

NERI Research inBrief

April 2019 (no 63)

Taxes on Capital in the Republic of Ireland

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ISSN 2009-5848

SUMMARY

Taxes on capital are an important part of government revenue in the Republic of Ireland. More broadly, capital taxes have implications for relative competitiveness, revenue sufficiency and equity.

In this inbrief, I investigate the role capital taxes play in revenues relative to other similarly developed European comparators. I then move to an exploration of the components of capital tax revenues. I find that, in aggregate terms, levied capital taxes per capita are very close to the peer-weighted average and constitute a comparatively large portion of aggregate revenues due to the comparatively low total tax take in the Republic of Ireland. Decomposing capital taxes, I show that disproportionate taxes on corporate income mask relative deficits in all other subcategories, particular under the subcategories of tax on *Income of self-employed* and *Stock of Capital*. The latter subcategory encompasses many taxes that the OECD classifies as both pro-growth and pro-equity. Thus, increased revenues in these areas could reduce inequality and address expenditure shortfalls in a growth friendly manner.

KEY POINTS

- In aggregate terms, capital taxes levied per capita were very close to the price adjusted population weighted average of nine similarly developed sizable EU states in 2017. Capital taxes make up a comparatively large portion of aggregate tax receipts because tax receipts in Ireland are among the lowest in the comparator group due to low levels of labour taxation.
- Decomposing capital taxes further, aggregate average receipts are driven by above average tax collected on the income of corporations, approximately €2.7 billion on a scaled basis. Scaled shortfalls in other categories are substantial, particularly in the areas of tax on self-employed income and taxes on capital stocks which together amount to a shortfall of about €2.5 billion.
- There is little evidence to suggest that development and equity run counter to each other. Taxes on Stocks on capital, particularly on property and net wealth are both pro equity and pro growth. Similarly, expanded access to benefits could encourage individuals to engage in business ventures. Receipts could also address expenditure shortfalls in key areas.

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Research for new economic policies

Introduction

Taxes on capital are an important part of government revenue in the Republic of Ireland. A major component of capital taxes in the state - Corporate tax revenue has grown substantially over the past several years. In contrast, other forms of capital tax rarely receive the same attention. More broadly, capital taxes have implications for relative competitiveness, revenue sufficiency and equity.

In this inbrief, I investigate the role capital taxes play in aggregate revenues relative to other similarly developed European comparators. I then move to an exploration of the components of capital tax revenues. I find that, in aggregate terms, levied capital taxes per capita are very close to the peer-weighted average and constitute a comparatively large portion of aggregate revenues due to the comparatively low total tax take in the Republic of Ireland.

Decomposing capital taxes, I show that disproportionate taxes on corporate income mask relative deficits in all other subcategories, particular under the subcategories of tax on Income of self-employed and Stock of Capital. The latter subcategory encompasses many taxes that the OECD classifies as both pro-growth and pro-equity. Thus, increased revenues in these areas could reduce inequality and address expenditure shortfalls in a growth friendly manner.

Capital Tax and Aggregate Revenues

Governments levy taxes on a number of streams of income, manner of assets and a great deal of consumption. One way of dividing tax revenues splits taxes by tax base. These tax bases are usually subject to a tripartite classification: Taxes on Labour, Taxes on Consumption and Taxes on Capital. Governments apply Labour taxes to wages on the employee and employer side, as well as non-employment earnings such as pensions. Consumption tax revenues are levied on the purchase of certain consumption goods. Finally, capital taxes are levied on capital and business income as well as certain stocks of capital.

Chart 1 displays tax receipts collected among 10 comparably developed European states on a per person basis in 2017. I use these data (excluding Ireland) to construct a population-weighted comparator, against which most comparisons in this inbrief are made.

This technique side-steps issues of tax capacity related to the use of GDP or other derived output measures and limits comparisons to states at a comparable level of economic development to Ireland, in contrast to certain EU level averages (McDonnell and Goldrick-Kelly, 2017). I express tax totals in Purchasing Power Standards, which adjust for price level differences between states.

Real capital tax receipts per capita in Ireland were very close to the peer-weighted average of the nine comparator states - €3209 in the Republic of Ireland vs a peer weighted average of €3208. Ireland ranked fifth of ten in per capita capital tax receipts in 2017.

However, real aggregate tax receipts were the second lowest in the comparator group, only exceeding the tax take of the United Kingdom. Aggregate per capita receipts were €1395 lower than the peer weighted average, equivalent to a gap of nearly €6.7 billion when scaled to the Irish population. Disproportionately low per capita labour tax receipts are responsible, which more than outweigh the excess of receipts registered under the consumption category.

As such, capital tax receipts made up an unusually large portion of aggregate receipts in Ireland comprising approximately 24 per cent of overall receipts relative to a peer weighted average of 21.7 per cent. The United Kingdom and Belgium were the only comparator states with a greater reliance on capital tax receipts in 2017.

