



COMMISSION ON TAXATION  
AN COIMISIÚN UM CHÁNACHAS

## PART 1

# EXECUTIVE SUMMARY AND LIST OF RECOMMENDATIONS



# Part 1: Executive Summary and list of Recommendations

## Introduction [Part 2 of our Report]

### **Establishment and terms of reference**

The Commission was established on 14 February 2008 to review the structure, efficiency and appropriateness of the Irish taxation system and with the intention that our work would help establish the framework within which tax policy would be set for the next decade at least.

Our terms of reference are far-reaching. We were asked to have regard to the commitments on economic competitiveness and on taxation contained in the Programme for Government, in particular the four commitments:

- To keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system
- To ensure that our regulatory framework remains flexible, proportionate, and up to date
- To introduce measures to further lower carbon emissions and to phase in on a revenue neutral basis appropriate fiscal measures including a carbon levy over the lifetime of the Government, and
- The guarantee that the 12.5% corporation tax rate will remain

We were invited, in the context of maintaining an equitable incidence of taxation and a strong economy, to consider the structure of the taxation system and specifically to:

- Consider how best the tax system can support economic activity and promote increased employment and prosperity while providing the resources necessary to meet the cost of public services and other Government outlays in the medium and longer term
- Consider how best the tax system can encourage long term savings to meet the needs of retirement
- Examine the balance achieved between taxes collected on income, capital and spending
- Review all tax expenditures with a view to assessing the economic and social benefits they deliver and to recommend the discontinuation of those that are unjustifiable on cost/benefit grounds
- Consider options for the future financing of local government, and
- Investigate fiscal measures to protect and enhance the environment including the introduction of a carbon tax

In our terms of reference we were requested to report by 30 September 2009. Following discussions during March 2009 between the Minister for Finance and our Chairman, this was subsequently brought forward to 31 July 2009.

When we were established in February 2008, our primary focus was on the medium and long term and on the fitness for purpose of the tax system for a period of 10 to 15 years. Since then there has been a very significant change in Ireland's economic circumstances and, while we are of course mindful of these changes, we consider that our primary focus should remain on the medium to longer term and we have

prepared our Report on this basis. The tax system we are proposing is one that we believe will provide greater equity and assist economic growth and this in turn will provide the resources for public services in the future.

### **Guiding principles**

We set down guiding principles – comprising both general principles of taxation and operational principles – to assist us in fulfilling our mandate.

**Equity** - Equity that is, taxing persons on their ability to pay.

**Flexibility** - A flexible tax system is one that is responsive to, and capable of adjusting in line with, changes in society, markets, business practices, technology and economic conditions. Flexibility may also be looked at in the context of budget volatility and the ability to raise one tax to compensate for a shortfall in another.

**Tax neutrality** - In a general sense, tax neutrality is used to describe a tax system that does not create a bias that could influence a taxpayer to choose one course of action over another. In other words, decisions are made on their economic merits and not for tax reasons.

**Simplicity** - The simplicity principle requires that the tax rules are known and that liability is clear.

**Evidence-based approach** - We adopted an evidence-based approach so that, where available, facts and appropriate benchmarks were used to support our analysis and conclusions.

**Pragmatism** - The tight timeframe we had in which to complete our deliberations, together with our wide terms of reference, suggested that we should mostly focus on tax reform rather than tax design. The obvious exceptions here were carbon tax and property taxation, as these are not features of the current tax system.

## **Our approach to tax reform**

### **Role of a tax system**

The primary role of a tax system is to raise revenue to fund Government expenditure.

The Irish tax system has evolved over time to reflect changing economic and social conditions and will need to be equally responsive to new developments in the future. In general, we consider that many aspects of the tax system work well and do not require reform. Other areas are in clear need of reform and are the main focus of the proposals in our Report.

### **Broaden the base rather than increase the rates**

Some of our proposals involve widening the scope of the charge to tax. We consider that lower tax rates on a broad base are better than higher rates on a narrow base. Having a broad tax base allows tax revenue to be raised from a wider range of sources and enables rates of tax to be kept low. In adopting this base broadening approach, we are positioning the tax system to support economic activity which has the potential to sustain and increase employment, encourage enterprise and thus enhance living standards for all.

## **Overall levels of taxation**

We do not seek to increase overall levels of taxation. Rather, we set out to broaden the tax base so that tax is levied on a wider range of income, gains and assets. It is our general view that the revenues raised through the measures we propose should be used to reduce the tax burden in other areas so that the reform is tax neutral overall.

## **Balance of taxation between income, capital and spending**

In striking the appropriate balance of taxation between income, capital and spending, Government in its approach to revenue raising should:

- Seek to broaden the base within each tax head, and
- Look to property taxes, spending taxes (especially environmental taxes), and income taxes in that order

## **A stable revenue base**

We consider that stability is an important attribute of a tax system. This implies that the tax system should be designed with a view to eliminating as far as possible volatility of tax receipts. A consideration in achieving a stable tax base is to tax those factors that cannot avoid the charge to tax. The most obvious example of this is immovable property. We consider that the taxation of property is one area of Ireland's tax system that is particularly in need of reform. Introducing an annual tax on residential property represents an important step towards providing a stable and non-volatile tax base.

## **Equity**

Equity is a key aspect of a tax system. A tax system has a role in the redistribution of income. This is achieved by taxing those with higher levels of income at a higher rate than those with lower levels of income. The redistribution occurs not only in the tax system but also through the welfare system and both systems should operate in a coordinated way. Equity should be considered in the context of the overall tax system. A lack of progressivity in one area of the system may be compensated for by having a high degree of progressivity in other areas, or by focused direct expenditure - which is financed from tax revenues.

## **Ireland's taxation system [Part 3 of our Report]**

Part 3 gives a broad overview of national taxes, of social insurance and levies and of local authority taxes and charges in operation in Ireland. These are considered in some detail in other Parts of our Report.

Income tax, value-added tax, excise duties and corporation tax together account for over 90% of tax receipts; stamp duties, capital acquisitions tax and capital gains tax make up most of the balance. Social insurance contributions and levies are also important in the Irish taxation context and we outline the key components of these in this Part. Finally, Part 3 also gives an overview of the principal charges imposed by local authorities, thus providing a context for our consideration of the future financing of local government in Part 11 in accordance with our terms of reference.

## The Macroeconomic Framework and the Balance of Taxation [Part 4 of our Report]

### **The Irish economy**

The Irish economy has experienced dramatic change since the reports of the previous Commission on Taxation over 25 years ago. In the intervening years Ireland has experienced significant economic growth with living standards converging on, and in some cases surpassing, those of other developed economies. The recent change in the Irish economy has impacted greatly on the country's fiscal position and resulted in a significant increase in unemployment levels. Our approach is that the extra revenue that is raised by our proposals for broadening the base of the tax system should be available to reduce existing tax rates, particularly taxes on labour. In this way our structural reform should allow the taxation system to collect a set amount of revenue with less distortion to the economy and in a more equitable manner. It should also contribute, along with other policies aimed at restoring competitiveness, to the policy goal of moving towards effective full employment in the medium term.

Our terms of reference make it clear that we are to have regard to keeping the overall tax burden low. Furthermore, our remit is to consider the structure of the taxation system for the "medium and longer term" rather than consider broader fiscal policy and the short-term situation.

### **Balance of taxation between income, capital and spending**

We note that in striking the appropriate balance of taxation between income, capital and spending, Government in its approach to revenue raising should seek to broaden the base within each tax head and look to property taxes, spending taxes (especially environmental taxes) and income taxes in that order.

This suggested hierarchy of different taxes is based on their economic impact. Policymakers will need to consider any trade-off with other objectives of tax policy, particularly equity. The basis for this ranking is that a tax on less mobile factors will cause less economic distortion, as confirmed by both international and Irish evidence. Corporation tax is omitted from the ranking because Ireland already has a low corporation tax rate and our terms of reference require us to have regard to "... the guarantee that the 12.5% rate of corporation tax will remain".

This ranking is not a simplistic 'one size fits all' model for tax policy. The particular circumstances of a specific country may give reason to expect deviations from this ranking. In this way different models may be appropriate for different countries. The appropriate ranking may also change at different points in time.

### **A sustainable fiscal balance**

It is our view that, for the longer term, fiscal policy should pursue a counter-cyclical budgetary approach that achieves balance over the economic cycle. Taking into account the position of the economic cycle involves the accumulation of resources in good times so that in less benign times fiscal policy can be expanded in order to support greater economic activity. There is now a greater emphasis on the role of fiscal policy in demand management in Ireland because, as a member of the Eurozone, we no longer have our own exchange-rate policy and monetary policy. With regard to capital spending we advise some flexibility, in particular so that the large costs that can be incurred by a 'start-stop' approach to large capital projects are avoided.

In addition, public spending should be based on a stable revenue base. Unstable sources of tax revenue can include pro-cyclical taxes which intensify the business and economic cycle. Thus we recommend a move away from a transaction-based tax on property such as stamp duty towards introducing more stable revenue sources, including an annual tax on residential property and user charges.

