Personal Tax Policy Review
Public Consultation

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Personal Tax Policy Review - Public Consultation

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Public Consultation - Personal Tax Policy

Dear Sir/ Madam

We are writing to you in response to your invitation for submission on the "Public Consultation on the Personal Tax System" document as published by the Department of Finance on 8 March 2023.

First and foremost, we welcome this public consultation. The personal tax system in Ireland is the largest annual source of revenue for the Exchequer which accounts for 37% of the projected tax revenues in 2023. It is critically important, at a time of high inflation where cash pressures are high, for the personal tax system to be comparable to other countries around the world to retain Ireland's attractiveness and thereby ensuring skilled labour stays within Ireland.

PwC Ireland is the largest professional services firm in Ireland, we offer a broad range of services across audit, tax and advisory. From a taxation perspective, PwC Ireland advises a broad base of taxpayers, ranging from individuals, indigenous entrepreneurs, Irish listed entities to foreign-owned multinationals. We have drawn on this knowledge and expertise in responding to this consultation.

We welcome the opportunity to discuss the matters outlined below at your convenience.

Yours faithfully,

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Executive summary

It is timely to review the effectiveness of the Irish tax system and its resilience for future tax years. Although it is one of the most progressive tax systems globally, respected commentators have indicated that there are particular aspects of the income tax system which have made its continued sustainability and yield more vulnerable in terms of future downturns. These issues broadly revolve around:

- The erosion of the tax base from 2012;
- The 'cut' point at which marginal rates of tax apply relative to employee's median income;
- Ireland's greater than average reliance on social transfers to address poverty and fairness; and
- Increasing global competition for foreign direct investment and the effectiveness of Ireland's offering to attract personnel.

We have included below a number of suggestions which could be considered in addressing some of these issues, including:

- The appropriate use of Universal Social Charge ("USC") as a means of broadening the tax base or its potential merger with income tax;
- Maintaining progressivity through additional tax bands targeted at lower to median incomes, extending the reach of lower tax bands and moderating any undesired effects through targeted means tested social transfers for low income individuals;
- Securing on a more permanent footing Ireland's expatriate offering and ways in which it could be improved at minimal cost to the exchequer;
- The merits in pursuing individualisation of the tax system to aid equality and enhance female workforce participation; and
- Certain specific tax measures that would benefit the Irish economy and its competitiveness.

Introduction

Ireland's personal tax system is a key source of revenue for the Exchequer, currently accounting for 37% of tax revenues forecast in 2023 (circa €32.1bn in total, €24.5bn Income Tax, €5.2bn USC, €2.4bn other - DIRT, PWST).

The top rate of income tax in Ireland is currently at 40%,USC is levied at a top rate of 8% (a surcharge of 3% is also applied to non PAYE income over €100K) and PRSI is currently levied at 4%. Accordingly, this brings the overall top rate of personal tax to 52% for PAYE income or 55% for non-PAYE income.

As part of Ireland's plans for the future, the Government expects that there would be an extra one million people living in Ireland by 2040.[1] In determining Ireland's competitiveness and attractiveness, personal taxes are often looked at by an individual when considering the net pay/ income they might have.

Over the past number of years the economy has grown significantly and it has become more important for companies at all stages to have the right people, in the right job, at the right time in order to remain competitive. Retaining skilled workers has become ever more important as we face a skilled labour shortage due to increased demand. The significant increase in inflation over the last year has placed even greater pressure on the labour market as employees look to competitors in Ireland and abroad to ensure that they can maximise their net take home pay.

The attractiveness of Ireland and its personal tax system will be at the forefront of an individual's mind when considering staying in Ireland for the long term or when relocating to Ireland to live and work.

[1] https://npf.ie/wp-content/uploads/Project-Ireland-2040-NPF.pdf

In response to your questions, we have set out our answers below:

1. **Do you have any suggestions on how the personal tax system could be reformed or enhanced, while broadly maintaining the yield and ensuring it continues to provide a sustainable and stable source of revenue to the Exchequer to fund public services?**

Ireland's tax system is recognised as being one of the most progressive in the world. However it is noted that the Irish tax system tends to be procyclical and therefore at risk of creating vulnerabilities to the personal tax base[2]. The effect of this is that tax rates and reductions have been targeted at low income to median income earners, many of which have been exempted from tax or had significant decreases in their effective tax rate.

