TASC

INVESTING IN *RECOVERY, JOBS, EQUALITY*

TASC's Proposals for Budget 2011

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1. TASC's Budget Proposals

Economic Context

1.1 Europe's recovery from the recent financial crisis has been very weak. The IMF's most recent World Economic Outlook (2010)[1] forecasts a reasonably healthy growth rate for the global economy of 4.2 per cent in 2010; however, economic growth in the Euro Area is forecast to be much slower than this at 1.5 per cent.

1.2 The IMF forecasts a contraction of 0.5 per cent (i.e. -0.5) for Ireland in 2010[2], as does the OECD's latest economic outlook[3]. Both organisations forecast economic growth to return in 2011. Ireland's economic output contracted by about 20 per cent over 2008-2010. The decline has primarily been in domestic consumption and investment, which have both fallen sharply. More positively, exports have declined less in Ireland during the global downturn than have exports elsewhere[4].

1.3 Unemployment in Ireland has increased from 4.5 per cent in 2007 to a current rate of over 13.6 per cent[5], or 293,600 people. CSO data show that the total number in employment has now fallen below 2005 levels[6]. The rise in unemployment is primarily accounted for by the collapse in the construction industry, and it is becoming increasingly apparent that there are now major structural problems in the labour force. Net outward migration is estimated to be 70,000 in 2010 and 50,000 in 2011[7].

1.4 The general Government deficit in 2010 will be around 32 per cent of GDP, with the capital support for the banking system accounting for almost two thirds of this figure[8]. Excluding the banking costs, Ireland's annual deficit will be around 12 per cent this year and the IMF estimates that the structural deficit[9] will be 7 per cent. Ireland's gross debt is forecast by the ESRI to reach over 93 per cent of GDP in 2011[10] and the equivalent figure for Ireland's net debt is forecast to be over 63 per cent of GDP[11]. The cost of state borrowing had reached 6.78 per cent by the end of September 2010. Ireland's debt interest payments will increase from €4.4 billion in 2010 to €5.7 billion in 2011

[1]IMF (April, 2010).
[2]IMF (June 15, 2010).
[3]OECD (May, 2010).
[4]IMF (June 18, 2010).
[5]CSO (September 21, 2010).
[6]CSO (June 15, 2010).
[7]ESRI (June, 2010).
[8]Department of Finance (September, 2010)
[9]The structural deficit is the residual deficit that persists even when the economy is operating at its long-term potential level.
[10]ESRI (June, 2010).
[11] Government net debt comprises all financial liabilities minus all financial assets of general government.

and by 2015 the interest bill can be expected to reach over €12 billion, based on the Government's projections for growth.

1.5 The deterioration in the public finances is primarily attributable to the collapse in tax revenues and rise in public spending associated with the increase in the unemployment rate. However, it has been exacerbated by two other factors. The first of these factors is the pro-cyclical budgetary policies that were adopted during the boom that left the Exchequer overly reliant on unsustainable transaction-based tax revenue (e.g. stamp duty). The result is a gap between revenue and expenditure of nearly €19 billion[12]. The second factor is the ongoing banking crisis, which has generated immense costs for the Exchequer. The Central Bank[13] has announced that the total cost of the bank bailout to the Irish taxpayer will be just under €50 billion.

1.6 There is a fundamental structural problem with the balance of how we tax and spend, which needs to be addressed: the issue of chronic under-taxation by average European standards.

1.7 In addition to this, the precipitous fall in property prices has left an overhang of private debt that has contributed to the constricted spending in the economy and compounded the slow pace of economic recovery. Three consecutive austerity budgets have simply served to deflate the economy further. Ireland is now suffering from the 'paradox of thrift'. As individuals, businesses, banks and Government all try to save, demand has plummeted further and the economy has stagnated. A fourth austerity budget in December risks extending the duration of the economic crisis by further dampening consumer demand.

A Framework for Recovery

1.8 TASC is proposing a set of evidence-based and costed measures for Budget 2011. These measures demonstrate that it is possible to reconcile solving the fiscal crisis with addressing the jobs crisis, while also balancing these aims with the concern to increase economic equality in Ireland. While there are still difficult times ahead, the goals of recovery, jobs and equality are not in conflict. In fact, these goals can be complementary parts of a recovery strategy for Ireland based on targeted investment and gradual tax increases.

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[12] The Stability programme update (December, 2009) has forecast that total receipts would be €52.9 billion in 2010 with total expenditure forecast to be €71.6 billion.

[13] Central Bank of Ireland (September, 2010).

1.9 TASC's budget proposals cover four inter-related areas and provide a strategy for to recovery based on:

- Restoring economic growth and returning people to employment through the creation of an Economic Recovery Fund.
- Identifying new sources of revenue to allow Ireland to meet its stated commitment to the European Commission on fiscal consolidation measures in budget 2011.
- Outlining a multi-annual strategy for returning the public finances to a sustainable long-term path that protects frontline services and levels of social transfers, thus promoting income equality.
- Identifying specific reforms of the budgetary process to promote transparency and improve the level of public analysis about the optimum budgetary strategy for Ireland.

The Economic Recovery Fund

1.10 In the short term, the goal must be to end the deflationary cycle and stop things getting worse. Restoring growth to the economy and increasing the numbers employed will require getting people to spend again. It will also require addressing the liquidity crisis by restoring credit lines to struggling businesses. In the longer term there is a need to put in place the necessary infrastructure (both physical and human capital) to address the structural imbalance in the labour force and to enable Ireland to transform its productive base and compete in an increasingly globalised economy. In particular, a massive programme for retraining and up-skilling the displaced workers from the construction sector will be required.

1.11 To meet these challenges TASC proposes the creation of a €3 billion Economic Recovery Fund which would be financed through the National Pension Reserve Fund (NPRF). The size of the Economic Recovery Fund would represent 1.8 per cent of GDP.

1.12 Given the scale of the economic crisis, it is unlikely that an investment of €3 billion will be sufficient to reverse the decline over the last number of years and, if necessary, further cash injections from the NPRF should be made available to the Economic Recovery Fund in future years, subject to cost-benefit analysis and the commitment to reinvest in the fund when the economic conditions allow. TASC has identified key areas for investment where the initial €3 billion should be used. There are many areas where investment is needed; however TASC has prioritised areas on the basis of their capacity to have an immediate impact on the economy and to be absorbed quickly into the system. More detailed costs are given in Section 2. Where possible, the Economic Recovery Fund should be used to provide additional resources for existing programmes rather than for the creation of new programmes or institutions.

- The first priority of the Economic Recovery Fund is to prevent the further loss of jobs and failure of businesses. This would be done by returning liquidity (credit) to the economy via the setting up of a loan guarantee scheme, accessible by small and medium enterprises (SMEs). A particular focus would be on supporting those SMEs that are experiencing temporary liquidity problems as a result of the weakness in the economy and that would, under normal conditions, be considered to have viable business models.
- The second aim of the Economic Recovery Fund is to encourage the starting-up of new enterprises and expansion of existing enterprises. This would be done through the provision of direct venture capital and/or seed capital for SMEs and high-potential start-ups. Enterprise Ireland is already investing half a billion in Irish firms by 2012, with most of that going to high-tech firms. However, TASC proposes that all viable firms, regardless of sector, should be considered for funding.
- The third requirement is to address the structural problems in the labour force that have arisen following the collapse of the economy; for example in the construction sector and related areas. This would be done by providing increased resources for the retraining and up-skilling of the labour force. Such an investment is essential if we wish to prevent segments of the labour force becoming long-term unemployed in the future. Life-long learning, the increased importance of human capital, and the diffusion and exploitation of knowledge are likely to be hallmarks of the 21st century economy. Ireland should be investing in the development of learning and innovation infrastructure, irrespective of the weakness or strength of the economy, because economic growth in the 21st century is likely to be built on the exploitation of new knowledge and technology.
- The fourth and fifth aims of the Economic Recovery Fund are to support short-time job creation and the development of strategic physical infrastructure that will enable Ireland to compete for jobs in the globalised economy of the 21st

century. One way to address both these goals would be through the construction of a world class fibre broadband network. A world class broadband network will improve the Irish economy's capacity to identify and exploit new ideas; to compete in the global market; and to generate indigenous technologies and enterprises.

- The sixth aim of the Economic Recovery Fund is to support research and development in the alternative energy sector, which has been identified as an area where Ireland could have a comparative advantage.

Fiscal Consolidation[14] with Equality

1.13 Ireland is currently committed to achieving Stability & Growth Pact[15] compliance by 2014 via €3 billion in adjustments in 2011, and a further €4.5 billion in subsequent years. However, more recent Government statements have suggested that a higher level of adjustment may be sought in 2011, between €4 billion and €5 billion, although the precise amount has not yet been officially confirmed.

1.14 The deficit (excluding banking costs) currently stands at almost €19 billion. TASC contends that fiscal consolidation measures should be taken in such a way as to minimise the impact on frontline services and to minimise hardship for low income households. There are a number of core principles that inform TASC's budgetary recommendations:

1) All income regardless of source should be treated in the same manner for the purpose of taxation.
2) All consolidation measures should seek to promote aggregate demand[16] or at least minimise damage to economic growth.
3) All budgetary measures should be progressive, in the sense that those who can better afford to pay should pay more.