## Tax system - structural issues [Part 5 of our Report]

### **Income tax structural issues**

The main purpose of the income tax system is to collect revenue to fund public services. The system has other important roles including the redistribution of resources as well as incentivising a number of desired outcomes such as participation in the labour force. There are now four parallel systems, with four different bases, which collect tax on income: income tax, PRSI, the health contribution levy and the income levy. We consider that there should be a single system that collects tax on income.

Income tax is charged by way of a two-rate structure. For the longer term we consider that a three-rate structure has merit on grounds of equity, greater progressivity and flexibility. Such a structure should reflect the need to keep taxes on labour low and marginal rates competitive.

### **Unit of taxation and individualisation**

We support, as a general principle, the continuation of the position whereby the family is the unit of taxation and that this should be the position for all direct taxes. However, in relation to income tax, a “hybrid” arrangement has been in place since 2000, with regard to the tax band structure and credits that apply to married couples. We consider that this arrangement should remain in place as it represents a balance between, on the one hand, acknowledging the choices families make in caring for children and, on the other, taking account of the need to encourage labour force participation.

### **Cohabiting couples**

As regards the tax treatment of opposite sex and same sex cohabiting couples under the tax code, we hold the view that tax law should follow the general law in this area. To the extent that general law extends to opposite sex and same sex couples the same treatment under the law as that afforded to married couples at present, we envisage that they should be covered by our recommendation as regards the unit of taxation.

### **Minimum wage and taxation**

Policy in relation to lower earners over the past decade was aimed, among other things, at taking low earners out of the income tax net so that people could keep more of what they earn. Our view is that the general aim should be to continue to exempt the minimum wage from taxation.

### **High earners**

A measure to limit the use of certain tax reliefs and exemptions for those on high incomes came into effect in 2007. It provides for more equity by improving progressivity in the income tax system. A balance has to be struck between providing tax incentives to encourage investment in areas of the economy and a measure which restricts the use of those same incentives. We recommend that the measure remains part of our tax code, that it be periodically reviewed and that it should apply to individuals availing of reliefs

and exemptions who earn more than €250,000 rather than the existing limit of €500,000.

## **PRSI**

PRSI has certain characteristics of a tax. It is a complex system that has a wide scope covering both benefits and contributions. It is not easily understood and contains a number of anomalies. We recommend that there should be a separate comprehensive consideration of the PRSI system. We examine the aspects of PRSI that have the characteristics of tax and make a number of recommendations regarding PRSI which include broadening and rationalising the base.

The health contribution levy does not confer any right or entitlement of benefit on the contributor. It is thus in the nature of a tax. We recommend that this levy should be abolished and integrated into the income tax system when fiscal conditions improve sufficiently to allow a transition to the new structure. We also recommend that the national training fund levy should be abolished and a different approach to funding the national training fund should be put in place.

## **Refundable tax credits**

A refundable tax credit is one where, if an income-earner has insufficient income to use all of his or her tax credit, the unused portion is paid to him or her by way of a cash transfer. We do not recommend a move to refundable tax credits at this stage. However, if there is not an appropriate level of uptake of direct expenditure support through measures like Family Income Supplement payments after a period of five years, the question of refundable tax credits should be considered as a policy option to ensure a more equitable distribution of resources.

## **Integration of the tax and welfare systems**

We recommend further integration of the tax and social welfare systems in terms of closer technical and policy integration, greater exchange of information and the further development of administrative co-operation between the Revenue Commissioners and the Department of Social and Family Affairs.

## **The tax treatment of social welfare payments**

Certain social welfare payments are exempt from tax. We conclude that, as a general rule, all social welfare payments should be subject to taxation and that the statutory provisions which exempt from income tax elements of social welfare payments should be discontinued. However, we do not recommend any change in the taxation status of maternity benefit, adoptive benefit and health and safety benefit and we recommend that specific exemptions from income tax should be introduced for the Family Income Supplement, domiciliary care allowance and the respite care grant. We also recommend that arrangements should be put in place as early as practicable to ensure that tax due on social welfare payments is collected at source by the Department of Social and Family Affairs. When in place, the arrangements for this would facilitate the taxation at source of child benefit payments. Section 8 of Part 8 contains our recommendations with regard to child benefit and taxation.

## **The taxation of capital**

In regard to capital gains tax we recommend that capital gains should not be taxed to the extent that they arise from inflation. We also recommend the reintroduction of rollover relief in the case of farm land disposed of under a compulsory purchase order. However, in Part 8 we recommend limiting the reliefs

available on the transfer of business and farm assets within families.

### **Residence**

Residence rules are important as regards equity and protecting Ireland's taxing rights. The present rules – which are based solely on time spent in the country – need to be strengthened. We are recommending that the existing 183/280 days test for determining the tax residence of an individual be supplemented by additional criteria, which should include tests relating to a permanent home and an individual's centre of vital interests.

### **Remittance basis**

The remittance basis is an anachronism that is not compatible, on equity grounds, with a modern tax system and it should be discontinued. However, withdrawal of the remittance basis is a significant change to the tax system and there should be a lead-time of three to five years before any legislation to discontinue it takes effect. We also recommend (in Part 7) a carefully targeted incentive aimed at attracting key skills into Ireland.

### **Regulatory framework**

Equity, efficiency and fairness should underpin the administration of Ireland's tax system. The perception of fairness is vital if a tax authority is to have the confidence of taxpayers. The relationship between the taxpayer and the taxing authority is enhanced where the compliance burden is minimised to the greatest extent possible. Against this background, we make a number of recommendations on the appeals process, interest charges and the regulatory and compliance burden.

### **Tax avoidance**

Tax avoidance offends the principle of equity and can undermine both the tax base and tax compliance. Against this background we consider the current approach to dealing with avoidance and we recommend a review of the effectiveness of the measures now in place.

## **Taxation of property [Part 6 of our Report]**

### **Restructuring of taxation of property**

We consider that all property should be subject to recurrent taxation – either through the local government commercial rates system or a recurrent tax on residential property. We recommend the introduction of an annual property tax on residential property. Such an annual tax should be put in place as soon as is feasible.

A rebalancing of the existing tax system to provide for a more stable tax base is desirable and an annual property tax will help achieve this. The restructured property tax system that we propose will help reduce economic distortion arising from the present emphasis on transaction based property taxes. It is appropriate to move away from an undue reliance on stamp duty – where the tax revenues are contingent on the level and value of property transactions. A property tax would provide a reliable revenue stream that cannot be avoided and can therefore provide stable revenue for the Exchequer and, in due course, local government financing.

### **Economic aspects of an annual property tax**

Our examination of property taxation measures had regard to evidence that annual taxes on land and buildings have a small adverse effect on economic performance and that taxes on capital and financial

transactions are highly distortionary. An over-reliance on transaction taxes – particularly stamp duty on property – has contributed to tax revenues dropping more quickly than (nominal) GNP. An annual property tax would, in our view, create a sounder base from which the property market can develop.

### **Other taxes on property**

When an annual property tax is introduced, stamp duty on a residential housing unit that is a person's principal private residence should be zero-rated. However, stamp duty should continue to apply for investor purchasers of residential housing units. The rate should take account of transaction tax rates (and thresholds) that apply across the EU.

There are two other specific areas where we propose changes to the taxation of property. Firstly, windfall gains arising from increases in land values due to rezoning decisions should be subject to an additional capital gains tax charge. Secondly, a recurrent property tax should be introduced on land zoned for development that is not used for the zoned development.

### **Design features of an annual property tax**

The annual property tax (APT) we recommend should:

- Apply to all residential housing units with the broad exception of local authority and social housing and some limited other exceptions
- Be payable by the owner of the property
- Be calculated by reference to the open market value of the property using valuation bands and be subject to self-assessment
- Apply at a rate which is proportionate
- Have regard to ability to pay with a general waiver provision exempting house-owners under a low income threshold. A deferral option should also be provided where certain criteria are met
- Have transitional rules in the case of a principal private residence of a person who paid stamp duty during the previous seven years, and
- Have a wide range of payment options

### **The need for an up-to-date valuation base**

We recommend the development of an up-to-date valuation base for all residential, business, commercial and industrial property in Ireland.

### **Implementation**

The timing of any change in policy on the taxation of residential property is a sensitive issue. However, it is arguable that such a change is less difficult at a time when the residential property market is at or near the end of a downturn in the economic cycle. Introducing an annual property tax would, in our view, create a sounder base from which the property market can develop when taken with other compensating measures such as the zero-rating of stamp duty on principal private residences.

### **Property tax rate**

Prescribing the rate of an annual property tax is not a matter for us. However, factors that should be taken into account in setting a rate to replace, in a stable property tax system, the somewhat volatile flows from

stamp duty include:

- The revenue flow to be replaced should not reflect the windfall receipts from stamp duty which arose from the rapidly growing property market during the period 2003–2007, and
- The need to finance waivers for those on low incomes

### **Local government financing**

We envisage that the annual property tax will be an important component in the future financing of local government and recommend that before the next local elections in June 2014, Government should give local authorities flexibility regarding setting the rates of tax. We explore other aspects of local government financing in Part 11 of our Report.

