The problem with tax breaks

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TASC Thinkpieces

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Foreword

TASC is an independent think-tank. Our research and analysis aims to challenge inequality and promote a more open and flourishing society.

This report by Paul Sweeney, chair of the TASC Economists' Network, is part of TASC's occasional Think piece series. The aim of these short reports is to stimulate discussion about particular areas of public policy. Think pieces do not set out to provide definitive analysis or research. Instead they highlight topics or patterns that TASC considers merit consideration or debate.

Taxation in Ireland is usually discussed from a narrow economic perspective. Around Budget time in particular, the national conversation usually collapses into each of us trying to calculate how much we individually gain or lose. TASC presents this report as a contribution to a broader discussion of taxation which also considers issues of equity and openness.

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Introduction

It is increasingly recognised that the growth in inequality is one of the greatest socio-economic challenges facing developed democracies. The rise in inequality is often held responsible for the growth of the Far Right in Europe, the support for Brexit and for Donald Trump, and even for the fractious political situation in Ireland today.

In Ireland the level of market incomes inequality is one of the most extreme in Europe (Hearne and McMahon 2016). However taxation and state expenditure reduce this inequality. On the one hand taxation funds public services which can be used by everyone and taxation also pays for the various benefits and subsidies to those with low incomes. On the other hand, taxation can reduce inequality if it is levied progressively. It is a widely accepted principle of social justice that taxation should be progressive – those on higher incomes should pay more, not just absolutely but also relatively.

While Irish direct tax rates are indeed somewhat progressive given the two income tax rates of 20 per cent and 40 per cent and the income bands of the Universal Social Charge (USC), this progressivity is significantly reduced by the existence of a large number of so-called *tax expenditures* or in popular terminology, 'tax breaks', 'tax reliefs' or 'tax shelters'.

This report identifies 126 separate tax expenditures, but this is in fact an incomplete list. The total cost of all such existing tax breaks is not known, although Revenue estimated that they cost €22.95 billion in 2014. However, in addition to the 126 tax reliefs identified here, there are a further 26 'undead' tax reliefs – so called because while the exemption has been ended for new claimants, exemptions already granted still have some time to run. These *zombie* reliefs cost over a hundred million euros every year (€157m in 2014).

This paper argues that although tax expenditures are usually justified in terms of social or economic objectives (e.g. recovering their costs in additional revenues), some of them seem to have been actually introduced as a result of lobbying by special interest groups, while others are engineered by the tax avoidance industry. While some tax expenditures bring little or no actual benefits in terms of their declared aim, they reduce the income available to the state. To the extent that they shield the wealthy from tax, they undermine the effectiveness of the government's efforts to reduce inequality.

The first section of this report reviews recent development in tax policy by the OECD and recent changes in Irish tax. We document the new arguments from the work of OECD in support of greater tax equity in order to stimulate more inclusive forms of economic growth; we summarise the general arguments against tax breaks; we document the expansion and subsequent removal of many tax breaks in Ireland. The second section of the report then reviews some of the separate tax breaks for individuals; section three reviews capital tax breaks.

The conclusion reiterates the arguments for removing many tax breaks in order to increase the progressivity of the Irish direct tax system. It also highlights the need for any future tax breaks to be introduced only after careful evaluation of their likely effectiveness as well as their overall impact in terms of equity.

Section 1 - The problem with tax breaks

Taxation, growth and equity

Every one of us enjoys some tax breaks. Even non-earners enjoy zero VAT on food, earners get tax personal credits and all of us pay no tax on part of our income. However, many tax breaks are regressive, costly and ineffective. Furthermore, once tax breaks are introduced they tend to remain in place long after they have served their original function. And even worse, tax breaks tend to diffuse as lobbying makes them available to more and more so-called special cases. All of this means that tax breaks should only be introduced after explicit evaluation not only of their likely effectiveness but also of their overall equity impact. Every line in every Budget should be vetted to quantify its potential impact on inequality.

Inequality has been rising for some time in all developed societies (OECD 2011) and it is widely recognised that this trend must be reversed if social cohesion is to be maintained. Until recently the OECD promoted regressive taxation policies claiming that they were “good for growth,” but taking no account of the impact of such policies on equity. Now however the OECD has produced a paper (Brys et al 2016) entitled “Tax design for Inclusive Growth” calling for governments to “use tax policy to drive forward economic agendas that seek to boost growth while sharing the benefits more evenly within society.” As the paper also says, “with fiscal consolidation, there is scope for tax policy to play a bigger role in income redistribution”.

According to this new OECD paper, “against a backdrop of historically high income and wealth inequality, this new research underlines the key role that tax policy can play in not only supporting growth, but also in addressing distributional concerns.” It continues that “recently, there have been calls to move away from a narrow focus on economic growth towards a greater emphasis on inclusiveness. These calls have been sparked by the rise in income and wealth inequality over the last 30 years as well as the economic crisis which caused the largest downturn in several generations.”

The OECD paper examines how the design features of countries’ tax systems can be strengthened to support inclusive economic growth. Indeed the paper seeks to re-assess the policy recommendations stemming from the OECD’s 2008 “Taxation and Economic

Growth" report (OECD, 2008). Whereas the former focused on the impact of taxes on economic growth only from an efficiency perspective, the more recent paper explicitly takes account of equity considerations.

In its earlier work on taxation the OECD coined the terms "harmful taxes" and "hierarchy of taxes". In that account taxes were ranked in terms of the extent to which they harmed growth, and the most harmful taxes were usually those which impacted on large corporations, high income recipients and the rich generally. For the OECD the most "harmful taxes" were those on corporate profits, followed by income tax, with taxes on property the least harmful. The OECD produced many documents calling for what it termed "growth friendly taxes". Since "growth friendly" meant friendly to business and to the very well-off, such taxes were usually highly regressive for working people. Until recently the OECD ignored this aspect and without any consideration of equity issues, the results of such analysis is flawed (Sweeney, 2015).