1.15 TASC's specific budgetary proposals are made based upon the anticipated impact of the measures on the labour market and on demand, and consideration was also given to the redistributive impact of the measures in question. There is an argument, albeit contested, that economic growth is less likely to be adversely affected by spending cuts

[14] Fiscal consolidation is a policy aimed at reducing government deficits and debt accumulation.
[15] The Stability & Growth Pact obliges Euro zone countries to keep their budget deficit below 3 per cent and their gross debt to GDP ratio below 60 per cent. At the current level of GDP, this would mean a maximum allowable deficit of €5 billion.
[16] Aggregate demand is the total demand for a country's output, including demands for consumption, investment, government purchases, and net exports.

than by tax increases. However, even if accepted, this argument presumes that Irish taxation levels are those of an average advanced economy, whereas in Ireland the overall tax take is well below European levels.

1.16 TASC's proposals include:[17]

A) The **introduction of a recurrent tax on residential property set at 0.28 per cent**. It is estimated that this rate would generate in the order of €850 million (net) for the Exchequer. The introduction of such a charge should be accompanied by a zero-rating of stamp duty on residential property, and would replace the €200 levy on rented properties, second homes and holiday homes.

B) **Changes to the system of tax expenditures**. TASC's proposals are estimated to yield in the order of €1.4 billion for the Exchequer, with the bulk of these proposed changes in the areas of pensions and in property-based reliefs.

C) Further progressive measures proposed by TASC include the abolition of inequities in the PRSI system, specifically the **removal of the €75,000 ceiling on employee's PRSI and the removal of the exemption from PRSI on share-based remuneration and capital gains.**

D) TASC proposes **increases in Capital Gains Tax and Capital Acquisitions Tax to 28 per cent** and the **application of the 4 per cent health levy to rental and dividend income.**

E) TASC also calls for a series of **savings in current expenditure**, e.g. increased charges for private facilities in public hospitals.

1.17 The overall effect of TASC's budget proposals when combined with the impact of the Economic Recovery Fund is designed to be growth-friendly,[18] while simultaneously narrowing the gap in the public finances. While recognising the advantage of targeted public expenditure during a recession to boost economic growth, it is essential that the state reinvests in the reserve fund once the economy has returned to a position of sustainable growth.

[17] A full list of proposals is given in the Executive Summary.

[18] This was extrapolated based on ESRI estimates of the different impacts of various tax increases and public expenditure cuts.

Table 1.1: TASC's Proposed Adjustments for Budget 2011 (Fiscal Consolidation with Equality)[19]

Proposal	Yield (€ millions)	Cost (€ millions)
Tax Measures		
Tax Expenditures:	**1,463**	
Standard Rate all pension tax reliefs	750[20]	
Abolish legacy property reliefs on non-residential property	435	
Abolish capital gains tax and stamp duty relief for disposal of a site to a child	38	
Abolish payment of tax by means of donation of heritage items	5	
Abolish payment of tax by means of donation of heritage property to the Irish heritage trust	4	
Abolish income tax relief for expenditure on heritage buildings and gardens	6	
Abolish tax exemption for patent royalties	84	
Limit the business relief for CAT by reducing the level of discount on market value before tax is calculated from 90% to 75% and by introducing a €3 million ceiling on the qualifying amount	30	
Limit the agricultural relief for CAT by reducing the level of discount on market value before tax is calculated from 90% to 75% and by introducing a €3 million ceiling on the qualifying amount	100	
Abolish PRSI exemption for share options	18	
Abolish the income tax exemption for share-option schemes	3	
Introduce a ceiling of €75,000 on the artist's exemption	20[21]	

[19] Unless otherwise indicated, all costings of tax measures shown are derived from the Commission on Taxation Report 2009 or from written answers to parliamentary questions.
[20] This is a conservative estimate. The ESRI (2009) *Pension Policy: New Evidence on Key Issues* estimated that a saving of €1 billion could be made by standard rating pension tax reliefs. TASC has reduced this estimate to reflect the reduction in the numbers employed and in wages over the last two years. People who are unemployed or on reduced wages are less likely to be paying into a private pension and benefiting from pension tax reliefs.
[21] Complete abolition of the artist's exemption is estimated to yield €66 million; as such €20 million is likely to be a conservative estimate of the yield.

Proposal	Yield (€ millions)	Cost (€ millions)
Property Tax:	839	
Introduce a 0.28% tax on residential property (assumes 25% deferral rate)	1,039	
Zero rating of residential stamp duty on residential property and abolition of the €200 levy on rented properties; second homes and holiday homes		200[22]
Social Security:	**199**	
Abolish the €75,000 ceiling on employee's PRSI	120	
Charge PRSI on share-based remuneration & Capital Gains	79	
Other tax measures:	**197**	
Increase Capital Gains Tax to 28%	48	
Increase Capital Acquisitions Tax to 28% and reduce all thresholds by 25%	60	
Apply the 4% health levy to rental and dividend income	89	
Expenditure Measures		
Savings:	**300 est.**	
Reduce all consultancy fees by 50%		
Reduce professional fees under GMS (General Medical Services)		
Make prescription of generic drugs mandatory where possible		
Make ex ante cost benefit analyses compulsory for major expenditure programmes		
Where feasible introduce centralised procurement by all State bodies		
Make competitive tendering mandatory for all major procurements		
Reduce support for fee paying schools		
Increase charges for private facilities in public hospitals		
Impose restrictions on travel and subsistence expenses		
Total	**2,998**	

[22] Based on figures from obtained from Revenue and from the Department of the Environment.

1.18 These measures are not exhaustive. Nonetheless, they represent a series of identifiable and costed measures which clearly illustrate that fiscal consolidation can be achieved in a progressive and equality-centred manner. Taken together, they support economic recovery by minimising the impact on aggregate demand.

1.19 A progressive Budget is possible that combines economic growth with job growth, while protecting the most vulnerable.

A Multi-Annual Plan for Consolidation and Recovery is Required

1.20 Fiscal consolidation is painful, but medium-term consolidation will nonetheless be a key element in generating economic recovery. To regain fiscal credibility, a multi-annual plan is needed that sets out specifically how the deficit-reduction targets will be achieved and by what year they will be achieved. TASC argues that this strategy must include:

1) An annual, full cost-benefit analysis, from an efficiency and equality perspective, of all major existing and proposed public spending and taxation measures (including all tax expenditures).

2) A comprehensive analysis to identify the most appropriate timescale for achieving Stability & Growth Pact compliance.

1.21 TASC argues that a fiscal consolidation strategy centred on public expenditure cuts will exacerbate economic inequality considerably more than a strategy based on broadening the tax base[23]. There are a number of progressive measures, beyond those identified in Table 1.1., that TASC argues can and should be implemented as part of a medium-term process of fiscal consolidation.

1.22 TASC proposes the following recommendations for inclusion in a multi-annual strategy of fiscal consolidation:

1) All regressive tax expenditures should be abolished or standard-rated unless a clear case of market failure can be established and it can be shown that the tax expenditure would be more efficient than direct expenditure. For example, TASC argues for the standard-rating of all tax expenditures related to pensions,[24] and the use of these funds to provide an increased universal State pension over a five-year period.

[23] See Section 3.4 for a full discussion.
[24] See TASC (2010) *Making Pensions Work for People* for a more detailed discussion of TASC's pension policy.

2) The levying of a recurrent property tax should be regarded as the first part of an all-encompassing asset tax which ought to be introduced in the medium term. TASC contends that the introduction of an asset tax would provide a stable source of funding for the Exchequer and would lead to a more equitable distribution of society's resources.

3) TASC argues that changes to the social security system are required. Currently, social security contributions are the second lowest in the European Union and less than half the European average. This low level is unsustainable. There are also a number of anomalies in the PRSI system that needs to be addressed. An example is the step effect in the PRSI system that currently creates perverse situations where small pay increases can result in less take home pay.

4) TASC supports the introduction of a Financial Transactions Tax (Tobin tax) at a European level and would urge the Government to lobby for the introduction of such a tax at a European level. The revenue raised from this tax could be used to create a contingency fund to pay for future financial crises and to start the process of the banks paying back taxpayers for the bailout of the banking system.

5) TASC recognises the challenges of climate change and argues for a medium-term strategy which includes an increase in the carbon tax. The carbon tax should be set at a level that would fully internalise the negative externalities[25] associated with carbon-based pollution.

6) TASC argues for a gradual move toward average levels of taxation for a Western European country so as to enable the provision of European-standard public services, including health and education.

7) An efficiency and equality audit should be undertaken of all public expenditure programmes to eliminate wastage and regressive effects, wherever they exist.

8) To counteract the deflationary impacts of the last three austerity budgets, in a way that is consistent with economic recovery with equality, while closing the gap in the public finances through further consolidation measures in the 2012 and subsequent budgets, further injections of financing from the NPRF may be required in future years.

[25] An externality is a cost or benefit, not transmitted through prices, incurred by a party who did not agree to the action causing the cost or benefit. A benefit in this case is called a positive externality, while a cost is called a negative externality (e.g. pollution).