## **Supporting economic activity [Part 7 of our Report]**

### **Context of our work – low effective tax rates**

We believe that the best way to achieve low effective tax rates is to broaden the tax base so that tax rates can be kept low. This highlights a trade-off between supporting overall economic activity and supporting specific economic sectors and activities. We believe that primacy should go to supporting overall economic activity and tax rates are centrally important in this regard. We do accept, however, that incentives are needed in limited circumstances and we deal with these in Part 8 of our Report. We also believe that the specifics of the tax code are important; how the Irish tax code compares with other jurisdictions has extra consequences for a small open economy with large levels of mobile investment.

It is generally agreed that corporation tax policy, in particular the introduction of the 12.5% standard rate of corporation tax from 2003 onwards, has been a key factor in Ireland's economic success. A low, stable corporation tax rate is very important in supporting economic activity in the long term.

We stress the importance of a low tax wedge in maintaining competitiveness. A core principle of tax policy into the medium term should be to keep taxes on labour and the labour tax wedge low, in order to reduce the costs of employment, stimulate demand for labour and encourage labour force participation.

### **Facilitating enterprise**

A tax code that facilitates enterprise is a key component in supporting economic activity. We identify specific areas where further improvement is warranted. We recommend measures to help new business and the removal of what we perceive to be barriers to the efficient functioning of existing business. Our key recommendations include abolishing stamp duty on share transactions, reducing the rate of tax on dividends from ordinary shares, relaxing the close company surcharge provisions and easing the preliminary tax payment rules for both large companies and new non-corporate enterprises.

We also propose a change to the treatment of capital expenditure for business purposes. Our recommendation is that accounts depreciation for tax purposes should replace the existing capital allowances regime for capital expenditure on 'tools of the trade' and also on buildings. In the case of buildings we recommend that the new regime should apply to buildings that currently qualify for capital allowances. We also propose that the list of such buildings be extended. This move will contribute significantly to the development of a tax system that is appropriate, flexible and capable of responding to change – key elements of our remit on supporting economic activity.

### **Supporting sectors and activities**

We also focus on the development, through taxation, of the knowledge-based economy, and make recommendations in relation to research and development (R&D) tax credits and the tax treatment of royalty payments from abroad. It is clear that Ireland's ability to regain the productivity per person it experienced in the period 1994-2000 will depend in substantial part on the development of a knowledge and innovation led economy. Tax incentives focused on these areas will assist in making this transition.

Maintaining the corporation tax rate at 12.5% is an important signal that enterprise is important and to be encouraged. The price signals for carbon and for water that we propose in Parts 9 and 11 create a market incentive for innovators. Our proposals as regards R&D tax credits are likewise supportive – we recommend that companies should be given the option of offsetting R&D tax credits against employer PRSI costs. These are significant changes which, we believe, will enhance the overall attraction of Ireland as a location of choice for enterprise.

We also explore the role of taxation in 'upskilling' the labour force as this is a key component of economic development. We propose two new incentives: one aimed at persons who are made unemployed so that they can offset the retraining costs they incur on certified training courses against income for previous years; the other aimed at attracting key skills into Ireland. We recommend a carefully targeted incentive based on specific skills, rather than salary criteria, to allow Ireland compete in world markets for mobile employees who are in demand internationally.

The measures that we recommend to support specific sectors and activities will also of course benefit enterprises outside the target sectors and complement our package of measures to support business generally.

## **The review of tax expenditures [Part 8 of our Report]**

### **Defining a tax expenditure**

There is no generally accepted definition in Ireland of what constitutes a tax expenditure. We therefore adopted the OECD definition of a tax expenditure – as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure. There are valid reasons why a tax system needs to incorporate relieving measures and exemptions, for example, to help it function equitably and efficiently and to interact with other systems at an international level. Such measures, while they may reduce the tax base, are part of the structure of the tax system or are desirable elements that make the tax system function efficiently. These are part of the benchmark tax system and, in accordance with the OECD definition, are not tax expenditure.

We also recommend that, in general, direct government expenditure should be used instead of tax expenditures.

Tax expenditures can involve a number of undesirable characteristics including a lack of equity as between different taxpayers and a lack of transparency and visibility in the allocation of public resources. They also have the potential to facilitate tax avoidance, have no cost restraints and are generally not reviewed regularly. The potential unequal distribution of public resources, which arises from the use of tax expenditures, was a key consideration for us.

### **Role for tax expenditures**

We consider, however, that tax expenditures, if carefully designed and controlled, have an important role to play in delivering desired behavioural responses.

There are three instances where it would be appropriate to examine the possibility of introducing a tax expenditure. They are:

- To correct market failure
- To attract mobile investment, and
- To offset shortcomings in other areas of public policy

Where a tax expenditure is proposed, or an existing expenditure's timescale is to be extended, we recommend that it be tested against these criteria as well as meeting the principles of efficiency, stability and simplicity. It would also be necessary to justify a departure from the equity principle which a tax expenditure invariably necessitates.

### **Evaluation of tax expenditures**

We recommend that for all future tax expenditures, and reforms of tax expenditures, there should be an *ex ante* evaluation process in advance of decisions to implement or extend any tax expenditure. As part of this process, the costs and benefits of the proposal should be assessed and the alternative of a direct expenditure approach should be considered. Only those which can be justified by reference to that test should be put in place.

We also recommend better measurement and data collection on the costs and benefits associated with the introduction or extension of the tax expenditure and the review of its impact. Data collection on costs and benefits needs to be considered in the design or modification of tax expenditure.

Finally, we recommend the publication of an annual tax expenditures report by the Department of Finance which should be a part of the annual budget process and subject to Oireachtas scrutiny. As a means of exerting control over spending through the tax system, a number of devices should be used including the imposition of thresholds and ceilings (outside of which no tax relief would be available) and reductions in the rate at which tax relief is given or in the quantum of a base figure to which tax relief might apply.

### **Benchmark tax system and review of current Irish tax expenditures**

Our Report first identifies a complete list of all tax relieving measures in the Irish tax system. In total 245 tax relieving measures are identified. Having reviewed these, we concluded that 130 were part of the benchmark tax system and 115 were tax expenditures. We classified these tax expenditures into the following eight categories:

1. Children
2. Housing
3. Health
4. Philanthropy
5. Enterprise, including farming
6. Employment
7. Savings and investment
8. "Other" tax expenditures

Each tax expenditure within these eight categories was analysed in terms of cost, numbers benefiting, the policy objectives underpinning them and how each rated when measured against the principles for a tax expenditure. Based on this examination we made a recommendation as to whether each tax expenditure should be continued, discontinued or modified. These are set out fully in the main body of Part 8 of our Report. We also recommend that transitional arrangements should be put in place, where appropriate, in relation to tax expenditures which are being discontinued.

## Tax and the environment [Part 9 of our Report]

### Overview

Under the provisions of the EU Energy and Climate Change Package agreed in December 2008, Ireland is legally obliged to reduce its emissions by 20% (from a 2005 base) by 2020 in the following sectors – agriculture, residential, low intensity energy and commerce, transport and waste. There is no price signal facing those operating in those sectors indicating that the capacity to absorb greenhouse gases is now very scarce and should be used sparingly and that reducing such emissions will be rewarded by reduced payments.

Those who emit more are in effect subsidised by those who emit less. A charge that would repair this market failure by rewarding the reduction of emissions and penalising the converse is, therefore, appropriate. In terms of impact on emissions it will be an important policy tool to help Ireland achieve its legally binding EU obligations and make a positive contribution to the climate change agenda.

Imposing a tax on the leading greenhouse gas (carbon dioxide) will incentivise the action needed in ways that leave the response up to the emitter and that reflect the polluter pays principle – in essence those who emit more pay more. We also recommend that specific arrangements be put in place to ensure that those who experience energy poverty will be fully protected from the impacts in terms of price rises.

### Carbon tax

The introduction of a carbon tax was specifically mentioned in our terms of reference and in Part 9 of our Report we outline a detailed proposal for a carbon tax. The tax should apply to fossil fuels consumed in Ireland, it should be based on tonnes of carbon dioxide (CO<sub>2</sub>) emitted by each fuel and it should be collected upstream, at the earliest point of supply. It should be visible at the point of final consumption, to help ensure that behavioural change aspects are maximized and it is not seen as 'just another tax'. In general, the rate should match the price of carbon available under the EU emissions trading scheme (EU ETS); however, we believe that a floor price is also appropriate, so that the tax will have some effect on behaviour and give certainty. Streamlining with existing excise provisions, exemptions for participants in the EU emissions trading scheme and possible accommodation of businesses with special agreements to reduce their carbon footprint, are other components of our recommendations.

We do not propose that a tax on other greenhouse gases (methane, nitrous oxide, and the three F-gases) should be imposed. Methane and nitrous oxide emissions from agriculture cannot at this time be accurately monitored, reported and verified so our conclusion not to impose a carbon tax is pragmatic. We recommend that research into measures to reduce agricultural emissions should be pursued. Our preferred approach for the F-gases is to conclude voluntary agreements with business and to foster producer initiatives.