Chart 1: Per capita tax receipts by tax type, PPS 2017

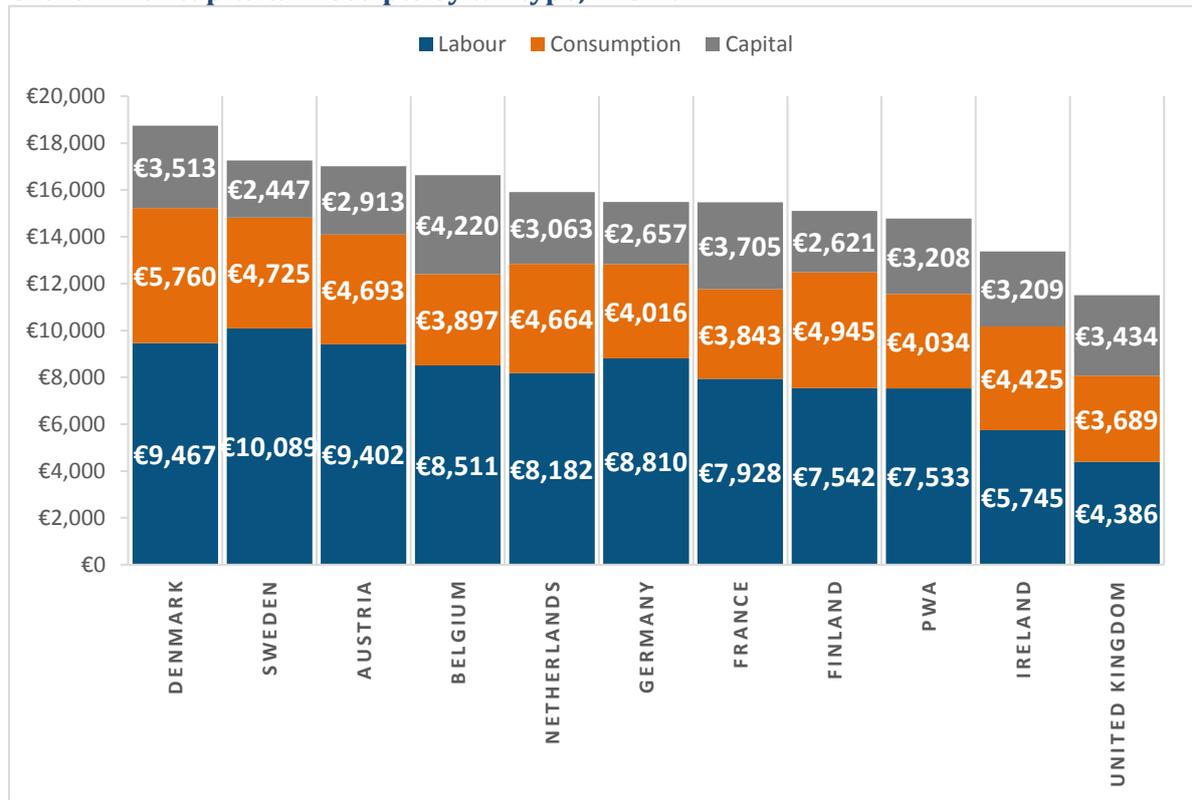
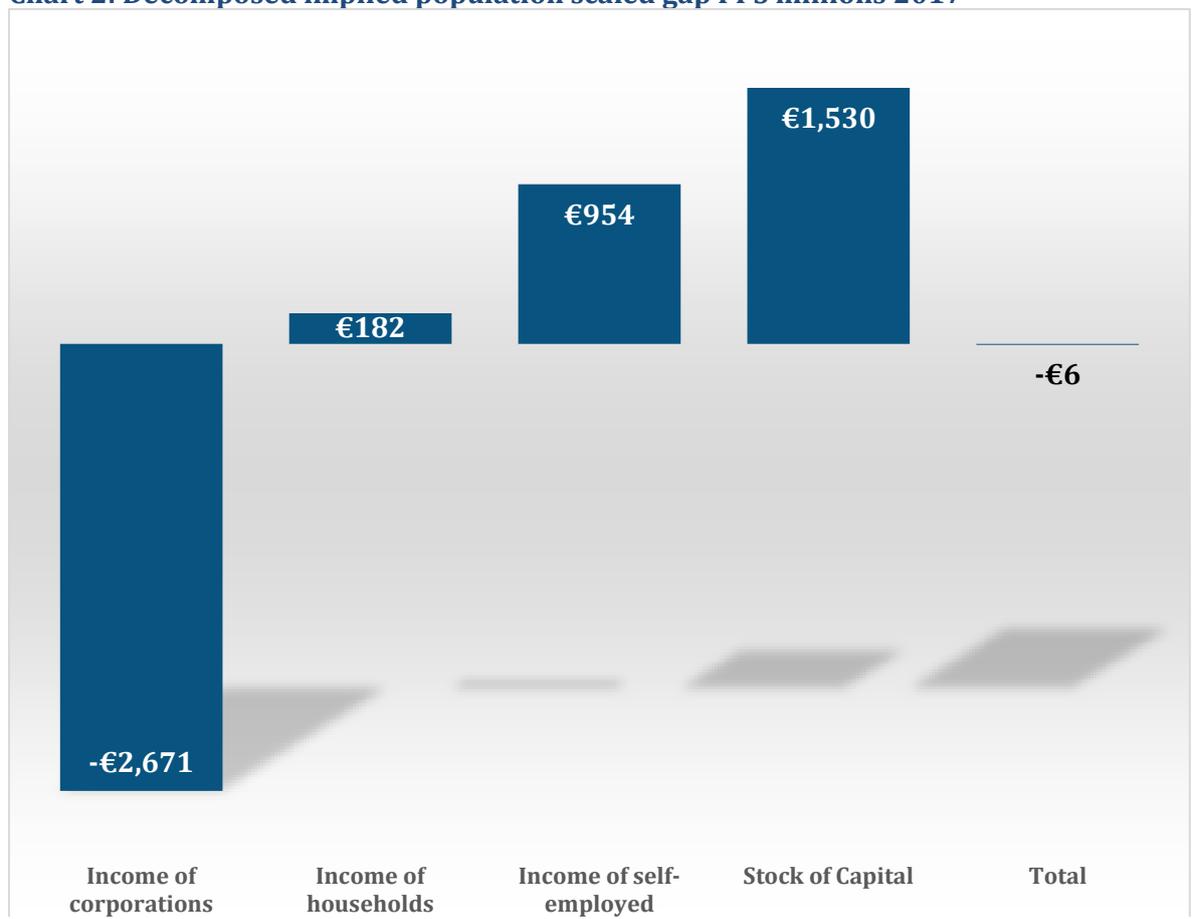


