to when the actual taxable event occurs.

Although multiple taxpayer touchpoints were either developed or revamped as part of the PMod programme, we believe there is scope for their ongoing expansion and redesign beyond PAYE services, particularly in the space of interactions with third parties.

Related to this, the Commission recognises the role of digital identity (eID) systems in assisting Revenue in interacting with other parts of Government, other governments (in the case-of cross border transactions) and approved private actors.[457] The Commission notes that in order for tax to become a more seamless process for individuals, the eID system, in terms of the level of assurance provided,[458] will become increasingly important.

Accordingly, the Commission believes that facilitating further digital transformation of tax administration processes requires the correct technology and technical architecture, and that investment is required to:

- develop whole-of-government solutions with other Departments and agencies,
- examine how best to use real-time data to conduct real-time interventions, and
- support the identification and formation of relationships with new stakeholders, such as private actors and software vendors (as was the case in PMod).

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457 Different organisations and actors do not necessarily need to have the same digital identity system - the key aim is that systems used by the taxpayer and the administration can interact with each other in a frictionless manner.

458 "Level of assurance" refers to the degree of confidence in the claimed identity of a person i.e. how certain a service provider can be that it is you using the eID to authenticate to the service, and not someone else pretending to be you.

Recommendation

17.5 The Commission recommends that the necessary investments are made by the State to further developthe appropriate technical architecture required to properly support modernised tax administration and data collection. This should also include developing appropriate frameworks for stakeholder engagement as part of a co-design approach to such modernisation.

17.4.3 New employee skillsets

As technology evolves, and administration processes are transformed, new demands will be placed on Revenue, and indeed DSP, in terms of their skills base. This will represent a significant change management challenge for both bodies. Although in the case of Revenue, tax technical staff will continue to be a key resource to deal with complex tax issues, we believe that additional investment, across the board, in staff (including ICT staff) who can both think digitally and apply digital solutions, will also become increasingly important. The Commission also recognises that training for existing staff and future recruitment will need to be increasingly focused on areas such as data science, analytics, data protection, cybersecurity and artificial intelligence.

Recommendation

17.6 The Commission recommends that the Revenue Commissioners and the Department of Social Protection be given supports as necessary to develop the skills base required to digitally transform tax and welfare administration.

17.4.4 Taxpayer acceptance

Taxpayer acceptance is a vital component of modernisation. In particular, increasing levels of data collection by Departments and agencies can create public unease with regard to how such data will be used and whether such data is properly secured.

The Commission has considered data from a number of sources[459] and, although we are satisfied that individuals and businesses are becoming increasingly comfortable with engaging with both public and private services online, we recognise that a degree of hesitancy remains in this space.

Furthermore, cybersecurity attacks are a serious concern wherever personal data is involved due to the valuable and sensitive nature of the information. We acknowledge the long-term ramifications of the 2021 HSE ransomware attack on the public's trust in government systems remain unknown.

As such, the Commission believes that the necessary time and capital must be invested in the digital transformation process to continue to ensure that:

- the public have confidence in the system and understand how their data is being used,
- there is continued investment in cyber-security arrangements for all systems and to prevent data being compromised,
- the individual protections provided for in GDPR are at the heart of any decisions made in relation to an individual's data,
- proper fall-back arrangements are in place to ensure business continuity.

Also, as cybersecurity attacks are often the result of human error, we believe it is imperative that administrations are mindful of their obligation to educate taxpayers and staff about the key risks and safeguards as digital communication becomes more mainstream.

Recommendation

17.7 The Commission believes that data protection and data security must be a key consideration in any modernisation process, and that the public must have a clear understanding as to how their data is being used.

459 Including public consultation responses, online interaction data from Revenue, the Department of Transport and the Department of Foreign affairs, DSP surveys and market research surveys.

17.4.5 Mechanisms to address digital exclusion

Although increasing numbers of people expect to be able to carry out their day-to-day activities online, the Commission is aware that some cohorts may not adapt to the digital environment. This can be down to many factors such as cost, internet access, generational factors, and digital literacy.

We also recognise that exclusion may occasionally impact wider audiences on a temporary basis due to unforeseen events such as power outages or the aforementioned cyberattacks.

While we note that these exclusionary factors are being partially mitigated through effective and interactive customer services as well as public outreach and educational campaigns – in our view, fully mitigating digital exclusion is likely not possible.

Accordingly the Commission recommends that non-digital methods of engagement (including manual filing solutions, telephone-based or other in-person supports) continue be retained to some degree and redesigned as required to allow people to comply with their obligations in a manner compatible with the wider modernised administration. As part of this, consideration should be given to further simplifying[460] forms and, where appropriate, completely reimagining non-digital supports entirely[461] to assist taxpayers and facilitate compliance.[462]

Recommendation

17.8 The Commission recommends that the necessary supports and alternatives are retained to address digital exclusion.

17.5 IMPROVED REVENUE AND DSP INTERACTIONS

17.5.1 Treatment of taxable social welfare payments

As noted in our terms of reference, the Commission has been asked to

460 Individuals affected by digital exclusion are less likely to have access to agents or to have engaged in complex transactions. As such, simplified forms are an appropriate way for this cohort to interact with Revenue.

461 For example through the use of Virtual Digital Agents (VDA) which can be made available 24/7 allowing for improved customer service at reduced cost.

462 When Revenue began introducing online solutions for employees to address their tax obligations, a simplified paper version of the employee tax return (Form 12S) was also introduced to facilitate the claiming of basic credits and expenses by individuals, which is helpful for those affected by digital exclusion.

consider the potential for improvements in simplicity and administrative efficiency that could be derived from integrating elements of the taxation and welfare systems. One particular area which the Commission has considered, and which was the subject of submissions by both DSP and Revenue, was the deduction of tax from taxable welfare payments at source in real time.

Where a social insurance or social assistance payment is taxable, it is subject to taxation under the PAYE system. However, in practice DSP does not operate PAYE on these payments. Instead, DSP provides details of taxable payments to Revenue on a weekly basis. Revenue then accounts for Income Tax[463] on these amounts by adjusting the tax credits and standard rate bands of the recipient or their spouse, or by restricting future tax refunds or making adjustments following end-of-year reviews.

While these mechanisms may ultimately result in the correct amount of tax being collected, not accounting for PAYE directly in real time on taxable social welfare payments creates a number of issues including:

- *Uneven tax deduction arrangements*
  Changes in benefit amounts, cessation of benefit payments and time lags in the exchange of data can cause unevenness in tax deduction arrangements that are often not resolved until a future period, which can lead to delays for taxpayers in availing of refunds[464] or the creation of outstanding tax bills that must be paid in the future.

- *Uncertainty for taxpayers*
  It is not always clear to the individual how the tax has been applied. In certain cases a taxable social welfare payment made now may be exposed to an unquantified tax liability in the future (such as when future employment earnings are received). This can make it difficult for taxpayers to plan their affairs and understand their financial position.

- *Increased customer contacts for both Revenue and DSP*
  The impact of these issues was of particular concern following the introduction of the Pandemic Unemployment Payment (PUP) on foot

463 As PRSI and USC do not apply to such amounts.

464 In scenarios where an employed or self-employed individual suffers an income shock, and is in need of a welfare payment, they are often in a refund position for tax purposes. Non-application of PAYE leads to the deferral of such refunds.

of the pandemic. Although the payment provided invaluable support to individuals in the face of unprecedented income shock,[465] the manner in which this support payment was taxed was not readily clear to the general public. This was exacerbated by the fact that the level of Income Tax due on PUP generally exceeded an individual's personal credits in a period, which is not the case for most taxable welfare payments currently paid.

However, the Commission recognises that the application of PAYE on taxable social welfare payments would represent a significant operational change for DSP. The move could also represent a significant administrative challenge for the Department on top of its extensive payment and service delivery responsibilities – with the Department currently responsible for making approximately 80 million individual welfare payments across 80 schemes annually.

Any change in this space would require significant investment, careful change management and further collaboration with, and cooperation between DSP and Revenue.

We also recognise that applying PAYE to such payments would require careful thought to ensure there is no undue hardship for recipients of the payments. A person claiming a social welfare payment does so because they have experienced a contingency such as unemployment, illness, maternity etc., and the social insurance system offers a minimum level of support that sustains people through this period of uncertainty. In addition, there should be no impediment to the timing of payments – such payments play a critical role in providing support to those facing loss of income, and recipients should not, solely by reason of the application of PAYE, be put in a position where they are required to apply for Supplementary Welfare Allowance to bring their income above the minimum floor provided for in legislation. It is important to recognise the role that cash payments play in alleviating poverty.

The Commission acknowledges that there are very strong ties and interactions between Revenue and DSP, and we have considered how improvements in these arrangements have led to substantive

465 PUP is outlined in further detail in Chapter 11 (Promoting Employment).

improvements[466] in the past. In our view, an opportunity exists for Revenue and DSP to further leverage their existing linkages, as well as the lessons learned from PMod and the pandemic experience, to explore, within a suitable framework, a solution that provides for application of PAYE[467] to taxable social welfare payments made by DSP as they are being paid, and to publish a feasibility study on the matter.

Furthermore, if a system of pay-related benefits, as outlined in Chapter 12 (Inclusive and Integrated Social Protection) is introduced, and if such payments are taxable, consideration should be given to the application of PAYE by DSP as those payments are being made.

Recommendation

17.9 The Commission recommends that existing linkages between Revenue and the Department of Social Protection (DSP) be further enhanced to explore a solution that provides for application of PAYE to taxable payments made by DSP as they are being paid. In exploring such a solution, careful consideration is required to avoid undue hardship for recipients of such payments, taking account of the importance of cash payments in poverty alleviation.

17.5.1.1 Scope for increased data sharing on payment details

As noted earlier in this section, DSP provide details of the majority of taxable welfare payments to Revenue on a weekly basis. However, full details of certain taxable payments including Carer's Benefit and Allowance, Blind Person's Pension and non-contributory pensions for widowed persons are not currently transferred. As such, the responsibility for reporting these payments lies with the recipient.

In the Commission's view, this creates an unnecessary reporting burden on a subset of welfare recipients and ambiguity as to their taxation status. Accordingly, arrangements should be made for full details of these payments to be transferred to Revenue on a weekly basis.

466 Improvements in data-sharing arrangements as part of the wider PMod project generated an Exchequer increase of at least €12m in 2019. Revenue (2020) Evaluation of Budget 2019 Compliance Measures.

467 Referring to the mechanism for the application of taxes. The application of PAYE would not, of itself extend the taxes or charges applicable to such payments.

17.5.2 Information to assist with means testing

The Pandemic Unemployment Payment (PUP) was a social welfare payment for employees and self-employed people who lost their employment due to the pandemic. While PUP was originally paid at a flat rate, a tiered payment structure was introduced in October 2020 to facilitate different levels of payment depending on individual circumstances.

We believe that PUP demonstrates the advantages of a whole-of-government approach to administration. Linkages between Revenue and DSP enabled DSP to access Revenue's real-time payroll data for the purposes of determining the correct rates of PUP payable to each recipient.