**Other environmental measures**

The targeting of greenhouse gas emissions via a carbon tax is just one application of environmental taxes. We recommend amendments to the VAT Directive to allow lower rates for energy efficient goods and services. We support the accelerated capital allowances scheme for energy efficient equipment, and suggest that the potential for expanding it to incentivise innovation, along the lines of the scheme used by the Netherlands, should be evaluated. We also recommend the gradual phasing out of VRT over a ten-year period and its replacement with taxes on motor usage. A car scrappage scheme, confined to the purchase of electric cars and vehicles with very low carbon emissions, may also be appropriate.

**Revenue neutrality and carbon tax**

Our terms of reference indicate an intention that environmental measures should be revenue neutral. The overall effects of our proposed carbon tax on vulnerable households should be appraised to ensure that such households (urban and rural) are cushioned from the effects of the tax. We also suggest that the recycling of carbon tax revenues to fund energy efficiency incentives for business and households would be appropriate. The availability of carbon tax revenues to improve competitiveness is also a valuable policy tool.

**Green economy**

Other aspects of our Report (set out in Part 11) include recommendations in relation to the introduction of domestic water charges and the pricing of waste collection and final disposal charges in accordance with the polluter pays principle. These are directly relevant to our environmental remit. We bring all elements together under a “green economy” umbrella in Part 9. The price signals for carbon and for water that we propose create a market incentive for innovators particularly those in energy efficiency, renewables supply and greenhouse gas abatement.

**Tax incentives for retirement savings [Part 10 of our Report]****Introduction**

The State provides a State pension through the social welfare system. The pension is intended to provide an adequate basic standard of living in retirement. In many cases this State pension will be supplemented by private pension arrangements, generally through occupational pension schemes and personal pension arrangements, which are regulated by the State and afforded support through the tax system.

The gap in coverage – whereby some individuals do not save for retirement and instead rely on the State pension to meet all of their needs – forms a backdrop to our deliberations. A key consideration in our examination of this issue was our changing demographics. By 2050, Ireland will move from an old-age dependency ratio of six people of working age to every one person aged 65 or over (6:1), to a ratio of 2:1 – in other words, just two people of working age to every one person aged 65 or over. Unless there is more personal saving for retirement in the meantime, there is likely to be a significant gap in coverage.

**Tax incentives for retirement provision**

The tax system offers incentives to encourage retirement provision, by allowing contributions to occupational pension schemes, personal retirement savings accounts (PRSAs) and retirement annuity contracts (RACs) to be deductible in calculating taxable income. While these incentives are widely used, there remains a

gap in retirement savings coverage, particularly in the case of those with low to middle incomes.

### **Equity issues**

There are a number of equity issues in regard to the tax treatment of retirement savings. Our proposals address some, but not all, of the equity issues involved.

The main issue is the inequity involved in the fact that those liable to tax at the higher rate of income get tax relief at 41% while those liable at the standard rate get tax relief at 20%. This involves the Exchequer giving different levels of support to different taxpayers. Relief should be given at a single rate irrespective of the individual's marginal tax rate.

Giving tax relief for all pension contributions at the higher rate would act as a strong incentive to those on lower levels of income who have not been providing for their retirement to begin to do so. In addition, it would not disincentivise those taxable at the higher rate who have been getting relief at that rate because they would continue to get relief at that rate. However, we had concerns about the costs of this approach, particularly the costs if auto-enrolment, which is another of our proposals, were to apply.

We present a model that could improve equity in the tax treatment of retirement savings and also act as an incentive to those liable to tax at the standard rate to make savings for their retirement. We also believe that coverage could be increased by applying an auto-enrolment approach and giving enhanced relief in the early years of retirement provision.

### **Package of measures for retirement savings**

We are putting forward a model through which the tax system could be used to encourage people to save for their retirement. The main elements are:

**Matching contribution** - All contributions towards supplementary retirement provision should qualify for a matching Exchequer contribution of €1 for each €1.60 contributed by the taxpayer. Giving State support to retirement provision in this way would improve equity and incentivise savings by low to middle income earners. Support could be given at a higher rate, of €1 for each €1 contributed by the taxpayer for a limited period for all supplementary pension contributions.

**Soft-mandatory approach** - Employers would be obliged to offer the PRSA facility and automatically enrol employees in the scheme. The 'soft' aspect is that an employee would be entitled to opt out of the scheme later.

**A retirement savings scheme** - A retirement savings scheme along the lines of the former special savings incentive accounts (SSIA) scheme, should also be introduced. This would be a simple savings scheme that would allow savings for retirement based on a minimum savings requirement and involving an Exchequer contribution of €1 for each €2 saved. It would also allow limited pre-retirement access to funds.

We recognise that the changed economic climate is not making it easy for individuals to decide to invest in pension products. One aspect of the model we present, that of the matching contribution by the Exchequer where pension contributions are made by individuals, may be appropriate to a more stable economic and retirement savings environment than exists at the time of publication of our Report.

### **Tax treatment of the lump sum**

The tax-free status of the lump sum on retirement facilitates transition from full pay to pension. It may also act as an incentive to individuals to save for their retirement. On the other hand, the payment of a

lump sum defeats to some extent the purpose of a pension which is to provide an income in retirement. We consider that changes should be made to the tax treatment of the lump sum.

Under existing rules a tax-free lump sum of 25% of the fund, or 1.5 times final salary, is allowed. We recommend that

- The first €200,000 of that lump sum should be tax-free
- The excess of that lump sum over €200,000 should be taxable at the standard rate

## Future financing of local government [Part 11 of our Report]

### Introduction

Our terms of reference asked us to consider options for the future financing of local government. Our recommendations in this Part are also informed by other considerations including the ongoing debate about autonomy and accountability in local government, re-establishing the linkage between responsibility and revenue raising and the polluter or user pays principle in regard to the supply of services.

Our recommendations for the future financing of local government focus on changing the balance between nationally provided and locally collected sources of income. Local authorities source around 55% of their overall current income from their own generated sources such as: commercial rates, housing rents and receipts for goods and services such as waste charges and water charges from the commercial sector. The share of local authority-budgeted income provided directly by the State in 2009 amounts to just over €2 billion – or 45% of total current income. Overall our recommendations will change that balance to a position where, by the end of a five-year period, local authorities would source well over 75% of their income from their own generated sources.

### Property taxation and local government financing

Ireland is one of the few countries which does not impose a tax on domestic property to fund local government. In Part 6 of our Report we set out our recommendations for introducing an annual property tax (APT). We also recommend that after an appropriate period all of the revenues from this tax should be used for local government financing

- In the first instance APT revenues should be hypothecated for local government financing once the tax has become established, and
- By no later than the next local elections (June 2014) APT rate setting powers should be devolved to local government

### Water charges

Ireland is investing heavily in the development and operation of water supply and waste treatment systems, and must continue to do so, both in order to ensure that water of high quality is available where and when it is needed, and to meet requirements of the EU Drinking Water and Wastewater Directives. With the exception of the contributions of business, these very substantial costs are funded from general taxation. Households do not pay for water, and there is no incentive to conserve, so that consumption per capita is about 30% more in Ireland than in jurisdictions that do charge based on use. Those who use water irresponsibly are in effect subsidised by those who use it sparingly, and there is a constant need to expand the supply of treated water involving major and expensive engineering projects. It is unlikely

that Ireland will be able to maintain this level of expenditure indefinitely from general taxation, and the outcome will be inadequacies in the quantity and quality of supply.

We recommend that domestic water charges should be phased in over a five year period. These charges should be substantially based on use but commence with a flat rate charge and move to volumetric billing once meters are put in place. Early installation of meters should be incentivised. Such charging will not just encourage water conservation but simultaneously generate the funds needed to ensure that water supply, water quality and Ireland's consumption levels per capita are up to international norms. Water wasters will no longer be subsidised by those who conserve. We recommend that waivers be made available to those who are unable to pay water charges.

### **Commercial rates**

We recommend a number of measures to broaden the commercial rates base which should increase financing from this source by at least 10%. The main measures include rating State properties, changing the relief for vacant properties and the part-rating of third-level and professional institutions.

### **Receipts for own goods and services**

The user/polluter pays principle was relevant to our review of the delivery of water and waste services by local authorities. We recommend a number of other measures to increase revenues from the supply of own goods and services by local authorities.

There is a wide gap (estimated at nearly €40 million in 2006) between the cost of running the planning system and the revenue received in planning fees. We recommend that this should be addressed and responsibility for setting planning fees should be devolved from the Minister for the Environment, Heritage and Local Government to local authorities, subject to central guidelines being developed.

There is considerable variation in the rental income per local authority housing unit across local authorities. We recommend that maximum rent levels should be removed to ensure that some tenants and households do not benefit disproportionately. The significant disparity across local authorities between rents collected on an income per housing unit basis should also be addressed urgently. A review of the current differential rents scheme should be carried out to improve the sustainability and effectiveness of the scheme, as previously recommended by National Economic and Social Council (NESC). Finally, there should be no deviation from the policy that housing rents are based on a person's ability to pay.

Encouraging behavioural change so that all consumers manage waste in a more efficient manner, and that waste reduction is achieved in line with the principle of 'reduce, re-use and recycle' should – along with landfill minimisation targets – be a primary focus of waste charge rates.

The Landfill Levy should be further increased to encourage diversion from landfill and meet our obligations under EU law and a similar mechanism should be considered for other forms of final disposal.

