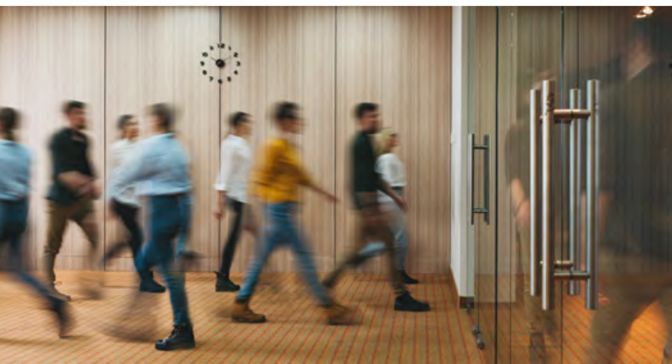
Irish Tax Institute

April 2023

Ireland's Personal Tax System

Response to the Public Consultation



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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 32,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, the Taxation Institute of Hong Kong and the South African Institute of Taxation. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Executive Summary

The Institute welcomes the opportunity to contribute to the Consultation on Ireland's Personal Tax System.

The Institute recommended several reforms to Ireland's personal tax system in our response to the public consultation undertaken by the Commission on Taxation and Welfare (CoTW) in January 2022.[1] Those recommendations to the CoTW remain valid and are reiterated in this submission.

Personal tax receipts collected under the Pay as You Earn (PAYE) system consistently represent the single largest source of tax to the State. It is therefore essential that Ireland's personal tax system can be relied upon in the future to provide a sustainable and stable source of revenue to the Exchequer to fund public services.

While the Irish personal tax system is highly progressive, the Irish personal tax base is unusually narrow and overly dependent on higher paid workers, a significant proportion of whom work for a small group of multinational companies. We consider a broader personal tax base, in which all taxpayers contribute according to their means, would be more sustainable long-term. A broader personal tax base would ease the burden on middle-income earners and it would bring Ireland more in line with competitor countries.

The Institute agrees with many of the tax base-broadening measures proposed by the CoTW in their report - Foundations for the Future - which was published in September 2022. Increased tax revenues will be necessary in the coming decades to counterbalance the cost of an ageing population and ensure there are sufficient resources to meet the cost of public services. We firmly believe that the balance needs to be tilted away from economically regressive labour taxes in favour of taxes such as VAT, property taxes and environmental charges.

The attractiveness of a country's personal tax system and the cost of employers locating workers in a country has become an increasingly important factor in determining where businesses locate investment with the implementation of Pillar Two of the OECD Inclusive Framework agreement on a *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Two-Pillar Solution). In our view, if Ireland is to attract and retain foreign direct investment (FDI), the marginal cost of employment must be reduced for individuals and ultimately, businesses that bear the cost of employment.

The draft terms of reference for the review of Ireland's personal tax system which are outlined in the Consultation Paper, include consideration of an intermediate or third rate of income tax. In principle, the Institute is generally supportive of any measure which reduces the burden on middle-income earners, which may include the introduction of a third rate of income tax to bridge the gap between the standard rate of 20% and the higher rate of 40%.

[1] https://taxinstitute.ie/wp-content/uploads/2022/01/Commission-on-Taxation-and-Welfare_vfinal.pdf

However, careful consideration must be given to ensure such a measure does not result in adding further complexity to the Irish personal income tax system. Alternative measures, such as continuing on the trajectory taken in recent Budgets of increasing the standard rate threshold, should achieve the same objective as a third rate of income tax of say 30%, without the need for structural changes to the income tax system.

The Institute believes that Ireland's personal tax system should be simple, fair and transparent. The Pay Related Social Insurance (PRSI) system is complex and difficult for individuals to understand and there are many differences in the bases of PRSI and the Universal Social Charge (USC). As both of these charges are intended to be social contributions, we believe that the ultimate objective must be to simplify the personal tax system by merging PRSI and USC, notwithstanding the difficulties and complexities involved.

Furthermore, it is important that the personal tax system continues to incentivise individuals to provide for their retirement through the deferral of income to supplement their income in later years.

We have summarised in section 3 of this submission, the Institute's recommendations for reform of Ireland's personal tax system. We have outlined in further detail our responses to the consultation questions in section 4.

The Institute is happy to engage further in this consultation through stakeholder meetings or direct discussions. Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information.

3. Institute Recommendations

Reforming the personal tax base

1. With one-third of income earners paying neither income tax nor USC in 2023, the Irish personal tax base is narrow. A broader personal tax base in which all taxpayers contribute according to their means would be more sustainable and help protect the Exchequer against the impact of a future potential economic downturn.

2. The original intention of the USC was to broaden and rebuild an income tax base that had been significantly narrowed to the point where 45% of income earners were outside of the tax net in 2010. On its introduction in 2011, 12% of taxpayers were exempt from the charge. According to Revenue that number now stands at 35%[2] post Budget 2023. In our view, it is now time to revisit the original purpose of the charge which was to broaden the base of personal taxes.

3. The Institute supports the CoTW recommendations that age should be removed as a factor for determining the charge to income tax and USC and that the rates of USC should be determined by income level.

4. We endorse the view of the CoTW that the tax treatment for all income earners should be aligned and therefore, the additional 3% USC surcharge which applies to self-employed income over €100,000 should be removed, as it does not comply with the principle of horizontal equity.

5. We agree with the Commission on Pensions that the "Package 4" of measures which proposes phased increases to the PRSI rates for the self-employed, employers and employees, a gradual increase in the State Pension age and Exchequer contributions is the most feasible option. However, we believe any increases in PRSI must factor in the overall impact on the marginal tax rate and on the cost for employers of employing people in Ireland.

6. Consideration should be given to introducing a cap on the level of earnings to which PRSI applies, similar to that which exists in other countries.

7. We agree with the recommendation of the Commission on Pensions that the exemption from PRSI for those aged 66 or over should be removed.

Supporting a competitive economy to incentivise and encourage work

8. The Institute is supportive of any measure which reduces the burden on middle-income earners such as a potential third rate of income tax of 30%. However, careful consideration must be given to ensure that such a measure does not result in additional complexity to the personal income tax system. Alternative measures, such as further increases to the standard rate threshold could achieve the same objective

[2] Revenue Ready Reckoner, Post-Budget 2023, October 2022 and Revenue Ready Reckoner, Post-Budget 2022, November 2021.

without the need for structural changes to the income tax system. At a minimum, we recommend that credits and bands should be automatically adjusted annually to ensure that taxpayers are not subjected to increased tax as a result of rising inflation.

9. The implementation of Pillar Two in the EU and globally, coupled with the unprecedented mobility in the current labour market internationally, means that there is a real risk that quality jobs will not come to Ireland if the marginal cost of employment for businesses and individual taxpayers is not reduced. In our view, an objective of any long-term strategy aimed at attracting and retaining FDI should include reducing the marginal cost of employment in Ireland for both businesses and individuals.

10. The Special Assignee Relief Programme (SARP) is a critical part of Ireland's competitive offering to attract FDI and the relocation of high-value employment to the State. Retaining SARP and continually benchmarking the Irish regime against key competitor countries is essential to enable Ireland to compete for talent on a global stage.

11. Given the importance of share-based remuneration as a means of attracting and retaining key talent within the FDI sector, the taxation of share-based remuneration needs to be simplified and aligned with other competitor countries.

