THE INSTITUTE OF EDUCATION

Economics

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Taxation

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Taxation is the money people have to pay the government in order to fund state services, social services, public health and education.

Jean Baptiste Colbert , the French Economist described taxation thus

" The art of taxation consists in so plucking the goose to get the most amount of feathers with the least amount of hissing "

Denis Healy , Chancellor of the Exchequer in Britain description of taxation was :

" The difference between tax avoidance and tax evasion is the thickness of a prison wall "

Principles and Canons of taxation

Adam Smith in his book The Wealth of Nations, 1776, set out the four canons of a good taxation system

1. Equity,

The tax levied on each person should relate to the person's ability to pay each according to his or her means.

2 . Certainty

The taxpayer must be clear and know the amount of tax they are due to pay the tax liability of an individual should not be arbitrarily determined.

3 . Convenience,

The manner and timing of the tax payment should have regard to the taxpayer. It is more convenient to have the tax deducted at the source of your Income, weekly or monthly, like P. A. Y.E.

4 . Economy,

The cost of assessment and collection should be cheap compared to the yield the tax brings from the government. Raising revenue is the prime purpose.

The following are further modern Principles / Characteristics of a good taxation system

5. A good tax system should not cause or act as a **disincentive to work** or economic activity.

6. A good system of taxation should not **discourage investment** it should aid the redistribution of income.
7 . A good tax system should help the government **redistribute income** from the rich to the poor. Progressive taxes allowed the government to do this.

8 . Taxes should be flexible capable of being varied upwards and downwards to suit government policy tax structures and the rates at which individual taxes are levied must be flexible to be capable of meeting new circumstances.

9 . Be consistent with national economic objectives. The tax is levied should help the government achieve its other objectives such as discouraging smoking.

10. Have a stabilising Influence on the economy .A good system can prevent the level of economic activity rising as fast as it otherwise could when the economy is booming and prevent the level of a economic activity falling as fast it otherwise could in a recession. Taxation acts as an automatic stabiliser in the economy.

11 . Evasion should be impossible A good tax should be impossible to evade. Otherwise the tax is not fair or convenient

Taxation is an Automatic stabiliser.

- Automatic stabilisers are mechanisms that operate by taking more money from the economy in during boom times, and taking less money out of the economy during times of recession.
- Stops overheating during boom periods.

Consumers who enjoy increase income and purchasing power will have to pay higher tax, which will cap their income so demand is lowered and inflation is controlled.

- Helps recovery during times of recession.

Consumers will experience a reduction in their purchasing power, and lower incomes, will pay tax at a lower rate, which will increase their purchasing power, generate demand, create employment and promote economic growth.

Other stabilisers include

- Government spending.
- Interest rate adjustments
- Exchange Rate adjustments

Direct Tax

- Direct tax is the tax that the Government collects from the taxpayer directly
- It is a tax levied on a business or individuals wealth or income
- It is a payment directly from the taxpayer to the Revenue Commissioners and cannot be avoided
- Examples of direct taxes are Income tax ,D.I.R.T tax Corporations tax and Capital taxes

Advantages of direct taxation.

Equity

- As a direct tax it is progressive., this means that the more you earn the more you pay.

Certainty

- The taxpayer can calculate in advance, the exact amount of direct tax they have to pay.

Convenience

- Direct taxation is deducted at source.

Economy

- The cost of collection and assessment is low, as the employer suffers all administration costs of collection

Government revenue.

- It is very difficult to avoid paying direct taxes, so the government can predict the amount of revenue it is likely to receive each year.

Automatic stabilisers.

- They automatically take more out of the economy during boom periods and less during a recession helping the smooth running of the economy

How to reduce levels of Direct Tax

1. Extend cut off point for marginal tax rate above € 36,500
2. Increase tax credits above € 1,760
3. Lower high rate from 41 %
4. Add a third rate for high income earners above € 100,000

Indirect taxation.