The Commission believes that similar mechanisms could be employed to assist with providing information for means testing of other DSP payments. Initially, such linkages could support payments that have some relativity to current or prior employment income. However, as real-time reporting solutions are developed across taxheads, we see potential for such linkages to have some role in the means testing of other sources of income or wealth.

Recommendation

17.10 The Commission recommends that further linkages be developed between Revenue and the Department of Social Protection (DSP) to facilitate the more effective means testing of DSP payments.

17.6 RECOMMENDATIONS

Chapter 17: Modernisation of Tax Administration

17.1 The Commission believes that digital transformations are fundamental to the successful modernisation of tax administration processes. The Commission recommends that such transformations should be a central tenet of a structured programme of tax administration reform that should be commenced as soon as possible.

17.2 The Commission recommends that, in so far as possible, compliance obligations should be built into natural taxpayer systems and that due consideration should be given by the Revenue Commissioners, in conjunction with other Government Departments as required, as to how such systems should be leveraged in order to improve real-time reporting.

17.3 The Commission endorses the use of whole-of-Government solutions to improve service delivery.

17.4 The Commission recommends that the necessary steps are taken to ensure that modernisation of tax administration is fully supported by legislation.

17.5 The Commission recommends that the necessary investments are made by the State to further developthe appropriate technical architecture required to properly support modernised tax administration and data collection. This should also include developing appropriate frameworks for stakeholder engagement as part of a co-design approach to such modernisation.

17.6 The Commission recommends that the Revenue Commissioners and the Department of Social Protection be given supports as necessary to develop the skills base required to digitally transform tax and welfare administration.

17.7 The Commission believes that data protection and data security must be a key consideration in any modernisation process, and that the public must have a clear understanding as to how their data is being used.

17.8 The Commission recommends that the necessary supports and alternatives are retained, or developed where necessary, to address digital exclusion.

17.9 The Commission recommends that existing linkages between Revenue and the Department of Social Protection (DSP) be further enhanced to explore a solution that provides for application of PAYE to taxable payments made by DSP as they are being paid. In exploring such a solution, careful consideration is required to avoid undue hardship for recipients of such payments, taking account of the importance of cash payments in poverty alleviation.

17.10 The Commission recommends that further linkages be developed between Revenue and the Department of Social Protection (DSP) to facilitate the more effective means testing of DSP payments.

Chapter 18: Strategic Reform

18.1 INTRODUCTION

In the course of its work, the Commission identified a number of significant strategic issues arising in the taxation and welfare systems, which need to be addressed over a number of years to come. Some of the Commission's recommendations can be implemented in the short-term, but many of the issues discussed in this report will require medium- and longer-term actions. As the future is always uncertain, the Commission has placed considerable emphasis on the importance of taking a principles-based approach to the development of policy in the areas of taxation and welfare and has adopted principles which will remain valid, even as the context changes.

It has, however, been more than a decade since the last Commission on Taxation reported and more than 30 years since the Commission on Social Welfare.[468] It can be expected that it may be some time before another exercise of this kind will be undertaken again. It is important, therefore, to consider how to further improve understanding and consideration of these strategic issues in the interim between major reviews, such as the one in which the Commission has been engaged.

18.2 ANTICIPATORY GOVERNANCE

Given the explicit mandate in its terms of reference to consider the taxation and welfare system within a medium- to long-term perspective, the Commission has made use of the strategic foresight approach described in detail in Chapter 2 (Context). As outlined in that chapter the methodology of strategic foresight involves identification of 'megatrends' that are likely to shape the future context for policy globally and nationally, and consideration of how best to prepare for and respond to different scenarios that may emerge as a result. Some

468 A number of other bodies have, however, examined the social welfare system, including the National Economic and Social Council and the Advisory Group on Taxation and Welfare.

of these megatrends are more certain than others with demographic change being subject to less uncertainty than some other factors.

The strategic foresight methodology is not new, and has been adopted by a number of multilateral organisations such as the EU and the OECD. The EU maintains a system called ESPAS (European Strategy and Policy Analysis System) which links multiple EU institutions and which examines medium- and long-term trends facing or relating to the European Union. The OECD is also active in this area and, during the period of the Commission's deliberations, the Irish Government has begun a project with the OECD on enhancing policymaking and strategic foresight, which is a welcome development. While strategic foresight has also been used by numerous national Governments, including Ireland, there are acknowledged difficulties in incorporating this kind of work into traditional governmental structures. Strategic foresight and the linked field of anticipatory governance explicitly attempt to tackle issues which are complex and uncertain and which are challenging for traditional policy development models.

The development of strategic foresight and anticipatory governance more generally lies outside the Commission's remit. There are, however, practical steps that could be taken to enhance ongoing consideration of strategic issues that have a bearing on policy development in the areas of taxation and welfare. The outcome of the OECD work with Ireland may also lead to developments which will assist in this regard.

18.3 THE BUDGETARY PROCESS

The Irish system of public financial management owes its origins to pre-independence structures and legislation, and in particular the system of public finance that was established in the UK in the nineteenth century. Elements of our existing system, for example, are heavily based on the Exchequer and Audit Act of 1866, introduced by William Gladstone. The Act marked the culmination of a long process of reform in the management of public finances, designed to root out the inefficiencies and corruption associated with the pre-Victorian era. It was also intended to copper-fasten core elements of 'Gladstonian Finance', including a minimalist view of what constituted appropriate Government spending. As result of the Act, the authority of the House of Commons and of the Treasury was enhanced, in terms of approving public expenditure in advance and auditing spending after the event, through the creation of the post of the Comptroller and Auditor General and the Committee of Public Accounts. The core elements

of this structure remain in place in our present system, reinforced by constitutional provisions, legislation and parliamentary practice.

This system, in other words, owes its origins to a time when balanced budgets were an article of faith, and the scale and complexity of government activity was a fraction of what it is now. A core component of the system is its concentration on annual accounting. While multi-annual planning is not impossible under this system, Peden (2000)[469] notes that:

> *"the system of strict annual accounting was designed to prevent a government from committing its successors to expenditure or taxation in future years."*

In other words, maintaining a focus on the short run was part of the overall objective of limiting the growth of public spending. The core elements of the system, which has important safeguards in terms of value-for-money have remained in place, even though, from 1911 onwards, the emergence of the welfare state meant, according to Peden, that:

> *"...it was difficult to avoid moral, if not contractual, obligations in future years."*

Over time the system has been enhanced through a combination of government initiatives and European requirements, in areas such as, for example, multi-annual capital expenditure envelopes, improved distributional analysis, and the introduction of carbon budgets and programme budgeting. It is also welcome that the Government has also now committed to implementing a series of reforms in the area of public sector accounting. These reforms are critical to move away from the existing cash-based approach to a cross-Government system of accrual accounting, and consolidated financial statements will be transformative in helping to improve long-term management of public finances and in unlocking latent value from State assets. There have also been institutional enhancements, such as the creation of the Irish Fiscal Advisory Council (IFAC) and the Parliamentary Budget Office.

Yet, the system continues to have limitations when it comes to assessing long-run fiscal risks, and their implications for the tax and

469 Peden, G.C. (2000) The Treasury and British Public Policy 1906 – 1959.

welfare system.

In its work, the Commission has benefited greatly from the work of IFAC and the Department of Finance on issues such as the implications of demographic change on fiscal sustainability. Nonetheless, there is a need to enhance analysis and discussion of medium-term and long-term issues, which would add an important dimension to the usual debates that take place about the annual budget. Given the challenges that Ireland faces, an injection of long-term thinking would be valuable.

Recommendation

18.1 The Commission recommends that the annual budgetary cycle be augmented in order to enhance debate about and public knowledge of long-term issues of fiscal sustainability.

18.4 SCENARIO MODELLING

Macroeconomic forecasts, of their nature, present important variables in terms of smooth graphs and average annual growth rates. In reality, economic turning points are extremely difficult to predict. There is no doubt that there will be numerous ups and downs in the medium- to long-term future that the Commission has been considering. This is of concern, not least in light of Ireland's experience during the financial crisis in the late 2000s, when the collapse of unsustainable revenues from the real estate sector was a major factor in making the fiscal correction more difficult. There are numerous risks to growth and fiscal sustainability – what is not knowable is which of these vulnerabilities will materialise and when, or whether several of them will materialise at once. In terms of developing tax and welfare policy into the future, therefore, it would be useful to develop a system of scenario modelling and associated stress testing, to examine a range of different future public finance scenarios and to assess how well the State could react to them. The outcomes, and related learnings, could be incorporated into future planning. Such an exercise should be conducted on a cross-departmental basis and could be linked to the National Risk Assessment Framework.

18.5 POLICY LEVERS

A simple question to ask, arising from such a stress-testing exercise, or similar consideration of long-term issues, is whether Ireland currently has the policy levers and administrative capacities and structures necessary to deal with scenarios that may, or indeed will, arise in the future. Another lesson from the financial crisis and the COVID-19 pandemic, is the difficulty in designing new fiscal instruments under crisis conditions. The fact that Revenue had completed a major reform in the PAYE system was central to its ability to deliver supports during the pandemic. Such a support system could not have been created quickly otherwise.

The Commission has pointed to the need for new tax instruments to be developed in the area of land and road usage. These are projects which, if adopted by Government, will take several years to implement in terms of finalising the detailed design, building administrative systems, and phasing-in. Once in place, however, these 'levers' can be adjusted to take account of changing circumstances. It is important, therefore, on an ongoing basis, to consider how well Ireland is positioned to deal with fiscal risks that may materialise, and whether there are adequate policy tools and administrative systems in place should they arise.

Recommendation

18.2 The Commission recommends that Government departments should build on existing long-term fiscal analysis capabilities to develop a system of scenario modelling and associated stress testing. The system should be used to examine different future public finance scenarios and how well the State could react to them. It should also analyse whether there are adequate policy tools and administrative systems in place to address potential outcomes.

18.6 MEDIUM-TERM REFORM ROADMAPS

As part of developing policy, there is merit in making greater use of medium-term reform roadmaps, such as those adopted by the Government on taxation matters such as Corporation Tax and the Carbon Tax, and on the social welfare matters such as the Roadmap for Social Inclusion and Pathways to Work.

By setting out a multi-annual roadmap for the trajectory of the Carbon Tax, for example, the State is sending a strong signal about the direction of policy over a period of years, and is providing certainty as to the direction of travel on carbon pricing. This provides a strong incentive for people to invest in alternatives to carbon, while also providing time to make the necessary adjustments.

While Government will always need flexibility to respond to circumstances, there is merit in adopting a similar approach more broadly to give greater certainty about how tax and social welfare policy is likely to change in specific areas. The development of roadmaps also provides an opportunity for stakeholder engagement as appropriate.

Moreover, and as noted above, in some areas of taxation and social welfare, reform will undoubtedly require a process of planning over several years. The Commission's recommendations on land taxes and road usage taxes will require detailed planning and project management, as will some of the recommendations in relation to social welfare. Setting out roadmaps in these areas, would also improve economic efficiency, by providing greater certainty as to the direction of travel.

Recommendation

18.3 The Commission recommends greater use of medium-term roadmaps to provide certainty as to the direction of travel of policy in respect of specific elements of the taxation and welfare system.