Tax breaks and inequality

Tax breaks or tax shelters are called tax expenditures because they mean that the Exchequer forgoes revenue – they *cost* the taxpayer money in a similar way as other forms of state expenditure. In some cases the intended effect is that the tax break stimulates additional economic activity and this in turn creates additional normal tax revenue and so there is no overall revenue lost to the state. This is the supposed objective of many tax expenditures, especially those aimed at business. In many cases however the economic activity would have taken place anyway in the absence of tax incentives. In such cases, the tax incentive is a waste of taxpayers' money and is *deadweight.* As we now show, there are however additional problems with many tax expenditures.

In general, tax expenditures stimulate aggressive tax planning by tax advisors and consultants who work out ways in which their clients – corporations and rich individuals – can utilise them. Consequently, there is always the risk that tax breaks will be used perfectly legally for purposes other than those for which they were intended.[1] Tax expenditures often shelter income for a specific period of time. The result is that even when the specific tax shelter is abolished, the loss of revenue can sometimes persist for many additional years.

By definition, tax expenditures shield particular activities from tax. Unsurprisingly, tax shelters are often the result of lobbying by particular groups for this special treatment. Certainly, once a tax shelter is in place, those who benefit will be stimulated to organise to

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[1] For example, Section 84 Leasing and S110 which cost hundreds of millions.

maintain it. As a result, even when a tax expenditure initially is time-limited, politicians usually extend it. Once a tax break is in place, groups will demand that it is expanded to benefit them. For example, if a tax expenditure shields activity in particular areas (e.g. for urban regeneration), there will almost inevitably be demands that it should be expanded to other areas. Equally, if an expenditure shields particular types of activity, there will be demands to expand the scope to other allegedly equally important activities. This so-called *diffusion effect* has the effect of reducing the effectiveness of the tax expenditures while simultaneously increasing their cost. The narrow group of beneficiaries make up a very strong lobby to retain tax breaks even when their effectiveness is diffused and they are costly. This makes it difficult for the government to terminate them.

Tax expenditures are subsidies. In many ways they are a politically acceptable form of cash handouts to business. Although conventional economists object to subsidies since they distort the market, economists seem surprisingly uncritical of tax expenditures. For example, tax subsidies to investment can be thought of as anti-competitive because they subsidise some forms of investment but not others. The European Union has a strong policy in curtailing state aid to private (and some public or state owned) companies, but until recently did not assess or quantify the cost of these subsidies in its annual report on state aid.

Unlike the more general tax expenditures applied to wide swathes of individual tax payers (e.g. personal tax credits), the more specialised tax expenditures are inherently regressive. They reduce taxation paid by the more affluent taxpayers and by large corporations. Tax shelters ensure that for wealthy tax payers there is a significant difference between the theoretical rate of tax and the actual rate of tax which they pay.

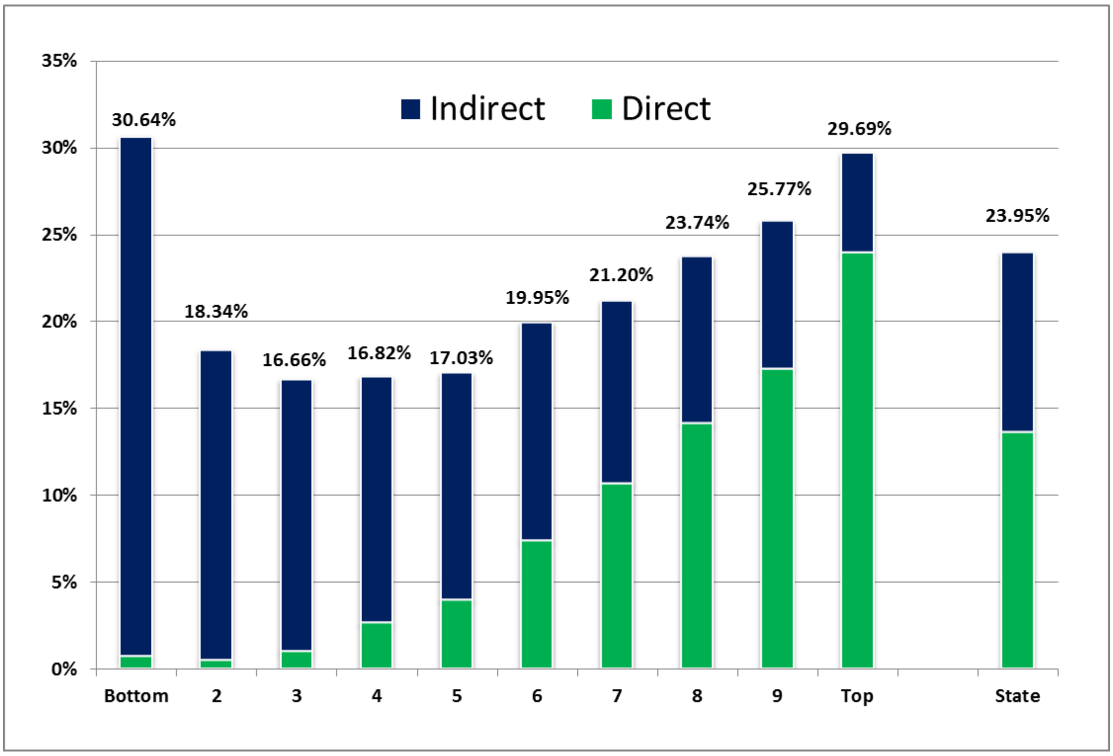
Tax breaks in Ireland

In its regular reviews and assessments of taxation policy, the government's Tax Strategy Group sometimes, but not always, assesses its impact on equity. It should now be mandated to assess the impact of all tax policies from an equity perspective. This is particularly important because inequality has been growing in Ireland. More consistency is required in this area.

From the mid 1990s it was government policy for Budgets to be "poverty proofed". Effectively this was confined to income tax and welfare, ignoring the impact of other taxes and policies. Thus in the light of the tax breaks introduced for investors at the end of that decade, in practice poverty proofing of the Budget as a whole was forgotten. This seems to be now reversed. In November 2014 the government's Tax Strategy Group stated that it is policy to undertake a social impact assessment of tax and welfare (TSG 15/08p1). This is to be welcomed but needs to be expanded to include all taxes and, importantly, all tax expenditures. A focus on income tax alone ignores: (1) indirect taxes; (2) taxes on capital and property; and (3) all forms of tax shelters and tax exemptions. Thus, with the focus only on direct tax, commentators can refer to what they term the "extreme progressivity of the Irish income tax system."