Simplifying the personal tax system

12. Notwithstanding the difficulties and complexities involved, we believe it is imperative that the personal tax system is simplified and that PRSI and USC should be amalgamated as part of that process. In this context, our recommendation on capping the level of earnings to which PRSI would be applied may not be achievable but should be borne in mind in the overall determination of a merged rate.

13. The Offshore Funds Regime is overly complex, and it is very difficult for individual taxpayers to correctly determine the appropriate tax treatment of income and gains arising on their investments. We welcome the recent confirmation[3] by the Minister for Finance that the parameters for a review of the taxation of different types of investment products are being finalised. We look forward to engaging with the Department on this matter as we believe the Offshore Funds Regime should be overhauled to simplify the regime and support tax compliance.

14. In our view, the distinction between proprietary directors and employees should be removed to simplify tax compliance. Consideration should be given to aligning the basis of assessment for proprietary directors with employees so that both cohorts of taxpayers are assessed to tax on Schedule E emoluments on the "receipts basis".

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[3] https://www.gov.ie/en/speech/bd702-irish-tax-institute-seminar-report-of-the-commission-on-taxation-and-welfare-the-practical-implications/

Encouraging workers to save for retirement

15. It is important that the personal tax system continues to incentivise individuals to provide for their retirement through the deferral of income to supplement their income in later years. The Institute endorses the conclusion by the CoTW that tax relief on pension contributions should be given at an individual's marginal income tax rate because such contributions are a deferral of income.

16. The Institute agrees with the recommendation of the CoTW that anomalies in the tax treatment of different retirement arrangements should be eliminated, as far as possible and that any further restriction on pension tax relief must be balanced against the tax treatment of unfunded pensions.

4. Consultation Questions

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 personal tax system should be broadly based, simple, fair and transparent. It should support economic growth while redistributing income to lower paid workers.

The Consultation Paper notes that income taxes are the largest annual source of revenue for the Exchequer, accounting for 37% of tax revenues forecast in 2023. Consequently, it is essential that the Irish personal tax system can be relied upon to provide a sustainable and stable source of revenue to the Exchequer.

In 2023, Irish taxpayers pay personal tax (including income tax, USC and PRSI) at marginal rates of 48.5% on salaries above €40,000 and 52% on salaries above €70,044. Self-employed taxpayers pay marginal rates of 55% on income above €100,000. Meanwhile, 35% of income earners pay neither income tax nor USC.[4]

For 2022, the top 20% of income earners, those earning in excess of €64,000 paid over three-quarters of the total income tax and USC receipts collected. The top 5% of income earners, those earning over €125,000, paid 45% of the total income tax and USC receipts collected.[5]

The Irish personal tax base is narrow and overly dependent on higher paid workers. There is also a risk associated with the sectoral concentration of income tax receipts. Employees of foreign-owned multinational firms accounted for about one-third of all income tax in 2020.[6] Therefore, a shock to the multinational sector would significantly impact both income tax and corporation tax receipts and have a knock-on impact on consumer spending and the corresponding VAT receipts.

We consider a broader personal tax base in which all taxpayers contribute according to their means would be more sustainable and would bring Ireland's personal tax system more in line with competitor countries.

We concur with the CoTW statement that: *"Both high and low earners are particularly responsive to changes to marginal tax rates, 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*

[4] Revenue Ready Reckoner – Post Budget 2023, Revenue Commissioners, October 2022, page 2.
[5] Income Tax, Tax Strategy Group – 22/02, Department of Finance, July 2022.
[6] Economic Context for Taxation Policy, Tax Strategy Group – 22/01, Department of Finance, July 2022.

high proportion of the workforce outside of the Income Tax base may not be sustainable in the long term."[7]

Undoubtedly, increased tax revenues will be necessary in the coming years to counterbalance the cost of an ageing population and ensure there are sufficient resources to meet the cost of public services. We firmly believe that a broader tax base in general is necessary to correct the current over reliance on labour taxes and that the balance must be tilted in favour of taxes, such as property taxes, VAT and environmental charges. This approach would also support the decarbonisation of the Irish economy.

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

As Ireland's high marginal tax rate applies at relatively low-income levels by international standards, moving from the income tax bracket of 20% to 40% has a disproportionate impact on middle-income earners which can act as a disincentive to work and striving for bonuses and promotion etc.

The Consultation Paper notes that the draft terms of reference for the review of Ireland's personal tax system includes examination of the option of the introduction of an intermediate or third rate of income tax.

In principle, the Institute is supportive of any measure which reduces the burden on middle-income earners such as a third rate of income tax of say 30%. However, we believe careful consideration must be given to ensure that such a measure would not further complicate the personal income tax system.

For example, the introduction of an intermediate rate of income tax would represent a very significant change to the current structure of the income tax system and would necessitate considerable changes for both Revenue's systems and for payroll providers. Alternative measures, such as continuing on the trajectory of the last two Budgets to increase the standard rate threshold should achieve the same objective of easing the tax burden on middle-income earners without the need for structural changes to the income tax system. At a minimum, we recommend that credits and bands should be automatically adjusted annually to ensure that taxpayers are not subjected to increased tax as a result of rising inflation.

With the implementation of the Pillar Two global minimum tax rate of 15% in Ireland and globally, an increasingly important factor in determining where multinational groups will invest is the attractiveness of a country's personal tax system and the cost for employers to locate workers in a country.

The unprecedented mobility in the current labour market internationally means that there is a real risk that quality jobs will not come to Ireland if the marginal cost of

[7]Foundations for the Future, Report of the Commission on Taxation and Welfare, 2022, page 84.

employment for businesses and individual taxpayers is not reduced. Indeed, feedback from our members would suggest that attracting talent to Ireland is now a key obstacle to growth in businesses and the wider economy.

In our view, an objective of any long-term strategy aimed at attracting and retaining FDI in Ireland should include reducing the marginal cost of employment in Ireland for individuals and ultimately, businesses which bear the cost of the employment. The consensus among our members is that a marginal rate of tax (including income tax, USC, and employee PRSI) set at 50% would help to attract highly skilled and mobile labour to Ireland.

Special Assignee Relief Programme (SARP)

Given the high rates of personal taxation and the intense competition for top talent across many jurisdictions, persuading highly skilled individuals and senior decision-makers to move to Ireland is challenging. SARP plays a critical part in Ireland's competitive offering to attract FDI and the relocation of high-value employment to the State.

Independent analysis of SARP has clearly and consistently demonstrated that it delivers value to the Irish economy through job creation and business expansion and that there is a strong policy rationale for its retention[8] with a Benefit-to-Cost Ratio of 1.8.[9] The number of jobs linked to SARP has increased while the cost of the scheme to the Exchequer has decreased, since the re-introduction of a cap on salaries qualifying for the relief in Finance Act 2018.[10]

The economic benefits of SARP extend beyond increased employment, with statistics showing SARP companies paid over €2.5 billion in corporation tax and €1.9 billion in PAYE taxes in 2017 alone.[11]

However, the attractiveness of SARP remains vulnerable to competitive pressures. Many other jurisdictions offer similar and often more attractive regimes to attract foreign executives, such as the Netherlands, France, and Portugal. Therefore, it is essential that SARP is retained and benchmarked on a regular basis against the top competitor jurisdictions for FDI and for senior decision-makers to ensure Ireland remains competitive.