Reforming the Budgetary Process through Improved Transparency

1.23 TASC is making a number of recommendations in relation to the transparency of Budget documentation and the need for unambiguous statements in relation to the impact of Budget decisions on equality (these recommendations are further elaborated in greater detail in later sections).

1.24 An annual Equality Statement should be published as part of the Budget to show distribution of income and wealth, and to show the distributional impact of all Budget measures. Good practice in Norway and Scotland should be examined in this regard.

1.25 The requirement of a cost-benefit analysis of all new items of tax expenditure (Section 1 in 2010) should be a permanent feature of all future Finance Acts. The Government should publish the recent Departmental reports on tax expenditure and the Department of Finance's analysis of these.

1.26 The Government should introduce an annual report on all tax expenditure as part of the Budget documentation, including *inter alia* their rationale, costs, predicted benefits, likely beneficiaries and indicators used to measure their success/failure. The Australian Tax Expenditures Statement should be looked at as one example of good practice in reporting tax expenditure. This annual report should be scrutinised by the Oireachtas as part of the Budget process.

1.27 A thorough review of the tax system is necessary, to expand the work of the recent Commission on Taxation. This should be conducted by a Commission representing different stakeholders, to detail the baseline or benchmark tax system in Ireland, against which tax reliefs, credits, etc. can be identified as tax expenditure, including concessions to narrow interests and measures that contain elements of tax expenditure alongside other characteristics.

1.28 The Government and Department of Finance should adopt a more comprehensive definition of tax expenditure, supplementing the basic OECD definition and including all concessions to relatively narrow sectors of the economy within the definition. This definition should also reflect the need to ensure that the benchmark tax system is neutral with respect to different taxpayers.

1.29 The Government should set strict parameters to control the overall cost of tax expenditure. For example, this could be a limit on the proportional size of tax expenditure as a percentage of total tax revenue. Ireland should aim for the total cost of tax expenditure (as revenue forgone) to be more closely aligned to European norms.

1.30 The Government should ensure that all new and existing tax expenditure is subject to economic efficiency auditing, to proof proposals against the many risks identified by domestic and international studies, and to compare proposals with a range of alternative options, including direct expenditure.

1.31 The Government should ensure that all new and existing tax expenditure is subject to equality auditing, to minimise inequitable and regressive effects, and to remove tax expenditure that benefits narrow populations of taxpayers without creating a corresponding social or economic benefit for the general public.

1.32 The Government and the Department of Finance should provide Budget documentation and supporting material in easily accessible formats, appropriate to the needs of different sectors, including civil society organisations, business and the general public.

1.33 The Government and the Department of Finance should make all data relating to the Budget available in raw form (e.g. spreadsheets) so that analysis can be conducted by analysts in civil society organisations and business. In this context, good practice in the UK (www.data.gov.uk) and USA (www.data.gov) should be examined.

1.34 The Government and Department of Finance should compile a single database of all state assets and liabilities, and make it publicly available.

1.35 Parliamentary questions should be permitted during the summer recess for topics related to the preparation of budget proposals, as this will allow for an improved level of debate and analysis using the most up to date figures available.

2. Restoring Jobs and Growth: The Economic Recovery Fund

2.1 The first element of TASC's budget proposals is the creation of a €3 billion Economic Recovery Fund which would be financed from the disposal of part of the National Pension Reserve Fund's unencumbered investments.

2.2 The size of the Fund is equivalent to 1.8 per cent of GDP.

2.3 Given the scale of the economic crisis, it is unlikely that an investment of €3 billion will be sufficient to reverse the decline over the last number of years and, if necessary, further cash injections from the NPRF should be made available to the Economic Recovery Fund in future years subject to cost-benefit analysis and the commitment to reinvest in the fund when the economy reaches sustained growth.

2.4 TASC has identified four key areas for investment where the initial €3 billion available to the Economic Recovery Fund should be used. There are many areas where investment is needed; however TASC has prioritised four areas on the basis of their capacity to have an immediate impact on the economy and to be absorbed quickly into the system. Consistent with the objective of achieving immediate impact, where possible, the Economic Recovery Fund should be used to provide additional resources for existing programmes rather than for the creation of new programmes or institutions. However, in some areas, such as education and training, it will not be possible to absorb the totality of proposed investment in a 12 month period and, in such instances, spending should be spread over two to three years.

2.5 While the primary focus of the Economic Recovery Fund is to stop the economic decline, it should also be used to lay the foundations needed to transform the productive base of the real economy over a longer timeframe. Ireland needs to invest in the restructuring of our economy to ensure the capacity exists to build export-driven indigenous companies that are equipped to survive and grow in a globalised economy.

Table 2.1: TASC's Economic Recovery Fund

	€ million
1. Maintaining & Creating Jobs	
Loan Guarantee Scheme	500
Extension of PRSI exemption	36
'Short-time' working scheme	300
Venture capital/seed capital	250
Sub-total	**1,086**
2. Education and Training	
Expand places – education and training	600
BTEA + Grant (reversal)	50
Investment in Further and Third Level	214
Sub-total	**864**
3. Infrastructure Upgrades	
Fibre broadband upgrade	500
Changes to National Broadband scheme	100
Additional funding for school building programme	250
Sub-total	**850**
4. Research and Development	
Funding to support R&D in the alternative energy sector	200
Sub-total	**200**
TOTAL	**3,000**

2.6 **Firstly, the Economic Recovery Fund should be used to protect existing jobs and prevent the further loss of jobs and failure of businesses.** This involves a number of inter-related measures:

2.6.1 Returning liquidity (credit) to the economy via the setting up of a Loan Guarantee Scheme, operated through existing lending institutions, and accessible to indigenous small and medium enterprises. Particular focus would go towards supporting those SMEs that would, under normal conditions, be considered to have a viable business model and are currently experiencing temporary liquidity problems as a result of the weakness in the economy. TASC is proposing that €500 million should be used for this purpose.

2.6.2 Extending for one year the twelve-month PRSI exemption for employing those who have been out of work for more than six months. Based on last year's costs, TASC has allocated €36 million to this.

2.6.3 Introducing a 'short-time' working scheme aimed at maintaining full-time employment and improving skills. Measures in other European countries, such as the shorter work-time policy in Germany (called *Kurzarbeit*), provide a successful model that should be investigated further. The OECD estimates that over 200,000 jobs may have been saved during the 2008-2009 period as a result of *Kurzarbeit*. An Irish 'short-time' work programme would involve the state providing financial support to companies for a limited term to retain their employees in temporary periods of low demand for their products or services. TASC's proposal is for €300 million to be used to fund this scheme.

2.7 **Secondly, the Economic Recovery Fund should be used to encourage the start-up of new enterprises and the expansion of existing enterprises**. This can be achieved through the provision of direct venture capital and/or seed capital for existing small and medium enterprises (SMEs) and high-potential start-ups. TASC proposes that all viable firms, even if not in the high-tech sectors, should be considered for funding through the Economic Recovery Fund. This would involve an additional €250 million on top of the €500 million Enterprise Ireland is already investing in Irish firms by 2012, with most of that going to high-tech firms. This added investment is essential if we are to build a more diverse economy in the medium term, where we produce a wider variety of goods and services and add value to products in new and different ways. The Economic Recovery Fund should include a focus on sectors where Ireland has a comparative advantage or niche marketing opportunities. Examples include renewable energy, agri-food, creative industries and tourism sectors.

2.8 **Thirdly, the Economic Recovery Fund should be used to address the structural problems in the labour force that have arisen following the economic crisis and in particular the collapse of the construction sector**[26]. This would be done by providing increased resources for the **retraining and up-skilling of the labour force**. Such an investment is essential if we wish to prevent segments of the labour force becoming long-term unemployed in the

[26] The education and training measures specific in the TASC proposals have been chosen to address the structural issues in the labour force in the short term; however, in the medium to long term, further investment in education at pre-school and primary level is essential, if necessary improvements in the education level of the entire population are to be achieved.

future. Life-long learning, the increased importance of human capital and the diffusion and use of knowledge are likely to be hallmarks of the 21st century economy. Ireland should be prioritising investment in human capital, irrespective of the weakness or strength of the economy, as future economic growth can be expected to increasingly derive from specialised knowledge. It is estimated that, for every year the average level of education of the adult population is raised, there is a corresponding increase of 3.7 per cent in long-term economic growth.[27] Innovation policy must be geared towards delivering world class learning infrastructure and an 'innovation system' that significantly increases the level of skill and education in the labour force, in order to expand Ireland's capacity to create 'added value' across a range of economic sectors.

2.8.1 According to a recent update on the National Skills Strategy, 21 per cent of the labour force has less than Junior Cert qualification (National Framework of Qualifications (NFQ) Levels 1-3).[28] Adult and community education providers are currently struggling to respond to two very different needs – those who left the system early and who are returning to education as adults, and those who want to upskill and retrain as a consequence of unemployment. Demand for further education has risen across all aspects of the education system. In the last budget (2010), €136 million was allocated to provide 26,000 up-skilling and training places. TASC is proposing an additional allocation of €600 million, in order to provide a further 100,000 upskilling and training places[29]. Investment should also be used to increase the number of education and training places across the education and training system (NFQ Levels 6-8), including VECs, Institutes of Technology and Universities.