However, a "whole of tax" policy approach yields a very different assessment of the progressivity of the Irish tax system than such a narrow focus. Certainly, the Irish income tax system is very progressive at the lower end of the income scale since very low incomes are not taxed at all, but there is less progressivity within the higher income groups. Once all taxes are taken into account, then those households at the bottom of the income scale also pay disproportionately high overall taxes. Collins points out that "on average households paid 24 per cent of income in income and indirect taxes" but there is a U shaped curve with those 10 per cent at the bottom paying 31 per cent in tax, those in the middle deciles paying much less and those 10 per cent at the top paying also at 30 per cent, as seen in Figure 1.

Figure 1: Direct, Indirect and Total Household Taxation as % Gross Income In Ireland (Equivalised Data, i.e. adjusted for household composition and size).



Source: Collins, 2014.

In Ireland the history of tax breaks for property investors highlights the problems and unintended consequences that tax expenditures can create. In the mid-1990s tax breaks were introduced in order to stimulate urban renewal. Initially these were breaks for property investors investing in delimited areas, but very quickly they spread. In a classic example of the *diffusion effect*, what was initially a targeted incentive with the potential to work well became ubiquitous as every Cabinet Minister sought one for his or her constituency. By the early 2000's tax breaks had proliferated – and this was on top of the property bubble. Since the Irish construction boom from the 1990s onwards would have taken place without these tax breaks, they were also *deadweight* incentives and were not just a waste of taxpayers' money, but they also boosted an overheating market.

In 2005, the Department of Finance undertook its long overdue Review of Tax Expenditures/Privileges. A vast number of tax breaks especially aimed at property had developed since the mid-1990s. Giving tax subsidies on the cost of buildings and all fixtures and fittings during a property boom had seemed extraordinary to some bodies like the government's own advisory National Competitiveness Council, the Congress of Trade Unions and some others. Their warnings were ignored until it was too late.

Most of the recommendations of the Department of Finance Review were for the termination of property-related tax breaks because they did not stand up to even the most basic economic analysis. While many such tax exemptions were terminated (see Appendix 3), there were a number which were retained. It is believed that these were favoured by a number of government ministers. The property tax breaks retained were mainly in the health sector – for private hospitals, private nursing homes, private sports clinics etc. These, of course, were private only in ownership (and benefits) because the taxpayer was and is still picking up most of the cost of construction and fittings. These health tax expenditures also consolidate the two tier health system.

In general the government and the Department of Finance have had great difficulty in anticipating the cost of such tax expenditures. Firstly, the costs depend on the extent to which they are taken up and this is not known in advance. Secondly, the costs also depend on how much tax the potential beneficiaries already pay, and while this information is supposedly available in tax returns, such information is not usually made available. Accordingly in the tables in this report the cost is frequently only given as 'N/A'.

In Ireland property based tax expenditures have not just sometimes been a waste of money, they have had directly harmful consequences. Tax expenditures boosted construction inflation during the boom years of the 2000s, ensuring that construction and asset price inflation ran at very high levels and then collapsed with disastrous consequences for house buyers, society and the economy. Without the tax expenditures available to developers and investors during the boom, there would have been less urban blight and fewer ghost estates. Arguably the very frenetic expansion that characterised the last years of the bubble also directly led to the housing shortages we have today. A slower pace of development would have resulted in more appropriate housing construction.

It is regularly pointed out that the Irish authorities built relatively few social houses over the past decades (e.g. Hearne and McMahon 2016: 37). What is not realised is that during the boom Irish authorities financed tens of thousands of housing units (and hotel bedrooms) for wealthy investors at this time through full tax exemptions. For example, most of the “private” apartment blocks around the Dundrum town centre in south Co. Dublin were massively subsidised by the taxpayer. Most of the hotels built during the property bubble were financed by tax breaks. These were unnecessary and indeed in the hotel sector drove out many good businesses as TASC pointed out at the time (Pentony 2010). Instead of directly building social housing – as Irish governments had done since the foundation of the state – policymakers relied on the markets albeit with large and distorting tax subsidies. This distorted market ultimately contributed substantially to the crash.

Section 2 - Income tax exemptions and privileges

Nearly all income earners who pay tax, do not pay tax at the full rate. There are a few general personal tax credits which all earners have; around 15 or 17 of these apply to many people in differing circumstances, e.g. child credits. Then many taxpayers also benefit from exemptions in relation to pensions and pension contributions. There are reliefs for things like third level fees and interest paid and renting a room. On top of this, there are more reliefs which go to businesses, farmers, investors and so on. Yet what is not usually appreciated is the extent to which these tax exemptions often disproportionately benefit the better off. Curbing those exemptions or tax privileges would make the tax system more progressive.

This section begins by examining some of the specific personal tax credits and the benefits-in-kind tax breaks available in Ireland. The second part of this section then examines the rather separate issue of the tax exemptions open to private pension holders. The third part of this section examines some particular tax breaks. As the conclusion reiterates, many tax reliefs or tax exemptions on individual incomes tend to reduce the progressivity of the tax system.

Personal tax credits and benefits in kind exemptions

There are some tax exemptions such as the PAYE credit which apply to the vast majority of taxpayers. There are also some highly specialised tax exemptions which apply to a very small numbers of taxpayers who are relatively disadvantaged. A small number of benefits in kind exemptions are also intended to change people’s behavior in ways that benefit society as a whole (e.g. the cycle-to-work scheme). Table 1 below lists some of these specialised personal tax credits, Table 2 lists some crucial Benefit-in-Kind tax breaks.