- Indirect taxes are collected by the government through intermediaries such as retailers and manufacturers. Many of the new indirect taxes introduced can be described as **Stealth Taxes** as they are called charges and are paid for the use of services which used to be provided free of charge. Examples include refuse collection, plastic bag taxes and toll charges for new roads.
- They are taxes paid when goods or services are bought.
- It may be possible, to avoid the payment of indirect taxes by changing purchasing patterns.
- Examples are VAT ,Excise Car , Stamp duty.
- Indirect taxation may charged on an **ad valorem rate**, which means as a percentage of the value of the good
- Indirect taxation, may also be charged as a **specific tax,** where the amount is fixed regardless of the value of the good

There has been a shift in focus by the Government away from direct taxation to indirect taxation. The Advantages of this situation are as follows

- Indirect taxes **do not act as a disincentive to work** as they are charged on the good not on a person and are based on expenditure not income.
- **Economic and Convenient** - As retailers and manufacturers collect indirect taxes the cost of collection by the government is minimal.
- **Tax evasion is difficult** as the tax is incorporated into the selling price of the good
- Indirect taxes act as an **automatic stabiliser**, as more are money will be taken in VAT during a boom period.
- Indirect taxation can be used by the government to **discourage the consumption of certain** goods example cigarettes and drink.

- Less unfavorable reaction from the public, **fewer complaints**

The main disadvantages of Indirect taxation is that they are

- Inflationary
- Regressive
- Elasticity dependant

Progressive taxation.

- This tax takes into account the taxpayers ability to pay.
- They take proportionally more in tax as a person Income increases.
- The PAYE system of income tax is a good example of a progressive tax as low income earners pay at the standard rate of 20 %, while those on the higher income pay at 41% .

Regressive tax.

- This system ignores the taxpayers ability to pay as regressive taxes tend to be indirect and are based upon the purchase of goods and services and not income.
- As no distinction is made between rich and poor everyone pays the same. However, a higher proportion of income will be taken from the low earner, rather than the high earner e.g. VAT.
- Example

Income	VAT paid	VAT as % of Y
€ 20,000	€ 2000	10 %
€ 80,000	€ 2000	2.5 %

Proportional tax.

- This is one where the percentage of tax paid by the taxpayer stays constant as the level of income changes e.g €500 tax taken from a person earning €20,000, is 2.5%

  €1000 tax taken from a person earning €40,000 is also 2.5%.

Revenue Buoyancy.

- This is the term used to describe the situation where the actual tax revenue collected is greater than the estimated or expected revenue predicted in the budget by the government.
-

Fiscal drag.

- This is when the government revenue is greater than planned, but the government expenditure remains unchanged.
- When the government is taking more out of the economy, and not putting more a back in. This has a deep deflationary effect and is called Fiscal Drag.

Tax Avoidance.

- These are legal methods of avoiding the payment of tax.
- Examples ;section 23 tax relief ,firms set up BMW region, and An Post savings are DIRT free.

Tax Evasion

- These are illegal methods of avoiding the payment of tax.
- Examples, people not declaring their full Income, those working in the black economy.

  (Remember the thickness of a prison wall !)

Tax Harmonisation

- This refers to the aim of members of the EU to move all tax rates to the same rate , I.e to align them.
- Ireland has used its veto on Fiscal issues, to prevent alignment within the EU on corporation tax.

Tax Wedge

- The difference between the total wage or salary, an employee costs an employer and the after-tax wage an employee takes home.
- Extra costs to an employer exist such as PRSI, insurance, staff facilities and pension contributions
- Gross salary - Net wage

Broaden the tax base

- Increasing the number of people or areas on which tax is levied
- Trying to include more people in the tax net

Stealth Taxes

- Indirect taxes that are applied to products or services that did not exist heretofore
- They can be camouflaged as charges for services and consequently may not be seen as a tax
- Examples include Road toll charges, Bin/ refuse charges, 22 c plastic bag charge ,airport charges, New water charges being introduced are another example

Universal Social Charge

- This is a new direct tax introduced this year on all incomes over € 4000 (€ 77 per week)
- It has replaced the health and income levy and is charged at 2 % / 4 % and 7 % for incomes over € 16,000

Carbon Tax

- This is an indirect tax on fuel added on to the existing excise tax on fossil fuels.
- Petrol and diesel , home heating oil and gas are included as are coal and briquettes

