

A cut in VAT would benefit everyone

Consumption taxes are paid by everyone, affecting people on low incomes more than those on higher incomes. If tax cuts are affordable at all, then cutting VAT would benefit more people than income tax cuts and would boost consumer spending.

Importance of Consumption Tax

In discussions on taxation it is important to look at the effect of consumption taxes. Last year in Ireland, consumption taxes (including VAT, excise and some customs taxes), raised as much revenue as income tax, both raising over €15 billion.

Everyone is a Tax Payer

Census 2011 tells us there are 3.6 million adults in Ireland, and that 1.8 million are not in employment, either due to unemployment, full-time education, inability to enter the labour force due to disability to care duties, or old age (although employment has risen since Census 2011).

Although not in formal employment, all of these people are tax payers (See Chart 1).

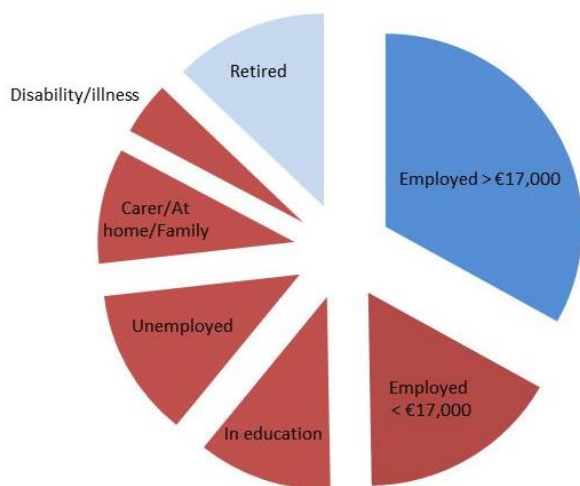


Chart 1: Those paying consumption tax, as percentage of adult population. Of these, only those employed on more than €17,000, and some pensioners, also pay income tax.

Ireland's income tax and social security contributions are largely progressive. However, while the average person may pay as much in consumption taxes as they pay in income tax, people on low incomes pay a much higher percentage of their income in consumption taxes. Conversely, people on higher incomes pay proportionately less.

VAT in Ireland

In Ireland, the standard rate of VAT (23%) is one of the highest in the world. Ireland, Greece, Finland Portugal and Poland are at 23% while only Denmark, Iceland, Sweden and Netherlands have a higher rate.

VAT is the largest source of indirect tax with the average household paying €3,360 in 2010, (6.3% of the average gross income). It is also highly regressive with the bottom income decile contributing 98% of their taxes in indirect taxes, while the top decile pays less than 23% of their total tax in consumption taxes.

Indirect Taxes are Regressive

Those on low incomes pay a higher percentage of their income in indirect tax compare to those on higher incomes, making indirect taxes a very regressive form of taxation.

Those at the very top of the income scale (top decile) pay most tax overall, contributing 29.4% of their income in taxation, mainly through income tax. However, the second highest contribution in percentage terms is not from the second highest earner decile, but from the bottom decile of households in Ireland, who pay 27.7% of their total gross income in direct and indirect taxation.

A cut in VAT to benefit everyone

The regressive nature of indirect taxes is demonstrated in Chart 2, taken from Collins and Turnbull's paper on contributions of direct and indirect taxation.

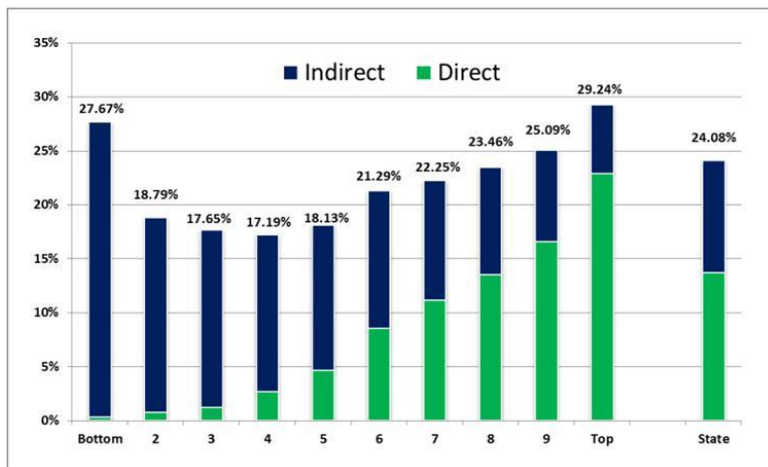


Chart 2: the effects of direct and indirect taxation by income decile

Indirect taxes include value-added tax (VAT) on goods and services, excise duties on alcohol, tobacco, and fuel, carbon tax, insurance levies, airline tax, vehicle tax (running cost taxes, not registration taxes), and television licence. Of these, VAT is the largest source of indirect taxation.

Cutting VAT

In 2012, the government increased the standard VAT rate by two percentage points. This raised €670 million in revenue in 2012. However, it also added to the downward pressure on domestic demand, as personal consumption fell by 6% between then and 2014.

Domestic demand is expected to begin to rise again, and a reduction in VAT would help this recovery while alleviating an unjust distortion.

Reducing VAT would boost domestic consumption and help kick-start the economy while reducing the total amount of tax paid by those on low incomes.

This would be a progressive tax reduction which would be far more equitable than a reduction in income tax, which would only benefit some better-off citizens.

A cut in the standard rate of VAT from 23% to 22% could be introduced in this year's Budget (to take effect in 2015). A further 1% the next year (2016) and again the year after would bring the standard rate down to 20%.

We estimate this would cost under €350 million in 2015, and a similar amount in each of the following years, depending on recovery in the economy.

Alternatively it could be funded through a tax increase on higher incomes, or a reduction in inequitable tax reliefs.

If a tax break is to be given to people, it is best done equitably. Those on low incomes have fared worst from the economic crisis, and are still paying a disproportionately high level of their incomes in indirect taxes.

Key Reference

This briefing paper is based on:

Nat O'Connor, Cormac Staunton and Paul Sweeney (May 2014) "A Defence of Taxation", TASC.

Available to download on the TASC website:

<http://www.tasc.ie/publications/tasc-a-defence-of-taxation/>

Other References

NERI (2013) Collins M and D. Turnbull, (2013) "Estimating Direct and Indirect Tax Contributions of Households in Ireland", NERI WP 2013/8
http://www.neri-institute.net/download/pdf/neri_wp_household_tax_contributions_collins_and_turnbull_nov_2013.pdf

Revenue Commissioners, Revenue Statistical Report Income Distribution Statistics - data for 2011 (forthcoming)

Example of earlier data from 2010 available here:
<http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-distribution-statistics.pdf>



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