Taxation

Chapter 12 Part I

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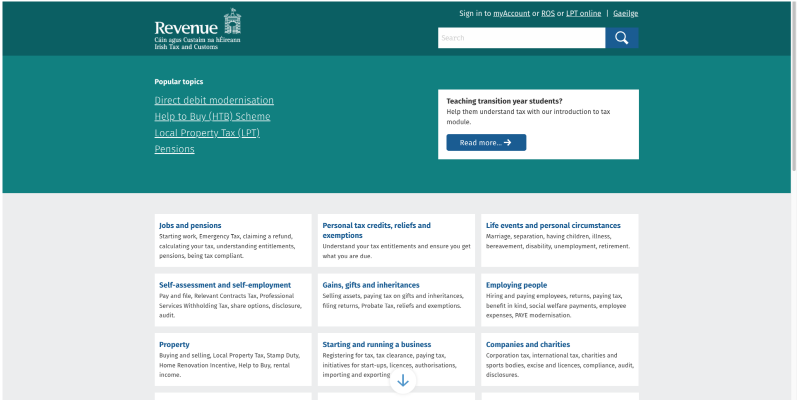
Learning Outcomes

In this chapter we will:

- debate the purpose and impact of taxation on the economy as a whole, explaining how tax policy can be used to address inequality

The Revenue Commission



The taxation data for these slides is sourced from the Revenue Commission website. This is a very useful resource and I would recommend that you use it in your research study if you are discussing Irish tax policy. The Revenue Commission is a gov't body which collects and manages taxation revenues for the Exchequer.

Value Added Tax

VAT – Definition

Value Added Tax (VAT) is tax on the sale of goods & services paid by the final consumer.

VAT can be used to manipulate consumption (aggregate demand) – higher rates reduce aggregate demand while lower rates encourage consumption.

Date effective	Standard rate %	Reduced rate %	2^{nd} reduced rate %	Livestock rate %
1 Jan 2025	23	13.5	9	4.8
1 Mar 2021	23	13.5	9	4.8
1 Sept 2020	21	13.5	9	4.8
1 Jan 2020	23	13.5	9	4.8

The standard 23% rate exists on sales of vehicles, fuel, household goods, and adult clothing. The reduced 13.5% is levied on products in tourism and hospitality.

Excise Duty

Excise Duty – Definition

Excise duties are charges levied on sale of alcohol, tobacco, and fuel (unleaded and diesel).

Item	Duty
Beer	€0.2255 per litre per 1% ABV
Vodka	€17.03 per litre of 40% ABV vodka
Cigarettes	$\approx$ €10.89 per pack of 20
Petrol	$\approx$ €0.95 per litre in taxes

Demerit Goods – Definition

Demerit Goods are socially undesirable goods whose problems/negative externalities are under-estimated by consumers. Tobacco, alcohol, fuel are considered demerit goods.

Since consumers don't see the impact, taxes increase prices, reducing demand.

Universal Social Charge

USC – Definition

Universal Social Charge (USC) is a tax you pay on your income – this is called ‘income tax’. You pay the USC if your gross income is more than €13,000 per year. Once your income is over this limit, you pay the relevant rate of USC on all of your income. It is calculated on a weekly or monthly basis.

Income Bracket	Rate
First €12,012	0.5%
€12,013 to €15,370	2%
€15,371 to €42,662	3%
Amounts over €42,662	8%

USC generates roughly €4 billion in Exchequer revenue annually. It can be seen as a disincentive to work – those who earn more, pay more.

Pay-Related Social Insurance

PRSI – Definition

Pay-Related Social Insurance (PRSI) is an income tax that goes towards funding social welfare. It acts as a type of insurance premium that the State collects to insure workers against risks like unemployment, injury, illness, pregnancy and disability.

PRSI rates are complex and numerous. There is a 118-page document, based on Budget 2025, detailing all the terms and conditions of paying PRSI. To see a list of rates, visit 'rates of payment' on gov.ie website.

If you have a job, take a look at your payslip. You should see a section containing the amount taken out of your wages by PRSI. There is a contribution by the employee (you) and your employer.

Pay As You Earn

PAYE – Definition

Pay As You Earn (PAYE) is an income tax regularly deducted from wages to fund government current expenditure.

2025	2024	2023	2022	2021
€44,000 @ 20% Balance @ 40%	€42,000 @ 20% Balance @ 40%	€40,000 @ 20% Balance @ 40%	€36,800 @ 20% Balance @ 40%	€35,300 @ 20% Balance @ 40%

Exercise

John earns €72,000 in 2025. How much will he pay in (i) PAYE (ii) USC?

$$PAYE : (44,000 \times 0.2) + ((72,000 - 44,000) \times 0.4) = 8,800 + 11,200 = 20,000$$

$$USC : (12,012 \times 0.005) + ((15,370 - 12,012) \times 0.02) + ((42,662 - 15,370) \times 0.03) + ((72,000 - 42,662) \times 0.08) = 3293.02$$

This means that $\frac{23{,}293.02}{72{,}000} \times \frac{100}{1} \approx 32\%$ of John's income is taken by USC and PAYE.