This is even more critical now as Ireland's 12.5% corporation tax rate is no longer a core competitive offering. In benchmarking SARP against equivalent regimes, care should be given to ensuring the Irish regime reflects emerging working arrangements and international norms regarding the types of remuneration that qualify for relief, for

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[8] Indecon Review of the Special Assignee Relief Programme - Budget 2020 Report on Tax Expenditures Incorporating outcomes of certain Tax Expenditure & Tax Related Reviews completed since October 2018 – October 2019.

[9] Page 40, Budget 2020 Report on Tax Expenditures Incorporating outcomes of certain Tax Expenditure & Tax Related Reviews completed since October 2018, Department of Finance, September 2021 224584_c50e1586-56aa-4efa-9272-a60e5844df93.pdf

[10] Special Assignee Relief Programme, Statistics for 2020, Revenue Commissioners, July 2022.

[11] Page 38, Budget 2020 Report on Tax Expenditures Incorporating outcomes of certain Tax Expenditure & Tax Related Reviews completed since October 2018, Department of Finance, September 2021 224584_c50e1586-56aa-4efa-9272-a60e5844df93.pdf

example, share-options and Restricted Stock Units which are used extensively as part of the remuneration of high-performing employees and executives.

To provide certainty to businesses, SARP should be extended beyond its expiry date of 31 December 2025 for a 10-year period to December 2035. This would assist businesses to plan for longer-term projects with the knowledge that SARP will remain a core offering under the Irish personal tax system. In an environment where there are high employment levels and skill shortages in some key areas, consideration should also be given to allowing “new hires” to qualify for SARP.

Taxation of share-based remuneration

The Irish system of taxation of share options and Restricted Stock Units is overly complex in comparison with the approach taken in other jurisdictions. Given the importance of share-based remuneration as a means of attracting and retaining key talent within the FDI sector, the taxation of share-based remuneration needs to be simplified and aligned with other competitor countries.

Do you have views on the progressivity of the personal tax system?
Do you think the personal tax system operates as an effective means of income redistribution?

Over the last two decades, successive governments have used the tax system, combined with social welfare payments, to reduce income inequality. Data from the OECD shows that the Irish personal tax system is strongly progressive, and the tax and social welfare systems combined contribute substantially to the redistribution of income and to the reduction of income inequality.

The reduction in market income inequality and poverty through social benefits in Ireland is the largest across OECD countries.[12] However, the OECD has also noted that the flip side of this is that the tax base is very narrow, with almost one-in-three workers paying little or no income tax in 2021, and the bottom 50% of taxpayers contributing just 4% to the overall income tax take.[13]

International Comparisons

Our Tax and Social Insurance International Tables 2022 prepared in association with KPMG, are attached in Appendix I to this submission. The tables were prepared in advance of Budget 2023 and therefore, do not take account of the personal income tax measures announced in Budget 2023 such as increases in personal tax credits and the standard rate threshold. It was not possible to update the analysis within the short timeframe for this consultation.

[12] OECD Economic Surveys: Ireland © OECD 2018, page 38
[13] OECD Economic Surveys: Ireland © OECD 2022, page 38

The tables examine the tax and social insurance contributions paid in Ireland in 2022 compared with seven competitor countries: namely, France, Germany, Singapore, Sweden, Switzerland, UK, USA.

The tables highlight the progressivity of the Irish personal tax system. At lower salary levels, Ireland has the second lowest effective personal tax rate (income tax, USC and employee PRSI) of all eight countries examined. While our employee PRSI rate is comparatively low, Irish taxpayers are subject to high rates of income tax and USC. Therefore, as income levels rise, taxpayers in Ireland move quickly up the international tables.

Our tables show that in 2022, the tax wedge[14] in Ireland exceeded that of countries such as the UK, the USA and Singapore at salary levels of €48,000 and above; but is lower than the tax wedge in France, Germany and Sweden, primarily due to the lower levels of social insurance contributions in Ireland.

On the other hand, Ireland's social insurance benefits are low by European standards. As the Report of the Commission on Pensions noted *"The more comprehensive range of social welfare benefits available in some European countries (e.g., comprehensive public health insurance) also accounts for the higher levels of social insurance contributions elsewhere in the EU."*[15]

Furthermore, the National Economic and Social Development Council acknowledges that ***"****In international terms, Ireland's benefit regime is a basic security system, where benefits remain modest and there is an 'almost mechanical relationship between benefits and earnings."* [16]

The Irish system currently operates on a flat payment basis, whereas some EU countries pay benefits on an earnings-related basis. For example, in France, Germany and Sweden a recipient's unemployment benefit is relative to their income in employment.

The Institute welcomes the recent public consultation by the Department of Social Protection to consider the design and development of a new Pay-Related Benefit (PRB) scheme for jobseekers in Ireland. In our view, the payment of benefits on an earnings-related basis during temporary breaks in employment, could ensure an individual can maintain their normal living standard, including paying their mortgage and utility bills, while searching for alternative employment.

Another key differentiating factor of the Irish social insurance system is that there is no cap or limit on the social security contributions payable irrespective of the income of the taxpayer. In other EU Member States, there is a limit on the social contributions

[14] The tax wedge is generally considered to be the difference between what employees take home in earnings and what it costs to employ them. It looks at income taxes paid by an employee and social contributions levied on both employees and their employers. The higher the tax wedge, the higher labour supply costs that will be incurred by an employer to produce the same service or product, compared to another country.
[15] Report of the Commission on Pensions, The Pensions Commission, para. 13.3.2
[16] The Future of the Irish Social Welfare System: Participation and Protection, No. 151 November 2020, National Economic and Social Development Office.

payable. For example, in Germany, pension and unemployment insurance contributions are payable up to an income ceiling of €84,600. In our view, consideration should be given to introducing a cap on the level of earnings to which PRSI applies, similar to that which exists in other countries.

OECD statistics show that in 2022 the level of public social spending in Ireland at 12.8% of GDP, is considerably lower than the OECD average of 21.1% and is a fraction of the spend in France (31.6% of GDP), Sweden (23.7% of GDP) or Germany (26.7% of GDP).[17] Within the EU, the average level of expenditure on social protection benefits[18] relative to GDP in 2020 was 30.4%, with Ireland at 15.1% of GDP ranking behind all other EU Member States.[19]

The OECD has noted that there was a sharp decline in the spending-to-GDP ratio between 2010 and 2019 in Ireland and states that this *"is related to a jump in GDP in 2015."*[20] Therefore, the public social spending per capita would appear to be a more appropriate measure than GDP. However, using public social spending per capita as the measure, Ireland at USD$10,793 continues to rank behind France (USD$13,793), Sweden (USD$12,776) and Germany (USD$12,830)[21].

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

In our view, the key areas in the personal tax system for future policy consideration should be:

(i) broadening the personal tax base;
(ii) reducing the marginal cost of employment in Ireland for both businesses and individuals;
(iii) simplifying the personal tax system; and
(iv) encouraging workers to save for retirement.

Broadening the personal tax base

As set out above, the Irish personal tax base is unusually narrow. A broader personal tax base would be more sustainable. The exclusion of a large proportion of taxpayers from the personal tax system should be reconsidered.