Table 1: Personal income tax breaks

Personal Tax Credits*			
Description	**Further Information**	**No. Utilising/ No. of Claims**	**Revenue foregone in most recent year for which information is available (€ millions)**
Age Tax Credit		149,600	55.3
Blind Person's Tax Credit	General & Guide Dog Allowance	1,540	2.2
Dependent Relative Tax Credit		18,000	1.8
Home Carer's Tax Credit		82,500	61.9
Incapacitated Child Tax Credit		17,700	51
Single Person Child Carer Credit	New, in effect from 1 January 2014	N/A	N/A
One Parent Family Tax Credit	Ceased end 2013	104,100	141.6
Approved Profit Sharing Schemes	2011 figures – latest year for which full data available	34,500 (in 2011)	25.1 (in 2011)
Approved Training Courses/Third Level Fees		23,600	12.5
Employment and Investment Scheme		1,028	12.7

Donation of Heritage Items		1	0.3
Donation of Heritage Property to Irish Heritage Trust/OPW	2008 figures – last year in which expenditure recorded	4 (in 2008)	3.8 (in 2008)
Donations to Approved Bodies		135,200	45
Donations to Approved Sporting Bodies		2,430	0.5
Employee Share Ownership Trusts		25,200	1
Employing a Carer		1,900	7.4
Exempt Income – Child-minding Exemption		590	1
Exempt Income – Rent-a-Room		4,370	5.9
Exempt Income – Artist's Exemption		2,580	5.3
Exempt Income – Foster-Care Payments		4,325	32.4
Film Relief	Note- this has been amended to a Corporation Tax relief	4,217	73.1

Home Renovation Incentive	Introduced 2013, first cost incurred in 2015	N/A	N/A
Health Expenses	General & Nursing Home	399,400	151.1
Medical Insurance Relief		1,118,400	575.8
Special Assignee Relief Programme (SARP)	2012 figures – latest year for which full data available	12 (in 2012)	0.1 (in 2012)
Save as You Earn Scheme (savings related share options)		1,920	3.5
Seafarer's Allowance		190	0.4
Start-Up Refunds for Entrepreneurs	New	N/A	N/A
Significant Buildings and Gardens Relief		120	2.1
Sportsperson's Relief		46	0.3
Start Your Own Business	From 2014	N/A	N/A
Woodlands Profits & Distributions		N/A	N/A
Exemption of Income of Charities, Colleges, Hospitals, Schools		2012 figures – last year for which full data available	N/A

Friendly Societies etc.			
Exemption for Veterans of the War of Independence, their Widows or Dependents	2005 figures – last year for which full data available	900	0.1
Investment Seed Capital		60	1.3
General Stock Relief (Section 666)		8,950	5.2
Stock Relief for Young Trained Farmer (Section 667B)		310	1.1
Stock Relief for Registered Farm Partnerships (Section 667C)		30	0.1
Living City Initiative	Commenced in 2015	N/A	N/A
Deduction for Maintenance Payments	Dispositions including maintenance payments to separated spouses	6,780	17.5
Flat Rate Expenses		571,000	70.9
Foreign Earnings Deduction	From 2012	119	0.9
Gifts to the Minister		N/A	N/A
Rental Deductions –		4,370	7.3

leasing of farm land			

* All figures for 2013 unless stated otherwise

Source: Department of Finance | Report on Tax Expenditures (October 2015)

Table 2: Benefit-in-Kind tax breaks

Benefit-in-Kind*			
Description	**Further Information**	**No. Utilising/ No. of Claims**	**Revenue foregone in most recent year for which information is available (€ millions)**
Cycle to Work Scheme	Tax relief on the purchase of a bicycle for commuting purposes	20,000**	4.0**
Tax Saver Travel Scheme	Tax relief on commuter tickets	35,000**	3.5**
Professional subscriptions relief	Tax relief on the payment of certain professional subscriptions.	150,000**	3.75**

* All figures for 2014 unless stated otherwise
**Estimates

Source: Department of Finance | Report on Tax Expenditures (October 2015)

Pensions

The second most costly tax relief after personal tax credits is for pensions. The thresholds for such reliefs have been reduced but still are very high for big earners. The issue of the rate of tax on pension deductions is contentious, being still at the marginal or top rate. The case for a hybrid rate of around 33 per cent is strong.

The standard fund threshold is very high at €2m and it should be reduced to €1m. The earnings limit on tax relief for high earners is also much too high at €115,000 and it should be reduced to €60,000. In addition there should be mandatory pension system improvements in the state pension with perhaps an option to add voluntary contributions to a second state pension.

Table 3: Pension tax breaks

Pensions*			
Description	**Further information**	**No. utilising/ No. of claims**	**Revenue foregone in most recent year for which information is available (€millions)**
Employees' contribution to approved superannuation schemes	Contributions are allowable as an expense in computing Schedule E income (Sections 774 & 776)	592,700	551.9 (in 2013)
Employers' contributions to approved superannuation schemes	Contributions are allowable as an expense in computing Schedule D Case I or Case II income (Section 774)	311,600	132 (in 2013)
Exemption of investment income and gains of approved superannuation funds	Exempts the investment income of a fund held/maintained for the purpose of a scheme (Section 774 – Approved Fund, Section 785 – RSA, Section 787I – PRSA)	N/A	865 (in 2013)
Tax Relief on "tax free" lump sums	From 1 January 2011, the lifetime tax-free limit on the aggregate of all retirement lump sums paid to an individual on or after 7 December 2005 is €200,000 (Section 790AA)	N/A	134 (in 2013)
Retirement annuity premium	Combined with PRSA with effect from 2013 – see Personal Pensions Contribution entry following (Section 787)	N/A	N/A
Personal retirement savings accounts	Combined with RAC with effect from 2013 - see Personal Pensions	N/A	N/A

	Contribution entry following (Section 787C/E)		
Pension Contribution	Figures in this field are a total for RAC's and PRSA's which are not available individually	99,800	211 (in 2013)
Exemption of employers' contributions from employee BIK	Sums paid by an employer into an approved, statutory or foreign government employee retirement scheme are not chargeable to tax in the hands of the employee (Section 778)	311,600	497 (in 2013)

*All figures for 2014 unless stated otherwise

Source: Department of Finance | Report on Tax Expenditures (October 2015)

Examples of personal tax breaks

Tax breaks aimed at top executives of multinationals

Under a special privileged tax deal, top executives of multi-national companies (MNCs) who earn over €75,000 pay little income tax. The Special Assignee Relief Programme (SARP) had given an exemption from income tax on 30 per cent of salary between a minimum of €75,000 and up to €500,000 over five years, with additional benefits. In Budget 2014, the ceiling was abolished after pressure from lobbyists from the accounting industry representing the multinational enterprises. For all the lobbying, the take-up was only seven executives in its first years of operation and 12 in 2012. These executives also get an additional tax break of €5,000 a year for school fees. In Budget 2017 it was extended to 2020.