18.7 PERFORMANCE REPORTING

The existing system of public financial management is derived from a time when strict limitation of Government spending was an overriding goal. While this system has carried over into modern audit and accountability for direct expenditure, as noted in Chapter 16 (Tax Expenditure Review Process), the high level of resources committed to various policy goals through tax expenditures does not receive the same level of scrutiny. Indeed, there appears to be a commonly-held view that tax expenditures are 'free' and that policy objectives can be pursued through tax expenditures at little to no cost to society or the economy.

The Commission has endorsed the general rule that a market failure should be clearly identifiable and that direct expenditure options should be examined before a tax expenditure is adopted. Moreover, one should also look for evidence of policy coherence, and for alignment between the policy objectives being pursued through direct expenditures and tax expenditures, such that the mix of both types of measure is appropriate and likely to achieve the stated policy objective.

To further this goal, information on tax expenditures relevant to particular Departmental votes could be included in expenditure reports and appropriation accounts. The formal accounting for direct expenditure could be accompanied by information notes on the extent of tax expenditures being directed at related policy objectives. Public Service Performance Reports, which are based on the concept of Performance Budgeting, include information on the total amount of expenditure allocated to each Department and what has been achieved with these resources. They do not, however, include information on tax expenditures. The Commission supports the increased use of performance budgeting to improve the link between the provision of the public services and the inputs that helped to deliver them, of which tax expenditures can often form a significant part. The Commission recommends that the performance budgeting process be changed so that outputs are assessed against the total level of resources, direct and indirect, being allocated to the policy objective concerned.

Recommendation

18.4 The Commission recommends that Public Service Performance Reports, and where appropriate other public accounts, should include information on the total amount of resources allocated to each Department and what has been achieved with these resources, including information on tax expenditures.

18.8 DATA COLLECTION AND RESEARCH

Just as tax expenditures are not free, neither is data collection, or the production of high quality research. Collecting and collating data involves the deployment of scarce resources. This in turn means that

choices are required as to which data should be collected and how it should be reported. Throughout this report the Commission comments extensively on the importance of the availability of timely and accurate data. We also make a number of recommendations about improved collection of such data to facilitate evidence-based policy analysis in respect of taxation and welfare within Departments and Agencies, linked to a broader strategic approach to data collection generally.

Furthermore, where investment is committed to collect such data, we believe that it is incumbent on policymakers to maximise the benefit of the data to support evidence-based decision making. Commitments should be made to enhance the analytical evaluation of this data and to further support the production of high quality research to derive insights that better inform Government and the broader public, particularly in the areas of property taxes, capital taxes, indirect taxes and pension tax expenditures.

Crucial to such a programme of research is greater access for researchers to suitably anonymised administrative data, in particular that collected by the Department of Social Protection and the Revenue Commissioners. The Commission also notes that Ireland lags behind many advanced economies in the provision of such data, most notably the Nordic countries, but also France, the US and the UK. This lack of access limits our understanding of pressing issues such as income inequality and mobility;[470] the effect of taxes on consumer and firm behaviour;[471] and also the impact of educational or welfare reforms on later life outcomes.[472]

The provision of this data access can and should be facilitated through the CSO in a manner that ensures confidentiality and anonymity of both individuals and firms. The Commission does not believe the provision of such data requires additional legislative measures, but rather greater prioritisation and a small amount of additional resources.

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470 Chetty, R., Hendren, N., Kline, P. and Saez, E. (2014) Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States, Quarterly Journal of Economics 129(4): 1553-1623.

471 Miller H., Pope, T. and Smith, K. (2021) Intertemporal Income Shifting and the Taxation of Business Owner-Managers. The Review of Economics and Statistics.

472 Bertrand, M. Mogstad, M. and Mountjoy, J. (2021) Improving Educational Pathways to Social Mobility: Evidence from Norway's Reform 94, Journal of Labor Economics, 39, 4, 965-1010.

Recommendation

18.5 The Commission recommends that greater access should be provided to suitably anonymised administrative data to support public interest research.

18.9 DISTRIBUTIONAL ANALYSIS AND IMPACT ASSESSMENT

Looking back over time, there have been enormous improvements in the quantity and quality of data and research available in respect of taxation and welfare policy in Ireland, particularly when compared to the position which obtained when the 1982 to 1986 Commission was undertaking its work. As a result of pioneering work undertaken in the ESRI from the late 1980s, supported financially by the Department of Social Welfare, new sources of information were developed that gave insights into poverty and the distribution of income which are now taken for granted, but which up to then had not been available. Indeed, meaningful international comparisons of income distribution and poverty have only been available since the mid-1990s, and Irish data was included in that initial wave of research.[473] These new databases then provided the basis for the development of new tools for assessing the impact of policy changes on poverty and the distribution of income, most notably the ESRI SWITCH model, which represented a major advance on the type of analysis that had gone before, particularly the use of 'typical household' examples.

As the models' developers regularly emphasise, however, such models have inherent limitations. They primarily focus on changes to personal taxes and welfare payments and, since they are built on survey data, may not be a good guide to the impact of policy changes that affect small numbers of households. Typically, survey data does not fully capture information on high incomes and wealth, and the models are correspondingly limited in these areas. It is important that in the years ahead further research and analysis is carried out to broaden our knowledge and understanding of income and wealth more generally, to support policymaking, public debate and distributional analysis. Using administrative data for this kind of modelling seems the logical extension in the medium-term, with the subject matter of SWITCH

473 See Atkinson, A.B., Rainwater, L. and Smeeding, T.M. (1995) Income Distribution in OECD Countries, Paris, OECD Publishing.

particularly suited to the move away from reliance on survey-based datasets.

This research and analysis will be required by Government Departments that have a role in advising Ministers on specific policy issues, must be underpinned by high-quality data, and ideally coordinated under the National Data Infrastructure (NDI). It is also important to support independent public-interest research in these areas, to promote informed debate on taxation and welfare policies.

Recommendation

18.6 The Commission recommends ongoing support for research in the areas of the distribution of income and wealth and the effects of taxation and welfare policy, as well as the development of improved tools for ex-ante evaluation and impact assessment of proposed policy changes.

18.10 SKILLS

Improving the evaluation of tax and welfare policies, and better policy development generally, relies on having enough people with the right skills. Significant advances have been made through the development of IGEES – the Irish Government Economics and Evaluation Service, and IGEES staff are currently working across a variety of Government Departments. Their work is complemented by the statisticians working across Government Departments as part of the Irish Government Statistical Service, IGSS. It is important to bear in mind, however, that economics is not the only relevant skillset required to do this work. The Department of Finance, the Department of Social Protection and Revenue have, for example, invested heavily in developing tax and data analytics skills among their staff, including through recruitment from the private sector, as well as enhancing internal capacity. The Commission endorses the importance of maintaining and enhancing the skills required within the public service to conduct strong evaluations of tax and welfare policies, including tax expenditures.

Recommendation

18.7 The Commission recommends that the public service continues to invest in the people and skills needed to improve policy analysis and policy development in the realm of taxation and welfare across a range of disciplines.

18.11 RECOMMENDATIONS

Chapter 18: Strategic Reform

18.1 The Commission recommends that the annual budgetary cycle be augmented in order to enhance debate about and public knowledge of long-term issues of fiscal sustainability.

18.2 The Commission recommends that Government departments should build on existing long-term fiscal analysis capabilities to develop a system of scenario modelling and associated stress testing. The system should be used to examine different future public finance scenarios and how well the State could react to them. It should also analyse whether there are adequate policy tools and administrative systems in place to address potential outcomes.

18.3 The Commission recommends greater use of medium-term roadmaps to provide certainty as to the direction of travel of policy in respect of specific elements of the taxation and welfare system.

18.4 The Commission recommends that Public Service Performance Reports, and where appropriate other public accounts, should include information on the total amount of resources allocated to each Department and what has been achieved with these resources, including information on tax expenditures.

18.5 The Commission recommends that greater access should be provided to suitably anonymised administrative data to support public interest research.

18.6 The Commission recommends ongoing support for research in the areas of the distribution of income and wealth and the effects of taxation and welfare policy, as well as the development of improved tools for ex-ante evaluation and impact assessment of proposed policy changes.

18.7 The Commission recommends that the public service continues to invest in the people and skills needed to improve policy analysis and policy development in the realm of taxation and welfare across a range of disciplines.

List of Tables

Table 1	Gini coefficient for market and disposable income distribution, 2018	*31*
Table 2	Government balance and debt from Stability Programme Update 2022, 2021-2025	*57*
Table 3	Age-related expenditure, as a percentage of GNI*(%), 2019-2070	*62*
Table 4	Breakdown of total tax receipts (€82 billion), 2021	*73*
Table 5	Implicit tax rates in European countries, 2020	*80*
Table 6	Value of total household assets as share of gross wealth (%) by type of asset, 2013, 2018 and 2020	*118*
Table 7	Net wealth decile threshold limits, 2020	*119*
Table 8	Share of total net wealth (%), 2013 and 2018	*119*
Table 9	Share of total net wealth (%) by income quintile, 2013, 2018 and 2020	*120*
Table 10	Joint distribution of equivalised net wealth and gross income (% share of individuals), 2018	*120*
Table 11	Capital Gains Tax transactions distributions by income decile, 2015	*121*
Table 12	Characteristics of the distribution of wealth, 2013-2020 and At Risk of Poverty Rate, 2021	*124*
Table 13	Lifetime consideration thresholds for Retirement Relief	*140*
Table 14	Current Capital Acquisitions Tax groups (2022)	*141*
Table 15	Impact of movements in reduction of Group A threshold on Exchequer yield	*143*
Table 16	Pension tax reliefs	*155*
Table 17	Tax treatment of lump sums	*161*
Table 18	Current tax treatment of ARF upon death	*163*
Table 19	Age-related percentage limits for tax relief on pension contributions	*165*

Table 20	Contribution of foreign-multinational companies across selected metrics (as a percentage of all companies in that sector and overall), 2020	*178*
Table 21	Breakdown of R&D claimants by size (number of employees), 2017 - 2020	*200*
Table 22	PAYE data on share-based remuneration, 2019 and 2020	*204*
Table 23	Recipients of working-age income supports by category, 2014-2019	*230*
Table 24	Earnings dispersion, Ireland, EU and OECD, selected years	*235*
Table 25	Headline poverty and inflation rates, and Social Welfare adequacy, 2004-2019	*240*
Table 26	Tax wedge in Ireland by household type, 2020	*270*
Table 27	Tax applied to selected fuels (€ per 1,000 litres)	*323*
Table 28	LPT valuation bands, 2022	*358*
Table 29	Examples of different tax expenditures	*401*
Table 30	Tax expenditure reviews published since 2014	*409*
Table 31	Levels of expenditure evaluation	*416*
Table 32	Five categories of tax-relieving measures included in the Irish tax benchmark system	*420*
Table 33	Median Income, At-Risk-of-Poverty thresholds and Poverty Gaps, 2004-2021	*483*

Note – Information and data referenced throughout the report is as available at end June 2022 unless otherwise stated.

