Irish Tax Institute

Leaders in Tax

Removing the PAYE Tax Credit – The Impact on Ireland's Competitiveness

JULY 2016

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WHY THE FOCUS ON THE PAYE TAX CREDIT?

Removing the PAYE Tax Credit is a stated objective in the Summer Economic Statement;

"Removing the PAYE tax credit for high earners to further enhance the progressivity of the income tax system".

WHAT YOU NEED TO KNOW ABOUT THE PAYE TAX CREDIT

- All individuals earning income taxable under the PAYE system are entitled to the PAYE Tax Credit
- The current PAYE Tax Credit is €1,650
- The PAYE Tax Credit is a credit against your total income tax bill
- The impact of the PAYE Tax Credit is that €8,250 of an individual's PAYE income is not subject to income tax, resulting in an annual tax saving of up to €1,650
- The number of people claiming the PAYE Tax Credit is 1,668,400[1]
- The total cost of the PAYE Tax Credit is €3bn[2]

[1] Revenue, Cost of tax expenditure (June 2016), based on individuals claiming the PAYE Tax Credit in 2014
[2] Revenue, Cost of tax expenditure (June 2016), based on the total cost of the PAYE Tax Credit in 2014

WHO WILL BE IMPACTED?

All indications are that the PAYE Tax Credit will only be removed from people earning above a certain salary level. There is no indication in the Summer Economic Statement as to what a “high earner” might be. However, tax cuts in recent Budgets have been capped at income levels of €70,044 and the highest USC rate of 8%[3] only applies to income over €70,044. So it seems reasonable to assume that the abolition of the PAYE Tax Credit might apply at a similar income level.

“... our definition of Middle Income is people below an annual salary of €70,000”

– Minister Michael Noonan in an interview with Sean O’Rourke, RTÉ Radio 1, 22 June 2016

If the PAYE Tax Credit is removed for those earning over €70,000, then 277,000[4] individuals would be impacted. If an income threshold of €80,000 was chosen, this would impact 203,000[5] individuals.

[3] Applies to income over €70,044
[4] Revenue, May 2016
[5] Revenue, May 2016

The PAYE Tax Credit in operation at present

SALARY OF €75,000			
Income Tax	**Taxable Income**	**Rate**	
	33,800	20%	6,760
	41,200	40%	16,480
	75,000		**23,240**
Less Credits:			
Personal credit		(€1,650)	
PAYE Tax Credit		(€1,650)	(€3,300)
Income Tax liability			**19,940**
USC			
	12,012	1.0%	120
	6,656	3.0%	200
	51,376	5.5%	2,826
	4,956	8%	396
	75,000		
USC Liability			**3,542**
PRSI			
	75,000	4%	3,000
PRSI liability			**3,000**
SUMMARY			
Salary		75,000	
Income Tax	19,940		
USC	3,542		
PRSI	3,000	(26,482)	
Take home pay		**48,518**	

Marginal Tax Rate - the key components

Income Tax	40%
USC	8%[6]
PRSI	4%
Total Marginal Rate	**52%**

[6] Applies to income over €70,044

WHAT APPROACH COULD BE TAKEN TO THE REMOVAL OF THE PAYE TAX CREDIT?

The PAYE Tax Credit could be removed by either:

1. **Abolishing it immediately above a certain income threshold; or**
2. **Tapering it over a certain income range above the threshold**

In either case, the removal of the PAYE tax credit will result in an increase in the tax rate paid on income above the chosen threshold.

ABOLISHING THE PAYE TAX CREDIT IMMEDIATELY

If the decision was taken to abolish the PAYE tax credit immediately for anyone earning more than €70,000, then:

- A taxpayer earning €70,000 would pay tax of €23,883
- A taxpayer earning €70,001 would pay tax of €25,534

The tax on the extra €1 earned above €70,000 would be €1,650.52

An immediate abolition of the credit would result in extremely high personal tax rates at certain income levels and is therefore unlikely to happen.

TAPERING THE PAYE TAX CREDIT ON A SLIDING SCALE - HOW DOES IT WORK?