SARP contravenes the core tax principle of horizontal equity: namely that people on the same income should pay the same amount of tax. SARP is not a large cost but it is the best example of tax expenditures being used by a tiny elite.

Tax Relief for Artists – the Artists' Exemption

An artist – writer, playwright, composer, painter or sculptor – is exempt from tax on all income up to €50,000 a year. Above €50,000, they still enjoy the usual tax credits (around €3,300 a head) before paying income tax. Since 2011, they have also had to pay the USC.

The Artists' Exemption was introduced in 1969. Up to 2011 there was no limit on the amount of tax-free income an artist could earn or receive. But after lobbying by NGOs and unions, a ceiling of €40,000 on tax free income was finally imposed in 2011. The threshold was increased to €50,000 in 2014. In 2012, 36 per cent of artists claiming the privilege were hit by the ceiling and had to pay some income tax. In the same year, almost 10 per cent of artists earned over €100,000. Conversely many were earning well below the ceiling with 44 per cent of claimants earning under €20,000. There are around 350-500 claimants of this tax relief each year. Thus for most artists, the ceiling has no impact at all.

Sports Persons Tax Relief

There is a special tax relief for all sports people who make money from their game. Under this tax subsidy, they are allowed to substantially reduce income tax for ten of their best 14 years. The tax break applies only to sporting income. It excludes fees from sponsorship appearances and use of images etc. It is very generous and, unlike the artists' relief, it is, surprisingly, not capped. The sportsperson – motor racer, rugby player, jockey, golfer, athlete, swimmer, cyclist, etc. – is allowed to deduct 40 per cent of his or her gross income which is then un-taxed.

The remainder is then taxed in the usual way. This allows them to deduct all expenses and then tax credits etc. before they begin to pay tax. The tax paid over their best paid decade is repaid by the Revenue at the end of the career. So they can pick the best ten years out of the last 14 and get their income tax back. If they earn €100,000 each year, that equates to €1 million. But only €600,000 is assessed for income tax. They can claim legitimate expenses for travel etc. as well. The argument is that they only have a short career and should be able to make the most of it and also it may keep some of the sports stars here rather than in other countries. There may be merit in this scheme but there is no reason why a ceiling similar in effect to that applying to artists, should not also apply to sports persons.

Employee Share Schemes and subsidised stock options

The Government supports Employee Financial Involvement (EFI) and provides several schemes to encourage employees to take a share in their employing: Approved Profit Sharing Schemes, Approved Savings-Related Share Option Schemes, Restricted Shares, and Employee Share Ownership Trusts (ESOTs). The key factor with these schemes is that they treat all employees in the same manner. Employee Share Ownership Plans (ESOPs) include tax incentives to reward employees who work for their firms appear to work well and are applied in an equitable way under current tax rules. They have the effect of aligning employees' objectives with those of the firm. The tax strategy paper (TSG 16/0) found that "Ireland compares very favourably with other European countries" in encouraging employee financial involvement.

However, lobbyists such as IBEC and the Institute of Taxation are seeking further tax privileges but only for high income earners and wealthy (or potentially wealthy) shareholders, which they would deem as key personnel, and so exclude most employees. If certain employees are seen as key, then they should be paid appropriately under the market system. The tax system should not be used to subsidise stock options for a minority of employees, that is, the top managers and executives of firms, big or small. Such privileges undermine equity and are a straight subsidy from all taxpayers to highly paid persons/owners of capital.

Between 20 May 2016 and 1 July 2016 the Department of Finance received more than 30 submissions from lobbyists for tax subsidies for share-based remuneration (TSG report 16/08, p3). As stated above, there is a case for tax relief which is universally applied to all employees. However, the lobbyists are seeking special tax subsidies and privileges for top executives, which they designate as having "a specific skill requirement". There should be no tax privileges on capital gains in particular because it is a tax on the ownership of capital which is generally taxed at a lower rate than income.

Restrictions on individual high earners' income

Since 2007 there has been a restriction on high income earners using tax avoidance schemes. This High Income Individuals' Restriction attempts to impose an effective rate of 30 per cent on very high earners. It has been quite successful, but the beneficiaries still paid less tax than others on comparable incomes. However, this is diminishing as many tax breaks have been abolished.

A total of 1,544 individuals were restricted and the tax yield from this measure was €80 million in 2010. A Tax Strategy Group study (TSG12/24) showed that those restricted taxpayers on average paid double the income tax they would have otherwise have been able to avoid though the use of these many tax subsidies/privileges.

However, it also has meant that some higher earners – those using tax expenditures/ tax avoidance schemes – have lower effective rates than other taxpayers on comparable incomes, as stated above. For example, 75 per cent of those restricted only paid an average effective tax rate of 19 per cent on incomes between €80,000 and €400,000. Other, regular taxpayers in this income range paid much higher effective rates of between 24 and 28 per cent in 2012 (TSG 12/24).

As many of the worst tax expenditures particularly those around property have been abolished, the need for these restrictions is declining. The government should nonetheless continue to monitor the use of such schemes and consider more effective alternatives, if required.

Under no circumstances should it concede further privileges to lobbying from the forestry and hotel sectors by delisting them from the high earners' income restriction. Giving further exemptions to the hotel and restaurant sectors would be especially reprehensible given that, as a recent TASC report has shown, many employers in this sector continue to impose poor working conditions on their employees (Wickham and Bobek 2016). Indeed, the hospitality sector is now noticeable for its refusal to engage in any sectoral bargaining with trade unions, unlike employers in some other service sectors such as contract cleaning or security.

One tax break, the Employment and Investment Incentive for investors, is remaining in place. Surprisingly, the restriction on high earners investing in this scheme was terminated In Budget 2017.

Section 3 - Reliefs on taxes on capital

Capital taxes are those on inheritances, on gains, on savings and on property. Such taxes can profoundly reduce inequality. To the extent that, as in Ireland, capital has been taxed at much lower rates than income this undermines meritocracy: an individual's position depends more on what he or she actually owns than on what they can achieve. Wealth inequality is greater than income inequality (Milanovic 2016, p39).