Deposit Interest Retention Tax

DIRT – Definition

DIRT is a tax on interest paid on savings accounts, Credit Union deposits or share dividends.

The DIRT rate is currently 33%. Say you have €2,500 in a savings account, earning 0.5% annually. Based on the current DIRT rate, how much tax would you pay annually?

$$2,500 \times 0.005 = 12.5 \text{ annual interest} \qquad \Rightarrow \qquad 12.5 \times 0.33 = 4.125$$

This is an example of tax being used to affect consumer behaviour. Higher DIRT reduces incentive to save, instead encouraging consumers to spend, to boost economic growth.

Environmental Taxation

A Carbon Tax directly sets a price on carbon by defining a tax rate on greenhouse gas emissions or on the carbon content of fossil fuels. In collaboration with the EU, Ireland has set legally binding targets to achieve a carbon-neutral status by 2050 but on current projections, Ireland is set to reach only a 29% reduction in emissions by 2030. As part of its efforts to achieve this target, Ireland introduced the carbon tax as part of Budget 2010.

The initial rate of carbon tax was set at €15 per tonne, which was subsequently raised to €20 the following year. The Finance Act 2020 has legislated for annual increases to the carbon tax of approximately €7.50 up until 2029 and €6.50 in 2030, when the rate will reach €100 per tonne of CO_2. The 2024 rate of carbon tax is €56 per tonne of CO_2.

Plastic Bag Levy: Retailers who supply plastic bags to customers must charge a levy to customers at the point of sale. Currently the levy is 22c per bag. Retailers then pay this levy to Revenue.

Corporation Tax

Corporation Tax

Corporation Tax is levied on a company's profits.

Country	Statutory rate
Ireland[IE]	12.5% (trading). 15% min for in-scope MNEs†
United Kingdom[UK]	25% (main rate)
United States[US]	21% federal rate. Average state top rate $\approx$ 6.5%‡
Germany[DE]	29.9% (combined national & local)
France[FR]	25%
Netherlands[NL]	25.8%
Luxembourg [LU]	23.87% (combined)
Switzerland[CH]	14.4% (avg combined)
Singapore[SG]	17%

Notes: † OECD Pillar Two 15% minimum applies to groups with global revenue $\geq$ €750m.
‡ State corporate income taxes vary by state; figure shown is average top state rate.

On-slide sources (short names): [IE] Revenue; DoF press release. [UK] GOV.UK. [US] PwC WWTS; Tax Foundation (states). [DE] PwC WWTS; GTAI/Tax Foundation (combined). [FR] PwC WWTS. [NL] PwC WWTS. [LU] PwC WWTS (Lux. City combined). [CH] KPMG Swiss Tax Report 2025. [SG] IRAS. [HK] Hong Kong IRD.

Canons of Taxation

Scottish economist Adam Smith (1723—1790) set out the framework for the ideal tax system.

1. Equity: tax should take up a higher proportion of income as income rises, or, in other words, the more you earn, the more you pay. An equitable tax system considers each individual's ability to pay.
2. Economy: collection of taxes should be efficient so that the cost of collection doesn't exceed the amount collected.
3. Certainty: amount of tax, date and method of payment should be clear to taxpayer.
4. Convenience: the time and method of collection should be convenient to taxpayer.

Other Functions of Taxation

1. **Finance Government Activities:** To finance all government activities e.g. running of civil service, wages of Public Sector workers.
2. **Economic Objectives:** To achieve economic objectives: reducing inflation, favourable balance of payments.
3. **Redistribution of National Wealth:** To redistribute the national wealth through transfer payments/social welfare payments.
4. **Automatic Stabiliser:** It acts as an automatic stabiliser for the economy. It helps to avoid wide fluctuations in the economic cycle by automatically taking more tax when economy is doing well and taking less when economy is performing poorly.
5. **Social Objectives:** To achieve social objectives e.g. discourage smoking, drinking / decrease pollution/damage to environment.
6. **Promote Enterprise:** To help industry through subsidies/grants and other services can be provided to help industry and encourage enterprise e.g. County Enterprise Boards.

Important Tax Definitions

Direct & Indirect Taxes

Direct tax levied on income & wealth. They're deducted *directly* from wages/contract.
Indirect tax imposed on consumption of goods and services. They are indirect because they are paid by consumers, collected by retailers and sent to Revenue.