### **The balance of local government financing and the equalisation of funding**

The Needs and Resource Model (developed by the Department of the Environment, Heritage and Local Government in 2000) ensures that the difference in the costs bases of local authorities are reflected in relevant decisions by central government on equalisation funding. We recommend that this be periodically reviewed and that a comprehensive review be carried out when our recommendation that the revenues from an annual property tax be used as a source of local government financing is implemented.

## Recommendations in our Report are as follows:

For ease of reference each recommendation number commences with the relevant Part number. There are no recommendations in Parts 1 to 3 of our Report.

### Part 4: The macroeconomic framework and the balance of taxation

- 4.1 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.

### Part 5: Tax system – structural issues

#### **Income tax**

- 5.1 There should be a single system which collects tax on income.
- 5.2 A three-rate income tax structure has merit but should have regard to the need to keep taxation on labour low and marginal rates competitive.
- 5.3 As a general principle, the family should continue to be the unit of taxation for all direct taxes.
- 5.4 The present arrangements with regard to band structure and credits which apply to married one-earner and married two-earner couples should remain in place.
- 5.5 If taxation is applied to child benefit, a child tax credit should be introduced to offset the additional tax payable in respect of child benefit for those in the lower half of the income scale.
- 5.6 The general aim should be to continue to exempt the minimum wage from income tax.
- 5.7 An earned income credit at a modest level should be phased in over time for proprietary directors and the self-employed.
- 5.8 A measure to limit the use of specified tax reliefs and exemptions by high earners should remain part of our tax code.
- The required effective rate should apply to those earning over €250,000. It should apply on a graduated basis to those earning between €200,000 and €250,000.
  - This measure should be periodically reviewed, including when economic growth returns to a more stable trend, to determine whether the level of the required effective rate should be increased.

#### **The interface between the tax and the social welfare systems**

- 5.9 In view of the burden on the Exchequer, the PRSI base should be broadened.
- 5.10 There should be a separate comprehensive consideration of the PRSI system.
- 5.11 A similar PRSI base should apply to employees and the self-employed and there should be a single rate of charge which should apply to both.
- 5.12 The employer PRSI ceiling should not be reinstated.
- 5.13 The employee PRSI ceiling should be abolished and this should be done on a phased basis.
- 5.14 Employees should be subject to PRSI on unearned income such as investment income and rental income.

- 5.15 Share-based remuneration, including share options, should be subject to PRSI.
- 5.16 Relief from PRSI should apply in respect of pension contributions made by self-employed contributors, subject to payment of a minimum PRSI contribution to secure future entitlement to benefits.
- 5.17 Trading losses should be deductible for PRSI purposes subject to the payment of a minimum annual PRSI contribution.
- 5.18 The step effect in PRSI and the health contribution levy should be eliminated.
- 5.19 The health contribution levy should be integrated into the income tax system.
- 5.20 The national training fund levy should be abolished and a different approach to funding the national training fund should be put in place.
- 5.21 There should be further integration of the tax and social welfare systems.
- 5.22 On balance, we do not recommend a move to refundable tax credits at this stage. If there is not an appropriate level of uptake of direct expenditure support through measures like Family Income Supplement payments within a five-year period, the question of refundable tax credits should be considered as a policy option to ensure a more equitable distribution of resources.
- 5.23 As a general rule, all social welfare payments should be subject to taxation.
- The statutory provisions which exempt from income tax elements of social welfare payments which are otherwise taxable should be discontinued.
  - There should be no change in the taxation status of maternity benefit, adoptive benefit and health and safety benefit.
  - Specific exemptions from income tax should be introduced for Family Income Supplement, the Domiciliary Care Allowance and the Respite Care Grant.
- 5.24 Arrangements should be put in place as early as practicable to ensure that tax due on social welfare payments is collected at source by the Department of Social and Family Affairs.

### **The taxation of capital**

- 5.25 Gains attributable to inflation should be excluded from the charge to capital gains tax.
- 5.26 Capital gains tax rollover relief should apply to the gains on disposal of farm land pursuant to a compulsory purchase order where the proceeds are re-invested in farm land.

### **Consumption taxes**

- 5.27 The policy approach to determining the level of excise duty applicable to alcohol and tobacco products should take account of factors such as health outcome, public order issues, cross-border trade and other societal issues.
- 5.28 A deferral system should be applied in place of the daily payment system that currently applies to excises on mineral oils. However, any change should ensure that there is no cash-flow cost to the Exchequer.
- 5.29 Stamp duty on ATM, credit and debit cards should be phased out in the interest of promoting the move towards a cash-free society.

### **International issues**

- 5.30 The 183/280 days test for determining the tax residence of an Irish citizen should be supplemented

by additional criteria, which should include a permanent home test and a test based on an individual's centre of vital interests.

- 5.31 The rule that allows an individual, who makes a gift of property to Ireland, to be regarded as neither resident nor ordinarily resident in Ireland, notwithstanding being present in Ireland for significant periods, should be discontinued.
- 5.32 The remittance basis of taxation for income tax and capital gains tax should be discontinued.

### **Regulatory framework**

- 5.33 The relationship between the State and the taxpayer should be informed by reasonableness and proportionality through the provision of safeguards to ensure equitable treatment. To the extent that it is practicable, safeguards should be provided on a statutory basis.
- 5.34 The State's interaction with the taxpayer so as to ensure tax compliance should be proportionate.
- Access to determinations of the Appeal Commissioners should be simultaneously available to taxpayers and the Revenue Commissioners.
  - A cost-effective route of appeal should be available to all taxpayers.
  - Other recommendations made in the Reports of the Law Reform Commission and the Revenue Powers Group in relation to the reform, jurisdiction and operation of the appeal system should be implemented.
- 5.35 The interest rate applicable to overdue tax payments should be reviewed each year having regard to the prevailing market rates and the rate should be sufficiently high to discourage taxpayers from deferring tax payments.
- 5.36 The Revenue Commissioners should adopt general criteria towards reducing the regulatory burden as outlined in section 7.2.2 of Part 5.
- 5.37 Dividend withholding tax exemption claims by foreign parent companies should not require third party certification.
- 5.38 Self-assessment should apply to interest and royalty withholding tax exemptions and reductions that are available in tax treaties.
- 5.39 The relevant contracts tax rate should be reviewed to ensure that it does not lead to a taxpayer paying tax in excess of final liability.
- 5.40 Flexibility should be given to the Revenue Commissioners to vary the strict application of interest and penalty provisions in *bona fide* situations where relevant contracts tax was not applied but at no loss to the Exchequer.
- 5.41 A system should be put in place to permit payments for professional services to be made without deduction of professional services withholding tax to compliant taxpayers with an appropriate certificate from the Revenue Commissioners.
- 5.42 Where detailed data is required to allow the appropriate evaluation and cost-benefit analysis of tax expenditures, the taxpayers and businesses availing of the tax expenditures should be required to e-file their tax returns.

### **Tax avoidance**

- 5.43 Where tax avoidance is identified and demonstrates a weakness in the law, a specific provision in the tax code should be enacted to prevent the avoidance in question.

- 5.44 Twenty years after the introduction of the general anti-avoidance provision, it is now opportune to review its effectiveness as a tool to tackle tax avoidance. This should include consideration of a time limit within which the Revenue Commissioners would be required to make a decision on the point at issue.

## Part 6: Taxation of property

- 6.1 The provision of an up-to-date valuation base for all property and land in Ireland should be addressed as a priority issue.
- 6.2 Provide for an annual property tax on all residential housing units with the broad exceptions of local authority and social housing units and some other limited exceptions set out in section 4.2 of Part 6.
- 6.3 Stamp duty for purchasers of principal private residences should be zero-rated.
- 6.4 Stamp duty should continue to apply to investor purchasers of residential housing units. The rate should be competitive having regard to the transaction tax rates and thresholds that apply across the EU.
- 6.5 The windfall gains from increases in land values due to rezoning decisions should be subject to an additional capital gains tax charge.
- 6.6 A recurrent property tax on land zoned for development should be introduced.

## Part 7: Supporting economic activity

### Corporation tax

- 7.1 A low stable corporation tax rate should remain a core aspect of Irish tax policy to support economic activity in the long term.

### Taxes on labour

- 7.2 A core principle of taxation policy into the medium term should be to keep taxes on labour income, and the labour tax wedge, low in order to reduce the cost of employment and to sustain and stimulate demand for labour.
- 7.3 Taxes on labour should be kept low to support economic activity.
- 7.4 The degree of progressivity of taxes on labour should take into account the potential economic effects, particularly on job creation and entrepreneurship, as well as equity considerations.
- 7.5 Policymakers should take into account the fact that the economic impact of labour taxes is not uniform across the income distribution range and by reference to other demographics.

### Supporting business

- 7.6 The 'corporation tax holiday' for new business should be extended to companies starting out in 2010 or 2011, and a similar scheme should be introduced for the non-corporate sector (see Recommendation 8.65).
- 7.7 An optional arrangement should be made available to new non-corporate businesses to allow them to spread their tax payments over the first three years.
- 7.8 Stamp duty on all share transactions should be reduced to zero.
- 7.9 The tax rate on dividends received by Irish residents should be reduced to the rate applying to

deposit interest.