Specific Tax

- This is applied at a fixed rate per physical size of the good being taxed regardless of the price .For example a 10 year old 2 litre car pays the same car tax as a 20 year old car

Black Economy

- This is unrecorded income not included in national income figures and upon which no tax is paid.
- It is also described as the underground economy or the shadow economy.
- While it does include illegal activities such as drugs and imported cigarettes , it also can include legitimate earnings such as cash sales , nixers done outside of normal working hours

Tax increases are subject to The Law of Diminishing Returns

- Direct Taxation

Increases in income tax may lead to a disincentive to work overtime, and an increase in activity in the black economy, both leading to a reduction in tax revenue collected.

Direct taxation can drive workers into unregistered economic activity or welfare

- Indirect Taxation

A VAT increase on the price of goods for a price sensitive elastic goods will have a significant drop in demand, leading to a fall in the revenue collected by the Government.

Imposition and Incidence of Taxation

Imposition of tax. (Formal incidence / Impact)

- Also called the Impact of a tax which means the person or good on which the tax is imposed.
- A tax on bank profits is imposed on the financial institution itself.

Incidence of tax. (Effective incidence)

- This refers to the individual who **actually** pays the tax.
- The tax placed on banks may be passed on to the consumer by increasing bank charges.
- example.

A bar sells Guinness for € 4 a pint. The government puts an imposition of tax on the publican by placing a € 1 tax on Guinness. The imposition of this tax is on the owner of the bar. The publican increases the price of a pint to € 5, therefore the Incidence of the tax is on the consumer as it is the consumer who will actually pay the tax.

- The Price elasticity of demand and supply of a good will determine who bears the burden of taxation.
- Elastic goods are price sensitive so price increase cannot be passed on to the consumer therefore imposition and incidence will be the same ie mainly fall on the producer.
- Inelastic goods however are not price sensitive so tax imposed on the producer can be passed on to the consumer in the form of a higher price . Imposition -producer , Incidence - consumer. (Draw diagrams)

Irelands Income tax burden

Irelands Marginal rate income tax rate is 52 % for employees and 55 % for employers
This is made up of 41 % income tax

4 % PRSI

7 % & 10 % USC

Ireland's Marginal income tax rate kicks in at € 32,800 for a single person and between € 41,800 and € 65,600 for a married couple

This is the 9 th highest of all OECD country's

Other countries Marginal tax rates start at

France	€ 186,749	US	€ 301,163
Germany	€ 259,103	Britain	€ 183,285

Current Tax Revenue figures

	€ billion
Income	20.2
VAT	13.3
Excise	5.6
Corporation	7.7
Stamp Duty	1.3
LPT	0.46
Others	1.5
Total	50.2

Irelands Tax Burden

Ireland's Tax Revenue as % of GDP **35.1%**

Others

Denmark	51.8%
France	47.7%
Belgium	46.6 %
Sweden	43.7 %
EU av.	40.5 %
Germany	39.3 %
U.K	34.2 %

U.S 26.3 %

- **Irelands tax burden** along with Spain and UK are lower than all of the other EU 15 countries. Taxes differ in their impact on economic output and the distribution of income.
- **A tax on house sales** may be effectively borne by the builder in the form of lower profits or by thee buyer in terms of higher prices depending on the sensitivity of demand and supply.
- **Higher income taxes** may result in higher wage demands or a reduced willingness to work . These effects lead to lower output than would otherwise be the case as lower income taxes may encourage increased output.
- **Indirect taxes** such as VAT which raise prices and reduce the real value of wages, also reduce potential output but to a lesser extent than taxes on income.
- By contrast **property taxes** cant be avoided by reducing working hours . They have little effect on labour supply and a much less negative effect on output and employment
- Research has shown that the **shifting of burden of taxation** away from taxes on income to taxes on property and carbon would significantly increase national output and employment.
- **The welfare system** plays a more important role in redistributing income than the tax system.
- **USC** brings in € 4 billion p.a. so outright abolition would be very costly. Because USC is charged on gross income without any allowances it is very effective in raising revenue from those on higher incomes i.e it is more effective than income tax. The major gap in the USC base is that social welfare payments are not subject to USC where as they are to income tax.