USC

The original intention of the USC was to broaden and rebuild an income tax base that had been significantly narrowed in the decade before the Financial Crisis to the point where 45% of income earners were outside of the tax net in 2010. On its introduction

[17] OECD Social Expenditure Database https://www.oecd.org/social/expenditure.htm
[18] Social protection benefits are transfers to households, in cash or in kind, intended to relieve them of the financial burden of several risks and needs as defined in the European System of integrated Social Protection Statistics (ESSPROS)
[19] Social protection statistics - social benefits, Eurostat, November 2022 https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Social_protection_statistics_-_social_benefits
[20] https://www.oecd.org/els/soc/OECD2020-Social-Expenditure-SOCX-Update.pdf
[21] OECD (2023), Social spending (indicator). doi: 10.1787/7497563b-en (Accessed on 31 March 2023)

in 2011, 12% of taxpayers were exempt from the charge. According to Revenue that number now stands at 35% post Budget 2023, up from 28% in 2022.[22] In our view, it is now time to revisit the original purpose of the charge which was to broaden the base of personal taxes.

We believe that the policy rationale for exemptions to the USC need to be re-examined. For example, all social welfare payments are currently exempt from USC irrespective of the total income of the recipient. This includes significant Exchequer payments such as the State Pension, Maternity Benefit, Illness Benefit and Jobseeker's Benefit which are subject to income tax.

Individuals aged 70 years and over, pay a maximum USC rate of 2% provided their total income is not more than €60,000 per year. However, this income cap excludes the USC exempted State Pension.

We would endorse the CoTW recommendations that age should be removed as a factor for determining the charge to income tax and USC and rates of USC should be determined by income level. In the interest of equity and fiscal sustainability, taxpayers should not be exempt from income tax or USC by reason of their age or any other personal circumstance.

PRSI

The Report of the Commission on Pensions examines sustainability and eligibility issues with the State Pension and the Social Insurance Fund and put forward four potential packages[23] for Government to address fiscal sustainability which each included two or more policy levers:

- increasing the rate of self-employed PRSI (Class S);
- increasing the rate of employees and employer PRSI (Class A);
- pension age increase; and
- Exchequer contributions.

Each of the four packages put forward by the Commission on Pensions propose that PRSI for the self-employed would increase from 4% to 10% initially by 2030 and then to the higher rate of Class A employer PRSI (currently 11.05%).

We would agree with the Commission on Pensions that the most feasible option is Package 4 which proposes phased increases to the PRSI rates for the self-employed, employers and employees and a gradual increase in the State Pension age. However, it is our firm view that any increases in PRSI must factor in the overall impact on the marginal tax rate and on the cost for employers of employing people in Ireland.

[22] Revenue Ready Reckoner, Post-Budget 2023, October 2022 and Revenue Ready Reckoner, Post-Budget 2022, November 2021.
[23] Table 1: Reform packages to address fiscal sustainability, page 11, Report of the Commission on Pensions, The Pensions Commission, October 2021

Furthermore, in the interest of equity, it would be important that irrespective of which package is adopted that the additional 3% USC surcharge which applies to the self-employed income over €100,000 is removed, which was recommended by the CoTW. The removal of the 3% USC surcharge is also a key commitment in the Programme for Government.

The CoTW recommended that future base-broadening reforms should focus on PRSI and on addressing horizontal equity concerns. The Commission on Pensions recommended maintaining the exemption from PRSI on social welfare payments but removing it from those aged 66 or over. It proposed that all those over State Pension age should pay PRSI on a solidarity basis (Class K) on all income currently subject to PRSI.

We agree with the Commission on Pension's recommendation that the exemption from PRSI for those aged 66 or over should be removed except for social welfare payments. This also concurs with the position of the CoTW which recommended that those over the State Pension age should pay PRSI on all income other than social welfare payments.

Reducing the marginal tax rate

The attractiveness of a country's personal tax system and the cost for employers to locate workers in a country is now a key deciding factor when multinational groups are considering where to locate their operations. As outlined above, it is our firm view that any long-term strategy aimed at attracting and retaining FDI should include reducing the marginal cost of employment in Ireland for both businesses and individuals.

Simplifying the Personal Tax System

Amalgamate PRSI and USC

With 12 different rates and 11 different classes, further divided into sub-classes, the PRSI system is complex and difficult for individuals to understand. In addition, there are many differences in the PRSI and USC bases. As both of these charges are intended to be social contributions, we believe that the ultimate objective should be to merge PRSI and USC.

The working group established in 2017 to consider the amalgamation of USC and PRSI submitted its report to the Minister for Finance in September 2018. We understand the report, which has not been published, acknowledges the complexity of the process and sets out a range of options as to how amalgamation could be achieved.

According to the Tax Strategy Group papers published in 2019, the group concluded that all options considered involved a trade-off between simplicity in design, loss of revenue to the State overall and losses/gains at a taxpayer level.[24]

Notwithstanding the difficulties and complexities involved, we believe the personal tax system should be simplified and that an amalgamation of PRSI and USC should be part of that process.

USC is charged on an annual cumulative basis, whereas PRSI is charged on a "week one" basis. This means that a PRSI charge only applies where the weekly thresholds are exceeded without regard to cumulative annual income. In our view, PRSI should be charged on a cumulative basis. This would be a pre-requisite to the amalgamation of PRSI and USC.

Consideration would also need to be given to whether a unified USC and PRSI charge should be charged at a progressive or flat rate. Given that a progressive rate structure already exists for income tax, a flat rate system would be preferable in our view.

In this context, capping the level of earnings to which PRSI would be applied may not be achievable but should be borne in mind in the overall determination of a merged rate.

Simplify the taxation of investments

The investment market has expanded exponentially over recent years with a wide array of investment products and platforms now available to investors.

However, determining the correct tax treatment of income and gains arising from foreign investments can be very complex. Investors must consider whether the investment falls within Ireland's Offshore Funds regime (outlined in Chapters 2, 3 and 4 of Part 27 TCA 1997). Performing the requisite analysis to determine whether the investment is in an offshore fund and the relevant tax treatment is costly and time consuming and the analysis can be difficult to complete due to the lack of full information on the investment products. Most private investors do not have the skillset or access to the tools required to ascertain the correct tax treatment.

We welcome the confirmation[25] by the Minister for Finance at the Institute's recent seminar on the *Report of the Commission on Taxation and Welfare - 'The practical implications'* that the parameters for a review of the taxation of different types of investment products are being finalised. We look forward to engaging with the Department on this matter as we believe the Offshore Funds Regime should be overhauled to simplify the regime and support tax compliance.

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[24] Income Tax, Tax Strategy Group – 19/03, Tax Strategy Group, July 2019
[25] https://www.gov.ie/en/speech/bd702-irish-tax-institute-seminar-report-of-the-commission-on-taxation-and-welfare-the-practical-implications/

Align the basis of assessment for proprietary directors PAYE income with employees

Another area of the personal tax system in need of simplification is the basis of assessment for taxing PAYE income of proprietary directors. Finance Act 2017 amended the basis for assessing income tax on PAYE income (Schedule E emoluments) so that such emoluments are assessed to tax by reference to the year in which they are paid by an employer to the employee (known as the "receipts basis"). Previously, the statutory basis for taxing emoluments was by reference to the year in which the emoluments were earned by the employee ("the earnings basis").