As a consequence, this places the tax emphasis on a smaller pool of median to higher earners who, by comparison with many of our larger trading partner countries, have high marginal tax and USC rates. This is borne out by data from Revenue which confirms that in 2021, the top 25% of income earners (i.e. those earnings €50,000 or more) paid 83% of the total income tax and USC[3].

Other characteristics of the Irish personal tax system include:

- Ireland's taxes on personal income, profits and gains being 9% higher than the OECD average[4];
- Ireland is unusual in that the marginal rate tax band is very close to that of those earning the average industrial wage;
- The effect of USC, which was used to broaden the tax base, has been significantly eroded from its inception, where in 2012 it represented more than one third of the combined income tax and USC to the position in 2020 where it represented 16.7% of the overall income tax and USC[5];
- Ireland is more reliant on social transfers than other EU and OECD jurisdictions[6];
- The percentage of taxpayers who are exempt from income tax and USC remains broadly static (36% of earners for income tax; 29% for USC).[7]

These characteristics create vulnerabilities in our tax system in that taxes are raised from an increasingly small pool of taxpayers, who enter into marginal rates of tax much earlier than EU counterparts. As a result, the tools to raise additional revenues in the event of a future downturn will be limited without increasing already high marginal tax rates. Any future tax policy should consider incorporating some of the following:

- Broadening the tax base by ensuring all earners contribute something towards the Exchequer;
- This can be moderated in cases of genuine hardship through the extension of social means tested transfers to affected societal groups;
- Consideration should be given to moderating the significant step in earnings that become subject to the marginal rate of tax - for example through introducing a third tax rate band linked to the average industrial wage (and which would reduce any barrier to work that may exist).

2. **Does the personal tax system sufficiently support a competitive economy to incentivise and encourage work?**

Ireland's workforce participation rate has proven resilient in the face of inflationary and global geopolitical headwinds and this is reflected in the current unemployment rate of 4.3%[8].

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[2] IMF Country Report - Ireland 19/165
[3] Tax Strategy Group Paper on Income Tax - 21/02
[4] OECD Revenue Statistics 2022 - Ireland
[5] IMF Country Report 19/165
[6] OECD Economic Survey 2018 - Ireland; also TSG 20/02
[7] TSG 21/02 - Income Tax
[8] https://www.cso.ie/en/statistics/labourmarket/monthlyunemployment/ - Monthly unemployment February 2023

It should, however, be noted that of the €21.4 billion income tax, USC & PRSI collected in 2020, €14.3 billion of this arose from employees of MultiNational Corporations (MNCs) i.e. 65.6% of the income tax/USC and PRSI yield. Also noteworthy is that the average earnings (and therefore tax payments) were highest among employments from foreign owned MNCs[9].. Consequently, Ireland's attractiveness as a location for foreign direct investment should be a key priority for any government policy and is something that policy makers/government should not be complacent about.

Businesses are created where people wish to go. Ireland is perceived as a high personal tax location. Equally, Ireland has always had a long standing tradition of providing some degree of special tax recognition to overseas individuals who worked here. Although such reliefs have been curtailed significantly over the years, the Special Assignee Relief Programme (SARP), continues to have a temporary placement on the statute book (it currently runs to 2025, having received extensions in 2020 and 2022). The absence of this relief would be highly detrimental to Ireland's ability to attract and retain jobs and projects in Ireland.

The purpose of this relief is to attract new enterprises to Ireland and generate new and increasing streams of revenue for the exchequer. To this end it can be viewed as successful due to the increase in qualifying claimants.It should also be noted that similar and more valuable versions of this type of relief exist in fellow EU jurisdictions and need to be recognised from an international competitive perspective. At a minimum, we would recommend that:

- The relief should be placed permanently on the Statute Books and not subject to expiry dates (which can act as a disincentive to organisations planning to transfer personnel to work in Ireland);
- The relief should not be limited to income tax but also be exempt from USC and PRSI (i.e. it should be treated in the same manner as flights or reimbursement of school fees);
- The relief should be extended to the provision of reasonable tax-free accommodation, which represents a key cost in transferring personnel to Ireland;
- The requirement for the qualifying individuals to have been non resident in the previous 5 tax years to arrival should be amended.This could be brought in line with rules on ordinary residence, requiring 3 years of non residence;
- The 'entry' earnings cap of €100,000 should be reconsidered to bring it in more in line with similar regimes in competing territories (such as the Netherlands, where a lower limit applies in attracting skilled post graduates).

