

Restructuring Taxes, Levies and Social Insurance: What Role for a Universal Social Charge?

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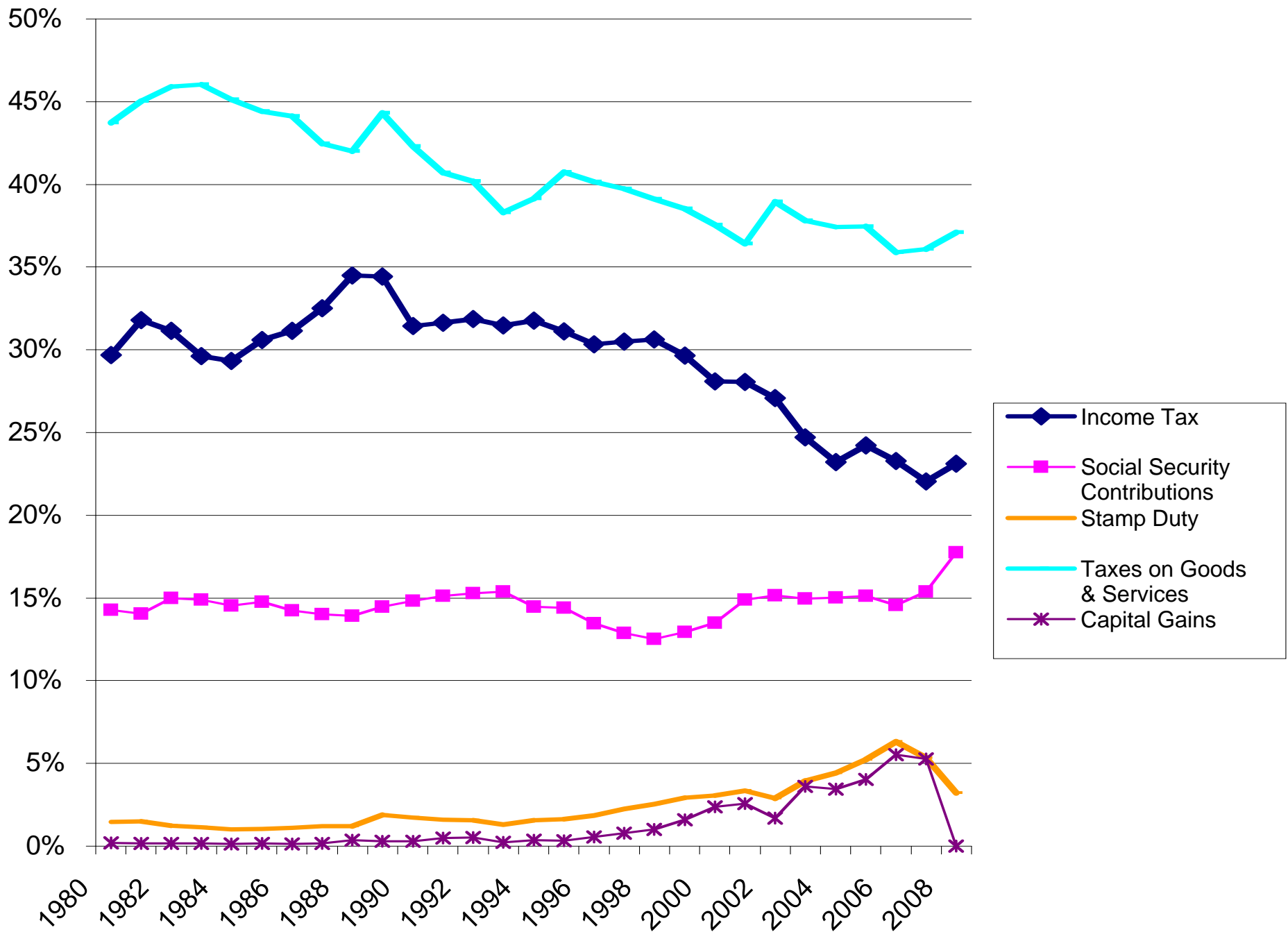


Outline

- Context
- Integrating Tax and Social insurance
- The Current Tax, PRSI Structure
- A “Universal Social Charge” for Ireland?
- Simulating the Distributional Impact
- Conclusions

The Context

- Income tax cut over boom as revenue became dependent on “evanescent taxes” - capital gains, stamp duty, profits
 - Average effective income tax rate down from 21% to 15%
 - Social insurance relatively stable
- Low growth compared to other OECD countries



The Context

- Tax revenue highly concentrated
 - 4% of taxpayers pay almost half total income tax,
 - bottom half of earners pay none (because of allowances and credits)
- Proportion of taxpayers facing high marginal tax rates stubbornly high
 - 45-50% on top rate pre-bust, lower now
 - Effective MTR (incl. levies, PRSI, benefit withdrawal) estimated via SWITCH show 25% face rates of 50% or more; significant numbers of standard rate taxpayers face MTR of 30%+

Integrating Income Tax and SI?