2.8.2 The Back to Education Allowance is a key tool in supporting adult learners back into education and training. In particular, it acts as an incentive for those at Levels 1-3 (Junior Certificate and below) to progress to Levels 4 and 5 (Leaving Certificate Level). In the last budget (2010), a decision was taken to prevent those on the Back to Education Allowance from applying for the Third Level Maintenance Grant, with an estimated saving of €35 million per annum. This means that the people at Level 5 are effectively 'stuck' at that level, unless they can financially afford to pursue their education at Third Level. The number of adults applying for places at

[27] Belem Framework for Action, Confintea VI, UNESCO, December 2009.
[28] Review of the National Skills Strategy, Department of Education and Skills, April 2010.
[29] The estimate includes the cost of hiring additional staff, facilities, equipment, student supports etc....

Third Level (Levels 6-8), through the CAO, has increased by 40 per cent (2009 – 2010). TASC is proposing that the decision in the last budget to prevent Back to Education claimants from applying for the Third Level Maintenance Grant is reversed through allocating €50 million to this measure.

2.9 Implement the recommendations relating to the provision of education and skills in the Comhar Report (2010) on *Skills and Training for a Green New Deal* and the Forfás Report (2010) on *Growing Enterprise for Ireland.* Many of these recommendations relate to the expansion/re-orientation of existing courses, development of new courses and key competencies needed to re-build and transform the productive base of the economy in the short and medium term. TASC is proposing that the budget for further and Third Level education is increased by 10 per cent (€200 million), to start this process. In future years, additional investment will be required at primary and secondary level to re-develop teaching curriculums in science and maths, and to put in place the necessary infrastructure and facilities required.[30]

2.10 **The fourth and fifth areas for investment through the Economic Recovery Fund focus on short-term job creation and the development of strategic physical infrastructure** that will enable Ireland to compete for jobs in the globalised economy of the 21st century. One way to address both these goals would be through the construction of a world class fibre broadband network. A world-class broadband network will improve the Irish economy's capacity to identify and exploit new ideas, to remain competitive internationally and to produce indigenous technologies and enterprises. Specific proposals include:

2.10.1 That Government adopt a much stronger role in implementing effective policies and actions that facilitate a more rapid rollout of next generation high-speed broadband services. Immediate action should be taken by further investment in the various broadband programmes – such as the National Broadband Scheme. The Government could also subsidise the primary existing broadband network in return for equity or control of part of the network.

2.10.2 Ireland needs to examine policy initiatives in other jurisdictions and combine effective policies with sufficient investment to deliver next generation broadband infrastructure in the short term. Governments in other European countries have

[30] However, there are current challenges associated with allocating existing resources for ICT that will have to be addressed immediately before any medium-term strategy can be developed and implemented. For example, ICT for schools has a budget line of €150 million, but only €22 million has been allocated to date. (General Secretary of the Irish National Teachers' Organisation, Ms. Sheila Nunan, Irish Times, 8th October 2010).

recognised the importance of investment in fibre-based next generation networks by intervening in their telecoms markets. For example, in 2009, the Finnish Government made universal minimum internet access speeds a legal requirement. In the UK, the British Government has set up a Next Generation Access Fund (by levying £0.50 per month on landlines) to fund the installation of fibre-optic cable in rural and suburban areas, where it may not be profitable for private providers to invest.

2.11 The sixth aim of the Economic Recovery Fund is to support research and development in the alternative energy sector, where Ireland's geography may give us a comparative advantage.

2.12 **Other physical infrastructural projects, such as the School Building Programme, should be prioritised and accelerated through the Economic Recovery Fund.** However, issues relating to the time it takes for projects to be approved and implemented will have to be addressed as part of any effort to accelerate capital investment.

3. Budgetary Reform

3.1 Fiscal Consolidation

Changes to Tax Expenditure

3.1.1 TASC has previously noted the inequality in the tax reliefs given for retirement savings.[31] The Revenue Commissioners' annual statistical report shows that the tax forgone from pension tax reliefs was €2.9 billion in 2006 and €2.6 billion in 2007. The ESRI (2009) estimates that a saving of €1 billion could be made by standard rating pension tax reliefs. TASC has reduced this estimate in its budget proposals (to €750 million) to reflect the reduction in the numbers employed and in wages over the last two years. People who are unemployed or on reduced wages are less likely to be paying into a private pension and benefiting from pension tax reliefs. TASC's policy argues for the standard-rating of the tax relief and the use of these funds to provide an increased universal State pension over a five-year period, from 2013, based on the assumption that the state pensions will not be cut in 2011 and are increased in line with inflation.

3.1.2 TASC argues that exemption from Capital Gains Tax and stamp duty on disposal of site to a child (S603A TCA; S83A SDCA) should be abolished. TASC agrees with the Commission on Taxation that equity requires that the gain be treated in the same manner as gains from the disposal of any other asset. This change is expected to yield in the order of €38 million.

3.1.3 The tax exemption for patent royalties (S234 and 141 TCA) should be abolished. The Commission on Taxation has pointed out that there is a significant deadweight element in the scheme and states the view that the relief was being used as a tax avoidance device to remunerate employees. This change is expected to yield in the order of €84 million.

3.1.4 TASC agrees with the finding of the Commission on Taxation that the artist's exemption (S195 TCA) is not consistent with the equity principle and is likely to involve a significant deadweight element. The exemption should only apply to the first €75,000 of the artist's earnings derived from his or her creative work, and should only apply to individuals who derive their income solely or predominantly from creative work. This change is expected to yield in the order of €20 million.

3.1.5 The PRSI exemption for share options (S985A (1A) TCA) and the exemption for approved share-option schemes (S519 TCA) should both be discontinued. On equity principles, share

[31] TASC (2010) *Making Pensions Work for People.*

option gains should not be considered distinct from earned income. These changes are expected to yield in the order of €21 million.

3.1.6 Payment of tax by means of donation of heritage items (S1003 TCA), payment of tax by means of donation of heritage property to the Irish heritage trust (S1003A TCA) and income tax relief for expenditure on heritage buildings and gardens (S482 TCA) should all be abolished on equity grounds. These changes are expected to yield in the order of €15 million.

3.1.7 On equity grounds, the business relief for CAT (S92 CATCA) and agricultural relief for CAT (S89CATCA) should be limited to reflect the findings of the Commission on Taxation. Specifically, the current level of discounts should be reduced from 90 per cent to 75 per cent and the reduction should be subject to an overall monetary limit of €3 million. These changes are expected to yield in the order of €130 million.

3.1.8 The Commission on Taxation notes that, while many tax expenditures have been discontinued or closed to new entrants, many live on for existing projects and 'for pipeline projects'. The Commission on Taxation also highlights that transitional arrangements have been provided for these 'pipeline projects' and that the writing down periods for the schemes will run on into the future for some time. The cost to the Exchequer (latest figures) of tax relief in respect of a range of property-based incentives was estimated by the Revenue Commissioners to be €435 million.[32] The majority of these 'pipeline projects' relate to discontinued property-based schemes, which have been identified as contributing to distortions in the property market, deadweight, and inequity (e.g. tax breaks for hotels). These should be immediately ended, with no further liability to the Exchequer.

Taxing Residential Property

3.1.9 Ireland is one of the few advanced economies not to have a tax on immovable residential property. This is despite OECD studies which have identified the growth-friendly and stable nature of such a tax. TASC proposes that a 0.28 per cent levy be imposed on all residential property with appropriate deferrals to prevent incidences of hardship. If such a tax is introduced it should be accompanied by the zero-rating of stamp duty on residential property and would replace the €200 levy on rented properties, second homes and holiday homes. TASC estimates (Section 3.3.) that these changes would, cumulatively, yield €839 million in 2011 (allowing for 25 per cent deferrals, and the lost yield from stamp duty and the second home levy).

[32] Written answer to parliamentary question, September 24th 2009 (Tax Cost is for 2007).

Reform of Social Security Contributions

3.1.10 TASC argues that the existing €75,000 ceiling on employees' PRSI is regressive, arbitrary and unjustified on economic grounds. Abolishing the ceiling will target those with the greatest ability to pay. TASC calls for the abolition of this arbitrary ceiling, which it is estimated (Department of Finance, 2010) would generate €120 million in revenue annually.

3.1.11 TASC also proposes that PRSI be charged on share-based remuneration and capital gains as there is no reason why these sources of income should be treated differently from earned income. It is estimated (Department of Finance, 2010) that this would generate €79 million in revenue annually.

Changes to Capital Gains Tax and Capital Acquisitions Tax

3.1.12 TASC proposes an increase in the rate of Capital Gains Tax (CGT) from 25 to 28 per cent. CGT is a progressive tax and increasing the rate would bring us into line with the United Kingdom. Department of Finance estimates indicate that this measure would be worth €48 million to the Exchequer, although this estimate assumes no behavioural changes.