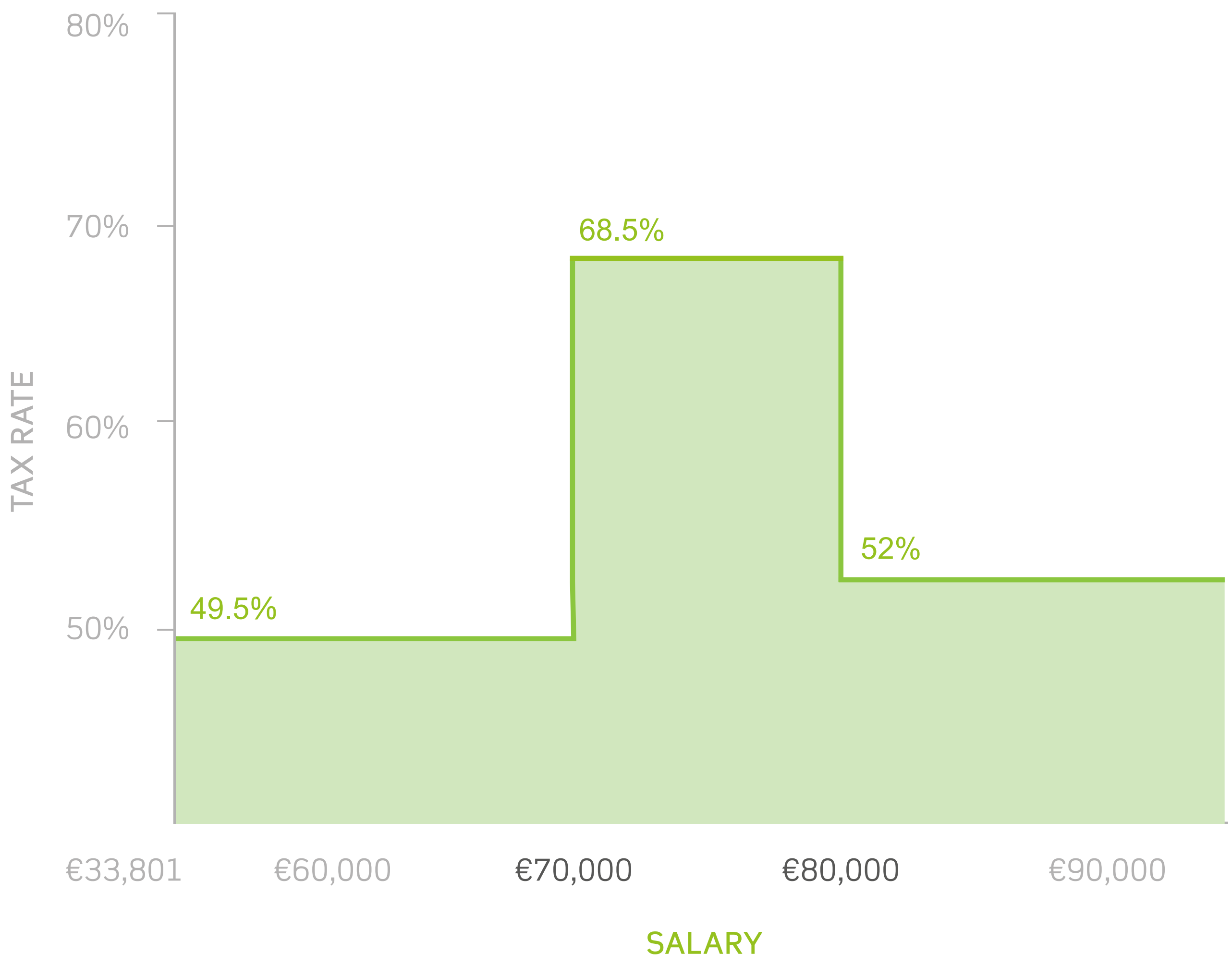
What is more likely is that the credit will be tapered out on a sliding scale. Instead of just abolishing the PAYE Tax Credit of €1,650 in its entirety once you reach a certain income level, you would lose it bit-by-bit as you move up the salary scale. The more gradual the tapering, the less severe will be the impact for those earning close to the threshold amount.

For example, if the credit is tapered out for income earned between €70,000 and €80,000 then the marginal rate of tax paid on income in this €10,000 band will be 68.5%. If the credit is tapered out on income between €70,000 and €85,000, the marginal rate of tax on income earned in this €15,000 band will be 63%[7].