- Widespread moves in OECD before crisis to reduce direct tax rates and broaden base
- Common to treat different income sources differently (capital versus labour) even in “flat tax” systems, SI still levied on labour income
- Income tax and SI contributions generally levied on different bases, with different exemption and rate structures, often different unit of taxation and period of assessment

The Irish Situation Pre-2009

- Income tax on income from all sources, rates of 20% and 41%; allowances and credits mean 40% of earners pay none
- Employee PRSI 4% levied on earnings with exemption limit, ceiling
- Health levy 4% with exemption limit
- Self-employed now paying PRSI

The Income Levy

- Introduced October 2008 Budget, increased April 2009; no allowances or reliefs
- Currently charged on anyone whose earned income is 15,028 pa or more
- At rates of
 - 2% up to 75,036
 - 4% from there to 174,980
 - 6% on amounts above that

A “Universal Social Charge”

- December 2009 Budget stated aim to introduce in 2011 a new system of just 2 charges on income:
 - “A new universal social contribution” to replace employee PRSI, the Health Levy and the Income Levy, paid by everyone at a low rate on a wide base as a collective contribution to public services
 - Subsequently referred to as “universal social charge”
 - Income tax to apply on a progressive basis to those with higher incomes
- Stated rationale is to address “imbalance” in tax burden; simplify system and make it fairer and more broadly based

Some Considerations

- New 'contribution/charge' brings together PRSI, health levy and income levy
- What are implications for accrual of entitlement to social insurance benefits?
- Would need to align rate structure, base, unit and assessment period for 3 elements
- How is new charge to relate to income tax?
 - How high is “higher”?
 - Is social charge offset against income tax?
 - Is base for IT as well as Charge to be broadened?

	PRSI	Health Levy	Income Levy
Exemption	352/500	500	289
Ceiling	No charge above 75,036 pa	Rate higher above 75,036 pa	Rate higher above 75,036 pa
Income base	Weekly earnings/self-employment income	Weekly earnings/self-employment income	Gross employment income; annual adjustment
Population base	Employees, self-employed	Employees, self-employed	In receipt of employment income incl. pensions
Unit	Individual	Individual	Mostly individual

SWITCH Model

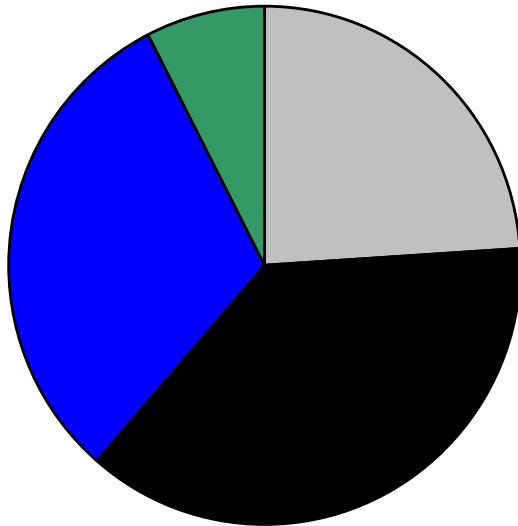
- Simulates income tax and welfare payments
- Nationally representative database of households
- Allows for the examination of the impact of policy changes and possible changes.
- Impact of policy changes on effective marginal tax rates
- Measures the distributional impact of policy changes
- Impact at family (individual tax units) and household level

Policies examined

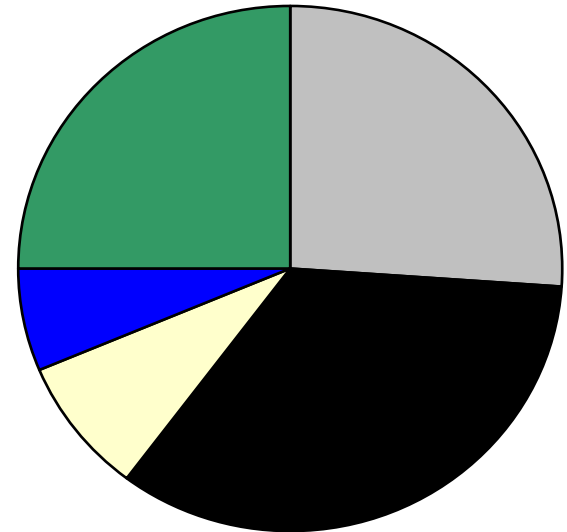
- 2010 actual situation (includes public sector pay cuts, pension levy, income levy & health levy increase)
- 2008 indexed in line with earnings – pre crisis policy
- Policy with a Universal Social Charge (USC)
- USC replaces PRSI, Health Levy & Income Levy
- 7.5 % rate (revenue neutral).
- No exemption limits/allowances