However, the basis of assessment for proprietary directors' emoluments (i.e., directors who own or control more than 15% of the share capital of a company) was not altered even though proprietary directors are liable to PAYE on their emoluments. Proprietary directors continue to be assessed to tax on the "earnings basis" on their PAYE income and this adds complexity in completing their income tax returns where income is received in a different year to which it is earned. For example, directors' fees or a bonus may be paid to a director after the financial year end of their employer company but paid in respect of that financial year. Such payments are liable to PAYE through the payroll and included on a payroll submission to Revenue when they are paid to the director but are assessable to income tax for the year in which the fees or bonus was earned.

The rationale for maintaining a distinction between the treatment of proprietary directors and employees is unclear. Proprietary directors' emoluments are subject to PAYE in the same manner as emoluments paid to employees. In the vast majority of cases, PAYE will have been withheld and paid on proprietary directors' emoluments, prior to the filing of their income tax returns. Thus, in general, the information provided on their emoluments in the tax return is included to meet a reporting requirement.

We believe that the distinction between proprietary directors and employees should be removed to simplify tax compliance. Consideration should be given to aligning the basis of assessment for proprietary directors with employees so that both cohorts of taxpayers are assessed to tax on Schedule E emoluments on the "receipts basis".

Encouraging workers to save for retirement

Given Ireland's demographic profile, it is critical that the personal tax system continues to incentivise individuals to provide for their retirement through the deferral of income to supplement their income in later years. In the UK, the final report from the Mirrlees Review, *Tax by Design*, [26] considered the need to incentivise saving for retirement and concluded: "*While achieving neutrality between different forms of saving and investment is our general aim, there may be a good case for treating pension saving more generously. Behavioural evidence suggests that people tend not always to make decisions in far-sighted and rational ways. Individuals with inadequate retirement savings are also more likely to draw on costly state benefit*

[26] Mirrlees, J., 2011. *Tax by Design: The Mirrlees Review*, Oxford: Institute for Fiscal Studies and Oxford University Press.

programmes in retirement. Encouraging them to save in a pension when young makes this less likely."

In considering the cost of pension tax relief, account must be taken of the tax paid on the drawdown of a pension at a later date. In principle, equity requires that people in receipt of the same income in real terms over their lifetime should pay the same amount of tax. Under the present system, those with fluctuating income pay more than those whose income accrues more evenly. From this perspective, the relief for pension contributions can be viewed as a form of income averaging rather than a tax relief.[27]

A number of changes were introduced in 2011 to pension tax relief including:

- the application of PRSI and USC to pension contributions;
- the reduction in employer PRSI relief on employee pension contributions by 50%;
- a reduction in the annual earnings limit for which tax relief is allowed on an employee's pensions contributions from €150,000 to €115,000; and
- a reduction in the Standard Fund Threshold from €5 million to €2.3million.

The 2020 Report of the Interdepartmental Pensions Reform & Taxation Group noted that public service pension entitlements are generally unfunded operating on a Pay As You Go basis, though public service employees make mandatory contributions and additional superannuation contributions towards their pension. As such, no explicit employer contributions are made annually.

The 2020 Report concluded *"any alteration in the tax treatment of explicit contributions made by employees and employers would result in horizontal inequity if not paralleled with regard to the State's implicit contributions."*[28]

The Institute welcomes the conclusion by the CoTW that tax relief on pension contributions should be given at an individual's marginal income tax rate because these contributions are a deferral of income.

We also concur with the recommendation of the CoTW that anomalies in the tax treatment of different retirement arrangements should be eliminated, as far as possible and that any further restriction on pension tax relief must be balanced against the tax treatment of unfunded pensions.

[27] This does not include tax relief on lump sums which may be regarded as a tax expenditure.
[28] Report of the Interdepartmental Pensions Reform & Taxation Group 2020, Department of Finance, November 2020, at para 5.58

Appendix I

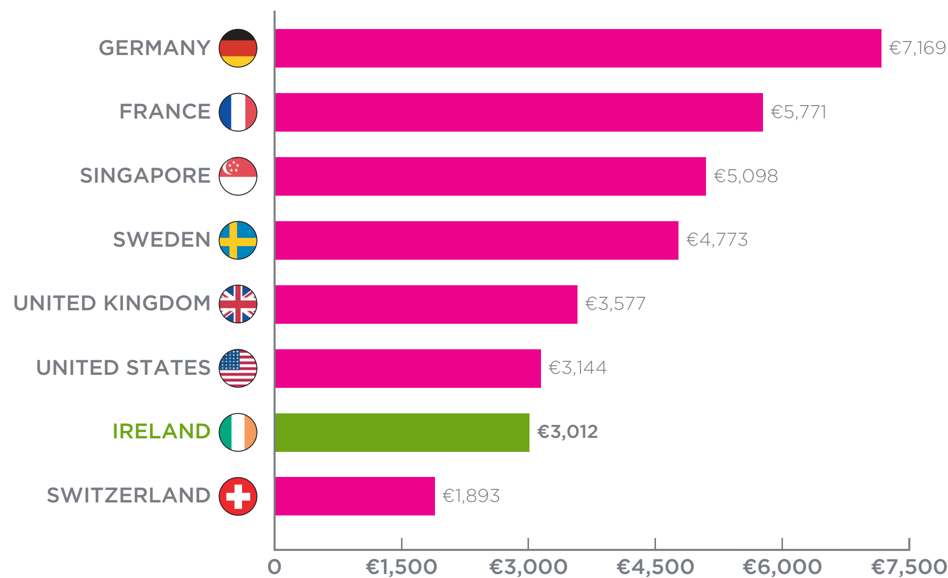
Tax and Social Insurance International Tables 2022

in association with KPMG

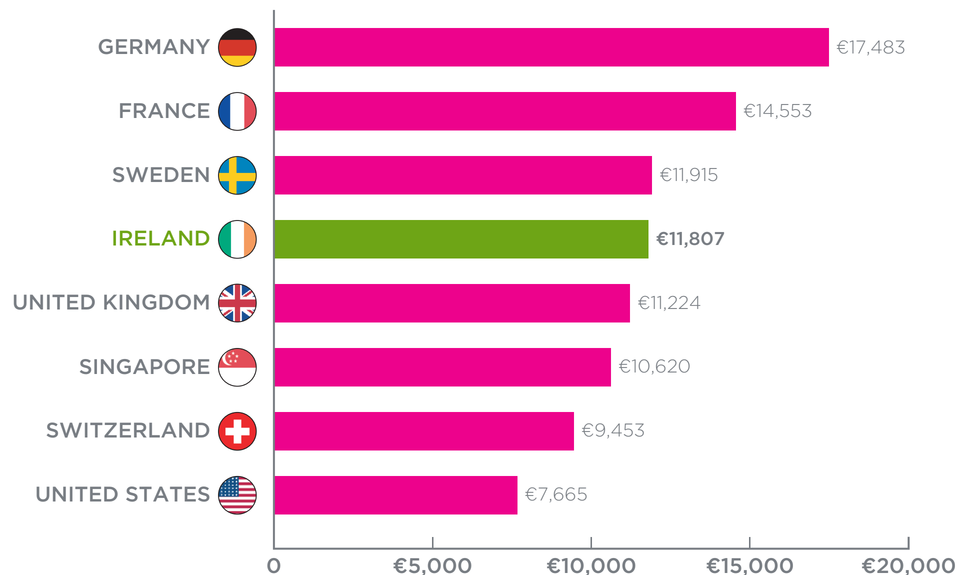
Personal Tax 2022 - Ireland v Competitor Countries

- Our personal tax tables compare the personal tax position (income tax, USC and employee PRSI) of employees in Ireland with competitor countries[i].
- At lower levels, Ireland has the second lowest effective personal tax rate of all eight countries examined.
- Whilst the rate of employee PRSI is low in Ireland compared with the countries examined, Irish employees are subject to high rates of income tax and USC. Therefore, as income levels rise, taxpayers in Ireland move quickly up the international tables.
- In 2022, Irish taxpayers were paying personal marginal tax rates of 48.5% on salaries above €36,800 and 52% on salaries above €70,044.