List of Figures

Figure 1	Employment growth in EU-15 countries, 1995-2020	*8*
Figure 2	i) GDP per capita and ii) real GDP and GNI* growth, 1995-2020	*9*
Figure 3	General Government Debt as percentage of GNI*, 1990-2021	*22*
Figure 4	Headline poverty measures in Ireland, % of population, 2004-2021	*32*
Figure 5	Revenues as a share of national income* i) Figure 5A: Ireland (IE) and selection of EU-27 countries, 2020 ii) Figure 5B: IE and EU-27, 1995-2020	*53*
Figure 6	Gross debt as a share of national income in EU-27, 2020	*58*
Figure 7	Age cohort projections, Ireland, 2021 and 2041	*61*
Figure 8	Irish tax receipts from earned income, consumption and wealth, 2010-2021	*75*
Figure 9	Balance of tax in a European context, 2020	*79*
Figure 10	Average tax wedge of single worker on average wage with no children in OECD, 2021	*83*
Figure 11	Household assets, liabilities and net worth, in quarters, 2002-2021	*117*
Figure 12	Composition of household wealth by net wealth decile, 2020	*122*
Figure 13	Historical CAT group thresholds, adjusted to January 2020 values, 1984-2020	*142*
Figure 14	SMEs, share of key variables, 2019	*182*
Figure 15	Annual earnings by percentile (Every 5th Percentile), 2019	*233*
Figure 16	Annual equivalised disposable income by percentile (Every 5th Percentile), 2019 reference year	*234*
Figure 17	Absolute and relative poverty measures, Survey on Income and Living Conditions, 2019	*237*

Figure 18 Participation rate, by age and sex, Ireland and EU average, 1995–2019 *242*

Figure 19 Social Insurance records by year of birth *243*

Figure 20 Implicit tax rates on labour in EU-27, 2020 *267*

Figure 21 At risk of poverty (AROP) rate and Social Welfare adequacy, 2004-2019 *290*

Figure 22 Economic activity and Greenhouse gas emissions, 2000-2020 *312*

Figure 23 Greenhouse gas emissions by sector, 1990-2020 *317*

Figure 24 Total environmental tax revenue, 2011-2020 *319*

Figure 25 Recurrent taxation of immovable property in the OECD, 2019 *342*

Figure 26 Number of deaths by risk factor in Ireland (all ages and genders), 2017 *379*

Figure 27 Ireland Top 10 risks contributing to total number of Disability-adjusted life years, 2019 and percentage change 2009–2019 *380*

Figure 28 Equivalent per capita annual tax needed to cover the increased fiscal pressure due to overweight, in US$ purchasing power parity, average 2020-2050 *386*

Figure 29 Economic impact of overweight on per capita labour market output based on average wages, per year, in US$ Purchasing Power Parity, average 2020-2050 *387*

Figure 30 Regression of prevalence of obesity among adults v. household availability of ultra-processed foods in selected Western European countries *389*

Figure 31 Prevalence of sweet/savoury snack consumption (number of 35g sweet/savoury snack portions/person/month), 2016 *390*

Figure 32 Medical Insurance Relief cost, 2012-2019 *396*

Figure 33 Estimated cost of tax expenditures (€ millions), 2020 *404*

Note – Information and data referenced throughout the report is as available at end June 2022 unless otherwise stated.

Glossary of Terms

At-Risk-of-Poverty rate

An individual is defined as being at risk of poverty if their nominal equivalised disposable income is under the at-risk-of-poverty threshold, i.e. 60 per cent of the median nominal equivalised disposable income. As such it is a relative measure of poverty.

BEPS

BEPS stands for Base Erosion and Profit Shifting. The term BEPS is often used refer to tax planning strategies that either:

- exploit gaps and mismatches in tax rules in different jurisdictions to reduce taxable profits, or
- shift profits to low tax locations where limited activity taxes place resulting in little or no overall corporate tax being paid.

Carbon budget

The total amount of greenhouse gases that may be emitted in the State during a five-year period (measured in tonnes of carbon dioxide equivalent). Economy wide carbon budgets include sectoral emissions ceilings setting out a decarbonisation target (within a range) for individual sectors. The process for setting and implementing carbon budgets is provided for in the Climate Action and Low Carbon Development (Amendment) Act 2021 and carbon budgets are overseen by the Oireachtas.

Consistent poverty

This is the measure of poverty used for the National Social Target for Poverty Reduction (NSTPR) that takes account of the household's living standards as well as the household size, composition and total income. Persons are regarded as being in consistent poverty if their income is below 60 per cent of the median income (i.e. at-risk-of-poverty) and are deprived of at least 2 out of the 11 items on the basic deprivation list (see list in 'Deprivation' below).

Deadweight and additionality

An economic concept that reflects the loss in economic welfare in a particular market due to a market that is out of equilibrium (usually due to a market failure or the tax wedge).

In practice, tax expenditures are associated with some degree of deadweight loss as a proportion of claimants will use a tax expenditure to replace funds that they would have directed toward the specific activity in the absence of the tax expenditure. The opposite of deadweight is additionality where a tax expenditure is used to fund a particular activity that would not have happened in the absence of the tax expenditure (a concept that is often difficult to measure in practice).

Deprivation

People who are denied – through lack of income – at least two items from a list of 11 indicators are regarded as experiencing deprivation. This is enforced deprivation as distinct from the personal choice not to have the items. The following 11 basic items are used to construct the deprivation index:

1. unable to afford two pairs of strong shoes;
2. unable to afford a warm, waterproof overcoat;
3. unable to afford new (not second-hand) clothes;
4. unable to afford a meal with meat, chicken or fish (vegetarian equivalent) every second day;
5. unable to afford a roast joint or its equivalent once a week;
6. without heating at some stage in the last year through lack of money;
7. unable to afford to keep the home adequately warm;
8. unable to afford to buy presents for family or friends at least once a year;
9. unable to afford to replace any worn-out furniture;
10. unable to afford to have family or friends for a drink or meal once a month; and
11. unable to afford a morning, afternoon or evening out in the last fortnight for entertainment.

The indicator of basic deprivation was developed by the Economic and Social Research Institute using data from the Survey on Income and Living Conditions.

Employment rate

The employment rate is the proportion of the working-age population that is employed. The International Labour Organisation (ILO) definition of employed persons are those aged 15 years and over who have worked for payment or profit in the reference week (usually the week preceding the survey) or who had a job from which they were temporarily absent for reasons such as holidays, maternity leave or sick leave.

Equivalised disposable household income

Disposable household income is divided by the *equivalised household size* to calculate *equivalised disposable income* for each person, which essentially is an approximate measure of how much of the income can be attributed to each member of the household. This equivalised income is then applied to each member of the household.

European Emissions Trading System (ETS)

The European Union (EU) Emissions Trading System (ETS) is a cap and trade system for greenhouse gas emissions. The cap is a firm limit or allowance on the levels of greenhouse gases that may be emitted, which gets stricter over time. Unused emissions allowances may be bought and sold. The EU ETS is in place for emissions from electricity generation and large industry. Emissions from agriculture, transport, the built environment and small industry are not covered under the EU ETS but are covered instead under the EU Effort Sharing Regulation.

Financial exclusion

Financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong. It is measured by the percentage of individuals/households with no current account.

Fossil fuel subsidies

Fossil fuel subsidies are subsidies created by government action to confer an advantage on consumers or producers to supplement their income or lower their costs. Where the tax system is used to confer these advantages, such subsidies are considered to be tax expenditures.

Gini coefficient

A measure of inequality, commonly used to measure inequality of income and wealth, representing the share of total resources held by a household's ranking in the distribution. Its value ranges from zero to one, with zero representing a state of perfect equality (everybody has the same share of income or wealth) and one representing perfect inequality (all income or wealth is attributed to one person).

Global warming/Greenhouse effect

The greenhouse effect is a process that occurs when energy from the sun goes through the earth's atmosphere and warms the earth's surface, but the earth's atmosphere then prevents the heat from returning directly to space, resulting in a warmer planet.

Light arriving from our Sun passes through Earth's atmosphere and warms its surface. The warmed surface then radiates heat, which is absorbed by greenhouse gases such as carbon dioxide.

Without the natural greenhouse effect, Earth's average temperature would be well below freezing. Current human-caused increases in greenhouse gases trap greater amounts of heat, causing the Earth to grow warmer over time.

Greenhouse gas

A gas that contributes to the greenhouse effect by absorbing infrared radiation such as carbon dioxide.

Gross Domestic Product (GDP)

The total monetary value of all final goods and services produced in a given jurisdiction within a given period of time (i.e. quarter or year). It is the most commonly used measure of economic output/national income, giving a sense of the size of an economy. However, in the case of Ireland, it has become an unreliable measure of national income, due to the economic activity of multinational enterprises operating here. Modified GNI (GNI*) is a more suitable measurement for assessing the Irish economy.

Gross Value Added (GVA)

Conceptually, it is a measure of output, similar to GDP. GVA differs in that it calculated prior to the addition of product taxes but includes product subsidies.

HFCS (Household Finance and Consumption Survey)

A survey compiled by the CSO that gathers information on household assets and liabilities, as well as data on gross income and credit constraints.

Implicit tax rate and effective tax rates

While statutory rates such as the 12.5 per cent Corporation Tax rate or the 33 per cent Capital Acquisitions Tax are defined in legislation as the headline tax rates that apply to corporate income and gifts/inheritances, they do not fully reflect the actual tax paid as a share of the base. This is because they often apply to a base that is narrowed for the purposes of taxation by means of credits, reliefs and tax-free exemptions. The effective tax rate faced by an individual is the tax paid divided by the base.[474]

Implicit tax rates attempt to give insight into the average effective tax rates faced by cohorts of tax bases such as consumption, labour income and capital income. The degree to which implicit tax rates are lower than the headline rates suggests that the tax base is reduced i.e. taxpayers avail of various reliefs, credits and allowances to reduce the average tax burden.

Immovable property

Generally, immovable property means land and any buildings or fixtures attached to the land. Simply put, the term refers to assets which cannot be practicably moved from one place to another.

Income

The flow of resources accruing to an individual/household in a given period. Disposable income is defined as gross income less taxes, plus any social transfers. Gross income is defined as market income plus income from social transfers. Market income is defined as income before tax, minus income from social transfers.

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474 Definitions of the base can vary depending on the data being used. For example, the effective corporate tax rate varies depending on the measure of 'profits' used. See Department of Finance (2014) for more information.

Just transition

This means ensuring the transition to a low-carbon economy is a fair one and the burden does not disproportionately fall on, or cause undue social or economic harm to, workers and communities reliant on damaging activities.

Marginal rate of tax

This is the rate of tax applicable to the next euro of income earned. The term is colloquially used to refer to the higher(est) rate of Income Tax in a jurisdiction. Both the 40 per cent Income Tax rate and the maximum combined rate applicable to employment income of 52 per cent[475] are often referred to as marginal rates in Ireland.