Fiscal Policy 2016/2017 Budget

Current Budget

	€billion		€ billion
Tax Revenue	**50.6**	**Central Fund Charges**	**9.5**
Non- Tax Rev.	**2.6**	**Supply Services**	**41.6**
		Current Surplus	**2.02**

Capital Budget

Capital Revenue	**1.2**	**Capital Expenditure**	**5.3**
Capital Deficit	**4.1**		

Exchequer Borrowing Requirement	2.1 € bn
=(Current and Capital deficit)	0.8 % of GDP
National Debt	€ 196 billion (€185 net)
Average interest rate	3.1 %
Debt to GDP ratio	99%
GDP	€ 263 billion

Current Budget Surplus / Deficit

2017	+	2.02
2016	+	1.4
2015	-	3.16
2014	-	5.64

2013	- 11.43
2012	- 10.89
2011	- 11.6
2010	- 13.2
2009	- 12.12
2008	- 12.7
2007	- 1.62
2006	+ 2.26

How the Irish economy has performed in the last 12 months

(Show approx figure, trend and relevant comment)

Employment

265,000 recorded on Live Register / 147,000 on The Q.N.H.S .

Unemployment is currently at 6.4 % of labour force expected to fall even further by year end .Ireland had one of the lowest rates in the EU but now only 2.048 million are in paid employment. Global downturn has affected Ireland more radically than others due to the fact we are more of an open economy, over-reliant on construction where property was overpriced, also reliant on multinationals who are facing high costs mainly labour rent and utilities. Emigration has camouflaged these figures putting them in a more favourable light

Comparable figures EU average 8% , U.S 7 %. UK 8 %. Spain 30 %

Inflation

Prices in Ireland have fallen, with deflation occurring in 2009 and 2010 but reappeared in 2011 and 2012 and 2013 at approx 1-2 % pa. Prices are generally flat this year with little or no inflation . Current fig for Ireland is 0.6 % (April 2017) EU average is 1.9 %

Severe austerity measures which included reduced public service take home pay and increased taxes ,higher mortgage costs through increased rates , electricity, together with

the global downturn and banking crisis had reduced demand so any increased prices have come about through increased costs and not increasing demand. The ECB if anything is concerned that inflation is running too low in member countries as a certain level of inflation is necessary for demand stimulus hence the introduction of Quantitative Easing

Economic Growth

The economy has contracted by almost 20 % from 2008 - 2012 as GNP figures remained negative while GDP figures have shown a small recovery in 2011 - 2014.
The Irish economy had grown by 50 % in the 10 years prior to 2008.
GDP is expected to rise by 3-4 % this year mainly due to the strong performance of FDI's.
Growth rate for 2016 was 5.2 %
GNP is also expected to grow similarly due to reduced costs and the re-emergence of dairy product demand. Agricultural exports are continually rising by over 20 % per year with this year suggesting an even bigger improvement as the falling Euro is making exports cheaper , milk quota is abandoned and the embargo on Irish beef is lifted form the US and many other country's.

Government Finances / National Debt

Government finances are improving as tax revenue had collapsed by 20 % since 2007 . Tax revenue from Budget 2017 has predicted an increase to almost € 47 billion it now seems likely revenue buoyancy will increase this figure to close on € 50 billion .Were it not for the new Universal Social Charge and Carbon taxes the revenue collected would be considerably worse. Our total national debt is currently € 200 billion with debt charges of € 6.8 b. p.a. As we have exited the bailout agreement Ireland is currently funding itself from the markets and is not reliant on external funding arrangements . Nevertheless our General Government Debt is € 200 billion which is just under 100 % of GDP (Stability Pact agreement to be less than 60 %)

Interest Rates

Since the beginning of 2008 the U.S. Federal Reserve has reduced its rates to almost zero.
The ECB has followed suit recently with rates of zero percent.
This softening of interest rates increases economic activity as consumers and investors are encouraged to borrow and are discouraged to save. As result aggregate demand in the economy increases as the economy expands. This lightening of monetary policy

combined with " Quantitative Easing " was designed to kick start the economies of Europe and protect the fragile banking system which had been on the brink of collapse.