While a tapering approach would somewhat mitigate the tax rate on the additional income, this rate would still be far in excess of the current marginal rate of 52%[8]. Once the credit completely tapers out, the marginal rate for those earning income above the tapering band will return to 52%, although their overall effective tax rate will have increased (as they will have no entitlement to any of the credit).

[7] See the marginal rate calculations in Appendix I
[8] This marginal rate applies for people earning €70,044

Impact on the tax rate if the PAYE Tax Credit is tapered out between €70,000 - €80,000



THE IMPACT OF THE REMOVAL OF THE PAYE TAX CREDIT – ON IRELAND'S COMPETITIVENESS

Productivity and Reward- those earning just above the point at which the PAYE Tax Credit is removed will see a steep increase in their personal tax rate on income earned above that threshold – a disincentive for overtime or extra performance related bonuses. The removal of the credit will also increase the cost for companies of hiring staff in Ireland, with the resulting increase in the tax wedge likely to create upward pressure on wages.

Ireland already has the most progressive tax system in the EU and is close to the very top of the world rankings on progressivity (2nd in the OECD). The Summer Economic Statement 2016 notes that the removal of the PAYE Tax Credit for high earners would *"further enhance the progressivity of the income tax system".*

Ireland's competitiveness vis-à-vis other EU countries is now of even greater importance following Brexit. While a number of factors dictate the location of choice for businesses, the tax offering will be given a significant weighting. While Ireland's corporate tax regime has long been successful in attracting FDI, it is important that it is complemented with a competitive personal tax offering. The removal of the PAYE credit would mean that individuals in Ireland earning a salary of €75,000 would pay more tax than individuals in Paris, Stockholm, Madrid and London[9].

In a recent survey by the Irish Times, tax was cited by Irish emigrants as being a factor which would influence their decision to return home, with almost one in five respondents saying it would be an "impediment to returning" to Ireland[10].

Many leading figures in Ireland have made clear in recent weeks that Ireland needs to address its personal tax regime.

[9] See Appendix II for effective tax rate calculations

[10] The Generation Emigration Survey, July 2016

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WHAT OTHERS ARE SAYING ABOUT IRELAND'S PERSONAL TAX REGIME

Irish Independent (7 July 2016) reports that Martin Shanahan says high personal taxes here, including the low level at which the top rate of income tax kicks in, are being raised as a concern by prospective investors.

"It is clearly an issue that comes up, I'm on the record as saying I believe we need to ensure personal tax rates are competitive,"

- Martin Shanahan, Chief Executive, IDA (7 July 2016)

"It (removal of the PAYE Tax Credit) is unlikely to raise much money and will further damage companies' ability to attract and retain highly skilled employees. No action should be taken in Budget 2017".

- IBEC Pre-Budget submission (July 2016)

"The next budget should include bold moves to support investment and job creation. We need to slash capital gains tax, cut the marginal tax rate to attract mobile talent and bring the tax treatment of share options into line with the UK,"

- Danny McCoy, Chief Executive IBEC (4 July 2016)

WHAT OTHERS ARE SAYING ABOUT IRELAND'S PERSONAL TAX REGIME

"Ireland has many strengths aside from our corporation tax rate. But with the UK signalling a lowering of its corporation tax to below 15%, Ireland needs to take a holistic approach ensuring we have the full suite of measures companies look for when considering where to locate, including a competitive personal tax regime and being at the cutting edge of international Research, Development and Innovation."

- Feargal O'Rourke, Managing Partner, PwC (7 July 2016)

"The search for appropriate personnel at higher levels may be a key constraint on companies' growth... in the labour market: it is becoming increasingly difficult to fill vacancies with suitable candidates."

- Kevin Doyle, tax partner at BDO Ireland (7 July 2016)

WHAT THE COMPETITION ARE SAYING

"We want to build the financial capital of the future... ...In a word, now is the time to come to France."

- Manuel Valls , French Prime Minister (6 July 2016)

"We are not in a war with London... but there is competition and we want to make Paris Europe's top financial center,"

- Valerie Pecresse, Head of the wider Paris region (6 July 2016)

THE PAYE TAX CREDIT AND THE USC/NEW SOLIDARITY LEVY

It is unclear how the proposed removal of the PAYE Tax Credit would fit with reforms to the USC regime.