Market failure

In economic theory, the free market produces the most efficient outcome from a societal perspective. However, there are often occasions where this is not necessarily the case in practice. A market failure occurs where those engaged in the market produce societally insufficient levels of 'goods' (such as Research and Development, a key driver of economic growth), or over-produce societal 'bads', such as pollution. In other words, those engaged in the market account solely for their own private gains, while failing to internalise the wider societal impacts of their choices (referred to as externalities). Tax expenditures are used to reflect, via reduced costs to the claimant, the wider societal benefits of the claimant's decision to undertake a particular activity.

Mean income (disposable)

The sum of all household disposable incomes divided by the number of households. When compared with the median, it gives insight into the distribution of incomes. When the mean is higher than what the middle person receives (median), a small number of households receive a disproportionate share of income.

475 Being Income Tax @ 40 per cent + USC @ 8 per cent and PRSI @ 4 per cent.

Median income (disposable)

If all households were ranked in order from poorest to richest in terms of disposable income, the household in the middle of this ranking would have the median disposable income. Half of the population have income below median income and half have incomes above it.

Modified Gross National Income (GNI*)

A measure of national income or economic activity that is reflective of economic activity in Ireland the income from which flows to Irish residents. It differs from Gross Domestic Product (GDP) as it strips out net factor income (e.g. profits flowing to owners of Irish resident capital who are not resident in Ireland) and a number of particular factors that distort national income relating primarily to high-depreciation[476] assets. Specifically, GNI* strips out:

- depreciation of intellectual property
- depreciation of leased aircraft
- net factor income of re-domiciled PLCs

GNI* is used as the measure of national income in this report in line with best practice by other organisations such as the Irish Fiscal Advisory Council, the Department of Finance and the ESRI. Due to the fact that other countries do not see their measures of national incomes distorted by the aforementioned factors, GNI* is an appropriate comparator with the GDP of other countries. For more information on GNI* see the CSO website.

Net-zero/carbon-neutral

Carbon neutrality means having a balance between carbon emissions and absorbing carbon from the atmosphere.

476 Depreciation (consumption of fixed capital) in national accounting, is closely related to the concept of business/accounting depreciation, however, it applies to the current value the asset, as opposed to the purchase price.

OECD/G20 Inclusive Framework on BEPS (the Inclusive Framework or IF)

The Inclusive Framework was launched in 2016 to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS related issues, while reviewing and monitoring the implementation of the BEPS Project. At its inaugural meeting there were 82 members of the IF. Since then, the membership of the IF has grown to 141[477] countries and jurisdictions, including 14 observer organisations.

Participation rate

The labour force participation rate is a measure of the proportion of the working-age population in the labour force - people who are either working or looking for work.

Progressivity

A progressive tax system is one where the average effective tax rate increases as the individual's income rises. The Income Tax system exhibits progressivity as those with higher incomes pay a proportionately higher share of their incomes in taxes than those on lower incomes.

Price elasticity of supply and demand

Elasticity is an economic concept that represents the responsiveness of one variable to a change in another. *Price elasticity of demand* is the percentage change in demand for a good, service or worker (in the labour market) due to a percentage change in the price/wage of that good, service or worker. The demand for a good is said to be *price inelastic*, if the demand for the good changes to a proportionately lesser degree than the price of the good, whereas the responsiveness in demand is greater for price elastic goods.

Supply elasticity also differs across markets, and it represents the degree to which the supply of a good/service responds to prices.

477 Since November 2021.

Regressivity

The opposite of progressivity. A regressive tax is one where those on lower incomes pay more, as a share of income in taxes than those with higher incomes. Consumption taxes are regressive; for example, A person with low income purchasing a certain good will pay the exact same level of VAT (e.g. 23 per cent) as person with high income, resulting in the person with low income paying more tax as a share of their income.

Renewable energy

Energy from a source that is not depleted when used, such as wind or solar power.

SILC (Survey of Income and Living Conditions)

This is a voluntary household survey carried out annually in EU member states, allowing comparable statistics on income and living conditions to be compiled. In Ireland, the Central Statistics Office (CSO) has conducted the survey since 2003, and produces analysis in accordance with Irish national poverty targets, indicators and related issues.

SMEs (Small and Medium Enterprises)

SMEs are defined as enterprises with less than 250 persons engaged. SMEs are further split into micro enterprises with less than 10 persons engaged small enterprises with between 10 and 49 persons engaged and medium-sized enterprises with between 50 and 249 persons engaged. Turnover and balance sheet thresholds also apply as follows:

COMPANY CATEGORY	STAFF HEADCOUNT	TURNOVER	(OR) BALANCE SHEET
Micro	<10	≤ €2m	≤ €2m
Small	<50	≤ €10m	≤ €10m
Medium	<250	≤ €50m	≤ €43m

Source: European Commission

Social exclusion

The inability to participate in society because of a lack of resources that are normally available to the general population.

Social protection

In an Irish context, social protection is the set of policies and programmes designed to reduce and prevent poverty and vulnerability across the life cycle.[478] It is a set of measures that a society provides to its members to protect them from poverty and social exclusion due to a lack of income caused by unemployment, old age, disability, maternity, and insufficient family support, particularly for children and adult dependants. Delivery options for the pursuit of social protection objectives, three of which are set out below, can be combined in different proportions.

- Income support through social insurance: entitlement is based on a record of having made social insurance contributions – typically a compulsory payment of a proportion of earnings from employment.
- Income support through targeting: this is generally applied through a means test, where the household income and means are assessed and the income support is available to those whose household income is below a certain amount. This is the dominant method in a social assistance system, where need is assessed at a point in time, without reference to a person's contribution history.
- Income support through universal payments: Also known as categorical benefits, this is where anyone within a certain category receives the benefit, regardless of means or contribution record.

Social transfers

Social transfers are income from non-market sources. This includes state means-tested allowances, state non-means-tested benefits (such as Child Benefit and payments based on prior social insurance benefits), occupational pensions, foreign pensions and other non-market transfers (such as from other households or from charities). They are generally categorised in SILC as unemployment benefits, old-age benefits, occupational pensions, children or family related allowances, housing allowances and other social transfers such as survivors, sickness or disability benefits.

478 International Labour Organization, World Social Protection Report 2020-2022.

Tax incidence

Discussions on taxation often focus on taxation systems by considering matters like the base, the rate and whether the structure is progressive or regressive. Another factor to consider is incidence. The statutory incidence of a tax refers to the legal obligation to remit taxes to the State. The statutory burden of taxes on employment, for example, is shared between employers (employer Pay Related Social Insurance 'PRSI') and employees (Income Tax, USC, employee PRSI). From the perspective of materiality, or who is actually burdened with a tax change, the best approach is to disregard where the responsibility to remit the payment lies and consider the impacts across all of the actors as a result of the tax change. This is the effective incidence: in other words, regardless of who remitted the tax, effective incidence focuses on who ends up with a net reduction in either pay, profit or well-being. The effective incidence will vary in different situations but, broadly speaking, it is expected to fall on the side of the transaction with relatively lower responsiveness to changes in prices, wages or costs to tax changes (in other words, the side with the least elastic response).

Tax wedge

The difference between the non-tax price and the price paid for a good/service. In the labour market, it refers to the difference between labour costs to the employer (including employer's PRSI) and net wages (i.e. after tax and employee PRSI).

The Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the Two-Pillar Solution):
This is a multilateral agreement that seeks to modernise the international tax framework. The agreement entails two pillars. A high-level overview of these pillars is set out below. Further detail in respect of the Two-Pillar solution is available on the BEPS hub on the OECD website. The hub is updated on an ongoing basis.

- *Pillar One*
  The Pillar One rules seek to reflect the fact that globalisation and digitalisation allows businesses to participate in the economic life of a jurisdiction without physical presence (traditionally the main factor in determining taxable presence). It achieves this by ensuring that the largest and most profitable multinational enterprises (MNEs), are subject to tax on 25 per cent of their worldwide residual profits (defined as profits in excess of 10 per cent of revenue) in their market jurisdictions (i.e. the countries where the end-consumers and users of their products and services are based), irrespective of whether the MNEs have a physical presence in those jurisdictions. It is anticipated that these rules will initially apply to approximately 100 MNEs worldwide.

- *Pillar Two*
  The Pillar Two rules contain a series of coordinated measures (the Global Anti-Base Erosion, or GloBE rules) which generally seek to ensure that in-scope large MNEs with worldwide group revenue of €750 million or greater pay a minimum effective rate of taxation on their profits in each jurisdiction in which the group operates. The rules will apply by charging a top-up tax to bring the effective rate of taxation up to the minimum rate. The agreed minimum rate is 15 per cent.

  Pillar Two also includes a bilateral tax treaty rule (the Subject to Tax Rule, or STTR) which would apply when certain payments (such as interest and royalties) are made to another jurisdiction which imposes low levels of taxation on the payment. It has been agreed that the minimum rate applied to such payments will be 9 per cent. This is lower than the GloBE rate because the STTR applies to gross payments rather than net profits.

US Global Intangible Low-Taxed Income ("GILTI") Regime:

The United States enacted a minimum tax known as the Global Intangible Low-Taxed Income ("GILTI") Regime in the Tax Cuts and Jobs Act 2017. This regime charges a parent company additional tax where its subsidiary companies are taxed below a certain rate and is believed to be the inspiration for the minimum tax rules in Pillar Two. However, there are a number of differences between how GILTI (as currently drafted) and Pillar Two's minimum tax rules will operate. Steps are currently being undertaken in the US to reform GILTI.

Annex 1: Impact Assessment

The Commission's role, as defined in its terms of reference, has been to conduct a high level and strategic assessment of the taxation and welfare systems over the medium and long-term. Accordingly, many of the Commission's recommendations are principles-based, or intended to indicate the appropriate direction for policy to evolve over time, rather than being set in very precise terms. The Commission has been clear that its recommendations should be phased in over time, and with appropriate consideration of the impacts and interactions of particular measures as they are introduced.

As a consequence of this approach it is not possible to conduct an overall impact assessment of the Commission's report. Nor do sufficient tools exist to conduct such an assessment – as set out in the main body of the report there are areas of the tax and welfare system where tools for costing policy changes in advance and assessing their distributional impact are limited or non-existent. It would also be difficult to 'add-up' all the various impacts into a single appraisal since there would be no way to understand the different interaction effects and behavioural responses that may influence those policy changes as they are implemented over time. The imperative to develop datasets and tools that facilitate a quantitative rather than a qualitative approach to assessing the impact of policy on various cohorts is set out in Part 4.

It is important, however, to set out how the Commission has considered the likely impact of its recommendations in specific areas including on poverty, gender and equality. It is also important to point to areas where further research and analysis are needed, and where policymakers would benefit from the development of tools to better understand the likely impact of policy changes before they are made.

This impact assessment was guided by the Poverty Impact Assessment framework but should not be seen as a full poverty impact assessment.

Counterfactuals

In any impact assessment or policy-proofing exercise, the proposed policy change is being compared to some implicit or explicit counterfactual. Often that is the status quo ante, or a version of it, such as the status quo updated by inflation. In considering a report such as this one, it is important to consider a wide range of possible counterfactuals. Specifically, one key message of the report relates to the importance of fiscal sustainability – raising the funding to finance public services and the benefits provided through the social protection system. In considering impacts therefore, it is important to consider what would happen if no policy action were taken, or if policy action were delayed. Furthermore, the Commission's role is to take a broad perspective and comment on systemic changes that will enhance the overall functioning of the taxation and welfare system – an assessment that accords undue regard to the status quo, by assessing all changes against it, will be constrained in making recommendations that enhance systems overall.