- The measure should apply to ordinary shares.
- Safeguards should be included to ensure that the provision operates as intended.

7.10 Corporation tax payable on gains on disposal of assets used for trading purposes should be at the rate applicable to trading profits.

7.11 All companies should be allowed to adopt a previous year option in relation to the payment of preliminary tax.

7.12 The recommendation that all companies should be allowed to adopt a previous year option in relation to the payment of preliminary tax should be implemented having regard to the cash-flow costs involved in such a move. In this regard, options might include:

- Gradually increasing the small company threshold over a number of years, until all companies are covered.
- Allowing large companies the option of using a fixed multiple – say 105% – of the previous year's figure.

7.13 The close company surcharge on professional service companies should be removed.

7.14 The close company surcharge on investment and estate income of companies should be retained. However, the *de minimis* amount before the provisions come into play should be substantially increased in order to ease the regulatory burden for companies in such cases.

7.15 The Revenue Commissioners should closely monitor the new regime to ensure that it operates as intended.

7.16 The remaining close company surcharge provisions should be examined by the Department of Finance and the Revenue Commissioners to ensure their effectiveness.

7.17 A review should be undertaken by Government to assess the effects of the air travel tax on business in general and tourism in particular. This review should be set in the context of the pending inclusion of air travel in the EU Emissions Trading Scheme (EU ETS) from 2012.

7.18 Taxable income should be computed for business income (Schedule D, Case I and II) based on the accounting profits of a business, with normal statutory disallowances. In particular, we propose that accounts depreciation for tax purposes should replace the capital allowances regime used in business.

- In the case of buildings, the new provision should only apply where the buildings qualify for capital allowances under the existing rules (but see Recommendation 7.19).
- Businesses should be permitted to change to the new regime at any time in a five-year transitional period.
- Existing special regimes should continue.

7.19 The list of buildings that qualify for deductibility for tax purposes should be extended.

### **Supporting sectors and activities**

7.20 Companies should, at their option, be permitted to offset their R&D tax credit against their employer PRSI costs.

7.21 Unilateral credit relief for foreign withholding tax on royalty payments should be extended to all trading companies.

- 7.22 An overall foreign pooling system for foreign withholding tax on royalty payments should be introduced.
- 7.23 Persons who are made unemployed should be entitled to offset the retraining costs they incur on certified training courses against income for the previous six years.
- 7.24 The partial reintroduction of the remittance basis in the Finance (No. 2) Act 2008 should be discontinued.
- 7.25 A carefully targeted tax incentive, along the lines indicated in Box 7.13, should be introduced to attract skilled persons into Ireland to meet short-term skills gaps.

## Part 8: The review of tax expenditures

### General

- 8.1 The OECD definition of a tax expenditure – as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure – should be adopted.
- 8.2 Measures that are part of the benchmark tax system should not be considered as tax expenditures.
- 8.3 In general, direct Exchequer expenditure should be used instead of tax expenditures.
- 8.4 There are three instances where it would be appropriate to examine the possibility of introducing a tax expenditure. These are:
- To correct market failure
  - To attract mobile investment
  - To offset shortcomings in other areas of public policy

Where a tax expenditure is proposed, or an existing expenditure's timescale extended, the following questions should be asked, in sequence:

- Does the expenditure fall within one or more of the three instances outlined above?
- If so, does the proposal adhere to each of the following principles:
  - Efficiency
  - Stability, and
  - Simplicity
- If so, can a departure from the equity principle, which the tax expenditure invariably necessitates, be justified?

A tax expenditure should only be introduced, or extended, if it answers affirmatively to each of these questions.

- 8.5 For all future tax expenditures, and reforms of tax expenditures, there should be:
- An *ex ante* evaluation process in advance of decisions to implement or extend any tax expenditure, including an assessment of the costs and benefits of proposals and consideration of the alternative of a direct expenditure approach.
  - Better measurement and data collection on the costs and benefits associated with the introduction or extension of the tax expenditure and the review of its impact.
  - Publication of an annual tax expenditures report by the Department of Finance as part

of the annual budget process and subject to Oireachtas scrutiny.

- Spending through the tax system should be controlled by, for example, the imposition of thresholds and ceilings and reductions in the rate at which tax relief is given or in the quantum of a base figure to which tax relief might apply.

8.6 Transitional arrangements should be put in place where appropriate in relation to tax expenditures which are being discontinued.

### **Relating to children**

8.7 Child benefit should be taxable income.

- The taxing of child benefit should be benchmarked against alternatives, including means testing, to ascertain the most effective method of achieving the aims and objectives of the child benefit programme.
- If taxation is applied, we recommend the introduction of a child tax credit to offset the additional tax payable in respect of child benefit for those in the lower half of the income scale.

8.8 The exemption of foster care payments from income tax should continue.

8.9 The one-parent family tax credit should continue and the credit should be allocated to the principal carer only and in a similar way to the current arrangements for child benefit.

8.10 The home carer tax credit should continue.

8.11 The widowed parent tax credit should continue.

8.12 The capital allowances for childcare facilities should be discontinued.

8.13 The income tax exemption for childcare service providers should be discontinued.

8.14 The exemption of employer-provided childcare from the benefit-in-kind charge should be discontinued.

### **Relating to housing**

8.15 Mortgage interest relief should be continued in the case of first-time buyers and discontinued for those who are outside this category. The current step down arrangements for first-time buyers regarding the rate at which relief is given should continue to apply.

8.16 Income tax relief for rent paid for private rented accommodation should be discontinued.

8.17 The capital gains tax exemption on the disposal of a principal private residence should be continued.

8.18 Income tax relief for service charges should be discontinued.

8.19 The rent-a-room relief should be discontinued.

8.20 The capital gains tax and stamp duty exemptions on the disposal of site to a child should be discontinued.

### **Relating to health**

8.21 Medical insurance relief should be continued on a more limited basis.

8.22 Relief for health expenses should continue at the standard rate.

8.23 Once the Fair Deal system for nursing home care has been implemented, removal of the tax relief for nursing home expenses should be considered.

8.24 The range of treatments contained within the scope of the relief for health expenses should be

subject to regular review.

- 8.25 Tax relief for contributions paid to permanent health benefit schemes should continue.
- 8.26 Tax relief for long-term care policies should be discontinued.
- 8.27 When direct expenditure support at the appropriate level is in place, the incapacitated child tax credit should be discontinued.
- 8.28 The allowance for employing a carer for an incapacitated individual should continue. However, the rate of relief should be the same as that available under health expenses relief.
- 8.29 The dependent relative tax credit should be discontinued.
- The entitlement to mortgage interest relief that is derived from entitlement to the credit in relation to a principal private residence occupied by a dependent relative should continue. A person should be able to avail of first-time buyer levels of relief once in respect of himself or herself and once in respect of a dependent relative who has not claimed for himself or herself.
  - The separate entitlement to CGT relief on the disposal of a principal private residence occupied by a dependent relative should be discontinued.
- 8.30 When direct expenditure support at the appropriate level is in place, the blind person's tax credit should be discontinued.
- 8.31 The arrangements for the scheme of accelerated capital allowances for palliative care units should be modified by the introduction of a termination date for the scheme.
- 8.32 The Disabled Drivers and Disabled Passengers Scheme should be modified in accordance with the recommendations of the 2002 Interdepartmental Review Group.

### **Relating to philanthropy**

- 8.33 The scheme for payment of tax by means of donation of heritage items should be retained but should be modified so that the tax relief is limited to 50% of the value of the item donated.
- 8.34 The scheme for payment of tax by means of donation of heritage property should be retained but should be modified so that the tax relief is limited to 50% of the value of the property donated.
- 8.35 The capital gains tax exemption on works of art loaned for public display should be retained but the exemption should only apply to the gain accruing in the period for which the work of art has been so loaned.
- 8.36 Income tax relief for expenditure on heritage buildings and gardens should be discontinued.
- 8.37 The benefit-in-kind exemption on employer-provided art objects in a heritage building or garden should be discontinued.
- 8.38 The CAT exemption of heritage property and heritage property of companies should be retained.
- 8.39 The threshold on the eligibility of individual donations to charities and approved bodies to attract tax relief should be reduced from €250 to €100.
- 8.40 The relief for individuals under Recommendation 8.39 should be at the standard rate in all cases.
- 8.41 An upper limit of €500,000 per person on the annual value of donations which may attract tax relief is recommended. This limit should be enforced using the principles of self-assessment and audit.
- 8.42 The self-employed should be treated in the same way as PAYE earners under the scheme with the tax relief being paid to the charity or approved body.
- 8.43 In relation to donations from companies, the amount that would attract tax relief should be the same

as for individuals, i.e. a maximum of €500,000 per annum. The rate of tax relief on corporate donations should be the corporate tax rate and, as with donations from individuals, the tax relief should be paid to the charity or approved body.

- 8.44 The tax relief scheme available on donations to sports bodies should be modified. The tax relief regime that is recommended in respect of donations to charities and other approved bodies should also apply in relation to relief for donations to sports bodies and aggregate limits should apply to both reliefs.
- 8.45 Relief for gifts made to the Minister for Finance should continue.
- 8.46 The tax-exempt status of philanthropic and sports bodies should continue. However, the capital gains tax exemption should be discontinued where development land is disposed of.