There is no wealth tax in Ireland as it was abolished during the 1970s. Stamp duty is essentially a tax on the transfer of property and hence is a tax on capital. In recent years Stamp duty has been reduced substantially from 9 per cent to only 1 or 2 per cent. This was done to aid the introduction of the much opposed property tax. An annual property tax is a tax on capital /wealth and as such contributes to social equity. The new Irish Property Tax has generous thresholds but is also a very stable tax. It is hard to avoid and so is a sound source of revenue for the state. Taxes on property in Ireland are about the average in OECD34, but are below average for English speaking countries (TSG15/03 p 11).

Inheritance Tax or CAT

In terms of taxes on property, the state provides one of the biggest reductions through the exemptions that are available for CAT, commonly referred to as inheritance tax. If a child inherits a business they can get a 90 per cent tax write down on the tax, without any limit on the sum. This tax break benefits the richest most and undermines any impact of CAT on inherited wealth. Those who believe in a meritocracy, on the right or left, should no longer support this exemption. If the purpose of the exemption is to ensure that individuals do not face sudden and perhaps unanticipated tax bills, then there are other ways to make this more tolerable, such as allowing the payments to be phased over time.

Table 4: Capital Acquisitions Tax Relief

Capital Acquisitions Tax*			
Description	**Further information**	**No. utilising / No. of claims**	**Revenue foregone in most recent year for which information is available (€millions)**
CAT business relief	Relief for transfers of businesses (90% reduction in market value for tax purposes)	495	139.7
CAT agricultural relief	Relief for transfer of farms (90% reduction in market value for tax purposes)	1,581	164.4
CAT exemption of heritage property	Exemption from tax for transfers of heritage houses and objects	Indicative information suggests the numbers using is negligible	Exact figures are not available, but thought to not be significant

*All figures for 2014 unless stated otherwise

Source: Department of Finance | Report on Tax Expenditures (October 2015)

Thus it can be seen that the generous 90 per cent reduction from inheritance tax when getting a business cost €140m on top of the cost of the individual exemption which is now €310,000. This 90 per cent reduction is grossly out of line with any thinking on equity and merit. An alternative would be to allow a time of some years to pay the tax form the profits of the business. The same applies to farmers. This huge reduction in tax properly due discourages entrepreneurship.

Capital Gains Tax Relief

The Tax Strategy Group paper on capital taxation issues (15/13 published in September 2015) examines options for reform of Capital Gains Tax (CGT) relief. It shows how the revenue raised has fallen from an unsustainable €3,100m during the property bubble in 2007 to €561m in 2014. While the TSG paper is informative, it fails to address the role of equity in CGT. CGT is a tax on capital, on the owners of capital and wealth. It only taxes the *gains* flowing from such ownership and so has an important role in addressing inequality.

There are changes which should be immediately made to CGT to address inequality. First is to limit the exemption on *principal private residences* to under one million euros which is four times the average house price in Ireland. Any gains above this should be taxed. According to the 2013 Property tax returns only 0.2 per cent of homes were valued at over €1m. While house price inflation has occurred since then, this is a modest number of homes.

Table 5: Capital Gains Tax Relief

Capital Gains Tax			
Description	**Further information**	**No. utilising/No. of claims**	**Revenue foregone in most recent year for which information is available (€millions)**
CGT Retirement Relief	Provides relief for disposals of business and farming assets.	1,064 (in 2013)	Tax cost is not avail as the only information in respect of this relief is the disposal consideration rather than the actual taxable gain foregone.
CGT entrepreneur relief	Provides relief for disposals of business assets.	This is a new relief (2014) and data will not be available for a few years.	N/A
CGT principal private residence relief	Provides relief for disposal of main residence.	N/A	N/A
CGT Farm consolidation relief	Provides relief for disposals of land in order to consolidate farm holdings.	Not separately identified on tax return	Not separately identified on tax return

CGT relief for venture fund managers	Provides relief in respect of carried interest earned by venture fund managers.	Not separately identified on tax return	Not separately identified on tax return
CGT exemption on disposal of site to a child	Provides relief for parents transferring a site to their children in order to build a house.	36 (in 2013)	Tax cost is not available as the only information in respect of this relief is the disposal consideration rather than the actual taxable gain foregone.
CGT relief on works of art loaned for public display	Provides relief for disposals of works of art loaned for public display.	Not separately identified on tax return	Not separately identified on tax return

*All figures for 2014 unless stated otherwise

Source: Department of Finance | Report on Tax Expenditures (October 2015)

Table 6: Deposit Interest Retention Tax Relief

Deposit Interest Retention Tax*			
Description	**Further information**	**No. utilising/ No. of claims**	**Revenue foregone in most recent year for which information is available (€millions)**
Deposit Interest Retention Tax Reliefs	Age 65 or over/total income under €18,000 (single)/€36,000 (couple)	Not available N/A	N/A
Deposit Interest Retention Tax Reliefs	Permanently incapacitated/total income under €18,000 (single)/€36,000 (couple)	N/A	N/A

Local Property Tax*			
Exemptions		41,789	12 m
Deferrals	LPT Deferrals, although foregone in a particular year, are still owed to the Exchequer at a later date	27,400	8

*All figures for 2014 unless stated otherwise

Source: Department of Finance | Report on Tax Expenditures (October 2015)

Unquantifiable tax breaks for business – and for rich individuals

The cost of the biggest tax breaks for businesses are not known and are not quantified by the Tax Strategy Group, the Department of Finance nor the Revenue since they do not know how much these cost. The biggest tax breaks are unintended by policymakers and devised by the Big Four accounting firms for their clients. These include the "Double Dutch Irish Tax Sandwich" partly devised by Fergal O'Rourke of PWC (Drucker 2013) which has cost sovereign states billions in lost taxes. They also include the current "Section 110" which may be costing Ireland and other states billions. "Section 84 Leasing" was another tax avoidance mechanism devised to cost Ireland over a billion in lost taxes from the banks back in the 1980s. And then of course there was the deal allegedly struck by the Revenue/government with Apple which has cost various government exchequers €13,000,000,000 according to the EU Commission in lost taxes from the world's biggest and most profitable company.