3.1.13 TASC proposes an increase in the rate of Capital Acquisitions Tax (CAT) from 25 per cent to 28 per cent, and proposes that there should be a reduction in all thresholds by 25 per cent. CAT is a progressive tax, and TASC argues that increasing the rate of CAT is an important element in achieving a more equitable distribution of wealth in Irish society. This measure is estimated to be worth €60 million to the Exchequer.

Other Tax Measures

3.1.14 TASC argues that the 4 per cent health levy be applied to rental and dividend income, as there is no reason why these sources of income should be treated differently from earned income. It is estimated (Department of Finance, 2010) that this would generate €89 million in revenue annually.

Public Expenditure Savings

3.1.15 There are a number of potential savings in current expenditure that can be readily identified, which would not be regressive and which would not lead to job losses. Suggestions include but are not limited to:

a. Reductions in consultancy fees;

b. Reduction in professional fees under GMS;

c. Making prescription of generic drugs mandatory where feasible;

d. Making ex ante cost benefit analysis of all major expenditure programmes mandatory;

e. Making centralised procurement mandatory;

f. Making competitive tendering mandatory;

j. Reduction in support for fee paying schools;

h. Increase fees for private facilities in public hospitals;

i. Impose further restrictions and caps on travel and subsistence claims:

j. Eliminating waste identified in the Comptroller and Auditor General's Report.

It is estimated that at least €300 million in savings could be made by adopting the above measures.

3.2. Reforming Tax Expenditures

3.2.1 TASC has identified Ireland's high level of tax expenditure as a major factor that has undermined the tax system. Along with the collapse in tax revenue between 2007 and 2009 by nearly a third (€14.2 billion), which illustrates the need for more stable forms of taxation such as property tax, there is also a pressing need to increase tax revenue by instituting tighter controls and limits on the continued use of tax expenditure by Government Departments.[33]

3.2.2 TASC's 2011 Budget proposals include only that specific tax expenditure where data is available on potential yield. There is little doubt that the systematic control of existing tax expenditure that TASC proposes would yield significantly more tax revenue, but data or official estimates are not always available.

The Definition of Tax Expenditure in Ireland

3.2.3 There are widely-acknowledged, technical difficulties in identifying tax expenditure, and distinguishing it from other elements of the tax system.[34] However, it is clear that the current definition used by the Commission on Taxation and the Department of Finance (in its analysis of new tax expenditure introduced in the Finance Act 2010) is inadequate for the purpose of addressing deficiencies in the Irish tax system.

3.2.4 The 2009 Report of the Commission on Taxation, and the Department of Finance, have adopted a definition of tax expenditure developed by the OECD, "a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure."[35]

3.2.5 There are two caveats to the straightforward adoption of this definition. Firstly, the OECD also notes another definition of tax expenditures, namely "provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax".[36] It is important to recognise that benefit accruing to

[33] See also TASC (2010) *Failed Design? Ireland's Finance Acts and their Role in the Crisis*
[34] See, for example: OECD (2010) *Tax Expenditures in EU Countries*; Brixi et al (editors, 2004) *Tax Expenditures – Shedding Light on Government Spending through the Tax System*. Washington: The World Bank; and Hungerford (2006) *Tax Expenditures: Trends and Critiques*, CRS Report for Congress.
[35] Commission on Taxation (2009) *Report 2009*, pp. 238-239, and Department of Finance (2010) *Section 1 of Finance Act 2010 Report on Tax Expenditures*, p.6. The original source of this specific wording is Kraan (2004) 'Off-budget and Tax Expenditures' in *OECD Journal on Budgeting*, Vol 4, No 1. However, Kraan references a more general discussion in OECD (2003) *Revenue Statistics 1965-2002*, which is a special edition on tax reliefs.
[36] Anderson (2008) Presentation to Asian Senior Budget Officials meeting; cited in OECD (2010) *Tax Expenditures in OECD Countries*, p. 12.

a "comparatively narrow population of taxpayers" is one of the recognisable features of tax expenditure, which distinguishes it from reliefs that might otherwise be classified as part of the benchmark tax system. In Ireland, a number of tax reliefs can be identified as concessions to narrow interests, even individual persons or companies. Reliefs created for narrow groups of taxpayers should be classified as tax expenditure.

3.2.6 Secondly, the definition of tax expenditure is entirely dependent on identifying the baseline tax system, also known as the benchmark tax system, against which tax reliefs, credits, etc can be clearly identified as tax expenditure. Neither the Commission on Taxation nor the Department of Finance have provided a detailed description of the benchmark system. In the absence of this information, it is simply not possible to credibly do what the Commission and Department attempt to do, when they categorise tax reliefs as either tax expenditure or elements of the benchmark tax system.[37]

3.2.7 In this context, it is noteworthy that the UK Government "acknowledges that the distinction between structural reliefs and tax expenditures is not always straightforward, and includes a third category of tax reliefs, which consists of tax concessions that combine elements of both the structural and expenditure categories."[38] In a similar vein, Canada has a series of 'memorandum items', which it lists separately from items it formally recognises as tax expenditure.[39] The UK and Canada have recognised that some tax reliefs may not fit neatly into either category. In some contexts, they offer tax relief to anyone as part of the structure of the tax system, but in other contexts act as tax expenditure for a specific sector of the economy and/or benefitting a narrow population of taxpayers.

Identifying the Benchmark Tax System

3.2.8 There is a risk that by engaging in a technical debate about what measures should, or should not, be considered 'tax expenditure', the more important issue of the problems of Ireland's tax system will be ignored. Ireland's tax revenue has consistently been a much lower proportion of GDP than the EU average. Despite this, Ireland's rates of income tax are closer (although still less) than the EU average and VAT in Ireland is at EU average levels. Ireland's low corporate tax rate is not sufficient to explain the difference, as tax revenue from this source is relatively high in comparison with other countries. Hence, the evidence suggests that there is a significant gap between the theoretical capacity of the economy to provide

[37] See, for example, Commission on Taxation (2009) p. 245.
[38] OECD (2010) p. 125.
[39] OECD (2010) p. 74.

tax revenue for the state and the actual level of revenue gathered. One highly plausible explanation for this gap is that tax law is full of loopholes, which permit people to reduce their taxable income and/or reduce the amount of tax that they pay by a much greater extent compared to tax law in other countries. It is these loopholes that are being called into question – whether they are formally tax expenditures, including concessions to narrow populations of taxpayers, or whether they are other tax reliefs/concessions that combine elements of tax expenditure with structural characteristics, such as those recognised as such in the UK or those listed as memoranda items in Canada.

3.2.9 Building on the work of the Commission on Taxation, TASC's proposals for the systematic and detailed description of the benchmark tax system include the following:

a. The systematic identification of all extant taxes, levies, etc. including major taxes (such as VAT and income tax) and relatively minor taxes (like the annual credit card levy);

b. The identification of the basic criteria, rates, bands, etc. that adjudicate each of the above taxes, including an estimated number of people in the population who are likely to pay them, by occupational category and income;

c. The identification of every possible means by which existing legislation permits exemptions, avoidance, reduction, etc. of each of the above taxes – including measures that permit individuals to reduce the calculation of their taxable income;

d. Categorisation of the means of avoiding each tax by type, whether structural (i.e. part of the benchmark tax system), programmatic (i.e. tied to a Government expenditure on a specific policy area) or mixed, including an estimated number of people in the population who are likely to be affected, by occupational category and income;

e. Only once the above (a-d) has been implemented can 'core' reliefs that are unquestionably elements of the benchmark tax system be identified. Core reliefs should only be identified as those measures that apply to taxes that affect many people, and if the reliefs are open to use for all or most people affected by the tax;

f. All other reliefs, including all reliefs which only benefit a relatively narrow population of taxpayers, must be considered tax expenditure.

Recent Developments

3.2.10 The Minister for Finance has acknowledged the need to investigate the benefits of tax expenditure. On 24 March 2010, the Minister announced his intention to ask each of his colleagues in the Government "to assess the effectiveness of tax expenditures within their sectors with particular reference to those that the Commission on Taxation recommended should be removed from the tax code." He further noted "This new approach will place the onus for objectively justifying retention of expenditure on the sector benefiting from the relief" and that the Department of Finance "will then be in a position to present the Cabinet, in good time for the 2011 budget, with an analysis on which decisions about the future of tax expenditures can be made."[40] TASC encourages the Government to publish the recent Departmental reports on tax expenditure and the Department of Finance's analysis of them.