Consultation

A broadly advertised public consultation entitled "Your Vision, Our Future" was undertaken by the Commission. 229 submissions were made through the consultation to date including 73 detailed submissions from key stakeholders, academic institutes, political parties and various Government Departments. A series of comprehensive public stakeholder events were held virtually in early March 2022. In addition, the Commission had engagement with a number of key Government Departments as part of the follow-up to the public consultation.

Poverty

As noted in Chapter 10 (Labour Markets and Social Protection Systems) the official measure of poverty in Ireland is 'consistent poverty', an indicator which is based on the overlap of two component indicators:

- At-risk-of-poverty which identifies the share of individuals with equivalised incomes below 60 per cent of the national median.
- Basic deprivation which captures individuals unable to afford two

or more of 11 basic necessities.[479]

Therefore, a person is in consistent poverty if they are both income-poor and deprived. Consistent poverty reflects a multi-dimensional understanding of poverty including the idea that poverty in an advanced economy results in people being excluded from activities that are considered part of the normal business of life in the community to which they belong.

The Commission has been particularly cognisant of the consistent poverty rate by principal economic status. In 2020 this rate was highest among persons unable to work due to long-standing health problems (17 per cent) and the unemployed (16.5 per cent), while it was lowest amongst those who were employed (1.7 per cent) and those who were retired (1.0 per cent). In terms of household composition, individuals living in households where there was one adult and one or more children aged under 18 had the highest consistent poverty rate at 21.6 per cent. Moreover, the Commission noted that children continue to be a group in society which experiences high levels of poverty and deprivation. In 2020, children (0 to17 years) experienced the highest consistent poverty rates of all age groups at 8 per cent. Children living in one-parent families experience particularly high levels of poverty.

The impact of social transfers in reducing poverty in Ireland is one of the highest in the EU. This reflects the progressive and targeted nature of social transfers. Social transfers also provide support across the life-course, from helping to protect children from the risks of inter-generational poverty and disadvantage, to ensuring an adequate standard of living across all life-cycle groups.

While there have been notable improvements in poverty levels over recent decades, there are important areas where further progress is needed, despite the fiscal risks which have been articulated in this report. The Commission's recommendations which have a bearing on poverty include the following:

- Including 'Adequacy' as a core principle for taxation and welfare policy.
- A series of reforms to Pay Related Social Insurance (PRSI) to fund social insurance payments.

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479 The measure, consistent poverty, was developed independently by the Economic and Social Research Institute (ESRI). It was devised in 1987 using indicators of deprivation based on standards of living at that time. These indicators were updated in 2007.

- Recommendations to remove 'traps' and cliff-edges in the taxation and welfare system which can cause or perpetuate poverty.
- Further development of the services offered by the Public Employment Service and expanded provision of those service to a wider range of people.
- A transparent and evidence-led process to benchmark social welfare payments and annual increases in welfare rates thereafter.
- Reform to working-age payments to provide for greater flexibility and to encourage transitions into employment.
- A second-tier integrated child income support which would be provided to families on low income and which minimise work disincentives.
- A series of recommendations to promote enterprise and employment to maximise the number of job opportunities available in the business economy.

At the same time, there are areas where caution and further impact assessment will be needed in the phased implementation of the Commission's recommendations. These include:

- Interactions between recommendations on the treatment of age for Income Tax purposes and other recommendations such as individualisation of the standard rate cut off point.
- The distributional implications of increases in indirect taxes and the combined impact of increases in VAT and Excise Duties where this might arise, and in particular the impact of such changes on fuel poverty.
- The implications of increases in the tax wedge on low paid employment.

Poverty-gaps

While the level of 'consistent poverty' is an important indicator which has gained wide usage in policy discussions, other poverty indicators should also be considered, including the poverty-gap. The relative at-risk-of-poverty gap is calculated as the difference between the median equivalised disposable income of people below the at-risk-of-poverty threshold and the at-risk-of-poverty threshold, expressed as a percentage of the at-risk-of-poverty threshold (cut-off point: 60 per cent of national median equivalised disposable income).[480] The purpose of the indicator is to measure how far below the poverty threshold the

480 Eurostat.

median income of people at-risk-of-poverty is, or in other words, the depth of poverty.[481] In developing our understanding of the impact of the taxation and welfare systems, and the impact of relevant associated policies, there would be merit in more regular publication of this data, and where possible the status of different groups in society in terms of both consistent poverty and the poverty gap.

Table 33: Median Income, At-Risk-of-Poverty thresholds and Poverty Gaps, 2004-2021

YEAR	NATIONAL MEDIAN EQUIVALISED INCOME (€)	AT-RISK-OF-POVERTY THRESHOLD (€)	MEDIAN INCOME OF THOSE AT-RISK-OF-POVERTY (€)	GAP BETWEEN MEDIAN AROP INCOME AND NATIONAL MEDIAN (€)	POVERTY GAP (%)
2004	€16,128	€9,677	€7,761	€1,916	19.8%
2005	€16,697	€10,018	€7,964	€2,054	20.5%
2006	€17,610	€10,566	€8,717	€1,849	17.5%
2007	€19,794	€11,876	€9,821	€2,055	17.3%
2008	€20,758	€12,455	€10,064	€2,391	19.2%
2009	€20,107	€12,064	€10,110	€1,954	16.2%
2010	€18,591	€11,155	€9,181	€1,974	17.7%
2011	€18,148	€10,889	€8,766	€2,123	19.5%
2012	€17,937	€10,762	€8,599	€2,163	20.1%
2013	€17,983	€10,790	€8,848	€1,942	18.0%
2014	€18,385	€11,031	€8,946	€2,085	18.9%
2015	€19,461	€11,677	€9,750	€1,927	16.5%
2016	€20,331	€12,199	€9,918	€2,281	18.7%
2017	€20,869	€12,521	€10,330	€2,191	17.5%
2018	€22,872	€13,723	€11,472	€2,251	16.4%
2019	€23,979	€14,387	€12,272	€2,115	14.7%
2020	€24,013	€14,408	€12,218	€2,190	15.2%
2021	€25,264	€15,158	€12,899	€2,259	14.9%

Source: CSO Ireland, Survey on Income and Living Conditions, various years

481 Department of Social Protection: Social Inclusion Monitor Series, 2010-2019.

Gender

The approach to gender equality has been strengthened in recent years through the requirement for all public bodies to comply with a 'Public Equality and Human Rights Duty' introduced in the Irish Human Rights and Equality Commission Act 2014. This requires public bodies to carry out ongoing gender impact assessments, gather sex-disaggregated data, address emerging inequalities and report annually on their progress and plans for further actions. The National Strategy for Women and Girls 2017-2020 was also prepared. The Strategy requires cross-departmental involvement for its implementation and advocated that gender mainstreaming becomes a whole-of-government obligation. The Strategy located the work on gender equality within EU legislation. As an all-government strategy, the National Strategy obliges all government departments to gender-proof new policies and review existing policies for gender equality – the Commission is supportive of this process and sees it as an important part of the implementation of its recommendations by the relevant policy holders/organisations which will take forward the Commission's recommendations.

The impact of recommendations on gender equality has been a factor in the Commission's decision making process. In this regard, the Commission has sought to address some of the inequities it believes continue to exist by recommending, for example, further individualisation of the social welfare and Income tax systems. It should be noted that disaggregated data on Gender is not available in many areas and this is something the Commission believes can be further improved on in the context of the successor to the National Strategy for Women and Girls 2017-2020.[482] At the same time, women make up the majority of those in part-time and low-paid employment and the Commission is concerned that women may be particularly affected by 'traps' and cliffs in the taxation and welfare systems. The Commissions' recommendations which are aimed at addressing these issues will accordingly have an important gender dimension, but this should be followed up with more detailed research.

As is the case with recommendations highlighted in the preceding poverty section there are some recommendations made by the Commission that have a bearing on gender. These include:

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482 There is a Programme for Government commitment on a successor strategy. It is likely to be developed in 2023.

- The further individualisation of social welfare working-age supports.
- Further individualisation of Income Tax.
- Interactions between recommendations made in respect of Income Tax and those made in respect of social welfare to encourage greater labour force participation.
- Enhanced opportunity to improve social insurance record through broader PRSI contributions.
- Improved data collection and dissemination to include more data disaggregated by gender.

Equality

The Equal Status Acts 2000-2018 list nine grounds on which discrimination is prohibited. These are:

1. Gender
2. Marital status
3. Family status
4. Sexual orientation
5. Religion
6. Age
7. Disability
8. Race
9. Membership of the Traveller community

In addition to the comments on gender above, a number of points are worthy of note:

- The Commission's recommendations on benchmarking of social welfare payments proposes an evidence-led and transparent process for setting social welfare rates which takes account of different people's needs.
- The taxation and welfare administrations are important points of contact for all members of society, and ongoing investment in these services is required, including facilitating access to everyone on an equal basis.
- Micro-enterprise, social enterprise and small businesses may be an important form of employment and income for minority groups, and will benefit from a favourable tax environment and modern tax administration.

Data

As outlined in Chapter 18 (Strategic Reform) the improvements in the quantity and quality of data and research available in recent years should not be underestimated. High level data is now available on key poverty trends, for example, and some tax and welfare changes can be modelled through the microsimulation model SWITCH. However, the data and analysis options remain limited. It was clear from the work of the Commission that more can and should be done in this area – particularly to understand the fiscal and distributional impact of policy changes in the future. The Commission has recommended that a substantial programme of research be undertaken in the areas of taxation and welfare policy to enhance understanding of the fiscal and distributional impact of policy changes.

The Commission has considered a wide range of research as part of its deliberations. Throughout its work the Commission has sought to consider from a wide range of sources including official publications and reports, academic research – both domestic and international, and other research as appropriate, in order to demonstrate that the overall report and its recommendations are evidence based.

Annex 2:
Letter from Rena Maycock

27th June 2022

Dissent from recommendation to increase Class S PRSI to 11.05%

Dear Ms. Moloney,
Firstly, please allow me to congratulate you and the Secretariat on a remarkable achievement in arriving at a set of recommendations that, in most ways, I believe are necessary and fully agree with, despite the ambitious Terms of Reference and tight timeline. Throughout this process and as per my letter of appointment, my role was to contribute to recommendations that would 'maintain sustainable resources and support economic activity and employment over the medium term'.

As a net revenue-raising Commission tasked with ensuring Ireland's fiscal sustainability into the future, along with my colleagues on the Commission, I have understood and embraced the necessity to compromise. However, while revenue raising is crucial, so too is the survival and growth of indigenous businesses. Where applicable, my approach to this process has been to carefully evaluate our decisions against two specific points set out in our Terms of Reference:

- 'Review how best the taxation and welfare system can support economic activity and income redistribution, whilst promoting increased employment and prosperity....'
- 'Review how best the taxation environment for SMEs and entrepreneurs can ensure that Ireland remains an attractive place to sustain and grow an existing business or to start and scale up a new business'

Additionally, I have found it necessary to consider our recommendations in the context of recent policy changes in Ireland, beyond the control of this Commission, which will have a profound effect on economic activity and enterprise.