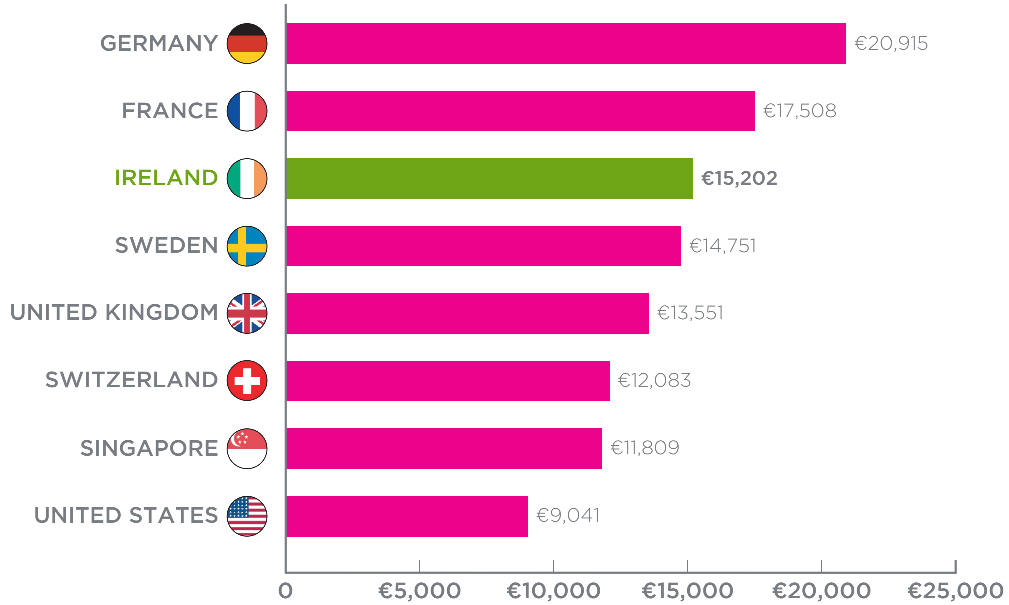
€ Tax paid at salary level of €25,000



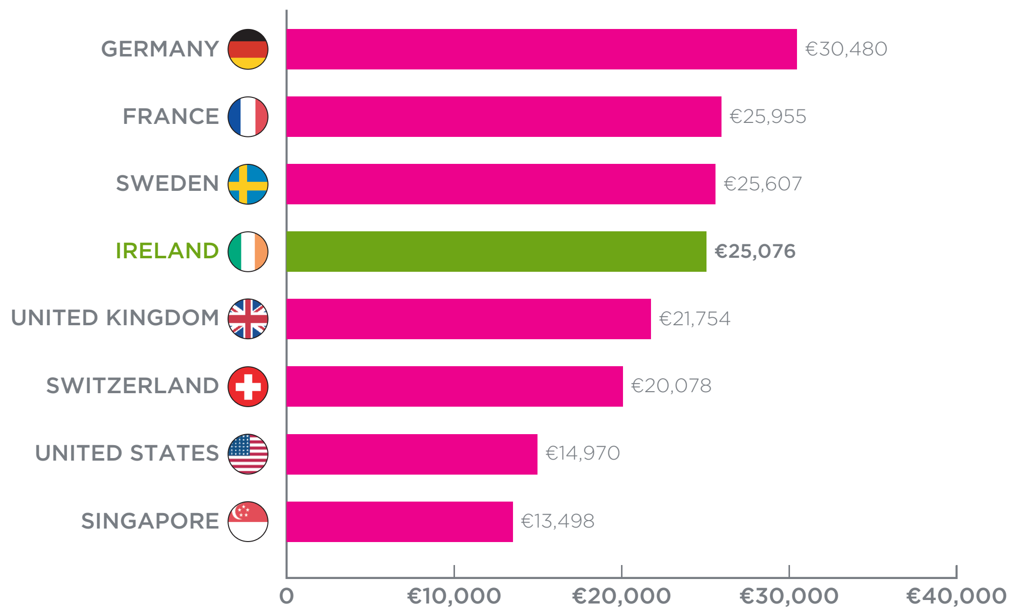
€ Tax paid at salary level of €48,000



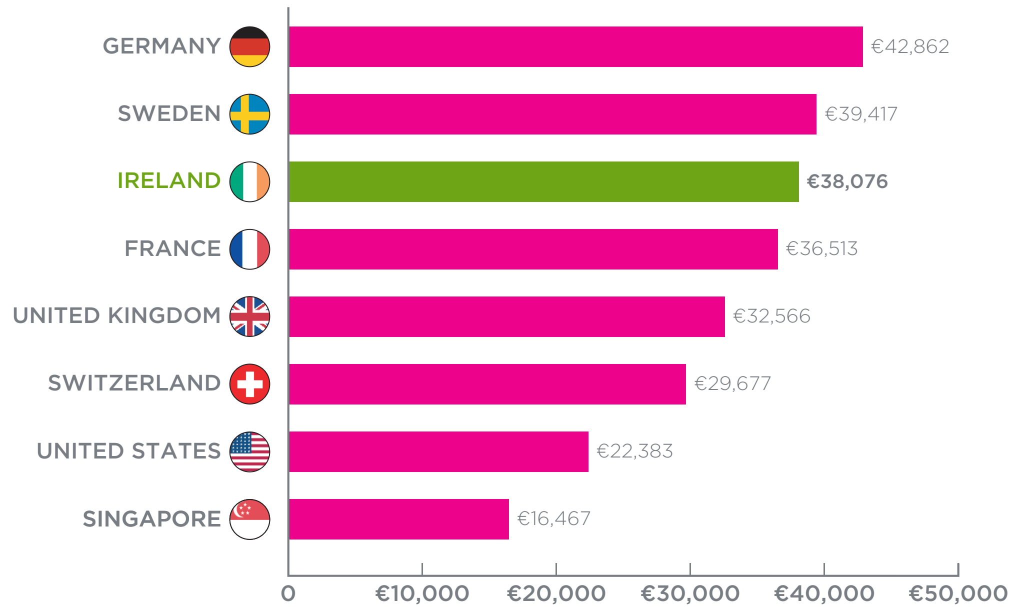
Tax paid at salary level of €55,000



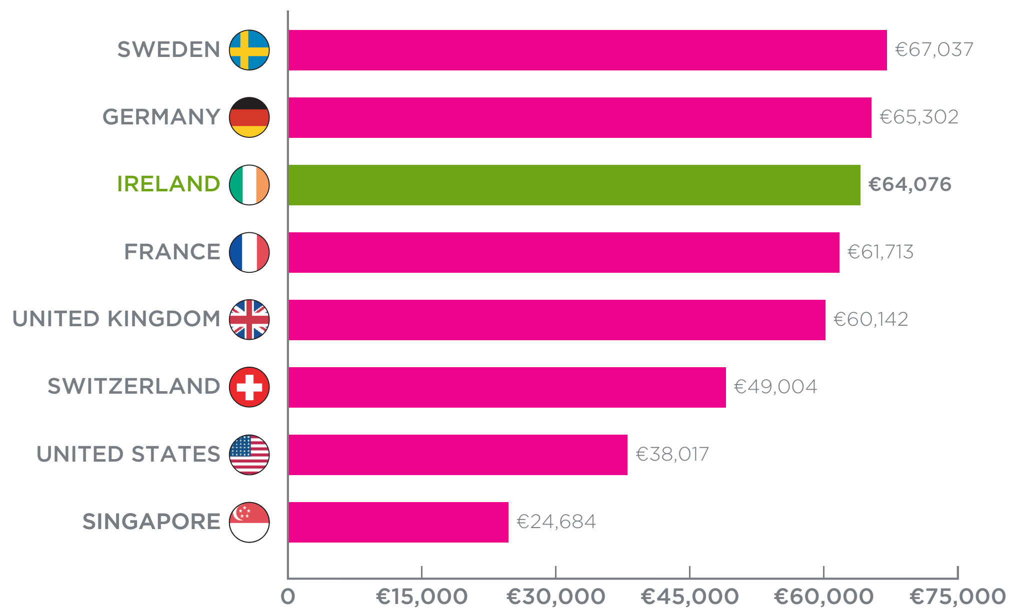
Tax paid at salary level of €75,000



Tax paid at salary level of €100,000



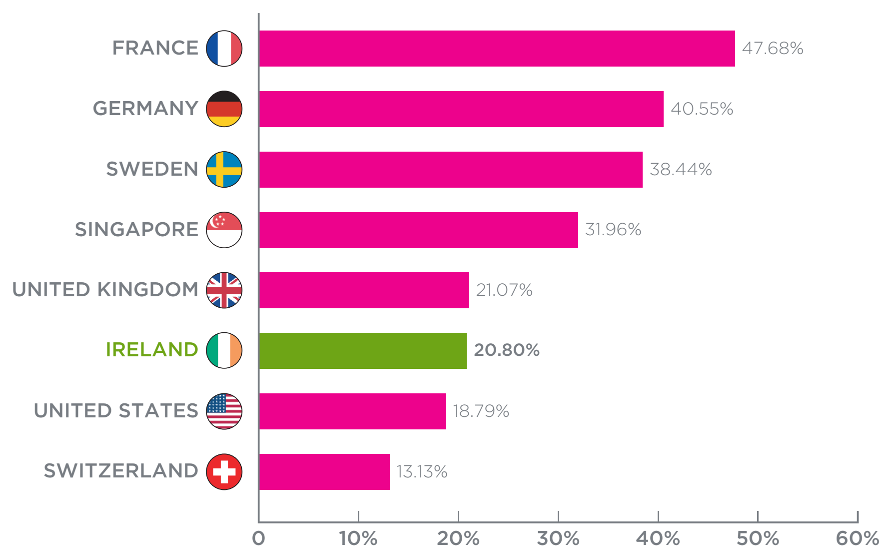
Tax paid at salary level of €150,000



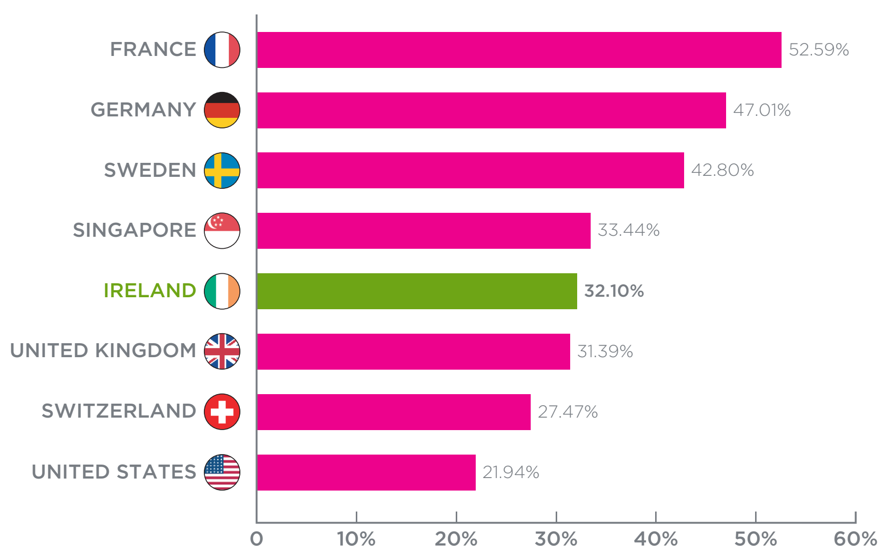
Tax Wedge 2022 - Ireland v Competitor Countries

- The tax wedge[2] is generally considered to be the difference between what employees take home in earnings and what it costs to employ them. It looks at income taxes paid by an employee and social contributions levied on both employees and their employers.
- The higher the tax wedge, the higher labour supply costs that will be incurred by an employer to produce the same service or product, compared to another country.
- The tax wedge in Ireland is higher than in the United Kingdom, the United States and Switzerland at salary levels of €48,000 and above; but is lower than the tax wedge in France, Germany and Sweden, primarily due to the difference in social insurance contributions.