Regarding incentivisation to work, the step between a standard rate and marginal rate tax payer is significant. Whilst Ireland is correctly recognised as having a highly progressive tax system, equally Ireland is unusual and an outlier insofar as the marginal rate of tax begins to apply at average wage levels[10] and continues to be a feature today. The introduction of an additional tax band(s) could have the effect of broadening the tax base and preserving the progressivity of the tax system. For low income households, consideration could be given to appropriately targeted tax credits or means tested social transfers.

3. **Do you have views on the progressivity of the personal tax system?**

Income tax costs are a burden and a disincentive for businesses and employers that wish to expand their footprint by hiring/promoting more employees. Ireland's marginal tax rate (including USC but excluding PRSI) is 48%, and is payable on all income exceeding €70,044. By comparison, the marginal rate of tax in the US is 37% (income exceeding US$523,601) and 45% in the UK (on income exceeding circa STG£125,140 from 6 April 2023). This was borne out by the 2018 IMD World Competitiveness Report, which confirmed that Ireland's effective tax rate for individuals was significantly higher than the rate in the location of our largest source of inward investment, the US, and in the UK. This highlights two matters:

- That Irish resident individuals move quickly into the higher tax bands at an earlier stage; and
- Ireland's personal tax rate internationally is recognised as being high, which will hinder the attractiveness of Ireland as a location to invest in.

[9] TSG 22/03 - Corporation Tax
[10] IBEC - Debunking Irish Income Tax Myths

Furthermore, the tax costs for the self-employed is higher again for any income over €100,000 with a marginal tax rate of 51% (i.e. exclusive of PRSI but including USC). Applying high marginal tax rates to self-employed income can discourage entrepreneurship. In addition, Irish social security (whilst beyond the scope of this document) has moved in the recent past from being capped to being uncapped and therefore applying without limit to an individual's income. This applies to both the employees and self employed individuals.

For example, if a single individual earned PAYE income of €90,000 in Ireland, their tax liability would be as follows:

	€	€	€
Gross income			**90,000**
Income Tax[11]			
€40,000 @20%	*8,000*		
€50,000@ 40%	20,000		
Personal tax credit	*(1,775)*		
PAYE tax credit	*(1,775)*		
Total Income Tax		***(24,450)***	
USC[12]			
€12,012 @ 0.5%	60		
€10,908 @ 2%	218		
€47,124 @ 4.5%	2,121		
€19,956 @ 8%	1596		
Total USC		**(3,995)**	
PRSI			
€90,000 @ 4%		**(3,600)**	
Total taxes			***(32,045)***
Net income			**57,955**
Net rate of personal taxes			**35.6%**

[11] https://www.revenue.ie/en/personal-tax-credits-reliefs-and-exemptions/tax-relief-charts/index.aspx - Current tax rates, rate bands and credits
[12] https://www.revenue.ie/en/jobs-and-pensions/usc/standard-rates-thresholds.aspx - Current USC rates in Ireland

In comparison to the above, if an individual earned a salary of £78,300 (€90,000 at an average 0.87 exchange rate), the rate of tax in the UK would be as follows:

	£	£	£
Gross income			**78,300**
Income Tax[13]			
Up to £12,750	0		
£12,571 to £50,270 @ 20%	7,540		
£50,271 to £78,300 @ 40%	**11,212**		
Total Income Tax		**18,752**	
National Insurance Contribution[14]			
£12,571 to £50,268 @ 12%	4,524		
£50,268 to £78,300 @ 2%	561		
Total NIC		**5,085**	
Total Taxes			**(23,837)**
Net Income			**54,463**
Net income in Euro			**€62,601**
Effective Rate of Tax			**30.4%**

You will note in the above example, that Ireland's tax rate is higher than our nearest neighbour, the UK, in terms of the rate of personal taxes. In summary, the attractiveness of Ireland decreases for individuals when they could instead pay a lower rate of tax by living and working in the UK.

4. **Do you think the personal tax system operates as an effective means of income redistribution?**

The Tax Strategy Group reporting on Income Tax (September 2021)[15] estimates that the top 25% of income earners (i.e. those earning more than €50,000) will pay 83% of the total Income Tax and USC. Equally, 75% of income earners (i.e. those earning less than €50,000) will pay 17% of the total Income Tax and USC. Furthermore, the Revenue Commissioners indicate that for 2021, 29% and 36% of income earners are exempt from USC and Income Tax respectively. The above indicates that the overall tax base is narrow given that the band of taxpayers who support the largest contribution to Income Tax and USC is small.