Recommendations introduced by Government and the Pensions

Commission, will most impact the self-employed, proprietary directors and SMEs. Specifically, the introduction of the Auto-Enrolment ("AE") pensions scheme and the proposed equalisation of Class A and Class S PRSI contributions.

SMEs make up the vast majority of businesses in Ireland. In 2019 they represented 99.7% of all enterprises – 271,799 in total. Owners of small and micro enterprises, depend on profits remaining in the business so they can pay themselves and are therefore, highly sensitive to rising costs of providing employment.

The introduction of AE pensions will add 6% to wage costs which will come directly out of the pockets of small business owners, as will the introduction of 10 days mandatory sick pay. Recent proposals to introduce a living wage will add a further c.20% to the current minimum wage. This cohort are also battling with labour shortages, wage inflation and general inflation all of which curtail growth.

Setting aside the very small proportion of medium-sized enterprise owners who can indeed afford to absorb these extra costs, in the main these policy changes are likely to cause serious financial hardship for the majority of business owners in Ireland, who have modest headcounts and correspondingly modest profits.

This Commission has made two recommendations that will further increase the costs of employment *(The Commission believes that only one rate of employer PRSI equal to the higher rate (currently 11.05 per cent) should apply on all weekly incomes, and that the lower rate of employer PRSI, which currently applies on incomes up to €410 per week, should be gradually phased out) and penalise the self-employed/proprietary directors (To minimise the distinctions between legal forms and to treat similar activity in similar ways the Commission endorses the principle that the rate of PRSI on employment (Class A) and self-employment (Class S) should be aligned over time with the employers rate of Class A PRSI attaching to employment (currently 11.05 per cent)*.

Fundamental realities about self-employment are disregarded in this second recommendation. In many cases, self-employment is not a choice. For those in the gig economy or domain experts who can only provide labour via limited contracts for example, standard employment contracts are not practical. Entrepreneurs who choose to create jobs for themselves and others, take substantial risks and there are inherent inequalities between the employed and the self-employed that cannot be ignored.

There can be no way of equalising (or minimising distinctions between) both legal forms of undertaking labour because there can be no way to confer the same rights and entitlements that employees enjoy, on the self-employed. Employees have job security under employment contracts, wage certainty, sick pay, paid annual leave, rights and protections under employment law, and under Auto-Enrolment they will have employers contributing 6% to their pension pots. On the other hand, the self-employed are vulnerable to market fluctuations, have no job security, no wage certainty, unequal entitlements, no rights or safety nets and must provide for their own retirement.

Under these recommendations, small and micro-sized enterprise owners will see the biggest change to their take home pay. Excluding the added costs they will incur through mandatory sick-pay and the proposed living wage increase, AE coupled with the increased PRSI contribution to 11.05% recommended by this Commission, they will pay an additional 13.05% in taxes (6% AE + 7.05% more PRSI). This increased cost will likely make many small businesses untenable.

While ensuring adequacy is a core tenet of our social protection system when it comes to jobseekers, and indeed adequacy is ensured for workers through minimum wage entitlements, there is no equivalent system to ensure that the self-employed earn an adequate wage.

This suite of recommendations and policy changes in the area of entitlements points to the burden of providing social protection for workers being shifted away from the State and onto employers.

It is my belief that this will make choosing entrepreneurship over standard employment unattractive with consequential negative impacts on job creation and economic growth. In recommending the equalisation of Class A and Class S, this Commission is contradicting our remit to promote employment, promote enterprise and make Ireland a better place to start and run a business. For the reasons set out above, I cannot support the endorsement of the Auto-Enrolment pensions scheme or the recommendation to equalise Class A and Class S PRSI contributions at 11.05%.

Yours Sincerely,



Rena Maycock

Annex 3:
Letter from Dr. Tom McDonnell

29th June 2022

Re: Report of the Commission on Taxation and Welfare

Dear Professor Moloney,

I would like to begin by expressing my admiration and gratitude for the immense work done by yourself as Chair and also by the Secretariat. The issues involved were complex and difficult. This was particularly so given the often-competing goals of adequacy, horizontal equity, vertical equity, efficiency, reciprocity and sustainability. Collectively balancing these goals is far from easy to address and requires careful judgement.

It is a great tribute to the professionalism, creativity and diligence shown by yourself and by the Secretariat that you were able to deliver the report on time despite the broad terms of reference and challenging timeframe.

I would also like to acknowledge the dedication and conscientiousness of the Commission members. They were a stimulating group and I was impressed by the energy, thoughtfulness and expertise that went into our collective attempts to understand and ultimately advise on many complex issues in an evidence based and collegial way.

In many ways the Report's recommendations would, if implemented, represent an improvement on the status quo. For example, the Report correctly recognises that the overall level of government revenues must increase materially as a share of national income to meet the immense challenges to fiscal sustainability that will arise over the medium-to-long term. This is an important and necessary intervention in the public debate that will hopefully guide policymakers in the future.

In addition, horizontal equity would be enhanced by implementation of the many base-broadening recommendations, while the Report recognises that taxes on property and other forms of wealth need to be fundamentally reformed and materially increased both for equity and for efficiency reasons. The Commission also makes important recommendations in relation to enhanced child income supports, and in relation to the benchmarking and tapering of working-age income supports. I wholly endorse these recommendations.

In most of the chapters there is a consistent acknowledgement of the need to minimise tax expenditures and differential tax treatment. Consequently, in these chapters the recommendations emphasise restricting and removing the use of such hidden subsidies and distortions. In my view, this approach is correct and is justified on the grounds of horizontal equity, vertical equity, economic efficiency and transparency. If there is an intellectual theme to the Report it is that the tax base should be broadened and tax expenditures eliminated.

In contrast, this approach is effectively set-aside in Chapter Nine 'Promoting Enterprise'. Instead, this chapter sets out a series of recommendations that endorse and support a range of very generous tax expenditures and low tax rates for enterprises and/or high earning individuals. While in some limited and special cases these types of reliefs may individually have an economic justification, they also breach the principles of vertical and horizontal equity, are highly regressive, reduce transparency, and are at odds with tax justice and solidarity principles. Individually they are problematic, albeit perhaps, in some cases, defensible. Collectively they undermine the approach taken in the rest of the Report. In my view, the overall balance between fairness and potential efficiency gains is not achieved. This imbalance is compounded by the recommended retention of other generous tax expenditures on capital transfers described elsewhere in the Report and also by a rate of employer PRSI that is low by Western European standards.

For this reason, I have reservations about Chapter Nine of the final 2021/22 Report of the Commission on Taxation and Welfare and unfortunately and respectfully must therefore decline to sign off on Chapter Nine of the report.

I do not endorse Chapter Nine.

However, the overall Report has much to recommend it, and my decision in declining to sign off on Chapter Nine should not in any way be interpreted as a rejection of the Report as a whole. My position is more nuanced.

The other seventeen Chapters represent constructive and coherent interventions that can be of assistance to any policymaker seeking to ensure income adequacy for all, ameliorate inequality, enhance efficiency, promote reciprocity and achieve sustainability across the various fiscal and environmental dimensions.

Yours sincerely,
Dr. Thomas A McDonnell

Annex 4: Members of the Commission on Taxation and Welfare

Professor Niamh Moloney is the Chair of the Commission on Taxation and Welfare. She is Professor of Financial Markets Law at the London School of Economics and Political Science where she was previously Head of the LSE Law School. Niamh currently serves as a non-executive member of the Central Bank of Ireland Commission and as a member of the Board of Appeal of the European Supervisory Authorities. She is a Fellow of the British Academy and an Honorary Member of the Royal Irish Academy and was awarded an honorary doctorate from the University of Zurich in 2019 in recognition of her work on EU financial markets regulation. Niamh is a graduate of Trinity College Dublin and Harvard Law School.

Philip Brennan is a former Assistant Secretary at the Revenue Commissioners and a former Associate of the Irish Tax Institute. He is also a former editor of Bloomsbury Ireland's annual tax legislation reference publication, "Tax Acts".

Marie Bradley is Managing Director of Bradley Tax Consulting. She is a Chartered Tax Adviser (CTA) and member of Chartered Accountants Ireland. Marie advises personal and corporate clients on Irish and international tax matters. She is a Fellow and past President of the Irish Taxation Institute.

Sandra Clarke is a Chartered Accountant and Chartered Tax Adviser and Managing Director in BCC Xeinadin Group. She is immediate past President of the Irish Tax Institute and previously served as Chair of the Business Division of the ITI Revenue Branch Network and TALC Collections.

Rowena Dwyer is manager of Climate and Sustainability with Enterprise Ireland. Prior to this she worked as manager of Policy, Planning and Government Relations also with Enterprise Ireland. Rowena was previously Chief Economist at the Irish Farmers' Association and prior to that consultant at PwC in Dublin as well as economist in the Ministry of Education, Ghana. Rowena is a graduate of Trinity College Dublin, The Institute of Public Administration and the University of York.

Philip Kermode is a former Director of the European Commission, responsible for Customs Policy, Legislation and Tariffs. Previous to this he was Director responsible for Direct Taxation, Tax Coordination, Economic Analysis and Evaluation. Prior to joining the Commission he worked in the Office of the Revenue Commissioners and PwC, Dublin. Philip is a graduate of Trinity College Dublin.

Dr. Barra Roantree is an economist at the Economic and Social Research Institute (ESRI). His work is focused on taxation, welfare and pensions. He is an adjunct assistant professor at Trinity College Dublin and an International Research Associate at the Institute for Fiscal Studies (IFS) in London. Barra is a graduate of Trinity College Dublin and completed his PhD at University College London.

John-Mark McCafferty is the Chief Executive Officer of Threshold. He has worked previously as Head of Social Justice with the Society of St. Vincent de Paul and served on the boards of One Family and Clúid Housing. John-Mark was a member of NESC and is a graduate of the University of Glasgow and University College Dublin.

Dr. Tom McDonnell is co-director of the Nevin Economic Research Institute (NERI). In addition to managing staff in the Dublin office he has co-responsibility for the NERI's research programme and for its strategic direction. Tom specialises in economic growth, economics of innovation, Irish and European economies, and fiscal policy. He previously worked as an economist at TASC and before that was a lecturer in economics at NUI Galway and at DCU. He has also taught at Maynooth University. Tom obtained his PhD in economics from NUI Galway.

Dr. Aoife Ní Lochlainn is Policy Officer at the Irish Environmental Network focusing on Environmental Policy. She has worked previously as a policy officer in TASC, as an independent researcher and as public policy manager with SIRO. She is a graduate of University College Dublin and completed her PhD with the European University Institute, Italy.

Rena Maycock is the CEO and Founder of Cilter Technologies. She is also co-founder and non-executive Director of Intro Matchmaking. Rena began her career in sales at 98FM and went on to hold a variety of senior management and director roles in Sky Media, Sunshine and iRadio. She writes a column for The Currency.