3.2.11 The Finance Act 2010, Section 1, included a new requirement that the Minister for Finance must, within three months, prepare and lay a report before the Dáil giving "...a cost benefit analysis of tax expenditures provided for by this Act, setting out the costs of tax foregone, and the benefits in terms of job creation or otherwise." The subsequent report from the Department of Finance is welcome because the publication of a rationale, as well as some quantification of costs, is a significant advance in setting controls on the cost of new tax expenditure created by the Finance Act and ensuring accountability for this to the Dáil. This requirement should be made permanent (in addition to TASC's call for further auditing of all tax expenditure)

Evaluating Tax Expenditure

3.2.12 In its *Economic Survey: Ireland* report, the OECD makes recommendations in relation to tax expenditure: "...tax expenditures remain a target for reforms aimed at raising revenue and enhancing the efficiency of the tax system. While personal allowances take the lowest earners out of the income tax system, the distributional nature of the other reliefs goes against progressivity as they only affect those who pay tax and benefit the highest earners the most. Fiscal consolidation should include a rationalisation and reduction of tax expenditures to restore the income tax to full functionality. Where it remains, deductibility should generally be limited to the standard rather than the marginal rate and the overall amount of relief available should be capped."[41]

3.2.13 Most countries in the OECD have reported on tax expenditure since 1996 as part of their budget processes.[42] Australia, Austria, Belgium, France, Germany, Italy, the Netherlands and

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[40] Seanad Éireann (12 March 2010) *Finance Bill: Second Stage*. Volume 201, No 11.
[41] OECD (2009) *Economic Survey: Ireland*, p. 61
[42] See, for example, Brixi et al (editors, 2004) *Tax Expenditures – Shedding Light on Government Spending through the Tax System*. Washington: The World Bank p. 182. See also, OECD (2010).

the US all have legal obligations to report on tax expenditure. For example, Australia produces an annual Tax Expenditures Statement, which ran to 246 pages in 2009 and uses a standard template to examine every item of tax expenditure.[43] Despite no legal obligation, the Canadian Department of Finance also produces an annual report, Tax Expenditures and Evaluations.[44] Similarly, the UK produces a statistical supplement on tax expenditures as part of its Pre-Budget Report.[45]

3.2.14 In contrast, Ireland's lack of control over this area is irregular and deficient from an international perspective. While the Department of Finance recognises the importance of keeping tax relief schemes "under continual review",[46] there is no formal system in place to do this, and reviewing tax expenditure has not been integrated into the Budget documentation or the Oireachtas's scrutiny of the Budget. It is noteworthy that the World Bank associates the absence of systematic reporting on tax expenditure with developing and transition countries.[47]

Costing Tax Expenditure in Ireland

3.2.15 The OECD Economic Survey for Ireland in 2009 identified the cost of tax expenditure on income tax and corporation tax alone as €13.7 billion in 2005, of which the basic personal tax credits (i.e. Married Person's Credit, Single Person's Credit and Widowed Person's Credit) cost €4.3 billion. The OECD method was to count all tax relief, credits, etc as tax expenditure, excluding the basic personal tax credits. The OECD uses data published by the Revenue Commissioners in its annual statistical report.[48] The cost of all tax reliefs on income tax and corporation tax, excluding the basic personal tax credits, was €9.4 billion in 2005.

3.2.16 €7.2 billion out of the total cost of €9.4 billion was from tax expenditure on income tax alone. This was equivalent to 18.3 per cent of all tax revenue gathered in 2005, from all sources.[49] The average of 22 other EU countries' tax expenditure was much lower at 5.6 per

[43] Australian Treasury (2010) *Tax Expenditures Statement*. www.treasury.gov.au
[44] Canadian Department of Finance (2009) *Tax Expenditures and Evaluations*.
[45] UK Treasury (December 2009) *Tax ready reckoner and tax reliefs*.
[46] Department of Finance (July 2008) Submission by the Department of Finance to the Commission on Taxation, paragraph 36.
[47] Brixi et al (editors, 2004) *Tax Expenditures – Shedding Light on Government Spending through the Tax System*. Washington: The World Bank. p. xi.
[48] Revenue (2007) *Statistical Report – Income Tax*, Table IT6, pp. 17-20
[49] Figure for all tax revenue for 2005 from Revenue (2005) *Statistical Report – Total Revenue*, Table TR2, p. 4. Figures are only available for whole years (1993, 1994, etc) so their match to the tax relief data is imperfect.

cent of all tax revenue.[50] Hence, if Ireland's level of tax expenditure had been 5.6 per cent, instead of 18.3 per cent, the figure of €7.2 billion would only have been €2.2 billion. However, it is not straightforward to assume that €5 billion could be recouped in tax. Many policies, such as child benefit, have become integrated into the tax system as exemptions. Also, the removal of a tax relief does not guarantee that revenue forgone will be recovered, as taxpayers may simply move their money to other remaining tax reliefs. Nevertheless, the calculations illustrate how tax expenditure in Ireland is exceptionally high in an EU context.

3.2.17 TASC has replicated the method used by the OECD for data for the 2006 tax year, which is the latest available data. The total cost of tax expenditure on income and corporation tax in 2006 was €16.9 billion, of which basic tax credits total €4.7 billion, leaving a total of €12.2 billion in other reliefs (€8.6 billion of which was on income tax alone). This is nearly 30 per cent higher than the figure of €9.4 billion for 2005, which suggests that tax expenditure ballooned during the boom period, due to a lack of caps/limits on each individual area where reliefs could be obtained.

3.2.18 Using the OECD method as a reference point, TASC estimated that the value of tax expenditure on income tax and corporation tax in 2009 was €7.4 billion (not including basic personal tax credits).[51] The 2009 estimate is considerably less than 2005 and 2006 to account for the phasing out of property-based tax reliefs, the effects of the recession, and other changes to tax relief in the intervening years.

3.2.19 It should be noted that tax expenditure also occurs in relation to PRSI, VAT, the Income Levy and other forms of taxation/levy. Comparable data is not available for these, but tax expenditure in these areas may also represent significant amounts of tax foregone. In total, it is reasonable to assume that if systematic reform were undertaken of tax expenditure, significant revenue yield could be generated for the state, in the order of several billion. These potential gains are not included in TASC's costed proposals for 2011 because of the lack of available data.

Economic Efficiency Auditing of Tax Expenditure

3.2.20 TASC has previously called for all items of tax expenditure to be subject to economic efficiency and equality auditing.[52]

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[50] OECD (2009) Table 2.5, p. 60.
[51] TASC (2009) Pre-Budget Statement on Tax Breaks.
[52] See, for example, TASC (2009) *TASC Pre-Budget Statement on Tax Breaks* and TASC (2010) *Failed Design?*

3.2.21 Economic efficiency auditing can involve different methods. It could, for example, involve cost-benefit analysis comparing the likely tax revenue forgone with the economic and social benefits likely to occur through whatever activity attracts a tax incentive. However, such cost-benefit analyses should also include, as standard, comparison between a range of options, including different ways of configuring the item of tax expenditure – such as different rates, caps, application to different forms of taxation, etc – as well as comparison with direct public expenditure and public-private partnerships.

3.2.22 TASC has identified at least eleven economic and fiscal problems with tax expenditure:

a. Tax breaks are regressive (that is, they increase economic inequality). They disproportionately benefit those with higher incomes or more resources. Tax expenditure measures on income tax erode the progressive structure of that tax, especially where costs can be off-set against tax at the higher marginal rate;

b. Tax expenditure is often less effective than direct expenditure in achieving social and economic goals;

c. Tax breaks and other tax expenditure are seen as costless or 'revenue neutral' by Government, whereas giving tax breaks is the same thing as the State spending money. Tax forgone through tax expenditure is money lost that the State could have spent elsewhere;

d. Tax breaks and other tax expenditure are effectively subsidies and can have anti-competitive effects;

e. Excessive tax expenditure erodes State revenue to an unsustainably low level;

f. The cost of tax breaks is difficult to calculate and is often underestimated;

g. The effects of tax breaks are often 'diffused', whereby they are extended to cover more people or more firms than originally intended, or are extended for longer periods of time or to new areas. This can dilute the incentive effect while also shrinking State revenue;

h. Tax breaks are sometimes given to incentivise activities that would have occurred regardless. This is called 'deadweight';

i. Tax expenditure measures can attract unintended users or have unexpected consequences, such as the construction of many more buildings than the economy can use in the near future;

j. Tax expenditure rules can distort markets by shifting incentives from long-term business goals to short-term minimising of 'tax exposure';

k. Decisions to extend or expand tax breaks, tax credits or other tax expenditure, including the detail of how they operate, can sometimes be made by Ministers without the constitutional safeguard of a Dáil vote and are not fully integrated into the annual Budget process.

3.2.23 These arguments are made in Irish reports,[53] as well as in various recent international analyses of tax expenditure.[54]

Equality Auditing of Tax Expenditure

3.2.24 In tax systems there is often a concern with 'equity':

> "Tax expenditures can result in individuals with similar incomes and expenses paying different amounts of tax, depending on whether they engage in tax-subsidised activities. Different tax liabilities for individuals in similar circumstances run counter to horizontal equity. Tax expenditures also violate vertical equity if the cost of government is unfairly distributed among income classes."[55]

3.2.25 In addition, it is well-documented that tax expenditure is generally regressive in its effect on a tax system: "the benefits of much of the tax expenditures go to taxpayers in the upper part of the income distribution, and they often subsidise an activity for which the taxpayer receives a benefit".[56] For example, the recipient of a tax relief to build a hotel also becomes the owner of the hotel.