Tax breaks for business can also be tax breaks for individuals. This is especially the case when individuals own companies. For example, the ICAV (Irish Collective Asset Management Vehicle) was introduced only last year to bring the off-shore funds industry to Ireland. It has been used by many companies to legally avoid large sums of tax. This in turn directly benefits the individual owners of such companies. The ICAV was reported to have been used by Clerys new owner, Deirdre Foley, to avoid tax (Paul 2016). Equally, Denis O'Brien is reported to have used an ICAV company network to avoid tax on a recent property transaction (Tighe 2016). This shows how tax "incentives" can be quickly turned against the public interest by legal and accounting firms.

The more tax exemptions granted by governments, the more possibilities the big accounting and legal firms have of driving a coach and four through them. Keeping the tax code simple and coherent has a lot of virtues, not least of which is fairness.

Section 4 - Conclusion

The total cost of all existing tax breaks is not known. In 2014, the Revenue (Revenue Commissioners 2016) estimated that they cost €22.95 billion. The Revenue publication "Cost of Tax Expenditures" was last updated on 9 Sept 2016. It includes a number of reliefs that apply both to individuals and companies and the cost shown in relation to these reliefs covers both Income Tax and Corporation Tax. Given that total tax revenue in 2014 was €41.3bn, the estimated cost of all the reliefs was equivalent to more than half of total revenue in the same year, though this must be treated with great caution.

As the Tables above show, many of these exemptions go overwhelmingly to ordinary taxpayers; most of have been debated and contested over the years and have considerable legitimacy. However, many other exemptions are less legitimate and are of questionable value. These figures, not to be taken literally, do put the complexity of the taxation system in perspective. Taxation is about far more than income tax rates.

We do not know how much additional tax is lost thanks to tax avoidance schemes which were never intended by policymakers. This report identified 126 tax expenditures, but our list is not complete. Quite a number of the worst tax reliefs have been terminated. However, in addition to the 126 tax reliefs there are further 26 "undead" tax reliefs – while the exemption has been ended for new claimants, exemptions already granted still have some time to run. These *zombie* reliefs cost over a hundred million euros every year (€157m in 2014).

The first tax breaks for property were introduced from the mid-1990s, and were focused on certain objectives such as urban renewal. Then they spread like wildfire. They boosted investment, but they ultimately helped to wipe out virtual all property and construction-related businesses. This led to the biggest state rescues (nationalisations) of both the banks and most property companies too. Many fine legitimate businesses would have survived without such over-generous tax breaks.

In essence, there has not been a "free market" in property in Ireland since the mid-1990s. It is still not fully emerging with so many property subsidies still in existence. Yet some groups are seeking more tax breaks for themselves. Yet in the past they got all they sought but were then wiped out.

There are few advocates of free, unsubsidised markets in Ireland. All business interests and their lobbyists appear to seek endless tax privileges. Many will do nothing unless there is a generous tax break attached. Direct state cash aid is easier to manage if subsidies are to be granted, rather than tax breaks.

Most tax expenditures are legitimate and useful. For example married and single persons tax credit cost nearly €4.5bn which applied to all income earners. Capital allowances for businesses cost almost €3bn and have the very legitimate purpose of encouraging investment, but they may be overgenerous. However, some tax breaks are debatable while others are of dubious value and should be curbed or ended.

Every tax break should have a cast-iron, independently proven benefit. Tax expenditures or tax breaks/ subsidies/privileges can be useful in generating economic activity, but they may also have many adverse impacts. They have unintended consequences; their costs are difficult to quantify in advance; they provide subsidies to some and not to others; they have diffusion effects (in that they spread into areas other than those for which they were originally planned); they can be regressive; most of the property-based schemes were deadweight (that is, unnecessary), costly and they ultimately accentuated the crash of 2008.

This report has set out the extent of the tax breaks/privileges, using data from the Department of Finance, the Tax Strategy Group and from Revenue. While we have been critical of some of these expenditures, this report does not claim to evaluate the extent to which each of these exemptions should be curbed or even abolished. Instead, the report aims to document the sheer extent of these exemptions and bring this into public debate.

The reviews of tax breaks being carried out now by the Department of Finance annually are most welcome, but now must include *equity* in assessing the impact of all tax breaks that is, on inequality as well as the perceived economic benefits.

There is a case for a new Tax Commission, with terms of reference which adhere to broad principles of taxation and take a long term perspective for all citizens. The last Commission on Taxation had narrow terms of reference and was constrained by them especially in against taking any innovative approach on corporation tax. A new Commission, while taking account of the main principles of taxation – efficiency, certainty, revenue raising, must also take that important principle — equity, into serious account, if inequality is to be addressed. Taxation plays a key role in the reduction of inequality.

Inequality has risen in Ireland and it is too high in spite of much state intervention. We should be proud that our tax and welfare systems combine with our public services to greatly reduce the inequality thrown up by the market. However, elements of the tax system continue to be used for the opposite purpose and so boost inequality. Thus the elimination or reduction of many of the tax breaks listed above would make Ireland a more equal and more meritocratic society.

Appendix 1: The cost in 2014 of tax breaks which are being phased out

Incentive	Amount claimed €M *Provisional*	Maximum tax cost assumed at 41% for Inc. Tax and 12.5% for CT €M *Provisional*	No. of claimants *Provisional*
Urban renewal	94.5	37.0	2,060
Town Renewal	34.4	14.0	623
Seaside Resorts	3.6	1.5	174
Rural Renewal	38.6	15.7	1,866
Multi-storey car parks	2.8	1.1	44
Living Over the shop	0.7	0.3	40
Enterprise Areas	2.3	0.9	50
Park and Ride	2.3	1.0	15
Holiday Cottages	13.1	5.3	452
Hotels	47.1	16.2	504
Nursing Homes	18.1	6.9	248
Housing for the Elderly/infirm	1.3	0.5	37
Hostels	0.3	0.1	N/A
Guest houses	0.2	0.1	N/A
Convalescent Homes	0.1	0.0	N/A
Qualifying Private Hospitals	16.3	6.7	245
Qualifying sports injury clinics	1.1	0.4	20
Buildings used for certain childcare purposes	5.6	2.3	172

Qualifying Hospitals	0.0	0.0	0
Qualifying Mental Health Centres	0.1	0.0	N/A
Student Accommodation	26.4	11.1	414
Caravan Camps	0.2	0.1	N/A
Mid-Shannon Corridor Tourism Infrastructure	0.5	0.2	N/A
Living City			8,234
Woodlands	101.4	30.0	
Patents*			
Other Property Incentives	421.9	4.5	480
Totals	**421.9**	**159.9**	**15,678**

Source: Revenue Statistical Reports

Appendix 2: Current tax expenditures for entrepreneurs and SMEs

Measure	**Tax Head**	**Aim of Measure**
CGT Entrepreneurial Relief	Capital Gains Tax	Encourage serial entrepreneurs to establish new firms.
3 Year Corporation Tax Relief for Start-up Companies	Corporation Tax	Improve cash flow for start-up business and encourage job creation and economic activity in the State.
Micro-brewery excise duty relief	Excise Duty	Encourage development of small independent breweries.