However, commentary on the matter of phasing out of the USC for those over €70,000 seems very much linked with the introduction of a new Solidarity Levy and has not been linked to the removal of the PAYE Tax Credit.

"at the end of a five-year period, it [USC] will be gone. And it will be gone for people over €70,000 as well, but an alternative tax, some kind of Solidarity Levy will be introduced."
– Minister Michael Noonan in an interview with Sean O'Rourke, RTÉ Radio 1, 22 June 2016

Similar quotes were attributed to Minister Noonan in the Irish Independent on 22 June 2016;

Workers with a salary of around €70,000 upwards will be subjected to a "solidarity levy" to ensure low and middle-income earners gain most, he said. Mr Noonan said the actual detail of USC cuts would have to be discussed, but it will be the "main tax target" in next October's Budget.

The Minister's remarks suggest that the elimination of the USC for high earners will be compensated for by the new Solidarity Levy, with the result that the removal of the PAYE Tax Credit could be an additional tax burden on those who constitute "high earners".

IMPLICATIONS FOR THE SELF-EMPLOYED AND THEIR EARNED INCOME CREDIT

There has long been a disparity in the tax treatment of the employed and the self-employed. One of the major differences is that self-employed individuals are not entitled to the PAYE Tax Credit.

In Budget 2016, the Government took steps to address this through the introduction of an 'Earned Income Credit' of €550 for the self-employed. The Programme for a Partnership Government commits to fully aligning the Earned Income Credit and the PAYE Tax Credit.

"We will increase the Earned Income Tax Credit from €550 to €1,650 for the self-employed, to match the PAYE credit, by 2018"

If the Government removes the PAYE Tax Credit for income above €70,000, it remains to be seen whether a similar move would be made in respect of the Earned Income Credit.

LAYERS OF COMPLEXITY BEING ADDED TO AN ALREADY HIGHLY COMPLEX PERSONAL TAX SYSTEM

The abolition or tapering of the PAYE tax credit, the introduction of a Solidarity Levy, the phased abolition of the USC across different salary levels and different rates, combined with the income tax system and a PRSI system creates a very complex personal tax system.

Ireland already has a number of moving parts in its Personal Tax Regime

- Our marginal personal tax rate comprises 3 separate elements – Income Tax, USC and PRSI
- All three systems have different entry points, bands and credits
- There are two income tax rates, five USC rates, one employee PRSI rate and two rates for employer's PRSI

A phasing out of the PAYE Tax Credit would create further layers of complexity.

Appendix I

Marginal tax rates resulting from the tapering out of the PAYE Tax Credit above €70,000

	SALARY OF €75,000	16.5% Taper (between €70,000 - €80,000)	
a.)	Income over €70,000		€5,000
b.)	Income tax due at the marginal rate of 52%	€2,600	
c.)	Reduction in PAYE credit *(for every €1 earned above €70,000, the credit is reduced by €0.165. At income of €75,000, the credit is reduced by €825)*	€825	
d.)	Tax due on additional income (b + c)		€3,425
	Effective Rate on additional Income (d/a)	**68.5%**	

	SALARY OF €75,000	11% Taper (between €70,000 - €85,000)	
a.)	Income over €70,000		€5,000
b.)	Income tax due at the marginal rate of 52%	€2,600	
c.)	*Reduction in PAYE credit (for every €1 earned above €70,000, the credit is reduced by €0.11. At income of €75,000, the credit is reduced by €550)*	€550	
d.)	Tax due on additional income (b + c)		€3,150
	Effective Rate on additional Income (d/a)	**63%**	

Appendix II

Comparison of effective personal tax rates on income of €75,000

EMPLOYEES ON A SALARY OF 75,000			
	Employee Effective Tax Rate	Total Tax / Social Security	
	Employee Effective Tax Rate	Total Tax/Social Security Paid	Difference in Taxes paid compared with Ireland
FRANKFURT	43.97%	32,980	5,673
AMSTERDAM	40.47%	30,351	3,044
DUBLIN*	36.41%	27,307	-
PARIS	35.87%	26,905	-402
STOCKHOLM	35.22%	26,413	-894
MADRID	32.47%	24,351	-2,956
LONDON	29.23%	21,920	-5,387

**Assumes the PAYE Tax Credit has been tapered between €70,000 - €80,000*

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