3.2.26 As such, equality auditing refers to a process of minimising inequity while also seeking to preserve a broadly progressive effect from the entire tax system, in order to lower income/wealth inequality in society. Progressivity – where those on higher incomes pay proportionately more than those on lower incomes – often occurs in the income tax system, but this principle must extend to the tax system as a whole. Ways of achieving an equality

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[53] Goodbody (2006), Indecon (2006), Department of Finance (2006)
[54] See, for example, Brixi et al (editors, 2004) Tax Expenditures – Shedding Light on Government Spending through the Tax System. Washington: The World Bank, p. 5; Hungerford (2006) *Tax Expenditures: Trends and Critiques*, CRS Report for Congress, p. 2 and p. 8.
[55] Cavalcanti and Swift in Brixi et al (editors, 2004) Tax Expenditures – Shedding Light on Government Spending through the Tax System. Washington: The World Bank, p. 206.
[56] Hungerford (2006) *Tax Expenditures: Trends and Critiques*, CRS Report for Congress, Summary; see also, pp. 12-14.

audit of tax expenditure could include the requirement for every budget to estimate the likely effects of proposed changes to tax law on the overall distribution of income and wealth. In addition, tax expenditure that benefits narrow populations of taxpayers would have to generate sufficient social benefit for such tax expenditure to pass an equality audit.

3.3. Design of the Recurrent Tax on Residential Property

3.3.1 A particularly noteworthy and unusual characteristic of the Irish tax system is the absence of any significant recurrent tax on residential property. A recurrent tax on residential property is a common feature of tax systems in most developed countries. Empirical studies on the impact of different taxes, for example, OECD, 2008; Johansson et al, 2008; and Heady et al, 2009, have consistently shown that recurrent property taxes (RPT) are more conducive to economic growth than any other type of taxation; however despite this, Ireland is almost unique amongst advanced economies in not having a recurrent tax on residential property.

3.3.2 TASC proposes the introduction of a recurrent 0.28 per cent tax on residential property. TASC argues that the rate of 0.28 per cent is appropriate because it strikes a balance between the need to generate sufficient revenue and the desire not to create undue hardship[57]. TASC accepts the strong economic rationale for a land or site value tax. However, introducing a land or site value tax would not be feasible in 2011, although it should be undertaken in the medium-term. For this reason, and, given the immediacy of the crisis in the public finances, TASC argues that a recurrent tax on residential property is more appropriate at this particular time.

Arguments for a Recurrent Tax on Residential Property

3.3.3 Given that property is a major component of wealth, Ireland's failure to tax residential property is an extremely regressive policy which reinforces economic inequality. The theoretical arguments in favour of introducing a recurrent tax on residential property (RPT) are compelling. These arguments include the following:

a. RPT has been shown empirically to have a minimal negative impact on GDP; in other words it is a growth-friendly tax;

b. RPT is hard to avoid or evade;

c. RPT is stable throughout the economic cycle (unlike transaction-based property taxes) and, therefore, provides a reliable tax base;

d. RPT does not penalise productive activity;

[57] The Commission on Taxation (2009) set 0.25 per cent and 0.30 per cent rates as illustrative examples and Callan et al. (2010) set a 0.40 rate as an illustrative example.

e. Taxes on immovable assets are particularly appropriate in the context of increasing globalisation, where the factors of production[58] are increasingly mobile;

f. RPT does not create a barrier to labour mobility (unlike transaction-based property taxes);

g. RPT can encourage investors to redirect capital to more productive sectors of the economy;

h. RPT can be progressive if correctly designed;

i. RPT enables the State to recoup some of the costs of public infrastructure provision through the increased (and unearned) value that will accrue to housing in the vicinity of the provided infrastructure.

Equality-Proofing a Recurrent Property Tax

3.3.4 The most common argument against a recurrent property tax is that it would be inequitable, in particular, if it does not address the ability to pay of the property owner. However, as Callan *et al* (2010) point out, it is possible to design a property tax that is progressive and equality-proofed, particularly as the better-off are disproportionately likely to hold property. The following options should be considered:

a. The property tax on the principle residence should be capped at a proportion of current income, regardless of the value of the asset.

b. Certain groups should be allowed to defer recurrent property tax liabilities on their principle residence until their decease, at which point their estate would be obliged to pay. It should not be possible to claim deferrals on the same property under more than one category.

c. Deferrals should be made available to property owners on low incomes with the precise level of relief available being dependent on the exact income of the property owner (see Table 3.2).

[58] Land; labour and capital are generally considered the core factors of production. The increase in globalisation has increased the ability of labour and capital to choose which tax regime to operate under. This means that land (including immovable property), which cannot move from state to state, is a particularly reliable source of taxation.

3.3.5 On the other hand, if not properly designed with sufficient safeguards, a recurrent property tax would fail to generate sufficient revenue for the Exchequer. It is, therefore, imperative to minimise the number of loopholes available for avoiding the tax.

Table 3.2: Property Tax Deferrals

Deferral Category		Amount of total charge deferred
A.	**Housing costs for the primary residence plus childcare costs (with each child costed at €5,000) exceed 50% of net income**	*100%*
B.	**Housing costs for the primary residence plus childcare costs (with each child costed at €5,000) exceed 40% of net income**	*20%*
C.	**Maximum charge on a particular property exceeds a defined proportion of gross income (see Table 3.4 for details)**	*The full amount above the capped percentage of the individual's gross income (see Table 3.4 for details)*
Deferrals cannot be claimed on the same property under more than one category		

Recurrent Property Taxes are Economically Efficient

3.3.6 When deciding what tax changes to implement, policymakers should strive to identify those taxes that are least damaging to economic growth and then implement those taxes in a way that generates progressive outcomes. Recent evidence from the OECD (2008) indicates that the tax structure does impact on growth performance. The OECD (2008) looked at various taxes from an economic efficiency perspective and found that property taxes are the least damaging to growth prospects. Heady *et al* (2009) also find that recurrent taxes on immovable property are the least harmful (most beneficial) tax instrument in terms of its effect on long-run GDP per capita.

3.3.7 In addition to the growth-friendly characteristic of recurrent property taxes, such taxes are also highly stable throughout the economic cycle.

Detail of the Property Tax Model

3.3.8 TASC supports the introduction of a property tax broadly along the general lines outlined in the Commission on Taxation Report, but with certain modifications. The design is as follows:

1. A recurrent (annual) tax on residential property should be introduced in Budget 2011.

2. The tax should apply to all residential property, regardless of whether it is owner occupied or non-owner occupied. The tax charge should fall with the property owner.

3. This tax should replace the existing transaction-based residential property tax (stamp duty), which should be zero-rated and the tax should also replace the €200 levy on rented properties, second homes and holiday homes.

4. Certain residential properties should be exempt from the recurrent property tax; for example social housing and communal residential facilities.

5. The charge should be a defined percentage of the gross-market value of the property.

6. In the short-term, the market valuation of the property should be undertaken on an owner-assessment basis. This would minimise the administrative burden. Properties would be categorised as belonging to one of a set of mutually-exclusive valuation bands, for example, the €150,001 to €300,000 band or the €300,001 to €450,000 band.

7. Random auditing should be undertaken to ensure that property owners correctly value their properties, and dissuasive fines should be imposed where a grossly false categorisation occurs. Revaluation should occur at least once every three years.

8. In the medium-term, properties should be valued using an appraisal system[59], similar to the system which has proved effective in Northern Ireland. This system uses objective criteria, such as location and size, to value properties. Such a system would make it possible to apply discrete valuations to properties.

9. The structure of the property tax should be designed in such a way as to reconcile the twin goals of being sufficiently wide to raise substantial revenue yet broadly progressive.

10. TASC recommends that the tax rate set in Budget 2011 should be 0.28 per cent of the value of the property. This would provide a substantial yield for the Exchequer and, at the same time, it is estimated that over 90 per cent of residential properties would attract a charge of €1,050 or less.

11. The Commission on Taxation Report (2009) has argued that 2004 house price data is broadly equivalent to house prices in 2009. Based on this premise, the Commission has

[59] The system used in Northern Ireland is known as a hedonic regression appraisal system. This system values properties based upon defined objective characteristics.

generated a house price distribution using 2004 data from the Department of Environment and adjusted for the increased number of housing units in 2009. A tax rate of 0.28 per cent applied to the midpoint of the valuation bands used by the Commission on Taxation housing price distribution (local authority houses are not included) would yield the following amounts (gross):

Table 3.3: Breakdown of Yields

Valuation Band (€)	No. Of Houses	Charge Per Property (€)	Projected Gross Yield (€ millions)
0 – 150,000	140,000	210	29.4
150,001 – 300,000	1,165,000	630	734
300,001 – 450,000	333,000	1,050	349.7
450,001 – 600,000	120,000	1,470	176.4
600,001 – 750,000	30,000	1,890	56.7
750,001-1,000,000	11,000	2,450	27
1,00,001-1,500,000	2,000	3,500	7
1,500,001 and higher	1,000	4,480	4.5
Total	**1,799,000**[60]		**1,384.7**

12. Although all property owners should be liable for the tax, the tax should not lead to hardship. Some people live in houses with values far in excess of anything they could afford based on annual income. This raises the question of how we should deal with situations (e.g. pensioners) where the value of the asset is far in excess of annual income. TASC recommends that deferrals should be made available to property owners on low incomes and that the maximum charge payable on a particular property should not exceed a defined percentage of gross income.

   a. This deferral should only apply to the property owner's principal residence.

   b. The deferral should be implemented by creating a defined cap on the maximum property tax charge in a single year.

   c. Any property tax charge beyond this capped amount would be payable upon decease, or upon sale or transfer of the property. The amount payable would not exceed 10 per cent of the value of the property.

   d. Deferrals should attract interest.