Fergal O'Brien is the Director of Lobbying and Influence at IBEC. Fergal has previously served as Head of Policy and Chief Economist with IBEC. Fergal is a graduate of the University of Limerick and holds a Master of Business Studies in Economics.

Anne Vaughan is a former Deputy Secretary at the Department of Social Protection where she had responsibility for policy development and service delivery in relation to working-age payments. During her Civil Service career Anne also worked in the Department of Finance and in the Department of the Taoiseach. Anne was a member of The Pensions Authority and previously served as a member of the Pensions Commission. She is currently Chairperson of the National Statistics Board. Other activities include mentoring and coaching, and membership of a number of not for profit boards. Anne is a graduate of University College Dublin and Trinity College Dublin. She holds a M.Sc. in Public Sector Analysis.

Index

A

Accommodation Tax *xxxiv, 111–112, 114*

Active Labour Market Programmes *xli, 230, 277–279, 286*

Adequacy *xi, xxii–xxiii, xxv, xxvii, xxix, xxv, 20, 29–35, 40–41, 43–45, 151, 232, 238–240, 249–250, 254, 256, 261, 288–295, 306, 369, 481, 489*

Aggressive and/or harmful corporate tax practices *xxix, xxxvi, 179, 184, 187, 191, 221*

Agricultural Relief *132, 144–146, 148*

Alcohol Products Tax *375, 380, 382*

At-Risk-of-Poverty rate *123–124, 235–238, 300, 466*

Auto-Enrolment or Automatic Enrolment Retirement Savings Scheme (AE) *xl, 149, 151, 156–157, 271, 284, 488, 489*

B

Base Erosion and Profit Shifting (BEPS) *xxix, xxiii, xxxvi, 21, 64–65, 85, 179, 187–188, 191, 221, 466*

Benchmarking *xi, xxiii, xxv, xxxvi, xlii, 43, 167, 170, 239, 261, 288, 292–295, 306–307, 485, 491*

Business Relief *xxxv, 132, 144–146, 148*

C

Capital Acquisitions Tax (CAT) *xxiv, xxxiv, xxxv, 69, 73, 77, 89, 90, 115–116, 129–135, 141–148, 163–164, 170, 367, 470*

Capital Gains Tax (CGT) *xxiv, xxviii, xxxiv, 69, 70, 73, 77, 89, 94, 103, 115–116, 121, 129–139, 147–148, 154–155, 193, 195–198, 205, 367, 370, 401, 404, 409, 412, 420*

Carbon Tax *xx, xxiv, xxx, xliii, 64, 69, 87, 212, 309, 313, 317–326, 335, 451–452*

Car Parking Duty *333*

Child Benefit *xxv, xlii, 40, 227, 229, 233, 300–304, 306–308, 475*

Child Income Supports *xxv, xxix, xlii, 288, 294, 300–304, 308, 482*

Climate Action Plan *56, 59, 314, 320, 329*

Commercial Rates *xxiv, xliv, 23, 66, 69, 73–74, 77, 88, 341, 343–344, 349–353, 356–357, 373*

Congestion Charges *xliv, 331–333, 336*

Corporate Tax Strategy *xxv, xxix, xxxvi, 85, 175–180, 185–191, 221*

Corporation Tax *xviii, xxiv, xxxi, 10–11, 21, 23, 25, 28, 53, 59, 64–65, 69, 73–74, 76, 78, 80, 85–86, 90, 98, 102, 104, 127, 158, 174–180, 184–191, 199–201, 211, 220, 347, 367, 416, 420, 451, 470*

D

Demographics *x, xvii, 15, 17, 21, 29, 52, 60–63, 93, 150, 244, 248–249, 265, 337, 376, 448, 450*

Deposit Interest Retention Tax (DIRT) *69, 73, 78, 92, 97–99, 371, 409*

Digital Transformation *xxvi, xxx, xlviii, 426–429, 431, 433–434, 437, 439, 445*

E

Electricity Tax *xliii, 327–328, 335*

Employment Investment Incentive (EII) *xxxvii, 193–198, 202–203, 221–222, 409–410*

Employment Services *xli, 35, 227, 231, 255, 278–279, 286*

Energy Tax Directive *313, 321, 327*

Entrepreneur Relief *xxxvii, 138, 193, 196–198, 206, 222, 409*

Excise Duty *xxvi, xliii, xlvi, 64, 69, 73, 76, 78, 87, 313, 318, 320–325, 327–330, 335, 375, 379–384, 391, 397, 404, 411, 482*

F

Fiscal Sustainability *x, xix, xxii, xxiii, xxiv, xxvii, xxx, xxxi, l, 20, 22, 41, 52–67, 78, 81, 84, 102, 106, 140, 146, 158, 208–209, 249, 318, 328, 450, 458, 480, 487*

Foreign Earnings Deduction (FED) *xxxviii, 214–216, 223, 409–410*

G

Gini Coefficient *31, 119, 469*

Global Mobility *95, 216, 220*

Group Thresholds *xxxiv, 132, 134, 141–144, 146–148*

H

Help to Buy *xlv, 370–371, 374, 401, 410–411*

Horizontal Equity *xxiii, xxviii, xxxi, xxxiv, xli, 29, 41, 45–46, 81, 84–85, 90–91, 93, 97–98, 100–101, 128, 134–136, 148, 209, 212, 219, 254, 272–274, 285, 351, 353, 369, 491*

I

Impact Assessment *l, 93, 455–456, 459, 479–486*

Implicit Tax Rate (ITR) *80, 266–267, 462, 465, 470*

Incentive to Work *255, 295–296, 299, 302*

Incidence (of Taxation) *91, 190, 297, 319, 351, 476*

Income Distribution *31, 33, 65, 88, 120, 251, 259, 274, 455*

Income Tax *xxiv, xxv, xxviii, xxxi, xxxii, xxxv, xli, 21, 46, 61, 64–66, 69–85, 90, 92–97, 98–99, 113, 127, 152, 157, 162–164, 170, 177–178, 184, 193, 197, 204–220, 247, 256, 258, 260–261, 266–267, 270, 273, 274–276, 285, 295, 305, 367, 371, 395, 409–410, 420–421, 441–442, 471, 473, 476, 482, 485*

Income Tax Individualisation *xxv, xli, 93, 274–276, 285, 305, 482, 484–485*

Intergenerational Equity *xx, 19, 35, 89, 91, 93, 125, 300*

Irish Real Estate Fund (IREF) *xxxiii, 102–103, 105–106, 114, 372*

J

Jobseekers Allowance *255, 296*

Jobseekers Benefit *299*

Just Transition *xx, 37, 87, 310, 314, 319–320, 376*

K

Key Employee Engagement Programme (KEEP) *xxxviii, 205–208, 222, 253*

L

Labour Force Participation *xx, 8, 11, 27–28, 232, 241, 244, 254, 256–257, 265, 274–275, 473, 485*

Local Property Tax (LPT) *xxiv, xliv–xlv, 23, 69, 73, 78, 116, 341, 343, 349, 357–366, 373, 401, 409*

M

Marginal Effective Tax Rate (METR) *244, 274*

Means Testing *xlix, 292, 301, 444, 446*

Medical Card *92–93, 245, 291, 293*

Medical Insurance Relief *395–396*

Minimum Capital Charge *xxviii, 146–147*

Minimum Unit Pricing *382*

Motor Tax *xliii, 87, 318, 320, 328–331, 336*

N

National Economic and Social Council (NESC) *xvii, 224, 251, 259, 278, 287, 297, 302, 305*

P

Pandemic Unemployment Payment (PUP) *10, 281–282, 296, 441, 444*

Pay-Related Benefits *xlii, 282–283, 298–299, 307, 443*

Pay Related Social Insurance (PRSI) *x, xi, xx, xxi, xxii, xxiv, xxv, xxviii, xxix, xxxi, xxxviii, xxxix, xl, xli, 23, 40, 54–55, 61, 64–65, 67, 69, 73–74, 78, 81–82, 85, 90, 91, 96–98, 153, 155, 163–164, 178, 205–210, 223, 229–230, 245, 248–255, 262, 271–273, 284–285, 298, 401, 476, 481*

Principal Private Residence Relief *xxxiv, 132, 136–138, 148, 370, 412*

Public Employment Service (PES) *xxix, xli, 225, 227, 231, 246, 255–256, 258, 266, 276–279, 285–286, 482*

R

Real Estate Investment Trusts (REIT) *xxxiii, 102–105, 114, 372*

Reciprocity *xxii, xxiv, xxvii, 3, 40–43, 82, 229, 249–250, 252, 255, 298, 432*

Refundable Tax Credits *257–258, 260–261*

Remittance Basis *xxxii, 94–96, 113, 216*

Research and Development (R&D) Tax Credit *xxxvii, 199–203, 222, 410*

Retirement Relief *xxxiv, 132, 134, 138–140, 148, 401*

Road Usage Charges *xxv, xxx, xliv, 329–333, 336*

Roadmap for Social Inclusion 2020-2025 *32, 257, 292–293, 304–305, 451, 483*

S

Secondary Benefits *xl, 225, 245, 268–269, 284, 290–291, 306, 370*

Share-Based Remuneration (including Restricted Stock Units and Share Options) *xxxviii, xxxix, 204–210, 216–218, 222–223, 253, 262, 410*

Site Value Tax (SVT) *xviii, xxiv, xliv–xlv, 337, 343–357, 366, 373*

Sláintecare *xlvi, 56, 66, 396–397, 407*

Social Assistance *227–230, 250–251, 268, 291–292, 301, 304–305, 441, 475*

Social Insurance Fund (SIF) *xi, xxiv, xlii, 82, 208, 229, 248–249, 252–253, 299, 307*

Social Transfers *32, 34, 233, 470, 475, 481*

Social Welfare Individualisation *257, 304–306*

Special Assignee Relief Programme (SARP) *xxxviii, 212–214, 223, 409, 411*

Stamp Duty *16, 66, 69, 71, 73–74, 77, 116, 131, 155, 361, 367, 372, 409, 411, 417*

Sugar Sweetened Drinks Tax (SSDT) *xlvi, 375, 379–381, 384, 391, 397*

T

Tax Wedge *82–83, 247–248, 269–270, 467, 476, 482*

Tobacco Products Tax *76, 382–384*

Trans-Border Relief *xxxviii, 218–220, 223*

U

Universal Basic Income *xxv, xxxix, 257–262*

Universal Benefits *228–229, 302*

V

Vacancy *338, 345, 353, 364–366*

Value Added Tax (VAT) *xxv, xxviii, xxxii, xxxiii, 64, 69, 73, 76, 78, 86–87, 90, 106–111, 114, 155, 176, 323–324, 327, 329, 367, 380, 382, 393–394, 401, 411, 474, 482*

Vehicle Registration Tax *xliii, 69, 318, 320, 328, 330, 336*

Vertical Equity *xxiii, 41, 46, 89, 91, 126, 212*

W

Wealth Tax *xxiv, xxviii, 78, 89, 116, 125–129, 131, 135, 342*

Working Age Payments *xi, xxv, xlii, 293, 297–298, 307, 482*

Working Family Payment *260, 296–297, 303*

Z

Zoned Land Tax (ZLT) *338, 341, 349, 353–354*

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