### **Relating to enterprise (including farming)**

- 8.47 The restriction of balancing charges on a building to the relevant holding period for that building should be discontinued for future acquisitions.
- 8.48 Grants to meet revenue expenditure should be taken into account in calculating taxable trading income and capital allowances should be available on expenditure net of capital grants. However, in the case of employment related grants, there may be a case for postponing the approach we suggest until more favourable labour market conditions apply.
- 8.49 The tax credit for research and development should continue.
- 8.50 Tax exemption for patent royalties should be discontinued.
- 8.51 The tax deduction for capital expenditure on scientific research should continue.
- 8.52 Film relief should be continued but should be subject to regular review in accordance with our principles as set out in Section 5 of this Part.
- 8.53
- The Business Expansion and Seed Capital schemes should remain in place up to their 2013 deadline.
  - The schemes should be reviewed to evaluate their effectiveness and the extent to which market failure exists in advance of any further extension beyond 2013.
  - The administrative burden placed on companies seeking to benefit from the schemes is onerous and should be reviewed.
- 8.54 Stock relief for farming businesses should be discontinued.
- 8.55 Income tax relief for farm land leasing income should be continued. However, the measure should be reviewed in 2012 in accordance with our principles as set out in Section 5 of this Part.
- 8.56 The accelerated allowance for capital expenditure on farm buildings for pollution control should not be continued when it expires in 2010. For subsequent years, normal capital allowances should apply.
- 8.57 The tax relief for the purchase of milk quota should be discontinued.
- 8.58 The restructuring aid for sugar beet growers should continue.
- 8.59 The tax exemption for payments to National Co-operative Farm Relief Services Ltd. and payments made to its members should be discontinued.
- 8.60 The accelerated capital allowances for energy efficient equipment should continue.
- 8.61 Relief for investment in renewable energy generation should continue. Any extension should adhere

to our general principles as set out in Section 5 of this Part.

- 8.62 The Mid-Shannon corridor scheme should not be continued beyond its current expiry date.
- 8.63 The investment allowance for machinery and plant and for exploration expenditure should be discontinued.
- 8.64 The tax treatment of the decommissioning of fishing vessels should continue.
- 8.65 The relief from tax for start-up companies should be continued. However, the scheme should be modified so that companies who begin trading in 2010 or 2011 would benefit from the exemption for two-years or one-year, respectively, within the existing three-year timeframe for the relief. In addition, the exclusion which applies to service companies should be removed.
- A new scheme for unincorporated businesses should be established which would have its own three-year time cycle in line with the approach we recommend for the existing scheme.
  - Both the existing scheme and the proposed new one for unincorporated business should be subject to review in accordance with our general principles as set out in Section 5 of this Part after a reasonable period of time.
- 8.66 The tax treatment of venture fund managers should be modified such that in the case of an individual who is a venture capital fund manager:
- Where the investment return on a carried interest represents income, it should be taxed at the appropriate marginal rate, and
  - Where the investment return on a carried interest is a capital gain, it should be subject to capital gains tax at the normal rate (25%).
- 8.67 The tonnage tax regime should be continued.
- 8.68 The capital gains tax relief for family transfers should be continued but limited so that it applies to asset values up to €3 million. Where the value of the asset transferred exceeds €3 million, only the part of the gain that is attributable to the excess over €3 million should be charged to tax.
- 8.69 Capital gains tax relief for disposal of a business or a farm on retirement should continue.
- 8.70 For business relief for CAT, a reduction of no more than 75% of the value of the business should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million.
- 8.71 For agricultural relief for CAT, a reduction of no more than 75% of the value of the property should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million. A condition of the relief should be that a farm asset is owned and operated as a farm for a period of six years after the transfer.
- 8.72 Business relief and agricultural relief should be amalgamated into a single relief.
- 8.73 Stamp duty relief for transfers of land to young trained farmers should continue.
- 8.74 The stamp duty exemption relating to the sale or transfer of EU Single Farm Payment Entitlements should be continued.
- 8.75 The tax incentives relating to forestry should be continued.

### **Relating to employment**

- 8.76 Income tax relief for trade union subscriptions should be discontinued.
- 8.77 The relief for benefit-in-kind for employer-provided personal security assets and services should continue to apply where arrangements are made for all employees at risk.

- 8.78 The relief for benefit-in-kind and PRSI exemption for employer-provided public transport travel passes should continue.
- 8.79 The relief for benefit-in-kind and PRSI exemption on employer-provided bicycles and related safety equipment should continue.
- 8.80 The income tax exemption for scholarships should continue.
- 8.81 The income tax relief for fees paid for third-level education should continue.
- 8.82 Income tax relief for fees paid for training courses should continue.
- 8.83 The exemption from income tax of statutory redundancy payments should continue.
- 8.84 Income tax relief for *ex-gratia* termination payments should continue but the quantum of the exempt payment should be limited to €200,000 and the reliefs for Standard Capital Superannuation Benefit and top-slicing relief should be simplified.
- 8.85 *Ex-gratia* termination payments related to death or disability should be subject to a limit in relation to the tax-free amount permissible.
- 8.86 Income tax relief for termination payments where an employment involves foreign service should continue. However, it should be subject to an overall monetary cap of €200,000 in line with our recommendation for termination payments in excess of the statutory redundancy amount.
- 8.87 The exemption from income tax for retraining on redundancy should continue.
- 8.88 There are grounds for discontinuing the systematic short-time relief for equity reasons. However, discontinuation should not be implemented until more favourable labour market conditions apply.
- 8.89 Income tax relief for long-term unemployed and double deduction in respect of payroll costs should continue.
- 8.90 Income tax relief for employees on payments related to compensation for loss of future earnings should continue.
- 8.91 The PRSI exemption for employee (unapproved) share options should be discontinued.
- 8.92 Continue the income tax exemption for approved profit-sharing schemes (APSSs) and remove the PRSI, health contribution levy and income levy exemptions.
- 8.93 The tax treatment which applies to employee share ownership trusts (ESOTs) should continue.
- 8.94
- The income tax exemption for approved share option schemes (APSOs) should be discontinued.
  - The taxable value of option gains should also be liable to both employer and employee PRSI and to the health contribution levy and the income levy.
- 8.95 Continue the income tax exemption for the save as you earn (SAYE) schemes and remove the PRSI, health contribution levy and income levy exemptions.
- 8.96 Extend the SAYE rules to permit a broader range of employee stock purchase plans (offered to all employees on similar terms and subject to an overall share purchase limit) to be eligible for income tax relief.
- 8.97 The income tax exemption for new shares purchased on issue by employees should be discontinued.
- 8.98 The artist's exemption should be discontinued; consideration should be given to introducing income averaging in the taxation of income from creative work.
- 8.99 The sportsperson's relief should continue.
- The total repayment of tax for any 10-year period should be capped at €350,000 as

adjusted for inflation.

- The sportsperson can only select a block of 10 consecutive years for which to claim the relief as opposed to the best 10 non-continuous years.
- The relief should be subject to review after five years of operation under these new arrangements.

8.100 The seafarer's allowance should be discontinued.

8.101 The expenses of members of the Oireachtas should be treated in the same way under the tax code as expenses paid to employees and office holders generally.

- A monetary limit should be put in place on the dual abode allowance and the flat rate element of the relief which applies in relation to hotel and guesthouse accommodation should be discontinued.

8.102 The income tax exemption for payments under Scéim na bhFoghlaimeoirí Gaeilge should be discontinued.

### **Relating to savings and investments**

8.103 Tax exemption for the income of credit unions should be continued.

8.104 The annual exemptions for interest and dividends on special term accounts and special term share accounts should be continued.

### **Relating to other expenditures**

8.105 The age tax credit should continue.

8.106 The age exemption and marginal relief should continue.

8.107 The tax relief for income under dispositions for short periods (deeds of covenant) should continue.

8.108 The tax relief available to Veterans of the War of Independence should continue.

8.109 The relief from income tax of military and other pensions, gratuities and allowances should continue. In future, the tax treatment of military service gratuities should be consistent with the tax treatment of lump sum payments in other public service employments.

8.110 The exemption from income tax of profits from lotteries should continue.

8.111 Consanguinity relief within the stamp duty code should continue.

## **Part 9: Tax and the environment**

### **Taxing carbon dioxide emissions**

9.1 A carbon tax on fossil fuels should be introduced.

9.1.1 The carbon tax should be based on a standardised measure of CO<sub>2</sub> content of the energy product. Measurement factors used should accord with international norms.

9.1.2 The carbon tax should apply to energy products released for consumption in Ireland.

- The tax rate should approximate the ETS price of carbon.
- The price should be established annually, on a recognised market place for trading carbon credits.
- A floor price for carbon should be set.