Marginal Effective Tax Rates

2008 Policy, Indexed in Line with a 4% Decline
in Wages

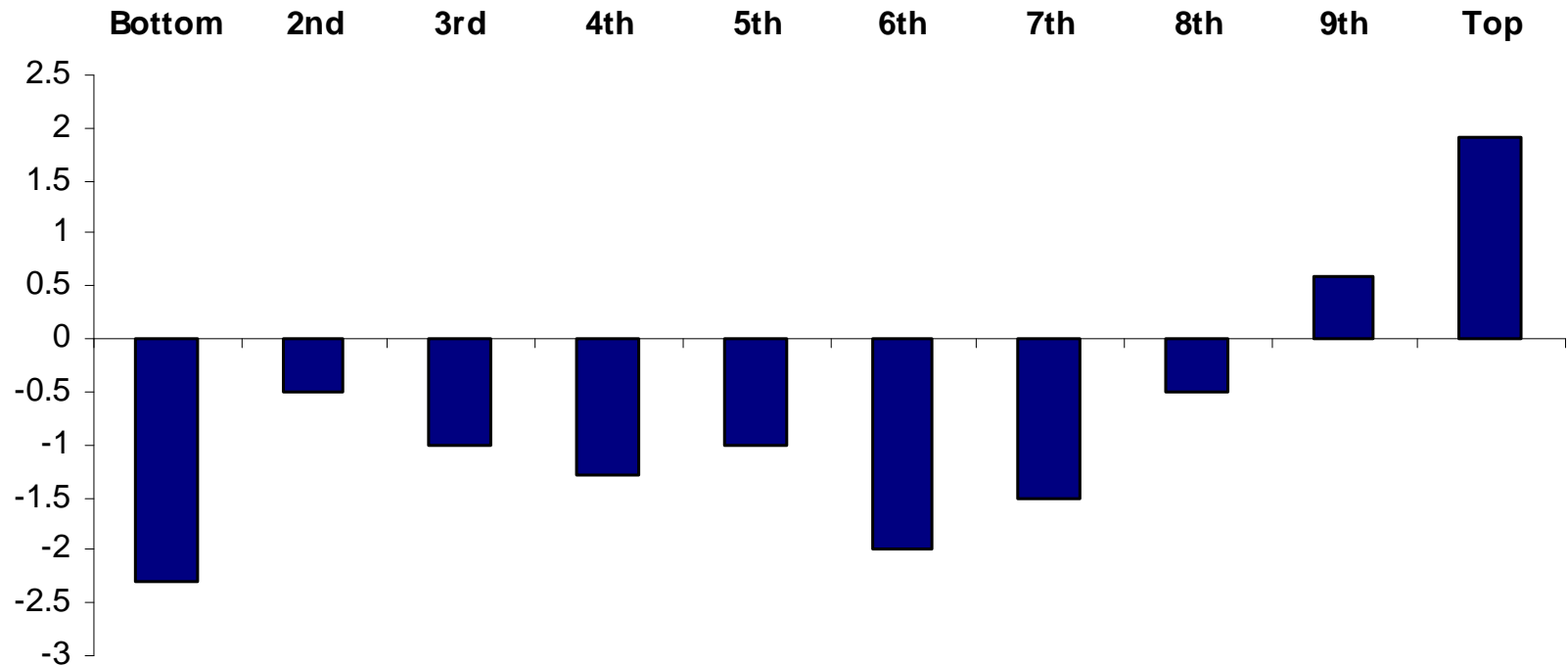


Actual 2010 Policy



- Under 20%
- 20-30%
- 30-40%
- 40-50%
- Over 50%

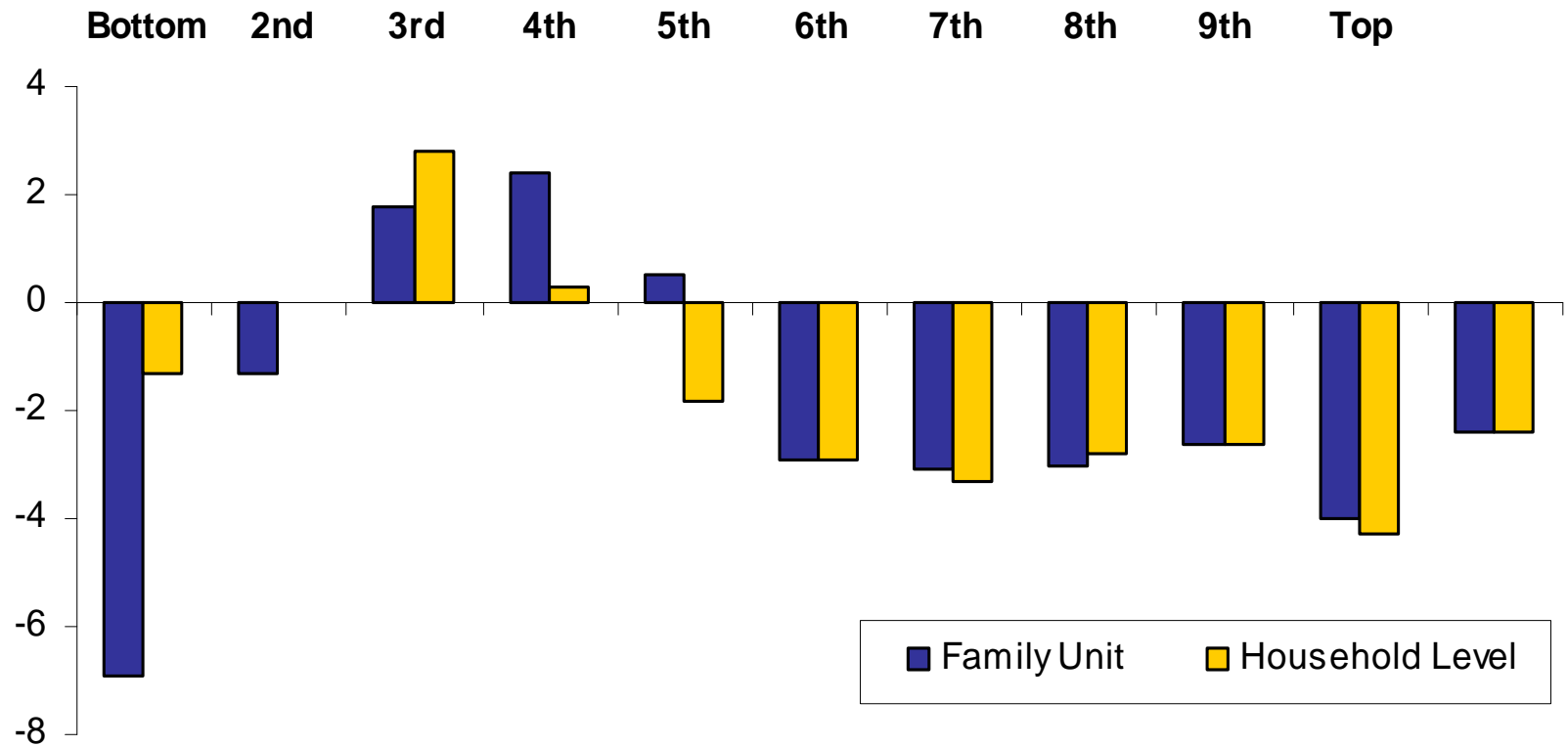
2010 policy v 7.5% USC: Percentage Change in Disposable Income



2010 policy v 7.5% USC

- Top two deciles gain (.6%, 1.9%)
- All other deciles lose, loss largest for the poorest decile (2.3%)
- Why?
 - Income levy – strongly progressive structure (2% up to 75,036
4% up to 174,980, 6% on amounts above that)
 - Income Levy, Health Contribution & EE PRSI all have exemption limits.
 - USC payable on all income, no exemptions.
 - Top effective tax rate up to 52% in 2010
 - Under USC, unless income tax rates change, top rate falls to 48.5%
- Possible to build an allowance in to counteract this effect

'Pre-crisis policy' v 7.5% USC : Percentage Change in Disposable Income



'Pre-crisis policy' v 7.5% USC

- Sharp loss for lowest income families – sharp cut to younger persons on JSA
- But, focussing on HH level we see a different pattern to the previous analysis:
 - ↓ disposable income at the bottom (USC payable on all income) but by a smaller amount
 - Sharp cuts to younger people JSA rates, most living with their parents
 - Gains in deciles 2-4 (pension payments were not cut)
 - More progressive structure above this point

Components of Top Effective Tax Rate

	Pre Crisis Policy	2010 Policy	USC Policy
Top tax rate	41	41	41
Income Levy	-	6	-
Health Levy	2	5	-
USC	-	-	7.5
Effective Tax Rate	43	52	48.5

*PRSI excluded due to income ceiling

Conclusions

- Direct taxes cut in boom has to be reversed
- Income levy introduced as temporary expedient
- Fundamental re-structuring envisaged but USC raises complex issues in aligning levies and PRSI
- Entitlement role of PRSI versus “social contribution”?
- USC regressive if compared to the 2010 actual policy
- Progressive when compared with a ‘pre-crisis’ policy, excluding the bottom decile. USC allowance possible to counteract this
- If USC successfully introduced, reform of income tax still required