Chart 2: Decomposed implied population scaled gap PPS millions 2017



Decomposing capital tax revenues

Category aggregates can disguise interesting differences in forms of capital taxation. Commission data offer a basic two way subdivision between Taxes on business and capital income and Taxes on Stocks of Capital. The first category can be divided further into taxes on the income of corporations, capital taxes on household and self-employed income.

The four-way subdivision shows substantial variation in Ireland's relative position in relation to the peer weighted averages. Per capita tax receipts from the Income of corporations show a relative overcollection of €558 per person relative to the peer weighted average (€1634 vs €1076) in 2017. Scaled to the population, this amounts to nearly €2.7 billion more in receipts than the peer-weighted average (Chart 2).

In contrast, the other three categories show relative revenue deficits. Capital tax arising from charges on household income shows a shortfall of €38 per person, or just over €180 million in scaled receipts. This corresponds with personal income tax paid on the capital income of households mainly in the form of tax on rents and dividends. The largest shortfalls occur under the categories of tax on the income of the self-employed and taxes on stocks of capital. The revenue deficit for the first category in 2017 was €199 per capita, or over €950 million in scaled receipts. This suggests that the state levies personal income taxes and social contributions from the self-employed (PRSI S in Ireland's case) at relatively low rates.

The largest deficit occurs under the heading Stocks of capital. The per capita gap of €320 in 2017 implies a gap of some €1.5 billion in aggregate. This implies a substantial revenue gap in areas such as estate taxes alongside wealth and property taxes.

Conclusion

These data indicate that the comparatively large role played by capital taxes in the Irish tax system are primarily a function of the low aggregate tax take, rather than particularly onerous levels of tax under that heading.

Decomposition of capital taxes reveals that the average level of aggregate capital tax masks substantial deficits in many areas, which are accounted for by unusually high corporate tax receipts.

Between them, taxes on self-employed income and taxes on capital stocks showed a scaled deficit of over €2.5 billion in 2017. As Goldrick-Kelly and McDonnell (2017) point out, there is little evidence to suggest that tax instruments automatically imperil growth and that equity and efficiency are counterposed.

In the case of self-employed taxation, tying increases in contributions to enhanced benefits may encourage entrepreneurship by lowering risk. These measures may also be pro-equity insofar as many self-employed individuals fall lower down the income distribution.

Similarly, the OECD ranks taxation on property, wealth and passive income (which fall under stocks of capital in this analysis) as among the most growth and equity efficient instruments. Wealth and property taxes could limit inequality and generate substantial revenues. Revenues under all of the deficit headings could go some way to addressing shortfalls in state expenditure, which could facilitate long-run sustainable economic development.

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