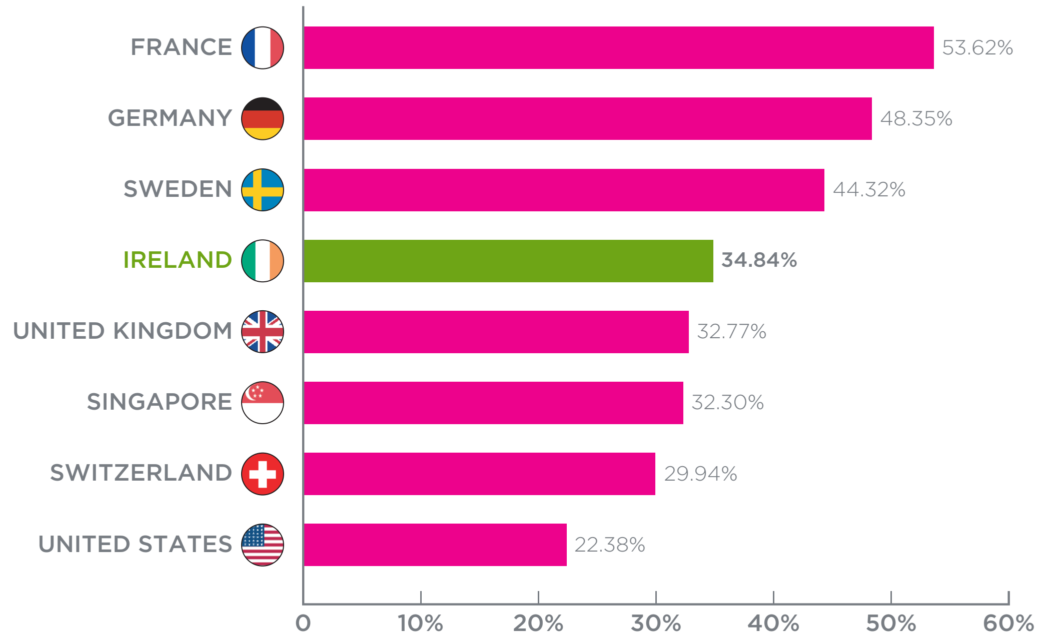
Tax wedge at salary level of €25,000



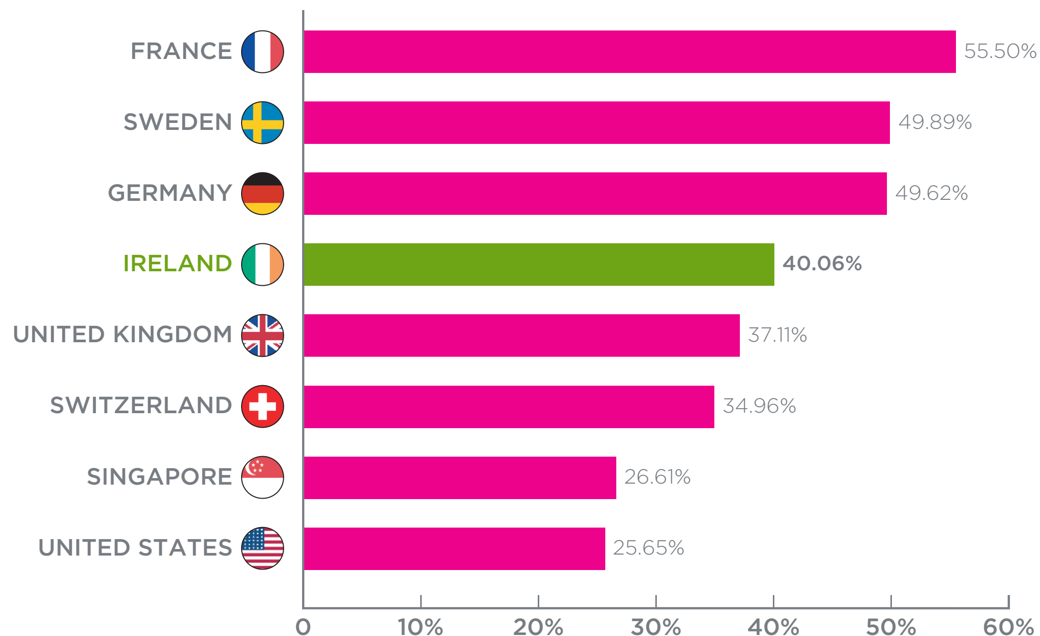
Tax wedge at salary level of €48,000



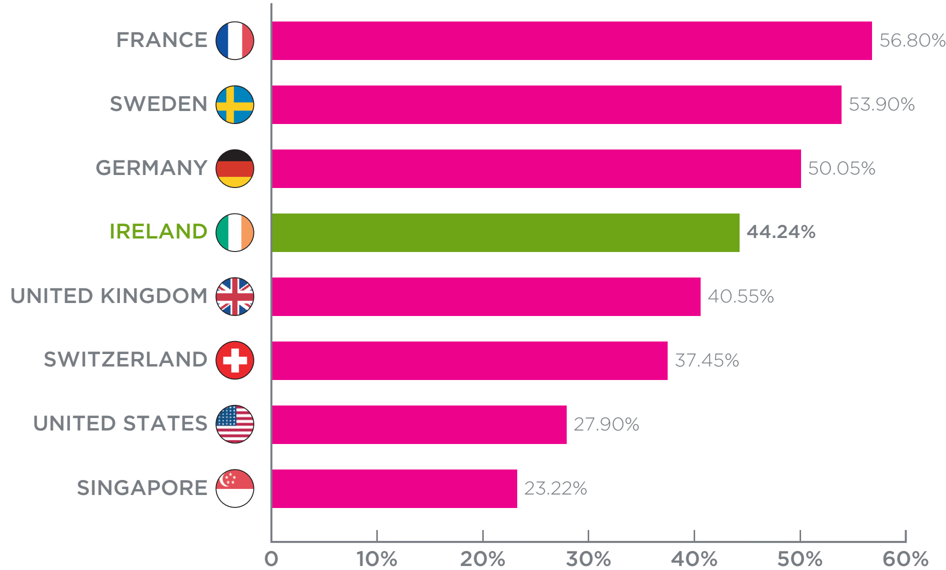
€ Tax wedge at salary level of €55,000



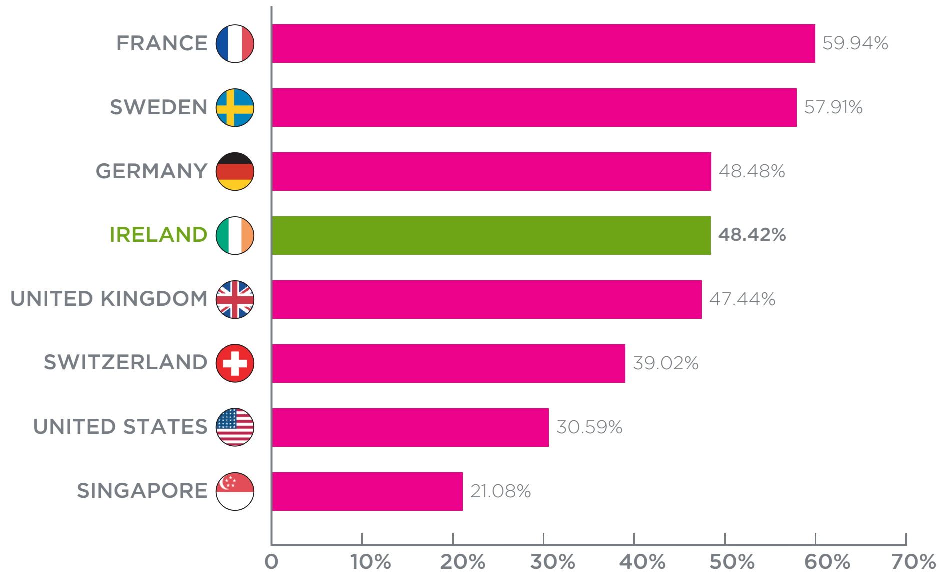
€ Tax wedge at salary level of €75,000



Tax wedge at salary level of €100,000



Tax wedge at salary level of €150,000



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[1] The tables contained in this document are based on indicative net income calculations prepared on the following assumptions:

- Employee is a single person, tax resident in the relevant country
- Employee is liable to social security contributions
- Employee has no children or other dependents
- Earnings represent cash salary only
- Property and wealth taxes are not included

[2] We have calculated the tax wedge as follows:

$$\frac{\text{Employee Taxes/Social Security + Employer Taxes/Social Security}}{\text{Gross Earnings + Employer Taxes/Social Security}}$$