Foreign Earnings Deduction (FED)	Income Tax	Encourage businesses to expand to emerging markets.
Employment and Investment Incentive (EII)	Income Tax	Improve access to funding for businesses.
Start Your Own Business (SYOB)	Income Tax	Incentivise long-term unemployed individuals to take up self-employment and establish their own businesses.
StartUp Refunds for Entrepreneurs (SURE) - formally Seed Capital Scheme	Income Tax	Encourage individuals to establish new businesses.
Home Renovation Incentive (HRI)	Income Tax	Encourage small construction companies and tackle the shadow economy in the sector.
Restricted Shares	Income Tax	For recruiting and retaining skilled employees.
Employer PRSI exemption from share-based remuneration	PRSI	Reduce cost to employer of share based remuneration.
Low rate of employer social contributions based on international comparisons	PRSI	Reduces cost of employing staff to employers.
Exemption for transfers of shares listed on Enterprise Securities Market of the Irish Stock Exchange	Stamp Duty	Improve access to non-bank funding for SMEs.
VAT thresholds for cash basis and registration extended	VAT	Improve cash flow for SMEs.

9% rate of VAT for tourism related goods and services	VAT	Reduce the cost of tourism related goods and services to increase tourist numbers.

Source: TSG 15/12

Appendix 3: Tax breaks which have been terminated

This list indicates how widespread tax subsidies become before and during the property boom. Those in the private health sector diverted revenue from the public to the subsidised but “private” sector.

Writing down allowances & balancing allowances in respect of capital expenditure on the following:

Hotels and holiday camps tax subsidies: Budget and Finance Act 2006 - termination of some.

Property based tax incentive schemes with transitional arrangements: Applying as they are phased out. Terminated on 31/07/2008. But the capital allowances in respect of hotels and holiday camps are now available at the reduced rate of 4% per annum over twenty five years and are ring fenced - may be set off only against rental income in the case of individual investors or partnerships.

Tax Subsidies for nursing homes, residential units attached to nursing homes, convalescent homes, hospitals and mental health centres

Supplementary Budget 2009 and Finance Act 2009, terminated capital allowance schemes in respect of nursing homes, residential units attached to nursing homes, convalescent homes, hospitals and mental health centres with transitional measures for pipeline projects.

Sports injury clinics tax subsidies: this scheme was terminated on 31/07/2008

Custom House docks area tax subsidies: 100% Capital allowances and 10 years of double rent allowance.

• Commenced 25 January 1988.

• Terminated June 2000.

• Full closure circa 2015.

Temple Bar Area Tax Subsidies: Capital allowances for industrial and commercial buildings, with double rent allowance for the Temple Bar area in Dublin. Relief provided for 50% of expenditure for new build and 100% for refurbishment. Writing down arrangements - 100% free depreciation for owner-occupiers and 50% year one allowance for lessors, with remainder at 5% per annum.

• Commenced 30 January 1991

• Terminated 5 April 1999.

• Last year of writing down period circa 2011.

Urban Renewal Scheme Tax Subsidies: Capital allowances for industrial buildings and another for commercial buildings from 1994 to 1998 but not closed until circa 2006. Relief available at 50% of spending.

Enterprise Area Tax Subsidy: capital allowances for certain buildings. Like the 1994 Urban Renewal Scheme in its tax reliefs. Introduced in 1995 and 1997. Terminated in 2000

Multi-Story Car Park Tax Breaks: Construction/refurbishment at 50% in year 1 and 4% per annum thereafter. From 1995 and terminated 31 July 2008. Last year of writing down period 2021.

Urban Renewal, Enterprise Area, and Multi-Story Car Park: Double rent allowance in respect of rent paid for certain business premises. A legacy of earlier schemes and closes a few years ago.

Qualifying Resort Areas Tax Breaks: for the construction or refurbishment of hotels, and holiday cottages under the Seaside Resort Scheme. Relief was provided at 75% (free depreciation) for owner occupiers and 50% year one allowance for lessors with the balance available at 5% per annum. Started in 1995 and terminated in December 1999 but actually ended in 2012. There were two additional Resort Areas tax subsidies for other types of investment which have gone.

Qualifying (Urban) Areas: Accelerated capital allowances in respect of capital expenditure incurred in the construction or refurbishment of industrial buildings (factories and mills) at 50% in year and 4% per annum thereafter. Commenced 1999, terminated 31 July 2008 but it remains till 2021 for some investors.

Qualifying (Urban) Area and Living Over the Shop Scheme: same as previous deal.

Qualifying Rural Areas: capital allowances for certain industrial and commercial buildings. Same terms and dates as previous two subsidies.

Park and Ride Investors: Terminated on 31/07/2008.

Town Renewal Area for certain industrial buildings: Capital allowances at 50% in year 1 and 4% per annum thereafter. Began April 2000 and terminated 31 July 2008 and it lasts till 2021.

Town Renewal Area: Capital allowances for certain commercial buildings (shops and offices). Same dates and terms as previous subsidy.

Mid Shannon Corridor Tourism Scheme for registered holiday camps and tourism infrastructure facilities over 7 years. Began 1 June 2008 and terminated in May 2013.

Various Tax Reliefs for different types of losses which can be offset against tax

Relief for investment in Films: Tax relief for investors in film production. Relief at 100% tax relief per year of up to €50,000 to individuals who invest in film production. Started in 1984 as part of the BES. Renewed many times.

Source: TSG

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