[13] https://www.gov.uk/income-tax-rates - UK tax rates.
[14] https://www.gov.uk/national-insurance-rates-letters - NIC tax rates
[15] https://www.gov.ie/en/collection/d5b41-budget-2023-tax-strategy-group-papers/

This should be viewed in the context of the Gini coefficient[16], which tracks the contribution of both the tax and welfare systems to changes in income inequality. This was considered in the Department of Finance Tax Policy Changes accompanying Budget 2020 where it was noted that "Ireland's welfare system makes a greater contribution than the tax system in reducing income inequality". The focus therefore moves to the structure of the taxation system and how this funds Welfare.

Equally, Ireland as an open economy with a substantial level of employment attributable to the multinational sector[17], must be conscious of Ireland's international ranking in terms of tax competitiveness. Ireland must remain capable of attracting and retaining large projects in order to support ongoing growth.

The Government has the tools to effect change within the tax system, consideration should be given to:

- Reducing the marginal tax rate. This would have the effect of reducing pressure on middle income earners and be advantageous from an international perspective.
- Whether there is a basis for extending the USC to all taxpayers, such that all income earners make a contribution to the national exchequer. This could be balanced somewhat by a lowering of the standard rate tax band or through carefully implemented transfers to those on low incomes.
- Options to support Ireland as an attractive location for inward investment. For example the Special Assignee Relief Programme, which operates at minimal cost to the exchequer is due to expire at the end of 2025. The relief should be improved and extended in order to ensure that Ireland continues to have a competitive offering when compared with competing European jurisdictions.

5. **What are the key areas in the personal tax system for future policy consideration?**

From a structural perspective, two areas might warrant further consideration:

- Merging USC with income tax: It has been noted[18] that, when it was initially introduced, USC achieved its aim of broadening and extending the tax base in Ireland. However, over the years, its effect has been reduced and to a large extent it has regained the characteristics of income tax. Unless it will be used to achieve the aim of broadening the tax base further, there may be merit in considering whether USC should be integrated into income tax. Whilst this would significantly simplify overall tax administration, care would need to be taken to ensure that progressivity, broadening of the tax base and preservation of the income tax yield continue to be maintained. This could be achieved through careful calibration of tax bands and credits, the possible introduction of an additional tax band and carefully targeted means tested social transfers.

- Individualisation of taxes: This would have the effect of achieving equality between taxpayers and act to encourage more female workforce participation. Care again would need to be taken to ensure that those households with one earner receive some degree of recognition and protection. This would need careful consideration of the tax bands (perhaps as suggested by the IMF) so that the single person's band equals that of the married person one earner and coupled with improvements in the home carer credit to grant additional relief to single earner households.

Specific considerations that should be thought through in future policy decisions include:

a) *Employment supports*

Government supports announced over the past year to ease the cost of living will help but it will not plug the gap for everyone, and many employees and families will still be feeling the strain. And while some companies say they cannot

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[16] The Gini co-efficient is a measure of statistical dispersion intended to represent the wealth or income inequality within a country.
[17] According to Indecon's Report on SARP (2019) 229,057 jobs were supported by the IDA in Ireland in 2018.
[18] IMF Country Report 19/165

afford to pay workers more, others and in particular family businesses, feel both an ethical imperative and intense commercial pressure, against a backdrop of labour shortages, to help those on low incomes.

Organisations are saying that they are struggling on affordability but they feel a moral obligation to help employees. They are trying to make their benefits package the best it can be. Attracting and retaining talent, reskilling and preparing their workforce for the digital future continue to be key areas of focus for many private business owners as they look forward. However, supporting employees while managing inflationary pressures has now also come to the fore.

There is a need to introduce measures for businesses to allow them to offer non-cash reward mechanisms to employees with a view to attracting, supporting and retaining key staff in order to supplement the more traditional cash-based packages (salary/bonuses/benefits) that many businesses cannot easily afford to pay.

i) Income Tax Bands

Income Tax bands and credits should be increased significantly, at least in line with the current rate of inflation, to avoid an unnecessary additional income tax burden on employees.

ii) Employer PRSI relief

We propose a reduction / rebate of up to 50% of employers' PRSI for an initial 12-month period so that businesses can partially offset the cost of increasing salaries and supporting employees. Inflation is putting pressure on employers to increase wages which is reducing profit margins and increasing overheads. Alternatively, such a reduction/rebate could be used to allow businesses to hire new staff and to fund the cost of training new hires.

