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Research Report: Economic update

Irish economy

Irish Commission on Taxation advisory report: key points

Commission's goal is to broaden tax base; corporation tax rate exempted from terms of reference of report

- Note that this report is advisory only: it has issued recommendations that may be used to frame taxation policy in the next few years.
- Commission's goal is to broaden the tax base —'lower taxes on a broad base' is better than 'higher taxes on a narrow base — and to keep it revenue-neutral.
- Ireland's corporation tax rate of 12.5% was exempted and remains a pillar of Irish economic policy.

Property taxation salient element of tax reform

- A residential property tax is proposed, based on self-assessment of the value of a home. That tallies with the report's priority of broadening through property taxes ahead of consumption taxes and, lastly, labour.
- But leaving aside the political difficulties, this cannot be introduced until a national property database is in place: the Commission stresses that this should be set up without delay. Because this will take time in reality, it is very hard to see a property tax being introduced for Budget 2010.
- Stamp duty on principal private residences should be abolished; investors would still be liable to stamp duty.
- No cut in stamp duty on commercial property is recommended; this is disappointing.

Commitment to prioritise low taxes on labour is positive

- Report prioritises lowering the tax burden on labour, as part of base broadening measures. This is welcome, as labour income has already been hammered with tax hikes in the October 2008 and April 2009 Budget.
- The government projected tax increases of €1.75bn for 2010 last April. The property tax will probably not come soon enough and the recommended carbon tax may only yield €500m. The economy cannot afford at least €1bn in further income tax hikes. In order to regain competitiveness and consolidate the fiscal position bigger expenditure cuts must be prioritised.

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Commission recommends keeping taxes on labour low and looking to property and spending taxes first

- This is an advisory report only, and no decisions have yet been taken to implement any part it. Bear in mind that the government has earmarked €1.75bn to be raised in tax for 2010 in December's Budget.
- Ideally, it would not look to raise quite that much in tax. Cutting wasteful public expenditure has to be the priority, drawing significantly on the report of the McCarthy group.
- The problem is that the property tax (see below) is probably a non-runner for 2010. Where is €1.75bn in tax going to be found in that context? Perhaps €500m can be found from sources other than labour, but taxing labour by at least €1bn again would be misguided.
- The terms of reference exempted looking at the 12.5% rate of corporation tax; that remains a pillar of Irish economic policy.
- The commission's goal was to broaden the tax base, but to keep it revenue-neutral; in other words, gains from broadening the tax base should be offset by lowering taxes elsewhere.
- The commission looked at property taxes, spending taxes and income taxes in that order; keeping tax away from labour was the priority.
- Indeed, the summary of part 4.1 states: 'The base-broadening measures in our report should be introduced on a revenue neutral basis. In this context, priority should be given to lowering the tax burden on labour'.
- Ireland's lowish tax rate system remained a priority for the commission: 'We consider that lower tax rates on a broad base are better than higher taxes on a narrow base. Having a broad base allows tax revenue to be raised from a wider range of sources and enables rates of tax to be kept low'.

Property

Property taxation is seen as the salient element of tax reform. The commission proposes:

- A **residential property tax, based on self-assessment of the value of a home** (including grounds up to one acre). There are exemptions for local authority housing, charities and educational facilities.
- **This cannot be introduced until a detailed, up-to-date and consistent national property valuation database is set up.** This should be a policy priority for the government. However, the implication is that the new tax could not be introduced in this December's Budget because of the time required to set up the property database. This is a technical block, never mind the political difficulties.
- **Stamp duty payable on principal private residences should be abolished.** That means that the current stamp duty on non-first-time buyers would disappear; this has been a barrier to liquidity in the

second-hand market. But the Commission suggests that the abolition of stamp duty on principal private residences should only be introduced when a new property tax comes into force. Note that we must avoid a situation where there is speculation about the date of introduction of a property tax (and simultaneous zero-rating of stamp duty). Speculation about timing could lead to the delay of purchases (in an already depressed market): prospective buyers will want to avoid being the last to pay stamp duty. The government should make its plans about a property tax clear in Budget 2010.

- **Investors, and those buying second or holiday homes, would still be liable to stamp duty**. (Investors currently pay no stamp duty on purchases of new homes.) The level of investor stamp duty would be set so as to be competitive with the rest of Europe.
- **The indicative rate is 0.25–0.3%, which would yield around €900m-1.1bn annually (after exemptions).**
- **The commission does not recommend a cut in stamp duty on commercial property from 6%.** This is disappointing, as it is 4% in the UK, and foreign ownership of Irish commercial property is low.
- **The commission proposes maintaining the current mortgage interest relief regime for first-time buyers** (available for seven years starting at 25% and falling to 20% by years 6-7), but relief should be discontinued for all other mortgage-holders.

Labour

- **A three-rate tax on income is discussed, but not actually recommended.** The commission notes the need to keep marginal rates competitive.
- **The employee PRSI ceiling should be abolished.**
- **Taxes on labour should be kept low to support economic activity.**

Consumption taxes

- **The stamp duty on credit and debit cards should be phased out.**

Business

- **The stamp duty on all share transactions should be reduced to zero.**
- **Air travel tax, which is damaging for tourism, should be reviewed**, but in the context of the pending inclusion of air travel in the EU emissions trading scheme from 2010.
- **Local authorities' rates charging system for commercial premises should be reformed.** Local authorities should collect their own rates directly from 2013 onwards.

Capital

- The commission makes no recommendations other than exempting gains attributable to inflation.

Carbon tax

- **A carbon tax on fossil fuels should be introduced.** The key component is likely to be a flat charge on energy products on top of current excise duty.
- The price should be established annually, based on a recognised market for trading carbon credits.
- This may yield €500m on an annual basis.

Environment

- **Water charges should be introduced for domestic consumers**. Initially, this would be a flat rate until meters are installed; thereafter, it should be based on consumption.

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