Progressive, Regressive & Flat Taxes

Progressive Tax a taxation measure which takes up more in tax as income rises.
Regressive Tax a taxation measure which takes up more in tax as income falls.
Flat Tax takes up the same proportion in tax regardless of income

Legal & Illegal Means of Not Paying Tax

Tax Avoidance legal arrangements to reduce tax liability or avoid paying tax – to avoid paying income tax some wealthy individuals like (Dennis O'Brien) live offshore.
Tax evasion illegal means of reducing tax liabilities, like, not declaring income to Revenue.

Important Tax Definitions Cont'd

Specific & Stealth Taxes

Specific Tax applied at fixed rate per unit of the good being taxed, regardless of its price.

Stealth Tax applied in a way that it is largely unnoticed as a tax.

Impact & Incidence of Taxes

Impact of Taxation: the initial economic effect of a taxation measure

Incidence of Taxation: the overall/long-term effect of a taxation measure, i.e., whomever ends up assuming the burden of the tax.

Exam-Style Question

You are appointed Economic Advisor to the Minister for Finance. Outline the economic arguments you would identify for the Minister in favour of lowering Irish income tax rates.

1. **Maintain Standards of Living during Falling Wages:** With wages falling at the moment, standards of living are falling. To alleviate this hardship it may be appropriate to reduce income tax rates – leading to greater disposable incomes.
2. **Incentivise the Workforce:** By allowing workers to take home more of their income it may act as a further incentive for more people to join the labour market or encourage existing workers to increase their level of work.
3. **Improve Competitiveness:** If workers have more disposable income, demands for wage increases are moderated, reducing the costs for employers and improve the competitiveness of Irish industry.
4. **Stimulate Economic Activity:** With lower tax rates, disposable income rises along with spending – boosting indirect tax revenues. This will increase demand and may lead to higher employment and economic growth. The adverse effects of this is that it could result in inflation and greater imports.
5. **Discourages the Black Economy:** Income tax cuts may encourage workers to avoid tax avoidance and tax evasion measures and so legislation achieves their objectives.

Merits and Drawbacks of Carbon Tax

Advantages of the Carbon Tax

1. **Government Revenues:** Higher government revenue through increased revenues from carbon tax.
2. **Investment in R&D and Encourage Innovation:** Greater investment in R&D into alternative (renewable) sources of energy. Government could promote 'green industries', creating jobs.
3. **Change Consumer Behaviour:** Consumers may be more aware of the scarcity of these resources and so become more efficient in their consumption.
4. **Environmental Protection:** The revenue collected can offset the cost of our collective carbon footprint. Also the revenue may be targeted for specific environmental projects.

Disadvantages of the Carbon Tax

1. **Inflationary Pressures:** Higher fuel prices will increase prices, pushing up the CPI.
2. **Loss of Competitiveness:** Industry will now be paying higher prices and this may reduce the international competitiveness of Irish firms. Increased costs may act as a disincentive to attracting foreign direct investment.
3. **Decrease in the Standard of Living:** Higher prices means less disposable income and so standard of living will fall.
4. **Regressive form of Taxation:** This tax focuses on physical emmissons so it would not take a person's ability to pay into account.

Who Actually Pays the Tax

This might seem to be somewhat of a silly question as it must be the person on whom the tax is levied is the one that pays the tax. The result might be suprising. It does not matter who the tax is levied on, what actually decides on who pays it is the PED of the buyer and the PES of the seller. Who pays the tax burden follows one simple rule.

The higher the price elasticity of supply (Elastic Supply) and the lower the price elasticity of demand (Inelastic Demand) the heavier the burden of an excise tax on consumers. Conversely, the lower the price elasticity of supply (Inelastic Supply) and the higher the price elasticity of demand (Elastic Demand) the heavier the burden of an excise tax on producers. The way the tax burden falls is called the *Incidence of Tax*.

The Incidence of Tax

The Incidence of Tax refers to the person who actually pays the tax. This is not necessarily the person on whom the tax was levied or placed.

Price Elasticity and Taxation

Why the Minister for Finance regularly taxes goods such as alcohol, cigarettes and petrol in the Government's annual budget.

1. **Inelastic Demand:** These goods have inelastic demand therefore the quantity demanded will only reduce slightly because of the increase in tax. The government will therefore collect more tax revenue
2. **Goods with Social Consequences:** The consumption of these goods has other consequences e.g. health issues with the use of tobacco and alcohol/social problems from excess alcohol/environmental damage. The government can use the tax system to try to discourage the consumption of these goods/could use the revenue to provide for extra healthcare etc.
3. **To Discourage Private Car Transport and Encourage Public Transport:** By making petrol dearer, the use of public transport may be more attractive and by encouraging its use, the environment is protected by reducing emissions.
4. **To Discourage Tax Evasion:** Since goods like alcohol, tobacco and petrol have inelastic demand people continue to purchase these goods and by including the tax it makes it harder for them to avoid these taxation measures and so legislation achieves their objectives.