iii) Travel and Subsistence

Increase the civil service travel and subsistence rates to account for the ever-rising costs associated with fuel, food and accommodation. Furthermore, while there is already employer PRSI relief on the provision of providing certain public transport benefits to employees (such as the Taxsaver Commuter Ticket Scheme), further relief could be granted to fully exempt such benefits from all Income Tax. This would have the dual benefit of both allowing private businesses to really support employees with the rising costs associated with commuting without increasing wages, as well as encouraging a greater use of public transport (with all the wider sustainability benefits for the environment that carries).

iv) Loan to employees

Currently, the preferential interest rate arising on loans made to an employee (which is not in relation to a loan for a PPR) is 13.5%. We would welcome either a general reduction to this rate so that an employee could avail of a cash advance from their employer to aide with the current cost of living or a carve out to the provisions which would reduce the preferential rate applicable to loans from an employer.

b) Employee participation

As the economy has grown significantly in recent years, more and more employers have been looking at innovative ways to attract and retain key employees within the business.

Many companies have focused on providing attractive remuneration packages which can compete with the many multinational companies operating in the same market. Remuneration packages have evolved and are no longer focused on a "basic salary". Most packages now include a range of cash benefits (bonuses, health care, pension etc.), non-financial benefits (such as flexible working arrangements, corporate social responsibility (CSR) etc. and incentives including share based remuneration.

The introduction of KEEP (Key Employee Engagement Programme) through the Finance Act 2017 has also brought share based remuneration to the fore for many employers when looking at remuneration packages as a way of rewarding, retaining, recruiting key employees for the business.

Employee participation in and ownership of a company has been proven time and time again to contribute to the growth of a company and is also a relevant factor in retaining key staff. The increased staff commitment and motivation can lead to higher company profits which in turn can create more jobs and result in higher tax payments towards the economy.

Employee ownership in a company can help to resolve issues such as high staff turnover and absenteeism while also retaining key individuals within the business. Attracting and retaining key talent remains an objective for all companies regardless of whether they are a start-up, fast growing business, established company etc.

i) Changes to the taxation of share options

For many private businesses thinking of rewarding staff with simple 'share options' to incentivise and retain is met with different and complex rules which apply between the tax treatment for 'short options' (only exercisable within 7 years from the date of grant) and 'long options' (capable of being exercised beyond 7 years). While neither give rise to an incidence of taxation at the date of grant, if priced at fair market value (FMV), an income tax liability can arise on 'long options' if valued below FMV at the date of grant.

Ireland is out of kilter by international standards in imposing this arbitrary 7 year rule which, in practice, is having a very detrimental effect on Irish scaling companies that, due to Covid-19 or other reasons, have often experienced delays in the execution of business plans in preparation for a liquidity event. The technical problem stems from the fact that any attempts to extend or renew options that are about to expire/lapse can crystallise an immediate 'dry tax' cost on the employer/employee .

The alternative of allowing options to expire/lapse causes obvious HR issues and ultimately disappoints and demotivates the affected employees, who invariably operate at a senior level and are key to the success of the business. For this reason, we recommend that the distinction between short options and long options be extended from 7 to 10 years (in line with KEEP) or, preferably, be removed altogether.

ii) Loan to employees to purchase equity

As mentioned above, the preferential rate of interest in Ireland for BIK purposes is 13.5% which is significantly higher than other jurisdictions such as the UK which has a rate of circa 2%. Often when looking at share plans within multiple jurisdictions, Ireland is seen as an unfavourable location in respect of offering a loan to an employee to fund the purchase of shares in their employer. Interest rates over the last number of years have reduced significantly and as a result the preferential rate is completely out of line with commercial interest rates. We would welcome a reduction in the preferential interest rate for employees where they purchase shares in their employer's business.

iii) Employee ownership trusts

The Employee Ownership Trust ("EOT") was introduced in the UK in Finance Act 2014 with the aim of promoting employee ownership as a business model in the UK. The EOT is an extension of a traditional Employee Benefit Trust, however, it has specific features and associated tax advantages.

Assuming the EOT holds a controlling stake in its company and is for the benefit all employees on an equal basis (which are two key qualifying conditions), then the main tax exemptions are:

- A complete CGT exemption on gains made by individual shareholders when a controlling interest in a company (or parent company of a trading group) is sold to an EOT.
- An income tax exemption of £3,600 per individual per tax year on certain bonuses issued to all employees (National Insurance Contributions would still apply).

The income tax relief provides a substantial benefit for all employees as it not only provides an additional source of remuneration in addition to wages or salaries, but it also helps create a culture of ownership and collective responsibility for the company's performance. This relief has proved hugely popular in the UK with a number of companies availing of this scheme.