[60] This figure does not include local authority houses.

e. The cap should be set at a percentage of the property owner's gross imputed income for that year. The recommended caps are shown below:

Table 3.4: Caps on Property Charges

Gross Income	Cap on Property Tax Charge	Gross Income	Cap on Property Tax Charge
€0-12,000	2% of gross income	**€12,001 - €18,000**	2.5% of gross income
€18,001 – 24,000	3% of gross income	**€24,001 – 30,000**	3.5% of gross income
€30,001 – 36,000	4% of gross income	**€36,001 – 42,000**	4.5% of gross income
€42,001 – 48,000	5% of gross income	**€48,001 – 54,000**	5.5% of gross income
€54,001 – 60,000	6% of gross income	**€60,001 – 66,000**	6.5% of gross income
€66,001 – 72,000	7% of gross income	**€72,001 +**	7.5% of gross income

13. Thus, an individual with a gross income of €35,000 would have her maximum property tax charge set at 4 per cent of her gross income, which in this case would be €1,400. The amount owed beyond this €1,400 would be deferred until either sale or transfer of the property, or decease.

14. As well as the cap on the maximum charge on the primary residence, it is recommended that individuals should have access to a 100 per cent deferral arising from a proven inability to pay. For example, it is suggested that an individual would qualify as 'unable to pay' if the individual can show the housing costs for the primary residence plus their childcare costs (calculated as €5,000 per child) are more than 50 per cent of net income. If the individual can show the housing costs for the primary residence plus their childcare costs (calculated as €5,000 per child) are more than 40 per cent of net income, then the individual would qualify for a 20 per cent deferral.

15. The Commission on Taxation's house price distribution values over 90 per cent of houses at less than €450,000 in 2004. Second quarter data for asking prices on residential properties in 2010 (Daft, 2010) indicates that house prices are indeed broadly equivalent to house prices in 2004.

16. It should be noted that a certain proportion of houses are second homes, and also that lower-income individuals are disproportionately more likely to own cheaper houses. If we apply a 25 per cent deferral rate to TASC's recurrent property tax, then we can estimate that the projected yield (net of deferrals) will be in the order of €1,039 million[61].

[61] This is the gross yield of €1,384.7 million multiplied by 0.75.

17. The revenue estimate (Revenue, 2010) of the yield from Stamp Duty on Residential property in 2009 is €150 million and the estimate of yield from Stamp Duty on Residential property to end of July 2010 is €57 million. The final year total (Department of the Environment, 2010) for the €200 tax on non-primary residences was €65.7 million in 2009 and was €57.1 million as of August 2, 2010. It is therefore reasonable to assume that up to €200 million would be lost from the abolition of these two taxes.
18. The net gain to the Exchequer is, therefore, in the region of €839 million, although the final figure will depend on the overall level of deferrals. It should be remembered that a large proportion of these deferrals will eventually be recouped by the State.

3.4. Medium-Term Strategy

3.4.1 To regain fiscal credibility, the Government needs to articulate a multi-annual plan for restoring order to the public finances. TASC welcomes the recent Department of Finance announcement[62] of the intention to outline a four-year plan by early November 2010 that will set out proposed measures to restore order to the public finances and bring the deficit into Stability & Growth Pact compliance.

3.4.2 This plan should set out specifically how the deficit reduction targets will be achieved. An Economic Council of independent experts should be established to advise Government and to analyse the Government's medium-term budgetary policy. All recommendations made by the council should be published in full.

3.4.3 A multi-annual plan should be made a permanent feature of budgetary policy. This will reduce uncertainty, which should boost investment. It would also encourage a more coherent medium-term Government strategy.

3.4.4 The multi-annual strategy should include an annual full cost-benefit analysis, from an efficiency and equality perspective, of all major existing and proposed public spending and taxation measures. TASC also argues that a comprehensive analysis should be undertaken to identify the most appropriate timescale for achieving Stability & Growth Pact targets. This analysis should be used to inform the multi-annual fiscal strategy.

3.4.5 TASC argues that any successful strategy to bring the public finances under control must be based on a sustainable growth model. Further deflationary budgets will make the return to growth less likely, as consumption falls and investment is taken out of the economy.

3.4.6 There is a clear need to design a tax base that will provide more stability in the future. TASC proposes the following recommendations for inclusion in a multi-annual strategy of fiscal consolidation:

1) The desire to achieve European-standard public services, coupled with the burden of paying for the bank bail-outs, makes Ireland's current low tax model unsustainable. TASC argues for a gradual move toward average levels of taxation for a Western European country, so as to enable the provision of European standard public services, including health and education.

2) All regressive tax expenditures should be abolished unless a clear case of market failure can be established and it can be shown that the tax expenditure would be more

[62] Department of Finance (September, 2010).

efficient than a direct expenditure. In such cases the tax relief should be standard-rated and subject to a cap.

3) The levying of a recurrent property tax should be regarded as the first part of an all-encompassing asset tax which should be introduced in the medium-term. The collapse in tax revenue was in part the result of a very cyclically-dependent tax base. A comprehensive asset tax would provide a stable source of funding for the Exchequer and would lead to a more equitable distribution of society's resources.

4) TASC supports the introduction of a Financial Transactions Tax on a European level, and urges the Government to lobby for its introduction.

5) The carbon tax should be set at a level that would fully internalise the 'negative externalities' associated with carbon-based pollution[63].

6) Social security contributions in Ireland are the second lowest in the European Union and represent just 5.3 percent of GDP. This is less than half of the European Union average of 11 percent. There would therefore appear to be some scope for broadening the PRSI levies base[64] and TASC argues that social security contributions will have to be increased as part of the move toward European-average levels of taxation.

7) An efficiency and equality audit should be undertaken of all public expenditure programmes to eliminate wastage and/or regressive effects wherever they exist.

[63] In this case the negative externality is the uncompensated impact (e.g. to health) on third parties caused by the pollution from carbon emissions.

[64] Although technically speaking increases in PRSI revenue would accrue to the Social Insurance Fund (SIF) rather than to the exchequer, the SIF is currently in deficit which means that the Government is obliged to increase public expenditure to subsidise the SIF. Thus TASC's recommendations would lead to reduced public expenditure rather than increased exchequer funding. The effect is the same.

3.5 Budget Transparency

3.5.1 The budgetary process is one of the most important annual elements of democratic politics in Ireland. It lays out the framework of resources within which Government policy objectives are to be achieved. How many or how few resources are allocated to different areas is a clear indication of the Government's priorities. Easy access to this information by all citizens should be a basic democratic requirement.[65] It should be clear to everyone where tax money is coming from, and where it is being spent. This is a basic democratic right.

3.5.2 There is a need for reform of how Budget documents are prepared and presented, to bring Ireland up to best practice in other countries. For example, the UK Budget website not only provides a clear set of documents, but also provides a range of other supporting material.[66] There are links to user-friendly summaries of the budget material for the general public,[67] as well as a business-focused summary.[68] The Treasury uses Internet new media to communicate with citizens.[69] Spending information is also provided as raw data in spreadsheet format. This is highly relevant to allow business, policy analysts and civil society organisations across the country to do their own analysis of expenditure. The UK provides forecasts up to 2015-16 for spending, which is important to allow a longer-term perspective to be taken on the direction of national policy.

3.5.3 In contrast, Ireland's Budget documentation falls short of what is needed to allow citizens easy access to this important information. The existence of a dedicated website is welcome,[70] but the material seems to be primarily provided for policy-makers, without regard for the needs of the general public to access and understand what is being done with their money. Equally, the needs of researchers and policy analysts are not served, as raw data is not made easily available.

3.5.4 In addition, basic data on Ireland's financial situation falls short of what is needed. There needs to be a single source that compiles all State assets and liabilities in one place. This should include data on the total assets and liabilities of all state bodies, semi-state companies, etc. It should also include social insurance alongside other taxation and expenditure, as well as data on the deficit, national debt, economic activity, etc.

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[65] See, for example, O'Connor (2010) *The role of access to information in Ireland's democracy*. TASC Discussion Paper.
[66] http://www.hm-treasury.gov.uk/budget.htm
[67] http://www.direct.gov.uk/en/Nl1/Newsroom/Budget/Budget2010/DG_186500
[68] http://www.businesslink.gov.uk/bdotg/action/detail?type=ONEOFFPAGE&itemId=1084757367
[69] See, for example, http://www.youtube.com/hmtreasuryuk
[70] www.budget.gov.ie

3.5.5 The Budget has the potential to greatly change the distribution of wealth and income through changes to taxation and social welfare, as well as to change the level of funding for public services upon which many people rely – especially people on low incomes. For example, the Scottish government produces an Equality Statement as part of its budget documentation, and the Norwegian government produces an analysis of the likely distributional effects of budget measures. Ireland should provide a comprehensive analysis of the distributional impact of measures as part of the annual Budget documentation.

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