- 9.1.4 Any phasing in of the tax rate should depend on the scale of the price.
- 9.1.5
- The carbon tax should be collected at the earliest practical point of supply and linked into the existing mineral oils tax system where appropriate.
  - The carbon tax should be clearly visible at the point of final consumption to ensure it is not seen as 'just another tax'.
  - Working capital problems caused to small distributors/suppliers with slow stock turnover by the imposition of a tax at the earliest point of supply should be accommodated where practicable.
- 9.1.6
- In general, there should not be preferential rates of carbon tax.
  - Binding action-based and/or target-based monitored agreements to reduce emissions should be accommodated under the carbon tax design.
- 9.1.7
- Carbon tax should not apply to ETS participants.
  - Tax should not be imposed at this time on ETS participants in order to capture the gains they made from the free allocation of permits; the issue should be monitored and taxation may be appropriate in the future.
- 9.1.8 Administrative rules for the carbon tax should fit in with existing tax provisions where practicable.

### **Tax on other greenhouse gases**

- 9.2 Research into measures to reduce agricultural emissions – such as alternative technologies and feeding systems – should continue and be intensified.
- 9.3 If methane and nitrous oxide emissions from agriculture become capable of being monitored, reported and verified with sufficient accuracy, their exclusion from the carbon tax should be reconsidered.

### **Product taxes**

- 9.4 Environmental product taxes should be considered where voluntary initiatives are unsuccessful. If such taxes are to be considered, the criteria developed by us (see Box 9.8) should be met.

### **Energy efficiency**

- 9.5 Continue the Accelerated Capital Allowance for energy-efficient equipment scheme for its current term; evaluate the potential for expanding the scheme to incentivise innovation (based, for example, on the Dutch model).
- 9.6 Ireland should support amendments to the EU VAT Directive that would allow the implementation of lower VAT rates for energy-efficient goods and services.
- 9.7 Businesses that are not in the emissions trading scheme should be given a rebate on their carbon tax payments if they participate in an approved mandatory energy reduction programme.

### **Transport**

- 9.8 The VRT system should be replaced by a system based on car usage, in the longer term. Such a system should be introduced over a 10 year period in order to minimise adverse impacts (in relation, for example, to the existing fleet of tax-paid vehicles).
- 9.9 A focussed scrappage scheme, targeted at encouraging a switch to the purchase of electric and very low carbon emitting vehicles, should be considered.

## Part 10: Tax incentives for Retirement Savings

- 10.1 The regime for non-funded pensions should be examined to identify the implicit tax cost to the Exchequer in the context of an equitable distribution of the tax expenditure on pensions.
- 10.2 The current tax relief for personal retirement provision should in the medium to long-term be replaced by a matching Exchequer contribution of €1 for each €1.60 contributed by the taxpayer.
- 10.3 The matching contribution approach should be accompanied by a kick-start provision involving a contribution of €1 for each €1 contributed by the taxpayer in the first, say, five years of pension provision by an individual.
- 10.4 The matching contribution should apply where an individual has relevant earnings including where, because of the level of his or her earnings, the individual is not liable to tax.
- 10.5 A soft-mandatory approach could make a significant contribution to increasing pension coverage and should be considered.
- 10.6 An employee's payslip should show the amounts contributed by the Exchequer to the employee's retirement savings.
- 10.7 A retirement savings scheme along the lines of the former SSIA scheme, that is easily understood and which involves an Exchequer contribution, should be introduced – the scheme is outlined in Box 10.16 of Part 10.
- 10.8
  - As the annual earnings limit does not apply to employer contributions, there is a need to retain the standard fund threshold.
  - There should be a correlation between the annual earnings limit and the standard fund threshold, and the reduction in the annual earnings limit suggests that there should be a corresponding reduction in the standard fund threshold.
- 10.9 A lump sum taken on retirement should be liable to tax as follows:
  - An amount of up to €200,000 should be tax free.
  - The balance of the lump sum should be subject to tax at the standard rate of income tax.
- 10.10 The current tax relief rules should be reviewed to ensure that contributions and remuneration levels cannot be manipulated close to retirement to allow individuals to take advantage of unintended and inappropriate benefits.
- 10.11 Age-related limits on the amount of an individual's relevant earnings should continue.
- 10.12 The flexibility of an ARF should be extended to defined contribution occupational pension schemes.
- 10.13 Anomalies in the treatment of different retirement arrangements should be eliminated as far as possible.
- 10.14 The various ages specified in the legislation governing the time at which benefits may commence should be reviewed and conformed.

## Part 11: Future financing of local government

### Local commercial property taxation measures

- 11.1 The revaluation initiative should be expedited to ensure that a transparent nationwide valuation system, including a cost-effective route of appeal, is in place as soon as possible. Regular revaluations should be carried out thereafter, in order to ensure that the valuation base remains up-

to-date. This should be done as provided for in legislation, at intervals of not more than 10 years.

11.2 The vacancy relief provisions should be amended to provide for the granting of vacancy relief by local authorities, in accordance with the following principles:

- Vacancy relief should only be granted where the following conditions are satisfied:
  - An owner/leaseholder is *bona fide* unable to obtain a suitable tenant, or
  - A property is vacant due to repairs or alterations being carried out on it, and
  - That the relief, where granted, is time-limited so as not to encourage the owners of a premises to allow it to become dilapidated, and
  - The rate of the relief to be granted by a local authority to be within the range 50-100% for the time-limited period
- Vacancy relief should be applied *pro-rata* according to the period of vacancy in any year.

11.3 The provision which states that a property must be vacant at the time of the striking of the rate by a local authority should be removed.

11.4 Permanent offshore structures should be made subject to commercial rates.

11.5 Bed and breakfast accommodation and guesthouses should be brought within the commercial rates base where there are four or more bedrooms in a dwelling house provided on an ongoing basis for overnight guest accommodation. Self-catering apartments and holiday homes provided by tourism operators should also be brought within the rates base.

11.6 Third-level and professional institutions should be part-rated to reflect the fact that they generate significant funds from their own resources and conduct commercial activity on their campuses.

11.7 Community halls should be part-rated where significant commercial activity takes place in such facilities.

11.8 Agricultural farm buildings which are owned by a body corporate should be subject to commercial rates.

11.9 All buildings or land occupied by the State should be brought fully within the commercial rates base.

### **Annual property tax as a source of local government funding**

11.10 After an appropriate period all of the revenues from an annual property tax should be used for local government financing.

11.11 The proposed annual property tax system should be established and operated as a national property tax system for a short initial period:

- Its revenues should then be hypothecated for local government financing as soon as is feasible – once the tax has become established, and
- By no later than the next local elections (June 2014), rate-setting powers should be devolved to local government subject to the considerations set out at section 5.3 of Part 11.

11.12 A new method of equalisation of funding, using a needs and resources model, should be developed in conjunction with the devolution of rate-setting powers to local government to reflect the changed funding base for local government.

### **Water charges**

11.13 Measures should be put in place immediately to ensure that the costs of water services provided are fully recovered from the non-domestic sector.

- 11.14 Domestic water charges should be introduced, as a sustainable approach to realising an acceptable conservation culture.
- 11.15 There should be some level of incentivisation to ensure that consumers are encouraged to install meters.
- 11.16 Charges should be phased in over a period of time.
- 11.17 The charging should commence with a flat rate charge and change to volumetric billing for consumers once meters are put in place.
- 11.18 A waiver scheme should be provided for low-income householders.
- 11.19 Water meters should be installed in all new housing units.
- 11.20 A public information campaign should clearly outline the rationale for water charges and the way in which they will be implemented.
- 11.21 Water pricing should be introduced for all water consumers by local authorities based on a consistent methodology and applying the principle of full cost recovery.

### **Waste charges**

- 11.22 The polluter pays principle should continue to underpin waste charges to ensure that all consumers pay for their own waste.
- 11.23 The landfill levy should be increased to encourage behaviour to divert waste away from landfill and meet our obligations under EU law and a similar mechanism should be considered for other forms of final disposal.
- 11.24 Waivers should be available from all service providers in all local authority areas to all clients who lack an ability to pay.
- 11.25 We do not support the establishment of a national waiver scheme. The pricing of waste and water services should be designed to fund the cost of providing services to consumers who qualify for a waiver.
- 11.26 Tax relief on service charges should be abolished.

### **Other means of financing local government**

- 11.27 Following an efficiency review:
- The Department of the Environment, Heritage and Local Government should develop a charging system in conjunction with local authorities to ensure a higher proportion of planning costs are recouped from planning applicants
  - Consideration should be given to devolving responsibility for setting planning fees from the Minister to local authorities subject to central guidelines being developed
- 11.28 There should be no deviation from the policy that housing rents are based on a person's ability to pay. Maximum rent levels should be removed to ensure that some tenants and households do not benefit disproportionately.
- 11.29 A review of the current differential rents scheme should be carried out to improve the sustainability and effectiveness of the scheme, as previously recommended by NESCC.
- 11.30 The significant disparity across local authorities between rents collected on an income per housing unit basis should be addressed without delay with a view to elimination.

- 11.31 The Needs and Resource Model should be periodically reviewed and evaluated to ensure that the difference in the costs bases of local authorities are reflected in relevant decisions by central government on equalisation funding. The reviews should be undertaken in partnership with local authorities.
- 11.32 The initiatives being undertaken to improve efficiencies in local authority expenditure programmes should continue to receive a priority focus at local authority level and from central government. That priority will be assisted by the new standardised costing system which provides for greater benchmarking of local authority performance.